Commonwealth of Massachusetts
Office of the State Auditor
Suzanne M. Bump
Making government work better

Official Audit Report – Issued August 25, 2011

Northeast Center for Youth and Families, Inc.

For the period July 1, 2004 through June 30, 2009

INTRODUCTION 1

The Northeast Center for Youth and Families, Inc. (NCYF) was founded in 1976 as a non-profit human service agency for the purpose of aiding and providing specialized care and services to delinquent and/or emotionally disturbed youths who demonstrated critical need and had not succeeded in treatment elsewhere. NCYF was originally founded under the name Tri-County Youth Programs, Inc., but after two name changes is now called Northeast Center for Youth and Families, Inc. Located in Easthampton, NCYF annually serves more than 600 emotionally disturbed or mentally ill children and adolescents in Massachusetts and Connecticut through therapeutic and educational programs that include: residential treatment programs, in-home support services, therapeutic foster care, individualized special education services, and after-school programs. For fiscal year 2009, NCYF received program funding that totaled $18,835,562, of which the Commonwealth provided $13,102,066, or approximately 70%.

The scope of our audit was to examine various administrative and operational activities of NCYF during the period July 1, 2004 through June 30, 2009. Our audit objectives included: (1) determining whether NCYF had implemented effective internal controls over its operations and (2) assessing NCYF'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.

Based on our audit, we found that during the audit period, NCYF inappropriately received state contract revenues totaling $651,221; incurred questionable staff bonuses totaling $918,422 and unallowable severance pay totaling $148,098; inappropriately used $406,360 in funding it received under its Massachusetts state contracts to pay for losses it incurred in programs it operated to serve citizens of the state of Connecticut; incurred $53,950 in nonreimbursable consultant costs; incurred $7,073 in nonreimbursable hospital, medical, and wage continuation costs relative to an insurance claim made by a staff member during a period in which NCYF had let its workers' compensation insurance coverage lapse; and did not properly account for employee retirement plan contributions totaling $260,000. Moreover, many of the unallowable expenses we identified during our audit were incurred by NCYF in an apparent effort to avoid retaining surplus state contract funds which it would have had to remit to the Commonwealth in accordance with state regulations. As a result, the Commonwealth was denied the potential opportunity to fund services for other needy consumers.

AUDIT RESULTS 4

1. FAILURE TO ACCURATELY REPORT PROGRAM FINANCIAL INFORMATION RESULTED IN NCYF RECEIVING UNALLOWABLE CONTRACT PAYMENTS TOTALING $651,221 4

During the period July 1, 2005 through June 30, 2008, NCYF operated two foster care programs, the Nexus and Safe Passage Programs, under contracts with the state's Department of Youth Services (DYS). During this three-year period, these two programs were significantly underutilized by DYS due to a decline in DYS's overall consumer population. Consequently, in order to help ensure the financial viability of NCYF, DYS revised the rates of reimbursement it paid for services under these contracts in order to reimburse NCYF for the actual costs it incurred in operating these two programs. As part of this rate adjustment process, NCYF was required to submit documentation to DYS detailing its actual costs of operating these two programs during the period in question. DYS needed this information in order to properly identify any unfunded costs within the Nexus and Safe Passage Programs and to calculate the additional funding that NCYF needed to operate both programs without incurring a financial loss. However, we found that NCYF did not submit documentation to DYS that detailed its actual costs for operating these two programs. Rather, during fiscal year 2006, NCYF provided DYS with a schedule showing the revenues it would have received in these two programs during this fiscal year if they were fully utilized less an estimate of some of the cost savings NCYF would realize in these programs from this underutilization. DYS used this information to adjust the fiscal year 2006 unit rates for the Nexus and Safe Passage Programs. Also, DYS adjusted NCYF's fiscal years 2007 and 2008 unit rates for these programs without receiving NCYF's actual costs of operating these two programs. As a result, NCYF received reimbursements from DYS that exceeded its actual costs by $651,221 during our audit period, which represent unallowable costs under these contracts.

2. QUESTIONABLE ADMINISTRATION OF EMPLOYEE BONUSES TOTALING $918,422 10

Between fiscal years 2006 and 2008, NCYF provided $918,422 in bonuses ranging from $48 to $7,500 to its employees. However, although NCYF developed plans to distribute staff bonuses, it did not have a written policy that provided for these payments nor did staff employment agreements provide for bonuses. According to state regulations, there are two ways to furnish bonuses to employees: (a) through a fixed bonus as part of an employee's salary based upon terms incorporated into his or her written employment agreement or (b) through a contractor's written employee morale, health, and welfare policy, which makes available bonuses to all employees based upon exceptional performance. Since NCYF met neither of these provisions, it did not properly administer the $918,422 that it expended on these employee bonuses. Moreover, we found that these bonuses were provided in a discriminatory manner. Specifically, 18 of 174 employees, or approximately 10%, received bonuses that were greater than the maximum amount agreed upon by NCYF's senior management team for fiscal year 2007. Also, during fiscal year 2006, an employee requested that her bonus be treated as a salary increase rather than a one-time payment. NCYF approved the employee's request, but offered no such benefit to anyone else at NCYF. Finally, the Massachusetts Office of the Attorney General has issued a publication, "The Attorney General's Guide for Board Members of Charitable Organizations" (Guide), to help board members of charitable corporations and associations in the exercise of their important responsibilities. According to the Guide, the Board's fiduciary responsibilities include, among other things, setting the compensation, including bonuses, of the Executive Director and other senior managers. We found however, that NCYF's Board of Directors did not approve bonus payments that were made to NCYF's senior management staff. Consequently, NCYF's Board did not fulfill this aspect of its fiduciary oversight responsibilities to the organization, the organization's donors, and the Commonwealth.

3. NCYF IMPROPERLY UTILIZED STATE PROGRAM REVENUES TOTALING $406,360 TO FUND OUT-OF-STATE PROGRAMS **20**

According to state regulations the revenue NCYF receives under its contracts with Massachusetts state agencies may only pay for expenses associated with the operation of the programs that are funded by these contracts. In addition, allowable surplus state revenues retained by providers are public revenues and therefore they may only be expended for activities and programs that are in keeping with the Massachusetts charitable purposes of the provider organization. Despite these requirements, our audit identified that between fiscal years 2006 and 2009, NCYF used revenues totaling $406,360 that it received under its Massachusetts contracts to fund losses that it incurred within programs it operated in the state of Connecticut. Since this $406,360 did not benefit consumers in NCYF's Massachusetts programs, NCYF's use of these contract revenues for these purposes represents unreasonable and unallowable costs against its state contracts.

4. NCYF DID NOT PROPERLY REPORT UNALLOWABLE SEVERANCE PAYMENTS TOTALING $148,098 IN THE FINANCIAL STATEMENTS IT FILED WITH THE COMMONWEALTH **24**

Between fiscal years 2005 and 2009, NCYF provided severance pay to nine employees that totaled $198,280. The individual severance amounts, which included a combination of extended medical insurance coverage, bonuses, and salary payments, ranged in amounts from $5,471 to $53,784. However, NCYF's policies and procedures did not provide for the provision of severance pay. Consequently, based upon state and federal regulations, these payments represent nonreimbursable costs to the Commonwealth. In addition, our analysis of these nine severance packages identified significant disparities between the severance compensation that was provided to these individuals. For example, when a former Director of Program Services left NCYF during fiscal year 2008, she received six months in paid medical insurance benefits ($5,471) as her severance compensation. In contrast, when a former Chief Financial Officer left NCYF during fiscal year 2009, he received four months of his salary ($34,961) plus a $5,000 bonus as his severance compensation. Finally, we found that even though the severance payments in question were nonreimbursable expenses, NCYF only disclosed the severance payments it made during fiscal year 2009 ($39,961) and a portion of its fiscal year 2007 payments ($10,221) as nonreimbursable expenses during these fiscal years. NCYF reported the remaining $148,098, or 75%, in the financial statements it filed with the Commonwealth as allowable personnel costs rather than nonreimbursable costs.

5. NONREIMBURSABLE CONSULTANT COSTS TOTALING $53,950 **30**

During the audit period, NCYF paid four consultants a total of $303,168 for educational, business, and legal consulting services, of which $53,950 represents nonreimbursable costs to the Commonwealth. Based on our review of the records that NCYF maintained relative to these services, we noted in several instances that NCYF failed to enter into formal written agreements with the consultants that clearly defined the duties and responsibilities of each party. As a result, NCYF lacked a mechanism to monitor each contractor's performance and to protect itself from any legal issues (e.g., claims for nonperformance of services, liability claims for any property damage or personal injury) that could arise. In addition, in several instances NCYF did not require these consultants to submit supporting documentation to substantiate what services, if any, they provided. Finally, NCYF awarded one consultant contract to a current NCYF employee in violation of both state regulations and federal cost principles for non-profit agencies.

6. LAPSE IN WORKERS' COMPENSATION INSURANCE RESULTED IN UNALLOWABLE INSURANCE CLAIMS PAYMENTS TOTALING $7,073 **37**

Chapter 152, Section 25A, of the Massachusetts General Laws requires all employers to maintain workers' compensation insurance. However, we found that during fiscal year 2007, NCYF did not pay its premium for its workers' compensation policy until 41 days after it was due, which caused it to lapse. During the period that NCYF operated without workers' compensation insurance, an employee of NCYF was injured on the job and required medical attention at a local hospital. The accident resulted in hospital, medical, and wage continuation costs for the employee totaling $7,073. Because NCYF did not have workers' compensation insurance coverage at the time of the accident, NCYF was responsible for paying the employee's medical expenses and lost wages. According to state regulations, expenses such as these that are unreasonable and unnecessary are nonreimbursable under state contracts.

7. NCYF DID NOT PROPERLY ACCOUNT FOR EMPLOYEE RETIREMENT PLAN CONTRIBUTIONS TOTALING $260,000 **40**

During the period covered by our audit, NCYF offered a retirement plan to all its employees. Under this plan, employees make their own contributions. The plan also requires NCYF's Board of Directors to determine annually what amount, if any, NCYF will contribute to the plan on behalf of its eligible employees. Between fiscal years 2006 and 2009, NCYF's Board only authorized one employer contribution to this plan which, according to NCYF's records, was a lump sum contribution of $260,000 during fiscal year 2007. Our review of the documentation NCYF was maintaining relative to this contribution identified that while NCYF recorded and reported this contribution as taking place during fiscal year 2007, NCYF's Board of Directors did not authorize this contribution until November 13, 2007, or approximately five and one half months after the close of fiscal year 2007. Also, NCYF did not remit the $260,000 payment to the plan's trustee until February 6, 2008, or approximately seven months after the close of fiscal year 2007. Clearly, since all the events pertinent to this transaction occurred after the close of fiscal year 2007, NCYF's $260,000 payment represents a reimbursable cost to the Commonwealth for the fiscal year 2008, and not fiscal year 2007.

APPENDIX **43**

Schedule of Identified Recoverable Costs **43**

INTRODUCTION

Background

The Northeast Center for Youth and Families, Inc. (NCYF) was founded in 1976 as a non-profit human service agency for the purposes of aiding and providing specialized care and services to delinquent and/or emotionally disturbed youths who demonstrated critical need and had not succeeded in treatment elsewhere. NCYF was originally founded under the name Tri-County Youth Programs, Inc., but after two subsequent name changes is currently known as the Northeast Center for Youth and Families, Inc. Located in Easthampton, NCYF annually serves more than 600 emotionally disturbed or mentally ill children and adolescents in Massachusetts and Connecticut through therapeutic and educational programs that include residential treatment programs, in-home support services, therapeutic foster care, individualized special education services, and after-school programs. According to the financial statements that NCYF filed with the Commonwealth, NCYF received funding from various sources during our audit period, as indicated in the table below:

	Fiscal Year				
Funding Source	**2005**	**2006**	**2007**	**2008**	**2009**
Commonwealth of Mass.	$7,773,218	$7,676,939	$8,282,650	$8,451,345	$7,985,244
Mass. Local Govt./Quasi-Govt. Entities	3,489,459	3,938,465	4,200,241	4,121,630	4,036,734
Medicaid	206,782	425,714	522,449	654,673	954,452
Mass. Govt. Client Stipends	103,700	99,685	130,632	140,598	125,636
Non-Mass. State/Local Govt.	5,039,558	4,020,509	3,840,627	5,603,124	5,544,772
Client Resources	61,133	46,872	35,648	27,639	45,180
Mass. Publicly Sponsored Client Offsets	334,072	112,253	61,786	63,600	96,000
Contributions and Other	237,390	105,143	47,841	74,961	47,544
Total	$17,245,312	$16,425,580	$17,121,874	$19,137,570	$18,835,562

Audit Scope, Objectives, and Methodology

The scope of our audit was to examine various administrative and operational activities of NCYF during the period July 1, 2004 through June 30, 2009. 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 objectives consisted of the following:

1. To determine whether NCYF 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; and
    - Policies and procedures to ensure that resources are safeguarded and efficiently used.
2. To assess NCYF'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 NCYF 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 NCYF's accounting system. We used this assessment in planning and performing our audit tests. We then held discussions with NCYF officials and reviewed organization charts; internal policies and procedures; and applicable laws, rules, and regulations. We also examined NCYF'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 NCYF's financial statements. We also did not assess the quality and appropriateness of program services provided by the NCYF under its state contracts. Rather, our objective was to report findings and conclusions on the extent of NCYF'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.

Based on our audit, we found that during the audit period, NCYF inappropriately received state contract revenues totaling $651,221; incurred questionable staff bonuses totaling $918,422 and unallowable severance pay totaling $148,098; inappropriately used $406,360 in funding it received under its Massachusetts state contracts to pay for losses it incurred in programs it operated to serve citizens of the state of Connecticut; incurred $53,950 in nonreimbursable consultant costs; incurred $7,073 in nonreimbursable hospital, medical, and wage continuation costs relative to an insurance claim made by a staff member during a period in which NCYF had let its workers' compensation insurance coverage lapse; and did not properly account for employee retirement plan contributions totaling $260,000. Moreover, many of the unallowable expenses we identified during our audit were incurred by NCYF in an apparent effort to avoid retaining surplus state contract funds which it would have had to remit to the Commonwealth in accordance with state regulations. As a result, the Commonwealth was denied the potential opportunity to fund services for other needy consumers.

At the conclusion of our audit, NCYF was provided with a draft copy of our report for its review and comments. The comments provided by NCYF are either included in this report or were considered and resulted in changes to our final report.

AUDIT RESULTS

1. FAILURE TO ACCURATELY REPORT PROGRAM FINANCIAL INFORMATION RESULTED IN NCYF RECEIVING UNALLOWABLE CONTRACT PAYMENTS TOTALING $651,221

During the period July 1, 2005 through June 30, 2008, NCYF operated two foster care programs, the Nexus and Safe Passage Programs, under contracts with the state's Department of Youth Services (DYS). During this three-year period, these two programs were significantly underutilized by DYS due to a decline in DYS's overall consumer population. Consequently, in order to help ensure the financial viability of NCYF, DYS revised the rates of reimbursement for services within these contracts in order to reimburse NCYF for the actual costs it incurred in operating these two programs. As part of this rate adjustment process, NCYF was required to submit documentation to DYS detailing its actual costs of operating these two programs during the period in question. DYS needed this information in order to properly identify any unfunded costs within the Nexus and Safe Passage Programs and to calculate the additional funding that NCYF needed to operate both programs without incurring a financial loss. However, we found that NCYF did not submit documentation to DYS that detailed its actual costs for operating these two programs. Rather, during fiscal year 2006, NCYF provided DYS with a schedule showing the revenues it would have received in these two programs during this fiscal year if they were fully utilized, less an estimate of some of the cost savings NCYF would realize in these programs from this underutilization. DYS used this information to adjust the fiscal year 2006 unit rates for the Nexus and Safe Passage Programs. Also, DYS adjusted NCYF's fiscal years 2007 and 2008 unit rates for these programs without receiving NCYF's actual costs of operating these two programs. As a result, NCYF received reimbursements from DYS that exceeded its actual costs by $651,221 during our audit period, which represent unallowable costs under these contracts.

During the period July 1, 2005 through June 30, 2008, NCYF contracted with DYS to annually provide 10,585 units of traditional foster care services within its Nexus Program. Under the terms and conditions of this contract, NCYF received a total of $82 for each unit of service provided (a unit of service equals one day of foster care for a DYS consumer), of which NCYF retained $52 per unit and provided the remaining $30 per unit to the foster family.

During this same three-year period, DYS also provided NCYF with a contract to operate its Safe Passage Program. Under this contract, NCYF was required to provide intensive foster care for

DYS consumers. For fiscal year 2006, NCYF's Safe Passage Program contract authorized 8,760 units of service; however, the number of its authorized units declined to 6,205 annually for fiscal years 2007 and 2008. The consumers placed in the Safe Passage Program require more specialized care than those clients placed in the Nexus program. Consequently, NCYF receives a greater unit rate from DYS ($112 per unit) for these more intensive foster care services. Of this total fee, NCYF retains $62 for program administration while the foster parent receives the remaining $50. The table provided below details the payment terms and service levels detailed in NCYF's Nexus and Safe Passage Programs contracts for the period July 1, 2005 to June 30, 2008.

	Nexus Program			Safe Passage Program		
Fiscal Year	Units Authorized	Unit Rate	Maximum Obligation	Units Authorized	Unit Rate	Maximum Obligation
2006	10,585	$82	$867,970	8,760	$112	$981,120
2007	10,585	$82	$867,970	6,205	$112	$694,960
2008	10,585	$82	$867,970	6,205	$112	$694,960
Total	31,755		$2,603,910	21,170		$2,371,040

As detailed in the table above, the Nexus and Safe Passage Programs were authorized to provide a total of 31,755 and 21,170 units of foster care, respectively, from July 1, 2005 to June 30, 2008. However, according to DYS and NCYF officials, DYS incurred a reduction in its overall consumer census that led to a significant underutilization of NCYF's two foster care programs during this period. Specifically, the Nexus program provided only 18,302 units of traditional foster care while the Safe Passage Program provided 11,514 units of intensive foster care during this three-year period. Thus, the average utilization rate for these programs was 58% and 54%, respectively, during this period. The table below details DYS's underutilization of NCYF's Nexus and Safe Passage Programs from July 1, 2005 to June 30, 2008.

	Nexus Program			Safe Passage Program		
Fiscal Year	Units Authorized	Units Served	Utilization Rate (%)	Units Authorized	Units Served	Utilization Rate (%)
2006	10,585	6,621	63%	8,760	5,218	60%
2007	10,585	5,770	55%	6,205	3,513	57%
2008	10,585	5,911	56%	6,205	2,783	45%
Total	31,755	18,302	58%	21,170	11,514	54%

In order to address this underutilization issue, on May 16, 2006 the Commissioner of DYS sent a letter to several of its contracted human service providers, including NCYF, in which the Commissioner stated that DYS was offering its foster care providers the opportunity to convert their unit rate contracts to cost reimbursement contracts. Under a cost reimbursement contract, providers are reimbursed for the actual costs of the services they provide. The Commissioner's letter states, in part:

> *DYS is obligated only to pay for the units utilized. However, the current practice within the Commonwealth is to convert, where appropriate, underutilized unit rate contracts to cost reimbursement contracts to reflect the actual allowable expenses incurred during the contract period. The conversion to a cost reimbursement contract recognizes that the fixed costs remain the same (facility costs and proportional administrative overhead) whether the program operates at 60% or 100% utilization and that unit related costs such as food supplies and staffing decline in proportion to the drop in census. If you have a program with a utilization rate less than your contract utilization rate, and the underutilization was related to a drop in the DYS population, you can request that your unit rate contract be converted to a cost reimbursement contract.*

The Commissioner's offer to change the terms of NCYF's contracts, which extended through fiscal year 2008, provided NCYF with an opportunity to operate its Nexus and Safe Passage Programs without incurring any losses, despite experiencing a significant underutilization of its foster care services. In order to effect this change, DYS increased the unit rates for the services NCYF provided under these contracts in order to allow NCYF to recover the actual allowable expenses it incurred in operating these programs. As part of the rate adjustment process, NCYF was required to submit documentation to DYS to support its actual costs of operating these programs. DYS needed this information in order to identify any unfunded costs within the Nexus and Safe Passage Programs and to calculate the additional funding that NCYF needed to operate both programs without incurring profits or losses.

However, our audit found that NCYF did not submit documentation to DYS that detailed its actual costs for operating the Nexus and Safe Passage programs. During fiscal year 2006, NCYF provided DYS with a schedule showing the revenues it would have received in these two programs during this fiscal year if these programs were fully utilized, less an estimate of some of the cost savings NCYF would realize in these programs from this underutilization. DYS used this schedule to adjust the fiscal year 2006 unit rates for the Nexus and Safe Passage programs. Also, DYS adjusted NCYF's fiscal years 2007 and 2008 unit rates for these programs without receiving NCYF's actual costs of operating these two programs. Because NCYF did not report its actual costs under the Nexus and Safe Passage Programs during these three fiscal years, it received unallowable contract payments from DYS that totaled $651,221 in these programs. This amount represents the difference between the actual costs that NCYF incurred under these programs, or $3,012,866, and the total contract payments (earned revenue plus additional payments) it received from DYS, or $3,664,087. The table below details the unallowable payments that NCYF received through the Nexus and Safe Passage Programs over the three-year period ending June 30, 2008.

Nexus Program

Fiscal Year	Earned Revenue	Additional Revenue	Total DYS Revenue	Actual Costs	Unallowable Payments
2006	$527,867	$233,152	$761,019	$659,965	$101,054
2007	453,055	180,257	633,312	481,767	151,545
2008	476,373	109,505	585,878	635,043[1]	(49,165)
Total	$1,457,295	$522,914	$1,980,209	$1,776,775	$203,434

Safe Passage Program

Fiscal Year	Earned Revenue	Additional Revenue	Total DYS Revenue	Actual Costs	Unallowable Payments
2006	$580,228	$150,125	$730,353	$450,835	$279,518
2007	398,343	118,081	516,424	401,621	114,803
2008	313,264	123,837	437,101	383,635	53,466
Total	$1,291,835	$392,043	$1,683,878	$1,236,091	$447,787

[1] The *Actual Costs* detailed in the table above, except for fiscal year 2008, were obtained directly from NCYF's annual UFR. For fiscal year 2008, NCYF had overstated salaries within the Nexus and Safe Passage Programs by approximately $71,544 and $145,234, respectively, due to a flawed cost allocation plan utilized by the Agency. Therefore, we needed to reduce the reported costs of these programs by the overstated amounts in order to accurately calculate NCYF's overpayment for fiscal year 2008. In order to make these adjustments, we obtained from the Nexus and Safe Passage Program Director her best estimate of employees' time that was dedicated to these programs. NCYF's Chief Financial Officer stated that prior to January 2010, payroll expenses were allocated based upon a pre-set percentage which did not reflect the actual percentage of staff time in various programs. The CFO stated that the problem has been corrected, and now staff time is allocated based upon actual time and attendance records. NCYF's Executive Director confirmed that the Center's time allocation plan was flawed prior to January 2010.

During our audit, we discussed these matters with DYS officials and NCYF's current Chief Financial Officer (CFO), who was not employed by NCYF during the period in question. NCYF's CFO told us that her predecessor submitted information to DYS that appeared to be intended to recover NCYF's estimate of its lost revenues as opposed to the actual expenses NCYF incurred in its Nexus and Safe Passage Programs. DYS's Director of Purchased Services stated that DYS believed that NCYF's fiscal year 2006 data submission represented the actual costs of the Nexus and Safe Passage Programs during fiscal year 2006 and DYS decided to use the method used by NCYF in this calculation for fiscal years 2007 and 2008. However, DYS's Chief Financial Officer stated that in retrospect, DYS should have reconciled NCYF's submitted information to NCYF's yearly financial statements to ensure that DYS's payments under these two contracts were allowable.

Recommendation

In order to address our concerns relative to this matter, the Commonwealth should recover from NCYF the $651,221 in excess revenues it received from DYS during the three fiscal years ended June 30, 2008 under the contracts in question.

Auditee's Response

In response to this issue, NCYF officials provided comments which are excerpted below:

> *The Center's billing under contracts with DYS for the Center's Nexus and Safe Passages Programs was in compliance with the terms of those contracts, and all reporting with respect to those programs was in compliance with the requirements of the Commonwealth's Operational Services Division ("OSD"). Accordingly, no funds with respect to these programs are recoverable by the Commonwealth.*
>
> *The Draft Report criticizes the Center for not submitting to DYS detail as to the Center's actual costs in operating its Nexus and Safe Passages programs. However, this type of cost data was not requested by DYS. Instead, the Center was asked to provide, and did provide, data that showed the Center's costs as originally projected and adjustments for savings that resulted from lower utilization. The latter consisted of reduced payments for foster parents and reduced costs for temporary help, staff mileage, program supplies and administrative costs. On the basis of this data, DYS and the Center negotiated revised unit rates that were reflected in contract amendments as discussed above.*

Auditor's Reply

In its response, NCYF asserts that its billings for the program services in question were in compliance with the terms of the contracts that funded these programs. However, while we do not dispute the fact that NCYF billed for these program services at the established rates, the process used to establish these rates was flawed. As stated in our report, DYS asked NCYF to provide it with a summary of the actual allowable costs NCYF incurred in operating these programs in order to accurately adjust the rates of reimbursement it was paying for these services to allow NCYF to recover the actual costs it incurred in operating these programs during the period in question. NCYF did not comply with the request and as a result, DYS's rate adjustments for these programs resulted in NCYF receiving amounts greater than its actual cost to operate these two programs. Clearly, DYS's attempt to adjust these rates was a good faith effort to help providers, including NCYF, minimize any financial hardships they may be incurring by operating DYS's programs during periods of program underutilization. It was not intended to afford providers an opportunity to generate excessive profits such as the $651,221 realized by NCYF under these contracts.

In its response, NCYF states that DYS did not request the actual costs in operating its Nexus and Safe Passage Programs. However, this statement is untrue. The DYS Commissioner's letter dated May 16, 2006, which was the basis for DYS amending the unit rates for the Nexus and Safe Passage Programs, specifically required that NCYF submit its actual costs to DYS's Director of Purchase Services. The Commissioner's letter states, in part, the following:

> *If your contract is within one of the above categories and you would like DYS to consider an amendment to the contract, you must submit your request to the Director of Purchase Services no later than Tuesday, May 23, 2006. You will need to provide documentation to support your actual costs and each request will be reviewed and approved or rejected by DYS.*

In addition, during the audit we spoke to DYS's Director of Purchase Services about this matter. The Director stated that the schedule submitted by NCYF was thought to contain the actual costs of the Nexus and Safe Passage Programs for fiscal year 2006. Moreover, the Director stated that the submitted documents were the basis for adjusting the unit rates for these programs. As noted within the report, DYS's Chief Financial Officer stated that in retrospect, DYS should have reconciled the information NCYF submitted to its yearly financial statements to ensure that DYS payments under these two contracts were allowable.

In its response, NCYF contends that it was asked by DYS officials to provide data that showed the Center's costs as originally projected and adjustments for savings that resulted from lower utilization. However, NCYF did not provide us with any documentation to substantiate this assertion. Moreover, this assertion is contrary to what the DYS Commissioner stated in the aforementioned letter and all the other evidence we gathered during our audit.

2. QUESTIONABLE ADMINISTRATION OF EMPLOYEE BONUSES TOTALING $918,422

Between fiscal years 2006 and 2008, NCYF provided $918,422 in bonuses ranging from $48 to $7,500 to its employees. However, although NCYF developed plans to distribute staff bonuses, it did not have a written policy that provided for these payments nor did staff employment agreements provide for bonuses. According to state regulations, there are two ways to furnish bonuses to employees: (a) through a fixed bonus as part of an employee's salary based upon terms incorporated into his or her written employment agreement or (b) through a contractor's written employee morale, health, and welfare policy, which makes available bonuses to all employees based upon exceptional employee performance. Since NCYF met neither of these provisions, it did not properly administer the $918,422 that it expended on these employee bonuses. Moreover, we found that these bonuses were provided in a discriminatory manner. Specifically, 18 of 174 employees, or approximately 10%, received bonuses that were greater than the maximum amount agreed upon by NCYF's senior management team for fiscal year 2007. Also, during fiscal year 2006, an employee requested that her bonus be treated as a salary increase rather than a one-time payment. NCYF approved the employee's request, but offered no such benefit to anyone else at NCYF. Finally, the Massachusetts Office of the Attorney General has issued a publication, The Attorney General's Guide for Board Members of Charitable Organizations (Guide), to help board members of charitable corporations and associations in the exercise of their important responsibilities. According to the Guide, the Board's fiduciary responsibilities include setting the compensation (including bonuses) of the Executive Director and other senior managers. We found, however, that NCYF's Board of Directors did not approve bonus payments that were made to NCYF's senior management staff. Consequently, NCYF's Board did not fulfill this aspect of its fiduciary oversight responsibilities to the organization, the organization's donors, and the Commonwealth.

Under 808 CMR 1.00, the Executive Office for Administration and Finance, Operational Services Division (OSD), issued its Uniform Financial Statements & Independent Auditor's Report (UFR), Auditor's Compliance Supplement. This document assists Departments and Contractors in making the determinations necessary for deciding what are reimbursable operating costs under 808 CMR 1.02 and 808 CMR 1.05 in Commonwealth state-sponsored vendor programs. Regarding employee bonuses, the Auditor's Compliance Supplement states, in part, the following:

> *Bonuses are not considered a fringe benefit; rather, they are properly classified as a salary allowance when attributable to services rendered by an employee. Bonuses are negotiable items, which are added to salaries in the budget and in the financial statements. The net salary amounts must not exceed what is considered reasonable compensation to be reimbursable. There are two ways to furnish bonuses to employees: one is a fixed bonus as part of an employee's salary based on terms incorporated into his or her written employment agreement, and the second is through a Contractor's written employee morale, health and welfare policy, which makes available bonuses to all employees based on exceptional employee performance. See section 162 of the Internal Revenue Code and 808 CMR 1.05(20) for further guidance.*

Based on the guidance provided in the Auditor's Compliance Supplement, staff bonuses are allowable expenses under state contracts, as long as they are reasonable and part of an employee's written employment agreement or included in an organization's written employee, morale, health and welfare policy which makes bonuses available to staff based on exceptional performance. The requirement that a provider has to have a written employee morale, health and welfare policy is the control implemented by the Commonwealth to ensure that staff bonuses paid for with public funds are provided to individuals in a fair and equitable manner. . Consequently, in order to use state funds to provide staff bonuses, NCYF was required to establish an employee morale, health, and welfare policy authorizing bonuses for all employees based upon exceptional employee performance.. Such a policy should include specific details such as the financial circumstances under which NCYF may award bonuses, employee eligibility, performance criteria, bonus levels, bonus adjustments, and distribution dates. More importantly, the policy has to be adopted by NCYF's Board of Directors since the Board is ultimately responsible for ensuring that NCYF operates in a fiscally sound manner.

However, as of the close of our audit fieldwork, NCYF's Board had not adopted such a policy, and NCYF did not have a functioning employee appraisal system necessary to identify exceptional employee performance and justify the awarding of any bonuses. Lastly, we reviewed NCYF's employee agreements and determined that they did not provide for a fixed bonus as part of any employee's salary.

Despite this, during the period covered by our audit, NCYF provided members of its staff with $918,422 in bonuses, as follows:

Fiscal Year	Employees	Bonuses	Average Bonus	Range of Bonuses
2006	197	$303,219	$1,539	$141 to $2,250
2007	174	271,770	$1,562	$250 to $6,617
2008	122	343,433	$2,815	$48 to $7,500
Total		$918,422		

Since state funds were used to provide these bonuses, NCYF must adhere to the state regulations that govern the provision of these bonuses. A description of the specific problems we found relative to these bonuses appears in the following sections.

Fiscal Year 2006 Bonus Awards

During fiscal year 2006, NCYF awarded bonuses to all 197 employees that totaled $303,219. This amount was comprised of two basic bonus levels: $1,000 for employees covered by a collective bargaining agreement (CBA), and $2,250 for employees not covered by a CBA. NCYF reduced these bonuses for part-time employees as well as any employee hired after the beginning of fiscal year 2006. These adjustments resulted in employees receiving bonuses that ranged from $141 to $2,250 during this fiscal year.

NCYF developed an internal document detailing its fiscal year 2006 employee bonus program that included two sections: (a) qualifications for receipt of bonus, and (b) bonus calculation. However, the document was not signed, dated, or approved by NCYF's Board of Directors. Moreover, the document specified that bonuses would be based upon merit and must be earned by exceeding job requirements as determined by each employee's immediate supervisor. However, NCYF did not have a functioning employee evaluation system and simply provided bonuses to all employees based upon employment longevity. Consequently, the plan neither represents an established policy of NCYF as required by the Auditor's Compliance Supplement, nor provides a valid basis for NCYF's fiscal year 2006 bonus awards. Further, this document included a provision that provided preferential treatment for one employee. Specifically, NCYF approved an employee's request to have her bonus treated as a salary increase, as follows:

> *There exists a singular exemption to this calculation, a Foster Care case manager who elected to receive the majority of the bonus to which she would have been entitled as a salary increase instead. This exception was made at the special request of this employee.*

NCYF's current Executive Director stated that he was unaware of this special exception and was unable to identify the individual involved in this matter.

Fiscal Year 2007 Bonus Awards

The Office of the Massachusetts Attorney General has issued a publication, The Attorney General's Guide for Board Members of Charitable Organizations (Guide), to help board members of charitable corporations and associations in the exercise of their important responsibilities. The Guide specifies that board members are responsible for governing the charity as it carries out its charitable mission. Regarding financial matters, the Guide specifies that board members 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. According to the Guide, the Board's fiduciary responsibilities include, among other things, setting the compensation, including bonuses, of the Executive Director and other senior managers.

During fiscal year 2007, NCYF's senior management team informed NCYF's Board of Directors about its intentions to award staff bonuses. However, the Board determined it was not its responsibility to approve these bonuses. Detailed below are excerpts from the minutes of the May 30, 2007 meeting of the Finance Committee of NCYF's Board of Directors detailing both the senior management team's plans for awarding employee bonuses as a means to avoid remitting any surplus state contract revenues to the Commonwealth, and the Board's decision to limit its involvement in the approving of these staff bonuses:

> *[Board of Directors] discussed their plans for managing the surplus expected for this year, so that we do not meet or exceed the state maximum. They are considering small bonuses for staff. It will likely be an equal amount across the board, given that the performance evaluation process has not been entirely operationalized, but hopefully this will be the last year any bonuses would be calculated in that way.*

Discussion followed, including whether the Board needs to "approve" bonuses. Consensus was that the Board should be informed of, but should not approve the bonuses, as it is an operational decision.

Clearly, the Board's decision to abstain from approving the fiscal year 2007 employee bonuses reflects a misunderstanding on the Board's part about its fiduciary responsibilities to the organization, the organization's donors, and the Commonwealth.

NCYF's senior management team met on several occasions to discuss and ultimately approve bonus levels for fiscal year 2007. In this regard, the senior management team's reports to the Board of Directors dated June 5, 2007 and June 7, 2007, respectively, state the following:

> *Due to the projected surplus for this fiscal year, the management team is considering modest bonuses for staff, and possibly a contribution to the retirement plan.*
>
> *The Agency will also give staff bonuses again this year, likely in the $1,500 range, with the same eligibility criteria as last year.*

In addition, we reviewed the notes maintained by NCYF's Executive Director regarding meetings with the senior management team that indicated that the senior management team had established that employees covered by a CBA would receive up to $1,000 and employees not covered by a CBA would receive up to $2,000 during fiscal year 2007. However, 18 of the 174 employees, or approximately 10%, received bonuses greater than the maximum level ($2,000) authorized by the senior management team. While some of the variances were relatively small, some employees received bonus payments that greatly exceeded the $2,000 limit, as detailed in the table below:

Title	Bonus Payment	Excess Bonus Payment
Director Program Services	$6,617	$4,617
Director of Human Relations	5,180	3,180
Administrative Assistant I	4,321	2,321
Comptroller/CFO	4,121	2,121
Director of Educational Services	4,067	2,067
Case Manager Supervisor	3,893	1,893
Program Director	2,829	829
Human Resource Assistant	2,507	507
Clinician	2,384	384
Shift Manager	2,373	373
Case Manager Supervisor	2,307	307
Shift Manager	2,251	251
Case Manager	2,087	87
Case Manager	2,082	82
Information Systems Manager	2,052	52
Shift Manager	2,044	44
Residential Manager	2,033	33
Case Manager	2,009	9
Total	$55,157	$19,157

As previously noted, the Commonwealth established regulations for providers to follow when employee bonuses are awarded in order to prevent discriminatory application of bonus programs. NCYF's failure to award its fiscal year 2007 bonus based upon written employee morale, health, and welfare policy led to the inequitable staff bonus described in the table above.

During the audit, we brought this matter to the attention of NCYF's Chief Financial Officer (CFO). The CFO, who was not employed by NCYF during fiscal year 2007, contacted other senior management employees and Board members in order to identify the cause of the issues we had identified in this area. Provided below are excerpts from a document the CFO provided to us after inquiring about the excess bonus payments in question.

- NCYF's Executive Director stated that he was not aware of anyone other than his Administrative Assistant receiving a bonus greater than the agreed-upon limit of $2,000 during this fiscal year. The Executive Director stated that the plan that he had endorsed and discussed with the Board of Directors and Finance Committee limited the bonus to a maximum of $2,000.

- NCYF's Director of Educational Services stated that the prior CFO had met with him alone and told him that since NCYF could not give him a salary adjustment, his bonus reflected the additional work he had assumed when the prior director left NCYF. The Director of Educational Services had always assumed that these matters had previously been discussed with the Executive Director and the other senior management team members.

- NCYF's Board President stated that he recalled many discussions involving levels of bonus payments among the finance committee and Board. He recalls the levels of $1,000 and $2,000 being discussed but no mention was ever made as to whether any staff member was to receive additional bonus compensation.

- NCYF's Administrative Assistant's recollection of why she received a larger bonus amount was that she was being compensated for having to pay more for health insurance when NCYF changed its plan.

Fiscal Year 2008 Bonus Awards

During this fiscal year, NCYF's senior management team developed the following plan for disbursing bonuses to employees:

> *A bonus based on duration of service over a year; 7.5% of base salary with a minimum of $2,500 for a full year employee and a maximum of $7,500 payable in three installments, August, October and December.*

In addition, NCYF's former CFO supplemented the requirements for staff participation in this plan in an August 6, 2008 e-mail to NCYF's payroll department, in which he instructed the payroll department that in order for an employee to receive an installment payment, the employee needed to be actively employed as of the first day of August, October, and December 2008.

However, we found that NCYF provided preferential treatment for a former Senior Case Manager who resigned from her position effective June 6, 2008. Since the former Senior Case Manager was not actively employed by NCYF as of August 1, 2008, she was not entitled to receive any of the three planned bonus installments. In fact, based upon the senior management team's meeting minutes dated August 27, 2008, the team appeared committed to excluding the Senior Case Manager from any bonus distribution. Specific excerpts from these minutes are provided below:

> *Message was received from the Senior Case Manager looking to be given the bonus. The Senior Case Manager knows of others who were given the bonus after they left. The Director of Human Relations feels the bonus was not part of benefit package as she agreed to a specific package and ceased being an employee in June. The CFO stated if the agency were to pay the bonus it would cost approximately $1,200 and the Director of Human Relations stated it set a precedent.*

Yet, contrary to the advice provided by the Director of Human Relations on this matter, as well as the sentiments offered by the Executive Director, NCYF provided the former Senior Case Manager a bonus totaling $1,136 on September 3, 2008. Clearly, the final action taken by NCYF on this case was contrary to the bonus plan developed by the senior management team and the written guidance the former CFO provided to the payroll department.

As noted above, although NCYF had established plans for distributing staff bonuses during each fiscal year covered by our audit, it failed to establish the required employee morale, health and welfare policy required by OSD regulations relative to the provision of this compensation. Further, we found a number of instances where NCYF did not even adhere to its established plan relative to the distribution of these bonuses. Clearly, NCYF's administration of these bonuses was questionable and not consistent with the requirements of state regulations.

Recommendation

The OSA recognizes that staff bonuses, if properly administered, are an effective means of recognizing exceptional performance and improving staff morale. However, in the instances discussed above, NCYF did not adhere to OSD regulations in its administration of these bonuses and in some instances did not even follow the distribution plan relative to the provision of these bonuses. In order to address our concerns relative to this matter, NCYF should remit to the Commonwealth, the $20,293 in bonus payments made to its staff that were both not done in accordance with OSD regulation or its established distribution plan. Further, OSD should review this matter and determine how much of the remaining $898,129 in funds that NCYF used to provide these bonuses, should be recovered by the Commonwealth. In the future, if NCYF wants to award employee bonuses, its Board of Directors must develop and implement a policy that is consistent with OSD's UFR Auditor's Compliance Supplement that allows for the provision of these payments. Also, NCYF's Board should vote to authorize all future employee bonuses, including those made to NCYF's senior management staff, in order to fulfill its fiduciary responsibilities to the organization, the organization's donors, and the Commonwealth.

Auditee's Response

In response to this issue, NCYF officials provided comments which are excerpted below:

> *The Draft Report does not challenge the reasonableness of amounts paid by the Center as bonuses in fiscal year 2006, and it acknowledges that the Center developed a plan setting forth the Center's bonus program. The Draft Report nonetheless criticizes the Center's payments on the grounds that they were not approved by the Center's Board of Directors. It is perfectly appropriate for the Board of Directors of the Center to leave to management the award[ing] of bonuses, especially in the ranges involved in this case. For all intents and purposes, these bonuses amounted to modest compensation adjustments that did not have the longer-term effects of salary increases. The fact that in one case the amount in question was paid over time as a salary increase is of no consequence. The key consideration [is] whether the dollar amounts in question were reasonable, and the Draft Report does not raise any issue in that regard.*
>
> *The Draft Report claims generally that the Attorney General's guide for Board Members of Charitable Organizations requires the Board of a charitable organization to determine bonus uses for executive directors of the organization and other senior managers. That Guide states in its Introduction that "this guide is not intended to prescribe the exact manner in which a Massachusetts public charity board must function." The authorization standard for the conduct of the director of Massachusetts non-profit corporations such as the Center is set forth in Massachusetts General Laws, Chapter 180, Section 6C: "A director…shall perform his duties as such…in good faith and in a manner he reasonably believes to be in the best interests of the corporation, and with such care as an ordinarily prudent person in a like position with respect to a similar corporation organized under*

> *this chapter would use under similar circumstances." This standard provides broad discretion to the Board of the Center in managing the organization's affairs. It is well within the Board's discretion to delegate to the chief executive officer authority to set compensation of employees (other than the Executive Director), as a part of more general authority to deal with human resources matters. As noted in the Draft Report, the senior management reported to the Board as to its plan.*

Auditor's Reply

In its response, NCYF asserts that our audit does not challenge the reasonableness of amounts paid by NCYF as bonuses in fiscal year 2006. However, we did not analyze individual bonus amounts for fiscal year 2006 because we determined that NCYF's bonus payments in total were not made in accordance with OSD's UFR Auditor's Compliance Supplement. NCYF asserts that the bonuses paid to its employees, and the delegation of setting criteria of bonus awards to senior management, were reasonable; however, against the advice of its own Human Relations Director, a bonus totaling $1,136 was improperly paid to a Senior Case Manager. This Senior Case Manager had agreed to a specific compensation package upon ceasing employment in June, and did not qualify for any bonus according to senior management's criteria for 2008 bonuses. Furthermore, as stated in our report, during this fiscal year, NCYF did not have a functioning employee evaluation system and simply provided bonuses to all employees based upon employment longevity. Consequently, the plan neither represents an established policy of NCYF as required by OSD's UFR Auditor's Compliance Supplement, nor provides a valid basis for NCYF's fiscal year 2006 bonus awards. While we acknowledge that NCYF had developed an informal employee bonus plan for fiscal year 2006, the plan did not constitute a written employee morale, health, and welfare policy, which makes available bonuses to all employees based upon exceptional employee performance as required by the OSD's UFR Auditor's Compliance Supplement. To meet this requirement, the Board would have had to vote to adopt the plan, and incorporate the adopted plan into the Center's operating policies and procedures. The Center's Board did not approve a Bonus/Policy Procedure until its June 23, 2010 meeting. In addition, NCYF did not have a functioning employee performance appraisal system during the audit period upon which to base employee bonuses. Consequently, contrary to the OSD's UFR Auditor's Compliance Supplement, the Center awarded its bonuses based upon an employee's length of employment, and not exceptional performance.

In its response, NCYF contends that it is well within the Board's discretion to delegate to NCYF's Chief Executive Officer the authority to set compensation of employees (other than the

Executive Director) as part of a more general authority to deal with human resources matters. NCYF bases its contention upon the provisions of Chapter 180, Section 6C, of the General Laws, which states, in part, the following:

> *A director, officer or incorporator of a corporation shall perform his duties as such, including, in the case of a director, his duties as a member of a committee of the Board upon which he may serve, in good faith and in a manner he reasonably believes to be in the best interest of the corporation, and with such care as an ordinarily prudent person in a like position with respect to a similar corporation organized under this chapter would use under similar circumstances.*

We agree that NCYF's Board is not responsible for setting compensation for non-senior management employees. However, in determining the Board's responsibility for setting the Executive Director's and senior management's compensation, one must consider both Chapter 180, Section 6C, of the General Laws and the Massachusetts Attorney General's Office Guide for Board Members of Charitable Organizations (Guide). In this regard, Chapter 180, Section 6C, of the General Laws provides a very broad framework under which Board members perform their duties and responsibilities. The Guide, which supplements Chapter 180, Section 6C, provides detailed guidance for Board members to follow when carrying out their important duties and responsibilities. Relative to executive compensation, the Guide clearly specifies that board members of charitable organizations are responsible for setting the compensation of CEOs and other senior managers. In short, the Guide states the board of a charitable organization's process for setting executive compensation, the amount of such compensation, and the terms of such compensation should all be well documented, approved by the full Board, and be sensitive to public concerns and regulatory oversight.

In its response, NCYF states that "the fact that in one case the amount in question was paid over time as a salary increase is of no consequence." However, NCYF's comments on this matter are inconsistent with the provisions of 808 Code of Massachusetts Regulations (CMR) 1.02 and Office of Management and Budget (OMB) Circular NO. A-122. Specifically, 808 CMR 1.02 states operating costs shall be considered "reasonably incurred" only if they are reasonable and allocable using the standards contained in OMB Circular A-122 or A-21, or successors thereto. Further, OMB Circular No. A-122 states, in part, "a cost is allocable to a federal award if it is treated consistently with other costs incurred for the same purpose and like circumstances. Consequently, because NCYF did not treat all employee bonuses in a consistent manner (one time payments versus salary increases), NCYF failed to adhere to both state and federal requirements. Contrary to NCYF's assertion, this inconsistent treatment of bonus payments in our opinion does represent a matter of significant consequence.

3. NCYF IMPROPERLY UTILIZED STATE PROGRAM REVENUES TOTALING $406,360 TO FUND OUT-OF-STATE PROGRAMS

According to state regulations revenue NCYF receives under its contracts with Massachusetts state agencies may only pay for expenses associated with the operation of the programs that are funded by these contracts. In addition, allowable surplus state revenues retained by providers are public revenues and therefore they may only be expended for activities and programs that are in keeping with the Massachusetts charitable purposes of the provider organization according to the Auditor's Compliance Supplement issued by the state's Operational Services Division pursuant to 808 CMR 1.00. Despite these requirements, our audit identified that between fiscal years 2006 and 2009, NCYF used revenues totaling $406,360 that it received under its Massachusetts contracts to fund losses that it incurred within programs it operated in the state of Connecticut. Since this $406,360 did not benefit consumers in NCYF's Massachusetts programs, NCYF's use of these contract revenues for these purposes represents unreasonable and unallowable costs against its state contracts.

According to OSD regulations, state contract revenues should only be used to pay for expenses incurred in providing services to consumers in state-funded programs. In this regard, 808 CMR 1.02, promulgated by OSD, defines reimbursable operating costs as follows:

> *Those costs reasonably incurred in providing the services described in the contract. Operating costs shall be considered "reasonably incurred" only if they are reasonable and allocable using the standards contained in Federal Office of Management and Budget Circular A-122 or A-21, or successors thereto.*

Further, 808 CMR 1.05 promulgated by OSD prohibits state contract revenues to be used for unreasonable expenses, defined as follows:

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

In addition, 808 CMR 1.03(7) restricts the use of surpluses that non-profit contractors accumulate from the revenues and expenses associated with services provided to state purchasing departments, as follows:

> *Surpluses may be used by the Contractor for any of its established charitable purposes, provided that no portion of the surplus may be used for any nonreimbursable cost set forth in 808 1.05, the free care prohibition excepted.*

OSD issued further guidance on the use of surpluses retained by providers within its UFR Auditor's Compliance Supplement. Specifically, the Supplement states the following:

> *The surplus revenues retained by the providers are public revenues and therefore their use is limited in the following manner:*
>
> - *The revenues may only be expended for activities and programs that are in keeping with the Massachusetts charitable purposes of the provider organization.*
> - *The revenues may not be spent on items that are prohibited by state or federal law and regulation, such as nonreimbursable state and federal costs set forth in 808 CMR 1.15, including depreciation expense for the purchase of capital items (except free care).*

While NCYF primarily serves Massachusetts children and adolescents who suffer from emotional and behavioral issues, it also operates three residential treatment programs within the state of Connecticut. NCYF opened the first of these three programs during fiscal year 2006 and since that time, NCYF has opened two additional programs. Each out-of-state program has incurred significant financial losses. Specifically, for fiscal years 2006 through 2009, NCYF received client service fees from the state of Connecticut that totaled $5,840,839. However, during the same four-year period, NCYF incurred operating expenses within its out-of-state programs that totaled $6,247,199. Consequently, NCYF's combined out-of-state program losses total $406,360 through fiscal year 2009. The table below details the losses that NCYF has incurred within its out-of-state programs through fiscal year 2009:

Fiscal Year	Ct. Locations	Expenses	Revenue	Results
2009	Mansfield	$999,158	$950,527	($48,631)
	Lebanon	964,194	949,525	(14,669)
	Chaplin	944,913	949,742	4,829
		$2,908,265	$2,849,794	($58,471)
2008	Mansfield	$1,053,025	$948,413	($104,612)
	Lebanon	943,815	871,624	(72,191)
	Chaplin	209,612	170,708	(38,904)
		$2,206,452	$1,990,745	($215,707)

Fiscal Year	Ct. Locations	Expenses	Revenue	Results
2007	Mansfield	$900,143	$841,935	($58,208)
	Lebanon	120,437	91,590	(28,847)
		$1,020,580	$933,525	($87,055)
2006	Mansfield	$111,902	$66,775	($45,127)
		$111,902	66,775	($45,127)
Totals		$6,247,199	$5,840,839	($406,360)

According to NCYF's financial statements, except for a $217 donation, its Connecticut programs were funded by client service fees that were provided by the state of Connecticut but were insufficient to cover the expenses associated with the operation of these programs. As such, NCYF required an alternative source of revenue in order to keep operating its out-of-state programs. Consequently, NCYF used accumulated surpluses from its Massachusetts state-funded programs. However, since the expenses related to the operation of its out-of-state programs in no way benefited NCYF's Massachusetts consumers, the $406,360 in accumulated program surpluses that NCYF used to pay for these expenses represents unreasonable costs based upon state regulations and should be refunded to the Commonwealth.

Recommendation

In order to address our concerns relative to this matter, the Commonwealth should recover from NCYF the $406,360 in state program revenues that it used to offset costs associated with its out-of-state programs. In the future, NCYF should take measures to ensure that no Massachusetts contract revenues are used for these purposes.

Auditee's Response

In response to this issue, NCYF officials provided comments which are excerpted below:

> *Regulation 808 CMR 1.03(7) provides that surpluses as determined under that section "may be used by the Contractor for any of its established charitable purposes" The purposes of the Center, as set forth in its articles of organization, are as follows:*
>
> > *To operate exclusively for charitable and educational purposes, including but not limited to charitable and educational purposes for young persons in the Connecticut Valley region.*
>
> *In its Connecticut programs, the Center provided services identical to those provided in the Center's programs serving Massachusetts residents; namely, therapeutic residential*

services for youths. All of those programs directly furthered the Center's charitable purposes. Regulation 808 CMR 1.03(7) specifies that surplus funds may not be applied to nonreimbursable costs as set forth in regulation 808 CMR 1.05, "the free care prohibition excepted." In effect, the Center used some of its accumulated retained surplus to provide free care to Connecticut clients.

While the Center's losses on its Connecticut programs totaled $406,360, of that amount only $216,618 represents a cash expenditure. The balance represents depreciation. The Center's retained surplus is a cash item. At most the Center's cash expenditure constitutes an impermissible use of the Center's surplus.

Auditor's Reply

Contrary to NCYF's response, 808 CMR 1.03(7) and the Auditor's Compliance Supplement prohibit it from using its accumulated surpluses from Massachusetts-funded programs to pay for out-of-state program expenses. While 808 CMR 1.03(7) indicates that accumulated surpluses may be used to provide free care, the Auditor's Compliance Supplement mandates that the recipients of the free care must be Massachusetts residents, and not Connecticut residents. As previously stated, OSD, under 808 CMR 1.00, issued the OSD's UFR Auditor's Compliance Supplement. Within this document, OSD specifies that surplus revenues retained by providers are public revenues and therefore their use is limited in the following manner:

*The revenues may only be expended for activities and programs that are in keeping with the **Massachusetts charitable purposes** of the provider organization.*

In addition, as noted in our report, 808 CMR 1.02 defines reimbursable operating costs as those costs incurred in providing the services described in the vendor's contract with the state. The services provided for Connecticut residents were not described in NCYF's Massachusetts contracts. As such, NCYF should not have used any surpluses it accumulated from state programs to offset funding deficiencies within its Connecticut-based programs.

We agree with NCYF that 808 CMR 1.04 requires that non-profit contractors maintain books and records in accordance with generally accepted accounting principles. In this regard, under 808 CMR 1.00, OSD issued the UFR Audit & Preparation Manual (Manual). Within the Manual, OSD provides general instructions for the preparation of the UFR as follows:

The basic financial statements must be completed in accordance with generally accepted accounting principles (GAAP), including the accrual basis (not cash basis) of accounting. Supplemental schedules must also be completed in accordance with GAAP except where a more restrictive accounting treatment is specifically required by the Account Definition. The supplemental information and the manner of its presentation in the organization's *supplemental schedules must not be materially inconsistent with the information or the manner of its presentation appearing in the basic financial statements of the UFR.*

Since OSD requires that non-profit contractors utilize the accrual basis of accounting to prepare their UFRs, NCYF's discussion of cash basis accounting is irrelevant to this matter.

4. NCYF DID NOT PROPERLY REPORT UNALLOWABLE SEVERANCE PAYMENTS TOTALING $148,098 IN THE FINANCIAL STATEMENTS IT FILED WITH THE COMMONWEALTH

Between fiscal years 2005 and 2009, NCYF provided severance pay to nine employees that totaled $198,280. The individual severance amounts, which included a combination of extended medical insurance coverage, bonuses, and salary payments, ranged in amounts from $5,471 to $53,784. However, NCYF's policies and procedures did not provide for the provision of severance pay. Consequently, based upon state and federal regulations, these payments represent nonreimbursable costs to the Commonwealth. In addition, our analysis of these nine severance packages identified significant disparities between the severance compensation that was provided to these individuals. For example, when a former Director of Program Services left NCYF during fiscal year 2008, she received six months in paid medical insurance benefits ($5,741) as her severance compensation. In contrast, when a former Chief Financial Officer left NCYF during fiscal year 2009, he received four months of his salary ($34,961) plus a $5,000 bonus as his severance compensation. Finally, we found that even though the severance payments in question were nonreimbursable expenses, NCYF only disclosed the severance payments it made during fiscal year 2009 ($39,961) and a portion of its fiscal year 2007 payments ($10,221) as nonreimbursable expenses during these fiscal years. NCYF reported the remaining $148,098 in the financial statements it filed with the Commonwealth as allowable personnel costs rather than nonreimbursable costs.

According to 808 CMR 1.02, operating costs shall be considered "reasonably incurred" only if they are reasonable and allocable using the standards contained in OMB Circular A-122 or A-21. Circular A-122 specifies that compensation for personal services includes all compensation paid currently or accrued by the organization for services of employees rendered during the award period. Compensation for personal services includes severance pay, commonly referred to as dismissal wages. Moreover, A-122 specifies that the costs of such compensation are allowable to the extent that total compensation to individual employees is reasonable for the services rendered and conforms to the established policy of the organization consistently applied.

NCYF's Termination of Employment Policy, contained within its Employee Handbook, does not provide for severance pay for terminated employees. Therefore, NCYF's severance payments directly violated state and federal regulations as well as its own policies and procedures.

NCYF has developed an Employee Handbook (Handbook) that details its personnel policies and procedures. One section of the Handbook, Termination of Employment, states that terminated employees will receive: (1) their final pay in accordance with applicable state law; (b) all accrued, vested benefits that are due and payable at termination; and (c) some benefits may be continued at the employee's expense if the employee so chooses. However, the Handbook does not identify severance payments as being available to any NCYF employee.

Despite the lack of any provisions providing for severance payments, we found that between fiscal years 2005 and 2009, NCYF provided nine members of its administrative staff with severance payments, as indicated in the table below:

Fiscal Year Employment Ended	Position	Severance Payments	Severance Description
2005	Chief Financial Officer	$20,192	3-months' salary
		914	13-weeks' Medical Insurance
2005	Executive Director	14,987	2-months' salary
		1,455	2-months' Medical Insurance
2006	Associate Executive Director	49,187	6-months' salary
		4,597	6-months' Medical Insurance
2007	Director of Family Based Services	15,935	10-weeks' salary
		1,125	1.5-months' Medical Insurance
2007	Assistant Director of Foster Care	23,582	16-weeks' salary
		2,250	Bonus
2007	Shift Supervisor	10,221	3-months' salary
2008	Director of Foster Care	8,403	5-weeks' salary
2008	Director of Program Services	5,471	6-months' Medical Benefits
2009	Chief Financial Officer	34,961	4-months' salary
		$5,000	Bonus
Total		$198,280	

Since NCYF does not have an established employee policy authorizing severance payments in accordance with 808 CMR 1.02, the severance payments NCYF made during the audit period represent nonreimbursable costs to the Commonwealth. We also identified other problems with these severance payments which are detailed in the sections below.

Disparities in Severance Packages

Our analysis of the nine severance packages identified significant disparities from one severance package to the next. For example, during fiscal year 2005, NCYF's Executive Director and Chief Financial Officer terminated their employment with NCYF. The Executive Director's severance agreement, dated March 29, 2005, specified that he would receive two months of his salary in severance pay. The Chief Financial Officer's severance agreement, dated November 23, 2004, provided for him to receive three months of his salary as severance pay. In addition, as part of the Executive Director's and Chief Financial Officer's severance agreements, NCYF agreed to continue paying their health insurance costs for two months and three months, respectively.

Severance Payments Not Properly Reported to Commonwealth

We also found that NCYF did not accurately report to the Commonwealth these severance payments. As previously noted, 808 CMR 1.00 requires human service providers such as NCYF to annually submit financial statements (UFRs) to OSD. As part of their UFR submissions, human service contractors must identify all nonreimbursable state and federal expenses as well as non-state contract revenues that were available to defray these costs. However, even though the severance payments in question were clearly nonreimbursable expenses, NCYF only disclosed two of the nine severance payments totaling $50,182 as being nonreimbursable expenses during the audit period. NCYF reported the remaining $148,098, or 75%, in its UFRs as allowable personnel costs rather than nonreimbursable costs. Consequently, contrary to 808 CMR 1.00, NCYF used $148,098 of state program revenues to fund the majority of the nonreimbursable severance payments it made during the audit period.

During our audit, we discussed this matter with NCYF's Attorney, who provided us with the following comments:

- She acknowledged that NCYF's Employee Handbook does not contain any provision authorizing severance payments.

- The Board of Directors, which met in Executive Session to discuss the severance payments, did not maintain minutes detailing their discussions and approval of the payments.
- The Board of Directors, through the Executive Director, requested that the Human Resource Attorney outline the potential legal liability in each case.
- Rather than expose NCYF to litigation and potential legal liability, the Board of Directors opted to award severance payments to resolve these matters.

Recommendation

In order to address our concerns relative to this matter, the Commonwealth should recover from NCYF the $148,098 in state contract revenues that NCYF used to provide severance compensation to certain staff members during our audit period. In the future, if NCYF wants to make severance payments available to all of its employees, it should establish a policy consistent with state and federal regulations. Finally, NCYF should amend its UFRs to properly account for these nonreimbursable expenses and in the future, take measure to ensure that all nonreimbursable costs, including staff severance payments, are properly reported to OSD.

Auditee's Response

In response to this issue, NCYF officials provided comments which are excerpted below:

> *Amounts paid by the Center in its fiscal years 2005-2009 constituted severance payments. Each was negotiated individually, and each reflected the reasonable judgment of the Board of Directors of the Center, based upon legal advice, as to whether and in what amount, a severance payment should be made. As the Draft Report noted, the Center has acknowledged in its UFR's for fiscal years 2007 and 2009 that a total of $50,182 in payments was not reimbursable. However, the Center had ample unrestricted assets in the years in question to cover these costs, so no amount is recoverable by the Commonwealth.*
>
> *… Circular A-122 provides, in substance, that severance pay is allowable if it is required under particular circumstances, one of which is "circumstances of the particular employment." The Draft Report acknowledges that the Center's Human Relations Attorney explained to the [state auditor] that each package was separately approved by the Center's Board of Directors on the basis of advice by counsel as to risks of liability in each case. The Board's decisions reflected the "circumstances of employment" in each case.*
>
> *The Draft Report cites the Center's Employee Handbook, which deals (in Part 7) with Termination of Employment. That Section addresses payment upon termination of an employee but does not contain any provision for severance payments, for good reason. The Center does not provide severance payments as a general rule. Rather, it approaches the subject as one of risk-management. Determinations were made on a case-by-case basis with the advice of counsel as appropriate, and the Center obtained releases of claims as appropriate.*

> *...During the years in question, the Center maintained insurance providing coverage related to the Center's employment practices. In order to reduce premiums for this insurance, the Center agreed to a deductible of $25,000. The Center's payment, in return for releases as appropriate, of severance amounts constituted reimbursable payments under Circular A-21(J)(25)(d) and Circular A-122, Attachment B(22)(a)(3). Those Circulars provide, in substance, that actual losses that could have been covered by permissible insurance will not be allowable except to the extent those losses are not covered under the terms of deductible clauses for insurance reflecting sound management practice. In this case, the Center incurred costs that were of the type covered by its employment practices insurance but were within the Center's deductible. The Center established the terms of its insurance policy on the basis of its judgment about trade-offs between premiums and deductible amounts. These costs were reimbursable under the applicable federal rules.*

Auditor's Reply

In its response, NCYF indicates that each severance payment was negotiated individually, reflected the reasonable judgment of the Board of Directors, and was based upon legal advice as to whether and in what amount a severance payment should be made. However, even if this was in fact the process that was followed in the awarding of these severance payments, this process is not consistent with applicable state and federal requirements. Specifically, 808 CMR 1.02 and OMB Circular A-122 require that severance payments be based upon an established policy of the organization that is consistently applied. While NCYF has a Board-approved Termination of Employment policy, this policy does not provide for severance payments. Additionally, NCYF was not consistent in the manner in which it provided severance payments to its former employees during the audit period, contrary to state and federal requirements.

Furthermore, NCYF did not have sufficient non-restricted revenues to cover the costs of these severance payments. The Appendix of this report shows the limited amount of non-restricted revenues NCYF had available to cover these expenses which were significantly less than the unallowable costs we identified during our audit period.

In its response, NCYF states that the severance payments in question resulted from "circumstances of the particular employment" and are allowable costs under OMB Circular A-122. In this regard, NCYF officials provided the following information regarding these settlements:

- Eight of the nine cases involve employees who were terminated due to failure to meet performance standards.

- The eight employees threatened to file claims against NCYF with the Massachusetts Commission Against Discrimination (MCAD).
- NCYF provided the severance payments in order to settle with the terminated employees, minimize legal costs, and prevent MCAD claims against NCYF.

Regarding "circumstances of a particular employment," a 2008 article published by Community Action Program Legal Services, Inc. states the following:

> *[United States Department of Human Services, Departmental Appeals Board] decisions suggest that the "circumstances of the particular employment" criterion applies where a severance payment is made in exchange for some benefit to the grantee from the employee's departure. South Central Florida Health Systems Council, Inc., DAB No. 488 (1983); see also Alcoholism Center for Women, DAB No. 222 (1981) and Health Systems Agency of Western New York, DAB No. 221 (1981).*
>
> *An example of where the circumstances of the particular employment might justify a severance payment is where the grantee might be harmed if an incompetent executive director were to remain in that position for a full term. Alcoholism Center for Women, DAB No. 222 (1981) and South Central Florida Health Systems Council, Inc., DAB No. 488 (1983). In such a case, according to the DAB, the element of give and take would exist where the grantee gives severance pay and the employee steps down in advance of a predetermined time. Id.*

Based on NCYF comments, the severance packages provided to eight of the individuals in question appear to have been provided not as a circumstance of their particular employment but rather to avoid any legal claims made against NCYF by these individuals for discrimination. NCYF's response indicates that it approaches the subject of severance payments as one of risk-management and determinations were made on a case-by-case basis with the advice of counsel, and that the Center obtained releases of claims as appropriate. While NCYF's approach might be acceptable for a non-governmental entity, human service providers contracting with the Commonwealth must adhere to state and federal regulations. As stated above, NCYF did not have a policy that provided for severance payments, contrary to state and federal regulations. As a result, NCYF did not treat its former employees in a consistent manner.

In its response, NCYF indicates that these incurred costs were of the type covered by its employment practices insurance and were within its deductible. Therefore, NCYF believed that the severance payments represented allowable costs to the Commonwealth. While NCYF did have employment practices liability insurance during the audit period, NCYF could not document that it reported these potential claims to the underwriter for payment. Moreover, in six of the eight cases, the severance payments actually exceeded NCYF's insurance policy deductibles of $10,000 and $25,000. Consequently, NCYF's underwriter should have been responsible for all amounts over the deductibles. Ultimately, NCYF should have reported the total amounts to the Commonwealth as nonreimbursable costs and utilized non-restricted revenues for the amounts not covered by the underwriter.

5. NONREIMBURSABLE CONSULTANT COSTS TOTALING $53,950

During the audit period, NCYF paid four consultants a total of $303,168 for educational, business, and legal consulting services, of which $53,950 represents nonreimbursable costs to the Commonwealth. Based on our review of the records that NCYF maintained relative to these services, we noted that in several instances, NCYF failed to enter into formal written agreements with the consultants that clearly defined the duties and responsibilities of each party. As a result, NCYF lacked a mechanism to monitor each contractor's performance and to protect itself from any legal issues (e.g., claims for non-performance of services, liability claims for any property damage or personal injury) that could arise. In addition, in several instances, NCYF did not require these consultants to submit supporting documentation to substantiate what services, if any, they provided. Finally, NCYF awarded one consultant contract to a current NCYF employee in violation of both state regulations and federal cost principles for non-profit agencies. As a result, NCYF allocated $53,950 in consultant payments to state contracts contrary to 808 CMR 1.05 and Office of Management and Budget Circular A-122.

OSD has promulgated regulations that define certain costs as being unallowable and nonreimbursable costs to the Commonwealth. Specifically, 808 CMR 1.05(26) and (22) define the following costs as nonreimbursable program costs:

> *(26) <u>Undocumented Expenses</u>. Costs which are not adequately documented in the light of the American Institute of Certified Public Accountants Statements on Auditing Standards for evidential matters.*
>
> *(22) <u>Unallowable Costs under OMB Circular A-122 and A-21, or Successor Provisions.</u> Costs which are not allowed under OMB Circular A-122 and A-21, or successor provisions, are nonreimbursable to Programs which receive federal financial assistance.*

During our audit, we reviewed the records NCYF maintained relative to four consultants to whom it paid a total of $303,168 during our audit period. A description of each of these consultant services and the problems we identified based on our review of these documents are described in the sections below.

Educational Consultant

During fiscal year 2006, NCYF awarded a $45,000 contract to an individual to provide educational consultant services to NCYF during the period August 15, 2005 through February 15, 2007 (18-month period). Our review of the records NCYF maintained relative to these services identified that the consultant's services were not documented in accordance with 808 CMR 1.05(26). Specifically, the educational consultant submitted only three of the six quarterly activity reports required under the terms and conditions of the contract. Consequently, NCYF could not document the services the consultant provided during nine of the 18 months of the contract period. As such, $22,500 of the $45,000 NCYF provided to the consultant represents nonreimbursable costs to the Commonwealth.

Program Proposal Writer

During the three-year period ended June 30, 2008, NCYF paid a company called Tectonic, Inc. (Tectonic), a total of $45,250. Based upon invoices submitted by Tectonic during this period, the consultant provided a variety of services including: developing program proposals for NCYF, overseeing the design of NCYF's website, and developing an agency brochure. During our audit, we reviewed the documentation NCYF maintained relative to the services it procured from this consultant and noted the following problems:

- NCYF negotiated a contract with Tectonic that only covered the six-month period January 1, 2007 through June 30, 2007 and did not provide for any contract extensions. NCYF did not have a written contract with Tectonic for the other 30 months in which Tectonic provided consulting services for NCYF.

- As previously noted, during the three fiscal years ended June 30, 2008, NCYF paid Tectonic $45,250. However, the consultant's billing invoices maintained by NCYF totaled only $32,850. Consequently, NCYF could not adequately support the remaining $12,400 that it paid Tectonic during this period.

- Tectonic submitted five billing invoices to NCYF, which indicated that the firm developed seven program proposals, prepared an agency brochure, and provided oversight of NCYF's website design. However, during the audit, NCYF could not provide most of the products supposedly developed by Tectonic.

As previously described within this report, OSD has promulgated regulations that define undocumented expenses as being unallowable and nonreimbursable costs to the Commonwealth. In addition, we determined that the Tectonic consultant who provided the services under this contract was also an employee (Director of Special Projects) and worked between 20 and 32 hours per week for NCYF during the contract period. As Director of Special Projects, this individual received a weekly payroll check from NCYF, which ranged from $749 to $1,384. Therefore, during the contract period, NCYF was simultaneously paying this individual both as a consultant and an employee. State and federal regulations prohibit non-profit organizations such as NCYF from awarding consulting contracts to officers or employees of the non-profit organization. Specifically, 808 CMR 1.02 and OMB Circular A-122 provide the following restrictions on such contracts:

> *Professional Services Costs* *Costs of professional and consultant services rendered by persons who are members of a particular profession or possess a special skill, and who are not officers or employees of the non-profit organization, are allowable*

Finally, we found that the Director of Special Projects received three salary advances that totaled $24,625 during the audit period. Agency officials stated the advances were not approved by the Board of Directors, supported by formal loan agreements, or required interest payments. Moreover, these officials stated that the advances were provided to the Director of Special Projects to help cover her family's medical costs and school tuition expenses. However, contrary to state regulations, NCYF did not have an established employee benefit policy authorizing such advances. Consequently, the salary advances provided to the Director of Special Projects represent a misuse of state funds by NCYF. The table below details the salary advances provided to the Director of Special Projects:

Loan Amount	Loan Date	Repayment Date
$6,000	December 2006	March 2007
$6,000	July 2007	November 2007
$12,625	January 2008	July 2008
$24,625		

Legal Services Consultant (Corporate Counsel)

NCYF retains an attorney to serve as its corporate counsel and to provide alternative dispute resolution services. During the five fiscal years ended June 30, 2009, NCYF paid this attorney a total of $84,000. However, our audit found that NCYF did not enter into formal written agreements with the attorney that clearly defined the duties and responsibilities of each party for fiscal years 2005, 2007, and 2008. In addition, during the audit period, the attorney's quarterly billing invoices did not provide a substantive description of the legal services he performed, and seemed to charge for services not yet performed. For example, the attorney's billing invoice dated June 23, 2006, which is representative of all invoices he submitted to NCYF during the five-year period, provided a service description that stated, "for services to be rendered from 7/1/06 to 9/30/06."

In addition, our audit found that NCYF over-compensated the attorney in the amount of $10,000 during fiscal year 2006. In this regard, NCYF signed a one-year retainer agreement with the attorney that defined the duties and responsibilities of each party commencing July 1, 2005 and ending June 30, 2006. Included within the retainer agreement were the following terms and conditions relative to NCYF's financial responsibilities and the attorney's legal duties:

> *NCYF retains and employs Counsel for and during a period commencing 7/1/05 and ending 6/30/06 for performance of legal services as set forth in this agreement. Counsel will have charge of the law business of NCYF in the Commonwealth of Massachusetts, at a salary of $12,000, payable in quarterly payments of $3,000. Counsel accepts such employment and agrees that such salary shall be in full for all services by Counsel for NCYF.*

Moreover, the retainer agreement emphasized the broad scope of legal services to which the attorney agreed to provide NCYF in return for quarterly payments of $3,000, as detailed below:

> *Counsel may be consulted at all times by the Officers and Directors of NCYF, its Executive Director and their designees, on all business requiring professional legal advice. Such advice includes but is not limited to matters arising before the state regulatory agencies and interpretation of its codes, representation before municipal agencies, real estate and commercial matters, employee matters, and business and corporate issues.*

Based upon the terms of the retainer agreement, NCYF was only responsible for paying the legal consultant $12,000 during fiscal year 2006. Moreover, by signing the retainer agreement, both parties agreed that the payment covered the full cost of all services provided by the legal consultant for NCYF. However, our review found that NCYF was billed an additional $10,000 by the corporate legal consultant on June 28, 2006. The Counsel's billing invoice states, in part, "for consulting and conflict resolution services rendered from 7/1/05 to 6/30/06 regarding corporate reorganization, board development, management team reorganization and CEO consultation."

808 CMR 1.05(2) promulgated by OSD identifies the following costs as being nonreimbursable under state contracts:

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

Clearly, the legal services described within counsel's billing invoice were fully covered under the retainer agreement signed by both parties. Therefore, NCYF was not responsible for paying the additional $10,000 legal fee. However, in so doing, NCYF effectively provided the legal consultant a duplicate and unreasonable payment of $10,000, which is nonreimbursable.

Legal Services Consultant (Labor and Employment)

During the five fiscal years ended June 30, 2009, NCYF paid another attorney $128,918 for legal services that it required relative to labor and employment matters. NCYF negotiated a consultant agreement detailing the duties and responsibilities of each party for the last six months of calendar year 2009. Under this contract, the attorney received six monthly payments that totaled $37,500. However, NCYF did not have similar agreements with the attorney for the first four and one half years of our audit period and the remaining $91,418 paid to this consultant. It should be noted that NCYF did provide documentation to adequately support the services that this consultant provided for NCYF during the audit period and that the charges and the rates paid for these services appeared to be reasonable. Consequently, we are not questioning any of compensation provided by NCYF to this consultant during this period.

Recommendation

In order to address our concerns relative to these matters, the Commonwealth should recover from NCYF $53,950 of the $303,168 ($45,000 for the Educational Consultant, $45,250 for the Proposal Writer, $84,000 for corporate counsel, and $128,918 for Labor and Employment) in state contract revenues that NCYF expended on these consultant services during our audit period. This amount consists of (a) $22,500 that the Educational Consultant was paid for undocumented services, (b) $21,450[2] of the $45,250 the Program Proposal Writer received

[2] NCYF reported $23,800 of the $45,250 that it paid Tectonic, Inc. as a nonreimbursable expenses on its fiscal year 2007 and 2008 UFR reports to OSD. Consequently, we recommend that the Commonwealth recover the remaining $21,450 from NCYF.

contrary to state and federal regulations, and (c) $10,000 the Corporate Counsel was over-compensated during fiscal year 2006. Regarding the Labor and Employment Consultant, we do not recommend that the Commonwealth recover any payments NCYF made to this consultant since NCYF was able to provide documentation to support the services she billed during the audit period. In addition, NCYF should take measures to ensure that in the future it (a) prepares contracts for all consultant services, (b) receives adequate supporting documentation for all consultant charges, and (c) awards consultant contracts in accordance with OSD regulations and federal guidelines.

Auditee's Response

In response to this issue, NCYF officials provided comments which are excerpted below:

<u>Educational Consultant</u>

- *The Executive Director had notes, emails and other documentation outlining the work the consultant was performing and provided these documents to the State Auditor. This documentation met the requirements of GAAP. Due to the limitations of the Center's email system, many of the quarterly reports were lost in the Center's archives. The consultant's services can be measured by the consultant's performance of the following:*
    - *Training of the Center's new school director in applicable regulations.*
    - *Represented the Center at national conferences to promote the Center nationally to receive out-of-state referrals.*
    - *Represented the Center at a federal level to support funding for the center's special needs school.*

<u>Program Proposal Writer</u>

- *The Center reported $17,000 in payments to Tectonic as nonreimbursable in the Center's fiscal years 2007 UFR, and it reported another $6,800 as nonreimbursable in its fiscal year 2008 UFR. The balance is $21,450. The Center had ample unrestricted assets to cover this figure.*

<u>Corporate Counsel</u>

- *There is no regulatory requirement that a consultant contract be in writing or that a bill have a particular level of detail. The Center was satisfied that the attorney's professional work product was satisfactory in nature and amount. The Center was fully familiar with the attorney's services in the form of meetings, phone calls, written work and email messages and other reasonable evidential matter. Supporting material was provided to the [state auditors] to the extent requested.*

- *The Center and this attorney had a retainer agreement in place calling for payment in the amount of $12,000 for the period July 1, 2005 – June 30, 2006 for certain services. The attorney provided, and was paid for, those services. Separately, the attorney provided, and was paid $10,000 for, other services, ones not covered by the retainer agreement. The attorney's bill for the latter appropriately uses different terms than are reflected in the retainer agreement. The additional $10,000 was separately paid for management consulting services and arbitration of employee/employer disputes performed during a restructuring when the former chief financial officer and executive director transitioned from the Center. These services were extraordinary and above the normal duties of corporate legal counsel. Evidence of his work can be found in minutes, emails and documents.*

Labor and Employment Consultant

- *The Center was not required by any regulation to have a written contract with its attorney or to secure billings in some particular detail. The Center's engagement of this attorney was on an at-will basis. Under the circumstances, the attorney's services were under continual review, as to both quality and price, by the Center. The Center's management and Board of Directors were well aware of the services being provided, through conferences, phone calls, emails and written work. Having a written contract or more detailed billing would not have enhanced the ability of the Center's leadership to provide prudent management of these services.*

Auditor's Reply

Contrary to NCYF's response, state and federal regulations require human services providers to adequately document all costs that they allocate to state contracts and federal awards. As such, throughout the audit process, we requested that NCYF provide us with all available documentation relative to these four consultants including contract awards, billing invoices, work products, etc. Based on our review of this information as detailed in our report, we determined that NCYF paid the consultants (a) without formal contracts and agreements detailing each party's duties and responsibilities, (b) based upon vague and non-descript invoices, and (c) without adequate evidence that services were actually performed. Consequently, NCYF administration of these consultant services clearly does not meet the requirements of applicable state and federal regulations.

In its response, NCYF provided us with notes, emails, and other documentation maintained by NCYF's Executive Director purportedly outlining the work the educational consultant performed. However, our review of this information only substantiated some of the services provided and the payments made to the educational consultant for the first nine months of the contract period. Moreover, we afforded NCYF numerous opportunities to locate additional documentation relative to the last nine months of the contract period including contacting the educational consultant for assistance in the matter. NCYF was unable to support the payments it made to the educational consultant from May 15, 2006 to February 15, 2007. Consequently, those payments, which totaled $22,500, clearly represent unallowable costs to the Commonwealth.

Contrary to NCYF's response, NCYF did not have ample non-restricted revenues to cover the unallowable payments that it made to Tectonic, Inc. during the audit period. NCYF's shortage of non-restricted revenues for this purpose is detailed in the Appendix of this report.

NCYF's response indicates that the legal services consultant was paid an additional $10,000 for consulting and conflict resolution services not covered by his fiscal year 2006 retainer agreement with NCYF. However, as stated in our report, NCYF's fiscal year 2006 retainer agreement with the consultant specifies, among other things, (a) counsel will have charge of the law business of NCYF in the Commonwealth of Massachusetts, at a salary of $12,000 payable in quarterly payments of $3,000; (b) counsel accepts such employment and agrees that such salary shall be in full for all services by counsel for NCYF; and (c) counsel may be consulted at all times by the officers and directors of NCYF, its Executive Director and their designees, on all business requiring professional legal advice. Clearly, based upon the terms and conditions of the retainer agreement which both parties signed, the legal services consultant was fully compensated through the retainer agreement for all services he provided for NCYF during fiscal year 2006. Consequently, the additional $10,000 that NCYF paid the legal services consultant represents an unallowable cost to the Commonwealth. It should be noted that NCYF did not execute an amendment to the retainer agreement in question. Rather, the legal services consultant simply submitted a billing invoice at the close of the fiscal year (June 28, 2006).

6. LAPSE IN WORKERS' COMPENSATION INSURANCE RESULTED IN UNALLOWABLE INSURANCE CLAIMS PAYMENTS TOTALING $7,073

Massachusetts General Laws, Chapter 152, Section 25A requires all employers to maintain workers' compensation insurance. However, we found that during fiscal year 2007, NCYF did not pay its premium for its workers' compensation policy until 41 days after it was due, which caused it to lapse. During the period that NCYF operated without workers' compensation insurance, an employee of NCYF was injured on the job and required medical attention at a local hospital. The accident resulted in hospital, medical, and wage continuation costs for the employee totaling $7,073. In addition, following the accident, NCYF negotiated a settlement agreement, which stipulated that the injured employee would receive $45,000 for releasing NCYF from any and all claims, demands, rights, actions, or causes of action on account of or in any way growing out of any and all personal injuries from the accident. Because NCYF did not have workers' compensation insurance coverage at the time of the accident, NCYF was responsible for paying the employee's medical expenses, lost wages, and settlement that totaled $52,073. According to state regulations, expenses such as these that are unreasonable and unnecessary are nonreimbursable under state contracts.

Massachusetts General Laws, Chapter 152, Section 25A requires all employers to maintain workers' compensation insurance. Specifically, the law states, in part:

> *In order to promote the health, safety and welfare of employees, every employer shall provide for the payment to his employees of the compensation provided for by this chapter in the following manner*
>
> *(1) By insurance with an insurer or by membership in a workers' self-insurance group, established pursuant to the provisions of sections twenty-five E to twenty-five U, inclusive, or*
>
> *(2) Subject to the rules of the department, by obtaining from the department annually, a license as a self-insurer…*

In order to comply with this law, NCYF purchases its workers' compensation insurance from Associated Industries of Massachusetts Mutual Insurance Company (AIM). For fiscal year 2007, AIM issued a renewal notice dated April 14, 2006, which specified that NCYF's annual insurance premium of $36,647 was due no later than June 11, 2006. However, we found that NCYF did not pay the premium until July 22, 2006, or 41 days later. Moreover, the delay caused a lapse in NCYF's workers' compensation insurance coverage for the period from July 1, 2006 to July 22, 2006 and resulted in unreasonable program costs totaling $52,073.

As previously described within this report, UFRs prepared by human service contractors must identify nonreimbursable state and federal expenses and revenues available within programs to defray these costs. NCYF identified $45,000 of the $52,073 as nonreimbursable costs to the Commonwealth. However, contrary to 808 CMR 1.05, NCYF used state program funds totaling $7,073 to cover the remaining nonreimbursable costs.

Based upon 808 CMR 1.05, funds received from departments may only be used for reimbursable operating costs, which OSD defines as follows:

> *<u>Reimbursable Operating Costs.</u> Those costs reasonably incurred in providing the services described in the contract. Operating costs shall be considered "reasonably incurred" only if they are reasonable and allocable using the standards contained in Federal Office of Management and Budget Circular A-122 or A-21, or successors thereto.*

During the audit, NCYF's Human Relations Attorney stated that the insurance invoice was not directed to the responsible parties, causing the lapse in workers' compensation insurance coverage.

Clearly, NCYF should have paid its insurance premiums in a timely manner which would have ensured its compliance with Massachusetts General Laws, Chapter 152, Section 25A and, at the same time, shifted full financial responsibility for this matter to AIM. By allowing its insurance coverage to lapse, NCYF incurred unreasonable program costs totaling $52,073 that represent nonreimbursable costs to the Commonwealth.

Recommendation

In order to address our concerns relative to this matter, the Commonwealth should recover from NCYF the $7,073 in state program funding that NCYF used to settle this employee matter. In addition, NCYF should take measures to ensure that it maintains the necessary insurance coverage in all areas of its operations.

Auditee's Response

In response to this issue, NCYF officials provided comments which are excerpted below:

> *As the Draft Report explains, the Center has already treated $45,000, the amount paid in settlement of claims that would have been covered by worker's compensation insurance, as nonreimbursable. The center frequently pays directly medical costs that would be covered by worker's compensation insurance, because it has found that doing so is less expensive than incurring higher workers' compensation premiums that would otherwise result. This is a prudent policy. In this case, $7,073 was reasonably paid by the Center and is thus a reimbursable cost.*

Auditor's Reply

NCYF did not provide us with any documentation to substantiate its assertion that it frequently pays medical costs that would be covered by workers' compensation insurance to minimize potential increases to its workers' compensation insurance premiums. Further, it was clearly not

NCYF's intention to directly pay the medical costs in question as it suggests in its response. Rather, NCYF initially filed a claim for this work-related injury with AIM. However, the claim was denied because as stated in our report, NCYF's workers' compensation insurance coverage had lapsed at the time of the accident. Consequently, NCYF's only viable option was to pay the employee's $7,073 medical expenses.

We do not agree that the medical expenses in question represent reasonable and therefore reimbursable costs under NCYF's state contracts. As previously noted, 808 CMR 1.02 specifies that operating costs shall be considered "reasonably incurred" only if they are reasonable and allocable using the standards contained in OMB Circular A-122 and A-21, or successors thereto. Regarding insurance and indemnification, Circular A-122, Attachment B, Section 22(a)(3) states, in part:

> *Actual losses which could have been covered by permissible insurance (through the purchase of insurance or a self insurance program) are unallowable…*

Clearly, based upon the provisions of 808 CMR 1.02 and OMB Circular A-122, the medical expenses paid by NCYF in this case represent nonreimbursable costs to the Commonwealth, since they would have been covered by NCYF's workers' compensation insurance policy had NCYF not allowed the policy to lapse. Similarly, medical costs paid directly that would otherwise be covered by workers' compensation insurance would represent nonreimbursable costs.

7. NCYF DID NOT PROPERLY ACCOUNT FOR EMPLOYEE RETIREMENT PLAN CONTRIBUTIONS TOTALING $260,000

During the period covered by our audit, NCYF offered a retirement plan to all its employees. Under this plan, employees make their own contributions and the plan also requires NCYF's Board of Directors to determine annually what amount, if any, NCYF will contribute to the plan on behalf of its eligible employees. Between fiscal years 2006 and 2009, NCYF's Board only authorized one employer contribution to this plan which, according to NCYF's records, was a lump sum contribution of $260,000 during fiscal year 2007. Our review of the documentation NCYF was maintaining relative to this contribution identified that while NCYF recorded and reported this contribution as taking place during fiscal year 2007, NCYF's Board of Directors authorized this contribution on November 13, 2007, or approximately five and one half months after the close of fiscal year 2007. Also, NCYF did not remit the $260,000 payment to the plan's trustee until February 6, 2008, or approximately seven months after the close of fiscal year 2007.

NCYF has established a 401(K) Profit-Sharing Plan for its employees. Employees can contribute to this plan as they deem appropriate and also according to NCYF's policies and procedures, NCYF can elect to make contributions to this plan on behalf of its employees. In this regard, NCYF's policies and procedures relative to this retirement plan state, in part:

> *Employer Contributions: Each plan year the Board of Directors will determine the amount of the employer base contribution (if any) that we will make for all eligible participants who are actively employed with us on the last day of the plan year.*

Between fiscal years 2006 and 2009, NCYF only made one contribution on behalf of its employees to this plan, $260,000, which was recorded by NCYF as a fiscal year 2007 contribution.

All human service providers who contract with the Commonwealth are required under the terms and conditions of their state contracts to maintain their financial records in accordance with GAAP. Under GAAP, expenses must be recognized in the period (e.g., fiscal year) in which they were incurred. However, NCYF did not adhere to this requirement when accounting for this retirement plan contribution. Specifically, NCYF did not authorize or pay the $260,000 contribution during fiscal year 2007 even though it had reported it had done so in the financial statements that it filed with the Commonwealth. Rather, on November 13, 2007, NCYF's CFO reported to the Board's Finance Committee that a $260,000 contribution to the retirement plan was being planned to address a surplus revenue retention issue NCYF was facing for fiscal year 2007[3]. On this same date, which was over five months after the close of fiscal year 2007 (June 30, 2007), the Board of Directors authorized this contribution to the employee's retirement plan. Further, NCYF did not actually provide the $260,000 contribution to the plan's trustee until February 6, 2008, or approximately seven months after the close of fiscal year 2007. Clearly, since all the events pertinent to this transaction occurred after the close of fiscal year 2007, NCYF's $260,000 payment represents a reimbursable cost to the Commonwealth for fiscal year 2008, and not fiscal year 2007.

[3] 808 Code of Massachusetts Regulations 1.03(7) allows contracted human service providers such as NCYF to retain a specified amount of any excess or surplus revenues they receive under their state contracts to meet various operational needs consistent with their non-profit activities. Any surplus funds that a provider realizes in excess of this allowable retention amount must be remitted to the Commonwealth.

Recommendation

In order to address our concerns relative to this matter, NCYF should amend its fiscal years 2007 and 2008 Uniform Financial Statements & Independent Auditor's Report (UFRs) to properly account for this pension contribution. Based on the information in these re-filed UFRs, the Commonwealth's Operational Services Division (OSD), the state agency responsible for regulating and overseeing the activities of all contracted human service providers such as NCYF, should recalculate NCYF's allowable surplus revenue retention for these two fiscal years and require NCYF to remit to OSD any funds that exceed the allowable surplus revenue retention amount. In the future, if NCYF wants to make contributions to this plan, it should establish specific annual contribution guidelines, including contribution limits. Further, all contributions should be properly recorded in accordance with generally accepted accounting principles.

Auditee's Response

In response to this issue, NCYF officials provided comments which are excerpted below:

> *The Center acknowledges that its retirement plan contribution in the amount of $260,000 should have been recorded as a cost in the Center's fiscal year 2008 UFR rather than in the Center's fiscal year 2007 UFR. The Center has asked its auditors to prepare amended UFRs for fiscal years 2007 and 2008 to correct this timing error in reporting.*
>
> *The Center's 401(k) Profit-Sharing Plan provides that the Board of Directors is to decide year-by-year what contribution, if any, the center will make to this Plan. The Center's Board does not make this determination in advance of, or during, a fiscal year, because the Center's revenues for a given year are dependent upon referrals from the Commonwealth, and those referrals cannot be predicted with any degree of certainty. Making a decision on this subject after the close of a fiscal year is prudent on the part of the Board, because only then can the Board determine whether, and to what extent, funds may be available.*

Auditor's Reply

NCYF's decision to re-file its fiscal years 2007 and 2008 UFRs will ensure that its $260,000 employee retirement plan contribution is accounted for properly, and that any excess surplus funds that NCYF realized from its fiscal year 2007 state contracts are remitted to the Commonwealth in accordance with 808 CMR 1.03(7). However, we still recommend that NCYF establish specific annual contribution guidelines including contribution limits which will ensure that NCYF's retirement plan contributions are made timely, reported accurately, and are equitable, reasonable, and non-discretionary in amount.

APPENDIX

Schedule of Identified Recoverable Costs

Fiscal Years 2005 through 2009

	2005	2006	2007	2008	2009	Total
Total Non-Restricted Revenue*	$178,953	$105,143	$47,741	$74,961	$47,544	$454,342
Reported Nonreimbursable Costs*	121,846	915	74,962	34,824	122,897	355,444
Net Available Non-Restricted Revenues	$57,107	$104,228	$(27,221)	$40,137	$(75,353)	$98,898
Audit Results (Unallowable Costs)						
Contract Payments		$380,572	$266,348	$4,301		$651,221
Employee Bonuses			19,157	1,136		20,293
Out-of-State Costs		45,127	87,055	215,707	$58,471	406,360
Severance Payments	$37,548	53,784	32,671	24,095		148,098
Consultant Costs		31,450	22,500			53,950
Workers' Compensation			7,073			7,073
Total Unallowable Costs	$37,548	$510,933	$434,804	$245,239	$58,471	$1,286,995
Less Net Available Non-Restricted Revenues (Revenues that can be used to fund unallowable costs)						$98,898
Net Amounts Recoverable from NCYF						$1,188,097

****Per NCYF's financial statements***