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INDEPENDENT STATE AUDITOR'S REPORT ON CERTAIN ACTIVITIES OF NFI MASSACHUSETTS INC. JULY 1, 2000 THROUGH JUNE 30, 2003

OFFICIAL AUDIT REPORT

MAY 20, 2004

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NFI Massachusetts, Inc. (NFI) was incorporated in 1974 as Northeast Family Institute, Inc., a private nonprofit corporation. NFI's mission is to provide flexible and innovative community-based services that help individuals maximize their potential and experience the full promise of community living. NFI operates an array of programs for children, adolescents, adults, seniors, and families, including residential programs, day programs, educational programs, family-based services, and therapeutic foster care. NFI also provides consulting, training, and management services to public and private agencies, school systems, and state, city, and county governments. NFI is a subsidiary of North American Family Institute (NAFI) and has two affiliates, NFI Vermont and NFI North. During our audit period, NFI operated 21 programs under contracts with the Department of Social Services (DSS), the Department of Youth Services, the Department of Mental Health, the Department of Mental Retardation, and the Executive Office of Public Safety. NFI also received funds from private, in-kind contributions, grants, client resources, and other state and local government sources.

The scope of our audit encompassed the various administrative and operational activities of NFI during the period July 1, 2000 to June 30, 2003. Our audit was conducted in accordance with applicable generally accepted government auditing standards for performance audits issued by the Comptroller General of the United States. The objectives of our audit were to (1) determine whether NFI had implemented effective management controls and (2) assess NFI's business practices and its compliance with applicable laws, rules, and regulations and the various fiscal and programmatic requirements of its state contracts.

Our audit identified $1,561,411 in expenses that NFI billed or allocated to its state-funded contracts during the audit period that were not in compliance with state regulations and guidelines.

We found that, contrary to the Massachusetts General Laws, Chapter 29, Section 29B, and state regulations, between September 14, 1998 and June 30, 2003 DSS used NFI as a fiscal conduit to pay as much as $395,287 of DSS's own expenses, many of which were undocumented or not related to NFI's contracted activities. For example, although contract funding was supposed to be used for "assessments" and "service planning" for consumers, DSS expensed $9,045 through these contracts for gift certificates (with no documentation on who received them); $2,280 for office supplies and food for various DSS meetings; $471 for immigration and Green Card expenses purportedly for a DSS client; and $800 for a home study purportedly for a DSS client in London, England. In return for NFI's processing of these bills, DSS paid NFI administrative fees totaling

$43,445. Because DSS's central accounting staff could have processed those payments, this $43,445 represents an unnecessary expense to the Commonwealth. Moreover, by processing expenses in this manner, DSS failed to comply with state law and regulations; did not adequately safeguard these funds against misuse; and misrepresented both its and NFI's total operating expenses to the Commonwealth for the period of our review. Of particular concern is that DSS officials provided documentation indicating that DSS had this same type of contractual relationship with 21 other contracted human services providers statewide and had provided them with as much as $10,150,406 in funding during the previous eight fiscal years.

Contrary to state regulations, during fiscal years 2002 and 2003 NFI charged nonreimbursable building facility expenses of as much as $175,355 and $438,353, respectively, to its state contracts. These expenses were for the maintenance staff, legal fees, occupancy costs, education software, professional liability insurance, telephones, interest, and management services associated with the operation of a building owned by NFI, where state-funded programs had been phased out and were no longer operating. According to state regulations, expenses such as these that are not directly related to the program purposes of NFI's state-funded programs are unallowable and nonreimbursable under state contracts.

We found that NFI had incorrectly allocated as much as $480,667 of direct payroll expenses as indirect expenses to its state contracts during fiscal years 2001 and 2002. As a result, NFI misreported those payroll expenses. We also question the reasonableness of some of those expenses, because the individuals receiving payment were purportedly providing Program Director services to programs that already had Program Directors. Consequently, at least a portion of these $480,667 in payroll costs were likely duplicative and unnecessary.

We found that contrary to state regulations, during fiscal year 2001 NFI paid a management fee to its parent company (NAFI), a related party, that was $11,378 greater than NAFI's actual costs for providing the service. Of this amount, NFI charged $10,923 to state contracts. According to state regulations, any management fee paid to a related party that is greater than the related party's actual costs is unallowable and nonreimbursable under state contracts.

We found that during the period July 1, 2000 through June 30, 2003, NFI charged various nonreimbursable expenses against its state contracts. These expenses included $5,523 of inadequately documented staff payroll expenses and a dishwasher costing $1,800 that NFI expensed against its state contracts during the fiscal year rather than depreciating its cost over its useful life as required by state regulations. According to state regulations, expenses that are not adequately documented or not properly capitalized are nonreimbursable under state contracts. We also found that during fiscal years 2001 through 2003 NFI provided $10,058 in loans to certain staff members. According to state regulations, fringe benefits such as these that are not part of an established written policy of the agency are unallowable and nonreimbursable under state contracts.

INTRODUCTION

Background

NFI Massachusetts (NFI) was established in 1974 as Northeast Family Institute, Inc., a private nonprofit corporation. NFI's mission is to provide flexible and innovative community-based services that help individuals maximize their potential and experience the full promise of community living. NFI operates an array of programs for children, adolescents, adults, seniors and families in Massachusetts, including residential programs, day programs, educational programs, family-based services, and therapeutic foster care. NFI also provides consulting, training, and management services to public and private agencies, school systems, and state, city, and county governments. NFI is a subsidiary of North American Family Institute (NAFI) and has two affiliates, NFI Vermont and NFI North.

During our audit period, NFI operated 21 programs under contracts with the Departments of Youth Services (DYS), Mental Health (DMH), Mental Retardation (DMR), and Social Services (DSS) and the Executive Office of Public Safety. NFI also received funds from private, in-kind contributions, grants, client resources, and other state and local government sources. The following is a summary of NFI's revenue during fiscal years 1999-2003:

	1999	2000	2001	2002	2003
Government In-Kind/Capital Budget	$474,937	$503,912	$757,102	$2,000	$487,885
Private In-Kind Contributions	-	-	-	401,494	8,590
Mass. Government and Other Grants	169,784	186,129	185,325	172,082	141,172
DMH	5,394,923	5,505,284	6,251,969	6,164,735	6,137,088
DMR	156,557	176,510	185,984	186,372	296,517
DSS	2,136,553	1,848,898	1,648,408	1,466,200	1,761,728
DYS	3,417,054	3,456,326	3,536,208	4,297,409	4,616,142
Department of Education	59,163	43,923	47,368	-	-
Subcontract Revenue	2,081,418	3,565,674	3,535,066	749,634	477,862
Other Mass. State Agency	36,427	-	-	16,999	-
Mass. Local Government/Quasi-Governmental Entities	558,672	765,555	786,056	490,863	331,612
Non-Mass. State/Local Government	376,161	387,771	418,579	778,174	742,705
Medicaid	268	26,240	(5,623)	32,076	19,295

	1999	2000	2001	2002	2003
Client Stipends and Resources	252,916	275,953	268,673	316,056	364,977
Other, Including Investments	179,308	335,306	237,251	188,003	119,643
Contributions	-	-	24,713	12,175	15,069
Total	$15,294,141	$17,077481	$17,877,079	$15,274,272	$15,520,285

Audit Scope, Objectives, and Methodology

The scope of our audit encompassed the various administrative and operational activities of NFI during the period of July 1, 2000 to June 30, 2003. However, in some instances it was necessary for us to extend the period covered by our audit in order to adequately examine certain transactions that were selected for testing during our review.

Our audit was conducted in accordance with applicable generally accepted government auditing standards for performance audits issued by the Comptroller General of the United States and included audit procedures and tests considered necessary to meet those standards.

Our audit procedures consisted of the following:

1. A determination of whether NFI had implemented effective management controls, including the following:
    - Processes for planning, organizing, directing, and controlling program operations
    - Policies and procedures to ensure that resource use is consistent with laws and regulations
    - Policies and procedures to ensure that resources are safeguarded and efficiently used
2. An assessment of NFI's business practices and its compliance with applicable laws, rules, and regulations and the various fiscal and programmatic requirements of its state contracts

To achieve our objectives, we first assessed the management controls established and implemented by NFI over its operations. The purpose of this assessment was to obtain an understanding of management's attitude, the control environment, and the flow of transactions through NFI's accounting system. We used this assessment in planning and performing our audit tests. We then held discussions with NFI and DSS officials and reviewed organizational charts, internal policies and procedures, and all applicable laws, rules, and regulations. We also examined NFI's financial statements, budgets, contracts, invoices, and other pertinent financial records to determine whether expenses incurred under its state contracts were reasonable, allowable, allocable, properly authorized and recorded, and in compliance with applicable laws, rules and regulations. Additionally, we reviewed various documents that DSS officials provided regarding certain activities conducted by DSS through NFI's operations.

Our audit was limited to a review of NFI activities. Although we reviewed various documents regarding certain activities conducted by NFI's parent company, NAFI, we did not conduct audit work at NAFI or its other affiliates. Our audit was not conducted for the purposes of forming an opinion on NFI's financial statements. We also did not assess the quality and appropriateness of all program services provided by NFI under its state-funded contracts. Rather, our report was intended to report findings and conclusions on the extent of NFI's compliance with applicable laws, regulations, and contractual agreements and to identify services, processes, methods, and internal controls that could be made more efficient and effective.

AUDIT RESULTS

1. CONTRARY TO STATE LAW AND REGULATIONS, THE DEPARTMENT OF SOCIAL SERVICES USED NFI MASSACHUSETTS, INC. AS A CONDUIT TO PAY AT LEAST $395,287 IN UNDOCUMENTED OR NON-PROGRAM-RELATED EXPENSES AND INCURRED UNNECESSARY EXPENSES TOTALING AT LEAST $43,445

We found that contrary to Chapter 29, Section 29B, of the Massachusetts General Laws and state regulations, between September 14, 1998 and June 30, 2003 the Department of Social Services (DSS) used NFI Massachusetts, Inc. (NFI) as a fiscal conduit to pay as much as $395,287 of DSS's own expenses, many of which were undocumented or not related to NFI's contracted activities, or both. For example, although contract funding was supposed to be used for "assessments" and "service planning" for consumers, DSS expensed $9,045 through these contracts for gift certificates, with no documentation as to who received them; $2,280 for office supplies and food for various DSS meetings; $471 for immigration and Green Card expenses purportedly for a DSS client; and $800 for a home study purportedly for a DSS client in London, England. In return for NFI's processing of these bills, DSS paid NFI administrative fees totaling $43,445. Because DSS's central accounting staff could have processed those payments, that $43,445 represents an unnecessary expense to the Commonwealth. Moreover, by processing expenses in this manner, DSS failed to comply with state law and regulations, did not adequately safeguard these funds against misuse, and misrepresented both its and NFI's total operating expenses to the Commonwealth for the period of our review.

Of particular concern is that DSS officials provided documentation indicating that DSS had this same type of contractual relationship with 21 other contracted human services providers statewide and had provided them with as much as $10,150,406 in funding during the previous eight fiscal years. During fiscal years 1999 through 2004, DSS awarded contracts with maximum obligations totaling $537,809 to NFI to operate a Multi Disciplinary Assessment Team (MDAT) program through DSS's Malden office. The following are the maximum obligations of these contracts for each fiscal year:

	1999	2000	2001	2002	2003	2004	Total
Maximum Obligation	$86,364	$90,089	$90,089	$85,089	$90,089	$96,089	$537,809

The original contract awarded to NFI for this program included a program description that stated, in part:

> *Staff from Northeast Family Institute are members of the Malden Department of Social Services Multidisciplinary Team (MDT), serving as the Resource Coordinator….The purpose of the Team is to provide a comprehensive and realistic assessment of the referred DSS family and to make recommendation[s] for service planning….The desired outcome for the MDT is to complete the most precise, comprehensive, and realistic assessment of the referred DSS family through utilizing the expertise of specialists and professionals from varied disciplines. The Team's recommendations will result in more creative and improved service planning directed toward meeting the families needs quickly and effectively….Appropriate accounting and tracking of expenditures will be of particular importance.*

In return for these services, DSS paid NFI an administrative fee equal to a percentage of expenses billed against this contract. The administrative fee was budgeted at 13%[1] of program expenditures, and the fees that DSS paid to NFI totaled $43,445 for fiscal years 1999 through 2003.

During our audit, we reviewed all the documentation that NFI was maintaining regarding its MDAT contracts with DSS during fiscal years 2002 and 2003. Our review revealed that the majority of the expenses being charged against this contract were not for "assessments" and "service planning" for consumers as described in the contract's program description, but rather for operating expenses, many of which were incurred by DSS, not NFI. We brought this matter to the attention of NFI's Business Manager, who stated that this particular MDAT contract was NFI's "fiscal conduit contract with DSS." Based on this information, we requested all documentation, including general ledger information, copies of contracts, and payment vouchers, for NFI's MDAT contracts covering the period September 14, 1998 through June 30, 2003. The information that NFI officials provided indicated that a total of $395,287 in expenses, excluding the administrative fees, was billed against these contracts by NFI. We then selected for review a judgmental sample of 199 transactions totaling $234,209, or 59% of the billed expenses. We also reviewed the $43,445 in fees that DSS paid to NFI to administer the payment of expenses during the same period. The following table summarizes the expenditures that we reviewed, by fiscal year:

[1] During some fiscal years, the percentage paid by DSS to NFI was less than 13% so as to not to exceed the contract's maximum obligation.

	1999	2000	2001	2002	2003	Total
Total of Expenses Tested	$93,474	$45,946	$39,054	$40,009	$15,726	$234,209
Administrative Fees	$4,426	$10,328	$9,362	$9,308	$10,021	$43,445

Our review of these expenses identified several problems, as detailed in the following sections.

a. DSS Used NFI as a Fiscal Conduit to Pay as Much as $395,287 in Expenses and Incurred Unnecessary Administrative Expenses Totaling at Least $43,445

Chapter 29, Section 29B, of the General Laws prohibits state agencies from using contracts with human services providers as fiscal conduits by stating, in part:

> *Such contracts [with human services providers] shall not be written or used by any department, office, agency, board, commission or institution of the commonwealth to procure full or part-time personal services, or equipment to be used by such department, office, agency, board, commission or institution, or any goods or services not required in the direct provision by the contractor of social, rehabilitative, health, or special education services to populations being served by the contracting department, office, agency, board, commission, or institution.*

Furthermore, when these contracts were initially awarded by DSS to NFI, 808 Code of Massachusetts Regulations (CMR) 2.03 (06), promulgated by the state's Operational Services Division (OSD), the agency responsible for regulating and overseeing contracted human service providers such as NFI, was in effect and stated, in part:

> *Fiscal Conduits Prohibited. No procuring Department shall award a Contract:*
>
> *a. to acquire any goods for the Procuring Departments use;*
>
> *b. to defray the expenses of services rendered by individuals hired or supervised in the daily performance of their work by personnel in the classified service of the Commonwealth; or*
>
> *c. solely to acquire payroll of fiscal management for a Program of Client services operated by the Commonwealth or any third party.*

We determined through our audit testing and our discussions with agency officials that although the funds in question provided to NFI under MDAT contracts were supposed to have been used to assess and plan program services for NFI clients, not all were used for those purposes. Rather, according to NFI officials, the $395,287 in expenses was incurred by DSS and approved by officials at the DSS Malden area office and then forwarded by DSS to NFI for payment.

During our audit, we met with officials from DSS's central office and Malden area office who had awarded this contract to NFI. According to DSS officials, this type of contracting system was set up by DSS to process payments more quickly because they would not go through the state's standard procurement system. The officials stated that they found that families benefited from having funds available to pay for unforeseeable expenditures and that paying these expenses helped to keep families together. Regarding the approval and processing of these payments, DSS officials explained that, originally, DSS had established a team of individuals comprising community professionals and advocates who would meet and share their expertise and knowledge of area resources in the assessment of the most difficult and high-risk DSS clients. Based on these meetings, the team would then recommend and approve expenditures for those clients. According to the DSS officials, as the program grew the team meetings became more of a forum for discussion. The officials stated that due to this growth there was less time for the team to approve specific expenses, and more and more of the expenses were simply approved by DSS's Malden area office staff.

When asked to provide copies of their policies and procedures for the processing of these expenditures, DSS officials stated that they had no formal policies or procedures regarding the approval of such expenses. As a result, DSS has not established adequate controls to protect these funds from lost, theft, or misuse.

Regarding the administrative fees that DSS paid NFI for processing these payments, we determined that the DSS central office had an accounts payable department that could have processed these expenditures. Consequently, the $43,445 in administrative fees that DSS paid to NFI constitutes an excessive and unnecessary expense to the Commonwealth. In addition, since these expenditures were not direct expenses incurred by NFI, they were misreported by NFI and DSS in their financial reports during the period under review.

Of particular concern is that according to DSS officials, DSS entered into this type of contract with other DSS area offices and 21 other human services providers statewide. We requested that DSS officials provide a list of all vendors awarded those contracts and the maximum-obligation amounts, from the inception of the contract to the current fiscal year. The following is a summary of the information that DSS provided:

Summary of MDAT Funding*
Fiscal Years 1997 through 2004

Vendor	1997	1998	1999	2000	2001	2002	2003	2004	Total
Berkshire County Kids	$ 45,555	$ 98,000	$ 108,960	$ 100,658	$ 102,174	$ 97,355	$ 97,355	$ 97,355	$ 747,412
MSPCC	91,110	270,000	542,350	533,296	451,823	418,175	418,175	418,175	3,143,104
Herbert Lipton Community	45,555	100,000	100,000	48,738	-	-	-	-	294,293
Concord Assabet Family & Adolescent	45,555	50,000	50,075	50,075	-	-	-	-	195,705
Wayside Youth & Family	91,110	300,723	310,000	219,887	203,579	194,004	181,200	181,200	1,681,703
South Bay Mental Health Center	45,555	50,000	62,379	25,000	-	-	-	-	182,934
Health & Education Services	-	60,000	141,000	150,040	150,090	135,112	135,000	135,000	906,242
The Family Center	-	30,000	50,000	50,000	-	-	-	-	130,000
Bay State Comm. Services Inc.	-	60,000	152,150	100,000	50,000	45,000	45,000	45,000	497,150
Child & Family Services Inc.	-	30,000	50,000	25,000	-	-	-	-	105,000
Northeastern Family Institute	-	-	86,364	90,089	90,089	85,089	90,089	96,089	537,809
Community Care Services	-	-	34,855	50,000	50,000	45,000	90,000	90,000	359,855
Old Colony YMCA Services Corporation	-	-	46,342	25,000	-	-	-	-	71,342
The Home for Little Wanderers Inc.	-	-	37,351	50,000	50,000	45,000	-	-	182,351
Family Service of Greater Boston	-	-	30,000	50,000	50,000	45,000	90,000	90,000	355,000
Roca Inc.	-	-	30,000	50,000	50,000	45,000	-	-	175,000
Community Health Inc.	-	-	-	22,035	50,000	50,000	50,000	50,000	222,035

Vendor	1997	1998	1999	2000	2001	2002	2003	2004	Total
Youth Opportunities Upheld Inc.	-	-	-	-	-	-	135,640	135,640	271,280
Key Program Inc.	-	-	-	-	-	-	180,000	180,000	360,000
The Guidance Center Inc.	-	-	-	-	-	-	45,000	45,000	90,000
Brockton Area Multiserv.	-	-	-	-	-	-	45,000	45,000	90,000
North Suffolk Mental Health Association	-	-	-	-	-	-	45,000	45,000	90,000
Total	$364,440	$1,048,723	$1,831,826	$1,639,818	$1,297,755	$1,204,735	$1,647,459	$1,653,459	$10,688,215

* DSS officials stated that these were budgeted amounts to be provided to service providers and may not represent actual expenditures.

Accordingly, DSS may be using 22 service providers, including NFI, to pay as much as $10.69 million of its own expenses or other expenses not provided for under these contracts.

b. Inadequate Documentation of at Least $234,209 in Expenses Billed against NFI's MDAT Contracts

According to regulations promulgated by the Office of the State Comptroller (OSC), with which all state agencies such as DSS must comply, state agencies are required to maintain adequate documentation for all expenses paid with state funds. Specifically, 815 CMR 10.00, promulgated by OSC, states, in part:

> *Departments shall maintain the Record Copy of the following documents in accordance with 815 CMR 10.00 and any policies and procedures issued by the Office of the Comptroller:*
>
> *a. all Bills and Vouchers on which money has been paid or will be paid from the Treasury upon the certificate of the Comptroller or warrant of the Governor; and*
>
> *b. all Contracts under which money may be payable from the Treasury....*
>
> *Departments shall maintain Record Copies of the documents identified under 815 CMR 10.03(1) at:*
>
> *a. a central Department location, or*
>
> *b. if the Department maintains Record Copies at multiple locations, the Department shall maintain a centralized list of the repository location of all Record Copies.*

Similarly, 808 CMR 1.05 requires all contracted human services providers, such as NFI, to maintain adequate supporting documentation for all expenses and further identifies the following as being nonreimbursable expenses under state contracts:

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

According to NFI officials, whenever DSS wanted a bill paid it simply faxed to NFI a request form that identified a specific vendor and the amount to be paid, often with no other documentation attached. NFI then issued a check to the vendor for the amount indicated and charged the expense against its MDAT contract.

During our audit, we reviewed all supporting documentation that NFI was maintaining for the 199 transactions (totaling $234,209) that we selected for review. We determined that the documentation for these expenses was inadequate. Specifically, NFI had in many instances only facsimile copies or photocopies of the request forms from DSS and no other supporting documentation. In fact, we found that of the $234,209 in expenses we reviewed, 21 expenses totaling $38,872 had no documentation (e.g., invoices, receipts) indicating that the expenses were actually incurred, and another 61 expenses totaling $52,011 had no documentation other than the DSS request form to verify the reasonableness or nature of the expense. For the remaining 117 expenses, the documentation provided included invoices, receipts, or bills for expenses relating to a particular service, but the documentation was insufficient to verify whether the family or individual who received the service was actually a DSS/NFI client.

In addition, NFI's MDAT contracts with DSS required that notes be taken by NFI staff at MDAT meetings. During our audit, we requested copies of the notes to verify whether the services being paid for by DSS under these contracts were in fact for DSS/NFI clients. However, NFI was unable to provide any notes regarding the $234,209 expenses in question. Consequently, it could not be determined whether MDAT in fact performed all of the services required under this contract or whether the services being paid for with state funds were proper.

Regarding these matters, DSS officials stated that they considered these expenses adequately documented and all the services properly paid for under these contracts. However, without adequate documentation, DSS could not ensure that the expenses billed against these contracts were reasonable.

c. DSS Expended $18,479 in Questionable Costs through NFI

The Executive Office for Administration and Finance (EOAF) has promulgated 801 CMR 21.08 (1), with which all state agencies must comply. This regulation states, in part:

> *[T]he Contractor shall only be compensated for performance delivered to and accepted by the Department in accordance with the specific terms and conditions of a properly executed Contract.*

Moreover, 808 CMR 1.05, promulgated by OSD, which applies to all contracted human services providers such as NFI, identifies the following costs as nonreimbursable under state contracts:

> *Unreasonable Costs. Any cost 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 to the inadequately documented expenses, we found that at least $18,479 of the $234,209 in expenses that we reviewed was questionable in that the expenses did not appear to benefit clients in NFI's program.

For example, during the period of our review, DSS expended $9,045 for gift certificates with no documentation regarding who received them. Moreover, in many instances a check was issued directly to the DSS employee who purportedly purchased the gift certificates rather than to the merchant. DSS also used at least $2,280 of these MDAT funds to purchase office supplies for itself, replenish the DSS Malden office's petty cash fund, and provide food and refreshments for various DSS meetings. Additionally, DSS used these funds to pay $471 in immigration and naturalization and Green Card expenses, in one case for a teenager to renew her Green Card because it had her baby picture on it. We also found that during fiscal year 1999 DSS paid $2,000 in back rent for an individual. In fiscal year 2000, DSS expended $925 for an individual to attend a 12-day college tour program and $745 to a storage facility for an individual to remove her belongings. In fiscal year 2001, DSS expended $800 for a home study to be done regarding an individual living in London, England, and $100 in penalty fees charged by a dentist for an individual who missed two appointments. However, none of the documentation we reviewed for these expenses clearly indicated that these individuals were NFI/DSS clients.

According to DSS officials, MDAT contracts are used to provide flexible dollars to purchase services and other activities to assist and stabilize families during the assessment process. However, despite this assertion, officials provided inadequate documentation to substantiate that the funding being provided to NFI under these contracts was being used for such purposes.

Recommendation

DSS should immediately cease using NFI and other human services providers as fiscal conduits. Furthermore, the Department of Mental Health (DMH), NFI's principal state purchasing agency, in conjunction with OSD should review the expenses that DSS paid for using funding it provided to NFI and the other 21 vendors under MDAT and similar contracts. Based on these reviews, DMH and OSD should take whatever actions they deem necessary to resolve this matter.

Auditee's Response

In response to this issue, NFI provided the following comments:

> *NFI objects to the inclusion of these findings in its audit report. NFI responded to what it believed was a legitimate and proper request by the Department of Social Services (DSS) to provide flexible funding to at-risk youth and families it serves. Since the Auditor's Office correctly places primary responsibility for this problem with DSS, inclusion in NFI's audit creates the false impression that NFI acted wrongly. NFI believes this matter should be taken up directly with DSS rather than NFI and the [21] other human service providers with similar contractual arrangements.*
>
> *As an aside, since this issue was identified by the State Auditor, it has come to light that certain expectations outlined by DSS Central Office were in conflict with practices of the Area Office, with which we were communicating.*

In response to this issue, DSS officials stated, in part:

> *The Department entered into a contractual agreement with NFI:*

- *To provide participation in the Malden MDAT and to serve as the Resource Coordinator;*

- *To provide a family advocate;*

- *To provide a comprehensive and realistic assessment to the referred DSS family and to make recommendations for service planning;*

- *To provide general coordination of goods and services recommended by the MDAT team;*

- *And to be responsible for taking minutes of each meeting.*

The Department did not enter into a contractual agreement with NFI to willfully acquire any goods for DSS' use, nor to acquire payroll of fiscal management operated by the Commonwealth. So at this time, the Department cannot agree that the $395,287 and the $43,445 were inappropriate costs to running this program.

The comments of NFI staff included in the draft report as well as the auditee's response, clearly document an inappropriate and very disappointing interpretation of their contractual responsibilities to this program/team and its families and children; and in fact are contradictory of their presence at team meetings both as resource coordinator and family advocate. So too, any absence of client records, meeting notes and proper accounting record keeping related to MDAT services by NFI is cause for finding the provider in serious breach of contractual obligations.

The Department of Social Services takes very seriously the issues raised in this report, both deficiencies by the Department and/or the provider as well as any perceived impropriety by the Department. In response, the Department is surveying each area-based MDAT program, reviewing compliance by both the area office and provider. We are very concerned with a generalization of the entire MDAT program based on this one contract. We will use the results of the survey to determine if improvements or changes to the MDAT program are required. Staff at the Department is strongly committed to not only providing the best services to its families and children but also providing these services in a manner consistent with the Commonwealth's laws and regulations.

The Department is not able to fully respond to the assertion that $18,479 in payments represent questionable client-related costs without copies of the State Auditor's work papers. . . .Additionally, it is recognized that the Department must establish the degree to which the Malden Area Office was or was not diligent in carefully adhering to the MDAT program requirements and in providing an appropriate level of oversight of the provider and its contracts.

Further, the Department believes it previously provided documentation to the auditor of policies and procedures for both programmatic and fiscal controls of the program. The Department staff is available to review such documents with the State Auditor's staff to clarify any confusion with the documents.

Auditor's Reply

As stated in our report, during our audit of NFI, we found that DSS was, contrary to state law and regulations, using NFI as a fiscal conduit. Since NFI was a party to this activity, it is clearly necessary and proper for us to disclose this matter in this audit report. As NFI correctly points out in its response, our report places the primary responsibility of noncompliance with state law and regulations with DSS.

Regarding DSS's response, we cannot comment as to whether DSS willfully entered into a contract with NFI for the purposes of using the agency as a fiscal conduit. However, based on the documentation we reviewed relative to this contract, it appears that this contractual relationship with NFI operated in this manner. Specifically, as stated in our report, the original contract awarded to NFI for this program included a program description that stated, in part:

> *Staff from Northeast Family Institute are members of the Malden Department of Social Services Multidisciplinary Team (MDT), serving as the Resource Coordinator…. The purpose of the Team is to provide a comprehensive and realistic assessment of the referred DSS family and to make recommendation[s] for service planning…. The desired outcome for the MDT is to complete the most precise, comprehensive, and realistic assessment of the referred DSS family through utilizing the expertise of specialists and professionals from varied disciplines. The Team's recommendations will result in more creative and improved service planning directed toward meeting the families needs quickly and effectively…. Appropriate accounting and tracking of expenditures will be of particular importance.*

In return for these services, DSS paid NFI an administrative fee equal to a percentage of expenses billed against this contract. The administrative fee was budgeted at 13% of program expenditures, and the fees that DSS paid to NFI totaled $43,445 for fiscal years 1999 through 2003.

During our audit, we reviewed all the documentation that NFI was maintaining regarding its MDAT contracts with DSS during fiscal years 2002 and 2003. Based on our review, we found that the majority of the expenses being charged against this contract were in fact not for "assessments" and "service planning" for consumers as described in the contract's program description, but for operating expenses, many of which were incurred by DSS, not NFI. Consequently, it is clear that DSS was using this contractual management to establish discretionary funds to be used by DSS staff as they deemed necessary. While nothing came to our attention to indicate that any of these funds were misappropriated, DSS failed to comply with state law and regulations, did not adequately safeguard these funds against misuse, and misrepresented both its and NFI's total operating expenses to the Commonwealth for the period of our review.

Moreover, we disagree with DSS's claim that NFI in its response provided a disappointing interpretation of its responsibilities under this contract. To the contrary, NFI's description of the purpose of this contract corresponds with what we observed taking place (i.e., DSS using these funds as discretionary funds). Further, it is clearly the responsibility of DSS to ensure that its contractors are aware of and are meeting all of their contractual responsibilities.

In its response, DSS states that it is taking this matter seriously and is surveying each of its area based MDAT programs to determine if any changes are necessary. We believe such measures are necessary and appropriate.

2. NONREIMBURSABLE BUILDING FACILITY EXPENSES OF AS MUCH AS $613,708 CHARGED TO STATE CONTRACTS

Contrary to state regulations, during fiscal years 2002 and 2003 NFI charged nonreimbursable building facility expenses of as much as $175,355 and $438,353, respectively, to its state contracts. These expenses were for maintenance staff, legal fees, occupancy costs, education software, professional liability insurance, telephones, interest, and management services associated with the operation of an NFI-owned building where state funded programs had been phased out and were no longer operating. According to state regulations, expenses such as these, which are not directly related to the program purposes of NFI's state-funded programs, are unallowable and nonreimbursable under state contracts.

The 808 CMR 1.05, promulgated by OSD, identifies the following as nonreimbursable costs under state contracts:

> *(1) <u>Unreasonable Costs</u>. 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….*
>
> *(12) <u>Non-Program Expenses</u>. Expenses of the Contractor which are not directly related to the social service Program purposes of the Contractor….*

> *(27) Administration and Support Costs. Costs which are otherwise non-reimbursable under the provisions of 808 CMR 1.05 may not be reimbursed through Administration and Support Costs.*

Moreover, 808 CMR 1.02, promulgated by OSD, defines reimbursable operating costs as follows:

> *Reimbursable Operating Costs. Those costs reasonably incurred in providing the services described in the contract and/or, in the case of a Program approved under the provisions of M.G.L. c. 71B, in providing the services mandated by DOE or specifically included in an Authorized Price, with the exception of costs enumerated in 808 CMR 1.05 and costs excluded in the Authorized Price….*

During out audit, we found that during fiscal years 2002 and 2003 NFI allocated $613,708 in administrative costs to its state contracts; it had incurred those costs in relation to the operation of a building that it owned on Queen Street, in Dorchester. A summary of these expenses appears in the following table:

Category	Fiscal Year 2002	Fiscal Year 2003*	Total
Payroll**	$105,966	$ 73,015	$178,981
Payroll Taxes/Fringe Benefits	9,522	16,063	25,585
Contracted Support	15,687	3,147	18,834
Interest	-	106,103	106,103
Occupancy	-	106,492	106,492
Transportation	8,347	-	8,347
Education Software	-	1,887	1,887
Equipment	2,227	5,939	8,166
Building Management & General	17,546	46,815	64,361
Professional Liability Insurance	16,060	-	16,060
Depreciation	-	78,892	78,892
Total	$175,355	$438,353	$613,708

* These costs were incurred after August 31, 2002.

** These amounts consisted of three maintenance staff, one facility maintenance director, one receptionist, and one administrative assistant.

According to NFI officials, in December 2001 NFI decided to sell this building and therefore began phasing out the programs that were operating there. The following table summarizes the percentage of each program's utilization of the building during the periods in question:

Program	UFR #	7/1/01-12/28/01	12/29/01 - 6/30/02	7/1/02 - 8/31/02	9/1/02 - 11/30/02	12/1/02 - 6/30/03
DYS Girls*	7	16%	16%	16%	0%	0%
NFIC/HA*	8	16%	0%	0%	0%	0%
Germaine Lawrence	28	28%	28%	28%	28%	0%
Unoccupied		40%	56%	56%	72%	100%
Total		100%	100%	100%	100%	100%

* State-funded programs

Although state-funded programs in this building had been phased out by August 2002, subsequent costs (e.g., for building maintenance and payroll associated with maintaining and operating the building) totaling $613,708 were still charged by NFI against its state contracts.

Regarding this matter, on September 9, 2003 NFI's Executive Director provided the following written comments:

> *The sites we develop and open to serve citizens of the Commonwealth have costs associated with them. More often than not, when we develop a new program or close an old program, expenses are incurred long before and after any direct dollars are received from the State. When these situations arise, we must exercise our business prudence and minimize our other administrative expenses. In most instances, whether it be buildings that we own or lease, we continue to have expenses that must be paid such as: insurance, interest on bank notes, utilities, and other maintenance expenses. These expenses continue until such time as the building is sold, the lease is settled, or the building is re-designated for use servicing other clients. It is important to note that in typical situations, selling property is not likely to take the amount of time the NFI Center took; most buildings are not 60,000 square feet. Nonetheless, these expenses must be allowable as State expenses in order to keep our organization strong and stable, meet our legitimate financial obligations and enable us to continue providing services to the Commonwealth.*
>
> *As the programs operating in the NFI Center closed, ongoing expenses associated with the then vacant space became administrative costs and were, therefore, part of our cost of doing and managing our business….*

We agree that if the building was originally purchased to house state-funded programs, it could be argued that NFI should be allowed to expense depreciation costs associated with this building against its state contracts. However, clearly discretionary operating costs (e.g., expenses such as the salaries of a receptionist and administrative assistant, educational software, building management services) charged to state contracts when there are no state clients being served are unreasonable and therefore not reimbursable. Since these expenses do not benefit state clients, they should be paid for with NFI's non-state revenues.

We discussed this matter with NFI officials, who agreed that when the property in question is sold NFI would use any surplus funds generated to offset the administrative costs it charged against state contracts for the operation of the building.

Recommendation

OSD should monitor the sale of this property to ensure that any surplus revenues generated from the sale are credited against expenses that NFI charges against its state contracts. If the surplus is insufficient to cover the $613,708 that NFI charged for these expenses, NFI should reimburse the Commonwealth for the difference, less any amounts deemed to be allowable expenses by OSD and DMH. In the future, NFI should take measures to ensure that only reimbursable costs are charged against its state contracts.

Auditee's Response

In response to this audit result, NFI stated, in part:

> *NFI disagrees, for several reasons. First, NFI believes the building facility costs were legitimate. Second, even if you disagree with NFI's conclusion, the calculations in the draft are internally inconsistent and must be changed. Third, even if you believe these costs are nonreimbursable, any reimbursement should be limited to amounts actually received by NFI from state contracts. Each of these positions is detailed below:*
>
> a. ***The Building Facility Costs are Proper and Legitimate Costs.*** *NFI operated state sponsored programs within a 60,000 square foot facility in Boston, providing intensive programming to some of the most needy, at risk and difficult to serve youth in the Commonwealth. The facility in question was never used by NFI for any purpose other than at the request of state agencies.*
>
> *When the types of service models preferred by the state began to change, NFI worked for many months with state agencies (at their request) to explore alternative program uses for the building. Given the historic difficulties of siting such programs in Boston, we were encouraged by the state to "hang onto the property" for a period of time. Efforts to find new users for the facility ultimately proved unsuccessful and NFI's losses began to quickly mount. We made the decision to begin the process of phasing out and/or relocating existing programming and disposing of the facility.*
>
> *While the draft audit speaks to "clearly discretionary costs", in fact, none of the costs at issue were discretionary. The receptionist, administrative assistant, and building management services positions were absolutely necessary to; (1) terminating the programs; (2) maintaining insurance on the building; and (3) stabilizing /maintaining the security and mechanical systems of the building. Long after the last client left the facility, thousands of client records needed to be sorted, reviewed and prepared for storage. Additionally, we had to continue to respond to requests for these client records from state funding agencies as well as other state-*

funded programs; courts, physicians, and a myriad of interested parties involved in the care of these children.

Due to the design of the building, it could not be "partially shut down." For the benefit of the programs operating at this site, maintaining their safety and security, the entire building had to be maintained. In our view, it would have been inappropriate to charge 100% of these costs to the programs in operation given that closure, as well as opening of programs, are part of the "overall direction of the agency.". As such, they were properly chargeable to NFI's administration and support costs under 808 CMR 1.02. In addition, NFI's insurance company required a security presence on a daily basis to maintain its fire and liability policy. Maintaining insurance was itself a condition to maintaining the bank loan on the building.

In the final analysis, opening and closing programs and facilities have related expenses which are a necessary and inescapable part of helping the Commonwealth meet its program and policy objectives.

b. *The logic put forward in the draft audit in support of its conclusion is that; "Although state-funded programs in this building had been phased out by August 2002, <u>subsequent costs</u> (e.g., for building maintenance and payroll associated with maintaining and operating the building) totaling $613,708 were still charged by NFI against its state contracts." . . . The chart included . . . in the draft audit shows clearly that $175,355 was for costs incurred in fiscal year 2002, prior to the losing of all programs in August 2002, which was in fiscal year 2003. NFI recommends that, at the least, the draft audit be revised to delete the claim for $175,355.*

c. *The draft audit states that NFI "should reimburse the Commonwealth" for these funds over and above any proceeds for the sale of the building. Of the amount claimed in the audit, the amounts disbursed by the state were $10,421.39 in fiscal year 2002 and $20,396.34 in fiscal year 2003 through our Cost Reimbursement Contracts for these facility expenses. . . .The balance of expenses was rolled into unit rate contracts and as such had no affect on dollars, which were or would have been received. The only effect the balance of these funds had was reflected by an adjustment to NFI's surplus revenue retention balance. . . .*

Auditor's Reply

As stated in our report, contrary to state regulations, during fiscal years 2002 and 2003 NFI charged nonreimbursable building facility expenses of as much as $175,355 and $438,353, respectively, to its state contracts. These expenses were for maintenance staff, legal fees, occupancy costs, education software, professional liability insurance, telephones, interest and management services associated with the operation of an NFI-owned building where state funded programs had been phased out and were no longer operating. Although we do not argue the fact that certain costs associated with the operation and maintenance of this building while housing state-funded programs would be legitimate and allowable costs against NFI's state contracts, we do not agree that the majority of costs associated with the operations of this building should have been charged by NFI against its state contracts once it stopped housing state programs.

Contrary to what NFI states in its response, NFI did not provide us any documentation to substantiate that it was encouraged by its state purchasing agencies to "hang onto the property." To the contrary, DSS officials stated that the department did not support NFI's purchase of this building.

Contrary to what NFI stated in its response, many of the costs NFI charged against its state contracts relative to the operation of this building were in fact discretionary in that there was no logical basis for NFI to charge them to its state contracts, and in fact should not have been charged against its state contracts once the building was no longer being used to house programs that were serving state clients. Clearly, NFI had the discretion to charge these expenses to the programs that were being served in this facility or to nonreimbursable line items in the UFR rather than to its state contracts.

The chart in our report does in fact show $175,355 in questioned costs for fiscal year 2002. However, this represents only the costs that were allocated to state-funded programs after they were closed during fiscal year 2002, and therefore are appropriately included in the questioned amounts.

Contrary to what NFI states in its response, the $10,421 for fiscal year 2002 and $20,396 for fiscal year 2003 were not the only funds that the Commonwealth disbursed to NFI to fund the program in question. NFI's unit rate contracts also provided funding to pay for allowable administrative overhead as well as the programmatic expenses incurred by NFI. As stated in our report, NFI charged these nonreimbursable expenses against the revenue it received from all of its state contracts and therefore should reimburse the Commonwealth the $613,708, less any amounts deemed to be allowable expenses by OSD and DMH.

3. NONCOMPLIANCE WITH STATE GUIDELINES REGARDING THE ALLOCATION OF AS MUCH AS $480,667 IN PAYROLL COSTS

We found that NFI had incorrectly allocated as much as $480,667 of direct payroll expenses as indirect expenses to its state contracts during fiscal years 2001 and 2002. As a result, NFI misreported those payroll expenses. We also question the reasonableness of some of those expenses because the individuals receiving payment were purportedly providing Program Director services to programs that already had Program Directors. Consequently, at least a portion of those $480,667 in payroll costs were likely duplicative and unnecessary.

In its manual for the preparation of Uniform Financial Statements and Independent Auditor's Report (UFR), OSD provides guidance for the allocation of administrative expenses by human service providers to state contracts. The *UFR Audit and Preparation Manual* states, in part:

> *Allocating Administration: Administration and support (management and general) costs include expenditures for the "Overall Direction" of the organization, general record keeping, business management, budgeting, general board activities, and related purposes. Administration costs (indirect costs) are disclosed separately in a column, as Administration (not allocated) in the Statement of Functional Expenses.... Direct supervision of program services and of fund-raising are not allocated administration and should be charged directly to those functions. "Overall Direction" will usually include the salaries and expenses of the chief officer of the organization and his or her staff. If they spend a portion of their time directly supervising fund-raising or program service activities, such salaries and expenses should be prorated among those functions.*

During our audit, we reviewed 100% of NFI's administrative payroll costs for fiscal years 2001 and 2002 and also spoke to NFI officials regarding the specific job-related tasks performed by certain administrative staff. Based on our work in this area, we determined that NFI incorrectly allocated as much as $480,667 in indirect payroll expenses against its state contracts for seven individuals who were providing direct program services in NFI's programs, as summarized in the following table:

Position Title	Fiscal Year 2001 Amount Allocated	Fiscal Year 2002 Amount Allocated
Medical Director	$ 38,400	$ 38,400
Director, Family-Based Services	1,261	13,260
Director, NFI Center	70,000	29,615
Agency Supervisor/Director	42,831	111,940
NAFI Director	8,869	-
Clinical Director	4,615	57,033
Director of Nursing	-	10,286
Subtotals	165,976	260,534
Payroll, Taxes & Fringe Benefits	30,744	23,413
Total	$196,720	$283,947

NFI officials stated that sometimes these seven individuals worked on providing overall direction to NFI, and sometimes they provided direct program services. However, contrary to state regulations, NFI did not have appropriate accounting procedures to properly identify the time that these individuals spent working directly in NFI's programs. As a result, these payroll expenses were not adequately documented, recorded, and reported.

In addition, we also question the reasonableness of some of these payroll expenses. Specifically, according to NFI officials, these seven individuals spent some of their time providing direct program services as Program Directors in state-funded programs. However, our review of the level of program staffing in those programs indicated that they were fully staffed, including Program Directors in accordance with the program budgets specified in the contracts funding these programs. Consequently, any other direct program services provided by the seven individuals would have been unbudgeted and therefore unreasonable and nonreimbursable under these contracts.

NFI officials stated that in its opinion these seven positions were necessary for quality management of the programs; however, they agreed that the corresponding expenses were not budgeted for directly in any of the state contracts that funded these programs. These officials also agreed that NFI has not established proper accounting procedures to ensure the accurate expensing of the payroll expenses associated with those seven individuals. However, NFI officials sated that they had been told by their state purchasing agencies to charge these expenses as indirect costs against their state contracts.

Recommendation

NFI should establish accounting controls and procedures that accurately identify, record, and report all indirect and direct agency personnel expenses in accordance with state guidelines. Furthermore, in conjunction with DMH, OSD should review the propriety of the $480,667 in payroll expenses in question and take whatever action they deem necessary to resolve this matter.

Auditee's Response

In response to this issue, NFI stated, in part:

Although NFI concurs that the positions in question may have been in part misclassified to administration instead of program expense, the statement that any of these costs/charges were "likely duplicative and unnecessary" is untrue. On the contrary, these positions and the individuals who hold them are integral members of NFI's management team. They provide support and oversight to specific programs and also have a number of agency-wide non-program specific administrative responsibilities, including quality management, staff training, strategic planning, policy and procedure development and other activities that support the overall direction and management of the agency. Each of the state agencies NFI contracts with knows the staff listed in our report and interacts with them regularly to ensure that each NFI program is well managed and professionally supervised by the senior administrator. . . .

NFI has, in fiscal year 2003 and beyond, changed the way it has been classifying these positions and shall provide time studies to ensure that are properly charged to both administration (for agency-wide administrative functions) and to those programs to which they provide direct program services.

Auditor's Reply

NFI acknowledges that it did not have controls on place to ensure proper classifications and reporting of the personnel costs in question, and indicated that it has taken measures to address this matter. We believe that the actions taken by NFI regarding this matter were necessary and appropriate. However, given the lack of controls over this process during our audit period and the representations made to us by NFI officials regarding where these individuals worked, we maintain our conclusion that some of these payroll expenses were clearly duplicative and unnecessary.

4. UNALLOWABLE MANAGEMENT FEES TOTALING $10,923

We found that contrary to state regulations during fiscal year 2001, NFI paid a management fee to its parent company (NAFI), a related party, that was $11,378 greater than NAFI's actual costs of providing the service. Of this amount, NFI charged $10,923 to state contracts. According to state regulations, any management fee paid to a related party that is greater than the related party's actual costs is unallowable and nonreimbursable under state contracts.

State regulation 808 CMR 1.05, promulgated by OSD, identifies the following costs as nonreimbursable under state contracts.

(8) <u>Related Party Transaction Costs</u>. Costs which are associated with a Related Party transaction are reimbursable only to the extent that the costs do not exceed the lower of either the market price or the Related Party's actual costs.

On July 1 of each fiscal year, NFI and NAFI, its parent corporation, entered into an inter-company management agreement that sets forth the management services that NAFI shall provide to NFI; defines inter-company transactions, including any shared expenses; and establishes the management fee NAFI is to receive. Management services provided by NAFI to NFI include "accounts payable, accounts receivable and billing, payroll, personnel, human resources (including benefits administration), general ledger, audit, budget and financial support, MIS technology and support, and executive supervision." The management fee is based on itemized budgets projected at the beginning of each fiscal year and is reconciled at fiscal year's end to NAFI's actual costs.

During our audit, we tested 100% of the NFI-NAFI inter-company management fee for fiscal years 2001-2003. Based on our review, we found that the management fee charged by NAFI to NFI exceeded its actual costs by $11,378, of which $10,923 was charged by NFI to its state contracts. We brought this matter to the attention of NFI and NAFI officials, who concurred with our conclusions.

Recommendation

NFI should remit to the Commonwealth the $10,923 in unallowable management fees that it charged against its state contracts. In the future, NFI should take measures to ensure that it does not bill its state contracts for any nonreimbursable related-party expenses.

Auditee's Response

NFI concurs with this finding.

5. INADEQUATELY DOCUMENTED PAYROLL EXPENSES TOTALING $5,523, IMPROPERLY EXPENSED CAPITAL ITEM TOTALING $1,800, AND UNALLOWABLE LOANS TOTALING $10,058 PROVIDED TO AGENCY STAFF

We found that during the period July 1, 2000 through June 30, 2003, NFI charged various nonreimbursable expenses against its state contracts, including $5,523 in inadequately documented staff payroll expenses and a dishwasher costing $1,800 that NFI expensed against its state contracts during the fiscal year rather than depreciating its cost over its useful life as required by state regulations. According to state regulations, expenses that are not adequately documented or not properly capitalized are nonreimbursable under state contracts. We also found that during fiscal years 2001 through 2003 NFI provided $10,058 in loans to staff members. According to state regulations, fringe benefits such as these that are not part of an established written policy of the agency are unallowable and nonreimbursable under state contracts.

a. Nonreimbursable Payroll Expenses Totaling $5,523

The 808 CMR 1.04 (1) promulgated by OSD establishes the following recordkeeping requirements to which contracted human services providers, such as NFI, must adhere:

> *The Contractor and its Subcontractors shall keep on file all data necessary to satisfy applicable reporting requirements of the Commonwealth…and financial books, supporting documents, statistical records, and all other records which reflect revenues associated with and costs incurred in or allocated to any Program of services rendered under the Contract. The Contractor and its Subcontractors shall maintain records of all types of expenses and income or other funds pertaining to the Program paid to the Contractor by every source, including from each Client. Books and records shall be maintained in accordance with generally accepted accounting principles as set forth by the American Institute of Certified Public Accountants (AICPA).*

Furthermore, OSD regulations (808 CMR) identify the following as nonreimbursable costs under state contracts:

> *1.05: (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.*

During our audit, we judgmentally selected and reviewed NFI's payroll records for all of its administrative staff and 5% of its direct-care staff for May 2002, June 2001, and December 2000. Based on our testing, we determined that one month of timesheets for December 2000 were missing for two administrative personnel totaling $4,883, and for one direct-care staff person totaling $640. Regarding this matter, NFI officials stated that NFI's parent company maintains NFI's general ledger and personnel and payroll records and that NFI does not have direct control of maintaining these records.

As a result of our audit, NFI recognized the need to update its policies, procedures, and internal controls over such recordkeeping.

b. Improper Expenses of $1,800 in a Capital Item

OSD has promulgated 808 CMR 1.05, which applies to all contracted human services providers, such as NFI, and identifies the following costs as nonreimbursable under state contracts:

> *(4) <u>Current Expensing of Capital Items</u>. All costs attributable to the current expensing of a Capital Item.*

During our audit, we reviewed fiscal year 2001 and fiscal year 2002 general ledger details. Specifically, we identified and tested all capital items greater than $500. We found that NFI had purchased a used dishwasher in fiscal year 2002 for $1,800 and billed it through a cost-reimbursement contract. According to 808 CMR 1.00, promulgated by OSD, the costs of this item should have been capitalized and expensed against NFI's state contracts in equal amounts over a period of five years. We determined, however, that this item was not depreciated; instead, its total cost was expensed by NFI in fiscal year 2002. In addition to not complying with state regulations, NFI did not follow its own policies and procedures, according to which all capital items should be depreciated if they have a useful life of over one year and a value of $500 or more.

NFI officials stated that because this item had not been purchased when new, they were unaware that it should have been depreciated.

c. Lack of Established Policies and Procedures to Control Advances for Employees

Through 808 CMR, OSD has also defined certain fringe benefits as nonreimbursable by the state, as follows:

> *1.05: <u>(9) Certain Fringe Benefits</u>. (a) Fringe benefits determined to be excessive in light of salary levels and benefits of other comparable Contractors and fringe benefits to the extent that they are not available to all employees under an established policy of the Contractor. Disparities in benefits among employees attributable to length of service, collective bargaining agreements or regular hours of employment shall not result in the exclusion of such costs*

During our review of NFI payroll and personnel, we found that although NFI does not have a formal written policy to do so, it routinely uses funds it receives under state contracts to provide loans to employees. We determined that the following loan amounts were extended to members of the NFI staff during fiscal years 2001 through 2003:

	Fiscal Year 2001	Fiscal Year 2002	Fiscal Year 2003 (Through December 31, 2002)	Total
Loan Amounts	$5,664	$3,009	$1,385	$10,058

As of the end of our audit fieldwork, all but $250 of these loans had been paid back to NFI. However, since this practice of providing loans to staff is not part of an established policy of NFI, expenses charged against state contracts for this purpose are unallowable and nonreimbursable.

Recommendation

As of the end of our audit fieldwork, the $10,058 in cash advances made by NFI for its staff had been repaid. Consequently, NFI should remit to the Commonwealth the $7,323 in other undocumented and unallowable expenses that we identified and which it expensed against its state contracts. In addition, NFI should take measures to ensure that all of its payroll expenses are adequately documented and all of its assets are properly depreciated and should discontinue using state funds to provide loans to staff members.

Auditee's Response

NFI provided the following comments regarding this issue:

a. *Payroll: Although we are confident that the payroll represented employees who worked for programs for the periods in question, we concur that we could not locate employees' signed timesheets for the amount of $5,523. However, we do have other controls in place to support payroll costs. As a matter of course, it is virtually impossible to pay an employee who did not work. Prior to data entry into our Ceridian payroll system, there are at a minimum, three check points. First, the employee must submit a signed timesheet to his/her supervisor. Secondly, when the timesheet is submitted, the supervisor creates a summary document, listing all of the supervisor's employees who worked in the program, and signs this document, verifying the information is correct. Finally, this document is forwarded to the Human Resources/Payroll Department and then entered in the Ceridian payroll system. In light of the layers of controls and in light of the facts that our audit, conducted by our CPA included payroll testing and the existence of good controls in accordance with GAAP, we respectfully request this finding be removed.*

b. *Capital Item: We agree that NFI had no written policy for depreciating or expensing used equipment, which the dishwasher represents. It is important to note that the program benefited from the dishwasher, which cost a fraction of a new dishwasher of the same commercial quality.*

c. Unallowable loans: While NFI did not have an established policy for providing advances to employees, these transaction were balance sheet transactions only and as such never "charged" against state contracts. These advances were not expensed and we request that this section be amended to exclude this provision.

Auditor's Reply

Despite NFI's payroll controls, our review revealed inadequately documented employee timesheets and related expenses. As stated in our report, such expenses are deemed to be nonreimbursable under state law.

APPENDIX

Programs Operated by NFI

Foster Care/Emergency Shelter

This program provides individualized placement services. Youths who are not appropriate for residential programs and cannot live at home are placed in foster families.

Outreach Counseling/Adolescent Tracking

This program provides intensive tracking and mentoring to add structure and support to the lives of male and female children and adolescents ages seven to 17 who are referred by DSS. The program targets youth who are currently living at home and those who are in transition from placement to home or preparatory independent living.

Shelter Care

This is a staff-secure assessment and stabilization program for 25 adolescent males that provides 24-hour intensive supervision. These individuals are primarily referred by the Department of Youth Services (DYS).

Alliance House

This program is a two- to four-month residential program for 14 adolescent males who are referred by DYS. It is a highly structured program offering a full array of clinical, educational, vocational, and case-management services.

North Shore Satellite

This program is designed to assist consumers referred by the Department of Mental Retardation (DMR) in developing independent living skills and appropriate community behavior in supported residential settings of consumers' own choosing. The program has two components: Individual Living Program and Intensive Case Management.

NFI Center—Girls Assessment

This program provides secure, comprehensive planning, advocacy, substance-abuse assessment, and treatment for 24 adjudicated female DYS clients, ages 11-20. Individual and group and family counseling are also provided.

NFI Center–Harbor Academy

This program provides staff-secure, high-intensity residential treatment programming for adolescent males with histories of sexually abusive behaviors.

Northeast Division

This program (14 beds) is a short-term coeducational residential program that offers 24-hour emergency coverage, stabilization, clinical assessment, respite, individualized treatment planning, family involvement, and access to a full range of home- and community-based services.

Wakefield Lodging

This program consists of a residential facility that houses men and women who are developmentally delayed. The focus of the program is on developing and strengthening independent living skills and greater integration with the community.

Riverside Respite

This is a short-term respite program servicing eight adults with mental-health needs. It provides crisis intervention, assessment, short-term treatment planning, and step-down programming for consumers discharged from hospitals.

Chauncy Hall Academy (Massachusetts)

This program (22 beds) is a secure, clinically intensive residential treatment program for emotionally disturbed, mentally ill young male adolescents. It offers on-site medical, clinical-counseling, and educational staff.

Chauncy Hall Academy (Out of State)

This is the same as the abovementioned program; however, it serves out-of-state clients.

Metro West Continuum

This continuum was developed to assist troubled youth and their families and consists of three program locations, which include a short-term residential program for men and women ages 13-18, an intensive long-term residential program for male and female adolescents, and a wraparound program that provides a variety of clinical and support services to youth and their families, in their homes.

Family Intervention Network

This is a unique interagency service planning team led by NFI and composed of representatives from DMH, DSS, DYS, and local school systems. The mission is to assess the various support and intervention needs for referred youths and families.

Multi-Disciplinary Assessment

This program consists of a team composed of community professionals who share their expertise and knowledge to assess the most difficult and high-risk DSS cases. The team authorizes spending from this program. NFI serves as the resource coordinator for the team and is responsible for the processing of payments and tracking of expenses.

Lawrence Overnight Arrest Unit

This program provides a secure alternative to lockup for up to nine youths, ages 12-17, who are in police custody to keep the youth from being detained in police stations.

Metro North

This is a non-state program funded by a fire-setting prevention grant. The program is located in Wakefield, Massachusetts.

Positive Opportunity Program

This is a staff-secure, residential treatment program for 16 adolescent males committed to DYS. It seeks to stabilize the behavior of these males, assess their treatment needs, and provide a safe, highly structured environment.

Supportive Living Program

This program was developed as a flexible program that provides services tailored to each individual's needs and preferences. It provides both direct and indirect supports to adults with mental retardation.