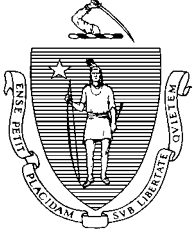

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INDEPENDENT STATE AUDITOR'S REPORT ON CERTAIN ACTIVITIES OF THE PAKACHOAG ACRES DAY CARE CENTER, INC. AND AFFILIATES JULY 1, 1995 THROUGH DECEMBER 31, 2003

OFFICIAL AUDIT REPORT

MARCH 4, 2005

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INTRODUCTION 1

Pakachoag Acres Day Care Center, Inc. (PADCC) is a 501(c)(3) nonprofit organization that was incorporated in Massachusetts in 1978 under Chapter 180 of the Massachusetts General Laws. The organization provides contracted and voucher-based child care services under contracts with the Commonwealth's Office of Child Care Services (OCCS) and the Department of Education (DOE). Services purchased by OCCS include Income Eligible Child Care for Infants and Toddlers, Preschool and School-Age children, as well as Family Day Care System services and Supportive services to children with Department of Social Services (DSS) involvement. PADCC also provides Child Care Nutrition Program services funded by DOE and Quality Childcare Initiative Apprenticeship Training services funded by the United States Department of Labor and Workforce Development's Division of Apprentice Training. Prior to fiscal year 1998, PADCC also functioned as the area Lead Agency for DOE's Community Partnership for Children initiative.

During our audit period, PADCC operated under common management with two for-profit related-party entities: Kincare, Inc. (Kincare) d.b.a. Hassanamesit Village Early Learning Center, incorporated in Massachusetts in 1997, and Kincare, LLC, incorporated in Massachusetts in 2000. Both for-profit entities are owned and operated by the Executive Director of PADCC and her husband, who is the Administrator of PADCC.

Our audit was initiated based on a request from the state's Operational Services Division (OSD), the state agency responsible for regulating and overseeing the activities of contracted human service providers such as PADCC. OSD made this audit request on behalf of OCCS following a contract monitoring review conducted by OCCS at PADDC during the fall of 2002. This review, which involved an examination by OCCS of PADCC's fiscal year 2001 and 2002 OCCS-funded activities, identified approximately $1 million in questioned costs and a variety of licensing, governance, documentation, and related-party compliance issues.

The initial scope of our audit was to follow up on the problems identified in OCCS's review and to examine in greater detail certain administrative and fiscal activities of PADCC during the period July 1, 2000 through December 31, 2003. However, during the conduct of our field work, we determined that the management and operation of PADCC and its related party entities is extensively intertwined and that the entities are effectively managed as a single business enterprise despite their separate nonprofit and for-profit legal statuses. We also noted that several of PADCC's principals received compensation through Kincare. In order to review these issues, we therefore expanded our audit scope to encompass all commonly controlled entities for the entire period July 1, 1995 through December 31, 2003.

Our audit was conducted in accordance with applicable generally accepted government auditing standards for performance audits and included procedures and tests considered necessary by the Office of the State Auditor (OSA) to meet these standards.

Our audit identified at least $1.4 million in unallowable expenses incurred by PADCC and Affiliates during our audit period and various programmatic issues, including PADCC's operating its School-Age programs for periods of time with enrollment that exceeded the program's licensed capacity by up to 40%, failing to conduct and properly document mandated Family Day Care system home visits on a monthly basis, and significant

governance and operational management control deficiencies and reporting and recordkeeping deficiencies, which in many cases limited our abilty to conduct effective audit testing in certain areas. Therefore, the amount of unallowable expenses billed by PADCC against its state contracts during the period of our audit could be significantly higher.

The governance, management control, documentation deficiencies, and disclosure violations identified throughout this report establish that the overall costs of PADCC and its related entities in many cases failed to meet applicable eligibility requirements. As a result, even though services were provided, significant questions exist regarding the extent to which any of the costs associated with the $11.9 million in direct and indirect state agency payments that PADCC and Kincare received during fiscal years 1996 through 2003 in support of services to state-sponsored clients are properly reimbursable under standards established by both state and federal regulatory agencies. Due to PADCC's widespread failure to meet reimbursable cost prerequisites and provide certain requested materials in a timely manner, audit testing was suspended when it became apparent that testing had already identified nonreimbursable amounts substantially exceeding any amount that could reasonably be expected to be recovered from the organizations or their principals. Consequently, although our report identifes specific questionable costs based on the audit testing we were able to conduct, OSD, in conjunction with OCCS, may want to conduct an additional review to ascertain whether additional recoveries are warranted.

AUDIT RESULTS **7**

1. HIGHLY QUESTIONABLE AND UNALLOWABLE RELATED-PARTY TRANSACTIONS TOTALING AT LEAST $1,031,967 **7**

We found that during the period covered by our audit, PADCC conducted various transactions with its related parties, of which we determined at least $1,031,967 to be questionable and unallowable. For example, during fiscal years 1997 through 2003, PADCC made unallowable lease payments totaling $343,405 to a related party. The 808 CMR 1.05 (8) limits the reimbursable amount to the lesser of the fair market value or the related party's actual costs, and the related party acknowledged that they incurred no reimbursable expenses during that period. In another instance, during the same period of time, we found that PADCC charged Kincare $86,098 less in lease costs than it should have in accordance with its lease agreements, thereby using more state funds than necessary to fund its operations.

2. UNREASONABLE COMPENSATION TOTALING AT LEAST $284,216 AND AS MUCH AS $479,955 PROVIDED TO PADCC'S EXECUTIVE DIRECTOR AND ADMINISTRATOR **17**

We found that the compensation provided by PADCC to its Executive Director and her husband, PADCC's Administrator, was unreasonable in that it significantly exceeded salaries paid for these positions by similar organizations by approximately $284,216 during our audit period. We also found that although PADCC is charging its state contracts for the full cost of the salary and fringe benefit expenses it agreed to provide to its Executive Director and Administrator, it is financially unable to provide this compensation to these individuals and is deferring the payment of a portion of this compensation. According to agency records, as of June 30, 2003 the amount of deferred

compensation and benefits due to these individuals totaled $479,955. Given that PADCC established levels of compensation for these two individuals that it was not able to pay, the entire deferred amount $479,955 could be considered unreasonable. Finally, we found that during our audit period, PADCC's Executive Director and Administrator billed and received from the Commonwealth $483,226 in salary for functioning as full-time employees of PADCC. However, according to the Uniform Financal Statements and Independent Auditor's Reports (UFRs) filed by PADCC's related organization, Kincare, both of these individuals were also working full-time at Kincare, at least during fiscal year 2002. Also, the federal tax returns filed by Kincare for calendar years 1998 through 2003 indicate that PADCC's Executive Director was working 100% of her time at Kincare. Moreover, the time sheets maintained by these individuals and the agency's payroll records did not clearly indicate the time these individuals worked at each agency. Therefore, the validity of the $483,226 in salary expenses PADCC paid to these two individuals during fiscal years 2001 through 2003 could not be determined.

3. NONCOMPLIANCE WITH BOARD GOVERNANCE STANDARDS APPLICABLE TO NONPROFIT HUMAN SERVICE CONTRACTORS **27**

PADCC has failed to comply with various board governance guidelines issued by the state's Office of the Attorney General (OAG) and with related requirements of the terms and conditions of its state contracts. Since its inception, PADCC has operated under the control of its Executive Director, employees, and family members without the necessary and required independent board oversight.

4. INADEQUATE INTERNAL CONTROLS OVER AGENCY OPERATIONS **32**

We found that PADCC had not developed and implemented an adequate system of internal controls over many aspects of its operations. Specifically, we found that PADCC did not properly document its accounting system. Moreover, in those areas where PADCC had established some controls, the controls were often ineffective due to the nepotistic nature of PADCC's management structure. As a result of these internal control deficiencies, the Commonwealth cannot be assured that public funds were properly safeguarded against misuse and expended for their intended purposes, or that all of PADCC's transactions were properly authorized, recorded, and reported.

5. UNALLOWABLE VEHICLE EXPENSES TOTALING AT LEAST $85,842 **36**

We found that PADCC had not established adequate controls over the use of corporate vehicles. Specifically, PADCC was not maintaining records that documented the business versus personal use of these vehicles. In addition, although the vehicles being charged by PADCC against its state contracts were also being used by Kincare for its program-related activities, PADCC was not maintaining any records that documented the nature and extent of Kincare's use of these vehicles. The inadequate manner in which PADCC was maintaining its financial records prevented us from documenting all of the expenses PADCC charged against its state contracts relative to the use and operation of these vehicles during the period covered by our audit. However, according to the fixed asset depreciation schedule provided to us by PADCC officials, the agency charged a total of $85,842 in nonreimbursable depreciation expenses for these vehicles during the audit period.

6. UNALLOWABLE DEPRECIATION EXPENSES TOTALING $37,956 41

We found that PADCC failed to depreciate assets in accordance with depreciation schedules established by OSD regulations. As a result, as of June 30, 2003, PADCC overcharged its state contract at least $37,956 for depreciation expenses.

7. INACCURATE, INCOMPLETE, AND MISSING AGENCY RECORDS 43

We found numerous instances in which PADCC and its related parties either failed to file reports required by state oversight agencies or filed reports that contained erroneous information. As a result, the Commonwealth has not been given the information it needs to properly monitor and evaluate the activities of PADCC.

8. FAILURE TO ADHERE TO GENERALLY ACCEPTED ACCOUNTING PRINCIPLES, MATERIAL MISSTATEMENTS IN AUDITED FINANCIAL STATEMENTS, AND OTHER SIGNIFICANT UFR FILING DEFICIENCIES 49

We found numerous instances in which PADCC failed to maintain its records in accordance with generally accepted accounting principles as required by state regulations. For example, PADCC did not establish an accounting system that clearly segregated expenses incurred by PADCC, a nonprofit organization, from those incurred by PADCC's for-profit related organization, Kincare, Inc. Consequently, the Commonwealth cannot be assured that all of the expenses PADCC billed and received reimbursements for under its state controls were actually related to PADCC's state-funded programs and not Kincare Inc.'s operations.

9. PROGRAM COMPLIANCE ISSUES 54

We found a number of instances in which PADCC and Kincare Inc. failed to comply with state regulations relative to the operation of their state-funded programs, including operating the School-Age programs for periods of time with enrollment that exceeded the program's licensed capacity by up to 40% and not conducting and properly documenting mandated Family Day Care system home visits on a monthly basis.

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INTRODUCTION

Background

Pakachoag Acres Day Care Center, Inc. (PADCC) is a 501(c)(3) nonprofit organization that was incorporated in Massachusetts in 1978 under Chapter 180 of the Massachusetts General Laws. PADCC provides contracted and voucher-based child care services under contracts with the Commonwealth's Office of Child Care Services (OCCS) and the Department of Education (DOE). Services purchased by OCCS include Income Eligible Child Care for Infants and Toddlers, Preschool and School-Age children, as well as Family Day Care System services and Supportive services to children with Department of Social Services (DSS) involvement. PADCC also provides child care nutrition program services funded by DOE and Quality Childcare Initiative Apprenticeship Training services funded by the United States Department of Labor and Workforce Development's Division of Apprentice Training. Prior to fiscal year 1998, PADCC also functioned as the area Lead Agency for DOE's Community Partnership for Children[1] initiative.

During our audit period, PADCC operated under common management with two for-profit related-party entities: Kincare, Inc. (Kincare) d.b.a. Hassanamesit Village Early Learning Center, incorporated in Massachusetts in 1997 and Kincare, LLC, incorporated in Massachusetts in 2000. Both for-profit organizations are owned and operated by the Executive Director of PADCC and her husband, who is the Administrator of PADCC.

PADCC operates a facility located at 73 Jerome Avenue, Auburn, that is owned by the Executive Director and her husband, as well as a facility at the Dorothy Manor School in Millbury, which PADCC leases from the Town of Millbury. Kincare utilizes a facility at 2 Eliot Trail in Grafton, which it leases from PADCC. Administrative offices for all corporations are located at the Grafton facility. Family Day Care services are provided at the homes of several OCCS-licensed Family Day Care providers in the area, who operate as PADCC subcontractors under the supervision of PADCC's Family Day Care system coordinator, who works out of the Grafton facility. Both for-profit and nonprofit entities also utilize the same "Early Learning Centers" d.b.a. name.

[1] This initiative grew out of the Chapter 188 early childhood program initiated by the School Improvement Act of 1985. Programs developed under Chapter 188 were primarily public school preschool programs that integrated young children with special needs and enhanced kindergartens. Under the CPC program, DOE awards grants and contracts to communities to serve three- and four-year-old children in preschool programs. Communities that receive CPC funds are expected to develop a plan that meets the objectives of the CPC program.

For fiscal years 1996 through 2003, PADCC reported in its audited financial statements that it had received over $13 million in funding of which over $11 million was governmental funding, primarily from contract payments and indirect child care voucher funding from DOE, DSS, and OCCS. A summary of revenues reported by PADCC appears in the following table.

Pakachoag Acres Day Care Center, Inc.

Revenue

Fiscal Years 1996 through 2003

	1996	1997	1998	1999	2000	2001	2002	2003	Total
DOE	$ 155,442	$ 750,546	$ 64,632	$ 66,458	$ 61,349	$ 57,005	$ 59,617	$ 50,677	$ 1,265,726
DSS/OCCS Contract	507,198	707,458	44,608	65,536	382,787	488,691	558,549	719,642	3,474,469
DSS/OCCS Voucher	313,998	420,430	1,017,702	847,106	641,476	611,833	493,657	402,005	4,748,207
DTA Contract	41,081	-	-	-	51,871	-	-	-	92,952
Govt. Grant	100,271	345,016	201,885	194,317	181,331	195,869	182,176	18,508	1,419,373
Govt. Subcontracts	-	119,271	-	-	-	-	-	-	119,271
Total Government	$ 1,117,990	$ 2,342,721	$ 1,328,827	$ 1,173,417	$ 1,318,814	$ 1,353,398	$ 1,293,999	$ 1,190,832	$ 11,119,998
Other Revenue	593,914	185,225	241,769	313,528	295,692	416,202	416,664	394,305	2,857,299
Total Revenue	$ 1,711,904	$ 2,527,946	$ 1,570,596	$ 1,486,945	$ 1,614,506	$ 1,769,600	$ 1,710,663	$ 1,585,137	$ 13,977,297

Audit Scope, Objectives, and Methodology

Our audit was initiated based on a request from the state's Operational Services Division (OSD), the state agency responsible for regulating and overseeing the activities of contracted human service providers such as PADCC. OSD made this audit request on behalf of OCCS following a contract monitoring review conducted by OCCS at PADDC during the fall of 2002. This review, which involved an examination by OCCS of PADCC's fiscal year 2001 and 2002 OCCS-funded activities, identified approximately $1 million in questioned costs and a variety of licensing, governance, documentation and related-party compliance issues. During a June 2003 meeting with OCCS officials, these officials informed us that a separate review of PADCC was also being conducted by the Public Charities Division of the state's Office of the Attorney General (OAG) regarding possible violations of laws and reporting requirements. This information was confirmed by the management of PADCC, who gave us a copy of a Civil Investigation Demand letter issued by the OAG pursuant to Chapter 12, Section 8H, of the General Laws and numerous binders containing hundreds of pages of document submissions made by PADCC in response to the OAG demand letter.

The initial scope of our audit was to follow up on the problems identified in OCCS's review and to examine in greater detail certain administrative and fiscal activities of PADCC during the period July 1, 2000 through December 30, 2003. However, during the conduct of our field work, we determined that the management and operation of PADCC and its related party entities is extensively intertwined and that the entities are effectively managed as a single business enterprise despite their separate nonprofit and for-profit legal statuses. We also noted that several of PADCC's principals received compensation through Kincare. In order to review these issues, we therefore expanded our audit scope to encompass all commonly controlled entities for the period July 1, 1995 through December 31, 2003.

Our audit was conducted in accordance with applicable generally accepted government auditing standards for performance audits and included procedures and tests considered necessary by the Office of the State Auditor (OSA) to meet these standards.

Our objectives consisted of the following:

> A determination of whether PADCC and its affiliates have established and implemented adequate and effective internal controls, including:

- Policies and procedures to ensure internal administrative and accounting controls over revenues, expenses, and fixed assets;

- Policies and procedures to ensure that resource use is consistent with laws and regulations; and

- Policies and procedures to ensure those resources are safeguarded and efficiently used.

- An assessment of PADCC's business practices and its compliance with applicable laws, rules, and regulations as well as the various fiscal requirements of its direct and indirect state funding agreements.

In order to achieve our audit objectives, we first assessed the system of internal controls established and implemented by PADCC 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 accounting systems for each organization. The assessment was used in planning and performing our audit tests. We held discussions with management officials and reviewed organizational charts and internal policies and procedures. We also reviewed applicable laws, rules, and regulations, including federal requirements associated with federal funds passed through state purchasing agencies to the organizations. Finally, we examined financial statements, budgets, cost reports, invoices, and other pertinent financial records for each organization to determine whether expenses incurred under state contracts and other state funding arrangements (e.g., OCCS voucher agreements) were reasonable, allowable, allocable, properly authorized and recorded, and in compliance with all applicable laws, rules, and regulations.

Our audit was intended to formulate findings and conclusions regarding compliance with applicable laws, rules, and regulations; the adequacy of performance; and specific processes, methods, and controls that could be made more efficient and effective. Our review focused on the following areas in order to provide a timely reporting of these issues:

- Governance arrangements for PADCC;

- The control environment and adequacy of control systems utilized by the organizations;

- Compensation and business arrangements with PADCC principals and their related parties;

- Compliance with disclosure, documentation, and reporting requirements;

- Compliance with state and federal reimbursable cost standards applicable to publicly funded services; and
- Disposition of prior audit and contract monitoring findings.

Our review was not made for the purpose of forming an opinion on the financial statements of PADCC and its affiliated organizations or for assessing the quality and appropriateness of program services. However, during our audit we identified issues involving both the accuracy of financial statements and various programmatic issues and have disclosed these issues in our report.

The OSA is authorized under its enabling legislation, Chapter 11, Section 12, of the General Laws, to perform audits of entities such as PADCC that contract with the Commonwealth to "determine compliance with the provisions and requirements of such contracts or agreements and the laws of the commonwealth." This statute further mandates that "the state auditor shall have access to such accounts at reasonable times" and that the OSA "may require the production of books, documents, vouchers, and other records relating to any matter within the scope of such audit." Additionally, regulations promulgated by OSD, the agency responsible for regulating and overseeing state funding agreements with human service providers such as PADCC and Kincare, require service providers to provide all records needed by the OSA as well as other organizations to complete an audit of the agency. Specifically, 808 CMR 1.04 (8) states:

> *A Contractor shall make available for review, inspection and audit all records relating to its operations and those of its affiliates, subsidiaries and Related Parties. . .to any contracting Department, Executive Office, DPS, the Office of the State Auditor, the federal government or their representatives.*

Also, as noted throughout this report, many of the reports and other documents provided to us by PADCC during our audit appeared to be inaccurate, deficient, or in conflict with other available information, creating substantial doubt regarding the reliability of these records. Therefore, the ability to perform sufficient audit testing in certain areas was partially impaired, and the audit results and opinions expressed in this report are based solely on the documentation made available to the audit team.

AUDIT RESULTS

1. HIGHLY QUESTIONABLE AND UNALLOWABLE RELATED-PARTY TRANSACTIONS TOTALING AT LEAST $1,031,967

We found that during the period covered by our audit, Pakachoag Acres Day Care Center, Inc. (PADCC) conducted various related-party transactions with its affiliated entities, of which we determined at least $1,031,967 to be questionable and unallowable. For example, during fiscal years 1997 through 2003, PADCC made unallowable lease payments totaling $343,405 to a related party. 808 CMR 1.05 (8) limits the reimbursable amount to the lesser of the fair market value or the related party's actual cost. The related party acknowledged they incurred no reimbursable expenses during that period. In another instance, during the same period of time, we found that PADCC charged Kincare $86,098 less in lease costs than it should have in accordance with its lease agreements thereby using more state funds than necessary to fund its operation.

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

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

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

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

Examples of related-party transactions include transactions between (a) a parent company and its subsidiaries and (b) subsidiaries of a common parent. Transactions between related parties commonly occur in the normal course of business. Examples of common types of transactions with related parties include sales, purchases, and transfers of realty and personal property; services received or furnished (e.g., accounting, management, engineering, and legal services); use of property and equipment by lease or otherwise; borrowing and lending guarantees; maintenance of bank balances as compensating balances for the benefit of another; inter-company billings based on allocations of common costs; and filings of consolidated tax returns. Transactions between related parties are considered to be related-party transactions even though they may not be given accounting recognition as such. For example, an enterprise may recover services from a related party without charge and not record receipt of the services.

As noted in the Background section of this report, PADCC conducts activities with its related party organizations and therefore is required to comply with regulations promulgated by OSD regarding related-party transactions. However, contrary to these requirements PADCC engaged in numerous questionable and unallowable transactions with its related entities, as detailed in the following sections.

a. Unallowable Lease Payments Totaling $343,405

The 808 CMR 1.05(8) promulgated by OSD defines the following costs as being unreasonable and therefore nonreimbursable under state contracts.

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

According to agency officials, since its inception, PADDC has paid rent to lease space for program purposes located at 73 Jerome Avenue in Auburn, which is owned by PADCC's Executive Director and her husband, PADCC's Administrator. According to PADCC's financial statements, during the period July 1, 1996 through June 30, 2003, these lease payments totaled $343,405. As noted above, 808 CMR 1.05(8) limits the reimbursable amount that can be paid to related parties such as the Executive Director and the Administrator to the lesser of fair market value or the actual reimbursable expense amount incurred by the "related-party." During our audit, we asked PADCC's Executive Director to

provide us with documentation to substantiate the actual reimbursable expenses she incurred in the operation of this property. In response, the Executive Director stated that she and her husband had incurred no reimbursable expenses for this facility since they had paid off the loan associated with this property in the late 1980s. Consequently, the $343,405 PADCC charged against its state contracts for lease expenses associated with this property during our audit period is unallowable in accordance with the aforementioned OSD regulations.

b. Nonprogrammatic Use of State-Funded Property and Unallowable Utility Costs Totaling at Least $4,860

OSD regulations 808 CMR 1.05(12) identifies the following as nonreimbursable costs under state contracts:

> *1.05(12) Non-Program Expenses. Expenses of the Contractor which are not directly related to the social service Program purposes of the Contractor*

We found that during our audit period, a PADCC manager (the son of PADCC's Executive Director) and his wife and child were using part of the space being rented by PADCC in its Auburn facility as their permanent residence but were not paying rent or reimbursing PADCC for any expenses associated with this property. In addition to all the lease payments that PADCC made to its Executive Director and her husband for use of this property that we question above, PADCC also paid all the utility costs associated with the operation of this facility, which totaled $34,717 during fiscal years 2001 through 2003. Since a portion of the space for which PADCC paid these utility expenses was used for nonprogrammatic purposes, clearly all of these utility expenses should not have been charged against the contracts that funded PADCC's state programs. During our audit, we calculated the square footage of the total facility as well as the percentage of square footage being used as a residence of the son of PADCC's Executive Director and his family and determined that approximately $4,860 of the utility expenses were personal in nature and should not have been charged by PADCC against its state contracts.

After we brought this matter to the attention of PADCC officials, PADCC made a year-end accounting entry to record a total of $6,769 for a partial reimbursement of the fiscal year 2003 annual rental amount for this property. However, PADCC did not make any

adjustment for the non-program-related utility costs that were expensed by PADCC against its state contracts during the period we reviewed.

Regarding this matter, PADCC's Executive Director stated that she believed the arrangement was justified since PADCC benefited from the security provided by having an employee live at the program site. However, since the space being occupied by this family is being used for non-programmatic purposes, clearly PADCC should not have charged its state contracts for any expenses, including utility costs, associated with the personal use of this facility.

c. PADCC Subsidized Its Related-Party Lease Expenses by at Least $86,098

As previously mentioned, during our audit period PADCC leased property to Kincare. The significant aspects of these leasing arrangements for this property were as follows:

Lease Document Period	Parties to the agreement	Date Lease was Signed	Significant Terms and Conditions of Lease
(Original Lease) October 1, 1996 to June 30, 1997	PADCC's Executive Director for Kincare and PADCC	Undated	Original lease states $4,420 per month for 4,900 square feet.
(Amendment) July 1, 1996 to June 30, 1997	PADCC's Executive Director for both PADCC and Kincare	Amendment dated July 15,1999 effective July 1, 1996	Amendment states $53,040 or $4,420 per month for 4,900 sq. ft. Additional space leased at $11 per sq. ft.
(Amendment) July 1, 1997 to June 30, 1998	PADCC's Executive Director for both PADCC and Kincare	Amendment dated July 15,1999 effective July 1, 1997	Amendment states $53,040 or $4,420 per month for 4,900 sq. ft. Additional space leased at $11/sq. ft. Additionally, $3/sq. ft. paid on lease-purchase of equipment located at the site.
(Amendment) July 1, 1998 to June 30, 1999	PADCC's Executive Director for both PADCC and Kincare	Amendment dated July 15,1999	Amendment states $82,500 or $6,875 per month for 7,500 sq. ft. Additional space leased at $11/sq. ft. Additionally, $3/sq. ft. paid on lease-purchase of equipment located at the site.
(New Lease) July 1, 1999 to June 30, 2005	PADCC's Executive Director for both PADCC and Kincare	Lease dated July 1, 1999	Lease states annually $82,500 or $6,875 per month based on 4,900 sq. ft. Additional space leased at $11/sq. ft.
(Lease Extension)	PADCC's Executive Director	Extension signed July 1, 2000	No changes noted.
(Lease Extension)	PADCC's Executive Director	Extension signed July 1, 2001	No changes noted.
(Lease Extension)	PADCC's Executive Director for both PADCC and Kincare	Extension signed July 1, 2002	No changes noted.
(New Lease) July 1, 1999 to June 30, 2004	PADCC's Executive Director for both PADCC and Kincare	Lease not dated but states "Approved by the Board: December 30,2002"	Monthly payments of $6,737.45 for 9,800 sq. ft.

Since Kincare is owned by PADCC's Executive Director and her husband, PADCC's Administrator, the lease agreements between PADCC and Kincare represent related-party transactions. Given the nature of these transactions, during our audit we first assessed the internal controls that were implemented by PADCC to ensure that the interests of the Commonwealth were protected in that fair and equitable lease terms and conditions were negotiated. Our review revealed the following internal control deficiencies:

- As noted in the table above, PADCC's Executive Director signed each of the leases and amendments on behalf of both PADCC and Kincare. Therefore, there is inadequate assurance that the terms and conditions specified in this contract were reasonable and in the best interest both PADCC and the Commonwealth.

- PADCC did not maintain accurate records to indicate the exact amount of space Kincare utilized during the period under review. Therefore, there is inadequate assurance that the amount of space Kincare was paying for was reasonable and accurate.

- Although the lease and the applicable amendments spanned a nine-year period, there was no per-square-foot cost escalation provision in the lease that would allow PADCC to increase the per-square-foot cost Kincare was paying if warranted by market conditions. In fact, as noted in the previous table, the lease dated July 1, 1999 for the period July 1, 1999 to June 30, 2005 specified a per-square-foot charge of $82,500 or $16.84 for the first 4,900 square feet with additional space being leased at cost of $11 per square foot. The final lease approved by the board dated December 30, 2002, required Kincare to pay $80,849 or $8.25 for 9,800 square feet. The final lease decreased the cost per square foot by $8.59 over the prior lease dated July 1, 1999, while doubling the size of the available square footage from 4,900 to 9,800 square feet.

- Kincare underpaid the lease by at least $86,098. We calculated the lease payments that should have been made to PADCC and compared these to the actual lease payments made by Kincare for fiscal years 1997 to 2003. Since it was not possible to accurately determine the amount of space used by Kincare from PADCC's records, we calculated our underpayment amount based on the amount of square footage PADCC said Kincare was utilizing each year. Based on this information, we determined that Kincare underpaid PADCC for the lease of this space by at least $86,098 during this period as indicated in the following table:

Fiscal Year	Amount Due per Lease	Actual Amount Paid	Underpayment
1997	$40,425	$40,425	-
1998	95,348	79,535	$15,813
1999	96,208	80,849	15,359
2000	104,192	97,999	6,193
2001	116,842	97,999	18,843
2002	116,842	115,149	1,693
2003	143,197	115,000	28,197
Total	**$713,054**	**$626,956**	**$86,098**

Because the Commonwealth was paying the costs associated with this facility, PADCC was obligated to use the revenues it received from renting space in this facility as offsets to defray the stated costs of operating this property in accordance with 808 CMR 1.02, which states, in part:

> *Off-Setting Revenue. The sum of the following revenues and support items. These revenues and support items must be received during the price year and must be dedicated for use in the same Program that also receives Commonwealth funds.*
>
> *(a) any Contractor revenues and support (including but not limited to public and private grants, gifts, contributions, bequests, or any income therefrom, income from endowments, funds received from the Massachusetts Department of Education's Bureau of Nutrition, or similar funding) to the extent that revenues and support are restricted to use in the Program. . . .*

By not collecting the appropriate lease payments from its related party, PADCC in effect used at least $86,098 in state funds to supplement costs associated with the operation of this property, which should have been offset by these lease payments.

d. Unallowable Building Expenses Totaling $597,604

OSD regulations 808 CMR 1.05(12) identifies the following as nonreimbursable costs under state contracts:

> *1.05(12) Non-Program Expenses. Expenses of the Contractor which are not directly related to the social service Program purposes of the Contractor.*

We noted that during the period July 1, 1996 to June 30, 2003, PADCC charged an additional $597,604 in non-program-related costs against its state contracts for the operational costs of the building that is leased by Kincare. These expenses included $277,358 in accumulated depreciation for the building and equipment and improvements being used by Kincare and $320,246 in mortgage interest payments made during the period July 1, 1999 to June 30, 2003 to its state contracts relative to the operation of this facility.

Since the building is being leased to Kincare, these expenses were not related to any of PADCC's state-funded program purposes and therefore should not have been charged by PADCC to its state contracts.

Recommendation

In order to address our concerns relative to this matter, we recommend that OCCS recover from PADCC the $1,031,967 in questionable and unallowable related-party transaction costs detailed above. In the future, PADCC should take measures to ensure that it does not charge any unallowable related-party transaction costs against its state contracts.

Auditee's Response

In response to this issue, a law firm representing Kincare stated, in part:

> *The rental rate for the Auburn property was established not by [PADCC's Executive Director and her husband] or Pakachoag but by Pakachoag's accountant . . . , based upon an independent appraisal of the Auburn property. That rental rate, $8.00 per sq. ft., triple net, is fair both to Pakachoag and to the Commonwealth. It has not been raised since 1997. Indeed, Pakachoag, despite extensive efforts, has been unable to find a facility in Auburn that is comparable, in terms either of cost or of appropriateness for the child care services Pakachoag provides. The building, located in a residential area, apparently could not be used for child care if it were sold to an unrelated party.*
>
> *The Draft Report fails to treat the fair rental value of the Auburn property as an allowable cost, relying on the argument that [PADCC's Executive Director and her husband] incur no "cost" as a result of their ownership of the property. This contention is hypertechnical. Obviously, the real cost to [PADCC's Executive Director and her husband] of their lease to Pakachoag is the value of their ability otherwise to lease, sell, or occupy the property.*
>
> *Under such circumstances it would be highly inequitable for the Commonwealth to seek to recover the amount of lease payments made over seven years and effectively obtain the rent-free use of an outstanding facility at Pakachoag's expense.*
>
> *Pakachoag's rental income from Kincare involves no unallowable related party expense of Pakachoag. Accordingly, the adequacy or not of the rental revenue received by Pakachoag does not give rise to any entitlement by the Commonwealth.*
>
> *Pakachoag's depreciation and interest expense incurred on account of the Grafton property are allowable to the extent Pakachoag used the Grafton property for its administrative and financial activities. To the extent that expense was incurred in connection with the space leased to Kincare, such expense was more than offset by the rental revenue received from Kincare.*

In addition, a law firm representing Kincare stated, in part:

> *This property is owned by Pakachoag, which rented a portion of the Grafton facility to Kincare beginning in January 1997.*
>
> *An independent appraisal of fair market value conducted by an unrelated consultant at the request of Pakachoag Board was the foundation for the Pakachoag Kincare Lease. The model terms require that the tenant (Kincare) pay $11.00 per sf for 4,900 sf on the first floor, all utilities and Pakachoag pay real estate taxes, building insurance and repairs and maintenance.*
>
> *The terms of the Pakachoag-Kincare lease differ from the appraisal recommendations with respect to allocating non-rent charges. Pakachoag retained space for its own use in the Grafton facility. Consequently, the lease states that Pakachoag and Kincare will share expenses: the lease states that Kincare shall pay 75% of all utilities-including electricity, heat, water, etc. and 50% of the phone bills. This implies that Pakachoag should pay 25% of the utilities, 50% of the phone bills, and the real estate taxes and insurance. In actuality, Kincare has paid 100% of phone, utility and real estate taxes.*
>
> *Kincare has leased space in Grafton since 1997, at $11.00 sf. It paid $80,849 in FY1999 and FY2000 according to the audited financial statements. However, it should have paid $53,900 in those years, because it only occupied 4,900 sf, thus overpaying approximately $54,000.*
>
> *On July 1, 1999, Kincare entered into a five year lease at $82,500 per year in rent, calculated at $11.00 sf. However, the lease contained a typographical error as to the total square footage. Instead of 4,900 sf, it should have indicated that 7,500 sf was being rented. Yet, the Auditor argues that Kincare should have been paying $16.84sf. This is patently unreasonable given the independent review only two years before and the fact that the Pakachoag board signed a lease to rent high quality space with an unrelated third party at $14.00 sf including utilities during that same time frame.*
>
> *Over the course of the rental period, Kincare paid $626,956 in lease payments, well in excess of what it was obligated to pay. During the lease period, Kincare was obligated to pay Pakachoag $576,942.50. It has exceeded this amount and thus the Audit report conclusion that it underpaid by $86,098 is erroneous.*

Auditor's Reply

When entering into contracts with the Commonwealth, PADCC, as with all other contracted human service providers, is required to comply with all applicable laws and regulations.

As stated in our report, 808 CMR 1.05(8) promulgated by OSD defines the following costs as being unreasonable and therefore nonreimbursable under state contracts.

> *<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 cost.*

According to agency officials, since its inception, PADDC has paid rent to lease space for program purposes at 73 Jerome Avenue in Auburn, which is owned by PADCC's Executive Director and her husband, PADCC's Administrator. This regulation limits the reimbursable amount that can be paid to related parties such as the Executive Director and the Administrator to the lesser of fair market value or the actual reimbursable expense amount incurred by the "related-party." During our audit, we asked PADCC's Executive Director to provide with us documentation to substantiate the actual reimbursable expenses she incurred in the operation of this property. In response, the Executive Director stated that she and her husband had incurred no reimbursable expenses for this facility since they had paid off the loan associated with this property in the late 1980s. Consequently, the $343,405 PADCC charged against its state contracts for lease expenses associated with this property during our audit period is unallowable in accordance with the aforementioned OSD regulations.

Regardless of whether the rental rate established by PADCC for this facility was a fair market rate, PADCC was obligated to comply with state regulations relative to the costs it could pay a related party for the use of this facility. This regulation was established to protect the taxpayers.

We acknowledge that, depending on market conditions, PADCC's Executive Director may have been able to sell or lease this space to another entity. However, it is the responsibility of PADCC's Executive Director to be aware of the state's regulations relative to related-party transactions and to conduct business in accordance with these regulations. Therefore, it is both equitable and reasonable for the Commonwealth to seek reimbursement of the unallowable related-party payments made by PADCC in this matter.

As stated in our report, Kincare underpaid the lease it entered into with PADCC by at least $86,098. We calculated the lease payments that should have been made to PADCC and compared these to the actual lease payments made by Kincare for fiscal years 1997 to 2003. Since it was not possible to accurately determine the amount of space used by Kincare from PADCC's records, we calculated our underpayment amount based on the amount of square footage PADCC said Kincare was utilizing each year. Based on this information, we determined

that Kincare underpaid PADCC for the lease of this space by at least $86,098 during this period as indicated in the table contained on page 11.

Because the Commonwealth was paying the costs associated with this facility, PADCC was obligated to use the revenues it received from renting space in this facility as offsets to defray the states costs of operating this property in accordance with 808 CMR 1.02.

By not collecting the appropriate lease payments from its related party, PADCC in effect used at least $86,098 in state funds to supplement costs associated with the operation of this property, which should have been offset by these lease payments.

In its response, PADCC states that "depreciation and interest expense incurred on account of the Grafton property are allowable to the extent Pakachoag use[d] the Grafton property for its administrative and financial activities. . . ." However, PADCC did not provide us documentation to substantiate the extent to which PADCC used this facility. In view of this lack of documentation, we used the numbers for depreciation and interest expense for this facility that were being maintained by PADCC in its financial records, which should have been adjusted for any nonreimbursable portion.

In its response, Kincare claims that it only used 4,900 sq. ft. of this building during fiscal year 1999 and 2000 and therefore overpaid PADCC by approximately $54,000. However, Kincare did not provide us with any documentation to substantiate this assertion. As stated in our report, neither PADCC nor Kincare had any documentation to substantiate the amount of space that was actually being utilized by Kincare during the period covered by the leases. Moreover, this assertion directly conflicts with information provided by PADCC relative to this lease to OCCS. Specifically, on January 20, 2004 a law firm representing PADCC provided OCCS with written comments relative to certain claims and allegations made by OCCS relative to PADCC's operations. In these comments, PADCC represents that Kincare occupied 6,972 square feet in the facility in question as opposed to the 4,900 square feet Kincare now says it occupied in its response. Given the lack of any documentation relative to the space utilized by Kincare in this facility and the conflicting information both in the lease documents and the representations made by both PADCC and Kincare, we took the most conservative approach in our analysis and

use the square footage figures PADCC provided to OCCS as being utilized by Kincare to perform our calculations.

2. UNREASONABLE COMPENSATION TOTALING AT LEAST $284,216 AND AS MUCH AS $479,955 PROVIDED TO PADCC'S EXECUTIVE DIRECTOR AND ADMINISTRATOR

We found that the compensation provided by PADCC to its Executive Director and her husband, PADCC's Administrator, was unreasonable in that it significantly exceeded salaries paid for these positions by similar organizations by approximately $284,216 during our audit period. We also found that although PADCC is charging its state contracts for the full cost of the salary and fringe benefit expenses it agreed to provide to PADCC's Executive Director and Administrator, it is financially unable to provide this compensation to these individuals and is instead deferring the payment of a portion of this compensation. According to agency records, as of June 30, 2003 the amount of deferred compensation and benefits due to these individuals totaled $479,955. Given that PADCC established levels of compensation for these two individuals that it was not able to pay, the entire deferred amount of $479,955 could be considered unreasonable. Finally, we found that during our audit period, PADCC's Executive Director and Administrator billed and received from the Commonwealth $483,226 in salary for functioning as full-time employees of PADCC. However, according to the Uniform Financial Statements and Independent Auditor's Reports (UFRs) filed by PADCC's related organization, Kincare, at least during fiscal year 2002, both of these individuals were also working full-time (one FTE) at Kincare. Also, the federal tax returns filed by Kincare from calendar years 1998 through 2003 indicate that PADCC's Executive Director was working 100% of her time at Kincare. The time sheets maintained by these individuals and PADCC's payroll records did not clearly indicate the time these individuals worked at each agency. Thus, the validity of this $483,226 in salary expenses PADCC paid to these two individuals during fiscal years 2001 through 2003 could not be determined.

a. Unreasonable Salary Expenses Totaling $284,216

The 808 CMR 1.05, promulgated by OSD identifies specific expenditures that are nonreimbursable under state contracts. In this regard, 808 CMR 1.05 identifies the following as nonreimbursable costs 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.*

PADCC employs an Executive Director, Administrator, Controller, and multiple Program Managers. During our audit period, certain PADCC management employees also held dual status as employees of both PADCC and Kincare. Given the independence issues we identified within PADCC's Board of Directors (see Audit Result No. 3), we wanted to determine whether the salaries being paid to PADCC's Executive Director, which is established by PADCC's board, and her husband, PADCC's Administrator, were reasonable. We found that there was inadequate documentation (e.g., performance appraisals) in both of these individuals' personnel files, to validate their salaries. The Executive Director's personnel file contained only one self-appraisal conducted in 1999, and the Administrator's file had only one appraisal conducted in 1999 by his wife, the Executive Director. Also, there was no indication in either employee's personnel folder of an annual ratification of the employment contracts for these two individuals by PADCC's Board of Directors.

OSD maintains a database of all UFR information, including the salaries paid to certain staff, filed by contracted human service providers such as PADCC. In order to assess the reasonableness of the salaries paid to these two individuals during our audit period, we reviewed the OSD UFR database for salaries paid to Executive Directors and Administrators at comparably sized child care agencies during fiscal year 2002. We obtained information from the database for 19 comparably sized agencies (including PADCC) whose total agency expenditures ranged from $1.3 million to $2 million. PADCC's total expenditures for fiscal year 2002 was $1.68 million. From that list of agencies, we found that 13 had a full-time Executive Director, whose salary ranged from a low of $49,354 to a high of $95,019 with an average of $69,365.

We conducted a similar comparison of salaries for PADCC's Administrator position. From the original list of 19 agencies we used for the Executive Director's salary comparison, we found that only six agencies had an Administrator or Chief Financial Officer. The salaries for these individuals ranged from a low of $35,605 to a high of $75,833 (PADCC), with an average salary of $50,160.

In addition, we found that only six of the 19 agencies in our sample had both a full-time Executive Director and an Administrator during fiscal year 2002. Our analysis showed that the combined salaries of the two positions ranged from $84,959 to $162,500, with an average combined salary totaling $124,613. PADCC paid its Executive Director and administrator the highest combined salary, $162,500, of the six agencies we reviewed.

Based on our analysis, we determined that the compensation provided to these two individuals during fiscal years 1998 through 2003 was unreasonable by at least $284,216, as indicated in the following table:

Fiscal Year	Executive Director Salary	Average Executive Director Salary	Difference
1998	$171,516*	$119,525**	$51,991
1999	$97,705	$69,365	28,340
2000	$93,333	$69,365	23,968
2001	$86,667	$69,365	17,302
2002	$86,667	$69,365	17,302
2003	$87,467	$69,365	18,102
Total			$157,005

Fiscal Year	Administrator Salary	Average Administrator Salary	Difference
1998	-	-	-
1999	$85,346	$50,160	$35,186
2000	$70,240	$50,160	20,080
2001	$75,892	$50,160	25,732
2002	$75,833	$50,160	25,673
2003	$70,700	$50,160	20,540
Total			$127,211

* This total represents a combined salary of the executive director and administrator. These salaries were shown as combined on the UFR for fiscal year 1998.

** The average salary used is the total average salary for the Executive Director and administrator positions.

b. Unallowable Deferred Compensation Benefits Totaling at Least $479,955

Another indication that the salaries PADCC paid its Executive Director and Administrator were unreasonable is that they significantly exceeded the amount that PADCC could pay for these positions. During our audit period, when funds were insufficient to provide these two individuals their established levels of compensation, PADCC would charge its state contracts

for the full amount of the salary and fringe benefit costs it had established for its Executive Director and Administrator but not provide the full amount of this compensation to these individuals. Rather, PADCC would provide a portion of this compensation to these individuals, defer the remaining balance, and accrue a liability for this unpaid amounts to be paid at a future date. According to Internal Revenue Service (IRS) regulations, in order for a deferred compensation plan to be eligible, it must satisfy the requirements of Section 457(b) of the Internal Revenue Code and related provisions both in form and in operation of IRS regulations. An eligible plan must be established in writing, include all of the material terms for benefits under the plan, and be operated in compliance with the requirements. Since the deferred compensation process used by PADCC does not meet any of these requirements, it is not an eligible plan under IRS regulations. Therefore, this practice of deferring compensation for these individuals, while authorized by employment contracts with the Executive Director and Administrator, may not be recognized as deferred compensation for the purposes of taxation. Further, since these deferrals do not meet the requirements of IRS regulations, they should have been distributed to these individuals in accordance with Chapter 149, Section 148, of the General Laws, which requires payment within seven days following the end of the payroll period and expressly prohibits the use of employment contract provisions to avoid compliance with the statutory timely payment requirement. As stated in Section 148, "Every person having employees in his service shall pay weekly or bi-weekly each such employee the wages earned by him to within six days of the termination of the pay period during which the wages were earned if the employed for five or six days in a calendar week. . . .No person shall by a special contract with an employee or by any other means exempt himself from this section or section one hundred and fifty." During our audit we noted several instances in which the Executive Director and Administrator had agreed to defer their salary. In its November 22, 2002 management letter, PADCC's private accounting firm reported that PADCC accrued $404,955 in liabilities for unpaid salary, vacation, and benefits for the Executive Director and Administrator and that an additional $86,300 in unfunded deferred compensation to the same individuals had been recorded in the corporation's books. According to its financial records, as of June 30, 2003 the accrued unpaid salary and benefits liability had risen to $479,955.

In its 2003 management letter, PADCC's private accounting firm discusses the potential impact of accruing a large payroll liability by stating, in part:

> *This situation could give the appearance of the key employees having an apparent conflict of interest with the Organization and possibly enabling them to exert undue influence. The Organization is creating a large barrier to exit concerning its top executives. If these people were to leave PADCC, the organization would have to pay the accrued payroll at that time. Given the large amount of money this represents it could eliminate the Organization's ability to operate from a financial perspective. Finally, under federal requirements, in order for costs to be reimbursable they must be considered prudent expenses. The Organization has the burden of proof to establish why it is continually incurring expenses, which, it does not appear to have the ability to repay from continuing operations.*

In this regard, Office of Management and Budget (OMB) Circular A-122, with which PADCC must comply, states, in part:

> *A cost is reasonable if, in its nature or amount, it does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the costs. The question of the reasonableness of specific costs must be scrutinized with particular care in connection with organizations or separate divisions thereof which receive the preponderance of their support form awards made by Federal agencies.*

Given that PADCC was not able to pay this $479,955 to these two individuals, it was not prudent of PADCC to establish these rates of compensation for these individuals and charge them against state contracts.

c. Non-Program-Related Compensation Expenses Totaling as Much as $483,226 Charged to State Contracts

In addition to our review of the salary expenses of PADCC's Executive Director and Administrator detailed above, we found that in the UFR filed for fiscal years 2002 (the first year Kincare filed a UFR) and 2003, PADCC's Executive Director and her husband were both identified as providing one full-time equivalent (FTE) position for both agencies. Given that both entities are in operation during the same time and providing the same day care services, it is unlikely that the Executive Director and Administrator could be performing as full-time employees of both agencies.

The salary provided to these two PADCC staff members appears in the following table:

PADCC Compensation

Agency	Staff Person	Fiscal Year 2001 Salary	Fiscal Year 2002 Salary Expense per UFR	Fiscal Year 2003 Salary Expense per UFR	Total
PADCC	Executive Director	$86,667	$86,667	$87,467	$260,801
PADCC	Administrator	$75,892	$75,833	$70,700	222,425
Total					**$483,226**

Kincare Compensation

Agency	Staff Person	Fiscal Year 2001 Salary	Fiscal Year 2002 Salary Expense per UFR	Fiscal Year 2003 Salary Expense per UFR	Total
Kincare	Executive Director	-	$20,074	$19,323	$39,397
Kincare	Administrator	-	$20,074	$12,656	32,730
Total					**$72,127**

During our audit, we attempted to determine the amount of time these individuals spent working at both agencies. Our review of a sample of times sheets (covering July 2002 to December 2002) that were maintained by these individuals revealed that they did not clearly indicate the amount of time the individuals worked at Kincare versus PADCC. However, during our audit, these individuals stated that they spent the majority of their time working at PADCC. During its review of this activity, OCCS noticed the same issue and indicated that the appropriate allocation of the Executive Director salary should be based on a 50% allocation to both PADCC and Kincare. Accordingly, OCCS disallowed 50% of the Executive Director's PADCC salary during fiscal years 2000 to 2002, which totaled $129,999. OCCS stated that the Executive Director "maintains her administrative office at the Grafton property where Kincare is located. Pakachoag pays approximately 93% of the Director's salary. The Executive Director's personal tax return states that she works 100% of her time at Kincare. OCCS may reasonably conclude that she spends one-half of her time at each program."

Recommendation

In order to address our concerns relative to this matter, OCCS, in conjunction with OSD, should determine what amount to recover from PADCC relative to the unreasonable and

questionable staff compensation it charged against its state contracts during our audit period. We believe that the amount recovered by OCCS should be at least the $284,216 we identified as being unreasonable in section 2.a. above. However, given that PADCC was unable to pay $479,955 in compensation accrued to its Executive Director and Administrator, OCCS and OSD may want to deem this entire amount as being unreasonable in accordance with state regulations and OMB Circular guidelines and consider recouping the $479,955 PADCC has accrued in its deferred compensation liability account for these two individuals. Clearly, since PADCC was unable to pay these expenses, they represent unreasonable costs that should not have been charged by PADCC against its state contracts.

Auditee's Response

In response to this issue, a law firm representing PADCC stated, in part:

The compensation paid to [PADCC's Executive Director] as Executive Director and to [PADCC's Administrator] as Administrator was within the Commonwealth's limit for such compensation as stated in its annual compliance manual.

Pakachoag questions the Auditor's comparison of [the PADCC's Executive Director's and Administrator's] compensation with that of other unnamed facilities. The Auditor has not demonstrated that the facilities and executive directors to which comparison is made are comparable, and indeed [PADCC's Executive Director's] compensation is lower than that of at least one other executive director to which the Draft Report makes comparison. Pakachoag's own review of compensation at five nearby child care facilities reflects that the executive directors were paid in the same range as [PADCC's Executive Director]. Pakachoag also contends that it is inappropriate to place [PADCC's Executive Director and her husband] at the average of the salaries to which comparison is made. [PADCC's Executive Director and her husband] have decades of experience in the positions they hold. Their responsibilities are far broader than those of the typical executive director and administrator. Further, the activities of Pakachoag requiring their management are extensive. Most important, they are the founders and builders of Pakachoag, having invested their vision, personal time, personal funds, and personal credit.

The Draft Report additionally treats as excessive and unreasonable the entirety of the $479,955 in deferred salary and vacation earned by [PADCC's Executive Director and her husband] over a number of years through June 30, 2003. The Auditor's contention is that Pakachoag was financial [sic] unable to pay the compensation amounts that were deferred and that compensation [sic] Pakachoag's ability to pay is inherently unreasonable. Pakachoag suggests that the Auditor fails to acknowledge that [PADCC's Executive Director and her husband] on multiple occasions volunteered to defer portions of their salary for the purpose of assisting Pakachoag to expand its programs and to support the acquisition and construction of the Grafton property. At a time when the Commonwealth lacked sufficient childcare slots and had large waiting lists for its childcare programs (see State Auditor Report No. 2001-5083-3), Pakachoag was investing in the expansion of childcare capacity. Under these circumstances the deferral

of salary does not demonstrate either Pakachoag's inability to pay in the absence of expansion nor that the salaries deferred were excessive.

The Draft Report further notes that in certain years [PADCC's Executive Director and her husband] were paid both by Pakachoag and by Kincare. The Draft Report further notes inconsistent statements regarding the amount of work performed by [PADCC's Executive Director and her husband] for each entity, and it suggests that [PADCC's Executive Director's] work for Pakachoag was less than the obligations of her position as Pakachoag's Executive Director. Pakachoag regrets the inconsistencies. [PADCC's Executive Director] devoted enormous amounts of time to her child care activities during the years in questions. She fulfilled the 1.0 FTE level of effort required by her position as Pakachoag's executive director. In addition, she performed work for Kincare. Thus [PADCC's Executive Director] devoted 1.0 FTE to Pakachoag's needs, but not 100% of her time. [PADCC's Executive Director's] work for Pakachoag consumed the great majority of her time. She worked predominantly at the Grafton facility because that is where Pakachoag's administrative offices were located. Pakachoag's January 20, 2004 response to OCCS regarding this issue details the roughly 85% breakdown in 2000 to 2002, as between Pakachoag and Kincare, of [PADCC's Executive Director's] work, and it describes the nature of her work for Pakachoag that required such a disparity of effort.

[PADCC's Executive Director] now is employed only by Pakachoag; she is not employed by Kincare, which has its own director. [PADCC's Administrator] is employed 20 hours per week each by Pakachoag and Kincare.

Auditor's Reply

As stated in our report, we found that PADCC's Executive Director, who also served as the President of PADCC's Board of Directors, and various PADCC employees and their immediate family members have effectively controlled PADCC's operations, including the establishment of compensation for the agency's Executive Director and her husband. It is important to note that the OAG Guide charges the full board with responsibility for setting the Executive Director's entire compensation package based on an annual evaluation. However, the only evaluation of the Executive Director during the entire audit period, other than one that was being initiated at the conclusion of our on-site fieldwork, appeared to be a self-appraisal completed in June 1999, which appeared in her personnel file with no documentation that it had actually been reviewed and approved by PADCC's board.

Given the lack of controls over the establishment of executive salaries, we deemed it necessary to assess the reasonableness of the level of compensation being provided to PADCC's Executive Director and her husband. In order to do this, as stated in our report, we reviewed the OSD UFR database for salaries paid to Executive Directors and Administrators at comparably sized child care agencies during fiscal year 2002. We obtained information from the database for 19 comparably sized agencies (including PADCC) whose total agency expenditures ranged from

$1.3 million to $2 million. PADCC's total expenditures for fiscal year 2002 was $1.68 million. From that list of agencies, we found that 13 had a full-time Executive Director, whose salary ranged from a low of $49,354 to a high of $95,019, with an average of $69,365.

We conducted a similar comparison of salaries for PADCC's Administrator position. From the original list of 19 agencies we used for the Executive Director's salary comparison, we found that only six agencies had an Administrator or Chief Financial Officer. The salaries for these individuals ranged from a low of $35,605 to a high of $75,833 (PADCC), with an average salary $50,160.

In addition, we found that only six of the 19 agencies in our sample had both a full-time Executive Director and an Administrator during fiscal year 2002. Our analysis showed that the combined salaries of the two positions ranged from $84,959 to $162,500, with an average combined salary totaling $124,613. PADCC paid its Executive Director and administrator the highest combined salary, $162,500, of the six agencies we reviewed.

Based on our analysis, we determined that the compensation provided to these two individuals during fiscal years 1998 through 2003 was unreasonable by at least $284,216.

Regarding the $479,955 in unallowable deferred compensation we cite in our report, PADCC states that our report fails to acknowledge that on multiple occasions PADCC's Executive Director and her husband volunteered to defer portions of their salary "for the purpose(s) of assisting Pakachoag to expand its programs and to support the acquisition and construction of the Grafton property." However, as stated in our report, we believe that the $479,955 deferred compensation liability being maintained by PADCC on behalf of the agency's Executive Director and her husband is unallowable since it is the result of excessive compensation levels provided to these individuals. Moreover, it represents an imprudent expenditure in that PADCC did not have the ability to pay these individuals and should not have been deferred since it did not meet the IRS requirements for an eligible deferred compensation plan. PADCC did not give us any documentation to demonstrate that it used any of the funds it billed to the Commonwealth for compensation to these two individuals to expand it programs or to support the acquisition and construction of the Grafton facility. However, if PADCC actually needed

funds for that purpose, we question why it would not seek more conventional financing options such as bank loans, which it had done in the past to fund necessary activities.

In its response, PADCC claims that PADCC's Executive Director "devoted 1.0 FTE to Pakachoag's needs." However, as stated in our report, during our audit we attempted to determine the amount of time these individuals spent working at both agencies. Our review of a sample of times sheets (covering July 2002 to December 2002) that were maintained by these individuals revealed that they did not clearly indicate the amount of time the individuals worked at Kincare versus PADCC. However, during our audit, these individuals stated that they spent the majority of their time working at PADCC.

Each contracted human service provider, including PADCC, is required under the terms and conditions of its state contract to maintain accurate and complete payroll records. In this regard, these General Contract Conditions state, in part:

> *The provider will maintain personnel records for each employee. These records shall include but not be limited to . . . payroll records, and . . . attendance records or effort reports, documentation program and assignment and hours and days worked.*

Further, 808 CMR 1.04(1) promulgated by OSD states:

> *The Contractor and its Subcontractors shall keep on file all data necessary to satisfy applicable reporting requirements of the Commonwealth (including DPS [now OSD], the Division of Health Care Finance and Policy and Departments), and financial books, supporting documents, statistical records, and all other records which reflect revenues associated with the 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). . . .*

Since PADCC did not maintain its payroll records with the level of detail required under its state contract for its Executive Director and Administrator, we could have legitimately questioned the entire compensation provided to these individuals during the period of our audit. However, we determined that a more reasonable approach would be to point out the recordkeeping deficiency and defer to OCCS the amount that should be recovered.

3. NONCOMPLIANCE WITH BOARD GOVERNANCE STANDARDS APPLICABLE TO NONPROFIT HUMAN SERVICE CONTRACTORS

PADCC has not complied with various board governance guidelines issued by the state's Office of the Attorney General (OAG) and with related requirements of the terms and conditions of its state contracts. Since its inception, PADCC has operated under the control of its Executive Director, employees and family members without the necessary and required independent Board oversight.

The state's Executive Office for Administration and Finance (EOAF), OSC, and OSD have jointly issued Commonwealth Terms and Conditions for Human and Social Services (General Contract Conditions), with which all human service contractors such as PADCC must comply. Regarding an organization's Board of Directors, these General Contract Conditions state the following:

> *11. Human and Social Services Contracting Provisions; a. Board of Directors Standards. If a non-profit organization, the Contractor shall comply with the principles in the Massachusetts Attorney General's "Guide for Board Members of Charitable Organizations" [Guide] and with the standards for boards contained in the American Institute of Certified Public Accountants (AICPA)'s statements on auditing standards, as may be amended from time to time. Further, the Contractor specifically agrees that: i) members of the Contractor's management and immediate family (as defined in the AICPA's Financial Accounting Standards Board Statement number 57) will not comprise more than 30% of the voting members of the Contractor's board or any of the board's committees or subcommittees; and, ii) the Contractor's Board of Directors will approve the selection of the Contractor's audit firm, will annually review its executive director's or other more senior manager's performance and set that person's compensation by formal vote, and will meet as frequently as necessary to fulfill the Contractor's obligations under this section. Where the board meets less than two times during its fiscal year, the Contractor shall submit a description of its board structure and the dates of each board and subcommittee meeting with its Uniform Financial Statements and Independent Auditor's Report (UFR).*

The OAG's Guide for Board Members of Charitable Organizations (OAG Guide) identifies the following financial responsibilities of charitable organizations' board members:

> *As a board member you 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. The board shall be involved in all aspects of the finances of the charity....*
>
> *The budget should be developed early enough so that the entire board can be involved in its review and approval before the beginning of the fiscal year.*
>
> *The board should be sure that the charity has adequate internal accounting systems.*

Board members should expect management to produce timely and accurate income and expense statements, balance sheets and budget status reports and should expect to receive these in advance of board meetings.

The board should require periodic confirmation from management that all required fillings (such as tax returns and the Massachusetts Form PC) are up-to-date and that employee withholding taxes and insurance premiums are being paid when due.

During our audit, we reviewed all of the provided minutes of the meetings of PADCC's Board of Directors that were available since PADCC's inception in 1977 through October 30, 2003. We also reviewed various documents filed by PADCC with the Secretary of State's Corporations Division, conducted interviews with PADCC staff and board members, and reviewed various documents filed by PADCC with its principal state purchasing agency, OCCS. Based on our review, we found numerous instances in which PADCC's Board composition and activities were not in compliance with the OAG Guide or the state's General Contract Conditions, as follows:

- In addition to the board requirements cited above in the General Contract Conditions, the OAG Guide calls for a diverse, independent board composition with representation including all the skills, experience, and background needed to adequately serve the charity's needs. However, we found that since its incorporation in 1977, PADCC's Executive Director, who also served as President of PADCC's Board, and various PADCC management employees and their immediate family members have effectively controlled PADCC's governance process with minimum participation by unrelated independent individuals. We also noted that two additional board members, the co-founder of the organization and his spouse, were characterized as being independent in board minutes but were in fact not independent because the co-founder received compensation from Kincare, the organization owned by PADCC's Executive Director and her husband. In addition, the co-founder and his wife were allowed to purchase group dental insurance through the PADCC even though they were not employees. These arrangements created a potential conflict-of-interest situation between PADCC and the co-founder and his wife that, in our opinion, impaired their ability to provide the independent oversight called for by the OAG Guide. A summary of the PADCC board composition and attendance information during our audit period appears in the following table:

Calendar Year	Composition per Board Minutes and Resolutions	Managers and Relatives % of Attending Directors	% Other Attending Directors with Impairment	% Actively Attending Independent Directors
1996	Ex. Dir., Administrator, Co-founder, Co-founder's wife, one member pro-tem, possibly two others never attending	40%	0%	60%
1997	Ex. Dir., Administrator, their son, Co-founder, four others. (Annual report filed with SOS omitted son and added spouse of Co-founder, creating appearance of only 25% role for Managers and their relatives.)	37%	0%	63%
1998	Ex. Dir, Administrator, their son, Co-founder (No Annual Report filed.)	75%	0%	25%
1999	Ex. Dir., Administrator, their son, Co-founder and spouse, three managers, a family member of one program director, and two others (only one other per annual report)	60%	0%	40%
2000	Ex. Dir., Administrator, their son, two additional managers and one of their relatives, Co-founder and spouse, one other.	67%	22%	11%
2001	One documented meeting where Administrator and one manager conducted all business and elected non-attending Ex. Dir., Co-founder, and two others	100%	0%	0%
2002	One meeting only on 12/30/02. Ex. Dir., Administrator, Controller, Co-founder and spouse, one other. Elected 2003 board.	50%	33%	17%
2003	Ex. Dir., Co-founder and spouse, one other. (Administrator, son and controller present but not voting.)	25%	50%	25% (Treasurer – resigned 3/7/03) One other independent member not attending.

- The OAG Guide requires that board members attend board and committee meetings. However, as detailed in the table above, we found that PADCC's board meetings were irregular (sometimes held only once per year) and were poorly attended by independent members. Typically, fewer than two documented meetings per year were held, with only four or five members in attendance out of the nine board members.

- The OAG Guide charges the full board with responsibility for setting the Executive Director's entire compensation package based on an annual evaluation. However, the only evaluation of the Executive Director during the entire audit period, other than one being initiated at the conclusion of our on-site fieldwork, appeared to be a self-appraisal completed in June 1999, appearing in her personnel file with no documentation that it had actually been reviewed and approved by PADCC's board.

- Regarding conflict-of-interest situations, the OAG Guide:

  a. Calls for strong formal conflict-of-interest policies, including annual written disclosures by all members to the entire board of all business involvements with the charity and involvement with other charitable and for-profit entities and the establishment of procedures for disclosure of financial interest and withdrawal from discussion and voting in conflict-of-interest situations.

  b. Recommends the use of outside evaluations and greater than majority votes in conflict-of-interest situations.

  c. States that transactions should not occur unless the board determines them to be clearly in the best interest of the charity.

  However, we found that PADCC's bylaws contravene the Attorney General's standards by allowing members to vote on matters in their self-interest even if the results are adverse to the interests of the charity. Specifically, Article VI.2 of the organization's bylaws expressly permits contracts and transactions where interested directors vote to authorize the transaction "provided the nature of such interest (though not necessarily the extent or details thereof) shall be disclosed or shall have been known to at least a majority of the directors then in office; and no Member, director or officer having such interest (even if adverse) shall be liable to this corporation. . . ." We also found that conflict-of-interest disclosures were sometimes absent or incomplete (e.g., no disclosure of the circumstances impairing the independence of the above-mentioned co-founder and his spouse appears in the board records) or were made on an irregular basis, often after the fact. Moreover, we found that the organization failed to implement appropriate conflict-of-interest policies and controls and that conflict-of-interest abuses were pervasive, as described throughout this report.

- The OAG Guide assigns the board primary responsibility for ensuring fiscal accountability and sound operation, calling on the board to review and approve the budget before the start of each fiscal year. The OAG Guide also states the expectation that board members receive timely and accurate income and expense, balance sheet, and budget status reports in advance of meetings. However, we found no documentation to substantiate that PADCC's board ever formally reviewed or approved any of PADCC's budgets or reviewed any of PADCC's financial reports during the period covered by our audit.

- The OAG Guide holds board members responsible for the proper conduct and integrity of fundraising activities. However, during our audit, PADCC officials could not provide us with any documentation that indicated that PADCC's Board was aware of or had approved PADCC's fundraising activities.

- The OAG Guide instructs boards to require periodic confirmation from management that tax returns, Public Charity filings, withholding tax, insurance premiums, etc. have been filed and paid when due. However, during our audit, PADCC officials could not provide us any documentation that PADCC's board ever required such confirmations from PADCC's management. In fact, during our audit we identified numerous instances

in which reports that were supposed to be filed by PADCC were missing, late, or inaccurate (see Audit Result No. 7).

- The OAG Guide also requires the board's review, acceptance, and certification of the Uniform Financial Statements and Independent Auditor's Reports (UFR) filed by an agency as well as the audit and the representations of management staff and expressions of opinion by auditors included in the UFR. In this regard, the UFR Audit and Preparation Manual published by OSD provides the following guidance to members of Board of Directors relative to these acknowledgements: "management may not participate in any of the above noted board of director's acknowledgments and oversight responsibilities." Despite this, our review of board documents indicated that management employees always participated in the board's UFR acknowledgment and oversight responsibilities and that, in some years, management employees were the only board members to participate in the process.

As the result of its noncompliance with these governance standards, PADCC received substantial public funding for which it may not have be eligible because of its noncompliance with the terms and conditions of its state contracts and because board oversight was inadequate to ensure that state funds were properly safeguarded against loss, theft, or misuse.

Recommendation

In order to address our concerns relative to this matter, we recommend that PADCC immediately take steps to fully comply with the OAG Guide and the terms and conditions of its state contracts relative to the composition and activities of its Board of Directors.

Auditee's Response

In response to this issue, a law firm representing PADCC provided the following comments:

Without agreeing with the Draft Report's characterization of the composition and performance of Pakachoag's past boards of directors, Pakachoag believes that the Draft Report should reflect that [PADCC'S Executive Director] resigned from Pakachoag's Board of Directors in May of 2004, that [PADCC's Administrator] has not been a board member for many years and that four additional, independent board members have been added in 2004. Pakachoag's Board is thus fully independent of its executive team. The current board is engaged in reviewing the performance and compensation of the executive team. The board has reviewed budgets and financial reports on a monthly basis. At such time as Pakachoag's UFR is ready for review (Pakachoag has requested an extension for its 2004 UFR), the board will review that report. In addition, the board has reviewed a draft of this Response prior to its submission.

Auditor's Reply

As stated in our report, PADCC did not comply with various board governance guidelines issued by the OAG and with related requirements of the terms and conditions of its state

contracts. Consequently, since its inception, PADCC has operated under the control of its Executive Director, employees and family members without the necessary and required independent Board oversight. Based on its response, PADCC has taken some measures to address our concerns relative to this matter but needs to implement our recommendations and take steps to fully comply with the OAG Guide and the terms and conditions of its state contracts relative to the composition and activities of its Board of Directors.

4. INADEQUATE INTERNAL CONTROLS OVER AGENCY OPERATIONS

We found that PADCC had not developed and implemented an adequate system of internal controls over many aspects of its operations. Specifically, we found that PADCC did not properly document its accounting system. Moreover, in those areas where PADCC has established some controls, we found that these controls were often ineffective given the nepotistic nature of PADCC's management structure. As a result, the Commonwealth cannot be assured that public funds were properly safeguarded against misuse and expended for their intended purposes or that all of PADCC's transactions were properly authorized, recorded, and reported.

According to GAAP, entities such as PADCC should establish and implement an adequate internal control system within the organization to ensure that goals and objectives are met; resources are used in compliance with laws, regulations, and policies; assets are safeguarded against waste, loss, and misuse; and financial data are maintained, reported, and fairly disclosed in reports.

In order to comply with GAAP, PADCC should have a documented comprehensive plan of internal control describing its goals and the means by which these goals and objectives are to be achieved. An effective internal control system would establish clear lines of authorization and approval for its various business functions, such as purchasing, contracting, asset management, travel, payroll, and personnel, as well as identify supervisory personnel and their responsibilities. In addition, an entity's internal control system should be backed up with a set of detailed subsidiary policies and procedures that would communicate responsibilities and expectations to subordinate staff throughout the organization. These policies and procedures would provide direction to employees on how to complete the various business functions, such as accounting, billing and receiving, cash receipts, accounts payable, human resources, and payroll. However,

we found that in addition to the internal control problems discussed in the other Audit Results detailed in this report, PADCC had not established adequate internal controls over many other aspects of its operation. The following is a summary of the additional internal control issues we identified during our audit.

- Failure to Adequately Document the Internal Control Environment and the Accounting System: Sound business practices advocate that entities such as PADCC establish a proper accounting system that is documented in formal policies and procedures and a written accounting manual, which describes the accounting system and the policies and procedures that are utilized in PADCC's accounting process. Such a manual not only maintains the integrity of the accounting process and its continuity in case of staff turnover, but also establishes accountability of various operation activities. However, during our review we noted that PADCC had not established formal written accounting procedures or an accounting manual. In fact, when asked to provide copies of all agency policies, procedures, management directives, manuals, organizational charts, and all other records that document the internal controls PADCC has established over its operations, PADCC officials provided us only with a copy of what PADCC officials represented as being a "draft version" of PADCC's accounting procedures.

- Failure to Maintain an Acceptable Cost Allocation Plan: As specified by 808 CMR 1.04(1) and in OSD's UFR Audit and Preparation Manual, a properly structured internal control system for a multi-function contracting entity must also include an appropriate written cost allocation plan as part of its documentation efforts for demonstrating that costs applying to more than one functional purpose are directly attributable or allocable to the functional purpose. However, PADCC and its commonly operated affiliates failed to maintain a written plan and failed to utilize even an informal cost allocation system adequate to ensure that costs were properly allocated to appropriate functional reporting centers. When asked for a copy of PADCC's cost allocation plan, the Executive Director stated that PADCC did not have one. Although PADCC's draft version of its accounting policies does address some allocation of costs, there is no explanation for the basis of these allocations. Indirect administrative cost allocations cannot be properly computed and allocated to state-purchased programs in the absence of adequately documented personnel and other direct costs by functional reporting center.

- Potential Weakness in Internal Controls due to Nepotism: We found that the overall control environment within PADCC was such that any control measures implemented were essentially ineffective due to the management structure of PADCC. The guidance given to contracted human service providers by OSD discourages nepotistic practices. Specifically, the UFR Auditors Compliance Supplement published by OSD states, in part: "Nepotism is not in keeping with the principles for good internal controls." Despite this guidance, we found that during our audit period, PADCC's Executive Director and her husband, PADCC's Administrator, were involved in multiple functions across corporate entities; three of the Executive Director's children were employed in management positions with either or both PADCC and Kincare, Inc.; and other children had past or current management positions, direct care, or indirect involvement (e.g., managing

retirement accounts, providing contracted maintenance services) within PADCC. These relationships are set forth in the following table:

Relationship to PADCC Executive Director	Position	Organization
Self	President and Executive Director	PADCC
Self	Owner and Executive Director	Kincare
Husband	Owner and Administrator	Kincare
Husband	Administrator and Past Board Officer	PADCC
Son A	Auburn Director, Past Board Chair, and Past Maintenance Contractor	PADCC
Son B	Past Business Manager	PADCC
Son B	Account Manager for Investment Firm	PADCC and Kincare
Son C	Childcare Program Director	Kincare
Son C	Past Childcare Worker	PADCC
Daughter	Family Daycare Director	PADCC
Daughter	Assistant Director/Contracts Manager	PADCC and Kincare

The UFR Auditors Compliance Supplement states, in part: "The contractor is also required to maintain adequate written policies and procedures for accounting and management and personnel activities in accordance with GAAP, including but not limited to conflict of interest and nepotism policies." PADCC's accounting policies do address conflict-of-interest issues; however, they do not contain a policy concerning nepotism. The Kincare employee handbook, Section 2.20, Nepotism and Romance between Co-workers, Employment of Relatives, states: "Kincare, Inc. hires qualified relatives of employees if the employment does not create an actual or perceived conflict of interest. If a supervisor is placed in a position of supervising a relative, the supervisor is responsible for using good judgment and impartiality in all decisions affecting the relative."

This policy appears inadequate and does not discourage situations where apparent conflicts could arise between family members. Moreover, this policy allows for the direct supervision of family members, which is not consistent with sound internal control practices, as direct supervision of family members can only create a perceived conflict of interest.

During our review of personnel files, we found situations in which family members were preparing performance appraisals for other family members. In one instance, we found PADCC's Executive Director preparing an evaluation of the Administrator, who is her husband. In another case, a family member working at Kincare had a performance appraisal prepared by two other Kincare employees who were family members.

- Personal Use of Corporate Credit Cards: A review of corporate credit usage during our audit indicated that PADCC engaged in the practices of using corporate credit cards to pay personal expenses. In addition to directly benefiting the Executive Director and her family, these arrangements greatly increased the complexity of administrative management tasks and heightened the risk that errors could escape detection. During its fiscal year 1998 audit, PADCC's private accounting firm criticized these arrangements in its draft management letter, which stated, "We strongly recommend that the practice of intermingling personal expenses and Agency expenses cease and desist immediately." However, despite the recommendation from their private auditors, we found evidence during our review that this practice has continued. For instance, during fiscal year 2002 our review of credit card expenditures identified $7,224 in employee personal expenses charged to PADCC's corporate credit cards. Although there was evidence indicating that the individuals in question reimbursed these expenses to PADCC, this practice is not in keeping with a good system of internal controls.

Recommendation

In order to address our concerns relative to this matter, we recommend that PADCC immediately develop and implement adequate internal controls over all aspects of its operations. Specifically, PADCC should finalize their written accounting manual and properly document their cost allocation plan. PADCC and Kincare should develop policies that discourage situations where apparent conflicts could arise between family members. Also, PADCC should follow the past recommendation of their private accounting firm and not use corporate credit cards to pay for personal expenses.

Auditee's Response

In response to this issue, a law firm representing PADCC provided the following comments:

Pakachoag's independent certified public accountants have reported to Pakachoag that they have tested Pakachoag's internal controls and have noted no matters involving the internal control over financial reporting and its operation that they consider to be material weaknesses. Pakachoag's auditors have assured it that Pakachoag does indeed have a written accounting and procedures manual. Finally, Pakachoag's auditors have assured it that a cost allocation plan does indeed exist.

A number of members of the [PADCC Executive Director's] family are employed by Pakachoag. The commitment of the [PADCC Executive Director's] family is a strength, not a weakness, for Pakachoag. Pakachoag's auditors have advised Pakachoag that they have performed tests to make sure that nepotism has not deterred employees from performing their intended tasks, and have observed no occasions of material override of management control.

The Draft Report criticized the use by Pakachoag personnel of Pakachoag credit cards to charge personal expenses, notwithstanding the full repayment of such expenses by the employees. It should be noted that the "Pakachoag" cards rely upon the credit of [name

of PADCC's Executive Director] personally and not Pakachoag. Nonetheless, the use of such cards for the charging of personal expenses has been discontinued as a practice.

Auditor's Reply

Despite what PADCC contends in its response, as stated in our report, we found that PADCC had not developed and implemented an adequate system of internal controls over many aspects of its operations. Specifically, in addition to the numerous internal control and governance deficiencies we discuss through the other sections of this report, we also found that PADCC did not properly document its accounting system. Moreover, in those areas where PADCC has established some controls, we found that these controls were often ineffective given the nepotistic nature of PADCC's management structure. Based on its response, PADCC is taking measures to improve its internal control environment. However, we again recommend that PADCC immediately develop and implement adequate internal controls over all aspects of its operations. Specifically, PADCC should finalize their written accounting manual and properly document their cost allocation plan. Also, PADCC and Kincare should develop policies that discourage potential conflict-of-interest between family members.

5. UNALLOWABLE VEHICLE EXPENSES TOTALING AT LEAST $85,842

We found that PADCC had not established adequate controls over the use of corporate vehicles. Specifically, PADCC was not maintaining records that documented the business versus personal use of these vehicles. In addition, although the vehicles being charged by PADCC against its state contracts were also being used by Kincare for its program-related activities, PADCC was not maintaining any records that documented the nature and extent of Kincare's use of these vehicles. The inadequate manner in which PADCC was maintaining its financial records prevented us from documenting all of the expenses PADCC charged against its state contracts relative to the use and operation of these vehicles during the period covered by our audit. However, according to the fixed asset depreciation schedule provided to us by PADCC officials, the agency charged a total of $85,842 in nonreimbursable depreciation expenses for these vehicles during the audit period.

OSD has promulgated regulations that define certain costs that are unallowable and nonreimbursable under state contracts. Specifically, 808 CMR 1.05(12) and 808 CMR 1.05(26), promulgated by OSD, defines the following as being nonreimbursable program costs:

> *<u>Section 1.05(12) Non-Program Expenses</u>: Expenses of the contractor which are not directly related to the social service program purposes of the contractor.*
>
> *<u>Section 1.05(26) 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 period, PADCC and Kincare used both leased and purchased vehicles to provide services to their clients. However, we found that PADCC failed to maintain adequate documentation (e.g., vehicle usage logs) and other documentation required to establish that vehicle costs were reasonable and necessary for the organization's purposes and that expenses associated with the use of these vehicles were properly allocated across corporations and functional reporting centers within each entity. PADCC also failed to properly identify nonreimbursable activities such as the providing commuting and personal vehicle use benefits to employees. The specific problems we identified in this area are detailed below:

a. <u>Failure to Document Business Versus Personal Use of Vehicles</u>: Management staff, primarily the Executive Director and other family members employed by the organizations, were authorized to use company vehicles for commuting and personal use. The Internal Revenue Service (IRS) requires that the commuting and personal use value of vehicles be disclosed and treated as taxable benefit compensation to the individuals benefiting from the use. As a result, in addition to maintaining usage records necessary to allocate reimbursable vehicle costs across functional activity centers, PADCC was required to maintain detailed mileage and use logs sufficient to meet IRS reporting requirements for taxable benefit reporting purposes as well as for the purpose of documenting the extent to which vehicle costs were either reimbursable or nonreimbursable. However, PADCC failed to maintain the required logs. PADCC then began using logs in August 2003 for selected vehicles. When we later reviewed this newly created system, including logs for vehicles used by the Executive Director, Administrator, and their daughter, we found evidence of extensive use of the vehicles for both commuting and non-commuting personal use. For example, for the month we reviewed, approximately 73% of the use of the vehicle assigned to the daughter was for non-business-related purposes.

   Moreover, our review of audit reports and audit management letters issued by the private auditing firms used by PADCC revealed that the issue of personal vehicle use, the need for adequate logs, and the inclusion of the value of vehicle-use benefits in IRS W-2 tax filings had been repeatedly identified by their auditors over an extended multi-year period. However, use benefit amounts had only been reported to IRS in a single year (2001), and the information reported for that year was erroneous. Use benefit amounts for the Executive Director were improperly reported as income to her husband, rather than to herself, and some use benefits for other employees were not reported at all. When asked why this issue had been dropped as a management letter item in 2002, representatives of PADCC's current accounting firm stated that it was because the firm had worked with its

client that year to implement appropriate controls, including vehicle mileage use logs. However, our review found that vehicle-use benefit amounts had not been reported on W-2 filings for 2002. Since logs prior to August 2003 were never produced for our examination and we were told by the Executive Director that none had ever been maintained, we determined that PADCC's failure to adequately document vehicle use precluded both an accurate determination of the nonreimbursable amounts associated with vehicle-use benefits and any remaining allowable amount associated with reasonable business use. (In late March 2004, PADCC's private accounting firm informed us that the vehicle use issue had been reinstated as a fiscal year 2003 management letter issue and that PADCC had included $2,450 in the Executive Director's calendar year 2003 W-2 filing to cover her personal vehicle use benefits. However, since no calculation basis for the reported amount was provided and adequate vehicle use logs were still not in place when our on-site field work was completed, we question the accuracy of the reported amount.)

b. Failure to Document the Use of Kincare's Vehicles by PADCC: During our fieldwork management staff acknowledged that various vehicles and equipment were used across corporate entities due to the commingled nature of business operations. For example, one of two trucks owned by Kincare was assigned to the Executive Director's son, who was not even an employee of Kincare but instead directed PADCC's facility in Auburn. A credit card in the name of PADCC was used by the son to purchase gasoline without adequate documentation of fuel costs for individual vehicles. Since he was responsible for two PADCC-owned passenger vans as well as for the Kincare vehicle that had been assigned to him, and he failed to document which vehicles were fueled and track the amounts for each vehicle, it was not possible to determine whether PADCC was being charged only for fuel costs associated with the vehicles it owned or whether vehicle expense costs for each PADCC van were properly allocated across the programs using each van.

c. Failure to Maintain Vehicle Usage Logs: Failure to maintain adequate vehicle-usage logs for cost documentation and allocation purposes also prevented the proper documentation and allocation of reimbursable and nonreimbursable vehicle expenses across required cost centers within business entities. For example, the Administrator made extensive use of a passenger minivan purchased by PADCC. This vehicle had been purchased with state approval for the express purpose of transporting children at the Auburn facility, using previously accumulated state Surplus Revenue Retention funds for the purchase. Although the minivan was occasionally utilized as a back-up child transportation vehicle when other vans were undergoing maintenance, the vehicle was primarily used by the Administrator for commuting and for nonreimbursable/non-charitable activities such as conducting Grafton facility operations.

In the absence of adequate resource utilization documentation covering these multiple-use arrangements, it was not possible to evaluate the extent to which vehicle use and associated expenses were reasonable and necessary for delivery of services purchased by the Commonwealth or to determine the correct reimbursable vehicle expense amounts properly

chargeable to each corporation and the functional activity centers within each corporation. When we attempted to gather vehicle expense information from PADCC's UFRs, we found that PADCC failed to properly classify and disclose its vehicle expenses. The failure of the organizations over the multi-year audit period to accurately classify and report vehicle expenses prevented us from determining the full amount of non-reimbursable expenses arising from vehicle lease and insurance, repair, maintenance and fuel expenditures. However, the fixed asset depreciation amounts reported in corporate records just for currently owned vehicles for PADCC establish that the nonreimbursable depreciation expenses alone for those vehicles totaled $85,842, as indicated in the following table.

Vehicle Owner	Vehicle	Accumulated Depreciation as of 6/30/03	Vehicle Assignment
PADCC	1998 Dodge Ram 3500 15-Passenger Van	$15,184	Van Driver
PADCC	2001 Chrysler Voyager	9,872	Administrator
PADCC	2000 Dodge Ram 3500 15-Passenger Van	16,097	Van Driver
PADCC	2000 Dodge Caravan	9,333	Van Driver
PADCC	2000 Dodge Ram Truck	16,014	Administrator
PADCC	2000 Dodge Neon	9,833	Executive Director
PADCC	2000 Dodge Neon	9,509	Social Worker/F.D.C. Coordinator
Total PADCC		$85,842	

Recommendation

PADCC should remit to the Commonwealth $85,842 for the undocumented program expenses related to vehicle usage. In the future, PADCC should establish controls, such as vehicle logs, to properly document all program-related expenses.

Auditee's Response

In response to this issue, a law firm representing PADCC provided the following comments:

> *The Draft Report alleges recordkeeping deficiencies relating to allocation of the use of Pakachoag vehicles between personal and business use as well as the allocation between Pakachoag and related entities. As with other sections of the Draft Report, the Auditor's recommendation, namely that all accumulated depreciation for all Pakachoag's currently owned vehicles be completely disallowed, fails to take into account the substantial and necessary use of those vehicles in Pakachoag's programs.*
>
> *Without disputing that recordkeeping deficiencies have existed, Pakachoag notes that it is clear that a provider of child care and education serving approximately 141 children at multiple locations needs a significant fleet to transport children and support its various programs. Pakachoag's vans are used extensively for the transportation of children. Pakachoag has logs showing the name of children dropped off and picked up. Pakachoag's truck is used for maintenance of facilities leased and owned by Pakachoag. This truck is equipped with a snow plow, and it is used to clear snow and ice from all of Pakachoag's facilities. It has saved the Commonwealth thousands of dollars in unutilized services which would have resulted from potential closure of Pakachoag's facilities had Pakachoag been required to rely upon outside snow removal contractors. Pakachoag's vehicles are also used to provide home visits and to oversee eight providers' home-based day care. Some of the children in Pakachoag's protective service programs live up to 25 miles from the respective centers, necessitating significant vehicle use. In addition, Pakachoag's management and administrative staff are obliged to travel both between Pakachoag's facilities and administrative offices and to meetings and training events. They routinely must use Pakachoag vehicles to accomplish Pakachoag's banking, shopping, and other administrative needs.*
>
> *The Draft Report's suggestion that the entirety of Pakachoag's vehicle depreciation be disallowed fails to take into account that several of the vehicles (the truck and several vans) have been used exclusively for Pakachoag activities and that personal use of other vehicles has been limited (notwithstanding poor documentation of that use). Since the fieldwork underlying the Draft Report was performed Pakachoag has traded in the truck and one Neon and has acquired an additional van for the transportation of children. Pakachoag has also tightened its recordkeeping with respect to the personal use of Pakachoag vehicles, such that mileage and usage logs are now maintained.*
>
> *In short, the Commonwealth has received enormous benefit to its programs through the vehicles Pakachoag has purchased. Disallowance of the entirety of the depreciation for those vehicles would unfairly penalize Pakachoag and would unfairly benefit the Commonwealth, which received substantially the value with respect to these vehicles to which it was entitled.*

Auditor's Reply

Although we do not doubt that some of PADCC's vehicle expenses may have been used for business-related activities, as stated in our report, we found that PADCC had not established

adequate controls over the use of corporate vehicles. Specifically, PADCC was not maintaining records that documented the business versus personal use of these vehicles. In addition, although the vehicles being charged by PADCC against its state contracts were also being used by Kincare for its program-related activities, PADCC was not maintaining any records that documented the nature and extent of Kincare's use of these vehicles. The inadequate manner in which PADCC was maintaining its financial records prevented us from documenting all of the expenses PADCC charged against its state contracts relative to the use and operation of these vehicles during the period covered by our audit. Since PADCC failed to comply with state regulations and the terms and conditions of their state contracts regarding the documentation of the use of these vehicles, we have reasonably concluded that PADCC charged at least $85,842 in nonreimbursable depreciation expenses against its state contracts for these vehicles during the audit period.

6. UNALLOWABLE DEPRECIATION EXPENSES TOTALING $37,956

We found that PADCC failed to depreciate assets in accordance with depreciation schedules established by OSD regulations. As a result, as of June 30, 2003, PADCC overcharged its state contracts at least $37,956 for depreciation expenses. PADCC failed to follow asset capitalization and depreciation practices mandated by OSD under 808 CMR 1.00 and set forth in the OSD UFR Audit and Preparation Manual depreciation instructions applicable to items to be reimbursed through state-purchased programs. Both organizations established useful service lives for some assets that were under the minimums set by OSD. As a result, the purchase costs associated with these assets were charged to state-purchased programs on an accelerated basis, allowing the organizations to recover full purchase costs for capital items before they were entitled to under OSD regulation. For example, PADCC capitalized $234,657 in improvements to the Grafton facility during fiscal year 2001 using a 10-year service life, rather than the 20-year minimum required by OSD. By the end of fiscal year 2003, this practice had generated $22,488 in excessive nonreimbursable accumulated depreciation expenses for those building improvements. Similar problems existed involving PADCC's use of foreshortened service lives for other improvements (e.g., a new roof for the Auburn facility), general equipment (e.g., a tractor, chainsaw, post-hole digger, and tractor-vacuum attachment), and kitchen equipment, resulting in an additional nonreimbursable excess accumulated depreciation amount of $15,468 by fiscal year 2003 year-end. These calculations were made only for assets still being maintained

by PADCC at the time of our audit and do not include any nonreimbursable amounts for fully depreciated items that had already been removed from corporate depreciation schedules prior to our review.

Description	Cost	Date Acquired	Depreciation Amount	Auditor-Calculated Depreciation	Variance
Basement Project	$234,657	June 29, 2001	$46,931	$24,443	$22,488
2002 Tractor	$18,630	June 28,2002	$6,727	$2,018	4,709
New Roof - Auburn	$17,200	February 9, 2001	$4,013	$2,078	1,935
Sander	$4,425	November 8, 2000	$3,810	$1,180	2,630
6-Foot Snow Plow	$3,299	November 8, 2000	$2,841	$880	1,961
Trac Vac Collection System	$1,535	October 13, 1997	$1,261	$883	378
Billy Goat Vacuum	$1,229	August 16, 2001	$1,127	$236	891
Dust Vacuum Extractor	$1,095	December 30, 1997	$860	$602	258
Oven	$990	October 12, 2001	$990	$346	644
Post Hole Digger	$950	June 20, 1998	$679	$482	197
Range	$910	October 12, 2001	$910	$319	591
Floor Machine	$909	October 15, 1997	$732	$523	209
Dishwasher	$840	October 12, 2001	$840	$294	546
Husky Brush Cutter	$770	October 1, 1997	$605	$443	162
Power Extractor Brush	$769	January 13, 1998	$604	$423	181
Chain Saw	$498	October 15, 1997	$409	$286	123
Auger	$257	June 28, 1998	$184	$131	53
Total					$37,956

Recommendation

OCCS should recover from PADCC the $37,956 in unallowable depreciation expenses that they charged against its state contracts during the period covered by our review. In the future, PADCC should only allocate the proper amount of depreciation in accordance with OSD regulations.

Auditee's Response

In response to this issue, a law firm representing PADCC provided the following comments:

Pakachoag acknowledges that three assets, the Basement Project and the two Additional Improvement items, were incorrectly depreciated. However, Pakachoag's auditors assure

it that the remaining items reflected in the Draft Report were correctly depreciated using the Schedule listed in the UFR Audit & Preparation Manual.

Auditor's Reply

The $37,956 in unallowable depreciation expenses we cited in our report were calculated using the asset depreciation information provided to us by PADCC officials during the conduct of our audit. These calculations were made only for assets still being maintained by PADCC at the time of our audit and do not include any nonreimbursable amounts for fully depreciated items that had already been removed from corporate depreciation schedules prior to our review. Consequently, we again recommend that PADCC remit the $37,956 in unallowable depreciation expenses it charged against its state contracts during our audit period.

7. INACCURATE, INCOMPLETE, AND MISSING AGENCY RECORDS

We found numerous instances in which PADCC and its related parties either failed to file reports required by state oversight agencies or filed reports that contained erroneous information. As a result, the Commonwealth has not been given the information it needs to properly monitor and evaluate the activities of PADCC. The specific problems we identified in this area during our audit are discussed in the following sections.

a. Inaccurate and Missing Annual Report Filings with the Secretary of the Commonwealth of Massachusetts

Massachusetts nonprofit organizations are required to file Annual Reports with the Commonwealth's Secretary of State in November of every year. These reports document the date of corporate annual meetings, the identity of corporate officers and directors and their terms of office. During our audit, we compared the information in the Annual Reports that PADCC filed with the Secretary of State to agency records and noted numerous discrepancies. For example, the Annual Report that PADCC filed with the Secretary of State on November 11, 1997, reported that PADCC's board was composed of only 25% management and family members. However, our review of board records indicated that the true board membership at this time consisted of three management and family members comprising 37% of board membership. In addition, according to records maintained by the Secretary of State, PADCC failed to file the required Annual Report due in November 1998. Board records indicate that the board at that time was composed of only four persons, three of whom were management and family members and the fourth of whom was one of the

previously referenced individuals impaired by conflict-of-interest issues. Moreover, Annual Reports filed by PADCC for subsequent years often described board compositions that conflicted with available board records and sometimes misstated annual meeting dates. For example, a comparison of PADCC's Annual Report dated June 30, 2000 and the minutes of a Board of Director's meeting of June 29, 2000 indicated a difference in the Board's composition. We also found that during our audit period, PADCC's related entities, Kincare and Kincare, LLC, failed to file the required Annual Reports with the Secretary of State for fiscal years 2000 through 2002.

b. Compensation Disclosure Violations on the OSD Uniform Financial Report

Each year, human service organizations such as PADCC are required to file a Uniform Financial Statements and Independent Auditor's Report (UFR) with OSD. Among other things, these reports require various disclosures relative to compensation provided to agency staff. We found, however, that on a number of occasions, PADCC failed to accurately disclose in these reports the compensation it provided to its Executive Director and other administrative staff members. Examples of these inaccurate disclosures follow.

Since fiscal year 2001, the UFRs that contracted human service providers file with OSD have required disclosure of compensation to agency officers, directors, and senior managers. The requirement covers compensation and benefit arrangements for the "filing organization and its parent organization, related parties, and affiliates." The UFR Audit and Preparation Manual Instructions for this disclosure promulgated by OSD state, in part: "Compensation consists of salaries, benefit packages, vehicles, consultant payments, loans, deferred compensation and other items identified as employee compensation in IRS Publication 525 Taxable and Nontaxable Income of the Internal Revenue Service." The instructions also provide clear guidance that the compensation must be disclosed for individuals on the board and in management, stating, "In most instances, management of a social service program will include program directors and program managers." Despite these instructions, disclosures were omitted for individuals other than the Executive Director and Administrator for all three years since the disclosure requirement was included in the UFR. Therefore, PADCC failed to disclose salary, bonus, personal vehicle use, and other benefits from PADCC and its related entities to family members of the Executive Director employed in management

positions, to the co-founder on the Board, and to certain non-related senior management staff such as the Controller and the Millbury facility Director. In addition, we found that the disclosures for the Executive Director and Administrator were incomplete. For example, although the combined paid and accrued PADCC salary amounts of $86,667 for the Executive Director and $75,833 for the Administrator (plus $48,533 rental income to the Administrator) was disclosed on the fiscal year 2002 UFR, no non-salary benefit compensation was disclosed and no information whatsoever was provided regarding the compensation these individuals received from Kincare, Inc. that year.

c. Conflicting and Missing Lease Documentation

We found that lease documentation for both the Grafton and Auburn facilities were questionable in that they contained retroactive execution dates and inserted provisions, conflicting information and lease versions, and discrepancies with board approval documentation. In addition, proper documentation for an additional facility rented by PADCC from the Town of Millbury was absent for multiple years due to a landlord/tenant dispute. Past and ongoing disputes regarding responsibilities of PADCC as the Millbury tenant also impaired our ability to determine which costs were reasonable and which were not.

- A lease between PADCC and the Executive Director and Administrator for the Auburn facility they owned appeared to have been executed for fiscal year 1997 as a one-year lease with multiple one-year renewal options. That lease appeared to have lapsed for fiscal year 1998 and fiscal year 1999 without timely execution of the fiscal year 1998 renewal option. However, the parties apparently attempted to retroactively generate lease documentation for those years by executing fiscal year 1998 and fiscal year 1999 renewal amendment documents in July 1999, two years after the lease contract had expired. The creation of documentation for the legally "dead" lease continued with retroactively executed amendments, including a fiscal year 2002 lease amendment signed by the Executive Director but never dated. Then, after lease issues were identified by OCCS contract monitors, an Auburn lease document appeared to have been executed on December 30, 2002 and placed in the board files. That document asserted that it was an amendment to an original five-year lease that had started on July 1, 1999. The purported amendment document included a retroactive schedule of rent amounts back to the claimed lease starting date, specifying a $45,000 annual rent amount rather than the $48,524 amount appearing in the previously executed amendments. However, the stated $45,000 amount had not appeared in any lease amendment document covering years after 1996. A review of lease amounts against expense amounts reported in audited financial statements revealed that the payment history information inserted into the December 2002 document was in error and that the organization had actually been

paying $48,533 per year since fiscal year 1999. The only year in which audited financial statements reported rent revenues as $45,000 was fiscal year 1998, a year in which the lease document had set the rent at the higher amount.

- Similar documentation issues were noted for the Grafton facility lease between PADCC and its for-profit entities. Those documents were generally executed by the Executive Director on behalf of both parties. The original lease started on October 1, 1996 and ended on June 30, 1997 with provisions for one-year renewals. It, too, appeared to have lapsed only to be resurrected through retroactively executed amendment documents signed in July 1999. At that time three retroactive amendments were executed that implemented significant modifications to the lease terms in conjunction with the renewals, including changes in rent amounts, definition of the premises covered, provisions for rental of additional space, and equipment lease/purchase provisions. A new lease was executed by the Executive Director on behalf of both parties for fiscal year 2000 in lieu of a renewal amendment of the prior lease. Among its provisions, the new lease abandoned the equipment lease/purchase arrangements and required monthly payments of $6,875 "based on 4,900 s.f."(the equivalent of $16.84 per square foot annually), with additional space available at $11 per square foot. The Executive Director extended these terms without modification at the start of fiscal years 2001, 2002, and 2003.

  The Executive Director, on behalf of both organizations and with the apparent approval of the PADCC board, executed a lease amendment on December 30, 2002. The amendment included major modifications to the lease terms, changing the monthly rent amount to $6,737.45 for 9,800 square feet (the equivalent of $8.25 per square foot annually) with a provision for rental of additional basement space at a rate to be negotiated with payment due only at year-end. Other terms included provisions requiring PADCC to pay for all repairs, maintenance, and improvements other than structural repairs to the building and providing for the sale price to be reduced in recognition of any improvements in the event of a sale of the building by PADCC to its for-profit entity. An informational schedule of past and future payment and utilization arrangements by fiscal year for the fiscal year 2000 through fiscal year 2004 life of the lease was also inserted into the document. We calculated that, from the start of the initial lease in fiscal year 1997 through fiscal year 2003, PADCC was paid at least $86,098 less than it should have been paid under the lease terms.

- PADCC's rental of the Dorothy Manor School from the Town of Millbury for most of the audit period has been characterized by landlord/tenant disputes regarding a variety of issues, including maintenance responsibilities, unauthorized building modifications, and failure to properly document expenditures and competitive bids for work done on the building and charged to the town by PADCC. During fiscal year 1997 the Millbury School Committee terminated existing lease arrangements as a result of the ongoing dispute and asked PADCC to vacate the premises. However, PADCC declined to vacate and continued to occupy the building as a tenant at will without a lease. A five-year lease was finally executed during fiscal year 2000 after the town refused to continue this inappropriate occupancy arrangement, and put out a bid for rental of the building, as required by chapter 30B of the General Laws. PADCC responded to the bid solicitation and secured the award and resulting lease. However, we noted that lease

disputes have continued with demands from the town that PADCC fulfill lease obligations, make required repairs, and refrain from unauthorized modification of the premises without first securing required approvals. PADCC has made counter-assertions and objected to lease provisions even though the provisions were clearly specified in the town's bid solicitation and were agreed to by the organization when the lease was executed. The absence of appropriate lease documentation for fiscal year 1998 and fiscal year 1999 is both a poor business practice and an administrative compliance issue, since it makes it impossible to determine exactly which costs were reasonable and the responsibility of PADCC and which were not. Moreover, the ongoing dispute regarding responsibilities under the new lease creates continued uncertainty regarding these reimbursable cost determination factors.

d. Disclosure Violation on Insurance Application for Officers and Directors

Our review of PADCC insurance documents revealed that the Executive Director filed an insurance application for officers and directors dated July 23, 2003, which certified that the organization did not conduct business with any insured parties. Insured parties under the plan include the Executive Director and the Administrator, as well as other principals of the organization. This certification was incorrect, given the presence of the extensive business transactions with the Executive Director and her family members and controlled business enterprises noted in this report. Insurance coverage for PADCC's officers and directors could be in jeopardy if the insurance carrier were to deny claims filed by the organization due to the disclosure violation.

e. Documentation Deficiencies in Child Attendance Records

During our review of client attendance records for individual programs, we found that electronic documentation maintained through a computerized sign-in/sign-out system was inaccurate. In addition to problems involving failure by parents to consistently sign children in and out of programs, management employees acknowledged that the tracking software contained a defect that caused it to retroactively report past services under the wrong program when a child moved to a new program. This problem was compounded by the failure of staff at the Grafton facility to record dates on backup manual attendance sheets that, although maintained to satisfy licensing requirements for tracking the presence of all children throughout the day, were neither designed nor used to verify or adjust the computer-based system information. Multiple months and years were stored in a single file cabinet drawer and most sheets were undated, making it impossible to retroactively verify attendance

records. As a result, neither system was adequate to properly document the delivery of program services as required by the Commonwealth.

Taken together, these deficiencies substantially impaired our efforts to verify that compliance requirements had been met and that costs and services were properly documented for both child care providers.

Recommendation

PADCC and their affiliates should file all required reports with the Secretary of the Commonwealth in a timely and accurate manner. PADCC should properly disclose all compensation to its staff as required by OSD on their UFR. All leases should be properly executed with clearly defined lease provisions to ensure that the Commonwealth is only paying for appropriate and reasonable costs. PADCC should ensure that all insurance disclosures are proper. Finally, PADCC should develop a system to properly document the delivery of program services.

Auditee's Response

In response to this issue, a law firm representing PADCC provided the following comments:

The Draft Report notes certain deficiencies, inaccuracies, and omissions in Pakachoag's filings and submissions to third parties. Pakachoag is taking steps to ensure that timely and accurate Annual Reports are filed and that its UFR's accurately disclose compensation as required. Pakachoag's auditors have noted that they have not interpreted the term "principals" in the UFR to include program directors/managers, who do not ordinarily have the authority to establish policies. They have accordingly not submitted compensation information for director/managers on behalf of any of their nonprofit clients, and have not heretofore been notified of any deficiency by OSD. Compensation information will be disclosed in future UFR's.

The July 23, 2003 insurance application was prepared by Pakachoag's former controller. The Executive Director relied upon the controller in executing the applications.

We understand that the comments in the Draft Report with regard to attendance records relate to Kincare and not Pakachoag.

Auditor's Reply

As stated in our report, we found numerous instances in which PADCC and its related parties either failed to file reports required by state oversight agencies or filed reports that contained erroneous information. As a result, the Commonwealth has not been given the information it

needs to properly monitor and evaluate the activities of PADCC. It is management's responsibility to ensure that all necessary reports are filed accurately and in a timely manner.

8. FAILURE TO ADHERE TO GENERALLY ACCEPTED ACCOUNTING PRINCIPLES, MATERIAL MISSTATEMENTS IN AUDITED FINANCIAL STATEMENTS, AND OTHER SIGNIFICANT UFR FILING DEFICIENCIES

We found numerous instances in which PADCC failed to maintain its records in accordance with generally accepted accounting principles as required by state regulations. For example, PADCC did not establish an accounting system that clearly segregated expenses incurred by PADCC, a nonprofit organization, from those incurred by PADCC's for-profit related organization, Kincare, Inc. Consequently, the Commonwealth cannot be assured that all of the expenses PADCC billed and received reimbursements for under its state contracts were in fact related to PADCC's state-funded programs and not Kincare Inc.'s operations.

According to 808 CMR 1.04(1), promulgated by OSD, contracted human service providers such as PADCC are required to maintain their books and records in accordance with generally accepted accounting principles as set forth by the American Institute of Certified Public Accountants (AICPA). Human service contractors are also required to submit UFRs to OSD annually that are prepared in accordance with AICPA standards and audited in accordance with government auditing standards. In order to promote accurate and uniform reporting practices, OSD has issued detailed instructions and technical assistance documents in the form of a UFR Audit and Preparation Manual for use by report preparers. Despite these requirements, we noted numerous deficiencies in the UFRs filed by PADCC and Kincare, Inc. with OSD during our audit period, as follows:

- Consistent with AICPA standards, 808 CMR 1.02 defines Administrative and Support Costs (Management and General) as "expenditures for the overall direction of the organization." However, PADCC improperly classified the expenditures associated with the non-charitable "Unrelated Business Income Tax" Grafton facility operations as Administration (Management and General) costs in its audited financial statements and supplemental schedules even though these expenditures were not associated with the overall direction of the organization. The amounts associated with the non-charitable activity totaled at least $597,604.

- During our audit period, PADCC failed to properly define and consistently use correct functional activity reporting centers. OSD's UFR Audit and Preparation Manual states, in part: "Expenditures for program services should be segregated from non-charitable, fund-raising and management and general expenditures and the amount of each should be

clearly disclosed in the financial statements." The manual goes on to provide detailed guidance regarding the proper definition of individual program and other functional activity centers. In addition to the above-noted misclassification of non-charitable activity expenses, PADCC also reported its direct service programs in an erroneous and inconsistent manner. Specifically, in some years separate programs within a facility (e.g., all infant/toddler, preschool, school age and supportive service activities) were improperly grouped together, whereas in other years, some programs were grouped together across facilities while some programs (e.g., school age and/or toddler or supportive services) remained consolidated instead of being maintained and reported on a program specific basis as required by 808 CMR 1.04(1) and UFR instructions. In fact, there was no year in which revenues, costs, staffing arrangements and service statistics had been accounted for and reported on the UFR using properly defined functional activity centers.

- Revenue line items were misclassified on the UFR and often misreported in amount. PADCC collected parent sliding fee payments for publicly sponsored children in each year of the audit period. These fees are required to be separately reported for use as offsets to reduce the amounts charged to OCCS and other public purchasing agencies paying the balance of program fees for the eligible children. However, PADCC reported these fees as a discrete revenue item in only a single year, 1996. In all other years, the publicly sponsored client fee payments were misreported on the UFR, improperly characterized as private payer fees or as "Other Revenue" available to offset nonreimbursable costs. In addition, we noted that other governmental revenue streams such as DOE Community Partnership for Children, DOE Nutrition, an OCCS contract, and OCCS voucher payments were frequently misreported or improperly split or consolidated. UFR revenue discrepancies involving OCCS contract revenue amounts were as follows:

OCCS Contract Revenue

Fiscal Year	Reported on UFR	Actual per State	Variance
1999	$65,536	$453,197	$(387,661)
2000	$382,787	$599,378	$(216,591)
2001	$488,691	$654,592	$(165,901)
2002	$558,549	$699,231	$(140,682)
2003	$719,642	$639,993	$ 79,649

- Similar reporting problems were noted for expense items. For example, in some years the Executive Director and others reported no administrative vehicle expenses whatsoever, despite significant administrative vehicle use. In fiscal year 2003, no vehicle depreciation or other vehicle expense was reported for any of PADCC's seven vehicles other than a small amount of non-reimbursable depreciation on a single minivan. Vehicle depreciation had been misreported and consolidated with office equipment depreciation. All other vehicle expenses had been misreported on line 25E, which is reserved solely for the

reporting of fees charged by external entities such as school bus companies for the contracted transportation of program clients. By failing to utilize the proper vehicle expense reporting lines, PADCC created the appearance that there was no need to file the separate supplemental detail schedules mandated by OSD for passenger vehicles PADCC owned or leased. Those supplemental schedules were not filed. We informed PADCC's contracted CPA firm on December 16, 2003 of many of these inconsistencies. However, no action to correct the UFR filing was initiated until late March 2004, when the CPA firm acknowledged the expense item misclassifications to us and we advised him that correction of the errors could not be recognized for the purpose of our audit until applicable OSD refilling requirements had been met.

We also noted that nonreimbursable expense items were repeatedly reported as being reimbursable. In fiscal year 2003 and prior to fiscal year 2000, nonreimbursable expense disclosures (e.g., for Auburn rental amounts, personal vehicle use and other non-reimbursable benefits to principals) were incomplete or were inconsistently reported, with disclosures in some years but not others, even when nonreimbursable items such as related party Auburn rent payments were of a regularly recurring nature. For fiscal year 2000 through 2002, PADCC failed to report any nonreimbursable expenses whatsoever, even though various recurring items such as the related-party Auburn facility rental expenses had been recognized as nonreimbursable in prior years such as fiscal year 1996.

- Employee full-time equivalencies (FTE) and program service statistics were misreported or left blank. For example, in fiscal year 2001 PADCC reported only 3.5 FTEs, leaving FTE fields on the UFR blank for most positions for which personnel costs had been incurred. Also in fiscal year 2002, fields for service statistics in PADCC's UFR were improperly left blank for two of the three program reporting centers.

- The cost basis valuation of PADCC's Grafton facility appeared to be significantly overstated in its financial statements, which resulted in a distortion of both the financial position of the entity, and, for fiscal year 1996, the calculation regarding whether sufficient eligible revenues existed to offset the agency's disclosed nonreimbursable costs for the year. The property was originally purchased from a local developer who had been planning to build a 30-unit residential complex for the site. Although the developer had had the site appraised at $525,000, the appraisal was expressly based on the assumption that the property would be used for a commercial housing venture for which the developer had already secured required permit approvals. PADCC instead purchased the property at a discount for the express purpose of building a child care facility, paying only $250,000 in cash and recognizing a paper-only charitable contribution of $275,000 from the developer. When the property was reappraised immediately thereafter by PADCC's bank for mortgage and construction loan purposes, the appraised value was stated at only $220,000, based on the actual use to be made of the property. Despite this appraisal, PADCC entered the property in its financial records as an asset with a value of $527,880 and recognized the charitable contribution from the developer. The property should have instead been valued at $220,000, the lesser of Fair Market Value or actual cost. The "contribution" was then reported by PADCC on its UFR schedules as eligible revenue available to offset nonreimbursable expense items disclosed for that year. However, since the claimed contribution was a paper-only transaction, these funds were in effect not available to offset any nonreimbursable costs identified by PADCC.

- While Kincare was exempt from UFR filing requirements prior to fiscal year 2002 due to the type and amount of state funding it received, its fiscal year 2002 filing contained the same types of deficiencies as those identified for PADCC. For example, even though Kincare operated three separate OCCS-licensed child care programs and engaged in other non-child-care business activities, it utilized only two functional activity reporting centers, one for indirect administration (management and general) and one for all other activity (consolidating all information for contracted, subcontracted and licensed child care programs and all non-child-care business activities, reporting all costs as reimbursable by the Commonwealth).

- Both PADCC's and Kincare's UFR filings were often delinquent (e.g., for 2002 PADCC filed over three months late and Kincare filed over seven months late). For fiscal year 2003, PADCC filed two weeks late and, as of the August 2004 preparation date of our report, PADCC had filed Kincare's UFR despite denial by OSD of their request for an extension of the November 2003 due date and repeated requests from our office for a copy of the filing. Although it was initially explained to us that the filing delay was associated with the need of managers and PADCC's contracted CPA firm to devote their energies to responding to OCCS contract monitoring findings and repayment demands regarding the commonly managed PADCC entity, Kincare's filing noncompliance continued far beyond the mid-January 2004 response date to the OCCS findings. At the end of March 2004, the contracted CPA firm informed us that, although the Kincare UFR had been prepared, it had not yet been approved by Kincare's Executive Director for filing with OSD.

- PADCC has appropriately characterized operation of the Grafton facility as a non-charitable "Unrelated Business Income Tax" activity on IRS 990 filings and has reported the gross rental income derived from this activity as non-charitable revenue. However, PADCC improperly classified the revenue and expense items as part of the indirect administrative management and general function in its accounting system and on its UFR filings, even though they are not properly part of the overall direction of the organization as required by generally accepted accounting principles. As a result of this improper treatment, the non-charitable/non-program-related expenses have been commingled with general administrative costs and have been indirectly allocated to the programs paid for by the Commonwealth, whereas the rental income has been characterized by PADCC as administrative revenue available in full to pay for unrelated costs (e.g., Auburn rental payments), which PADCC now acknowledges in its response to the OCCS review to be nonreimbursable by the Commonwealth.

Recommendation

PADCC and Kincare should properly maintain their records in accordance with GAAP and other applicable state and federal requirements.

Auditee's Response

In response to this issue, a law firm representing PADCC stated, in part:

The Draft Report takes issue with Pakachoag's reporting of various items of revenue and expense. Pakachoag acknowledges that as to some items, reporting could have been handled differently, and Pakachoag's auditors are prepared to address that matter with OSD. However: 1) In some instances, e.g., definition of a "program" for reporting purposes, Pakachoag faced conflicting, confusing or incomplete instructions from OSD; 2) all costs were reported, and in each instance, Pakachoag's auditors had good reason to believe that they classified revenues and expenses properly; 3) Pakachoag's rental income from its Grafton facility exceeded expenses reported for that facility, so there is no basis for a claim that net costs unrelated to program purposes were charged to the Commonwealth; and 4) as to fees received by Pakachoag for services to private clients, Pakachoag is entitled to an offset against non-reimbursable costs.

Auditor's Reply

As stated in our report, we found numerous instances in which PADCC failed to maintain its records in accordance with generally accepted accounting principles as required by state regulations. For example, PADCC did not establish an accounting system that clearly segregated expenses incurred by PADCC, a nonprofit organization, from those incurred by PADCC's for-profit related organization, Kincare, Inc. Consequently, the Commonwealth cannot be assured that all of the expenses PADCC billed and received reimbursements for under its state contracts were in fact related to PADCC's state-funded programs and not Kincare Inc.'s operations.

Any information that PADCC may have received from OSD would have been the same information that OSD gives to all of the state's contracted human service providers, which for the most part are able to file their financial statements accurately and in a timely manner. If PADCC did receive information from OSD that it deemed confusing, it was management's responsibility to seek clarification of these matters so that its financial statements were prepared in accordance with state regulations. Given the significance of some of the problems we identified in this area, we question how PADCC's auditors could have believed that the agency was reporting its revenues and expenses properly. For example, PADCC has appropriately characterized operation of the Grafton facility as a non-charitable "Unrelated Business Income Tax" activity on IRS 990 filings and has reported the gross rental income derived from this activity as non-charitable revenue. However, PADCC improperly classified the revenue and expense items as part of the indirect administrative management and general function in its accounting system and on its UFR filings, even though they are not properly part of the overall direction of the organization as required by generally accepted accounting principles. As a result of this improper treatment, the non-charitable/non-program-related expenses have been commingled with general administrative costs and have been indirectly allocated to the programs

paid for by the Commonwealth, whereas the rental income has been characterized by PADCC as administrative revenue available in full to pay for unrelated costs (e.g., Auburn rental payments), which PADCC acknowledged to be nonreimbursable by the Commonwealth. Finally, OSD has established guidelines for the proper reporting of nonreimbursable costs by human services providers such as PADCC. Specifically, OSD's Uniform Financial Statements and Independent Auditor's Report (UFR) Audit and Preparation Manual states, in part:

> *The existence of non-reimbursable costs, as contained in 808 CMR 1.05 (Effective 2/1/97, 808 CMR 1.05) and OMB Circulars A-21 and A-122, must be itemized by natural classification and disclosed in the component and program as applicable. Non-reimbursable costs that exist and have not been disclosed are presumed to have been defrayed using Commonwealth and Federal funds....*

Since PADCC did not properly report all of its nonreimbursable costs as required by OSD, we clearly have a basis for our contention that PADCC's non-program-related and other nonreimbursable costs were charged against its state contracts.

9. PROGRAM COMPLIANCE ISSUES

We found a number of instances in which PADCC and Kincare Inc., failed to comply with state regulations relative to the operation of its state-funded programs. These included the School-Age programs being operated for periods of time with enrollment that exceeded the program's licensed capacity by up to 40% and PADCC's failure to conduct and properly document mandated Family Day Care system home visits on a monthly basis.

During our audit, we reviewed all of the records PADCC was maintaining relative to its program-related activities (e.g., licensing and permit documents, program attendance sheets, other program records). We also conducted observation of programs at the Auburn, Millbury, and Grafton facilities and spoke with PADCC employees, board members, and state agency officials regarding PADCC's programs. Based on our work in this area, we noted the following problems relative to PADCC's operation of its state funded programs:

- The 102 CMR 7.09(1), promulgated by OCCS, states, in part: "The licensee shall not admit or enroll, at any one time, more children than the licensed capacity of the program." During our audit we found that during fiscal year 2003, while some of PADCC's programs operated significantly below their licensed capacity, other programs, particularly the School Age program operated by Kincare, Inc., at the Grafton facility, operated in excess of OCCS licensed capacity limits for extended periods. During the two periods we reviewed, the Kincare program was over-enrolled by up to 40%, with actual attendance running 14% over

capacity. OCCS made a licensing visit during the time we were on site and found that Kincare was operating in excess of its licensing capacity for a period of at least three months. OCCS recommended that Kincare freeze all intakes in the program and granted a temporary increase in the license capacity.

- As a Family Day Care (FDC) System operator, PADCC was obligated by contract to perform a variety of oversight functions such as monthly home visits for participating subcontracted home-based providers. OCCS specifically requires that reports for these monthly visits be maintained in individual files covering each subcontracted home along with required documentation on home licensure, child placements, etc. For fiscal year 2003 PADCC failed to document, if not conduct, required monthly home visits on a regular basis. At least 78 visits were required to be conducted for at least seven subcontractors, but only a total of 10 visits to four of the seven subcontractors were properly documented. No visits at all were documented for the remaining three family day care homes. Required documentation of child registration and of various FDC subcontractor compliance requirements was also missing for at least one of the homes. Although the program director asserted that the problem was one of incomplete documentation rather than failure to perform visits, informal alternative documentation provided by the program director failed to conclusively establish that PADCC had conducted a significant number of the remaining visits, causing us to question compliance with both documentation and program performance requirements of the contract.

Recommendation

PADCC should take immediate action to correct the deficiencies noted above and implement appropriate controls to prevent future deficiencies of a similar nature. In addition, OCCS should conduct follow-up visits to ensure that all of the programmatic deficiencies we identified are adequately addressed by PADCC.

Auditee's Response

In response to this issue, a law firm representing PADCC provided the following comments:

> *Pakachoag understands that the licensing issues with respect to capacity are related to Kincare's programs and not Pakachoag's.*
>
> *With respect to its Family Day Care responsibilities, Pakachoag believes that the required monthly visits were made but it cannot document or demonstrate that in fact all such visits were made. Pakachoag is, however, in regular contact with its FDC providers.*

In addition, a law firm representing Kincare stated, in part:

> *Kincare expresses its opinion that the Audit is improperly over-broad in subject matter and time frame. Kincare provided outstanding care to the children that it serviced consistent with a good faith understanding of its license capacity and or other lawful programs. Notwithstanding that fact, Kincare has always expressed a willingness to improve the service provided to the children who attend its programs.*

In addition to its comments, the law firm representing PADCC provided a copy of a document entitled, "Affidavit of [PADCC's Executive Director] Concerning Notice of Sanctions and Order," dated October 18, 2004. In this affidavit, PADCC's Executive Director takes issue with the sanctions imposed by OCCS as a result of various program compliance/licensing issues identified by OCCS as noted in the Background section of this report. Regarding the issue of program capacity, PADCC's Executive Director stated that PADCC had applied for a license to increase the capacity in its School Age Program from OCCS and had taken the measures necessary to obtain this increased capacity, but OCCS had not been expeditious in its issuance of this new license.

Auditor's Reply

Despite the assertions made by PADCC and Kincare, as stated in our report, during our audit we reviewed all of the records PADCC was maintaining relative to its program-related activities (e.g., licensing and permit documents, program attendance sheets, other program records). We also conducted observation of programs at the Auburn, Millbury, and Grafton facilities and spoke with PADCC employees, board members, and state agency officials regarding PADCC's programs. Based on our work in this area, we noted several problems relative to PADCC's operation of its state funded programs. In its response, PADCC claims that the monthly site visits in question were made but were just not documented. However, without adequate documentation, there is clearly no evidence that these visits were ever conducted.

SUBSEQUENT EVENTS

In May 2004, after completion of audit fieldwork but prior to the finalization of our report, the OAG, acting on behalf of OCCS, initiated legal action to place financial restrictions on PADCC, pending resolution of the contract monitoring issues identified by OCCS.

Auditee's Response

In response to our disclosure on subsequent events to our audit, a law firm representing PADCC provided the following additional information:

In addition to the changes in salary allocation, governance, and vehicle use noted in Section II, III, and V above, Pakachoag has begun moving its administrative offices out of the Grafton facility it leased to Kincare. Pakachoag's board has also explored ways to reduce or eliminate the related party issues arising from its arrangements with respect to the Auburn and Grafton

facilities. Thus far, it has not been possible to alter those arrangements without substantial harm to Pakachoag and its programs.

APPENDIX I

Direct and Indirect Commonwealth Payments to Pakachoag Acres Day Care Center, Inc.

	1996	1997	1998	1999	2000	2001	2002	2003	Total 1996 - 2003
DOE Direct Payments	$ 484,644	$ 433,531	$ 70,129	$ 64,075	$ 67,690	$ 53,212	$ 53,482	$ 60,459	$1,287,222
DOE Voucher Payments	-	-	181,387	170,244	195,651	185,148	174,745	79,024	986,199
EOL/DAT Direct Payments	-	-	-	-	-	-	-	26,508	26,508
DSS and OCCS Direct Payments	554,960	653,401	558,732	433,800	579,635	654,592	669,231	639,993	4,744,344
DSS/DTA/OCCS Voucher Payments	420,430	378,185	374,948	465,163	459,976	450,737	382,923	393,440	3,325,802
Comptroller Adjusting Payments	-	-	-	19,397	19,743	-	-	-	39,140
Total Direct and Indirect Commonwealth Payments	$1,460,034	$1,465,117	$1,185,196	$1,152,679	$1,322,695	$1,343,689	$1,280,381	$1,199,424	$10,409,215

Source: Office of the State Comptroller for direct payments; PADCC UFR for 1996 DSS/DTA/OCCS voucher payments: Voucher intermediary payment agencies for all other indirect payments.

APPENDIX II

Direct and Indirect Commonwealth Payments to Kincare, Inc.

	1997	1998	1999	2000	2001	2002	2003	Total 1997 - 2003
DOE Voucher Payments	-	$ 15,883	$ 59,244	$ 76,189	$100,451	$ 81,207	$ 50,630	$ 383,604
DSS and OCCS Direct Payments	-	-	-	34,643	65,768	64,165	64,093	228,669
DSS/DTA/OCCS Voucher Payments	$37,616	110,701	180,536	149,193	121,781	126,671	165,789	892,287
Total Direct and Indirect Commonwealth Payments	$37,616	$126,584	$239,780	$260,025	$288,000	$272,043	$280,512	$1,504,560

Source: Office of the State Comptroller for direct payments