Commonwealth of Massachusetts
Office of the State Auditor
Suzanne M. Bump

Making government work better

Official Audit Report – Issued May 17, 2012

Massachusetts Rehabilitation Commission

For the period July 1, 2010 through June 30, 2011

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Chapter 6, Section 74, of the Massachusetts General Laws established the Massachusetts Rehabilitation Commission (MRC), whose primary mission is to help permanently disabled individuals live as independently as possible. The MRC operates two programs that were the subject of this audit: the Vocational Rehabilitation (VR) program, which provides education opportunities, job placement, and training for individuals who are capable of becoming gainfully employed, and the Disability Determination Services (DDS) program, which determines initial and continued eligibility for federal Supplemental Security Income and Social Security Disability Insurance public benefits. For fiscal year 2011, the MRC received approximately \$109.4 million in appropriations, approximately \$90.3 million of which consisted of federal funds, including approximately \$3.5 million in VR American Recovery and Reinvestment Act (ARRA) funding.

In accordance with Chapter 11, Section 12, of the General Laws, the Office of the State Auditor (OSA) conducted an audit of the MRC in conjunction with the Single Audit of the Commonwealth of Massachusetts for the fiscal year ended June 30, 2011. We have concluded that except as reported in the audit results section of this report, for the period July 1, 2010 through June 30, 2011, the MRC had adequate internal controls in place and complied with the requirements of the federal Department of Education; the Social Security Administration; OMB Circular A-133 and the Compliance Supplement; and other applicable laws, rules, and regulations for the areas tested.

Our prior audit report, No. 2011-0054-16S, disclosed that the MRC did not have necessary policies, procedures, and controls in place to ensure that the allocation of central support service costs (chargebacks) assigned to its federal VR program were limited to those activities that benefited the program. As a result, our audit disclosed \$16,170 in questioned costs due to the incorrect allocation of chargebacks to the VR grant.

Our follow-up review disclosed that the MRC has taken the necessary corrective action to resolve this issue. Specifically, our analysis of chargebacks for secretarial central services and information technology data processing costs from July 1, 2010 to June 30, 2011 disclosed that necessary procedures and controls are in place to ensure that chargeback costs assigned to its federal VR program were limited to activities that benefit the program.

Our prior audit disclosed that while the MRC had made considerable improvements in reviewing and approving employee timesheets, our site visits to area offices showed that payroll internal controls had not been fully implemented. In addition, our prior examination identified other key payroll issues that further highlight the need for continued monitoring and training to ensure that management-prescribed procedures are consistently followed.

Our follow-up review disclosed that the MRC continues to make progress in ensuring that all employee timesheets are properly reviewed and approved by the employee's supervisor. However, our follow-up review disclosed $14,446 in questioned costs (VR $12,341, ARRA $2,105) due to employee timesheets lacking a supervisory approval signature ($12,432) or payroll inaccuracies (e.g., vacation, sick-days, hours worked by hourly employees, etc., not accurately recorded ($2,014). Additionally, our examination of other key payroll controls disclosed that the MRC needs to continue to improve its internal controls to ensure that payroll expenditures are valid and accurately processed and that established policies are consistently applied.

In response to the audit report, the MRC indicated that it continues to train staff to ensure that payroll policies and procedures are understood and followed. In addition, MRC has instituted an internal control requiring review of payroll time designation changes.

Our prior audit disclosed that the MRC had not developed written policies and procedures detailing its process for completing the federal Rehabilitation Service Administrative (RSA) Annual Vocational Rehabilitation/Cost Report (RSA-2) and lacked documentation of management's review and approval of the report. Also, our audit noted certain financial reporting shortcomings during our review of the quarterly Financial Status Reports (SF-269/425).

Our follow-up review disclosed that the MRC continues to improve documentation regarding financial and statistical data reported in its annual RSA-2 report; however, additional improvements are needed. Our audit also determined that even though the MRC timely submitted its RSA-2 report and documented management's review and approval of the report, the MRC continues to complete its RSA-2 report without written policies and procedures detailing its process. Additionally, our audit noted financial reporting shortcomings during our review of the SF-269/425 reports, including the lack of written policies and procedures detailing the process for completing these reports. Numerous attempts to obtain pertinent information regarding financial reports submitted by the MRC to the RSA were repeatedly met with significant delays by MRC management, demonstrating a fundamental lack of understanding regarding the purpose of our audit and management's responsibilities. Moreover, delays in obtaining information heighten concerns about the effectiveness of management over the VR program funds. As a result of our audit, the MRC must continue to undertake improvements and strengthen its internal controls to ensure compliance with federal requirements.

In response to the audit report, the MRC stated that it has designed, developed, and implemented policies and procedures for the preparation and submission of required federal reports and that reports for all years have been submitted and accepted with no outstanding questions or concerns. The MRC further stated that it believed federal report policy directives issued by the RSA were subject to reader interpretation.

4. INTERNAL CONTROLS OVER NON-GAAP CAPITAL (FIXED) ASSETS NEED IMPROVEMENT **13**

Our review disclosed that the MRC did not have in place the necessary policies and procedures and internal controls to ensure that fixed assets were adequately safeguarded against loss, misuse, or theft as required by state and federal regulations. Specifically, our review of documentation regarding annual physical inventory for MRC's central office and twelve area offices for Electronic Data Processing (EDP) equipment disclosed that, in most instances, only a partial physical inspection was completed. Also, we noted that MRC's inventory records for EDP equipment were not completely or accurately maintained. As a result, our audit disclosed $105,959 in questioned costs due to MRC's inability to account for EDP equipment (computers and printers) purchased in fiscal year (FY) 2011 with VR funds. Lastly, our audit disclosed that the MRC did not have formal written policies and procedures detailing its accounting, reconciliation, reporting, and recording of fixed assets and that greater supervision and guidance was needed over fixed asset management activities and conducting annual physical inventories.

In response to the audit report, the MRC noted that it was in the process of correcting its fixed asset inventory as well as designing, developing, and implementing fixed asset management policies and procedures and internal controls.

5. INTERNAL CONTROLS OVER CLIENT ELIGIBILITY DETERMINATIONS NEED IMPROVEMENT **17**

Our audit disclosed that the MRC did not have the necessary policies, procedures, and control system in place to ensure that eligibility determinations performed for individuals applying for VR services are carried out within the 60-day timeframe required by state and federal regulations. In addition, in one case we determined that client application data (e.g., date of completion) keyed into the Massachusetts Rehabilitation Client Information System (MRCIS) - was not inputted timely and accurately. As a result, the MRCIS report, used by management to monitor area office compliance with the 60-day time limit, did not identify the case as noncompliant. For this reason, the MRCIS management monitoring report cannot be relied upon due to the risk of inaccurate client data.

In response to the audit report, the MRC commented that it has improved upon making eligibility determinations in a timely manner by making compliance a measurable objective for VR managers, conducting monthly reviews of area office operations, implementing corrective action plans as needed, and providing additional training to all staff. Furthermore, the MRC stated that it is in the process of updating its MRCIS system to include safeguards to ensure confidence in the system's results, with an anticipated roll out on or about July 1, 2012.

INTRODUCTION

Background

Chapter 6, Section 74, of the Massachusetts General Laws established the Massachusetts Rehabilitation Commission (MRC), whose primary mission is to help permanently disabled individuals live as independently as possible. The agency operates two programs that were the subject of this audit: the Vocational Rehabilitation (VR) Program, which provides education opportunities, job placement, and training for individuals who are capable of becoming gainfully employed; and the Disability Determination Services (DDS) program, which determines initial and continued eligibility for federal Supplemental Security Income and Social Security Disability Insurance public benefits. For fiscal year 2011, the MRC received approximately $109.4 million in appropriations, approximately $90.3 million of which consisted of federal funds, including approximately $3.5 million in VR American Recovery and Reinvestment Act (ARRA) funding.

Audit Scope, Objectives, and Methodology

In accordance with Chapter 11, Section 12, of the General Laws, the Office of the State Auditor conducted an audit of the MRC for the period July 1, 2010 through June 30, 2011. We conducted our audit in conjunction with the Single Audit of the Commonwealth of Massachusetts for the fiscal year ended June 30, 2011. The Commonwealth's Fiscal Year 2011 Single Audit Report consists of the following volumes:

- Statutory Basis Financial Report
- Comprehensive Annual Financial Report
- [Office of Management and Budget] OMB Circular A-133 Report

The audit results contained in this report are also reported in the Fiscal Year 2011 Single Audit of the Commonwealth of Massachusetts, OMB Circular A-133 report as mentioned above. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Our audit was also conducted in accordance with standards set forth in OMB Circular A-133 and the American Institute of Certified Public Accountants (AICPA) Audit and Accounting Guide, Audits of State and Local Governments. Additionally, our audit evaluated MRC's compliance with Office of the State Comptroller (OSC) policies and procedures; Massachusetts General Laws; and other applicable laws, rules, and regulations.

In performing our audit of MRC activities, we referred to OMB Circular A-133 and the March 2011 Compliance Supplement to determine the compliance requirements that must be considered in an audit conducted under OMB Circular A-133. Based upon the audit, we determined requirements applicable to the VR and DDS programs and designed appropriate tests to determine the MRC's compliance with these requirements.

Specifically, our objectives were to:

- Assess the internal controls in place at the MRC during the review period.
- Assess and evaluate the program for compliance with the requirements of the Compliance Supplement, the federal Department of Education, the Social Security Administration, and the OSC.
- Determine the status of prior audit results (No. 2011-0054-16S).

The criteria for our audit were drawn from OMB Circular A-133, the March 2011 Compliance Supplement, the Code of Federal Regulations, and the OSC's Internal Control Guide. Those criteria dealt with the MRC administration and operation of the programs tested above for compliance with laws and regulations governing:

- Activities Allowed or Unallowed
- Allowable Costs/Cost Principles
- Cash Management
- Davis-Bacon Act
- Eligibility
- Equipment and Real Property Management
- Matching, Level of Effort, Earmarking
- Period of Availability of Federal Funds
- Procurement, Suspension and Debarment
- Program Income

- Real Property Acquisition and Relocation Assistance
- Reporting
- Special Tests and Provisions
- Subrecipient Monitoring

We examined, on a test basis, evidence about the MRC's compliance with the applicable requirements and performed other procedures as we considered necessary. Based on these tests, we have concluded that, except as reported in the Audit Results section of this report, for the period July 1, 2010 through June 30, 2011, the MRC had adequate internal controls in place and complied with the requirements of the federal Department of Education; the Social Security Administration; OMB Circular A-133 and the Compliance Supplement; and other applicable laws, rules, and regulations for the areas tested.

AUDIT RESULTS

1. PRIOR AUDIT RESULT RESOLVED – CHARGEBACK AMOUNTS FOR CENTRAL SUPPORTIVE SERVICES CORRECTLY ALLOCATED TO FEDERAL VOCATIONAL REHABILITATION PROGRAM GRANT

Our prior audit report, No. 2011-0054-16S, disclosed that the MRC did not have necessary policies, procedures, and controls in place to ensure that the allocation of central support service costs (chargebacks) assigned to its federal Vocational Rehabilitation (VR) program were limited to those activities that benefited the program. As a result, our audit disclosed $16,170 in questioned costs due to the incorrect allocation of chargebacks to the VR grant.

Our follow-up review disclosed that the MRC has taken the necessary corrective action to resolve this issue. Specifically, our analysis of chargebacks for secretarial central services and information technology data processing costs from July 1, 2010 to June 30, 2011 disclosed that necessary procedures and controls are in place to ensure that chargeback costs assigned to its federal VR program were limited to activities that benefit the program.

2. PRIOR AUDIT RESULT UNRESOLVED – INTERNAL CONTROLS OVER THE SUPERVISORY REVIEW OF EMPLOYEE ATTENDANCE RECORDS NEED IMPROVEMENT

Our prior audit disclosed that while the MRC had made considerable improvements in reviewing and approving employee timesheets, our site visits to area offices showed that payroll internal controls had not been fully implemented. In addition, our prior examination identified other key payroll issues that further highlight the need for continued monitoring and training to ensure that management-prescribed procedures are consistently followed.

Our follow-up review disclosed that the MRC continues to make progress in ensuring that all employee timesheets are properly reviewed and approved by the employee's supervisor. However, our follow-up review disclosed $14,446 in questioned costs (VR $12,341, ARRA $2,105) due to employee timesheets not having a supervisory approval signature ($12,432) or payroll inaccuracies (e.g., vacation, sick-days, hours worked by hourly employees, etc., not accurately recorded ($2,014). Additionally, our examination of other key payroll controls disclosed that the MRC needs to continue to improve its internal controls to ensure that payroll expenditures are valid and accurately processed and that established policies are consistently applied.

Title 2 in the Code of Federal Regulations (CFR), Chapter 2, Part 225—Cost Principles for State, Local, and Tribal Governments (Office of Management and Budget (OMB) Circular A-87), Appendix B, Section 8 (a), states:

> *a. General. Compensation for personnel services includes all remuneration, paid currently or accrued, for services rendered during the period of performance under Federal awards, including but not necessarily limited to wages, salaries, and fringe benefits. The costs of such compensation are allowable to the extent that they satisfy the specific requirements of this Circular, and that the total compensation for individual employees:*
>
> *(1) Is reasonable for the services rendered and conforms to the established policy of the governmental unit consistently applied to both Federal and non Federal activities;*
>
> *(2) Follows an appointment made in accordance with a governmental unit's laws and rules and meets merit system or other requirements required by Federal law, where applicable; and*
>
> *(3) Is determined and supported as provided in subsection h. […]*
>
> *h. Charges to Federal awards for salaries and wages, whether treated as direct or indirect costs, will be based on payrolls documented in accordance with generally accepted practice of the governmental unit and approved by a responsible official(s) of the governmental unit.*

Furthermore, the Commonwealth of Massachusetts Human Resources Division's Time and Attendance Policy (revised May 27, 2010) requires that timesheets be approved by each employee's supervisor, as follows:

> *The official time and attendance record consists of (1) an employee's confirmation of his/her daily time, (2) his/her supervisor's approval and (3) its entry in the Human Resource Compensation Management System (HR/CMS).*

During our audit, we examined 50 weekly timesheets covering five pay periods for payroll costs charged to the federal VR grant (one pay period was selected for each of the 25 area offices). We also reviewed 38 weekly timesheets for 19 employees covering one pay period for payroll costs charged to the VR American Recovery and Reinvestment Act (ARRA) grant. These timesheets represented 13 area offices and two departments in the central office. For the Disability Determination Services (DDS) program, we inspected 50 weekly timesheets for 25 employees covering five pay periods (30 from the Boston office and 20 from the Worcester office) that were charged to the federal DDS grant. For the above examination, all payroll support documentation was received from agency personnel. The results from this test disclosed that two of the 38 weekly timesheets for the ARRA grant were missing supervisory approval signatures. Questionable costs for the timesheets involved amounted to $2,105. No payroll exceptions were identified for the federal DDS grant.

As an alternative test, site visits to five VR area offices[1] were also conducted. Our review of 50 weekly timesheets covering five pay periods disclosed that one of the 50 weekly timesheets was missing a supervisory approval signature. Questionable costs for the timesheets concerned (VR grant) amounted to $10,327.

Electronic Timesheet Transmittals to the Executive Office of Health and Human Services (EOHHS)

Payroll exceptions (e.g., sick, vacation, personal leave, etc.) noted on employee timesheets are entered onto an Excel spreadsheets by designated timekeepers in each office/department. On a weekly basis, the spreadsheets are electronically submitted to the EOHHS, which then records the exceptions into the Commonwealth's Human Resource/Compensation Management System (HR/CMS). To facilitate the process, EOHHS developed a Time & Attendance Reporting Training Job Aid (issued February 2007) that established the following procedure:

> *Print the Excel spreadsheet and have the supervisor (person whose name appears in the "Approved by" section) sign the sheet and keep this on file. This is a very important step.*

In addition, the MRC's Administrative Bulletin: Payroll, issued July 2010, states, in part:

> *The Unit Supervisor or Manager is responsible for reviewing and approving time and attendance for the Unit. This review includes careful attention to accuracy on the part of both employees and timekeeper. Raw data from timesheets is used to create the official record of the Commonwealth, and so review is required for both the timesheet signed by the employee and for the electronic timesheet that the timekeeper sends to payroll. …The Unit Supervisor or Manager approves and signs the Electronic Timesheet.*

Our test of the weekly electronic timesheet transmittals disclosed the following:

- Two of the 50 EOHHS electronic timesheet transmittals (payroll costs charged to the VR federal grant) lacked supervisory approval signatures.
- One of the 38 EOHHS electronic timesheet transmittals (payroll costs charged to the VR ARRA federal grant) lacked a supervisory approval signature.

[1] The following VR area offices were visited: Boston, Lawrence, Milford, Plymouth, and Salem.

- Two of the 50 EOHHS electronic timesheet transmittals inspected during our site visits to area offices (payroll costs charged to the VR federal grant) did not have evidence of a supervisory approval signature.

Bi-Weekly Payroll Reports

After each bi-weekly payroll is processed, the MRC retrieves attendance data recorded on HR/CMS and records the data on separate Excel spreadsheets (bi-weekly payroll reports) submitted to each department for the Unit Supervisor's or Manager's review. The MRC's Administrative Bulletin: Payroll, issued July 2010, states, in part:

> *The Unit Supervisor or Manager is responsible for reviewing and approving time and attendance for the Unit… The Fiscal Department downloads and sends via interoffice mail a biweekly report of hours and exceptions posted for each employee in a unit, and the Unit Supervisor or manager is expected to review these postings for accuracy.*

The above policy differs from the MRC's prior payroll Administrative Bulletin—issued March 2010—that included explicit emphasis on Unit Supervisors' or Managers' signatory approval for each bi-weekly payroll report. This certification and documentation of supervisory review and approval was deleted from MRC's amended July 2010 policy because management considered the task unnecessary.

Our test of bi-weekly payroll reports disclosed the following:

- In September 2010, the MRC changed its practice of distributing bi-weekly payroll reports. Instead of delivering the reports via interoffice mail, the reports were posted on the MRC's server. During our site visits to five area offices, completed in June and July 2011, Area Directors explained that they were either: unaware of the above change (one instance), were notified of the change by MRC management roughly two to four weeks prior to our visit (three instances), or were advised by MRC management nearly two months after the change took place (one instance). MRC management later acknowledged that no formal communication regarding the change was issued to area offices and central office departments.

- As a result of this lack of notification, eight of 25 (32%) bi-weekly payroll reports (payroll costs charged to the VR federal grant) inspected during our site visits had not been reviewed by either the Unit Supervisor or Manager. All eight payroll reports were generated after the MRC changed its method of delivering the bi-weekly payroll report.

- In 21 instances, payroll exceptions recorded on employee weekly timesheets were not accurately recorded in HR/CMS. Of the 21 occurrences, seven were not detected by the area office Unit Supervisor or Manager because the bi-weekly report was not reviewed. An additional 14 had not been identified even though area office reviews had been performed. Questionable costs for the payroll exceptions not correctly recorded amounted to $2,014. During the audit, the area offices advised EOHHS to correct the 21 instances.

The lack of adequate enforcement and an effective process for monitoring existing payroll policies and procedures, as well as the absence of necessary policies, processes, and controls regarding the communication of useful information to allow employees to carry out their responsibilities, increases the risk that unauthorized and/or inappropriate payroll transactions will not be detected timely or at all. Further, without supervisory review and approval signatures, management lacks an appropriate level of assurance that payroll expenditures are valid and accurate, that programs are being charged only for the time an employee works on the program, and that payroll transactions are being approved in accordance with prescribed procedures.

Recommendation

The MRC should continue to improve and strengthen its existing internal controls to ensure that all payroll transactions are being reviewed and approved by signature in accordance with prescribed procedures. Toward that end, the MRC should consider implementing a monitoring control that calls for periodic reviews of area offices to identify issues of potential noncompliance and training needs as well as to address the importance of oversight over payroll activities. In addition, we strongly recommend that MRC management reinstate its prior payroll policy that required the review, approval, and signing of the bi-weekly payroll report by a Unit Supervisor or Manager. Also, steps should be taken to develop and implement policies, processes, and controls that ensure communication channels provide timely information, inform employees of their duties and responsibilities, and furnish the information necessary to enable employees to carry out their responsibilities. A formal communication process would have ensured that all area offices and central office departments were timely notified of the aforementioned bi-weekly payroll report distribution change.

Auditee's Response

> *The Agency continues to train staff to ensure that its Payroll Policy and Procedures are understood and followed. The Agency has instituted an internal control that reviews payroll time designation changes to ensure that the changes were made by EOHHS HR [Human Resources] staff.*

3. PRIOR AUDIT RESULT UNRESOLVED – FINANCIAL REPORTING NEEDS IMPROVEMENT

Our prior audit disclosed that the MRC had not developed written policies and procedures detailing its process for completing the federal Rehabilitation Service Administrative (RSA) Annual Vocational Rehabilitation/Cost Report (RSA-2) and lacked documentation of management's review and approval of the report. Also, our audit noted certain financial reporting shortcomings during our review of the quarterly Financial Status Reports (SF-269/425).

Our follow-up review disclosed that the MRC continues to improve documentation regarding financial and statistical data reported in its annual RSA-2 report; however, additional improvements are needed. Our audit also determined that even though the MRC timely submitted its RSA-2 report and documented management's review and approval of the report, the MRC continues to complete its RSA-2 report without written policies and procedures detailing its process. Additionally, our audit noted financial reporting shortcomings during our review of the SF-269/425,[2] including the lack of written policies and procedures detailing the process for completing these reports. Numerous attempts to obtain pertinent information regarding financial reports submitted by the MRC to the RSA were repeatedly met with significant delays by MRC management, demonstrating a fundamental lack of understanding regarding the purpose of our audit and management's responsibilities. Moreover, delays in obtaining information heighten concerns about the effectiveness of management over the VR program funds. As a result of our audit, the MRC must continue to undertake improvements and strengthen its internal controls to ensure compliance with federal requirements.

34 CFR 80.20, Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Governments, states, in part:

> *(a) A State must expand and account for grant funds in accordance with State laws and procedures for expending and accounting for its own funds. Fiscal control and accounting procedures of the State, as well as its subgrantees and cost-type contractors, must be sufficient to:*
>
> *(1) Permit preparation of reports required by this part and the statutes authorizing the grant, and*

[2] Financial Status Report (FSR) (SF-269) (OMB No. 0348-0039) was replaced by the Federal Financial Report (FFR) (SF-425) (OMB No. 0348-0061), effective October 1, 2009. Starting with the fiscal year 2011 grant, the frequency for reporting SF-425 reports changed from quarterly to semi-annual.

(2) Permit the tracing of funds to a level of expenditures adequate to establish that such funds have not been used in violation of the restrictions and prohibitions of applicable statutes.

(b) The financial management systems of other grantees and subgrantees must meet the following standards:

(1) Financial reporting. Accurate, current, and complete disclosure of the financial results of financially assisted activities must be made in accordance with the financial reporting requirements of the grant or subgrant.

(2) Accounting records. Grantees and subgrantees must maintain records which adequately identify the source and application of funds provided for financially-assisted activities. These records must contain information pertaining to grant or subgrant awards and authorizations, obligations, unobligated balances, assets, liabilities, outlays or expenditures, and income.

(3) Internal control. Effective control and accountability must be maintained for all grant and subgrant cash, real and personal property, and other assets. Grantees and subgrantees must adequately safeguard all such property and must assure that it is used solely for authorized purposes.

Moreover, 34 CFR 361.12, State Plan and Other Requirements for Vocational Rehabilitation Services, Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Governments, Methods of Administration, states, in part:

The State plan must assure that the State agency, and the designated State unit if applicable, employs methods of administration found necessary by the Secretary for the proper and efficient administration of the plan and for carrying out all functions for which the State is responsible under the plan and this part. These methods must include procedures to ensure accurate data collection and financial accountability.

Generally Accepted Government Auditing Standards (July 2007 revision) states, in part, as follows:

Government managers are responsible for providing reliable, useful, and timely information for accountability of government programs and their operations.

Our examination of the MRC RSA-2 report and supporting documentation for the federal fiscal year ended September 30, 2010 disclosed the following issues:

- The RSA-2 report must reflect all expenditures made during the federal fiscal year from federal, state, and other rehabilitation funds. It must include those expenditures made during the reporting period and charged to Section 110 federal funds, Title VI-B federal funds, or program income funds that were carried over from the previous fiscal year. For the purposes of the RSA-2 report, expenditures include unliquidated obligations. Our audit identified the following expenditure reporting deficiencies totaling $4,225,589:

(a) Federal un-liquidated obligations totaling $871,031—of which $455,989 represents American Recovery and Reinvestment Act (ARRA) obligations—were not included in the reporting period ending September 30, 2010. Not reporting un-liquidated obligations as expenditures in the proper reporting period results in the overstatement of funds carried over to and expenditures reported in the next fiscal year (period ended September 30, 2011).

(b) VR expenditures did not include fringe benefit costs incurred during the period July 3, 2010 to September 30, 2010. As a result, expenditures were understated by $2,089,888.

(c) Program income expenditures paid for with funds carried over from the previous fiscal year were understated by $1,264,670.

In addition, our review of SF-269/425 reports for the quarter ended September 30, 2010 and the quarter ended March 31, 2011 (fiscal year (FY) 2010 grant), respectively; the semi-annual SF-425 report for the period ended March 31, 2011 (FY 2011 grant); and the SF-269 report (ARRA) for the period ended March 31, 2011 disclosed that the MRC did not have controls in place to ensure the accuracy, completeness, and reasonableness of these reports. Specifically, our audit disclosed the following deficiencies:

- State expenditures totaling $819,062 reported on the VR September 2010 SF-269 report for the fiscal year 2009 grant lacked supporting documentation.
- Federal un-liquidated obligations were overstated by $467,323 on the VR September 2010 SF-269 report for the fiscal year 2009 grant. Both the accrued expenses and unobligated balance were reported as un-liquidated obligations in error.
- Un-liquidated obligations totaling $181,123 reported on the ARRA September 2010 SF-269 report lacked supporting documentation.
- Federal expenditures were overstated by $897,478 on the VR March 2011 SF-425 report (FY 2011 grant) because an April 2011 cash drawdown (reimbursement) totaling $897,478 was reported in error. The April 2011 cash drawdown should have been reported on the VR September 30, 2011 SF-425 report for the fiscal year 2011.
- State expenditures were understated by $3,304,568 on the VR March 2011 SF-425 report (FY 2011 grant) because fringe benefit costs totaling $3,304,568 were not reported.
- Federal un-liquidated obligations were overstated by $6,565,804 on the VR March 2011 SF-425 report for the fiscal year 2011 grant. The MRC reported the unobligated balance in error.

In all the above instances, we noted that management had signed and dated each report, an official recognition of management's review and approval; however, none of these reporting deficiencies were identified during management's review. As a result, we question the thoroughness and effectiveness of management's oversight and monitoring activities over the preparation of scheduled financial reports. While we recognize improvements made in the financial reporting and data collection process, the above reporting deficiencies highlight the need for continued monitoring and greater oversight. Without adequate controls in place, the MRC will continue to be exposed to the risk that financial reports submitted to the RSA could be inaccurate and incomplete, which could lead to enforcement action by the RSA that may include the recovery of Title I VR funds. Moreover, by not providing our auditors with timely information, the MRC did not carry out its managerial responsibilities.

Recommendation

The MRC must continue to improve and strengthen its internal controls to ensure the accuracy of VR program accounting and reporting and compliance with federal requirements. Accordingly, management should establish formal written policies and procedures for the preparation and filing of all required reports. As part of this process, management should also develop and put in place controls that consistently and effectively track and monitor the progress of financial reports and ensure that appropriate supporting evidence is retained. Additionally, management must commit greater attention to detail during its review and approval of financial reports to ensure that all reports are accurate, complete, reasonable, and properly supported. As evidence of management's review, the reviewer should continue to sign and date all reports as well as retain a copy on file. As a final point, in order to meet its managerial responsibilities, the MRC must provide timely information regarding its accountability of government programs and their operations for examination by appropriate audit organizations.

Auditee's Response

> *The Agency previously reported that policies and procedures regarding the preparation of SF-425 and RSA-2 would be designed, developed and implemented by December 31, 2011. The Agency designed, developed, and implemented policies and procedures for the preparation and submission of SF-425 and RSA-2 by December 31, 2011. The Agency understands the guidance and instructional document put forth in "POLICY DIRECTIVE RSA-PD-11-02: October 26, 2010 provides Information and guidance for completion of SF425" and "POLICY DIRECTIVE RSA-PD-09-04 DATE: August 31, 2009 provides Information and guidance for completion of RSA-2" that are subject to reader*

interpretation. Reports for all years have been submitted and accepted and there are no outstanding questions and or concerns.

4. INTERNAL CONTROLS OVER NON-GAAP CAPITAL (FIXED) ASSETS NEED IMPROVEMENT

Our review disclosed that the MRC did not have in place the necessary policies and procedures and internal controls to ensure that fixed assets were adequately safeguarded against loss, misuse, or theft as required by state and federal regulations. Specifically, our review of documentation regarding annual physical inventory for MRC's central office and 12 of the 25 area offices for Electronic Data Processing (EDP) equipment disclosed that, in most instances, only a partial physical inspection was completed. Also, we noted that MRC's inventory records for EDP equipment were not completely or accurately maintained. As a result, our audit disclosed $105,959 in questioned costs due to MRC's inability to account for EDP equipment (computers and printers) purchased in FY 2011 with VR funds. Lastly, our audit disclosed that the MRC did not have formal written policies and procedures detailing its accounting, reconciliation, reporting, and recording of fixed assets and that greater supervision and guidance was needed over fixed asset management activities and conducting annual physical inventories.

The Office of the State Comptroller's (OSC) Massachusetts Management Accounting and Reporting System (MMARS) Accounting and Management Policy on Fixed Assets, revised November 1, 2006, sets forth the following policies, which state, in part:

> *<u>Annual Inventory</u>*
>
> *There shall be an annual inventory taken of fixed assets owned by every Department. This inventory shall include, at a minimum, a verification of the existence and location of fixed assets owned by a Department. This inventory shall be done on or about June 30th of each year for GAAP and non-GAAP assets.*
>
> *<u>Reconciliation of Fixed Asset Inventory</u>*
>
> *There shall be a reconciliation of the fixed asset inventory against the books and records maintained by the Department, either on the Fixed Asset Subsystem or other documented methods. This reconciliation is to be done, at a minimum, on an annual basis. This reconciliation shall be available for audit either by the department's internal auditors, the State Auditor's Office or the Commonwealth's external auditors. Internal records must reconcile to the records available on the Fixed Asset Subsystem. A Department will maintain supporting documentation of fixed asset transactions available for examination by appropriate audit organizations.*
>
> *<u>Chief Fiscal Officer</u>*
>
> *The Chief Fiscal Officer of each department is responsible for the management of fixed assets. Management includes an annual physical fixed asset inventory, the reconciliation of the results of that inventory, and the reporting the results of that inventory to the*

proper authorities. Department staff shall be properly trained on the workings of the Fixed Asset components of MMARS.

In addition, the MRC is required by the uniform administrative requirements of 34 CFR 80.32(d) to establish procedures for the managing of equipment (including replacement equipment), whether acquired in whole or in part with grant funds, until disposition occurs. Specifically, 34 CFR 80.32(d) states, in part:

> *(1) Property records must be maintained that include a description of the property, a serial number or other identification number, the source of property, who holds title, the acquisition date and cost of the property, the percentage of Federal participation in the cost of the property, the location, use and condition of the property, and any ultimate disposition data, including the date of disposal and sale price of the property.*
>
> *(2) A physical inventory of the property must be taken and the results reconciled with the property records at least once every two years.*
>
> *(3) A control system must be developed to ensure adequate safeguards to prevent loss, damage, or theft of the property. Any loss, damage, or theft shall be investigated.*
>
> *(4) Adequate maintenance procedures must be developed to keep the property in good condition.*
>
> *(5) If the grantee or subgrantee is authorized or required to sell the property, proper sales procedures must be established to ensure the highest possible return.*

Also, Chapter 647 of the Acts of 1989 requires that agencies immediately report unaccounted-for variances, losses, shortages, or thefts of funds or property to the Office of the State Auditor (OSA), stating, in part:

> *All unaccounted for variances, losses, shortages or thefts of funds or property shall be immediately reported to the State Auditor's Office, who shall review the matter to determine the amount involved which shall be reported to appropriate management and law enforcement officials.*

Our review showed that the MRC maintains two databases for Non-GAAP fixed assets,[3] one for EDP equipment, and one for Furniture/Non-EDP equipment. As of June 30, 2011, the EDP equipment database acquisition costs for computers and printers (2,155 items) totaled $1,879,505. The total acquisition cost for the Furniture/Non-computer database for items over

[3] Non-GAAP fixed assets are defined, in part, as singular assets (including infrastructure) with the following characteristics: vehicles, equipment, furniture, computer software, and all electrical and computer components with (1) a useful life of more than one year and (2) with an original cost between $1,000 and $49,999.

$1,000 (32 items) totaled $132,754 as of June 30, 2011. No exceptions were identified in our review of Furniture/Non EDP equipment records.

However, our review of supporting documentation of MRC's annual physical inventory of EDP equipment conducted at its central office and 12 of the 25 area offices disclosed that physical inspections of EDP equipment was not complete and, as a result, did not fully account for all EDP equipment assigned. Our examination identified the following discrepancies between MRC's database—totaling 1,393 computers and printers with an acquisition cost of $1,223,535 that were assigned to its central office and the 12 area offices selected—and supporting documentation of actual physical inspections performed:

- Of the 1,393 computers and printers, only 277 (20%) were accounted for on supporting documentation of actual physical inventories conducted. Of the 1,116 items not accounted for during physical inspections by MRC staff, 814 were computers and 302 were printers with total acquisition costs of $910,351.
- Of the 784 computers and printers assigned to MRC's central office, only 84 (11%) were accounted for on physical inventory supporting documentation. Of the 700 items not accounted for during physical inspections, 507 were computers and 193 were printers with total acquisition costs of $576,696. Furthermore, although we were informed by management that additional supporting documentation was completed, it was not retained and available for our review.
- Of the remaining 416 items not accounted for on physical inventory supporting documentation for the 12 area offices, 307 were computers while 109 were printers. Moreover, supporting documentation further showed that nine of the 12 area offices were instructed by the central office to only conduct a physical inventory of the two FY 2011 transactions we selected as part of our test of fixed assets.

In addition to the above review, we selected all FY 2011 EDP equipment acquisitions of computers and printers purchased with VR funds that had not been assigned to verify the assets' existence, location, and proper recording. Our analysis identified 144 items—82 computers and 62 printers—that had not been assigned to the central office, an area office, or a client. In order to physically inspect all unassigned equipment, we were brought by MRC staff to two storage rooms located at the central office where management indicated all unassigned equipment was stored. Nonetheless, our inspection did not locate any of the 144 pieces of equipment designated as unassigned. As a result, our audit disclosed $105,959 in questioned costs due to MRC's inability to account for unassigned equipment.

Without adequate internal controls and detailed policies and procedures, the MRC cannot ensure that fixed assets are being managed in accordance with applicable OSC and federal regulations and properly safeguarded against theft, loss, or misuse. Given that the MRC did not perform a complete annual physical inventory and reconciliation, the physical security of its assets may be at risk. Moreover, an effective review and approval practice by management at critical points of its fixed assets management process likely would have drawn attention to the above-noted deficiencies.

Recommendation

We recommend that the MRC establish and implement the necessary corrective action to ensure that its management of fixed assets complies with applicable state and federal regulations and that a control system is in place that properly safeguards fixed assets against loss, theft, or misuse. Toward that end, management should:

- Conduct a complete/comprehensive physical inspection and reconciliation of all EDP equipment to its EDP database. As part of this process, management should ensure that staff conducting the physical inventory is provided proper instruction and training to ensure inspections are conducted as prescribed and that all differences identified are properly documented and resolved.
- In accordance with Chapter 647 of the Acts of 1989, immediately report to the OSA any unaccounted-for variances, losses, shortages, or thefts of fixed assets as a result of physical inventories.
- Ensure that its EDP database is accurate, complete, and up-to-date.
- Establish formal written policies and procedures that detail its accounting, reconciliation, reporting, and recording of fixed assets, as well as its maintenance of fixed asset databases and the performance of annual physical inventories.

Auditee's Response

The Agency is in the processes of correcting its fixed asset inventory. The Agency is in the process of designing, developing and implementing policies and procedures as well as internal controls for fixed asset management. To support its new web-based VR consumer database [the Massachusetts Rehabilitation Client Information System], the Agency purchased many IT items during the fiscal year. During the same period, the Agency was in the process of transitioning IT purchases and inventory control from IT staff that are now under the supervision of EOHHS to MRC Administrative staff.

5. INTERNAL CONTROLS OVER CLIENT ELIGIBILITY DETERMINATIONS NEED IMPROVEMENT

Our audit disclosed that the MRC did not have the necessary policies, procedures, and control system in place to ensure that eligibility determinations performed for individuals applying for VR services are carried out within the 60-day timeframe required by state and federal regulations. In addition, in one case we determined that client application data (e.g., date of completion) keyed into the Massachusetts Rehabilitation Client Information System (MRCIS)[4] was not inputted timely and accurately. As a result, the MRCIS report, used by management to monitor area office compliance with the 60-day time limit, did not identify the case as noncompliant. For this reason, the MRCIS management monitoring report cannot be relied upon due to the risk of inaccurate client data.

34 CFR 361.41 (b)(1), promulgated by the Department of Education, states, in part:

> *Once an individual has submitted an application for vocational rehabilitation services, an eligibility determination must be made within 60-days, unless exceptional and unforeseen circumstances beyond the control of the designated State unit preclude making an eligibility determination within 60-days and the designated State unit and the individual agree to a specific extension of time.*

107 Code of Massachusetts Regulations (CMR) 4.07 (11) states, in part:

> *Eligibility will be determined as soon as there is sufficient information to decide whether or not the individual meets or does not meet the requirements for ineligibility but not more than 60-days from the date of application. The 60-day time period for determining eligibility can be extended only if there are exceptional and unforeseen circumstances beyond the Commission's control that prevent an eligibility decision within the 60-day time period. If an extension of time for the purposes of determining eligibility is needed, the counselor must: reach an agreement with the individual to extend the 60-day limit, provide him or her written notice concerning the circumstances for the delay, and discuss how the eligibility determination cannot be completed within the new time frame. If an extension of time is needed and no agreement can be reached, an individual must be advised of the rights and remedies that are available, including the right to a hearing by an impartial hearing officer and a referral to the Client Assistance Program.*

Chapter 1 of the OSC's Internal Control Guide, Monitoring, states, in part:

> *Monitoring is the review of an organization's activities and transactions to assess the quality of performance over time and to determine whether internal controls are effective .... The purpose of monitoring is to determine whether the internal control is adequately designed, properly executed, and effective.*

[4] MRCIS is an in-house client file database created by the MRC to track the progress/status of all client cases and used by management to monitor compliance with applicable state and federal regulations.

During our site visits to five area offices, we selected 25 client files (five from each area office) to ascertain whether MRC's eligibility determination process for VR services was conducted within the 60-day time period required by state and federal regulations. Our review disclosed that in four of the 25 cases (16%), eligibility was not determined within 60 days of the date of the client's application. Moreover, a closer examination of the four cases disclosed one case in which there was an unexplained 63-day delay in recording of the client's application date into MRCIS. With regard to this case, our review disclosed that:

- The area office director was unable to provide an explanation for the application date delay.
- MRC management informed us that MRCIS system controls prevented data from being backdated for more than three days. However, a special request can be made through the area office director and assistant commissioner for extenuating circumstances.
- A special request was not made in this case. Moreover, no written policies and procedures were provided regarding the MRCIS special request process. Therefore, it is unclear whether area office personnel are trained and familiar with MRCIS special request procedures.
- The incorrect application date recorded in the MRCIS resulted in a 10-day period, rather than 73 days, between the client's application date and the eligibility determination date. As a result, the MRCIS monthly report used by management (area directors) to monitor area office compliance with federal and state regulations did not identify this case as noncompliant.

Our review of the MRCIS fiscal year 2011 new application data showed that the percentage of noncompliant cases—client eligibility not determined within 60 days of the client application date—totaled 6.4%, or 717 of the 11,140 cases received during the period July 1, 2010 to June 30, 2011; well within the 90% compliance standard used by the Rehabilitation Service Administration (RSA). Nonetheless, given the risk of untimely and inaccurate client data, little, if any, reliance can be placed on the information and reports generated by the MRCIS.

If the determination of client eligibility is not conducted as specified by regulations, the MRC cannot ensure that individuals requesting vocational rehabilitation services are advised of their eligibility status on a timely basis. Moreover, without adequate internal controls and documented policies and procedures, the MRC will continue to be exposed to the risk that its MRCIS client database contains inaccurate client information that will impede management's ability to effectively monitor area office compliance with federal and state regulations.

Recommendation

We recommend that the MRC establish the necessary policies and procedures and control system to ensure that client eligibility determinations are done within the timeframe promulgated by state and federal regulations. Toward that end, the MRC should reexamine and strengthen existing internal controls to ensure that client data is timely and accurately keyed into its MRCIS system and that noncompliant cases are properly identified and reported for management's review and resolution. The MRC should also consider developing a MRCIS report that identifies cases where there is a delay in completing a client's application. Such a report would likely have drawn attention to the above-noted case. Furthermore, management should establish written policies and procedures that detail the process and define exceptional circumstances in which special request modifications to its MRCIS system ought to be performed as well as ensure that changes are appropriately authorized and documented and that the process is properly communicated to responsible personnel.

Auditee's Response

> *MRC has made outstanding gains in making eligibility determinations in a timely manner. The Assistant Commission[er] of VR Operations has made compliance a measurable objective for VR managers. Monthly reviews are conducted of Area Office operations with corrective action plans implemented as necessary. MRC does have the necessary policies and procedures regarding timely eligibility determinations. Further, additional training has been provided to all staff. The auditors did provide information regarding cases from a specific location where the counselor did not appropriately enter the application date. This, in turn, eroded the efficacy of the eligibility timeframe. In this situation the counselor was placed on disciplinary action. MRC is currently working on a new web based case management system. It is anticipated that [this] new MRCIS system will be rolled out on or about July 1, 2012. This issue has been discussed with the team of consultants building the new system. It is anticipated that safeguards will be in place [to ensure] confidence in system results.*