The Commonwealth of Massachusetts

AUDITOR OF THE COMMONWEALTH

ONE ASHBURTON PLACE, ROOM 1819
BOSTON, MASSACHUSETTS 02108

A. JOSEPH DeNUCCI
AUDITOR

TEL. (617) 727-6200

NO. 2005-4224-3C

INDEPENDENT STATE AUDITOR'S REPORT
ON CERTAIN ACTIVITIES OF
THE EDCO COLLABORATIVE
JULY 1, 1994 THROUGH JUNE 30, 2004

OFFICIAL AUDIT REPORT

JUNE 30, 2005

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The Education Collaborative for Greater Boston, Inc. (ECGB) was established in 1969 under Chapter 180 of the Massachusetts General Laws as a private not-for-profit corporation. In 1988, ECGB formed an additional organization, the EDCO Collaborative (EDCO) under Chapter 40, Section 4E, of the General Laws. EDCO is governed by a 40-member board of directors that oversees a collaborative of 20 urban and suburban school districts serving the Greater Metropolitan Boston area. EDCO's board of directors is composed of school superintendents and school committee members representing each of the member's school districts. EDCO's mission is to improve education through inter-district and interagency collaboration; provide high-quality educational and related services to at-risk students; and enhancing equity, intercultural understanding, and equal opportunity in education.

The state's Department of Education (DOE), in accordance with Chapter 647 of the Acts of 1989 (An Act Relative to Improving the Internal Controls within State Agencies), reported to the Office of the State Auditor (OSA) concerns DOE had regarding six accounts being maintained by EDCO. EDCO's new Executive Director had contacted the DOE in late June to share his belief that the administrator responsible for directing the activity of these accounts, a DOE employee, had been instructing EDCO to spend against these accounts without proper authority or the knowledge of the Chief Financial Officer. Consequently, DOE requested that the OSA review the activity in these accounts and determine whether any of the funds in these accounts should be remitted to the Commonwealth. Consequently, the scope of our audit was to review the activities within these six accounts, which as of June 30, 2004 had balances totaling $1,007,477. Our audit, which was conducted in accordance with applicable generally accepted government auditing standards for performance audits issued by the Comptroller General of the United States, had the following objectives: (1) assessing the system of internal controls EDCO had established over the administration of the six accounts in question and (2) conducting testing of these accounts' revenue and expense transactions to assess their reasonableness.

Our audit identified that EDCO, under the direction of the ESIS Administrator, had retained $966,585 in revenues that should have been remitted to the Commonwealth and various communities; that DOE in conjunction with DPH improperly used a vendor as a fiscal conduit to pay certain program expenses, thereby incurring $57,024 in unneccesary administrative costs; that EDCO under the diretion of the ESIS Administrator had expensed $116,060 in capital items rather than depreciating these assests over their useful lives as required by state regualtions; and charged nonreimbursable expenses totaling $31,919 against its state contracts.

During fiscal years 1995 through 2004, DOE awarded a contract to EDCO for the management of DOE's Educational Services in Institutional Settings (ESIS) program. Under this contract, EDCO provided program services and collected revenues for these services in the form of tuition payments from the school districts of local cities and towns and from out-of-state agencies whose students received services in the ESIS program. However, we found that contrary to state regulations, the ESIS Administrator did not first use all of these tuition revenues to offset the Commonwealth's costs of running its program. Instead, according to EDCO officials, between fiscal years 1998 and 2003, the ESIS Administrator (who was a DOE employee) directed EDCO's administrative staff to shift $966,585 in ESIS program expenses that were originally charged to the program's tuition accounts to the DOE contract that was used to fund this program. This resulted in EDCO accruing $853,691 in excess funds in its ESIS program tuition accounts that should have been returned to the Commonwealth. In addition, EDCO retained an additional $112,894 in tuition revenues in excess of its actual costs, which we believe should be remitted to the communities that paid these tuition expenses. Finally, the financial reports that EDCO submitted to the Commonwealth did not adequately disclose that EDCO was maintaining these excess revenues in its accounts.

We found that, contrary to state regulations and Chapter 29, Section 29B, of the General Laws, DOE in collaboration with DPH used a contracted human service provider, Toward Independent Living Inc. (TILL), as a fiscal conduit to pay as much as $434,943 of ESIS program expenses during fiscal years 2002 through 2004. In return for TILL's processing these bills, DPH paid TILL administrative fees totaling $57,024. Because DOE's and DPH's own accounting staff could have processed these payments, this $57,024 represents an unnecessary expense to the Commonwealth.

We found that during our audit period, EDCO expensed $116,060 in capital items in its ESIS program rather than depreciating them over their useful lives as required by state regulations and Generally Accepted Accounting Principles (GAAP). According to state regulations, capital expenses such as these that are not properly capitalized are nonreimbursable under state contracts.

Between fiscal years 1999 through 2004, the ESIS Administrator directed EDCO to charge $31,919 in expenses relative to an office he was renting to the ESIS contract. Since the ESIS Administrator already had office space at the Massachusetts Hospital School in Canton, MA, the payment of the expenses relative to this additional office was unnecessary and should not have been charged to the Commonwealth.

INTRODUCTION

Background

The Education Collaborative for Greater Boston, Inc. (ECGB) was established in 1969 under Chapter 180 of the Massachusetts General Laws as a private not-for-profit corporation. In 1988, ECGB formed an additional organization, the EDCO Collaborative (EDCO) under Chapter 40, Section 4E, of the General Laws. EDCO is governed by a 40-member Board of Directors that oversees a collaborative of 20 urban and suburban school districts serving the Greater Boston Metropolitan area. EDCO's Board of Directors is composed of school superintendents and school committee members representing each of the member's school districts. EDCO's mission is to improve education through inter-district and interagency collaboration; provide high-quality education and related services to students at risk; and enhance equity, intercultural understanding, and equal opportunity in education.

EDCO offers a variety of school services that assist member school districts in strengthening their curriculum, instructional, and professional development programs. The objectives of these school services are to establish and support networks and forums for sharing information, curriculum products, and theory and practice on teaching and learning to provide professional development for school personnel and to offer access to programs, resources, and materials through projects and alliances with local institutions. During the period covered by our audit, EDCO operated a variety of programs that provided academic support, therapeutic, and counseling services to consumers residing in various settings within the Greater Metropolitan Boston area. EDCO also participates in community partnerships with various schools and organizations, including Mass Insight for Research and Education, the state's Department of Education (DOE), Boston College School of Education, Research for Better Teaching Inc., and Wellesley College.

EDCO's funding primarily comes from state and local government agencies. For fiscal years 2002 through 2004, EDCO received the following revenues:

EDCO Collaborative Revenue

	Fiscal Year 2002	Fiscal Year 2003	Fiscal Year 2004[1]
Grants*	$ 5,597,036	$ 8,164,175	$ 6,374,059
Department of Social Services	71,732	71, 801	71,836
Department of Youth Services	4,298,460	2,178,190	236,348
Department of Education	8,972,845	8,643,292	8,474,779
Other Revenue	33,732	32,939	5,732
Total Revenue	$ 18,973,805	$ 19,090,397	$15,162,754

* The grant category includes assessments and tuitions charged to EDCO's member districts, grants awarded its School Service Division, federal grants, and special education tuitions collected for the ESIS program from other states and from local municipalities throughout the Commonwealth.

Audit Scope, Objectives, and Methodology

DOE, in accordance with Chapter 647 of the Acts of 1989, reported to the Office of the State Auditor (OSA) concerns it had regarding six accounts being maintained by EDCO. EDCO's new Executive Director had contracted the DOE in late June to share his belief that the administrator responsible for directing the activity of these accounts, a DOE employee, had been instructing EDCO to spend against them without proper authority or the knowledge of the Chief Financial Officer. Consequently, DOE requested that the OSA review these six accounts in order to identify any internal control weaknesses relative to their administration and determine whether any of the funds in these accounts, which as of June 30, 2004 totaled $1,007,477, should be retained by the Commonwealth. DOE officials informed us that the funds in these six accounts had been reverted by EDCO to the Office of the State Treasurer pending the result of our audit.

The scope of our audit was to review certain activities of EDCO primarily as they pertained to the administration of the six accounts that had been identified by DOE in its request for our audit. Three of these accounts as noted above are what EDCO calls "tuition accounts," whose revenues are derived from tuition charged by EDCO to both local educational agencies (LEA), and out-of-state agencies to pay for services students receive in EDCO's Educational Services in Institutional Settings (ESIS) program. The other three accounts are what EDCO refers to as "revolving accounts," whose revenue according to EDCO officials is derived from fees collected in relation to the accounts' activity. For example, according to EDCO officials, the funds deposited in the

[1] As of the end of our audit field work EDCO had not filed its fiscal year 2004 Uniform Financial Statements and Independent Auditor's Report (UFR) with the Commonwealth. Consequently, the figures provided for fiscal year 2004 are based on EDCO's financial records but are unaudited.

Performing Arts revolving fund are derived from fees charged to view performances. A summary of the activity in the six accounts in question appears in the table below:

ESIS Program Accounts	Fiscal Years	Revenue	Expenses	Fund Balance	Accounts Receivable as of 6/30/04	Amount Reverted
ESIS- DOE Tuition	1995 to 2004	$7,253,884	$6,512,484	$741,400	$45,428	$734,087
ESIS- DPH* Tuition	1999 to 2004	779,579	743,380	36,199	1,859	36,199
ESIS -Out of State Tuition	1995 to 2004	1,348,159	1,158,256	189,903	37,120	196,299
Adaptive Design**	Balance Forward plus 2002 to 2004	12,731	4,862	7,869		7,869
Performing Arts**	Balance Forward plus 2002 to 2004	36,543	10,805	25,738		25,738
Print Shop**	Balance Forward plus 2002 to 2004	9,704	2,419	7,285	______	7,285
Totals		$9,440,600	$8,432,206	$1,008,394	$84,407	$1,007,477

*Massachusetts Department of Public Health

** The amounts in these accounts were determined by adding the beginning balance in these accounts as of June 30, 2001 to actual revenues received in these accounts during fiscal years 2002 though 2004.

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

Our audit procedures consisted of (1) assessing the system of internal controls EDCO had established over the administration of the six accounts in question and (2) testing revenue and expense transactions in these accounts to assess their reasonableness.

In order to achieve our objectives, we first assessed the internal controls established and implemented by EDCO over its operations, particularly as they pertain to the six accounts in question. The purpose of this assessment was to obtain an understanding of management's attitude, the control environment, and the flow of transactions through the six accounts. We used this assessment in planning and performing our audit tests. We then held discussions with EDCO, Department of Public Health (DPH), and Operational Services Division (OSD) officials and employees. We reviewed organizational charts and internal policies and procedures as well as all applicable laws, rules, and regulations. We also examined EDCO's financial statements, budgets, cost reports, invoices, and other pertinent financial records to determine whether expenses that were transacted through these six accounts were reasonable, allowable, allocable, properly authorized and recorded, and in compliance with applicable laws, rules, and regulations.

Our special-scope audit was not conducted for the purposes of forming an overall opinion on EDCO's financial statements. We also did not assess the quality or appropriateness of all program services provided by EDCO under its state-funded contracts. Rather, our report was intended to assess the activities conducted through the six accounts in question and report findings and conclusions on the extent of EDCO's compliance with applicable laws, regulations, and contractual agreements.

At the conclusion of our audit, we met with EDCO and DOE officials to discuss the issues we identified during our audit. The comments made by DOE and EDCO officials during these meetings were considered in the drafting of our final report. In addition, on March 21, 2005 the Commissioner of the Department of Education sent a letter to the State Auditor, which in part indicated that DOE was taking actions to ensure that it is implementing proper management controls and systems over its ESIS program.

AUDIT RESULTS

1. EDCO, UNDER THE DIRECTION OF THE ESIS ADMINISTRATOR, RETAINED $966,585 IN FUNDS THAT SHOULD HAVE BEEN REIMBURSED TO THE COMMONWEALTH AND VARIOUS COMMUNITIES

During fiscal years 1995 through 2004, the state's Department of Education (DOE) awarded a contract to the EDCO Collaborative (EDCO) for the management of DOE's Educational Services in Institutional Settings (ESIS) program. Under this contract, EDCO provided program services and collected revenues for these services in the form of tuition payments from the school districts of local cities and towns and from out-of-state agencies whose students received services in the ESIS program. However, according to EDCO officials, we found that contrary to state regulations, the ESIS Administrator did not first use all of these tuition revenues to offset the Commonwealth's costs of running its program. Instead, between fiscal years 1998 and 2003, the ESIS Administrator (who was a DOE employee) directed EDCO's administrative staff to shift $966,585 in ESIS program expenses that were originally charged to the program's tuition accounts to the DOE contract that was used to fund this program. This resulted in EDCO's accruing $853,691 in excess funds in its ESIS program tuition accounts that should have been returned to the Commonwealth. In addition, EDCO retained an additional $112,894 in tuition revenues in excess of its actual costs, which we believe should be remitted to the communities that paid these tuition expenses. Finally, the financial reports that EDCO submitted to the Commonwealth did not adequately disclose that EDCO was maintaining these excess revenues in its accounts.

During fiscal year 1995, DOE awarded EDCO a cost reimbursement contract to operate its ESIS program. Under the terms and conditions of this contract, EDCO was to assist the ESIS Administrator in providing educational services to institutionalized residential students up to the age of 22. These services are provided at the Massachusetts Hospital School (MHS), which is a Department of Public Health (DPH)-operated facility located in Canton, as well as other Division of Youth Services (DYS) and Department of Mental Health (DMH) facilities across the Commonwealth. In addition, ESIS program services are also provided to students who commute to MHS for services but do not reside at the facility.

In return for these services, EDCO was to be reimbursed for all expenses incurred in providing these services up to the maximum obligation of the contract.

The ESIS program contract's maximum obligations, by fiscal year, were as follows:

Fiscal Year	Amount
1995	$ 6,323,516
1996	6,722,963
1997	6,648,480
1998	6,948,932
1999	7,610,852
2000	7,838,923
2001	8,381,736
2002	8,937,921
2003	8,662,909
2004	8,413,214
Total	$76,489,446

Under this contract, EDCO was also required to establish mechanisms to manage and administer the various state, federal, and tuition funds received by the program. The tuition funds that EDCO collected for the ESIS program are composed of tuition fees set by DOE and charged by EDCO to local educational agencies (LEA), including cities and towns and school districts within Massachusetts, and out-of-state agencies that send students for services in the ESIS program. The tuition funds that EDCO collected in the ESIS program since fiscal year 1995 are detailed below:

Fiscal Year	Mass. Tuition Funds	Out-of-State Tuition Funds
1995	$ 644,618	$ 129,463
1996	633,995	68,636
1997	698,904	102,778
1998	773,994	134,167
1999	729,195	140,695
2000	635,920	181,111
2001	746,653	171,111
2002	768,318	143,750
2003	777,254	133,429
2004	845,033	143,019
Total	$7,253,884	$1,348,159

During our review of the ESIS program, we identified several internal control issues. First, although EDCO was required to collect tuition payments, DOE had not established policies or procedures to manage these funds. Further, a DOE memorandum of understanding with other state agencies, calling for the collection of these tuitions, did not specify how and in what manner these payments should be collected and managed. Also, the ESIS contract did not adequately specify the scope of services EDCO was to provide under the contract. Rather, the Request for Responses (RFR) issued for this contract stated that the ESIS Administrator was the sole fiscal person and that EDCO's services under this contract would be determined on an ongoing basis by the ESIS Administrator.

Based on these internal control problems, we reviewed EDCO's administration of the ESIS program, including the receipt of tuition payments and the payment of expenses from the ESIS program's tuition accounts. Based on our review, we found that EDCO was not properly administering the revenues it received for ESIS program services. Specifically, the Commonwealth's Operational Services Division (OSD), the agency responsible for regulating and overseeing the activities of all contracted human service providers such as EDCO, has established regulations that identify costs that are nonreimbursable under state contracts. Specifically, 808 Code of Massachusetts Regulations (CMR) 1.03 (5), identifies the following as nonreimbursable expenses under state contracts:

> *Any client resources or third party payments made on behalf of a client (covered by the contract), that are not expressly recognized or anticipated in the computation of the price, shall reduce the amount of the department's obligation for services provided to that client.*

The contract that funded EDCO's ESIS program is a cost reimbursement contract, which OSD defines as:

> *A payment arrangement under which the purchasing agency reimburses the provider for budgeted costs actually incurred in rendering the services specified in the agreement, up to the stated maximum obligation.*

We noted that none of the tuition revenue that was going to be received in this program was considered by DOE (e.g., specifically designated to be used to offset the state's cost of operating the program) in establishing the ESIS program contract's maximum obligation. Therefore, all the tuition payments received in this program, in accordance with OSD regulations, should have been used to reduce the amounts DOE was paying to fund this program.

We found, however, that ESIS was not using all of the tuition payments EDCO had collected to offset DOE's cost of running the program. Rather, according to EDCO officials, the agency provided the ESIS Administrator with bi-monthly DOE contract expenditure reports. These reports indicated the current status of the amount of funding that remained in the DOE contract that funded the ESIS program by budget category (e.g., staff salaries). These reports also noted the anticipated "free cash" in the contract, which was the amount of contract funding anticipated to be available due to a variety of reasons, such as vacant teacher positions not being filled. According to EDCO officials, two months before the end of each fiscal year, the ESIS Administrator would determine how much free cash was available and then would instruct EDCO staff to shift expenses that were charged to the ESIS program's tuition accounts to the DOE contract. According to EDCO officials, this was done to avoid having to revert any unused funds that were available under this contract back to the Commonwealth.

The result of this cost shifting was that EDCO's tuition accounts built up significant reserves. During our audit, we reviewed the documentation EDCO was maintaining relative to these cost-shifting activities and noted that, between fiscal years 1998 and 2003, the following costs were shifted from EDCO's ESIS program tuition account to the DOE contract:

Costs Shifted from Tuition Accounts to DOE's Contract

Fiscal Year*	Shifted Costs
1998	$104,664
1999	170,381
2000	-
2001	138,416
2002	58,983
2003	381,247
Total	$853,691

* For the fiscal year ended June 30, 2004, EDCO did not shift costs from its ESIS program tuition accounts to its DOE contract and consequently reverted approximately $114,000 of ESIS program funding to the Commonwealth.

Because EDCO did not use all of the tuition funds it received from the ESIS program to offset the state's costs of funding the program, the Commonwealth should retain the $853,691 in expenses that were shifted from these accounts to the DOE contract. Further, since EDCO agreed to operate this program on a cost-reimbursement basis, the excessive tuition revenues of

$112,894 ($966,585 in tuition revenues less $$853,691 in program expenses that should have been charged to these accounts) should be refunded to the communities and school districts that paid these tuition costs.

Finally, regarding the reporting of these revenues, the American Institute of Certified Public Accountants (AICPA) Audit and Accounting Guide, Not-for-Profit Organizations states, in part:

> *Some not-for-profit organizations receive assets in agency transactions. If cash and other financial assets are held under agency transactions, the organization should report a liability to the specified beneficiary concurrently with its recognition of those assets received from the donor. If the assets received from the donor are donated materials, supplies, or other nonfinancial assets, the recipient organization may choose either to (a) report the receipt of the asset as a liability to the beneficiary concurrent with recognition of the assets received or (b) not to report the transaction at all. The choice is an accounting policy that should be applied consistently from period to period. An organization should consider the need for disclosure in the notes to the financial statements pursuant to APB Opinion No. 22, Disclosure of Accounting Policies, and FASB Statement No. 136, paragraph 11.*

We determined that although EDCO did report the tuition revenue received in its ESIS program as a liability owed the Commonwealth, it did not properly disclose the nature of this liability in the notes to its financial statements. Also, the revenue in this program was not clearly shown as funds received from local and out of state cities and towns.

Regarding this matter, EDCO officials stated that they complied with the ESIS Administrator's instruction to transfer costs between the tuition accounts and the ESIS program contract because this individual was the chief fiscal person for this program. In addition, regarding the financial statement disclosures, these officials stated that because they had consistently reported the financial information to the ESIS Administrator as requested, and assumed it to be satisfactory to DOE, they were unaware that EDCO's financial statements did not adequately disclose the information relative to these six ESIS related accounts.

Recommendation

The Commonwealth should retain $853,691 of the funds that were transferred by EDCO to the Office of the State Treasurer in order to compensate for the expenses that should have been charged by EDCO to the ESIS program's tuition accounts, rather than to the DOE contract. Additionally, DOE should remit the remaining $153,786 to EDCO and instruct it to refund

$112,894 of this amount, which constitutes the balance remaining in the three tuition accounts to the communities that paid these tuition expenses. In the future, EDCO should fully utilize all the tuition revenue it receives in the ESIS program to offset the state's cost of operating this program. If excess revenues are received in the program, these funds should be remitted to the Commonwealth at the end of each fiscal year. Finally, EDCO should also ensure that it maintains accurate and complete financial information and properly records and reports all of its financial transactions.

2. DOE, IN COLLABORATION WITH DPH, USED A VENDOR AS A FISCAL CONDUIT TO PAY $434,943 IN ESIS PROGRAM EXPENSES AND THEREBY INCURRED $57,024 IN UNNECESSARY ADMINISTRATIVE EXPENSES

We found that contrary, to state regulations and Chapter 29, Section 29B, of the Massachusetts General Laws, DOE, in collaboration with DPH, used a contracted human service provider, Toward Independent Living Inc.,(TILL), as a fiscal conduit to pay as much as $434,943 of ESIS program expenses during fiscal years 2002 through 2004. In return for TILL's processing these bills, DPH paid TILL administrative fees totaling $57,024. Because DOE's and DPH's own accounting staff could have processed these payments, this $57,024 represents an unnecessary expense to the Commonwealth.

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

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

Furthermore, when these contracts in question were initially awarded, 808 CMR 2.03 (06), promulgated by the state's Operational Services Division (OSD), the agency responsible for regulating and overseeing contracted special education service providers such as EDCO, was in effect and stated the following:

> *<u>Fiscal Conduits Prohibited</u>. No procuring Department shall award a Contract:*
>
> *to acquire any goods for the Procuring Department's use;*

> *to defray the expenses of services rendered by individuals hired or supervised in the daily performance of their work by personnel in the classified service of the Commonwealth; or*
>
> *solely to acquire payroll of fiscal management for a Program of Client services operated by the Commonwealth or any third party.*

During our audit, EDCO officials stated that the agency has for many years been directed by the ESIS Administrator to forward $4,500 of the $19,500 in tuition fees paid by each LEA for each commuting or day student in the ESIS program to another nonprofit human service organization, TILL. The total amount of tuition funds that EDCO forwarded to TILL between fiscal years 2002 through 2004 was $434,943. This funding was to compensate TILL for the services it was providing under Memorandums of Understanding (MOU) that TILL had entered into with MHS. Under these MOUs, TILL was to work collaboratively with MHS, DOE, and EDCO to facilitate the provision of services to patients at MHS. However, our review of the terms and conditions of these MOUs disclosed that TILL was only required to provide various fiscal management services, whereas the actual recruitment, training, and supervision of staff that was to provide the services in this program was done by MHS.

Specifically, our review of the MOUs between MHS and TILL that were renewed on an annual basis by mutual consent identified that the MOUs contained language that clearly indicated that TILL was to merely function a fiscal conduit. Examples of this language are excerpted below:

- *MHS is required to perform CORI checks on all personnel hired with copies of reports sent to TILL's Director of Human Resources*
- *MHS will be responsible or orienting and training each person hired. MHS certifies that it will provide the proper training necessary for them to perform their job safely and thoroughly….*
- *MHS is to recruit, screen and hire personnel. Supervise and train all such personnel accordance with MHS's job descriptions and expectations. Provide performance reviews and salary reviews…Fill vacancies and or substitute personnel.*
- *MHS is to provide TILL with a list of training expectations and indicate in writing that TILL is absolved of any responsibilities to ensure training and performance standards.*
- *TILL will ensure that personnel selected by MHS meet with TILL's requirements for hire, provide orientation regarding TILL's paperwork and hiring procedures necessary for payment.*
- *TILL will hire the appropriate personnel as noted in Appendix A, B and C who are recruited and screened by MHS and will provide those eligible for benefits with the*

> *TILL benefits package in accordance with its personnel handbook for which 23% will be charged as noted above….*

In addition to the MOU language above that clearly indicates that TILL was being used as a fiscal conduit, MHS and DPH personnel stated that the employees who were supposed to be hired by TILL were in fact hired by DPH and that TILL only processed their paperwork. In return for these services, TILL was able to bill an administrative fee that ranged between 11.5% and 13%, which during fiscal years 2002 through 2004 totaled $57,024. Because DOE's and DPH's own accounting staff could have processed these payments, this $57,024 represents an unnecessary expense to the Commonwealth.

Regarding this matter, EDCO officials indicated that the ESIS Administrator had told them to provide this $4,500 per-student amount to TILL and that they were unaware of any fiscal conduit situation.

Recommendation

EDCO should immediately discontinue using TILL as a fiscal conduit to provide services at MHS. In the future, EDCO should not participate in the procurement of program services using state funds that include the inappropriate use of fiscal intermediaries.

3. CAPITAL ITEMS TOTALING $116,060 IMPROPERLY EXPENSED

We found that during our audit period, EDCO improperly expensed $116,060 in capital items in its ESIS program rather than depreciating them over their useful lives as required by state regulations and Generally Accepted Accounting Principles (GAAP). According to state regulations, capital expenses such as these that are not properly capitalized are nonreimbursable under state contracts.

OSD regulation 808 CMR 1.05 identifies the following costs as nonreimbursable under state contracts:

> *(4) Current Expensing of Capital Items. All costs attributable to the current expensing of a Capital Item.*
>
> *(26) Undocumented Expenses. Costs which are not adequately documented in the light of the American Institute of Certified Public Accountants statements on auditing standards for evidential matters.*

OSD also provides the following guidance in its *UFR Audit and Preparation Manual*:

> *Generally accepted accounting principles require that purchases having a future economic benefit and life beyond one year be capitalized and depreciated over a certain time period. . . .*

An example of the depreciation schedule established by OSD appears below:

Schedule of Service Lives of Assets

Asset Category	Years of Life	Yearly Rate
Equipment	10	10.0%
Computer Equipment	3	33.33%
Other Office and Other Program Equipment:	5	20.0%
Includes items such as copiers, ovens, washers, dryers, office files, and capitalized office and program supplies.		
Life Safety Improvements:	5	20.0%
Building or leasehold improvements or equipment acquisitions made solely to satisfy the requirements of any department regarding life safety or physical environment. Purpose must be documented.		
Motor Vehicles	5	20.0%
Used Motor Vehicles	3	33.33%
Residential Furnishings	3	33.33%
Office Furnishings	7	14.2%

During our audit, we reviewed the expenditures made by EDCO relative to its ESIS program and noted that EDCO inappropriately expensed at least $116,060 in capital items in its ESIS program rather than depreciating them over their useful lives as required by OSD regulations. The capital items, dates of acquisition, and their related costs appear in the table below:

Vendor	Date(s)	Amount	Description
Potentials	4-15-98	$ 17,000	Sound and lighting at MHS Performing Arts program
Adv Lighting	11-18-98	6,060	Flood lamps and lights at MHS Performing Arts program
ABC Contractor	10-29-99	5,000	Demolition and renovation of structures at MHS Performing Arts program
ATS Corp	5/00 - 7/01	18,919	Installation of an intercom system, electrical and audio/sound equipment at MHS Performing Arts program
Brite-Light Electrical	3/23/01	1,164	Installation of receptacles and microphone at MHS Performing Arts program
Theatrix	1/01 through 2/02	67,917	Staging platforms, design and install stage lighting, stage pulleys, ½ ton hoist, rigging and chain control system at MHS Performing Arts program
Total		$116,060	

Regarding this matter, EDCO officials indicated that they were instructed by the ESIS Administrator to expense these items rather than depreciate them over the estimated useful lives as required by state regulations.

Recommendation

EDCO should amend its UFRs to properly account for the depreciation of the $116,060 in capital asset expenses it incorrectly charged against its state contracts during our audit period. In the future, EDCO should take measures to ensure that it properly depreciates all capital items, including improvements, in accordance with state regulations.

4. NONREIMBURSABLE COSTS TOTALING $31,919 CHARGED TO STATE CONTRACTS

Between fiscal years 1999 through 2004, the ESIS Administrator had EDCO charge $31,919 in expenses relative to an office he was renting to the ESIS contract. Since the ESIS Administrator already had office space at the Massachusetts Hospital School in Canton, MA the payment of the expenses relative to this additional office was unnecessary and should not have been charged to the Commonwealth.

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

> *(1) <u>Unreasonable Costs</u>. Any costs not determined to be Reimbursable Operating Costs as defined in 808 CMR 1.02 or any amount paid for goods or services which is greater than either the market price or the amount paid by comparable Departments or other governmental units within or outside of the Commonwealth.*
>
> *(12) <u>Non-Program Expenses</u>. Expenses of the Contractor, which are not directly related*

During our audit, we determined that during fiscal years 2000 through 2004, the ESIS Administrator directed EDCO to lease 356 square feet of office space located at 225 Water Street, Plymouth, for his use and to charge the expenses associated with this lease to EDCO's ESIS program contract. The lease for this space was executed on November 22, 1999 between EDCO and Harborview Trust. The initial term for this lease was 19 months, but two amendments were signed that extended the lease for an additional two-year term. According to EDCO staff, this space was only utilized by the ESIS Administrator, and no EDCO staff used this space. EDCO staff also indicated that they did not know why this additional space was necessary, given that the ESIS Administrator had office space both at EDCO's administrative office and at MHS. A summary of the expenses EDCO charged against its ESIS program contract relative to the leasing of this space, by fiscal year, is summarized as follows:

Fiscal Year End	Office Space	Telephone	Total
2000	$4,747	$409	$5,156
2001	5,696	698	6,394
2002	5,696	1,236	6,932
2003	5,696	1,085	6,781
2004	5,696	960	6,656
Total	$27,531	$4,388	$31,919

Since the ESIS Administrator already had office space at EDCO's administrative office and at MHS, the costs associated with the leasing of this additional office space in Plymouth were unreasonable and therefore represent nonreimbursable expenses to EDCO's state contract. Regarding this matter, the ESIS Administrator indicated that this space was close to his home and that he and other DOE staff used it to conduct business related to DOE programs. However, DOE officials stated that they were not aware of any DOE employees except the ESIS Administrator working at this location.

Recommendation

DOE should review this issue and take whatever measures it deems necessary to resolve this matter. In the future, EDCO should not charge ay unreasonable or non-program-related expenses against its state contacts.

APPENDIX

Communities/School Districts Served by EDCO

As of June 30, 2004

Acton

Acton-Boxborough Regional School District

Arlington

Bedford

Belmont

Boston Archdiocesan Schools

Boxborough

Brookline

Carlisle

Concord

Concord-Carlisle Regional School District

Lexington

Lincoln

Lincoln-Sudbury Regional School District

Newton

Sudbury

Waltham

Watertown

Weston

Winchester