# The Commonwealth of Massachusetts

**AUDITOR OF THE COMMONWEALTH**

ONE ASHBURTON PLACE, ROOM 1819

BOSTON, MASSACHUSETTS 02108

TEL. (617) 727-6200

A. JOSEPH DeNUCCI

AUDITOR


**NO. 2000-4396-3**

# INDEPENDENT STATE AUDITOR'S REPORT ON CERTAIN ACTIVITIES OF TOWARD INDEPENDENT LIVING AND LEARNING, INC. JULY 1, 1997 THROUGH DECEMBER 31, 2000

**OFFICIAL AUDIT REPORT**

**JANUARY 7, 2002**

# TABLE OF CONTENTS/EXECUTIVE SUMMARY



Toward Independent Living and Learning, Inc., (TILL) was originally organized in May 1979 as a not-for-profit human service agency to serve both children and adults with autism and developmental disabilities. During the period of our audit, TILL operated programs that provided a variety of mental health and other human services to eligible adolescents and adults residing in the Commonwealth. These services fall into four major areas: family support, residential services, day programs, and a mental health center. Our audit had the following objectives: (1) to determine whether TILL established an adequate system of management controls and (2) to assess TILL's business practices and its compliance with applicable laws, regulations, policies, procedures, and various fiscal and programmatic requirements of its state contracts. Our audit identified several undisclosed related-party relationships and transactions; $934,557 in unallowable and questionable related-party transactions; at least $3,203,587 in undocumented payroll costs; at least $273,274 in questionable salary and vehicle expenses for TILL's President; $50,836 in undocumented and questionable costs charged against a cost reimbursement contract; and inadequate administrative and internal controls over various aspects of TILL's operations.



We found numerous problems relative to related-party activities at TILL. First, contrary to state guidelines, TILL failed to adequately disclose at least five related-party relationships and transactions during the period covered by our audit. Second, TILL used members of its administrative staff who were being funded under Massachusetts state contracts to provide services to two other related-party organizations that were owned by TILL's President. According to TILL officials, TILL billed these two related parties for the cost of this administrative staff. However, the agency did not have any documentation (e.g., payroll records), to substantiate the number of hours TILL's administrative staff spent performing administrative tasks for these related parties. Thus, it could not be demonstrated whether the reimbursements TILL received from its two related parties for these administrative services were appropriate. Further, TILL did not bill these related parties for any overhead costs (e.g., rent, electricity, heat, supplies) that may have been incurred by the agency in providing these services. As a result, TILL used at least $7,746 in state funds to subsidize the activities of these two related parties during our audit period. We also found that TILL conducted several other questionable related-party transactions totaling $926,811, including using agency funds to subsidize the payroll expenses of a related party and a down payment on a property being purchased by one of its related parties.



We found that TILL had not established adequate controls over the allocation of payroll expenses for its salaried employees as required by state regulations and the terms and conditions of its state contracts. Specifically, although the agency has policies and procedures relative to the preparation and maintenance of payroll records, including weekly payroll records for its hourly (direct care) employees, these policies and procedures did not require TILL's salaried employees to complete weekly payroll records documenting the hours worked and the functions benefited (e.g., specifies program, cost center). As a result, there is inadequate assurance that all of the approximately $3,203,587 in salaries and related costs that TILL allocated against its state contracts for its salaried employees during our audit period was accurate.



During our audit period, TILL's President billed and received from the Commonwealth $267,334 in salary and related expenses for functioning as a full-time employee of the agency. However, according to TILL-NH's financial records, during this same period of time, TILL's President also received $120,347 for functioning as an employee of TILL-NH. None of TILL's administrative staff, including TILL's President, maintained payroll records that documented the days and hours or the programs on which they worked. Thus, the reasonableness of the $267,334 in salary expenses TILL's President received from the Commonwealth during the same time that the President also reportedly received a full-time salary from TILL-NH could not be demonstrated. We also found that during our audit period, TILL's President charged $11,880 to Massachusetts state contracts to lease a vehicle that was used to commute to TILL-NH. Given that this vehicle was, in part, used in a non-Massachusetts program, we question the propriety of charging at least half of these lease expenses, or $5,940, to Massachusetts state contracts.



During fiscal year 1999, TILL billed and received payments from the Department of Mental Retardation (DMR) totaling $90,000 under a cost-reimbursement contract to operate its Project Engage Program. Our review of the costs that TILL billed DMR for provided program services identified at least $50,836 in expenditures that were either undocumented, inadequately documented, or non-program-related. According to state regulations, such expenses are unallowable and nonreimbursable under state contracts.

We found that TILL did not develop and implement an adequate system of internal controls over all aspects of its operations. For example, TILL had no written accounting policies and procedures or an accounting manual to ensure the accuracy of its financial transactions, reports, and recordkeeping. Also, TILL's accounting system did not adequately document personnel and related-party costs. As a result, TILL and the Commonwealth cannot be assured that TILL's financial assets and Commonwealth funds were being properly safeguarded or that transactions relative to these accounts were properly authorized, recorded, and reported.

# INTRODUCTION

***Background***

Toward Independent Living and Learning, Inc. (TILL) was originally founded in May 1979 as a not-for-profit human service agency to serve children and adults with autism and developmental disabilities. During the period of our audit, TILL operated programs providing a variety of mental health and human services for both eligible adolescents and adults residing within the Commonwealth. These services fall into four major areas: family support, residential services, day programs, and a mental health center. (A description of the services provided by TILL during our audit period appears in the Appendix section.)

During fiscal year 1998, TILL assumed the operation of The Springboard Inc., an unrelated not-for-profit organization that liquidated its assets and transferred them to TILL. TILL also has five related parties, two of which were parties TILL conducted transactions with during our audit period and were disclosed on TILL's Uniform Financial Statements and Independent Auditor Reports (UFRs) for fiscal years 1998 through 2000, which TILL filed with the state's Operational Services Division (OSD). These related parties are TILL New Hampshire (TILL-NH) and LEAD Inc., (LEAD). A description of these related parties follows:

- <u>TILL-NH</u>: This entity was originally incorporated under Chapter 156B of the Massachusetts General Laws on July 1, 1993, and has its administrative office located in Nashua. During fiscal year 1998, TILL-NH elected to become a subchapter "S" corporation under IRS Code Section 1362. According to its Articles of Organization, its primary mission is to serve as a private, for-profit human service agency to develop and operate programs and services to meet the needs of individuals with mental retardation, mental illness, physical handicaps, emotional problems, and other developmental disabilities. TILL-NH's operations are funded primarily through contracts with the state of New Hampshire. The President of TILL, who also serves as the President and Treasurer of TILL-NH, owns 100% of TILL-NH's corporate stock.

- <u>LEAD</u>: LEAD was incorporated on October 9, 1985, under Chapter 156B of the General Laws. According to its Articles of Organization, its primary mission is to provide life-enrichment service programs, including programs for the developmentally disabled. LEAD revenues are primarily generated from food service catering contacts under which it operates local school and municipal cafeterias. The President of TILL, who also serves as the President and Treasurer of LEAD, owns 100% of LEAD's corporate stock. Other members of TILL's senior management staff serve as officers and board members of LEAD; specifically, TILL's Director of Contracts serves as LEAD's Treasurer, and TILL's Vice-President serves as the Clerk of LEAD's Board of Directors.

During our audit, we determined that TILL's UFRs did not disclose three other related parties; Training, Research and Implementation Inc., (TRI); Specialty Management Services Inc., (SMS); and Specialty Management Services LP (SMS LP). A description of these three related parties appears in Audit Result No. 1.

During the period of our audit, TILL received funding from a variety of sources, as indicated in the table below:

**Toward Independent Living and Learning, Inc.**

**Summary of Revenue ***

**July 1, 1997 through June 30, 2000**

| | Fiscal Year | | |
|---|---|---|---|
| Revenue Source | 1998 | 1999 | 2000 |
| Department of Mental Retardation (DMR) | $ 8,519,899 | $ 9,028,518 | $ 9,764,288 |
| Department of Social Services (DSS) | - | 1,650 | 37,564 |
| Massachusetts Rehabilitation Commission (MRC) | 68,248 | 77,915 | 74,387 |
| Third-Party Fees | 832,926 | - | - |
| Client Resources (SSI, Foodstamps, etc.) | - | 898,999 | 876,139 |
| Medicaid | 2,923,118 | 3,098,922 | 3,029,934 |
| Private Client Fees | 284,808 | 116,790 | - |
| Investment Revenue - Unrestricted | 47,485 | 49,254 | 71,580 |
| Gain on Sale of Assets - Unrestricted | 107,526 | - | 6,589 |
| Revenue and Services from Commercial Products | 140,678 | 179,207 | 147,702 |
| Gifts and Contributions | 4,520 | 4,209 | 208,223 |
| Other Unrestricted Revenue | - | 13,306 | 18,635 |
| Total Revenue | $12,929,208 | $ 13,468,770 | $ 14,235,041 |

* Information extracted from TILL's UFRs.

### *Audit Scope, Objectives, and Methodology*

The scope of our audit was to examine various administrative and operational activities of TILL during the period July 1, 1997 to December 31, 2000. However, in some instances it was necessary for us to extend the period covered by our audit in order to adequately examine certain transactions that were selected for testing during our review.

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

Our audit procedures consisted of the following:

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

In order to achieve our objectives, we first assessed the management controls established and implemented by TILL over its operations. The purpose of this assessment was to obtain an understanding of management's attitude, the control environment, and the flow of transactions through TILL's accounting system. We used this assessment in planning and performing our audit tests. We then held discussions with TILL officials, members of the agency's Board of Directors, and officials from the state's Operational Services Division (OSD) and reviewed organization charts and internal policies and procedures as well as all applicable laws, rules, and regulations. We also examined TILL's financial statements, budgets, cost reports, invoices, and other pertinent financial records to determine whether expenses incurred under its state contracts were reasonable, allowable, allocable, properly authorized and recorded, and in compliance with applicable laws, rules, and regulations. Finally, we reviewed various documents that were provided to us by TILL officials relative to certain activities conducted by TILL's related-party organizations and spoke with certain members of the Board of Directors of one of the related parties.

During our audit, the scope of our review was limited by TILL's inability to provide the audit team with certain requested documents. A scope limitation occurs when an auditee places restrictions on the scope of the auditor's work. These restrictions result in a disruption in the timing of the audit work performed, including the inability to apply all the audit procedures considered necessary by the auditor in the circumstances of the engagement. Such restrictions were encountered by the staff during our audit engagement. The OSA is authorized by its enabling legislation, Chapter 11, Section 12, of the General Laws, to perform audits of entities such as TILL that contract with the Commonwealth to "determine compliance with the provisions and requirements of such contracts or agreements and the laws of the commonwealth." This statute further mandates that "the state auditor shall have access to such accounts at reasonable times and said department [OSA] may require the production of books, documents, vouchers, and other records relating to any matter within the scope of such audit..." Additionally, regulations promulgated by the OSD, the agency responsible for regulating and overseeing all state contracts awarded to contracted service providers such as TILL, require service providers to provide all records needed by the OSA as well as other organizations to complete an audit of the agency. Specifically, 808 Code of Massachusetts (CMR) 1.04 (8) states:

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

Despite these statutory requirements, during the conduct of our audit fieldwork, TILL did not make some of the requested records available to the audit staff. Specifically, TILL was unable to provide us with some of the documentation we requested relative to various inter-company financial activities between TILL and its related parties. Therefore, our ability to perform sufficient audit testing in this area was impaired, and the audit results and opinions expressed in this report are based solely on the documentation TILL provided to the audit team.

Our audit was limited to a review of the activities of TILL. Although we reviewed various documents relative to certain activities conducted by TILL's related parties, we did not conduct any audit work onsite at any of these entities. Our audit was not made for the purposes of forming an opinion on TILL's financial statements. We also did not assess the quality and appropriateness of all program services provided by TILL under its state-funded contracts. Rather, our report was intended to report findings and conclusions on the extent of TILL's compliance with applicable laws, regulations, and contractual agreements; to determine the adequacy of TILL's performance; and to identify services, processes, methods, and internal controls that could be made more efficient and effective.

# AUDIT RESULTS

## 1. UNDISCLOSED RELATED-PARTY RELATIONSHIPS AND TRANSACTIONS, UNALLOWABLE RELATED-PARTY COSTS TOTALING AT LEAST $7,746, AND QUESTIONABLE RELATED-PARTY TRANSACTIONS TOTALING AS MUCH AS $926,811

We found numerous problems relative to related-party activities at Toward Independent Living and Learning, Inc., (TILL). First, contrary to state guidelines, TILL did not adequately disclose at least five related-party relationships and transactions during the period covered by our audit. Second, TILL used members of its administrative staff who were being funded under Massachusetts state contracts to provide services to two other related-party organizations that were owned by TILL's President. According to TILL officials, TILL billed these two related parties for the cost of this administrative staff. However, the agency did not have any documentation (e.g., payroll records), to substantiate the number of hours TILL's administrative staff spent performing administrative tasks for these related parties. Thus, it could not be demonstrated whether the reimbursements TILL received from its two related parties for these administrative services were appropriate. Further, TILL did not bill these related parties for any overhead costs (e.g., rent, electricity, heat, supplies) that may have been incurred by the agency in providing these services. As a result, TILL used at least $7,746 in state funds to subsidize the activities of these two related parties during our audit period. We also found that TILL conducted several other questionable related-party transactions totaling $926,811, including using agency funds to subsidize the payroll expenses of a related party and a down payment on a property being purchased by one of its related parties.

### a. Undisclosed Related-Party Relationships and Transactions

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

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

FASB 57 defines a related party as follows:

> *Affiliates of the enterprise; entities for which investments are accounted for by the equity method by the enterprise; trusts for the benefit of employees, such as pension and profit-sharing trusts that are managed by or under the trusteeship of management; principal owners of the enterprise; its management; members of the immediate families of principal owners of the enterprise and its management; and other parties with which the enterprise may deal if one party controls or can significantly influence the management or operating policies of the other to an extent that one of the transacting parties might be prevented from fully pursuing its own separate interests. Another party also is a related party if it can significantly influence the management or operating policies of the transacting parties or if it has an ownership interest in one of the transacting parties and can significantly influence the other to an extent that one or more of the transacting parties might be prevented from fully pursuing its own separate interests. . . .*
>
> *Examples of related-party transactions include transactions between (a) a parent company and its subsidiaries; (b) subsidiaries of a common parent; . . . . Transactions between related parties commonly occur in the normal course of business. Some examples of common types of transactions with related parties are: sales, purchases, and transfers of realty and personal property, services received or furnished, for example, accounting, management, engineering, and legal services; use of property and equipment by lease or otherwise; borrowing and lendings, guarantees; maintenance of bank balances as compensating balances for the benefit of another; inter-company billings based on allocations of common costs; and filings of consolidated tax returns. Transactions between related parties are considered to be related-party transactions even though they may not be given accounting recognition. For example, an enterprise may recover services from a related party without charge and not record receipt of the services.*

In addition to promulgating regulations, OSD has published various documents that provide guidance to human service organizations such as TILL and their private accounting firms on how to assess an entity's compliance with applicable laws and regulations. Regarding the disclosure of related-party relationships, the Uniform Financial Statement and Independent Auditor's Report (UFR) Auditor's Compliance Supplement under 808 CMR 1.00 published by OSD, which was in effect during fiscal year 1999, states, in part:

> *All material related-party transactions that are not associated with programs purchased by the Commonwealth or that could affect the provider's financial statements and all instances of common ownership or management control relationships for which 808 CMR 1.02 and the AICPA Statement of Financial Accounting Standards No. 57 (SFAS No. 57) require disclosure, even though there*

*are no transactions, should be disclosed in the UFR notes to the financial statements....*

During our audit, we reviewed the UFRs submitted by TILL to OSD for fiscal years 1997 through 2000 and found that the following related-party relationships were not disclosed by TILL as required by OSD guidelines:

- **Training Research and Implementation, Inc., (TRI)** - This entity is a nonprofit corporation that was formed on June 28, 1990. According to its Articles of Organization, its primary mission is to locate, purchase, and manage residential homes for individuals with disabilities. The President of TILL is also the President and Treasurer of TRI, which constitutes a related-party relationship that should have been disclosed in TILL's UFRs.

- **Specialty Management Services, Inc., (SMS INC)** - This entity is a for-profit subchapter "S" corporation that was formed March 3, 1997. According to its Articles of Organization, its purpose is "to engage in the business of consulting and business development services and in general carry on any business which may lawfully be done by a corporation organized under Chapter 156B of the Massachusetts General Laws." The President of TILL is also the President, Treasurer, and sole shareholder of SMS INC, which constitutes a related-party relationship that should have been disclosed in TILL's UFRs.

- **Specialty Management Services Limited Partnership (SMS LP)** - This entity is a limited partnership that was formed on September 5, 1997. Its Limited Partnership Certificate on file with the Secretary of the Commonwealth states its purpose as being "to invest and manage real and personal property as well as manage other entities." The President of TILL is a partner in SMS LP, of which her partnership share is 99%. The other partnership share of SMS LP, which amounts to 1%, is owned by SMS INC, which is wholly owned by the President of TILL and constitutes a related-party relationship that should have been disclosed in TILL's UFRs.

OSD has also established penalties for organizations that do not comply with its regulations relative to the disclosure of related-party transactions in 808 CMR 1.04 (11)(c), which states, in part:

*If, after a hearing, DPS [now OSD] finds a violation of 808 CMR 1.04(4), 1.04(5) or 1.05, DPS may order that the contract(s) directly affected by such violation be terminated or may assess a civil penalty of not more that $2,000 or 10% of the Contractor's annual Maximum Obligation under such contract(s), whichever is greater. If DPS determines after a hearing that a Contractor has committed* *repeated willful violations of 808 CMR 1.04(4), 1.04(5) or 1.05, DPS may debar the Contractor for a period not to exceed five years.*

Despite these requirements, during our audit, we reviewed the UFRs submitted by TILL to OSD for fiscal years 1997 through 2000 and found the following related-party transactions were not fully disclosed by TILL as required by OSD regulations and guidelines.

- LEAD, INC., (LEAD) - In its fiscal years 1998, 1999, and 2000 UFRs, TILL disclosed that it had charged LEAD for $489,202, $383,852, and $323,190, respectively, for "shared employees" and related expenses. These shared employees were members of TILL's staff who were providing administrative services to LEAD (See Audit Result No. 1b). However, TILL failed to disclose in these UFRs that it was also using funds that it received under its state contracts to pay the monthly payroll expenses for all of LEAD's staff and not just the costs of "shared employees." During the three-year period covered by our audit, these payroll costs totaled $726,811 (See Audit Result No. 1c). Although according to TILL officials LEAD reimburses TILL for these payroll costs, these transactions should clearly have been disclosed in TILL's UFRs.

- During our audit, we asked TILL's Director of Finance to provide us with a summary of all inter-company account activity between TILL and its related parties during our audit period. Based on our review of this information, we noted that as of December 31, 1997, SMS LP owed $202,183. As of the end of December 31, 1999, $192,183 of this amount had been repaid, leaving an outstanding balance due of $10,000. We asked TILL officials to provide us with details relative to the nature of these transactions (e.g., loans, contracts, etc.). However, to date, TILL officials have not provided us with this information.

Because TILL did not disclose this information on its UFRs, the Commonwealth and other users of these reports were not provided with all the required information necessary to properly monitor and evaluate TILL's fiscal, operational, and programmatic activities during these fiscal years.

### b. Unallowable Related-Party Costs of at Least $7,746

During our audit period, TILL conducted transactions with two related parties, TILL-NH and LEAD. According to TILL's fiscal year 1999 UFR, the nature of these transactions were as follows:

- TILL-NH: During the fiscal year ended June 30, 1999, TILL allocated $34,285 of expenses for shared employees and related expenses directly to a related business corporation, TILL-NH. The President and Executive Director of TILL is a stockholder and Director of TILL-NH. Expenses attributable to TILL-NH are billed by TILL and reimbursed by TILL-NH. Included in other accounts receivable as of June 30, 1999, is a $6,330 receivable from TILL-NH.

- LEAD: During the fiscal year ended June 30, 1999, TILL allocated $383,852 of expenses for shared employees and related expenses directly to a related business corporation, LEAD. The President and Executive Director of TILL is a stockholder and Director of LEAD. Expenses attributable to LEAD are billed by TILL and reimbursed by LEAD. TILL charged LEAD $8,280 of interest, at 5.5% per year, on outstanding balances owned by LEAD to TILL. Included in other accounts receivable as of June 30, 1999, is $105,429 receivable from LEAD.

In addition to the notes to TILL's financial statements discussed above, we noted based on the documents that we reviewed at TILL that the mailing address for both TILL-NH and LEAD were the same as TILL's mailing address. TILL's Director of Finance stated that several of TILL's administrative employees, including himself and TILL's Contract Manager, provide administrative support and management services for these two related parties. The Director of Finance stated that TILL, in turn, bills and is reimbursed by these related parties for the gross salary costs of the TILL employees that provide these services. Additionally, TILL officials stated that the agency bills these related parties an amount equal to 21.5% of the gross salary costs of each employee to pay for the cost of fringe benefits and payroll taxes for these employees and also charges an additional 5.5% interest on any unpaid balances from month to month. The Director of Finance stated that these expenses are billed to the related parties and reimbursed by them to TILL on a monthly basis, and that any outstanding receivables due at fiscal year end from the related parties are disclosed in TILL's UFRs.

TILL bills its state contracts for the cost of its administrative staff under a budget category entitled Agency Administrative and Support. According to OSD's UFR Audit and Preparation Manual for fiscal year 1998, this budget cost category includes the following:

> *This component is for resources which cross all agency programs and cannot be directly associated with one program or a combination of programs. This component includes all resources reasonably necessary for the policy making, management, and administration of the provider organization as a whole and all other agency activities. It may include management, administrative, clerical and support personnel, office*

*supplies and materials, leasing or routine replacement (depreciation and financing interest only) of office equipment, telephone, costs related to occupancy of administrative premises, advertising and recruitment, postage, printing and reproduction, administrative and support staff training and travel, officer/director/trustee compensation, parent organization costs, legal, auditing, management consultants and other professional fees, working capital interest, directors and officers insurance, and all other similar or related resources/expenses that are not directly attributed to one or more programs. The reimbursable price cannot include resources defined as Non-Reimbursable Costs by regulations 808 CMR 1.15. . . .*

We reviewed the amount TILL billed its state contracts for its administrative staff that worked providing services to TILL-NH and LEAD to the amounts it was getting reimbursed by these two related parties and noted significant problems. First, TILL billed and received from TILL-NH and LEAD a total of **$**108,141 and at least $85,511, respectively, in reimbursements for agency administrative and support expenses during fiscal years 1998 through 2000. As previously noted, TILL's Director of Finance stated that several members of TILL's administrative staff provided these services to these two related parties. However, TILL could not provide us with any documentation (e.g., payroll records), to substantiate what TILL staff provided these services or the amount of time this staff spent providing these services. Thus, it could not be demonstrated whether the $193,652 in total reimbursements TILL received from these two related parties for the salary and fringe benefit expenses during our audit period was appropriate. Additionally, although TILL was purportedly reimbursed for the salary and fringe benefit costs of its staff who provided services to TILL-NH and LEAD, we found that TILL did not seek reimbursement from these related parties for other overhead costs (e.g., rent, heat, lights, telephone service, photocopying, etc.) that were incurred by TILL in providing these services.

The average amount TILL charged its state contracts for overhead costs, excluding all administrative salaries and related costs, was approximately 4%, as detailed in the following table:

**TILL**

**Determination of Administration Overhead Rates**

**Excluding Salaries and Related Expenses**

**Fiscal Years 1998 through 2000**

| | Fiscal Year | | | |
|---|---|---|---|---|
| | 1998 | 1999 | 2000 | Total |
| Amount of Administration and Support Expense (less salary expenses) | $561,218 | $476,977 | $559,272 | $1,597,467 |
| Total Expenses | $12,449,061 | $13,245,448 | $14,198,770 | $39,893,279 |
| Administrative Overhead Rate* | 4.51% | 3.6% | 3.94% | 4.0% (avg.) |

* Calculated by dividing the total administrative and support expenses (less total administrative salary and related costs) by total agency expenses for each fiscal year.

This administrative overhead rate (4%) represents, on a percentage basis, the average costs TILL charged its state contracts for non-salary-related overhead costs such as utilities, rent, supplies, etc.) as a percentage of its total expenses. As previously noted, during fiscal years 1998 through 2000, TILL received reimbursements totaling at least $193,652 from TILL-NH and LEAD for salary and related fringe benefit costs associated with those members of TILL's staff whose positions were being funded by state contracts but were purportedly providing services to these related parties. Assuming that this $193,652 is accurate, TILL-NH and LEAD under-reimbursed TILL by at least $7,746 ($193,652 x .04).

**c. Questionable Related-Party Transactions Totaling at Least $926,811**

During our audit, we identified some questionable transactions between TILL's related parties that totaled approximately $926,811 during our audit period.

OSD regulations 808 CMR 1.05 identifies the following as a nonreimbursable cost under state contracts:

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

During the period covered by our audit, TILL used funding, in part, that it received under its Massachusetts state contracts to fund the following non-program-related activities:

- During fiscal year 1999, TILL used $25,000 of its funds as a down payment on property located on 1174-1178 River Street in Hyde Park that was being purchased by its related party, LEAD. According to TILL's Director of Finance, this $25,000 was recorded as a receivable due from LEAD to TILL in fiscal year 1999. TILL officials did not provide us documentation to substantiate what funds were involved in this transaction. However, TILL did not identify these expenses as nonreimbursable costs to its state contracts in the UFRs it submitted to OSD. According to guidance issued by OSD (OSD's UFR Audit and Preparation Manual), "Non-reimbursable costs that exist and have not been disclosed are presumed to have been defrayed using Commonwealth and federal funds. . . ." Clearly, since this transaction was not directly related to the program purposes of TILL's Massachusetts state-funded programs, no state funds should have been used in this transaction.

- During the period covered by our audit, TILL used a total of $726,811 in funds received under its Massachusetts state contracts to pay for LEAD's payroll costs, as indicated in the following table:

**LEAD Payroll Expenses Paid by TILL**

| Fiscal Year | Payroll Expense | Payroll Fringe | Total |
|---|---|---|---|
| 1998 | $215,838 | $47,175 | $263,013 |
| 1999 | 261,584 | 56,856 | 318,440 |
| 2000 | 118,464 | 26,894 | 145,358 |
| Total | $595,886 | $130,925 | $726,811 |

According to TILL officials, TILL pays LEAD's payroll costs each month and is reimbursed by LEAD for these expenses within 30 days. However, we found that LEAD did not always reimburse TILL for the payroll expenses that were paid by TILL in a timely manner. For example, during fiscal year 1998, LEAD did not reimburse TILL for payroll costs paid for a seven-month period, resulting in LEAD's owing TILL a total of $279,945 at the end of the fiscal year. TILL's President acknowledged that during fiscal year 1998, LEAD's reimbursements to TILL for LEAD's payroll expenses lagged by several months. However, the President stated that beginning in October 1998 (fiscal year 1999), this problem has been corrected. However, we reviewed the reimbursements made by LEAD to TILL during fiscal years 1999 and 2000 and noted at least 10 months in which reimbursements from LEAD to TILL were not made in a timely manner. In fact, as of fiscal years 1999 and 2000, the receivables due from LEAD totaled $105,429 and $55,123, respectively. Since these transactions are not directly benefiting TILL's Massachusetts state-funded programs, no state funds should be used by TILL for this purpose.

- During fiscal years 1998 and 1999, SMS LP billed and received from TILL-NH a total of $165,000 for administrative management fees. We question the reasonableness of this expense given that TILL and not SMS LP was performing essentially all of TILL-NH's administrative support activities. Because TILL-NH was utilizing Massachusetts state-funded staff to provide administrative support to TILL-NH (see Audit Result No. 1b), and therefore state resources were involved in this transaction, we asked a representative of SMS LP's accounting firm to provide us with documentation to substantiate the nature of these expenses. In response, this individual stated that, in fact, no services were actually provided by TILL-NH to SMS LP. Rather, this money was merely transferred to SMS LP from TILL-NH for tax purposes. Because no documentation was provided to us, it could not be determined whether state funds were transferred.

- During our audit, we asked TILL's Director of Finance to provide us with a summary of all inter-company account activity between TILL and its related parties during our audit period. Based on our review of this information, we noted that as of December 31, 1997, SMS LP owed TILL $202,183. As of December 31, 1999, $192,183 had been repaid but TILL still had an outstanding balance due of $10,000. We asked TILL officials to provide us with details relative to the nature of these transactions (e.g., loans, contracts). However, to date, TILL officials have not provided us with this information. Thus, it cannot be determined whether any state funds were used in these related-party transactions or if the summary of inter-company transactions provided to us by TILL officials was complete and accurate.

Based on the evidence shown above, TILL's President used funds generated from state contracts for the benefit of the President and other related-party organizations owned by the President. Specifically, as noted above, TILL's President was able to use funding derived from state contracts to provide administrative support services and financing to some of TILL's related parties, not all of which were disclosed in the agency's UFRs. Additionally, TILL's President distributed funds totaling at least $234,750 to herself and other TILL administrative employees, as shown in the following table:

## Summary of Cash Disbursements

## From TILL's Related Parties to TILL's Staff

## Fiscal Years 1998 through 2000

| Job Title at TILL | Date of Distribution | Distribution Amount | Source of Distribution |
|---|---|---|---|
| President | 1999 | $139,000 | SMS LP |
| | 1999 | 80,000 | TILL-NH |
| Director of Employment Services | Jul-99 | 3,500 | TILL-NH |
| | Sep-99 | 1,000 | LEAD |
| Director of Facilities | Aug-99 | 500 | TILL-NH |
| | Jun-98 | 1,500 | TRI |
| Recreation, Music, Director | Feb-00 | 300 | LEAD |
| Landscape Director | Feb-00 | 200 | LEAD |
| Director of Contracts, MIS | Sep-99 | 1,500 | LEAD |
| Director of CLOs | Jul-99 | 1,000 | SMS |
| | Apr-99 | 350 | LEAD |
| Director of Behavioral Services | Jun-98 | 1,500 | TILL-NH |
| | Apr-99 | 350 | TILL-NH |
| Director of Support Services | Jun-98 | 1,500 | TILL-NH |
| | Apr-99 | 350 | TILL-NH |
| Director of Human Resources | Feb-00 | 200 | TILL-NH |
| Director of Finance | Mar-00 | 2,000 | TILL-NH |
| Total | | $234,750 | |

Regarding this compensation, TILL's President stated that the funds provided to TILL's administrative staff were bonuses based on merit and were provided to individuals who provided services to these related-party organizations. The President stated that the self-provided funds were merely a distribution of excess revenues over expenses. TILL's President added that none of these transactions involved state funds. However, as previously noted, since TILL was using state funds to subsidize the activities of both LEAD and TILL-NH, we question the reasonableness of the President's assertion.

### *Recommendation*

In order to address our concerns relative to this matter, we recommend the following:

- TILL should amend the notes to its financial statements in its fiscal years 1998 through 2000 UFRs to properly disclose all related-party transactions and relationships. In the future, TILL should fully disclose all related-party relationships and transactions in its UFRs. In addition, OSD should take whatever measures it deems appropriate to resolve this matter.

- The Department of Mental Retardation (DMR), TILL's principal state purchasing agency, should recover from TILL the $7,746 it undercharged TILL-NH in non-personnel overhead costs. Further, DMR, in conjunction with OSD, should conduct its own review of the reimbursements TILL received from TILL-NH and LEAD during the last seven years. Based on this review, DMR should recover from TILL any funds it deems appropriate. DMR should also determine whether it wants to allow TILL to continue providing administrative services to these related parties. If DMR wants to allow this type of activity, it should require TILL to accurately and completely document all services provided by TILL to these related parties and fully recover the costs of all services and related overhead costs from the related parties. Otherwise, DMR should negotiate with TILL to discontinue this practice.

### *Auditee's Response*

In response to this audit result, TILL's President provided the following comments:

> *TRI, SMS Inc. and SMS LP did not have any transactions with the state and therefore it was our initial understanding that it did not have to appear on the UFR. However, as the relationship evolved, so did the reporting disclosures on the UFR. Such that, with the exception of disclosure of TRI for the 1999 year end, all transactions were reported for 1999 and 2000. We showed the auditors the paperwork with regard to the dissolution of TRI, which had been approved by the Attorney General's Office. We will follow the report's recommendations in reporting in the future and will work with our independent auditor to assure compliance.*

*Some of the materials [the auditors] requested did not exist, but that in no way is a limitation on the part of TILL as the audit reads. We provided the auditors with extensive documentation, which met all of their requests.*

*The $25,000 [property down payment] referenced was not a cost to begin with and does not meet the definition of an expense but rather a loan, which was repaid, plus 5.5%. It was never billed to the Commonwealth. The report states that the administrative overhead rate (4%) represents on a percentage basis, the average costs TILL charged its state contracts for non-salary-related overhead costs. All related parties reimbursed TILL for all expenses as well as 5.5% administrative overhead or 1.5% above the Commonwealth's rate. In other words, the Commonwealth was indirectly benefiting from this relationship since TILL was getting a higher rate for this related party expense. In addition, 21% fringe and taxes was charged to the related parties for all payroll expenses, which again took into account the non-salary-related expenses.*

***Auditor's Reply***

As stated in our report, OSD guidelines require all instances of common ownership and management control to be disclosed in an organization's UFR, even if there are no transactions. The fact that TILL may have had an incorrect understanding of this requirement does not mitigate this problem. Further, contrary to what TILL asserts in its response, the agency did not adequately report all of its related-party relationships and transactions during fiscal years 1999 and 2000. As stated in our report, during our audit we found at least three instances in which TILL failed to disclose these relationships and at least two instances in which TILL failed to fully disclose related-party transactions during these fiscal years. We acknowledge that one of TILL's related parties, TRI, was dissolved. However, TILL's relationship with this organization up until the time of its dissolution should have been disclosed in TILL's UFRs, as required by OSD guidelines.

As stated in our report, during our audit TILL was unable to provide us with some of the documentation we requested relative to various inter-company financial activities between itself and its related parties. The documentation that we requested was primarily information to substantiate a summary provided to us by TILL officials relative to all the inter-company account activity between TILL and its related parties during our audit period. In its response, TILL states that some of the documentation does not in fact exist. According to state regulations, contracted service providers such as TILL are required to maintain their records for seven years. Since the transactions in question occurred within the last seven years, TILL is required by state regulations to maintain documentation relative to these transactions and provide this information upon request to the OSA. Further, contrary to what TILL states in its response, the agency did not provide us with documentation that met all our requests. For example, as noted in Audit Result No. 1.b., TILL was unable to provide us with documentation to substantiate specific individuals and the number of hours they worked performing activities for TILL's related parties. Further, as noted in Audit Result No. 2, TILL was not able to provide us with documentation on how it allocated the salaries of its salaried staff to state contracts.

In its response, TILL states that the $25,000 in funds that it used as a down payment on a property being purchased by a related party was a loan to a related party that was repaid with interest and was never billed to the Commonwealth. However, TILL was unable to provide us with any documentation to substantiate this assertion.

Furthermore, TILL contends that the Commonwealth indirectly derived financial benefits from TILL's providing services to TILL-NH. The agency bases this assertion on its contention that the rate it was charging its related entities was in excess of the rate it charged against its state contracts for the costs of the staff it was using to provide these services. However, this assertion is flawed. Specifically, as stated in our report, TILL could not provide us with any documentation to substantiate the amount of time TILL staff spent providing these services. Consequently, the reasonableness of the reimbursements TILL received from its related parties, including any reimbursements for administrative costs, could not be demonstrated.

Notably, TILL's response does not comment on a number of concerns we raised relative to this matter. For example, the agency did not respond to our concerns that it is using state funds to subsidize the activities of its related parties or that SMS LP billed and received from TILL-NH a total of $165,000 in administrative management fees when TILL was purportedly providing these services to TILL-NH. We believe these issues are serious and should be addressed by TILL and its state purchasing agencies. The Commonwealth provides funds to TILL to provide services to the state's needy consumers, not to finance the activities of other organizations.

## 2. INADEQUATE DOCUMENTATION TO SUBSTANTIATE THE ALLOCATION OF $3,203,587 IN PAYROLL COSTS

We found that TILL has not established adequate controls over the allocation of payroll expenses for its salaried employees, contrary to state regulations and the terms and conditions of its state contracts. Specifically, although TILL has policies and procedures relative to the preparation and maintenance of payroll records, including weekly timesheets for its hourly (direct care) employees, these policies and procedures did not require TILL's salaried employees to complete weekly records documenting the hours worked and the functions benefited (e.g., specific program, cost center). As a result, there is inadequate assurance that all of the approximately $3,203,587 in salaries and related costs that TILL allocated against its state contracts for its salaried employees during our audit period was accurate.

OSD has promulgated Terms and Conditions for Human and Social Service Contracts (General Contract Conditions), which all human service providers, such as TILL, that contract with state agencies must comply. According to these General Contract Conditions, contacted human service providers such as TILL are required to maintain accurate and complete financial records, including payroll records, in order to receive reimbursement of these costs. Specifically, these General Contract Conditions state, in part:

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

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

> *The Contractor and its Subcontractors shall keep on file all data necessary to satisfy applicable reporting requirements of the Commonwealth (including DPS [now OSD], the Division of Health Care Finance and Policy and Departments), and financial books, supporting documents, statistical records, and all other records which reflect revenues associated with and costs incurred in or allocated to any Program of services rendered under the Contract. The Contractor and its Subcontractors shall maintain records of all types of expenses and income or other funds pertaining to the*

> *Program paid to the Contractor by every source, including from each Client. Books and records shall be maintained in accordance with generally accepted accounting principles as set forth by the American Institute of Certified Public Accountants (AICPA); which for not-for-profit Contractors shall be the Industry Audit Guide for Audits of Voluntary Health and Welfare Organizations, unless otherwise provided in the UFR. . . . If the Contractor or a Subcontractor receives any federal funds from the Commonwealth, directly or through subcontract, the Contractor or Subcontractor shall also keep data necessary to satisfy Federal Office of Management and Budget (OMB) Circular A-133, or successor provision and shall also maintain books and records in accordance with OMB Circular A-110 and OMB Circular A-122, or successor provisions.*

As noted above, according to state regulations, because TILL receives federal funds, it is required to maintain its records in accordance with Office of Management and Budget (OMB) Circular A-122. This Circular requires the following items relative to documenting an organization's payroll expenses:

1. Charges to awards for salaries and wages, whether treated as direct costs or indirect costs, will be based on documented payrolls approved by a responsible official(s) of the organization. The distribution of salaries and wages to awards must be supported by personnel activity reports, as prescribed in subparagraph (2), except when a substitute system has been approved in writing by the cognizant agency. . . .

2. Reports reflecting the distribution of activity of each employee must be maintained for all staff members (professionals and nonprofessionals) whose compensation is charged, in whole or in part, directly to awards. In addition, in order to support the allocation of indirect costs, such reports must also be maintained for other employees whose work involves two or more functions or activities if a distribution of their compensation between such functions or activities is needed in the determination of the organization's indirect cost rate(s) (e.g., an employee engaged part-time in indirect cost activities and part-time in a direct function). Reports maintained by non-profit organizations to satisfy these requirements must meet the following standards:

   a. The reports must reflect an after-the-fact determination of the actual activity of each employee. Budget estimates (i.e., estimates determined before the services are performed) do not qualify as support for charges to awards.

   b. Each report must account for the total activity for which employees are compensated and which is required in fulfillment of their obligations to the organization.

   c. The reports must be signed by the individual employee, or by a responsible supervisory official having first-hand knowledge of the activities performed by the employee, that the distribution of activity represents a reasonable estimate of the actual work performed by the employee during the periods covered by the reports.

d. The reports must be prepared at least monthly and must coincide with one or more pay periods.

3. Charges for the salaries and wages of nonprofessional employees, in addition to the supporting documentation described in subparagraphs (1) and (2), must also be supported by records indicating the total number of hours worked each day maintained in conformance with Department of Labor regulations implementing the Fair Labor Standards Act. . . .

During fiscal years 1998 through 2000, TILL received reimbursements under its state contracts for approximately $3,203,587 in salary, fringe benefits, and related expenses for its salaried staff, as indicated in the table below:

**TILL**

**Summary of Salaried Employee Costs and Related Expenses**

**Fiscal Years 1998 through 2000**

| Fiscal Year | Salaries | Fringe Benefits (21.5%) | Totals |
|---|---|---|---|
| 1998* | $ 878,899 | $188,963 | $1,067,862 |
| 1999 | 758,699 | 163,120 | 921,819 |
| 2000* | 999,099 | 214,807 | 1,213,906 |
| Total | $2,636,697 | $566,890 | $3,203,587 |

*Due to insufficient documentation maintained by TILL, these amounts are estimates made by the audit team based on data that was made available by TILL officials.

During our audit, we reviewed the policies and procedures TILL had implemented relative to the maintenance of payroll records. Our review revealed that TILL requires all staff who are compensated on an hourly basis to submit weekly payroll records that indicate the hours worked by the individual and any leave taken during the period. These payroll records need to be signed by the employee and approved by the employee's supervisor prior to the employee being paid. In contrast, TILL does not require any of its salaried employees to submit payroll records to document the hours they work and in which programs they worked. Rather, each employee's supervisor submits a "Payroll Approval for Salaried and Exempt Employees," which lists the salaried or exempt employees supervised by him or her for the pay period. This form indicates the supervised employee's names and any leave taken (sick, vacation, or other) for the pay period. These forms do not indicate the hours worked or function benefited and are signed by the supervisor but not the employee.

TILL's President and Vice-President stated that the agency does not require salaried employees to submit weekly payroll records as a result of an audit performed by the United States Department of Labor (DOL) of TILL in the early 1990s. According to TILL officials, the report generated by this DOL audit stated that if TILL required its administrative and other salaried staff to file weekly payroll records, it would have to pay these employees overtime for hours worked in excess of 40 hours. Therefore, TILL officials stated, the agency has discontinued the policy of requiring administrative and other salaried staff to submit weekly payroll records. We asked TILL officials to provide us with a copy of this DOL audit report; however, agency officials were unable to provide us with this information.

Consequently, we contacted the Wage and Hour Division of DOL and requested and received a copy of this audit report, which covered the period January 1, 1990 through September 30, 1991. We reviewed this report but found no references, statements, or recommendations suggesting that TILL not require its administrative and other salaried staff to compete payroll records. Additionally, we met with the manager of DOL's Wage and Hour Division, who stated that DOL does not discourage employers from mandating their employees to keep payroll records. The manager further stated that salaried employees, such as executive, administrative, and professional personnel, would probably be classified as "exempt" employees under DOL guidelines and not be eligible for overtime even if they completed payroll records.

Based on this lack of weekly payroll records, we asked TILL's Vice-President to provide us with the documentation the agency maintained to substantiate the allocation of its salary costs to state contracts and other cost centers during the three years covered by our audit. In response, the Vice-President stated that there was no supporting documentation for how the agency allocated its salary expenses for fiscal year 1998. The Vice-President provided us with a spreadsheet that was generated to show how the costs of salaried employees were allocated to state contracts during fiscal year 1999 and a summary of the agency's gross salary expenses for fiscal year 2000.

We reviewed this documentation and noted several problems. First, adequate documentation did not exist (e.g., personnel activity reports supported by timesheets) to substantiate either the hours worked or the method used to allocate the approximately $1,067,862 in expenses for salaried employees that TILL charged against its state contracts during fiscal year 1998 or the $921,819 that it charged against its state contracts for its salaried staff for fiscal year 1999. Since all contract service providers are required by state regulations to maintain their records for a period of seven years, TILL was not in compliance with this regulatory requirement. Also, the spreadsheet the Vice-President provided the audit team relative to the agency's allocation of salary and related expenses for these staff members did not include the fringe benefits and payroll tax expenses associated with these salary expenses, and adequate documentation could not be provided to substantiate the basis for TILL's allocation of these expenses. Rather, TILL's Vice-President told us that this allocation was performed based on year-end interviews with salaried staff. During such interviews, staff members would tell the Vice-President how much time they spent working in each program, supported by work logs, appointment books, or other records that these staff members were purportedly maintaining. Based on these representations, the Vice-President would then allocate the salaries and related costs of these staff to state contracts and other agency cost centers.

As a result of this inadequate documentation, there is inadequate assurance that all of the $3,203,587 of these expenses that TILL allocated to its state contracts were actually incurred and properly allocated. In fact, we tested TILL's allocation of some expenses for its salaried staff during fiscal year 1999 (the only year for which TILL gave us a summary of how these costs were allocated), and found several problems with the way the agency allocated some of these salaries and related expenses, as follows.

- TILL's payroll clerk, who performed payroll functions for all of TILL's staff including those functioning in non-commonwealth-funded programs, had his entire salary and fringe benefit expenses, which totaled $43,218 for fiscal year 1999, allocated 100% to state contracts. Since he spent part of the time working on non-commonwealth-funded program activities, clearly some of this compensation should have been allocated to other non-commonwealth-funded programs.

- TILL's principal bookkeeper, who performs bookkeeping related activities for all of TILL's programs including non-commonwealth-funded programs, had her entire salary and fringe benefit expenses totaling $42,734 for fiscal year 1999 allocated 100% to state contracts. Since this individual spent part of the time working on non-commonwealth-funded program activities, clearly some of this compensation should have been allocated to other non-commonwealth-funded programs.

- According to the spreadsheet provided to the audit team by TILL's Vice President, during fiscal year 1999 the agency allocated 77% of the salary and related benefits of TILL's Director of Finance ($33,717) to state contracts. However, according to the agency's UFR for this fiscal year, 80% ($34,805) of this individual salary and related expenses were allocated to state contracts.

### *Recommendation*

TILL should develop and implement policies and procedures relative to the maintenance of payroll records for its administrative employees that are in compliance with OSD guidelines. These policies and procedures should require all employees to complete weekly payroll records documenting hours worked and functions benefited (e.g., program, cost center, contract.). These payroll records should be signed by employees and their supervisors. The allocation of all costs, including those of salaried employees, should be adequately documented and based on an allocation methodology that is consistent with OSD regulations.

Additionally, DMR in conjunction with OSD should review all expenses reimbursed by the Commonwealth to TILL for salaried employees during the period covered by our audit as well as the periods prior and subsequent to our audit to assess the propriety of these expenses. Based on this review, DMR should take whatever steps it deems necessary to resolve this matter.

### *Auditee's Response*

In response to this audit result, TILL's President states in part:

*While the report states that there was no weekly timesheets available for salaried employees, they cite no state regulations or term and condition of our state contracts that requires weekly timesheets to be completed. Although this and other audit results refer to a lack of payroll records, that clearly is not the case as was told and shown to the auditors repeatedly through records, by TILL management during the course of the audit. They were told of and shown:*

- *daily schedules*
- *mileage submission forms detailing travel locations and purpose and cost centers*
- *supervision notes*
- *individual Service plans based on contracts and cost center assignments of staff*
- *progress notes, supervision notes, departmental meetings*
- *receptionist calendars kept monthly for each administrative person*
- *"routines" which are electronic procedures which is part of the software*
- *our hard copy payroll manual . . . .*

*We specifically require that these documents be maintained. . . .*

*I doubt that the auditors would find administrative staff who work on as many projects simultaneously as those at TILL do, keeping time logs. That is an inefficient use of time and one which we cannot find to be required by any regulation. . . .*

*[The report] refers to requirements of the General Contract Conditions, 808 CMR 1.04(1) and OMB Circular A-122. The implication is that we are not in compliance with those standards. This is not true. TILL has a very sophisticated, detailed, computerized accounting and payroll system which records all transactions in detail and provides an accurate system of internal controls. The accounting department has a very detailed Payroll Manual with over 200 pages of forms, policies and procedures. The manual is in a loose-leaf binder primarily due to the large number of forms and changes associated with payroll….During the time of this audit we upgraded our accounting system to the latest version of Microsoft Great Plains Dynamics software. This is the premier mid to large business software in the world. The sophistication of the software (as was true in earlier versions used as well), allows completely flexible control of security, accounting procedures (called "routines"), reporting, and internal auditing. All of this capability is built into the software and precludes the requirements of paper version of the policies and procedures. . . .*

*We maintain personnel records for each employee. . . .*

***Auditor's Reply***

Our report does not state that weekly payroll records are a mandatory document that needs to be maintained by contracted service providers such as TILL. Rather, our report clearly states that providers are required by state and federal regulations to maintain accurate and complete payroll records that clearly identify the distribution of activity of each employee. Each provider is also required to produce and maintain activity reports that account for the total activity of each employee. During our audit we determined that TILL was not maintaining these required records. Ancillary documents such as work schedules, supervision notes, work progress notes, and receptionist calendars would be documents that could be used to support the accuracy of employee activity reports if they existed but these documents clearly cannot be used as a substitute for these activity records, as TILL suggests in its response.

Of particular concern was the methodology used by TILL to allocate the costs of its salaried employees, which, notably TILL did not dispute in its response. Specifically, TILL's Vice-President stated that there was no supporting documentation for how the agency allocated its salary expenses for fiscal year 1998. The Vice-President provided us only with a spreadsheet that was generated to show how the costs of salaried employees were allocated to state contracts during fiscal year 1999 and a summary of the agency's gross salary expenses for fiscal year 2000.

Moreover, we reviewed this documentation and noted several problems. First, adequate documentation did not exist (e.g., personnel activity reports supported by weekly payroll records) to substantiate the hours worked or the method used to allocate the approximately $1,067,862 in expenses for salaried employees that TILL charged against its state contracts during fiscal year 1998. Second, no weekly payroll records exist for any of TILL's salaried staff for fiscal year 1999. Also, the spreadsheet the Vice-President provided the audit team relative to the agency's allocation of salary and related expenses for these staff members did not include the fringe benefits and payroll tax expenses associated with these salary expenses, and adequate documentation could not be provided to substantiate the basis for TILL's allocation of these expenses. Rather, TILL's Vice-President told us that this allocation was performed based on year-end interviews with salaried staff. During such interviews, staff members told the Vice-President how much time they spent working in each program, supported by work logs, appointment books, or other records that these staff members were purportedly maintaining. Based on these representations, the Vice-President then allocated the salaries and related costs of these staff to state contracts and other agency cost centers.

Clearly, this methodology is not in compliance with state and federal requirements to prepare monthly employee activity reports. Moreover, contrary to what TILL states in its response, the agency does not have ample documentation to support these allocations.

Finally, in its response, TILL contends that the expenses associated with the agency's Payroll Clerk, Principal Bookkeeper, and Vice-President that we question in our report were, in fact, properly allocated. However, the agency did not provide us with any documentation to substantiate this assertion. Given the fact that, as noted above, TILL does not have an established documented process for allocating the expenses of its salaried employees, we therefore question the validity of this assertion.

### 3. QUESTIONABLE SALARY AND VEHICLE EXPENSES FOR TILL'S PRESIDENT TOTALING AT LEAST $273,274

During our audit period, TILL's President billed and received from the Commonwealth $267,334 in salary and related expenses for functioning as an employee of the agency. However, according to TILL-NH's financial records, during this same period of time TILL's President also received $120,347 as a full-time salary from TILL-NH. None of TILL's administrative staff, including TILL's President, maintained payroll records to document the days and hours worked or the programs where they worked. Thus, the validity of this $267,334 in salary expenses TILL received from the Commonwealth for the same period of time that the President was collecting a full-time salary from TILL-NH could not be determined. We also found that during our audit period, TILL's President charged $11,880 to Massachusetts state contracts to lease a vehicle that the President used to commute to TILL-NH. Given that this vehicle was, in part, used in a non-Massachusetts program, we question the propriety of charging at least half of these lease expenses, or $5,940, against Massachusetts state contracts.

During fiscal years 1998 through 2000, TILL's President received salary and fringe benefits totaling $317,312, of which $267,334 was allocated to state contracts, as follows:

**Summary of TILL President's Compensation Costs**

**Fiscal Years 1998 through 2000**

| Fiscal Year | Full-Time Equivalent (FTE) | Salary | Percent Allocated to State Contracts | Amount Allocated to State Contracts | 21.5% Fringe and Taxes | Total to State |
|---|---|---|---|---|---|---|
| 2000 | 0.88 | $108,807 | 70% | $ 76,165 | $16,375 | $ 92,540 |
| 1999 | 1.00 | 104,500 | 68% | 71,060 | 15,278 | 86,338 |
| 1998 | 1.00 | 104,005 | 70% | 72,804 | 15,652 | 88,456 |
| | | $317,312 | | $220,029 | $47,305 | $267,334 |

During our audit, we reviewed the documentation maintained by TILL relative to this compensation and noted the following problems:

- According to 808 CMR 1.05 (26) promulgated by OSD, any expense that is undocumented is unallowable and nonreimbursable under state contracts. During our audit we requested supporting documentation for the $267,334 in salary and related expenses for TILL's President that the agency charged against its state contracts. We were informed by TILL officials that the agency's President does not maintain payroll records to document the hours the President worked or the specific function benefited (see Audit Result No. 2). The President stated that the only documentation maintained relative to days worked was the President's daily planner. Consequently, it could not be determined whether the $267,334 in salary expenses that were reimbursed by state agencies during our audit period was appropriate.

- According to TILL-NH's financial records, during fiscal years 1998 through 2000, TILL's President was working as a full-time employee for both TILL and TILL-NH at the same time. During calendar years 1998 through 2000, TILL's President received $120,347 from TILL-NH for services performed. According to TILL's President, each working day lasted 20 hours and after working all day at TILL the President would drive to New Hampshire to work at TILL-NH. The President added that although the financial records of TILL-NH that were reviewed by the audit team indicated that she was a full-time employee, she really worked only 20 hours per week at TILL-NH but was carried as a full-time employee due to a "software problem" in TILL-NH's payroll system. However, the President did not provide us with documentation to substantiate these claims. Given that the normal business hours for both of these agencies are 9:00 AM to 5:00 PM, we question how the President can be working full time in two agencies, in two different states, during the same business hours.

- During fiscal years 1999 and 2000, TILL provided its President with a leased vehicle, a 1999 Jeep Grand Cherokee. Although the President paid for gas and normal maintenance costs, TILL paid for the lease costs, which during fiscal years 1999 and 2000 totaled $11,880. TILL's President did not maintain a log that indicated the business versus personal use of this vehicle. However, the President told us that she used this vehicle to commute daily to TILL-NH. Since this vehicle was used at least part of the time for non-Massachusetts state program activities, we believe as much as 50% of its lease costs totaling $5,940 should have been charged to TILL-NH and not TILL's Massachusetts state contracts.

***Recommendation***

TILL should develop and implement written policies and procedures that require all TILL employees to maintain payroll records in compliance with applicable regulations and contracted terms and conditions. Also, DMR should perform a review of the billings TILL submitted to the department for the salary and related expenses of TILL's President as well as the President's vehicle expenses for the last seven years. Based on this review, DMR should take whatever measures it deems appropriate to resolve this matter.

***Auditee's Response***

In response to this audit result, TILL's President provided the following comments:

> *At no point were the auditors told that the President worked full time at TILL-NH. We must make the distinction of working full time and being the owner of a company. "The salary",derived from that company is not necessary for full-time service but rather a withdrawal of company profit. The profit is not a direct measure of time spent [n]or was it represented as such. [The report] references the President working in NH daily and driving there after working a full day at TILL. That defies logic and common sense. At no point were the auditors told that....*
>
> *The salary allocated to state contracts does not reflect 100% of her salary nor is it an unreasonable salary in relation to the size of the agency and is well within the recommended limits of a President's salary in the Commonwealth....*
>
> *Your recommendation is that we implement written polices and procedures that require all TILL employees to maintain payroll records. Again, this was previously reflected in review comment number 1....*

***Auditor's Reply***

Contrary to what TILL states in its response, our report does not indicate that we were told that TILL's President was working full time at TILL-NH. Rather, our report correctly states that according to TILL-NH's and TILL's financial records, during fiscal years 1998 through 2000, TILL's President was working as a full-time employee for both TILL and TILL-NH at the same time. During calendar years 1998 through 2000, TILL's President received $120,347 from TILL-NH for services performed. TILL's President did, in fact, tell us that each working day lasted 20 hours and after working all day at TILL she would drive to New Hampshire to work at TILL-NH. The President also told us that, although the financial records of TILL-NH that were reviewed by the audit team indicated that she was a full-time employee, she really worked only 20 hours per week at TILL-NH but was carried as a full-time employee due to a "software problem" in TILL-NH's payroll system. However, as noted in our report, the President did not provide us with any documentation to substantiate this claim.

In TILL's response, the President now states that it defies logic to believe that she drove from TILL to TILL-NH on a daily basis to work. We agree with this assertion, which is why we questioned her salary expenses in the first place. However, TILL's President did not provide us with any further information as to when she actually worked at TILL-NH so that we could analyze the reasonableness of the salary expenses she charged against her Massachusetts state contracts. Clearly, given the fact that TILL's President is involved to some degree with the operation of several other related entities, the agency needs to fully and adequately document the time she spends providing service to these entities as opposed to the time she spends providing services under the agency's state contracts.

Notably, TILL's response does not comment on the fact that the cost of the vehicle that is being leased by TILL and used by the agency's President should not be entirely charged to state contracts. Consequently, we again recommend that TILL and its principal state purchasing agency implement the recommendations we made relative to this matter.

## 4. UNDOCUMENTED AND QUESTIONABLE COSTS TOTALING $50,836 CHARGED TO A COST-REIMBURSEMENT CONTRACT

During fiscal years 1999, TILL billed and received payments from DMR totaling $90,000 under a cost-reimbursement contract to operate its Project Engage Program. Our review of the costs TILL billed DMR for the services it provided under this program identified at least $50,836 in expenditures that were either undocumented, inadequately documented, or non-program-related. According to state regulations, expenses such as these are unallowable and nonreimbursable under state contracts.

OSD regulations 808 CMR 1.05(12) and 808 CMR 1.05(26) identify the following as nonreimbursable costs under state contracts:

> *1.05(12) <u>Non-Program Expenses</u>. Expenses of the Contractor which are not directly related to the social service Program purposes of the Contractor.*
>
> *1.05(26) <u>Undocumented Expenses</u>. Costs which are not adequately documented in the light of the American Institute of Certified Public Accountants statements on auditing standards for evidential matters.*

During fiscal year 1999, DMR awarded TILL a cost-reimbursement contract to operate its Project Engage Program, which was to operate in the public elementary schools in Lowell and is designed to serve families with developmentally disabled children. This program relies primarily on elementary schools to provide support, training, and services to these families.

OSD defines a cost-reimbursement contract 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 reviewed the supporting documentation TILL maintained relative to all 149 expenditures totaling $51,909 for direct care/program support expenses that TILL charged against this cost-reimbursement contract during fiscal year 1999. Based on our review, we found that $50,836 (98%) of these expenses were either inadequately documented or did not appear to be related to the social service program purposes of TILL's state-funded programs. The table below summarizes the nonreimbursable expenses we identified:

### TILL

### Summary of Non-Reimbursable Expenses

### Fiscal Year 1999*

| Description | Amount |
|---|---|
| Inadequately Documented/Non-Program | $36,557 |
| Inadequately Documented | 14,279 |
| | $50,836 |

*During fiscal year 1999, the contract that funded TILL's Project Engage Program was changed from a cost-reimbursement contract to a unit rate contract to be effective during fiscal year 2000. Therefore, we limited our audit testing to this one year.

Our review of the documentation TILL maintained relative to expenditures in this program identified that 80 expenditures totaling $14,279 contained no supporting documentation (e.g., invoices, receipts) to substantiate that these expenses were actually incurred in this program. We also found an additional 59 expenditures totaling $36,557 to be questionable in that there was inadequate documentation to substantiate that they were program related. Examples of these questionable expenditures follow.

- On September 14, 1998, TILL purchased two clothes dryers for $1,096 and on July 23, 1998 purchased three air conditioner units for $1,167, which it billed to the Project Engage Program. Our review of the documentation maintained by TILL relative to these purchases revealed that the invoices for these items did not indicate where these items were delivered or who received these items. Thus, it could not be determined whether these expenses were related to TILL's Project Engage Program.

- On January 26, 1999, TILL's President purchased a 48-inch extension table costing $804 from a furniture store using a TILL corporate check. According to the supporting documentation maintained by TILL, the table was shipped to an address located in Burlington. However, no other documentation (e.g., the name of the program participant who might have received this table) indicates that this expense was related to TILL's Project Engage Program.

- On March 26, 1999, TILL issued a check for $24,187.50 to an unidentified individual. According to TILL's President, this check was for the purchase of a handicapped accessible van for the parent of a child in the Project Engage Program. We reviewed the documentation TILL was maintaining relative to the issuance of the check and noted several problems. First, this check was issued to an individual rather than an automobile dealer, and this individual did not appear to be an employee of TILL or a member of the Project Engage Program staff. Second, TILL provided us with a copy of a motor vehicle purchase contract from an automobile dealer in Hingham for the vehicle that was purportedly being purchased. This invoice said the vehicle was a 1997 conversion van with a power wheelchair lift. The invoice indicated the cost of this vehicle was $29,000 (a $4,812.50 variance in the amount of the check that was issued). TILL did not have any documentation that explained the difference between the purchase price on the purchase contract and the check issued to this individual. TILL's President told us that DMR had approved the purchase of the van; however, the only documentation TILL had to substantiate this assertion was an October 23, 1998 letter addressed to the "DMR – Dorchester Fuller" office from TILL's Director of Support Services, in which the Director asked DMR whether the client, DMR, or TILL would own this van. However, no other documentation (e.g., a response to this letter) indicates whether DMR formally approved the purchase of this vehicle in this program or who owns this vehicle.

- On April 19, 1999, the President of TILL purchased a sofa from Pier 1 Imports costing $320. The documentation that was provided to us did not identify the client or where it was delivered. Thus, it could not be determined whether this was an appropriate expense for the Project Engage Program.

- On April 30, 1999, TILL reimbursed the manager of its Children's Intensive Support Services for travel expenses totaling $130 with funds provided under the contract that funded its Project Engage Program. Our review of the supporting documentation maintained by TILL indicated that this individual did not work in TILL's Project Engage Program and, therefore, that these travel costs should not have been charged to this program.

- During fiscal year 1999, TILL's President purchased various items, including a cordless telephone, gardening supplies, plants, and silk flowers totaling at least $693 and charged these expenses to the Project Engage Program. TILL officials could not provide us with any documentation to substantiate that these expenses were related to the operation of this program.

- The salary expenses (salary and fringe benefits) for a TILL secretary totaled $40,066 for fiscal year 1999, 100% of which was allocated to state contracts as administrative overhead costs. In addition, TILL charged its Project Engage Program $2,430 in additional direct salary expenses for this same individual. Since TILL already charged 100% of this individual's salary expense to state contracts, this represents a duplicate billing totaling $2,430 to the Project Engage Program.

TILL's President claimed that she had additional documentation to substantiate that some of the purchases in question were in fact related to the Project Engage Program. However, to date TILL officials have not provided us with any additional documentation.

***Recommendation***

TILL should remit to the Commonwealth the $26,648.50 (excluding the $24,187.50 expended for the handicapped accessible van) in questionable and inadequately documented non-program-related expenditures that it charged against its state contracts during 1999. In the future, TILL should take measures to ensure that it only bills for costs that it can adequately document. Also, given the questionable nature of these expenses, DMR, in conjunction with other appropriate oversight and law enforcement agencies, should conduct its own review of the expenses billed by TILL against the contract that funded its Project Engage Program during and subsequent to the period covered by our audit, including the $24,187.50 for the handicapped accessible van, and take whatever measures deemed necessary under the circumstances.

***Auditee's Response***

In response to this audit result, TILL's President stated, in part:

> *The auditors discussed this contract extensively with the President as well as with one of the state funding agency's Area Directors who came to our office at their request. She explained to them how a family support contract works, the types of expenses which are made in those contracts and the fact that these are as the name implies, family support contracts intended to maintain children at home by offering support at home, at school, in recreation, etc. The types of expenses are determined by DMR, the provider, and by the family. The President provided the auditors with the letters from the Lowell area office and suggested that they call the area director who was responsible for writing the contract and its specifications at the time. All expenses begin with an internal, yellow Request for Funds form that becomes part of the documentation. The auditors are making a subjective determination that the expenses don't "seem" to relate to the contract. However, this conclusion is made without an understanding of the facts as explained to them and without knowing the purpose of the contract or speaking to other appropriate personnel. The letters from DMR clearly state the request for expenses. . . .*
>
> *The couch from Pier 1 Imports did not have a delivery address because it was picked up by the Director of Facilities in order to save the Commonwealth $25 in delivery fees.*

***Auditor's Reply***

Contrary to what TILL implies in its response, we fully understand the purpose of the contract and how this program operates. However, based on its response, TILL does not seem to understand that this contract was a cost reimbursement contract, and according to state regulations, any cost that is not adequately documented is unallowable and non-reimbursable under state contracts. As stated in our report, our review of the documentation that TILL maintained relative to expenditures in this program identified that 80 expenditures totaling $14,279 contained no supporting documentation (e.g., invoices, receipts) to substantiate that these expenses were actually incurred in this program. We also found an additional 59 expenditures totaling $36,557 to be questionable in that there was inadequate documentation to substantiate that they were program-related. Request for Funds forms alone clearly do not constitute adequate documentation. When contracted service providers such as TILL are awarded state contracts, they are obligated to take measures to ensure that they fully comply with all applicable laws, regulations, and contractual terms and conditions. Since TILL did not take such measures, it should remit the funds in question to the appropriate state agency.

In its response, TILL states that the couch it purchased from Pier 1 Imports did not have a delivery address because it was, in fact, picked up by TILL's Director of Facilities. However, TILL could not provide us with any documentation to substantiate this claim.

## 5. INADEQUATE ADMINISTRATIVE AND INTERNAL CONTROLS OVER CERTAIN AGENCY OPERATIONS

We found that TILL had not developed and implemented an adequate system of internal controls over all aspects of its operations. For example, TILL had no written accounting policies and procedures or an accounting manual to ensure the accuracy of its financial transactions, reports, and recordkeeping. Also, TILL's accounting system did not adequately document personnel and related-party costs. As a result, TILL and the Commonwealth cannot be assured that TILL's financial assets and Commonwealth funds were being properly safeguarded or that transactions relative to these accounts were properly authorized, recorded, and reported.

According to Generally Accepted Accounting Principles (GAAP), entities such as TILL are required to establish an adequate system of internal controls over all aspects of their operations. However, in addition to those internal control differences discussed in Audit Results No. 1 through 4, we found that TILL had not developed and implemented adequate internal controls over other aspects of its operations. Specifically, we noted the following problems:

- Sound business practices advocate that entities such as TILL establish a proper accounting system that is documented in formal polices and procedures and a written accounting manual, which describes the accounting system and the polices and procedures that are utilized in the agency's accounting process. Such a manual not only maintains the integrity of the accounting process and its continuity in case of staff turnover, but also establishes accountability of various operational activities. However, during our review we noted that TILL had not established formal written accounting procedures or an accounting manual.

- According to 808 CMR 1.04 (1) promulgated by OSD, entities such as TILL are required to maintain all financial records relative to revenue and expenses in accordance with Generally Accepted Accounting Principles (GAAP) as set forth by the American Institute of Certified Public Accountants for a period of seven years. However, during our audit, TILL officials were unable to provide us with various documentation, including time and attendance records for its salaried employees (see Audit Result No. 2) and related party transaction information (see Audit Result No. 1). Also, TILL's accounting system did not adequately document and allocate costs that were related to services provided by TILL to its related parties, and TILL did not enter into formal written contracts with its related parties that clearly determine the scope of service to be provided and the amounts and methods of compensation.

***Recommendation***

TILL should immediately develop and implement a written system of internal controls over all aspects of its operations in order to ensure that its financial records are properly maintained and that its financial activities are properly authorized, recorded, and reported.

***Auditee Response***

In response to this issue, TILL's President stated, in part:

> *[This issue] seems to be "routine recommendation" included in all audits and therefore we have no comment.*

***Auditor's Reply***

We take issue with the President's dismissive characterization of this, or in fact any, audit issue as being "routine" in nature. As stated in our report, TILL's lack of adequate internal controls over its operations seriously jeopardizes the accuracy and reliability of its financial transactions, reports, and recordkeeping and provides inadequate assurance that Commonwealth funds are properly safeguarded and that TILL's financial transactions are properly authorized, recorded, and reported. We therefore reiterate our recommendation that TILL immediately develop and implement a written system of internal controls over all aspects of its operations in accordance with sound business practices and GAAP.

# APPENDIX

## Description of Services Provided by TILL

## December 31, 2000

Family Support Services:

**Respite Care Services** – TILL offers respite care services through the utilization of over 150 providers in the North, Central, and Boston Community Service Centers.

**After-School Programs** – TILL has two after-school programs located in Randolph and Boston that offer structured social and recreational activities to children and adolescents ages 5 to 22, during after-school hours and school vacations.

**Family Exchange Programs** – TILL formed these programs so that families may exchange respite and other services among themselves rather than relying on state intervention.

**Personal Care Attendant Services** – TILL designed this program to offer in-home services to individuals with disabilities who need assistance with the activities of daily living.

**The Parent-TILL Partnership for Autism** – This program offers parent and professional training and support groups, skills training, sibling groups, professional consultation services, in-home services, and resource libraries.

**Daycare** –This daycare service is fully licensed and serves children to the age of seven from families of TILL employees as well as the general public.

**Children's Intensive Support** – This program is designed to offer in-home consultation, training, support, and case-management to children under the age of 22 and their families to prevent the imminent or potential need for resident placement.

**Recreation Services** – This program allows both children and adults to participate in age-appropriate, integrated recreational programs, such as sports, dance/socials, leisure education groups, community outing clubs, and camping trips.

**In-Home Training** – This program provides training in community mobility, access to community resources, and other areas to allow individuals with mental retardation to live as independently and fully as possible.

**Estate Planning** – This program develops an extensive network of families who are seeking residential placements for their disabled adult family members.

**Time to Enjoy – Elder Services** – TILL has established several types of community-based service models to address the needs of individuals as they age and change their priorities and preferences.

**Residential Services**:

**Community Residences** –These residences serve individuals with a primary diagnosis of mental retardation, autism, psychiatric disorders, and so forth. TILL has community residences in Watertown, Concord, Arlington, and Easton.

**Staffed Apartments** – These programs located in Maynard, Dorchester, and Randolph serve three to four residents with mild to profound mental retardation.

**Limited Group Residences** – These residences serve individuals with serious medical and functional defects and are conducive to mobility for residents who are blind. These programs operate in Acton, Danvers, Hyde Park, Roslindale, Framingham, and Westboro.

**Creative Living Options** – This program was created to place individuals with families in Specialized Home Care and other alternative situations. It also allows for the design of residential settings with the individual's unique needs in mind.

**Condominiums** – In this program, TILL provides the clinical and administrative support necessary to allow adults with mental retardation to live in shared condominiums in Brighton and Weymouth.

**Facility-Based Respite** – This program offers short-term respite in an attractive, comfortable home to individuals of families in Eastern Massachusetts.

<u>**Day Programs**</u>:

**Creative Expressions Gift Gallery** – This program provides clients with vocational services in a retail setting.

**Day Habilitation** – This program serves individuals with multiple disabilities and attempts to encourage a natural integration with the community and enhance the community's perception of individuals with developmental disabilities.

**Essence of Thyme Catering and Café** –This catering business offers vocational training in food services on a long-term or short-term basis.

**Supported Employment** – This individualized vocational training program trains and places individuals with the ultimate goal of independent, competitive employment.

**MowTown Landscaping** –In this program, trainees work with staff on landscaping, outdoor projects, and odd jobs.

<u>**Specialized Areas**</u>:

**Mental Health Center – STRATTUS** – STRATTUS provides an array of services for individuals with developmental disabilities and their families.