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**INDEPENDENT STATE AUDITOR'S REPORT ON
ACTIVITIES PERTAINING TO THE
MASSACHUSETTS ESTUARIES PROJECT
AT THE UNIVERSITY OF MASSACHUSETTS AT
DARTMOUTH, SCHOOL OF MARINE SCIENCE
AND TECHNOLOGY
APRIL 1, 2002 TO JUNE 30, 2005**

**OFFICIAL AUDIT
REPORT
DECEMBER 11, 2007**

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The University of Massachusetts at Dartmouth (UMD) is one of 25 public higher educational institutions in the Commonwealth of Massachusetts that are organized under Chapter 15A, Section 5, of the Massachusetts General Laws. UMD, one of five campuses of the University of Massachusetts, is a four-year public university with approximately 6,500 students in undergraduate day programs, 700 students in graduate programs, and 1,400 students in continuing education evening courses. UMD operates under the oversight of the Board of Higher Education, which is responsible for monitoring each educational institution to ensure that state funds support measurable performance, productivity, and results.

UMD has a Board of Trustees consisting of 21 appointed members, including five students. The board establishes UMD's administrative policies, and UMD's Chancellor is responsible for implementing the policies set by the trustees. UMD's financial activity and its compliance with applicable laws and regulations are the responsibility of its management. For fiscal year 2005, UMD received state funding of \$82,838,717 and federal funding of \$19,143,479.

UMD's Massachusetts Estuaries Project (MEP) was formed under a Memorandum of Understanding between the Executive Office of Environmental Affairs (EOEA) and the University of Massachusetts. In December 2001, the Massachusetts Department of Environmental Protection (DEP) and the UMD School for Marine Science and Technology (SMAST) initiated this collaborative project, which is an effort to combine state, regional, and local agencies and groups for the restoration and protection of estuarine resources. The project includes significant partnerships with the Massachusetts Watershed Initiative Coastal Basin Teams, Cape Cod Commission, United States Geological Service and municipalities. The Project integrates more than 10 years of effort by DEP, SMAST, and their partners and includes the development of regional estuarine monitoring programs, eelgrass mapping, groundwater, land-use, and estuarine model development and implementation.

The MEP was initiated to reduce the level of municipal and state funds expended to meet the requirements of wastewater planning and implementation. A lack of consistent and defensible design targets for the development of these large municipal capital projects was resulting in significant delays and often the need for additional implementation studies. The effect was increasing, yet preventable, cost burdens on communities.

We conducted an audit of UMD's MEP for the period April 1, 2002 to June 30, 2005. The purpose of our audit was to review internal controls; financial records; procurement practices; and compliance with applicable laws, rules, and regulations.

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Our review indicated that, due to inadequate controls over its procurement process, UMD incurred \$629,362 in questionable contract costs. Moreover, we found that UMD charged costs on an as-needed basis to projects without complete underlying vendor

contracts and invoices to substantiate its basis for accounting allocations. As a result of these deficiencies, there is inadequate assurance that UMD paid only for services that were rendered in accordance with contractual obligations and that the actual costs paid and the timeliness of the services rendered, delivered, and attributable to the MEP are accurately represented. In its response, UMD indicated that it has strengthened its internal controls, hired a new director of sponsored research with a strong background in accounting, and implemented the grants and contracts module of its business process software to improve its tracking and oversight of sponsored research projects.

2. TWO SUBCONTRACTS TOTALING \$833,254 AWARDED WITHOUT A COMPETITIVE PROCUREMENT PROCESS

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Our audit indicated that, contrary to state and federal laws and its own procurement policies and procedures, UMD awarded subcontracts totaling \$833,254 to Applied Coastal Research and Engineering, Inc., (ACRE). UMD entered into an Interdepartmental Service Agreement (ISA) Phase III with DEP and awarded subcontracts funded under these agreements without conducting the required competitive procurement process. On July 8, 2002 ACRE was awarded a contract that, with subsequent amendments, grew from \$80,000 to \$479,741 under the initial \$2,172,000 ISA. On December 22, 2004 ACRE was awarded another contract that, with subsequent amendments, amounted to \$353,513 under the second \$1,200,000 ISA. As a result of its awarding contracts on a noncompetitive basis, UMD cannot ensure that it acquired the highest-quality services at the lowest-possible price to the Commonwealth. In its response, UMD indicated that it believes the competitive-bid procurement requirement is applicable to purchaser/vendor relationships, but not grant recipient (UMD)/subrecipient (ACRE) relationships. However, contrary to UMD's claim, state and federal laws, rules, and regulations define the relationship between UMD and ACRE as that of contractor/subcontractor, which requires a competitive bid process.

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Our audit indicated that a conflict of interest may have existed between the Principal Investigator of the MEP and ACRE, a primary subcontractor of MEP funds. Specifically, the Principal Investigator had a professional relationship with a principal at ACRE, and his for-profit company's location as a renter or landlord at the same location as ACRE were not disclosed prior to or subsequent to the awarding of the no-bid contracts to ACRE as a subcontracting entity under the MEP. Moreover, the Principal Investigator was not in compliance with Chapter 268A, Sections 6 and 23, of the General Laws, which requires an employee who is in a position to "improperly influence" a decision in his official duties to disclose this information to the "appointing official" (UMD). UMD, in turn, would be required to assign responsibility to another employee, assume responsibility itself, or make a written determination that the interest in the matter is not so substantial as to affect the integrity of the service and forward copies of this determination to the employee and the State Ethics Commission. Ultimately, this potential conflict of interest calls into question the competitiveness of the procurement procedures used by the MEP. By choosing contractors for the MEP with which the Principal Investigator had a close professional and business relationship and not having a competitive procurement for awarding contracts totaling \$833,254 UMD cannot ensure

that it obtained the highest-quality services at the lowest-possible cost or that the Principal Investigator complied with Chapter 268A, Sections 6 and 23, of the General Laws. In its response, UMD noted that there was no specific evidence of an actual conflict interest but agreed that it should have been aware of certain aspects of the relationship between the Principal Investigator and ACRE. UMD also indicated that a new conflict-of-interest agreement that all research faculty must sign has been implemented to ensure compliance. However, we reiterate that a potential conflict of interest exists between the Principal Investigator, an employee of UMD, and the subcontractor for which he was responsible and that UMD should contact the State Ethics Commission for guidance concerning this issue.

4. RELATED-PARTY TRANSACTION BETWEEN MEP'S PRINCIPAL INVESTIGATOR AND ITS PRIMARY SUBCONTRACTOR

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We found that the Principal Investigator for the MEP did not disclose to UMD officials his outside business interests and his relationship with an Officer of ACRE. Additionally, the Principal Investigator was one of the UMD employees assigned to work on the UMD SMAST for which ACRE contracted with UMD to provide professional consulting services on the Hydrodynamic Flushing Study and Water Quality Modeling project. The Principal Investigator's work on this project was charged at a rate of \$97 per hour under a \$156,521 contract between ACRE and SMAST that was agreed to and funded by ACRE in October 2000. This contract, with amendments, was extended in service until June 2002. However, during this period in which the Principal Investigator was working for UMD under a contract funded by a grant from ACRE, UMD was simultaneously negotiating a contract with ACRE that would be funded through the MEP for which he was the Principal Investigator. The ISA for the MEP, under which ACRE received an \$80,000 no-bid subcontract, was awarded to ACRE in July 2002 and increased the total subcontractor payments to ACRE of \$833,254 between July 2002 and June 2005. UMD officials indicated that in October 2005 they had no knowledge of the Principal Investigator's own for-profit corporation or his relationship to the Officer of ACRE simultaneous to the Principal Investigator's official capacity as an employee of UMD. Also, the Principal Investigator's company, Coastal Environmental Associates, Inc., and ACRE share the same address and property in Mashpee, Massachusetts. The two relationships -- the UMD consulting contract, under which the Principal Investigator was involved with the Officer at ACRE and the Principal Investigator's for-profit corporation, Coastal Environmental Associates, Inc., sharing property at the same location as ACRE, are connections that bind the Officer and the Principal Investigator as related parties. Moreover, this type of circular sales arrangement, in which the seller of services (the Principal Investigator) has concurrent obligations to the buyer (ACRE Officer) to purchase goods or services or provide other benefits and later becomes a buyer of services from the initial buyer is also indicative of the related-party nature of these transactions. Also, the supervisor at UMD who approves the subcontractor invoices for payment under the MEP is the Treasurer, the Secretary, and a Director of the Principal Investigator's for-profit corporation, Coastal Environmental Associates, Inc. Therefore, the Treasurer, Secretary, and Director of Coastal Environmental Associates, Inc., is approving payment for invoices to a related party, ACRE, that occupies the same address as a company in which she is an Officer and a Director. In response to the audit report, UMD indicated that although the advice the OSA provides

to ensure disclosure of related-party transactions is sound, there is no evidence of related-party transactions but rather of a "long-time scientific collaboration" between two scientists. However, as stated in our report, the long-term scientific collaboration between these two scientists changed character with the formation of separate corporations by these two scientists while the Principal Investigator retained status as an employee of UMD. The transactional relationships outlined in our report reflect the changed nature of their status and of the influence of these transactions, as outlined in Financial Accounting Standards Boards (FASB) Statement Number 57, Related Party Disclosures. Moreover, a "long-term scientific collaboration" does not qualify for any unique recognition, distinction, or exemption.

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INTRODUCTION

Background

The University of Massachusetts at Dartmouth (UMD) is one of 25 public higher educational institutions in the Commonwealth of Massachusetts that are organized under Chapter 15A, Section 5, of the Massachusetts General Laws. UMD, one of five campuses of the University of Massachusetts, is a four-year public university with approximately 6,500 students in undergraduate day programs, 700 students in graduate programs, and 1,400 students in continuing education evening courses. UMD operates under the oversight of the Board of Higher Education, which is responsible for monitoring each educational institution to ensure that state funds support measurable performance, productivity, and results.

UMD has a Board of Trustees consisting of 21 appointed members, including five students. The board establishes UMD's administrative policies, and UMD's Chancellor is responsible for implementing the policies set by the trustees. UMD's financial activity and its compliance with applicable laws and regulations are the responsibility of its management. For fiscal year 2005, UMD received state funding of \$82,838,717 and federal funding of \$19,143,479.

Massachusetts Estuaries Project

UMD's Massachusetts Estuaries Project (MEP), which was formed under the Memorandum of Understanding between the Executive Office of Environmental Affairs (EOEA) and the University of Massachusetts, is an effort to combine state, regional, and local agencies and groups for the restoration and protection of estuarine resources. The Massachusetts Department of Environmental Protection (DEP) and UMD's School for Marine Science and Technology (SMAST) initiated this collaborative project in December 2001, which includes significant partnerships with the Massachusetts Watershed Initiative Coastal Basin Teams, Cape Cod Commission, United States Geological Service, and municipalities. The MEP integrates more than 10 years of effort by DEP, SMAST, and their partners and includes the development of regional estuarine monitoring programs, eelgrass mapping, groundwater, land-use, and estuarine model development and implementation.

The MEP was initiated to reduce the level of municipal and state funds expended to meet the requirements of wastewater planning and implementation. A lack of consistent and defensible

design targets for the development of these large municipal capital projects was resulting in significant delays and often the need for additional implementation studies. The effect was increasing, yet preventable, cost burdens on communities.

Audit Scope, Objectives, and Methodology

In accordance with Chapter 11, Section 12, of the General Laws, we conducted an audit of UMD's MEP for the period April 1, 2002 to June 30, 2005. Our audit was conducted in accordance with applicable generally accepted government auditing standards.

The purpose of our audit was to:

- Review and analyze UMD's internal controls over its contracting and contract monitoring procedures.
- Review and analyze SMAST's financial records pertaining to the MEP to determine whether expenditures appear reasonable, applicable, and in compliance with contract/agreement provisions.
- Determine whether SMAST subcontracted any project work to outside vendors and whether such subcontract work has been properly bid and awarded.
- Determine whether UMD was in compliance with applicable laws, rules, and regulations.

To accomplish our objectives, we:

- Interviewed UMD officials and staff and reviewed UMD policies and procedures to gain an understanding of UMD's contracting system and controls.
- Tested MEP subcontract awards.
- Tested MEP expenditure transactions to determine whether they were reasonable, applicable, and in compliance with contract/agreement provisions.

Based upon our review we determined that, for the areas tested, during the period April 1, 2002 to June 30, 2005 UMD needed to improve its management of the MEP.

AUDIT RESULTS

1. INADEQUATE INTERNAL CONTROLS OVER GRANT CONTRACT PROCUREMENT RESULTING IN \$629,362 IN QUESTIONABLE CONTRACT COSTS

Our review indicated that, due to inadequate controls in its procurement process, the University of Massachusetts at Dartmouth (UMD) incurred \$629,362 in questionable contract costs. Moreover, we found that UMD charged costs on an as-needed basis to projects without the complete underlying vendor contracts and invoices to substantiate its basis for accounting allocations. As a result of these deficiencies, there is inadequate assurance that UMD paid only for services that were rendered in accordance with contractual obligations under contract and that the actual costs paid and the timeliness of the services rendered, delivered, and attributable to the MEP are accurately represented.

UMD provided a listing of contracts it entered into with Applied Coastal Research and Engineering, Inc., (ACRE) and other subcontractors performing services under the Massachusetts Estuaries Project (MEP) as well as the invoices and payments made for these services. The first of these contracts commenced on July 1, 2000. There are 11 such contracts that ACRE engaged in with UMD: 10 contracts in which ACRE was contracted with by UMD to provide services for projects and one in which UMD contracted to provide consulting services to ACRE.

In addition, there were nine subcontractors other than ACRE that were paid for services in Phase III of the MEP, but only six had signed contracts. Under Phase IV of the MEP, there were six sub-contractors paid, all of which had signed contracts.

Our review of these matters included repeated requests to UMD to document, with vendor invoices and correspondence, the rationale for the allocation of these costs to projects other than those indicated in our analysis. However, UMD was unable to provide adequate invoices or correspondence.

Our review revealed several discrepancies in the procurement procedures, as follows:

- There are five other grant projects, other than the MEP, for which UMD is being invoiced for and making payments to ACRE without the benefit of a contract. These payments total \$64,596 for non-MEP project work performed by ACRE.

- There were six subcontracted vendors, other than ACRE, that were awarded MEP contracts without a request for procurement and a bid process. These no-bid contracts amounted to \$196,839 in Phase III and \$123,998 in Phase IV of the project.
- There were payments totaling \$103,794 made to other subcontracted vendors, other than ACRE, during Phase III of the project that were charged as subcontractor payments for which UMD had no contract.
- The expenditures made for the invoices billed by ACRE under the agreements between the MEP and ACRE that were signed on July 8, 2002 and December 22, 2004 equaled the contracted amount of \$833,254, but UMD charged their accounts for these projects \$693,119, which was \$140,135 less than the amount contracted for and paid for by UMD for the services to these projects. This \$140,135 discrepancy is the result of an incorrect allocation by UMD of \$107,885 in Phase III payments to ACRE to other projects and a \$32,250 difference between an incorrect charging of a \$65,475 ACRE paid invoice to Phase IV instead of Phase III and the incorrect charging of a \$97,725 ACRE invoice to Pleasant Bay that should have been charged to Phase IV of the MEP. UMD could not provide documentation from ACRE to substantiate this reallocation of \$140,135 in contract expenditures that was incorrectly allocated to other projects.

This contract, "Subaward Agreement between the University of Massachusetts Dartmouth and Applied Coastal Research and Engineering, Inc.," signed by UMD on July 8, 2002, states, in part:

Sub recipient [ACRE] assumes the sole responsibility for reimbursement and will reimburse University [UMD] a sum of money equivalent to the amount of any expenditures disallowed should the granting or funding agency or an authorized agency rule, through audit exception or some other appropriate means, that expenditures from funds allocated to Sub-recipient for direct and/or indirect costs were not made in compliance with the regulations of the granting or funding agency or the provisions of this Agreement.

Further, Generally Accepted Accounting Principles (GAAP) advocate that a coherent audit trail of transactions be transparent as to the origin of the burden of costs and reimbursement for costs between UMD's accounting for them and ACRE's invoicing of them. Also, UMD is responsible under regulatory provisions of the Code of Massachusetts Regulations (CMR) and its own Policy for Management of University Funds to make contractual payments to contractors only for services for which there is a signed contract.

The 815 CMR 6.03(5)(c) states:

When expending ISA [Interdepartmental Service Agreement] funds, Seller Departments must treat these funds the same as any other contract funds, and conduct procurements

and make ISA expenditures in accordance with the same state finance law and applicable general and special state and federal laws and regulations that apply to other types of contracts procure by the Seller Department.

Moreover, the University of Massachusetts Policy for Management of University Funds under Doc. T92-031 revised in 2001, Appendix D, "University of Massachusetts Consultant Services," states, in part:

A standard contract form for each contract, where the amount expended annually exceeds \$5,000, shall be used as a binding contract. The standard forms shall be prepared by the Vice President for Management and Fiscal Affairs and approved by the General Counsel.

UMD charged costs on an as-needed basis to projects without the complete underlying vendor contracts and invoices to substantiate these accounting allocations. These inadequacies, which were the result of UMD's not managing the internal controls over the procurement process, have clouded the transparency of the audit trail of transactions, from the source invoice documents, to the payments made to the subcontractors, to the costs charged in their accounting records for these payments under the MEP. Further, the ability of UMD to roll charges into future periods and allocate charges to other projects without sufficient documentation to produce a coherent audit trail of transactions represent weaknesses in UMD's internal control system over costs.

These internal control weaknesses obscure the accountability of the actual costs and timeliness of the services rendered, delivered, and attributable to the MEP. As a result, there is inadequate assurance that the costs of this project are accurate, reliable, and representative of its true costs in the accounting records of UMD. Without a reconstruction of the costs allocated to this project, there is inadequate assurance that DEP and the Commonwealth of Massachusetts were not overcharged for the project.

Recommendation

UMD should develop adequate internal controls and policies and procedures over the payment and accounting for grant contractual expenses. UMD should account for payment of services under contract and should match the invoices paid for those services in the timeframe in which they were delivered for that contracted work. The accounts charged should be the accounts assigned for the contract in UMD's chart of accounts and not other accounts. Accounting records and payment records for invoices should match one another in a timely and substantive

basis; any deviation from these standards should be adjusted by the contractor through the issuance of correcting invoices by the service provider at UMD's request, as is indicated in the contractual agreements' guidelines. UMD should pay only for services rendered under contract. This timely matching of invoicing, payment, and accounting records are required under GAAP. UMD should review the costs and charges allocated to this project to ensure their accuracy.

Auditee's Response

The SAO report provides information that has helped UMass Dartmouth strengthen its internal controls. In May 2006, the University hired a new director of sponsored research with a strong background in accounting and has implemented the grants and contracts module of its business process software to improve our tracking and oversight of sponsored research projects. Both actions have and will continue to strengthen our internal controls.

2. TWO SUBCONTRACTS TOTALING \$833,254 AWARDED WITHOUT A COMPETITIVE PROCUREMENT PROCESS

Our audit indicated that, contrary to state and federal laws and its own procurement policies and procedures UMD awarded subcontracts totaling \$833,254 without conducting a competitive procurement process. As a result, there is inadequate assurance that the no-bid contracts represent the highest-quality services at the lowest-possible price.

On April 18, 2002, UMD's School for Marine Science and Technology (SMAST) entered into an Interdepartmental Service Agreement (ISA) - Phase III with the Massachusetts Department of Environmental Protection (DEP) totaling \$2,172,000 to study selected estuaries' nitrogen abatement in selected embayment systems comprising the coastline of southeastern Massachusetts under the MEP. A subsequent agreement, Phase IV, was approved on November 30, 2004 totaling \$1,200,000, which continued the project work on other selected embayment in the region through June 30, 2005.

We found that \$1,201,545 in noncompetitive contract procurements were awarded for all subcontracts funded under these agreements. UMD's Principal Investigator was involved in the award by UMD of two subcontracts totaling \$833,254 to ACRE. The Principal Investigator had collaborated professionally with a principal of ACRE, as stated in his memorandum to the Office of the State Auditor (OSA), in estuarine research at other organizations prior to the formation of ACRE and prior to their collaboration under these agreements. Also, the Principal Investigator is the person responsible for the design, conduct, and reporting of grant research

funded by UMD. This collaboration and role at UMD raises the question of a conflict of interest and whether, as a result, UMD followed competitive procurement procedures. Also, ACRE was formed as a for-profit entity after the initial research was begun on the estuaries in Massachusetts, and Coastal Environmental Associates, Incorporated, which operates in Massachusetts at the same address as ACRE, was formed as a for-profit Delaware company not long afterward. The President of Coastal Environmental Associates, Incorporated is the Principal Investigator of the MEP.

The Principal Investigator described this collaboration or partnership in a memorandum provided to the OSA dated October 5, 2005. The following excerpts from this memorandum clearly indicate the Principal Investigator's involvement with ACRE and why ACRE was selected:

*(a) While it seems that DEP "awarded" UMD funding, in actuality the Estuaries Project is titled the "DEP/SMASST Estuaries Project," in other words it was not a grant award, but funding to pursue a partnership project. This is why there was no RFR [Request for Responses]. This Partnership concept is clear in all of the documents and in all of the press the project has received. (b) DEP awarded the funds to support the Project of which [an officer] of Applied Coastal was an integral part (from the earliest phases) and indeed he has fulfilled the role of a Co-Principal Investigator (again from the start). **In research it is the individual researcher that is the essential component.** [Emphasis added by OSA.]*

Back to your specific point, there was no other group in the state system that could conduct the Estuaries Project, other than SMASST, specifically because it had both the in-house expertise and the greater collaborative network to draw upon. And again, this group of collaborators developed the scientific approach employed by MEP and had the region knowledge, contacts and pre-existing data. In the specific case of . . . [an officer] of ACRE, there was no other group within logistically reasonable distance (MA, RI, NH) that had the expertise required.

***You should be aware that in the period 1987-1999, pre-Estuaries Project phases, my research group had \$millions [dollars] in contracts with virtually all of the major environmental consulting firms in the region that do work related to what we do.** [Emphasis added by OSA.]*

*Equally important, as I had conducted multiple studies with each of the various groups, I was fully aware of their various capabilities and specialties. The niche expertise of Ramsey's group was the fit for the Estuaries Project, **none of the other groups were even marginally comparable in this very narrow area.** [Emphasis added by Principal Investigator]*

Relative to the other potential modeling firms in 2000, some of them claimed to have done modeling projects that in actuality they had subcontracted to others. In my position as a coastal ecologist, I am aware of these things through the course of my

research efforts, role as a reviewer, and role as a technical advisor to various funding and regulatory agencies.

The Principal Investigator's professional relationship with ACRE and work relationship with other groups are why compliance with competitive procurement laws, rules, and regulations is necessary to ensure a fair, transparent, unbiased, and independent procurement process and to avoid a conflict of interest or the appearance thereof. Moreover, the Principal Investigator was not in compliance with Chapter 268A, Sections 6 and 23, of the Massachusetts General Laws, which requires an employee who is in a position to "improperly influence" a decision in his official duties to disclose this to the "appointing authority" (UMD), which, in turn, is required to assign responsibility to another employee, assume responsibility itself, or make a written determination that the interest in the matter is not so substantial to affect the integrity of the service and forward copies of this determination to the employee and the State Ethics Commission.

ACRE was awarded a contract on July 8, 2002 for \$80,000 that, with amendments, grew to \$479,741 under the initial \$2,172,000 ISA. In addition, ACRE was later awarded a contract on December 22, 2004 that, with subsequent amendments, amounted to \$353,513 under the second \$1,200,000 ISA. UMD awarded and entered into these contracts contrary to CMR procurement regulations, the Massachusetts General Laws, federal laws and regulations, and UMD's policies and procedures for Grants, Contracts and Cooperative Agreements as promulgated by the Board of Trustees of the University of Massachusetts.

In addition, our audit disclosed that there was no Request for Responses (RFR) prepared by UMD to solicit prospective bidders for the entire amount of the subcontracted funds expended in the MEP. As a result, it is apparent that the competitive bidding process was not used (See Audit Result No. 1) by UMD and the Principal Investigator by ascribing the term "sub-recipient" to a contract with ACRE which resulted in the award of a vendor contract for \$833,254 in services for the benefit of a colleague of long-standing professional and commercial collaborative acquaintance of the Principal Investigator. (See Audit Result No. 3.)

These type agreements are governed by rules set forth in 815 CMR 6.00, "Interdepartmental Fiscal Business," which governs the transfer of funds between two Commonwealth departments. UMD's awarding of no-bid contracts under the ISA does not comply with the

General Laws and regulations governing expenditures by Seller Departments (UMD) in Interdepartmental Service Agreements under 815 CMR 6.03(5)(c), which states:

When expending ISA funds, Seller Departments must treat these funds the same as any other contract funds, and conduct procurements and make ISA expenditures in accordance with the same state finance law and applicable general and special state and federal laws and regulations that apply to other types of contracts procure by the Seller Department.

Moreover, Chapter 75, Section 13, of the General Laws, which governs University of Massachusetts purchases, states:

The board of trustees shall have the authority to make any purchase or purchases in the amount of one hundred thousand dollars or less, and to purchase without limitation of amount library books and periodicals, educational and scientific supplies and equipment, printing and binding, emergency repairs and replacement parts, and perishable items, without recourse to any other state board. Such purchases shall be subject to competitive bids wherever practicable. The board of trustees shall promulgate regulations further defining the process for the purchase of said supplies.

The Board of Trustees of the University of Massachusetts has promulgated such “regulations further defining the process for the purchase of said supplies” under the Policy for the Development and Administration of Grants, Contracts and Cooperative Agreements For Sponsored Programs (Doc. T94-034), passed by the Board of Trustees on April 6, 1994, which states that “Each campus will establish internal implementation procedures for sponsored project administration maintaining consistency with the policy of this document.” In addition, regarding the preparation and submission of proposals, the policy states that “Proposals must conform with the policies of the Board of Trustees and of the University Administration.”

Similarly, regarding consultant services, Appendix D of the University of Massachusetts Policy for Management of University Funds (Doc. T92-031), revised December 2001, states, in part:

Any professional service contract whose annual projected expenditure exceeds \$50,000 annually shall be bid competitively whenever practicable or sole source justification shall be provided.

However, UMD did not provide us with any sole-source justification of these subcontracts.

The responsibility for contract compliance for services provided to UMD from service providers that it contracts with rests with UMD under the ISA’s Scope of Service Section, Part V. Section

5, “Additional Condition,” states that the burden of compliance for subcontracting is primarily on UMD and not on the Department of Environmental Protection (Department):

*Any persons named to provide services to the Department under this ISA will be subject to the provisions of the Massachusetts Conflict of Interest Law, M.G.L. c268A, and must conform their conduct accordingly. Such persons have an affirmative duty to identify and report to the Department all relationships and situations where the potential for a conflict of interest may arise. **Such relationship and situations include but are not limited to contracts or subcontracts to perform work concerning the matter in which the state has an interest and in which the person is participating.** In addition, the Department may on its own request such persons to provide information relevant to determining whether an actual or potential conflict of interest exists. The parties to this ISA agree that the existence of an actual or potential conflict of interest, as determined by the Department and/or the State Ethics Commission, authorizes the Department to restrict the activities of a relevant person named to provide services to the Department under this ISA or to terminate the ISA. [Emphasis added by OSA.]*

Further, we conferred with DEP officials and concluded that DEP placed reliance on UMD to comply with any all applicable laws, rules, and regulations.

The policies of the Board of Trustees and the University Administration in regard to the procurement process are clearly outlined in UMD’s Internal Control Plan, which, under Administrative and Fiscal Controls, Purchasing Cycle, Specific Objectives, requires the following:

(a) Purchases and Accounts Payable. . .

- 4. Competitive bidding procedures are used.*
- 5. Purchase orders and contracts are issued under numerical or other suitable control.*
- 6. Changes to purchase orders and contracts are subjected to the same controls and approvals as the original agreement. . . .*

(c) Grants and Contracts

- 1. Grant disbursements are processed under the same degree of controls applicable to the organization’s other transactions, i.e., budget, procurement, etc.*

Therefore, UMD’s awarding of \$833,254 in no-bid contracts to ACRE was not in compliance with the procurement procedures outlined in the General Laws, the CMRs, and UMD’s internal control policies.

UMD officials indicated that UMD concluded that ACRE was a “subrecipient” and not a “vendor” under Office of Management and Budget’s (OMB) Circular A-133 and the Single

Audit Act of 1984 and that therefore the award could be made outside the competitive procurement process. However, if ACRE were determined to be a vendor, then procurement regulations would have been followed and bids would have been solicited by UMD for ACRE's services, then any agreement between UMD and ACRE would have been awarded through the competitive procurement process.

The distinction of these contracts being awarded based on this assessment by UMD, with ACRE as a subrecipient of funds, rests on the assumption of a University determination made as to ACRE's status as a subrecipient under the Office of Management and Budget's Circular A-133 of the Single Audit Act of 1984. OMB Circular A-133 contains a determination matrix checklist to determine whether an entity is a subrecipient or a vendor. UMD officials could not provide us with the analysis UMD performed prior to entering into this agreement with the approved determination matrix checklist in determining ACRE's status as a subrecipient.

However, had the determination matrix checklist been used by UMD it would have clearly shown that ACRE was a vendor and not a subrecipient: This is demonstrated by answering the relevant questions offered by OMB A-133, Section 210, "Subrecipient and Vendor Determinations," using the matrix table checklist below as an example for determining ACRE's status:

Subrecipient	Yes or No	Vendor	Yes or No
Determines who is eligible	No	Provides goods or services within normal business operations	Yes
Has performance measured against program objectives	No	Provides similar goods or services to many different purchasers	Yes
Makes program decisions	No	Operates in competitive environment	Yes
Is responsible for ensuring that federal requirements are met	No	Provides goods or services that are ancillary to the program	Yes
Uses federal funds to carry out a program, not provide goods or services	No	Is not subject to compliance requirements	Yes

Given these positive attribute responses in the matrix table checklist above, ACRE would be considered a vendor to UMD under the MEP, not a subrecipient. A fair examination of the for-profit corporation, ACRE, on its Web address also reveals that ACRE offers itself as a vendor of these type services in the competitive marketplace among corporations conducting the type of business for which they contracted with UMD. ACRE provided these services within its normal business operations and provided such services to other purchasers in a competitive environment, which demonstrates a vendor rather than a subrecipient relationship between ACRE and UMD. Also, this relationship is demonstrated by the fact that the ISA funding requires ACRE to provide services and report to UMD under the contract. These services were provided as ancillary services to the UMD program due to their nature as subcontracted services as part of the larger ISA agreements and due to the primary position of the Principal Investigator, who ensures that any federal requirements of the grant are being met. The Principal Investigator is paid out of the funds generated in the ISA agreement, and any subcontractors (e.g., ACRE) are subordinate and not responsible for any pass-through federal funds expended. If ACRE were a subrecipient and not a vendor, then ACRE would have been responsible for ensuring compliance with federal contract compliance. Therefore, UMD is responsible for contract compliance.

Further, the A-133 Compliance Supplement for Federal Audits issued March 2004, under Subpart M, "Sub-recipient Monitoring, Compliance Requirements," describes the following responsibilities of a pass-through entity such as UMD:

A pass-through entity is responsible for:

(a) Award Identification – At the time of award, identifying to the sub-recipients the Federal award information (e.g., CFDA title and number, award name, name of Federal Agency) and applicable compliance requirements.

(b) During-the-Award Monitoring – Monitoring the sub-recipient's use of Federal awards through reporting, site visits, regular contact, or other means to provide reasonable assurance that the sub-recipient administers Federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements and that performance goals are achieved.

(c) Monitoring activities normally occur throughout the year and may take various forms, such as:

(d) Reporting - Reviewing financial and performance reports submitted by the sub-recipient.

(e) Site-visits – Performing site visits at the sub-recipient to review financial and programmatic records and observe operations.

(f) Regular Contact – Regular contacts with sub-recipients and appropriate inquiries concerning program activities.

UMD officials also indicated that they classified ACRE as a subrecipient in accordance with OMB Circular A-110, “Uniform Administrative Requirements for Grants and Agreements With Institutions of Higher Education, Hospitals, and Other Non-Profit Organizations.” However, OMB Circular A-110, under Procurement, Subpart 43, Competition, requires that all procurement transactions be open and free to competition and that the recipient of the contract be alerted to organizational conflict of interest that may restrict or eliminate competition, as follows:

All procurement transactions shall be conducted in a manner to provide, to the maximum extent practical, open and free competition. The recipient shall be alert to organizational conflicts of interest as well as noncompetitive practices among contractors that may restrict or eliminate competition or otherwise restrain trade. In order to ensure objective contractor performance and eliminate unfair competitive advantage, contractors that develop or draft specifications, requirements, statements of work, invitations for bids and/or requests for proposals shall be excluded from competing for such procurements. Awards shall be made to the bidder or offer or whose bid or offer is responsive to the solicitation and is most advantageous to the recipient, price, quality and other factors considered. Solicitations shall clearly set forth all requirements that the bidder or offeror shall fulfill in order for the bid or offer to be evaluated by the recipient. Any and all bids or offers may be rejected when it is in the recipient's interest to do so.

As stated above, OMB A-110 requires the procurement process to be a competitive solicitation process, and UMD officials agree that, notwithstanding this requirement, UMD awarded the subcontract to ACRE without a competitive bid procedure.

Our requests of UMD to outline the charges that ACRE incurred as a subrecipient, as stated by UMD, to determine the reasonableness, allowability, and allocability of \$833,254 in costs invoiced under these agreements yielded no substantive responses. Further, UMD could not ensure that the amounts charged by ACRE represented reasonable, allowable, and allocable costs for the services provided to and paid for by UMD because the ACRE-paid invoices provided to us by UMD officials do not fully agree with the expenses charged for the MEP in UMD's General Ledger.

Also, OMB A-110 requires that “the recipient shall be alert to organizational conflicts of interest as well as noncompetitive practices among contractors that may restrict or eliminate competition

or otherwise restrain trade.” We have found potential conflicts of interest in our examination of the relationship between ACRE and the Principal Investigator for the MEP with regard to the selection of ACRE as the primary sub-awarded contractor under the MEP. (See Audit Result No. 3.)

In this regard we have made requests to ascertain whether related-party transactions were made by or to either of the parties in the agreement, UMD or ACRE. We were verbally assured that there were no related-party transactions. Similarly, we requested to review the indirect cost allocation plan being employed by ACRE to allocate indirect costs that it was charging (10% per the two agreements) to determine whether the Commonwealth was reimbursing ACRE in a reasonable, allowable, and allocable manner for these costs. We received no documentation from UMD officials as to the existence of any related-party transactions by and between the parties to the agreement or any assurance from UMD that it had reviewed or was in custody of an Indirect Cost Allocation plan from ACRE.

OMB Circular A-133 stipulates that the responsibility rests upon officials of the pass-through agency (in this case UMD) in determining whether costs are reasonable, allowable, and allocable as incurred by a subrecipient. Contrary to the requirements of OMB A-133, UMD officials could not document in any way that they performed any due diligence work at ACRE as the subrecipient of federal funds. Further, there was no identification of the Catalog of Federal Domestic Assistance (CFDA) numbers that ACRE would have noted in its financial reporting system as being the recipient of federal funds in the Award Identification process, and there was no documentation of site visits or contacts with the subrecipient by UMD officials to provide reasonable assurance that the subrecipient administers federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements and that performance goals are achieved under the federal award. It is clear that these contracts were awarded to ACRE by UMD in a manner contrary to the above requirements.

Recommendation

UMD should award grant contracts under the procurement procedures as outlined in the General Laws, the Code of Massachusetts Regulations, and the policies and procedures for procurement outlined by the University of Massachusetts and reflected in the Internal Control Policies and Procedures of UMD. UMD should also have a system in place that monitors grant

contract procurement and the implementation of internal control policies and procedures. In addition, UMD should contact the State Ethics Commission for guidance on how to proceed to resolve this potential conflict of interest. (See Audit Result No. 3.)

Auditee's Response

In response to this issue, UMD stated:

The University respectfully, but fundamentally, disagrees with this finding. This finding arises from the inappropriate conflation of the terms: subcontractor, sub-recipient, collaborator and co-principal investigator.

A University scientist collaborated with another independent scientist to produce a unique model to study nitrogen abatement in selected embayment systems. This original model was applied to specific coastal sites using proprietary information and data histories accumulated over time in order for those communities to meet state and federal environmental mandates. The University is the grant recipient through the ISA and ACRE is the designated sub-recipient, a relationship consistent with OMB A-133, Section 210. The bid process implied by the OSA applies to purchaser/vendor relationships, not recipient/sub-recipient.

Auditor's Reply

Contrary to UMD's claim, state and federal laws, rules, and regulations define the relationship between UMD and ACRE as that of contractor/subcontractor and accordingly, a competitive bid process is required.

3. POTENTIAL CONFLICT OF INTEREST BETWEEN MEP'S PRINCIPAL INVESTIGATOR AND AN OFFICER OF ACRE, MEP'S PRIMARY SUBCONTRACTOR

Our audit indicated that a conflict of interest may exist between the Principal Investigator of the MEP and ACRE, a subcontractor of MEP funds. Specifically, the Principal Investigator's professional relationship with a principal of ACRE and his for-profit company's location as a renter or landlord at the same location as ACRE was not disclosed prior to or subsequent to the Principal Investigator's involvement in UMD's award of the no-bid contracts to ACRE as a subcontracting entity under the MEP. Moreover, UMD and the Principal Investigator did not avail themselves of the statutory options provided under Chapter 268A, Sections 6 and 23, of the General Laws to avoid this potential conflict of interest. Ultimately, these potential conflicts of interest call into question the appropriateness of the award procedures employed by UMD. Since the Principal Investigator was involved in UMD's award process for selecting contractors for the MEP with which he had close professional and business associations and in the awarding

of \$833,254 of these contracts without using the normal procurement procedures for contract expenditures, UMD cannot ensure that it obtained the highest-quality services at the lowest-possible price and that there was not a conflict of interest.

ACRE was formed as a for-profit corporation in the Commonwealth of Massachusetts on March 26, 1998. An Officer of ACRE has had a professional relationship with the Principal Investigator of the MEP dating back to the 1980s. In addition, the Principal Investigator did not disclose to UMD officials that he is a principal in a for-profit corporation that is located at the same address as ACRE. The Principal Investigator formed this corporation, Coastal Environmental Associates, Incorporated, as a Delaware corporation on January 1, 1998 and subsequently registered this corporation in Massachusetts as a foreign corporation doing business in Massachusetts on March 30, 2000.

The Principal Investigator and the Officer began work on estuaries research in the early 1990s. We requested from the Principal Investigator an overall summary of the relationship that UMD has with ACRE. In a correspondence dated October 5, 2005, the Principal Investigator indicated, "The relationship with Officer of ACRE relative to the work which became the Estuaries Project started in the early 1990's." However, ACRE was formed as a for-profit corporation in the Commonwealth of Massachusetts on March 26, 1998 and did not exist in the early 1990s; therefore, ACRE was not involved in the MEP from the beginning. ACRE is a for-profit corporation, and an Officer of ACRE and the Principal Investigator were collegial researchers in the estuaries projects working in the field cooperatively for other organizations "in the early 1990s." A sample of the Officer of ACRE and the Principal Investigator's published work, prior to the contractual relationship that they engaged in as representatives of a corporation and of a university doing business under the MEP and under a consulting agreement, is in the listing of the publications of the Officer at ACRE's Web site:

Officer and Principal Investigator, 1995- "Draft Report, Hydrodynamic Evaluation of Proposed Culvert Design for Green Pond, Falmouth, MA." Aubrey Consulting, Inc. report prepared for the Massachusetts Highway Department.

Officer and Principal Investigator, 1996- "Hydrodynamic Study and Weir Design Oyster Pond, MA." Aubrey Consulting, Inc. and Woods Hole Oceanographic Institution report prepared for the Town of Falmouth.

Officer and Principal Investigator, 2000- "Water Quality Analysis and Implications of Future Nitrogen Loading Management for Great, Green, and Bourne Ponds, Falmouth,

Massachusetts.” Environment Cape Cod, Volume 3, Number 1 (May 2000), Barnstable, MA, pp. 1-20.

Principal Investigator and Officer, 2001- “Nitrogen Modeling to Support Watershed Management: Comparison of Approaches and Sensitivity Analysis.” School of Marine Science and Technology (University of Massachusetts Dartmouth) and Applied Coastal Research and Engineering, Inc. report prepared for the Massachusetts DEP and the U.S. Environmental Protection Agency. 94 pp.

The UMD policies and General Laws concerning conflict of interest governing individuals’ activities are clear concerning these matters. UMD Document T96-047 “Faculty Consulting and Outside Activities,” passed by the Board of Trustees on April 2, 1997 and revised on February 7, 2001, describes the responsibility of faculty concerning these activities:

D. Administrative Procedures

Disclosure and Approval of Outside Activities - Before the commencement of any Outside Activity subject to this Policy, the University requires a Faculty Member to disclose the proposed Outside Activity to his or her Department Chair, and to receive approval of such Outside Activity.

Chapter 268A, Section 23, of the General Laws, which provides standards of conduct that a state employee should adhere to, indicates that an employee’s official position should not be used to influence or secure for himself or others unwarranted privilege or exemption and details the responsibility of state employees to disclose outside financial interest, penalties for non-disclosure, and agency responsibilities in these matters, as follows:

(2) use or attempt to use his official position to secure for himself or others unwarranted privileges or exemptions which are of substantial value and which are not properly available to similarly situated individuals;

(3) act in a manner which would cause a reasonable person, having knowledge of the relevant circumstances, to conclude that any person can improperly influence or unduly enjoy his favor in the performance of his official duties, or that he is likely to act or fail to act as a result of kinship, rank, position or under influence of any party or person. It shall be unreasonable to so conclude if such officer or employee has disclosed in writing to his appointing authority or, if no appointing authority exists, discloses in a manner which is public in nature, the facts which would otherwise lead such a conclusion.

Further, Chapter 268A, Section 6, of the General Laws states:

(a) Except as permitted by this section, any state employee who participates as such employee in a particular matter in which to his knowledge he, his immediate family or partner, a business organization in which he is serving as officer, director, trustee, partner or employee, or any person or organization with whom he is negotiating or has any arrangement concerning prospective employment, has a financial interest, shall be

punished by a fine of not more than three thousand dollars or by imprisonment for not more than two years, or both.

Any state employee whose duties would otherwise require him to participate in such a particular matter shall advise the official responsible for appointment to his position and the state ethics commission of the nature and circumstances of the particular matter and make full disclosure of such financial interest, and the appointing official shall thereupon either

- (1) Assign the particular matter to another employee; or*
- (2) Assume responsibility for the particular matter; or*
- (3) Make a written determination that the interest is not so substantial as to be deemed likely to affect the integrity of the services, which the commonwealth may expect from the employee, in which case it shall not be a violation for the employee to participate in the particular matter. Copies of such written determination shall be forwarded to the state employee and filed with the state ethics commission by the person who made the determination. Such copy shall be retained by the commission for a period of six years.*

In these matters, OMB Circular A-110, Subpart 43, Competition, provides the following overall guidance to agencies to follow for open and free competition in the procurement process:

All procurement transactions shall be conducted in a manner to provide, to the maximum extent practical, open and free competition. The recipient shall be alert to organizational conflicts of interest as well as noncompetitive practices among contractors that may restrict or eliminate competition or otherwise restrain trade. In order to ensure objective contractor performance and eliminate unfair competitive advantage, contractors that develop or draft specifications, requirements, statements of work, invitations for bids and/or requests for proposals shall be excluded from competing for such procurements. Awards shall be made to the bidder or offeror whose bid or offer is responsive to the solicitation and is most advantageous to the recipient, price, quality and other factors considered. Solicitations shall clearly set forth all requirements that the bidder or offeror shall fulfill in order for the bid or offer to be evaluated by the recipient. Any and all bids or offers may be rejected when it is in the recipient's interest to do so.

This procurement guidance is stated in other state laws and regulations and University policies that have been noted in earlier portions of this report. The Principal Investigator should have disclosed to UMD and the State Ethics Commission a potential conflict of interest, as outlined in Chapter 268A of the General Laws, so that the contract was awarded under the highest level of integrity as outlined in applicable laws, rules, and regulations. At least \$833,254 in contracts were awarded outside of the conflict-of-interest guidance and outside of all proper procurement procedures. Further, as OMB A-110 notes, this represents that, “the recipient [of federal funds, in this case UMD] shall be alert to organizational conflict of interest as well as noncompetitive

practices among contractors that may restrict or eliminate competition or otherwise restrain trade.”

Recommendation

UMD should require that all individuals associated with the approval of contracts procured with grant funds place on file a statement outlining all potential conflicts of interest in the procurements on a “Conflict of Interest Disclosure Form.” These statements should be written to take into account, at a minimum, any appearance of a conflict of interest in the procurement under consideration in accordance with Chapter 268A of the General Laws and UMD Document T96-047, “Faculty Consulting and Outside Activities.” UMD should contact the State Ethics Commission for guidance on how to proceed to resolve this potential conflict.

Auditee’s Response

In response to this issue, UMD stated:

No specific evidence of an actual conflict of interest is offered, however, the University should have been aware of certain aspects of the relationship between the Principal Investigator and... [ACRE]. In that regard and consistent with the SAO recommendation, a new conflict of interest agreement that all research faculty must sign has been implemented to assure compliance.

Auditor’s Reply

As stated in our report, at a minimum a potential conflict of interest existed between the Principal Investigator, an employee of UMD, and a subcontractor for which he was responsible. We reiterate that UMD should contact the State Ethics Commission for guidance concerning this issue. Finally, UMD has taken appropriate action to help avoid future conflicts-of-interest for research faculty.

4. RELATED-PARTY TRANSACTION BETWEEN UMD’S PRINCIPAL INVESTIGATOR AND ITS PRIMARY SUBCONTRACTOR

We found that the Principal Investigator did not disclose his outside business interests and his business relationships with an Officer of ACRE to UMD officials at the time that contractual relations began between UMD and ACRE. In October 2005, UMD officials indicated that they had no knowledge of the Principal Investigator’s own for-profit corporation or of his relationship to the Officer of ACRE while simultaneously functioning in an official capacity as an employee of UMD. The outside relationship between the ACRE Officer and the Principal

Investigator that the Principal Investigator did not disclose to UMD officials was that his corporation, Coastal Environmental Associates, Inc., and ACRE share the same address and property in Mashpee, Massachusetts. Additionally, the Principal Investigator for UMD, MEP was one of the UMD employees assigned to work on the UMD, SMAST for which ACRE contracted with UMD to provide professional consulting services on the Hydrodynamic Flushing Study and Water Quality Modeling project. The Principal Investigator's work on this project was charged at a rate of \$97 per hour under a \$156,521 contract between ACRE and UMD, SMAST that was agreed to and funded by ACRE in October 2000. This contract, with amendments, was extended until June 2002. The ISA for the MEP under which ACRE was listed as a prime subcontractor was signed on April 18, 2002.

The two relationships -- the UMD consulting contract with the Officer's ACRE and the Principal Investigator's for-profit company Coastal Environmental Associates, Inc., sharing property at the same location as ACRE -- bind the Officer and the Principal Investigator as related parties. Also, this type of circular sales arrangement, in which the seller of services (UMD Principal Investigator) has concurrent obligations to the buyer (ACRE Principal) to purchase goods or services or provide other benefits and later becomes a buyer of services from the initial buyer is indicative of the related nature of these transactions.

The Principal Investigator of the MEP and an Officer of ACRE began working on estuaries research in the early 1990s. They were colleagues in the field of estuaries research who occasionally worked cooperatively with one another as employees or consultants for other organizations during that time period (see Audit Result No. 2). ACRE was formed as a for-profit corporation in the Commonwealth of Massachusetts on March 26, 1998, and the Officer became an Officer, Director, and founder of ACRE at that time.

The Principal Investigator formed a for-profit corporation, Coastal Environmental Associates, Inc., as a Delaware corporation on January 1, 1998 and he subsequently registered this corporation in Massachusetts as a foreign corporation doing business in Massachusetts on March 30, 2000.

A further indication of the relationship of these transactions, individuals, and entities in general occurs in the approval process by UMD for the payment of ACRE and other subcontracted

invoices. The supervisor at UMD who approves the subcontractor invoices for payment under the MEP is the Treasurer, the Secretary, and a Director of the Principal Investigator's for-profit corporation, Coastal Environmental Associates, Inc. Therefore, the Treasurer, Secretary and Director of Coastal Environmental Associates, Inc., is approving payment for invoices to a related party, ACRE, that occupies the same address as a company in which she is an Officer and a Director. Accordingly, there \$833,254 in payments were remitted to the payee, ACRE, at 766 Falmouth Road in Mashpee, Massachusetts, the same address of the Principal Investigator's for-profit corporation, Coastal Environmental Associates, Inc.

The Financial Accounting Standards Board (FASB) Statement Number 57 defines related parties by stating, in part:

Another party is also a related party if it can significantly influence the management or operating policies 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.

FASB Statement Number 57 also outlines examples of related party transactions and relations, stating, in part,

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. . . . 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 receive services from a related party without charge and not record receipt of the services.

The collegial research relationship that the Principal Investigator of the MEP and the Officer of ACRE shared in the past by performing cooperative work in the estuaries research field, their business relationship outside of government employment and the contractual relationship inside government employment prior to the beginning of DEP's funding of the MEP at UMD SMAST appeared to have been factors in the process that resulted in the initial awarding of an \$80,000 contract with ACRE that increased to \$479,741, a 500% increase for a contract with a duration from July 8, 2002 to June 30, 2005 under Phase III of the MEP. Further, an initial \$75,000 contract with ACRE for services under Phase IV of the MEP escalated to \$353,513, a 371% increase for contract with duration from July 1, 2004 to June 30, 2005.

These ACRE contracts under the MEP, with their amended increases, totaled \$833,254 of MEP funds for contracts between July 2002 and June 2005. As a result of the relationship that the Principal Investigator has established with the Officer of ACRE, ACRE, as the principal subcontracting entity under the MEP, was awarded these no-bid contracts in this amount by UMD without full disclosure of the Principal Investigator's professional relationship with ACRE. These relationships are significant regarding the management or operating policies of the MEP that led to these related-party transactions.

By not disclosing his outside business interests the Principal Investigator has further placed UMD in the position of acquiescence for procurements that may not have resulted in arm's-length transactions due to the related-party nature of the transactions. UMD's internal controls were also compromised in that a key member of a related party was approving payments to the other related party and that in this capacity she acted as a conduit of UMD funds to a related party. This has resulted in related-party transactions totaling \$833,254.

Recommendation

UMD should develop adequate internal controls and policy procedures so that related-party transactions are disclosed. Employees, when engaging as agents of the Commonwealth of Massachusetts and in this case as agents of UMD, should make disclosures as to their outside financial and business interests so that transactions that they are involved in will be at arms length. These disclosures should be followed up by responsible UMD officials reviewing and performing the necessary due diligence for signs of related-party relationships in selecting and monitoring individuals who become Principal Investigators for the grant research work that is a necessary and common function of a major university. UMD should contact the State Ethics Commission for guidance on how to proceed to resolve this potential conflict.

Auditee's Response

In response to this issue, UMD stated:

While the advice the SAO provides to assure disclosure of related party transactions is sound, there is no evidence here of related party transactions but rather a long-time scientific collaboration between two scientists.

Auditor's Reply

The “long-term scientific collaboration” between these two scientists changed character with their formation of separate corporations while the Principal Investigator retained status as an employee of UMD. The transactional relationships outlined in our report reflects the changed nature of their status and of the influence of these transactions, as outlined in FASB No. 57 “Related Party Disclosures.” Further, a “long-time scientific collaboration” does not qualify for any unique recognition, distinction, or exemption, particularly when public funds are involved.

APPENDIX I

Funding for Massachusetts Estuaries Project

April 1, 2002 through June 30, 2005

Project 01-26/319					
Invoice #	Funding	CFDA	Account #	Date	Amount
1	Federal	66.460	22409727	09/02/02	\$ 12,533.34
1	Federal	66.460	22409728	09/02/02	\$ 76,202.16
2	Federal	66.460	22409728	11/02/02	\$ 30,077.36
5	Federal	66.463	22409761	04/03/03	\$ 12,442.16
8	Federal	66.463	22409761	06/03/03	\$ 5,060.14
8	Federal	66.463	22409766	06/03/03	\$ 25,000.00
9	Federal	66.463	22409766	08/03/03	\$ 25,000.00
2	Federal	66.605	22309702	11/01/02	\$ 2,004.98
3	Federal	66.605	22309702	03/03/03	\$ 48,342.97
8	Federal	66.605	22309702	06/03/03	\$ 20,894.70
10	Federal	66.605	22309702	07/03/03	\$ 80,972.03
9	Federal	66.605	22309702	08/03/03	\$ 54,474.03
14	Federal	66.605	22309702	06/04/04	\$ 8,709.98
15	Federal	66.605	22309702	12/04/04	\$ 168,470.14
16	Federal	66.605	22309702	12/04/04	\$ 289,363.33
TOTAL FEDERAL					\$ 859,547.32
4	State	N/A	22002011	04/03/03	\$ 43,845.22
5	State	N/A	22002011	04/03/03	\$ 23,154.78
6	State	N/A	22002011	05/03/03	\$ 12,497.70
7	State	N/A	22002011	06/03/03	\$ 32,954.98
11	State	N/A	22002011	12/03/03	\$ 227,379.52
12	State	N/A	22002017	05/04/04	\$ 398,348.39
13	State	N/A	22002017	06/04/04	\$ 370,278.60
14	State	N/A	22002017	06/04/04	\$ 203,993.49
TOTAL STATE					\$ 1,312,452.68
PROJECT TOTAL					\$ 2,172,000.00
Project 02-05CAP					
DEP Invoice #	Funding	CFDA	Account #	Date	Amount
1	State	N/A	22002017	03/05/05	\$ 44,826.99
2	State	N/A	22002017	03/05/05	\$ 294,224.84
3	State	N/A	22002017	04/05/05	\$ 120,510.44
4	State	N/A	22002017	05/05/05	\$ 88,242.14
5	State	N/A	22002017	05/05/05	\$ 98,357.07
6	State	N/A	22002017	07/05/05	\$ 553,838.52
PROJECT TOTAL					\$ 1,200,000.00

APPENDIX II

Related-Party Flowcharts/Chronology

Related-Party Relationship between *ACRE* Officer and *UMD MEP* Principal Investigator

