# GENERAL AUDIT AND COMPLIANCE REQUIREMENTS

*Refreshed November 10, 2011*

The Operational Services Division, as the responsible oversight entity, has established standard methods of complying with various federal and state requirements specifically for human and social services contracts and for private special education school programs provided pursuant to M.G.L. c.71B. This document highlights certain of these additional legal and contractual requirements. It is intended to be a general summary of reporting requirements and associated policies. It accompanies the audit materials which are used in preparation of the Uniform Financial Statements and Independent Auditor's Reports (UFR).

All UFR materials, including this document, are available on the eFile information page. The materials include, but are not limited to, the *UFR Audit and Preparation Manual* and the UFR *Auditor's Compliance Supplement*. Please note, however, that the scope of this document is general in nature and is not intended to provide a complete description of all applicable legal or contractual rights and responsibilities.

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## Compliance Source Material

In addition to the above UFR manuals, departments and contractors should also refer to the following source material:

* Regulations: 801 CMR 21.00, Procurement of Commodities or Services, Including Human and Social Services.
* 808 CMR 1.00, Compliance, Reporting and Auditing for Human and Social Services; 815 CMR 3.00, Ready Payment System.
* Contract Documents: Commonwealth Terms and Conditions for Human and Social Services, Standard Contract Form, Request for Response (RFR), contractor response, Purchase of Service (POS) attachments.
* Policy: The *UFR Audit and Preparation Manual* and the *UFR Auditor's Compliance Supplement.*
* Statutes: St. 1993 c.110, s.274, as amended by St. 1993, c.151, s.113, St. 1993, c.296, s.3 and St. 1993, c.495, s.99 and M.G.L. c.29, s.29B.
* Massachusetts Constitution: Article 18, ss.2 and 3, commonly referred to as the “Anti-Aid Amendment” (these provisions limit payment to non-profit organizations for services purchased by the Commonwealth to reasonable and necessary costs of providing such services).
* Federal (if applicable): OMB Circulars, Catalog of Federal Domestic Assistance.

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## General Contractor Compliance

The Commonwealth has an obligation to establish a strong system of accountability to ensure that public funds are well spent. In addition, the Commonwealth has a special responsibility to protect the interests of the consumers being served through its human and social service contracts and special education programs. Finally, the federal government, which funds a large portion of the state’s human and social services contracts, has imposed particular spending restrictions and reporting requirements where federal funds are involved. This section briefly highlights important general provisions that are applicable to all human and social services contractors. Unless the language of a provision clearly indicates otherwise, when the term “contractor” is used, it also includes subcontractors and organizations providing special education services even if the organization does not have a service contract with a department under 801 CMR 21.00. Consistent with its contract management and monitoring responsibilities, departments should ensure that relevant staff are aware of the requirements described in this document and the source materials listed above.

### OSD Regulation 808 CMR 1.00

Operational Services Division regulation 808 CMR 1.00, Compliance, Reporting and Auditing for Human and Social Services, is the primary regulation covering contract compliance, financial reporting and auditing requirements for contractors and subcontractors providing human and social services. These requirements are derived primarily from M.G.L. c.29 s.29B, applicable industry auditing and accounting standards set by the American Institute of Certified Public Accountants (AICPA), federal restrictions, the Internal Revenue Service (IRS) or other relevant sources.

In addition, OSD issues policies, procedures, and forms to support and standardize how contractors and departments meet their responsibilities under this regulation. Departments and contractors should carefully review 808 CMR 1.00 in its entirety and any related policies, procedures and forms, as well as their contracts. Even if a department or OSD fails to initially identify violations of 808 CMR 1.00 through the contracting or auditing process, the contractor is not relieved of its responsibility to comply with its obligations under 808 CMR 1.00.

Please note, however, that there are limited instances when the standards imposed in 808 CMR 1.00 are not appropriate or reasonable for the specific circumstances. Therefore, on request of a department or a contractor, OSD has the authority to waive the applicability of one or more provisions of 808 CMR 1.00 (see 808 CMR 1.03(2)).

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### Commonwealth Terms and Conditions for Human and Social Services

The Commonwealth Terms and Conditions for Human and Social Services is the fundamental agreement underlying all human and social services contracts subject to OSD’s authority. The Commonwealth Terms and Conditions for Human and Social Services sets forth general contractual terms that apply to all Commonwealth procurements for human and social services.

A contractor’s Commonwealth Terms and Conditions for Human and Social Services must be recorded on the Vendor/Customer Table, which the Office of the Comptroller (CTR) maintains as part of the Massachusetts Management Accounting and Reporting System (MMARS) in order for a contract or payment to be processed.

The Commonwealth Terms and Conditions for Human and Social Services takes effect upon execution by the contractor and applies to all human and social service contracts subsequently executed by the contractor and a department. The Commonwealth Terms and Conditions for Human and Social Services CANNOT be amended or altered.

In addition, unless already on file, the Commonwealth Terms and Conditions for Human and Social Services requires the attachment of a valid “Request for Taxpayer Identification Number and Certification” (W-9) form (Massachusetts Substitute W-9 Format), that contains the contractor’s correct Tax Identification Number (TIN), name and legal address information.

Note: A contractor who provides human and social services as well as other types of services (indirect or support services related to human and social services, and/or commercial, consulting, operational or certain entitlement services) must execute both versions of the Commonwealth Terms and Conditions. In either case, the execution of a Commonwealth Terms and Conditions document is a prerequisite to contracting but by itself is not an authorization from the Commonwealth to deliver any specific services.

Some provisions included in the Commonwealth Terms and Conditions for Human and Social Services to be aware of include:

*Board of Director Standards*

The Commonwealth Terms and Conditions for Human and Social Services establishes requirements regarding board of directors of non-profit organizations contracting with the Commonwealth. The tone set by the board of directors in the form of the appropriateness of its actions, independence from management, interaction with its auditors, scrutiny of management activities, and stature and makeup of its members is the foundation for the internal controls needed to fulfill the board of director’s responsibilities to its mission and the Commonwealth.

*Client Care and Use of Funds*

The Commonwealth Terms and Conditions for Human and Social Services requires that contractors furnish their contracting department(s) with copies of all legally mandated reports of client abuse or neglect where the alleged abuse or neglect was a direct or indirect consequence of the services rendered under a human and social services contract.

In addition, contractors must comply with all other requirements imposed by the contract itself with regard to checking Criminal Offender Record Information (CORI), use of client funds or resources, and any additional reporting requirements relative to client abuse and neglect.

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### Review and Audit of Contractors (the UFR)

The Commonwealth requires human and social services contractors and subcontractors to annually submit an independent audit (the Uniform Financial Statements and Independent Auditor’s Report, the UFR). The Purchase of Service system utilizes a single audit approach through the UFR that is designed to meet the needs of all public, private and government report users (such as the United Way, lending institutions, state and federal agencies, the Attorney General’s Division of Public Charities, private grant making organizations, bond rating organizations and government rate setting bodies) and to target areas of risk in the system. The UFR is filed electronically via the Internet using the UFR eFiling application: [www.mass.gov/ufr](https://ufr.osd.state.ma.us/home.asp). The UFR and its associated online application are described later in this document.

The UFR provides the Commonwealth with basic industry financial statistics and indicators of contractor operating risk. The data can also be used by departments to review program specific financial results or by oversight bodies to identify “exceptions” which can then be targeted for post-audit or additional monitoring. This approach allows the Commonwealth to allocate an appropriate level of audit resources toward problem contractors while having reasonable assurances that the rest of the system is operating well.

Departments, contractors and subcontractors should be aware of the following audit related documents and procedures developed by OSD:

* Auditor’s Compliance Supplement. This document is used in conjunction with the UFR to assist the contractor’s auditor in determining areas of audit risk that need to be tested, the extent of the testing required and how to conduct the tests.
* Audit Resolution Policy. This policy establishes standards and procedures for the correction and elimination of deficiencies noted in UFR and various governmental audit reports. The policy delegates audit resolution responsibilities to the appropriate state departments who resolve identified deficiencies by executing administrative agreements with contractors.
* Inter-Agency Agreement with State Auditor. This agreement has been established to provide for emergency audit services when needed.

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### Additional Federal Requirements

If any federal domestic assistance funds are furnished to a contractor by the Commonwealth, certain additional requirements concerning audits, cost principles, and contract administration requirements are applicable, as set forth in: **Office of Management and Budget (OMB) Circulars A-21, A-110, A-122, and A-133, or successor provisions thereto.** Further information about these circulars is available on the Internet at: [whitehouse.gov/OMB](http://www.whitehouse.gov/omb/). In addition to the general federal compliance requirements that are triggered, contractors may be responsible for grant specific requirements as outlined in the Catalog of Federal Domestic Assistance. Human and social services contracts that are wholly or partially federally funded are required to be identified with the relevant Catalog of Federal Domestic Assistance (CFDA) numbers. The Catalog of Federal Domestic Assistance is available at <http://12.46.245.173/cfda/cfda.html> or by contacting the Superintendent of Documents, Government Printing Office, Washington, DC 20402 (telephone 202-512-1800). Some of the key general federal compliance circulars are summarized below.

* Office of Management and Budget Circular A-110 - *Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals and Other Non-Profit Organizations*

This circular sets forth financial, program management and administrative requirements for federal funds. It also sets forth important standards for program performance and monitoring as part of the provisions concerning reports and records requirements, which are further discussed later in this document. OSD has also published information on this circular in its *UFR Auditor's Compliance Supplement.*

Office of Management and Budget Circular A-122 - *Cost Principles for Non-Profit Organizations* (and *A-21 - Cost Principles for Educational Institutions)*

This circular establishes principles for determining allowable and unallowable costs of grants, contracts, and other agreements with non-profit organizations that receive federal funds either directly from the federal government or as sub-recipients through the Commonwealth. It sets standards for allowability and reasonability of various cost items. Further, it requires that the allowability of costs be fully in keeping with Generally Accepted Accounting Principles. (Note: A-21 is the companion circular for colleges and universities.)

* Office of Management and Budget Circular A-133 - *Audits of States, Local Governments, and Non-Profit Organizations*

This circular, requires states, local governments and non-profit organizations that are recipients or sub-recipients of federal funding and expend those funds above a certain threshold to produce a single audit. For contractors of human and social service programs, completion of the UFR is a starting point for meeting their single audit responsibilities under A-133. In addition, A-133 requires contractors to engage their auditor through competitive procurement in accordance with OMB Circular A-110, and to file and resolve audits as required by A-133 or by the Commonwealth.

Additional guidance concerning single audit requirements is contained in the UFR instructions. Governmental entities, other than cities and towns of the Commonwealth, which contract with the Commonwealth to provide social service programs must file the appropriate single audit with OSD to meet the requirements of A-133. However, governmental entities are currently exempt from preparing some parts of the UFR. Cities and towns of the Commonwealth which contract with the state to provide social service programs will meet their filing requirements by submitting the appropriate single audit to the Department of Revenue (DOR).

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### Enforcement Tools: Penalties and Debarment

Departments have several regulatory tools to manage contractor compliance issues, including penalties and debarment. Contract penalties for failure to comply with important legal and contractual requirements and obligations are listed in 808 CMR 1.04(11). OSD is required to impose additional civil penalties for a contractor’s failure to comply with the requirements on related party transactions, inventory of furnishings and equipment, and mortgage principal non-reimbursability.

Both the Commonwealth of Massachusetts and the federal government operate under legal provisions which allow for certain individuals or organizations to be excluded from doing business with government entities on the basis of poor contract performance, prior misdeeds, or criminal activity. The process which leads to this formal exclusion is called debarment under M.G.L. c.29, s.29F.

Under federal oversight standards (48 Code of Federal Regulations c.1 subpart 9.4) and under Massachusetts law, departments are required to determine that the contractor has not been debarred under state or federal law prior to entering into a contractual relationship.

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## Regulatory and Contractual Reimbursement Limitations

When the Commonwealth enters into a contractual relationship with a contractor for the delivery of human and social services, that relationship is subject to a host of contractual and regulatory provisions. Many of these provisions have been established in response to the need of the Commonwealth and the federal government to ensure that public funds are spent in an accountable and efficient manner and that individuals in public programs are well served.

These standards strive to ensure that emphasis is placed upon the need to effectively attain desired client outcomes in the most efficient and economical way possible.

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### Pricing Limitations

The Commonwealth has established regulatory provisions, 808 CMR 1.03(4) and (5), to ensure that it receives quality services at the lowest available cost possible to the taxpayers of the Commonwealth. The Commonwealth only pays for services after it has been demonstrated that the client or other payers are unable to bear the expense of the needed services. The Commonwealth accomplishes this through three provisions:

1. Price Limit. Payment is limited to the lowest fee charged to all other payers or to the general public.
2. Reimbursement as Full Payment. Payment and obligations for services provided is limited to the contractually agreed upon authorized price between the contractor and one or more departments. Contractors may not “balance bill” a client for services.
3. Off-set of Duplicate or Supplemental Resources. The regulatory language in 808 CMR 1.03(5) is intended to ensure that the Commonwealth only pays for its share of services and does not subsidize other purchasers. It prohibits duplicate payments or supplemental payments from other purchasers. “Off-set” is the term used to describe revenue sources which are applied to reduce the Commonwealth’s costs. Off-sets may be required to defray program costs by the department, OSD regulation, the federal government or another revenue source. Off-sets may also be volunteered by the contractor.

808 CMR 1.03(5) also stipulates that any client resources or third party payments made on behalf of a client (covered by the contract), that are not expressly recognized or anticipated in the computation of the price, must go to reduce the amount of the department’s obligation for services provided to that client. Therefore, contractors and departments should make every effort to anticipate and incorporate into the authorized price any alternative resources such as client fees and third party reimbursements.

If additional revenues for contracted services are received, such as client fees and third party reimbursements, even if they were not anticipated in the authorized price, contractors must proportionately adjust billings to the Commonwealth or amend the contract for these services. In many cases, the department will be able to increase the number of units purchased under the contract as a result of the increased availability of other sources of revenue.

Any additional or departmental specific expectations regarding compliance with the pricing limitations should be described in the RFR and documented in any executed contracts. If a Commonwealth contract or program (including special education programs) is supported with federal financial assistance, all other sources of support and revenue except charitable contributions and matching income are generally considered program income pursuant to OMB Circular A-110. These sources must be used as off-sets to reduce the cost to the federal government for its share of the program.

Also, if a contractor’s proposed cost or price includes non-reimbursable expenses as delineated in 808 CMR 1.05, voluntarily designated off-setting revenue that has not been committed to defray reimbursable costs must be used to cover those non-reimbursable costs. However, if a Commonwealth contract or program (including special education programs) is supported with federal financial assistance, only charitable contributions may be used to off-set non-reimbursable costs. In these cases, off-setting revenue should be itemized and reconciled with the amount of non-reimbursable expenses.

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### Limits on Earnings or Surpluses

OSD has established policies for limiting a contractor’s earnings or surpluses from contracts.

*For-Profit Earnings/Commercial Fee*

For-profit contractors who provide human and social services to the Commonwealth may earn a commercial fee on their contracts. However, this fee must be negotiated and agreed upon by the department and the contractor before contract execution, even if it is anticipated to be zero. Each contract executed between a department and a for-profit contractor must either a) explicitly indicate when a commercial fee has not been established by indicating that the earnings allowance is zero or b) clearly indicate the amount of the negotiated earnings allowance, by percentage or dollar amount, in the contract.

The commercial fee as defined in 808 CMR 1.02 and the provisions of 808 CMR 1.03 applies to all compensation structures and types of contracts available to POS contractors with several exceptions. One exception to the types of compensation structure that may contain a commercial fee (other than zero), is a cost reimbursement structure. Cost reimbursement contracts pay for actual costs incurred by the provider, and thus do not allow for any surplus. In addition, a for-profit contractor may not retain a commercial fee from a contract with deficit operating results.

The for-profit contractor may only retain the portion of a surplus as defined in 808 CMR 1.03(6) that is attributable to Commonwealth revenues in a POS contract or Chapter 71B tuition price from the excess of Commonwealth revenues that has been prospectively negotiated as the commercial fee pursuant to 808 CMR 1.03(6).

To arrive at a commercial fee, departments may negotiate contract language that permits a contractor to retain an agreed upon amount of fee based on the maximum obligation of the contract or the total payments made by the department or a percentage of the surplus as defined in 808 CMR 1.03(6). In determining a reasonable fee, departments may want to consider comparable industry standards for earnings allowances and the standards for surpluses that non-profit contractors can retain.

It is important to note that, regardless of the fee derived by the above methods prospectively, and as articulated in 808 CMR 1.03(6), a commercial fee is considered a discretionary earnings allowance that is in excess of the actual costs for the services being procured.

An explicit limit on the amount of fee that a contractor may retain must be noted, for informational purposes only, on POS Attachment 3, Fiscal Year Program Budget. A commercial fee may not be added into the price (rate) paid by the Commonwealth. In those contracts where an Attachment 3 is not used, the amount of the commercial fee, if any, must be included within the contract specifications.

The provisions of the Commercial Fee also apply Chapter 71B Approved Special Education Programs for which the Operational Services Division will prospectively negotiate a commercial fee with the private schools.

*Non-Profit Surplus Revenue Retention*

Non-profit contractors may also be able to produce revenues in excess of the originally proposed cost or price for services rendered under a contract by implementing cost-saving initiatives that do not interfere with achieving the program and contract requirements. In those cases, contractors may retain some or all of the surplus generated, as specified in the 808 CMR 1.03(7) and the OSD policy on surplus revenue retention.

### Non-Reimbursable Costs

State and federal law impose limitations on how program funds may be spent by human and social services contractors and subcontractors, which are enumerated in 808 CMR 1.02 (definition of “Reimbursable Operating Costs”) and 808 CMR 1.05 (“Non-Reimbursable Costs”). In essence, the Commonwealth and federal government intend to pay no more than the necessary, reasonable cost for providing services. In addition, 808 CMR 1.05 specifically identifies certain costs which have been determined not reasonable because they are excessive or not ordinarily necessary for the operation of organizations providing human and social services or because they were not established in accordance with such factors as sound business practices, arm’s length bargaining, generally accepted accounting principles, terms and conditions of the contract, or state and federal laws. Many costs could meet multiple criteria for being non-reimbursable. For instance, if certain depreciation costs were not computed over enough years (and therefore not according to GAAP and Internal Revenue Service requirements) they would be considered unreasonable. In addition, the excess portion of this inappropriately calculated depreciation would be considered a non-program expense because it is not directly related to the expenses associated with the current contract but instead is related to a program or service that may or may not be purchased by the Commonwealth in the future.

Other non-reimbursable provisions, such as salaries of officers and managers and mortgage principal have been imposed by the legislature or by other policy memoranda to respond to concerns about the use of Commonwealth funds. Please review the provisions of 808 CMR 1.02 and 1.05 for further guidance on determining reasonable operating costs and understanding the non-reimbursable provisions.

### Cost Standards for Transfers of Program Ownership

In cases where the ownership of Commonwealth funded programs or their assets are transferred by sale from one contractor to another, the Commonwealth needs assurance that any contract price adjustments resulting from the transfer are justified. In addition, the Commonwealth needs assurance that the transfer of program ownership or its assets is in fact a genuine transfer of ownership and not simply a method of financing or a vehicle for increasing the cost paid by the Commonwealth for use of the transferred assets by either party.

808 CMR 1.05(17) sets standards for determining when and which costs associated with a transfer of ownership are non-reimbursable. OSD has developed guidelines to apply this regulatory provision so it has assurance that an actual transfer of ownership took place and that no non-reimbursable costs are included in the contract price. Please note that this section only addresses costs associated with a transfer that the Commonwealth will consider reimbursable. Requirements for assigning or otherwise transferring Commonwealth contracts are contained in the Commonwealth Terms and Conditions for Human and Social Services and Guidelines on Material Changes in a Contractor’s Identity.

*Recognizing a Transfer of Ownership*

A sale and transfer of ownership is recognized when:

* The sale of the program or its assets has not occurred between related parties.
* The sale of the program or its assets has been made for reasonable compensation as defined by reimbursable operating costs in 808 CMR 1.02.
* The sale of the program or its assets is a genuine transfer of ownership with free title to all powers and rights of ownership of the program or its assets.
* The sale of the program or its assets has been made for the purpose of selling the assets and transferring title of ownership of the program or its assets. It is not intended to finance or refinance a loan to increase the cost to be paid by the Commonwealth. Costs which are not reimbursable operating costs, such as goodwill, may not be included in the sale.
* The agreement has been designed to bring about a complete transfer of ownership of the program or its assets and there has been complete compliance with the terms of the finance or loan agreement (if this transfer is a finance or loan agreement between the seller and the buyer to facilitate the sale).

OSD and/or the department reserves the right to evaluate the relationship between the seller and buyer, and to monitor compliance with the agreement to assure that a complete transfer of program ownership has occurred.

*What is Reimbursable in a Transfer of Ownership?*

When the Commonwealth recognizes a sale and transfer of program ownership on or before the date the assets are fully depreciated in accordance with OSD service lives (see “Schedule of Asset Service Lives” which follows), the costs paid for the use of the assets by the Commonwealth **must** not exceed the following:

* Land: The lower of (1) the acquisition cost, or (2) the basis allowed the immediate prior owner (land is a non-depreciated asset; therefore, the Schedule of Asset Lives is not applicable).
* Furnishings, fixtures and equipment: The lower of (1) the acquisition cost, or (2) the reimbursable basis allowed the immediate prior owner minus the amount of accumulated depreciation that was taken (or principal payments in lieu of depreciation).
* Buildings: The lower of (1) the acquisition cost, (2) the most recent property valuation assessed by local taxing authorities at 100% valuation minus the amount of reimbursable accumulated depreciation (or principal payments in lieu of depreciation) allowed to the immediate prior owner, or (3) an independent appraisal made by a qualified appraiser. Appraisals using the income approach to establish value are not recognized.

In all transfers where the amount of actual depreciation (or principal payments in lieu of depreciation) reimbursed to the immediate prior owner is not known, the new owner shall have the burden of demonstrating the amount. Otherwise, the amount will be calculated by the procuring department or OSD using the best available information.

When a sale and transfer of program ownership meets the criteria above, interest expense to finance the transfer shall be allowed in accordance with the financing agreement. These expenses are also subject to the following limitations:

1. The principal upon which interest expense is calculated must not exceed the allowable basis of fixed assets or as defined in 808 CMR 1.05(17).
2. The rate used to calculate allowable interest expense must not exceed the prime rate plus one percent at the time of sale, as published in *The Wall Street Journal*.

*Price Adjustments in a Transfer of Ownership*

The department or OSD may adjust the authorized price to include those costs meeting the transfer of ownership requirements and exclude the prior owner’s costs which are superseded by the new costs included in the authorized price. The effective date of the adjusted price shall be the date when the transfer of program ownership occurs, subject to the review and approval of the department.

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### Schedule of Asset Service Lives/Depreciation

There are capitalization and depreciation requirements for human and social services contractors. The financial statements and unaudited schedules of the UFR and the contractor’s records must segregate, capitalize and depreciate those assets in Commonwealth-funded programs which are material, have a useful life of more than one year, and a cost exceeding the capitalization level established by the contractor for financial statement purposes.

An asset should be capitalized if it is expected that it will be useful for more than the current period (typically a one year period). For non-profit organizations, the Financial Accounting Standards Board (FASB) Concepts Statement No. 6 indicates that capital assets are assets used for the operating purposes of the organization over long periods of time in order to produce scarce goods or services that have the capacity to satisfy human wants and needs. For a commercial organization, this statement defines capital assets as assets purchased by a for-profit company for production of services or goods rather than resale. However, for some items subject to loss or excessive usage or having relatively low value in relation to other assets of the organization, e.g., portable tools, the decision to capitalize may be less obvious. In these instances, a contractor should set up rules to define capitalization criteria.

One expedient guideline for many companies is the amount of the expenditure. For instance, for some organizations assets costing less than $500 for each item (or in aggregate), while for others assets costing less than $800 may be considered immaterial and may be expensed. Those items with an acquisition cost greater than $500 (or $800) may be capitalized. Assets that are capitalized then need to be depreciated in accordance with generally accepted accounting principles.

The American Institute of Certified Public Accountants (AICPA) defines depreciation as a system of accounting which aims to distribute the cost or other basic value of tangible capital assets (less salvage, if any) over the estimated useful life of the unit (which may be a group of assets) in a systematic and rational manner. It is a process of allocation, not of valuation. Depreciation for the year is the portion of the total charge under such a system that is allocated to the year.

The OSD Schedule of Asset Service Lives utilizes either the useful life contained in the Modified Accelerated Cost Recovery System (MACRS) of the Internal Revenue Service or a shorter useful life. The MACRS depreciation periods have been designed for depreciating assets used in offices, manufacturing, nonresidential real property, residential rental property and low-income housing. The MACRS depreciation periods are recognized by members of academia, federal income tax guides and tax services, publications by prominent members of the AICPA and higher education accounting text books as having lower depreciation recovery periods (i.e., shorter) than actual useful lives. In addition, MACRS depreciation tables are frequently used to estimate useful lives when computing depreciation disclosed in GAAP financial statements.

Pursuant to 808 CMR 1.00, OSD has issued the following Schedule of Asset Service Lives to specify the depreciable life that is used to determine the amount of allowable depreciation expense for the asset categories listed. This listing is not exhaustive. The service lives of assets not properly includable within any of the following categories shall be determined in accordance with OSD guidelines. Please contact the OSD Audit Bureau in these circumstances.

Note: Capital items purchased via a capital budget (either by the department or by the contractor) for use by a human and social services contractor are capitalized and depreciated by the contractor but are non-reimbursable. However, the contractor must record the free use of or benefit received from the asset in its UFR and must maintain the appropriate inventory records (see 808 CMR 1.04 (5)). Please see the Purchase of Service Capital Items Procurement Policy.

|  |  |  |
| --- | --- | --- |
| ASSET CATEGORY | **YEARS****OF LIFE** | **YEARLY RATE** |
| Buildings:Type 1 - Fireproof Construction and Type 2 - Non-Combustible Construction (as classified by the State Board of Building Regulations and Standards in accordance with 780 CMR 400.00)Type 3 - External Masonry Wall Construction and Type 4 - Frame Construction (as classified by the State Board of Building Regulations and Standards in accordance with 780 CMR 400.00) | 4027.5 | 2.5%3.6% |
| Building/Improvements | 20 | 5.0% |
| Leasehold Improvements | 5(or term of lease, whichever is greater) | 20.0% |
| Equipment | 10 | 10.0% |
| \* Computer Equipment | 3 | 33.33% |
| \*\* Other Office and Other Program Equipment: Includes items such as copiers, ovens, washers, dryers, office files and capitalized office and program supplies. | 5 | 20.0% |
| Life Safety Improvements:Building or leasehold improvements or equipment acquisitions made solely to satisfy the requirements of any Department regarding life safety or physical environment. Purpose must be documented. | 5 | 20.0% |
| Motor Vehicles | 5 | 20.0% |
| Used Motor Vehicles | 3 | 33.33% |
| Residential Furnishings | 3 | 33.33% |
| Office Furnishings | 7 | 14.2% |

The contractor may request OSD to make an exception in the calculation of allowable depreciation in circumstances where the useful life employed by the contractor differs from the above schedule (due to greater or lesser consumption). The request must be substantiated by adequate documentation.

## Record Keeping Requirements

The record keeping systems employed by contractors and subcontractors participating in the Purchase of Service system must adequately document contractor activities and meet financial and program reporting requirements. OSD has established record keeping requirements which are consistent with relevant industry standards as specified by Generally Accepted Accounting Principles (GAAP). Failure to maintain adequate documentation upon inspection or audit may result in certain penalties, as listed in 808 CMR 1.04(11).

### Financial Records

808 CMR 1.00 (see particularly section 1.04(1)), the Commonwealth Terms and Conditions for Human and Social Services and federal OMB Circular A-122, if applicable, outline the minimum record keeping standards for contractors and subcontractors, including retention of records for seven years. These standards require the use of GAAP for the establishment and maintenance of certain financial and program records.

Financial activities should be recorded and summarized in a manner that clearly and fully reveals the sources and amounts of support, revenue, and the type and extent of expenditures. The accounting and program record keeping system should also identify the benefits accruing to clients or consumers of the services.

### Personnel and Payroll Records

Personnel records must be sufficient to meet all state and federal employment, wage and labor standards, GAAP internal control needs and industry reporting requirements. The personnel and payroll records maintained by the contractor and subcontractor must also adequately and clearly document all staff time directly charged or allocated to state or federally funded contracts.

To meet this standard, most contractors will need to maintain resumes, job applications, statements of job descriptions and responsibilities, statement of job qualifications, payroll records, and time and attendance records or effort reports in keeping with the documentary requirements of the Fair Labor Standards Act of 1938 as amended, M.G.L. Chapter 151 and OMB Circular A-122 or OMB Circular A-21.

### Inventory Records

Any contractor in possession of furnishings and equipment to which the Commonwealth has title must maintain a written inventory of the property in such form as prescribed by 808 CMR 1.04(5). This inventory shall contain the sources of funding, description and location of each item, as well as any other information required by the department.

### ClientRecords

Client records must be maintained as specified by the department and pursuant to the confidentiality, access and maintenance provisions of M.G.L. c.66A. In addition, inspection or review of client records must be made available to persons employed, engaged or authorized by the federal government with specific responsibilities for oversight as well as a number of Executive department and other oversight authorities including the secretariat, the department, OSD, the Office of the State Auditor, or the contractor (if services are subcontracted), including independent public accountants engaged by the contractor.

These entities may review records to: (a) determine federal reimbursement to departments for funds provided to the contractor, (b) assure that services are being furnished, (c) evaluate quality and effectiveness of services, (d) monitor maintenance of client files, (e) monitor record keeping, client eligibility and service delivery standards and/or (f) collect data to plan or assess systems of service delivery.

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## Reporting Requirements

### Uniform Financial Statements and Independent Auditor’s Report (UFR)

The Purchase of Service system utilizes a uniform financial reporting system that has been codified by OSD as the Uniform Financial Statements and Independent Auditor’s Report (UFR). The UFR replaced many of the multiple financial reports that contractors had previously been required to submit annually to state and other authorities or funding sources, including the Attorney General’s Public Charities Division, certain Bureaus of the Division of Health Care Finance and Policy, certain chapters of the United Way of America, and most federal departments. The extensive use of the UFR by these organizations and other report users has made the UFR the primary set of financial statements for contractors and subcontractors, thereby eliminating the need for separate financial statements or reports.

The UFR is filed electronically via the Internet using the UFR eFiling application: [www.mass.gov/ufr](http://www.mass.gov/ufr). UFR eFiling provides a dynamic reporting system to support the on-line submission, tracking and viewing of the financial and performance information contained in the UFRs of human and social service contractors. Contractor information is viewed electronically by multiple department users at the same time eliminating time delays and a labor-intensive process of sharing information. UFRs are also made available to the citizenry on-line thereby eliminating the need for OSD and departments to provide for paper based storage, copying and public viewing space for public records requests.

This system has been designed to meet the Commonwealth’s need for fiscal accountability and to provide report users with current, reliable information regarding contractors’ financial status and the results of operations. The UFR is audited independently by the contractor’s independent auditor. It contains a single uniform chart of accounts which insures that the contractor, the state, and other funding sources and oversight authorities have the basic necessary information about a contractor’s operations.

The report also includes the auditor’s opinions about the adequacy of internal controls and compliance with laws and regulations, in keeping with the requirements of Generally Accepted Government Auditing Standards (GAGAS).

The UFR is required to be prepared in accordance with Generally Accepted Accounting Principles (GAAP) as applied to non-profit voluntary health and welfare organizations and is audited in accordance with Generally Accepted Auditing Standards (GAAS). The UFR format conforms to the accounting principles and audit standards promulgated by the American Institute of Certified Public Accountants (AICPA) in its “Audit and Accounting Guide for Not-for-Profit Organizations.” For-profit organizations must prepare their own basic financial statements in accordance with relevant industry standards.

The UFR or alternate format financial statements are subject to audit in accordance with Generally Accepted Government Auditing Standards (GAGAS), which incorporates the auditing standards noted above. Additional benefits of GAGAS include requirements for disclosure of audit findings, resolution and follow-up on deficiencies, continuing education requirements for the auditor, and internal and external quality control requirements for the report and auditor. These additional elements of GAGAS have permitted the Commonwealth to utilize the UFR as a starting point for meeting its federal financial assistance sub-recipient single audit responsibilities under OMB Circular A-133.

In addition to the basic financial statements, two core unaudited supplemental schedules detailing program revenues, expenses, and performance statistics accommodate pricing, data collection, and federal reporting needs.

The contractor must file its UFR annually with OSD’s Bureau of Audit. Contractor organizations that are generally subject to the UFR filing requirements (pursuant to St. 1993, c.110, s.274, as amended, or any successor provision) include every legal entity which owns or operates one or more programs of human and social services.

There are notable exceptions and exemptions from this filing requirement, which are published by OSD as part of its annual information package. OSD regulation 808 CMR 1.04(11) also includes certain penalties for failure to file the UFR as required.

### Related Party Disclosure

Generally speaking, all transactions and events reported in financial statements are presumed to be completed on an “arm’s length” basis. When related party transactions exist, this presumption of an arm’s length relationship no longer applies and the contractor needs to identify such transactions to avoid misleading report users. St. 1993, c.110, s.274, as amended and 808 CMR 1.04(4) require that related party transactions be reported in writing to OSD and the department(s) prior to execution. Notification of a related party transaction may occur:

1. in an RFR response submission
2. during contract negotiations
3. through risk management reporting procedures established pursuant to 808 CMR 1.04(3) and/or
4. in notes to the financial statements of the UFR.

OSD has adopted the definition for related party (808 CMR 1.02) as set forth in Statement of Financial Accounting Standards No. 57 (FASB 57) of the Financial Accounting Standards Board (FASB). Participants in the Purchase of Service system are encouraged to consult the full text of the original FASB 57 and section R36 of the current text of the accounting standards published by FASB to gain a full understanding of the various considerations that **must** be applied when determining if a related party condition exists. To assist in understanding and applying the FASB 57 definition for all reimbursement and disclosure requirements associated with 808 CMR 1.00, this section reiterates some FASB information and includes relevant examples developed by OSD *(in italics*).

*FASB 57 Related Party Definitional Guidance and OSD Comment/Examples:*

Related parties are affiliates of the enterprise, entities for which investments are accounted for by the equity method by the enterprise, trusts for the benefit of employees (e.g., pension and profit-sharing trusts that are managed by or under the trusteeship of management or principal owners of the enterprise) and members of the immediate families of principal owners of the enterprise. All of the above are related parties if they control or can significantly influence the management or operating policies of the organization to an extent that the organization could be prevented from fully pursuing its own interests*.*

*An example of this influence is when a person or organization who is associated with the reporting contractor engages in a joint program or business venture directly or indirectly in which the contractor or other person or organization receives direct or indirect financial benefits.*

1. Affiliate. A party that, directly or indirectly through one or more intermediaries, controls, is controlled by or is under common control of an enterprise*.*

*A company is under common control**with the contractor through common ownership or management, even though no transaction occurred, if the common control could have a material impact on the financial statements of the reporting contractor. “Common ownership” exists if there is direct or indirect ownership of ten percent or more in voting interest or ten percent of the financial interest in the capital assets or profits of any organization.*

1. Control. The possession, direct or indirect, of the power to direct or cause the direction of the management and policies of an enterprise through ownership, by contract or otherwise.
2. Immediate family. Family members whom a principal owner or a member of management mightcontrol or influence or by whom they might be controlled or influenced because of the family relationship.

*The following family members are generally considered able to exert control or influence or be controlled or influenced: a parent, child, brother, sister (whether by whole or half-blood), spouse, adopted child, adoptive parent, stepparent, stepchild, father-in-law, mother-in-law, sister-in-law, brother-in-law, son-in-law, daughter-in-law, grandparent or grandchild.*

1. Management. Persons who are responsible for achieving the objectives of the enterprise and who have the authority to establish policies and make decisions by which those objectives are to be pursued. Management normally includes members of the board of directors, the chief executive officer, the chief operating officer, vice presidents in charge of principal business functions (such as sales, administration, or finance), and other persons who perform similar policy-making functions. Persons without formal titles also may be members of management.

*Generally, management of a social service program will include program directors and program managers.*

1. Principal owners. Owners of record or known beneficial owners of more than 10 percent of the voting interests of the enterprise.

*This may also include those with more than 10% of the financial interest in the capital assets or profits of an organization.*

The Operational Services Division incorporates all of the requirements and interpretations embodied in FASB 57 into its related party policy. Further, OSD has identified a number of examples in the human and social service purchasing context which would satisfy at least one related party definition of FASB 57. As such, without limiting the scope of the definition, the following are considered by OSD to be related parties:

* *Another organization that does business with the contractor if:*
1. *The contractor has a manager with a family relationship to the management or board of the other organization.*
2. *The contractor has a board member who is related to a manager of the other organization.*
3. *The contractor has a board member who is also a board member of the other organization.*
* *A real estate holding company that holds real estate primarily for the contractor or owns all or a significant portion of the contractor’s program sites.*
* *Another organization which is in “competition” with the contractor organization where a contractor member of the board or an owner is a member of the board or an owner of the other organization.*
* *Another organization that does business solely with the reporting contractor or the contractor’s related parties.*

*FASB 57**Guidance Concerning Transactions:*

Transactions between related parties commonly occur in the normal course of business. Some examples of common types of transactions are: sales, purchases and transfers of realty and personal property, services received or furnished (accounting, management, engineering, and legal services), use of property and equipment by lease or otherwise, borrowings and lending, guarantees, maintenance of bank balances as compensating balances for the benefit of another, inter-company billings based on allocations of common costs and filings of consolidated tax returns.

Transactions between related parties are considered to be related party transactions even though they may not be given accounting recognition. For example, an enterprise may receive services from a related party without charge and not record receipt of the services*.*

*OSD Related Party Disclosure Standards*

The following disclosures are required for all material related party transactions:

* Nature of related party relationship.
* The receivables or payables associated with related party transactions for each date that a balance sheet is presented, and, if not clearly determinable, the conditions and methods of settlement.
* For each period that an income statement is presented, the following is required:
1. A description of the transactions and other necessary information needed for an understanding of the impact of the transactions, and
2. Dollar amounts assigned to the transactions and their impact, if different from prior periods.

Note: If two or more companies are under common control via ownership or management, the disclosures above are required if this common control could have a material impact on the financial statements of the reporting contractor, even if there have been no financial transactions.

All related party disclosures must be made in accordance with the principles set forth in 808 CMR 1.00 and the AICPA Financial Accounting Standards Board FASB No. 57. There are also important restrictions placed upon the allowability of costs associated with related party transactions. These restrictions are set forth in OSD regulation 808 CMR 1.05(8).

### Other Reporting Requirements

In addition to reporting requirements outlined above (annual audit and related party transaction disclosures), human and social service contractors are generally subject to reporting requirements established or coordinated through two other sources:

* The contract itself, which outlines programmatic and other contract specific reporting requirements, and
* Secretariat established procedures related to contractor qualification and risk management. This may include a requirement for the contractor to file the UFR annually with a designated department. Contractors that are subject to the UFR filing requirements at OSD may not submit alternate sets of financial statements for such purposes.