



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

Making government work better

Official Audit Report – Issued March 7, 2012

Life Focus Center of Charlestown, Inc.

For the period July 1, 2008 through December 31, 2010



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Life Focus Center, Inc. (LFC) was incorporated on November 26, 1979 under the provisions of Chapter 180 of the Massachusetts General Laws as a not-for-profit corporation. Located in Charlestown, LFC provides consumers with disabilities and their family members residing in the Boston area with social, vocational, educational, and community-based residential and support services.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence that provides a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The scope of our audit was to examine various administrative and operational activities of LFC during the period July 1, 2008 through December 31, 2010. Our audit identified various problems relative to \$1,237,105 in expenses and billings, including \$129,982 in unallowable expenses related to LFC's state-funded contracts during the audit period. We also found inadequate oversight by LFC's Board of Directors and inadequate internal controls over LFC's time, attendance, and payroll-related activities, resulting in over \$1.1 million in undocumented employee compensation expenses. At the conclusion of our audit, LFC officials provided us with a draft copy of an internal control plan that LFC was developing to address many of the issues we identified during our audit.

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LFC has not established adequate controls over how it documents the services it provides to consumers in its state-funded programs. LFC has not established any written policies and procedures relating to documentation of attendance by consumers in the program, and it does not retain the sign-in and sign-out logs used by the consumers in each of its programs. As a result, it was not possible for us to substantiate the amounts billed to the Commonwealth by LFC during our audit period. LFC does use block schedules to track whether the consumers are present or absent from each of its programs. During our audit, we reviewed the block schedule information that LFC maintained relative to billings totaling \$994,818 that it submitted to the Department of Developmental Services (DDS) for services it purportedly provided to consumers in three of its programs: Special Solutions, E.Z., Inc., and CompuChallenge, during the 12-month period July 2009 through June 2010. Based on our review, we determined that LFC could only document that it provided \$203,511 of the services billed in these programs for this period. For billings totaling \$536,673, the client services billed did not reconcile to the number of consumers in attendance in these particular programs as indicated by the block schedules. For 114 days in which LFC billed DDS \$239,969, there were no block schedules or other records to substantiate these billings. Of particular

concern are 230 instances totaling \$14,665 in which consumers were clearly indicated as absent from the program in the block schedule, but LFC billed the Commonwealth as if these consumers were present.

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During fiscal years 2009 and 2010, LFC's Executive Director and Deputy Director charged 1,291 expenses totaling \$123,173 against LFC's corporate credit cards. However, we found that LFC has not established any policies and procedures relative to the use of these credit cards. We reviewed the documentation LFC maintained relative to 189 of these expenses totaling \$28,436 and found that all of these expenses were questionable in that they were either inadequately documented or did not appear to be directly related to LFC's program-related activities. For example, the following expenses do not appear to be related to LFC programs: numerous purchases were made by the Executive Director at various restaurants out-of-state, located close to the town in which he lives, and many weekend purchases were made that lacked any documentation identifying the business nature of these expenses. Other questionable purchases include: a \$52 purchase at a New Hampshire liquor store and 13 expenses totaling \$610 that appear to be relative to a vacation that the Executive Director took in Florida. Finally, many of these purchases, including those for restaurants, were improperly charged as program supply expenses against LFC's state contracts. According to state regulations, expenses such as these that are inadequately documented and/or non-program-related are nonreimbursable under state-funded contracts.

3. QUESTIONABLE AND INAPPROPRIATE CONTRACT BILLINGS TOTALING \$48,809 **20**

During our audit period, LFC billed and received payments totaling \$48,809 for services it did not provide. Specifically, LFC requested and received funding totaling \$48,809 from DDS to procure unanticipated emergency services for consumers, but LFC used this funding to purchase an agency van and two SMART Tables. DDS officials admitted that they were aware of the fact that LFC was going to use the funds to purchase these items and agreed that it was a mistake to provide this funding to LFC.

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During calendar years 2008 through 2010, LFC paid the husband of its Staff Director a total of \$183,008 for consultant services. In addition, during fiscal years 2009 and 2010, LFC made payments totaling \$6,600 to a brother-in-law of LFC's Executive Director and \$11,036 to a brother-in-law of LFC's Deputy Director for various maintenance services. Based on our review of LFC's records, we noted the following issues. First, contrary to state regulations, LFC did not appear to use a competitive procurement process in obtaining these services. Second, LFC did not enter into a formal, written agreement with these consultants that clearly defined their duties and responsibilities. As a result, LFC lacked a mechanism to monitor their performance and to protect itself from any legal issues (e.g., claims for nonperformance of services, liability claims for any property damage or personal injury) that could arise. Third, LFC did not require the husband of LFC's Staff Director to submit supporting documentation to substantiate what services, if any, he provided. This consultant worked from home and would simply submit an e-

mail invoice to LFC's Payroll Department each week indicating that he worked 25 hours per week (five hours per day) without indicating the specific hours he worked or what LFC-related tasks he performed. Finally, there is very limited documentation to indicate what services this individual provided to the LFC. For example, according to this individual's payment records and job description, he was hired to function primarily as a grants writer. However, according to the financial statements LFC filed with the Commonwealth, during the three fiscal years this consultant was employed by LFC, the agency only received a total of \$9,284 in grants. Finally, contrary to requirements established by the Internal Revenue Service (IRS) and the state's Department of Revenue (DOR), LFC did not report to these tax oversight agencies the compensation that it provided to the two individuals who provided maintenance services. As a result of these issues, LFC and the Commonwealth cannot be assured that all of the \$200,644 in payments that LFC provided to these consultants and charged against its state contracts during the period covered by our audit were proper or that the \$17,636 in compensation that LFC provided to the two individuals who performed maintenance services was properly reported to the IRS and the DOR by these individuals.

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We found that LFC has not established adequate internal controls over its staff attendance and payroll-related activities. Specifically, contrary to the terms and conditions of its state contracts, six members of LFC's administrative staff, including the agency's Executive Director and Deputy Executive Director, do not document their attendance or the activities on which they worked. We also found that approximately 42% of the timesheets submitted by staff members during our audit period were not signed by their supervisors. Without documentation demonstrating these employees' attendance and employment activities, we question the propriety of the \$1,150,801 in compensation provided during the period covered by our audit.

6. INADEQUATE OVERSIGHT BY LFC'S BOARD OF DIRECTORS **36**

We found that during the period covered by our audit, LFC's Board of Directors was not composed of required members as promulgated by the Operational Services Division (OSD). We also found that LFC's board was not meeting all of its oversight responsibilities. For example, one of the responsibilities of LFC's board is to annually review the performance of the Executive Director and, through formal vote, set the Director's level of compensation. However, LFC's board never formally evaluated the Executive Director's performance and in only one instance established and approved his annual rate of compensation. Because LFC's board is not meeting all of its oversight responsibilities, LFC and the Commonwealth cannot be assured that the agency is meeting all of its objectives in the most economical and efficient manner.

7. QUESTIONABLE ADMINISTRATION OF EMPLOYEE BONUSES TOTALING \$35,100 **40**

According to OSD regulations and guidelines, bonuses can be provided to employees only if they are made pursuant to an agency's written employee morale, health, and welfare policy that makes bonuses available to all employees for exceptional performance, or according to the terms of an individual employee's written contract. During fiscal years 2009 and 2010, LFC provided members of its staff with bonuses

totaling \$35,100 in what appears to be a discriminatory manner. Moreover, LFC neither maintained an employee morale, health, and welfare policy nor contracted with these employees individually for the provision of these bonuses. Consequently, the \$35,100 in bonuses represents questionable expenses against LFC's state contracts.

8. UNALLOWABLE VEHICLE COSTS TOTALING \$38,072 **44**

During our audit period, LFC provided two vehicles that were used by its Executive Director and Deputy Executive Director and charged \$38,072 in expenses associated with these vehicles against its state contracts. However, LFC did not have any formal, written policies and procedures granting this fringe benefit to these individuals. Unless an agency has established a policy that explicitly provides fringe benefits to its employees, expenses representative of fringe benefits are unallowable and nonreimbursable according to state regulations. Additionally, LFC neither required its Executive Director and Deputy Executive Director to document their business or personal use of the vehicles nor reported the use of these vehicles as taxable fringe benefits on the W-2 Forms issued to these employees.

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INTRODUCTION

Background

Life Focus Center, Inc. (LFC) was incorporated on November 26, 1979 under the provisions of Chapter 180 of the Massachusetts General Laws as a not-for-profit corporation. Located in Charlestown, LFC provides consumers with disabilities and their family members residing in the Boston area with social, vocational, educational, and community-based residential and support services. A detailed description of the services offered by LFC appears in the Appendix to this report. During fiscal years 2009 and 2010, LFC received revenues from a variety of sources as indicated in the table below:

<u>Revenue Source*</u>	<u>Fiscal Year 2009</u>	<u>Fiscal Year 2010</u>
Contributions and Gifts	\$51,054	\$84,652
Private In- Kind	125,909	126,135
Other Grants	350	1,738
Department of Developmental Services	1,760,286	1,711,329
Department of Early Education & Care	171,320	172,060
Department of Elementary & Secondary Education	3,806	6,208
Other Mass State Agency	10,276	0
Mass Local Gov't/Quasi-Gov't Entities	108,000	108,000
Medicaid Direct Payments	265,604	477,184
Client Resources	82,229	103,346
Mass Publicly Sponsored Client Offsets	9,760	10,256
Private Client Fees (Excluding 3rd Party)	226,916	214,691
Commercial Activities	75,395	100,521
Investment Revenue	(63,453)	22,806
Other Revenue	<u>83,136</u>	<u>23,980</u>
Total Revenues	<u>\$2,910,588</u>	<u>\$3,162,906</u>

* This information was extracted from the Uniform Financial Statements and Independent Auditor's Reports that LFC filed with the Commonwealth.

Audit Scope, Objectives, and Methodology

The scope of our audit was to examine various administrative and operational activities of LFC during the audit period July 1, 2008 through December 31, 2010. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence that provides a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Our audit procedures consisted of the following:

- A determination of whether LFC had implemented effective management controls over certain activities, including: staff time and attendance, credit card expenditures, payroll expenses including fringe benefits, and contracting and billings for program services. These controls include:
 - Processes for planning, organizing, directing, and controlling program operations;
 - Policies and procedures to ensure that resource use is consistent with laws and regulations; and
 - Policies and procedures to ensure that resources are safeguarded and efficiently used.
- An assessment of LFC's business practices and its compliance with applicable laws, rules, and regulations, as well as the various fiscal and programmatic requirements of its state contracts.
- Transaction testing in the specified areas to determine if expenses are reasonable, allowable, and allocable to LFC's state contracts.

In order to achieve our objectives, we first assessed the internal controls established and implemented by LFC over certain aspects of its operations. The purpose of this assessment was to obtain an understanding of management's attitude, the control environment, and the flow of transactions through LFC's accounting system. We used this assessment in planning and performing our audit tests. We then held discussions with LFC officials and reviewed organization charts and internal policies and procedures, as well as all applicable laws, rules, and regulations. We also examined LFC's financial statements, cost reports, invoices, and other pertinent financial records to determine whether the expenses it incurred during the period covered by our audit were reasonable,

allowable, properly authorized, recorded, and in compliance with applicable laws, rules, and regulations. The specific areas involved in our substantive testing included contract billings, payroll and fringe benefits, corporate credit cards, consultant contracts, and board activities.

Our audit was not conducted for the purposes of expressing an opinion on LFC's financial statements. We also did not assess the quality and appropriateness of program services provided by LFC under its state-funded contracts. Rather, our report was intended to report findings and conclusions on the extent of LFC's compliance with applicable laws, regulations, and contractual agreements, and to identify any operational and administrative processes, methods, and internal controls that could be made more efficient and effective.

Our audit identified various problems relative to \$1,237,105 in expenses, including \$129,982 in unallowable expenses related to LFC's state-funded contracts during the audit period. We also found inadequate oversight by LFC's Board of Directors and inadequate internal controls over LFC's time, attendance, and payroll-related activities, resulting in over \$1.1 million in undocumented employee compensation expenses. At the conclusion of our audit, a draft copy of this report was provided to LFC for its review and comments. Excerpts from the comments provided by LFC appear at the end of each audit result, and the full text of LFC's response to this report is available in the OSA's administrative office.

AUDIT RESULTS

1. INADEQUATELY DOCUMENTED BILLINGS FOR PROGRAM SERVICES TOTALING \$791,307

LFC has not established adequate controls over how it documents the services it provides to consumers in its state-funded programs. Specifically, during our audit period, LFC had not established any formal, written policies and procedures as to how program staff should document the attendance of consumers in their programs. Further, LFC staff told us that although each program has a sign-in and sign-out log for consumers, the agency does not retain these records. As a result, it was not possible to confirm the accuracy of all the billings submitted by LFC for program services to Commonwealth agencies during our audit period. We did find that LFC program managers hand out what the agency calls block schedules to staff members in each program on a daily basis. These block schedules document that the consumer is either present or absent from the program and the activities that are scheduled for each particular consumer each day. During our audit, we reviewed the block schedule information that LFC maintained relative to billings totaling \$994,818 that LFC submitted to the Department of Developmental Services (DDS) for services it purportedly provided to consumers in three of its programs (Special Solutions, E.Z., Inc., and CompuChallenge) during the 12-month period July 2009 through June 2010. Based on the information in these block schedules, LFC could only document that it provided \$203,511 of the services billed in these programs for this period. For billings totaling \$536,673, the client services billed did not reconcile to the number of consumers in attendance in these particular programs as indicated by the block schedules. For 114 days in which LFC billed DDS \$239,969, there were no block schedules or other records to substantiate these billings. Of particular concern are 230 instances totaling \$14,665 in which consumers were clearly indicated as being absent in the block schedule, but were billed as being present in the program by LFC. According to state regulations, these inadequately documented expenses are unallowable and nonreimbursable under state contracts.

The state's Operational Service Division (OSD), the state agency responsible for regulating and overseeing the activities of contracted human service providers such as LFC, has promulgated 808 Code of Massachusetts Regulations (CMR) 1.05, with which all contracted human service organizations such as LFC must comply. These regulations identify the following costs as being nonreimbursable costs under state contracts:

1.05(26) Undocumented Expenses. Costs which are not adequately documented in the light of the American Institute of Certified Public Accountants statements on auditing standards for evidential matters.

Further, 801 CMR 21.08, promulgated by OSD, states the following:

(1) The Contractor shall only be compensated for performance delivered to and accepted by the Department in accordance with the specific terms and conditions of a properly executed Contract. All Contract payments are subject to Available Funding, as described in 801 CMR 21.06(2), and shall be subject to automated intercept pursuant to M.G.L. c. 7A, § 3 and 815 CMR 9.00. Contract payments for Human and Social Services are also subject to the provisions of 808 CMR 1.00. A Department shall be under no legal obligation to compensate a Contractor, or to obtain additional funding for any performance, costs or other commitments, which are made outside of the scope of a Contract.

During our audit, we determined that LFC had not established any formal, written policies and procedures as to how its staff should document the attendance of consumers in the agency's programs. We asked LFC officials how the agency documents the attendance of consumers in its programs in order to ensure accurate billings for program services. In response, LFC officials told us that each program has a consumer sign-in and sign-out log. This information is sent on a daily basis to the agency's Day Habitation Director, who inputs this information into a spreadsheet stored on her computer, and ultimately this spreadsheet is used to generate the agency's billings for program services to DDS. However, LFC officials told us that consumer sign-in and sign-out logs are not retained by LFC and that consequently we could not review them to verify program attendance and the accuracy of the billings submitted by LFC to DDS during our audit period. Although LFC did not have any program sign-in and sign-out logs, we did find that LFC program managers hand out what the agency calls block schedules to staff in each program on a daily basis. These block schedules document that the consumer is either present or absent from the program and the activities that are scheduled for them on a daily basis. Other designated areas on the block schedules account for time it takes to complete an activity, sign-off area for staff and supervisors and managers, and the program to be billed.

Given the lack of any program attendance records, it would have been reasonable for us to question all of the billings for program services submitted by LFC to DDS during our audit period. However, we compared the information that LFC maintained on its block schedules forms for three of its programs—Special Solutions, E.Z., Inc., and CompuChallenge—for the period July 1, 2009 through June 30, 2010 to the billings that LFC submitted to DDS. During

this period, LFC billed for 15,656 units (days of service) for a total of \$994,818. However, when we compared the program block schedules against the actual billings, we identified that LFC could only document that it provided 3,270 units, or \$203,511 of these services, as indicated below:

<u>Month</u>	<u>Units Billed</u>	<u>Units Verified by Attendance Records</u>	<u>Units Not Verified by Attendance Records</u>	<u>Amount Billed</u>	<u>Documented Amount</u>	<u>Undocumented Amount</u>
July	1,356	0	1,356	\$79,538	\$0	\$79,538
August	1,291	37	1,254	75,728	2,157	73,571
September	1,375	491	884	80,777	28,792	51,985
October	1,337	192	1,145	78,517	11,214	67,303
November	1,180	218	962	69,589	15,342	54,247
December	1,437	216	1,221	80,783	12,609	68,174
January	1,160	194	966	67,889	11,383	56,506
February	1,216	361	855	65,844	15,775	50,069
March	1,562	527	1,035	85,166	24,465	60,701
April	1,004	456	548	98,345	25,264	73,081
May	1,316	298	1,018	101,934	29,908	72,026
June	<u>1,422</u>	<u>280</u>	<u>1,142</u>	<u>110,708</u>	<u>26,602</u>	<u>84,106</u>
Total:	<u>15,656</u>	<u>3,270</u>	<u>12,386</u>	<u>\$994,818</u>	<u>\$203,511</u>	<u>\$791,307</u>

For 114 days in which LFC billed DDS \$239,969, there were in fact no block schedules or other records to substantiate these billings. Of particular concern are 230 instances totaling \$14,665 in which consumers were clearly indicated as being absent from the program in the block schedule but were billed as being present in the program by LFC.

We brought this matter to the attention of LFC's Deputy Director, who could not explain why the agency does not retain its program attendance records.

Recommendation

In order to address our concerns, DDS should recover from LFC at least the \$14,665 in unsubstantiated billings in which LFC billed and received payments for consumers who were indicated as being absent from programs during our audit period. In addition, DDS, in

conjunction with OSD, should conduct its own review of LFC's billing records for program services for at least the last five fiscal years and determine whether any additional funds should be refunded by the agency. Further, LFC should immediately develop and implement formal, written policies and procedures relative to the maintenance of complete and accurate consumer attendance records in all of its programs and ensure that staff members adhere to these policies and procedures.

Auditee's Response

In response, LFC provided the following comments, excerpted below:

LFC kept daily attendance records in electronic form as permitted under GAAP and AICPA standards and, therefore, in compliance with the requirements of the Commonwealth's OSD. Accordingly, LFC's billing under contracts with the Department of Developmental Services ("DDS") for the Special Solutions E.Z., Inc., [and] CompuChallenge[/]Day Support programs examined in the Draft Report was in compliance with the terms of those contracts, and no funds with respect to these programs are recoverable by the Commonwealth. . . .

LFC kept daily, contemporaneous attendance records at its programs in electronic form, on the basis of a variety of sources within the agency and as a consistent procedure over a period of many years. Electronic records are permitted audit evidence under AICPA Statements of Auditing Standards Section 326: Audit Evidence ("AU Section 326"), which is the standard OSA is required to use in determining whether a cost is nonreimbursable under 808 CMR 1.05(26). . . .

Under such standards, LFC's electronic evidence is permitted as the primary source of units delivered. It is unreasonable for OSA to reject LFC's electronic attendance data and to review instead block schedule records solely because they are in paper form. Block schedules are a planning tool and are not intended by LFC to be used as the sole support for units delivered.

In addition, and as discussed below, DDS has expressed approval for LFC's increased use of technology in its programs and operations; keeping electronic attendance records is a reasonable use of technology. LFC submitted attendance records with its invoices to DDS each month. LFC made available to OSA auditors all of its attendance records during the audit. No explanation was given for their rejection of the electronic data, even though such data is clearly acceptable under auditing standards.

The Draft Report criticizes LFC for not keeping written records of attendance at these programs. However, as discussed above, LFC staff did take attendance and record that information in LFC's computer system on a daily basis. As such, this electronic information is a written record of attendance at LFC programs on which OSA should have reasonably relied. . . . Instead, and without explanation, OSA reviewed block schedule records, which are planning tools and not intended by LFC to be attendance records for unit-based contracts. As discussed below, DDS has expressed approval of LFC's increased use of technology in its programs and operations, and keeping appropriate electronic records for attendance is a reasonable use of technology.

LFC's long-standing procedure for recording attendance is informed by the close-knit nature of its programming, the LFC staff and their relations to the consumers. That is, LFC has an excellent record of retaining its employees and its consumers so most staff members know who each consumer is and [are] aware of where that person is or should be on a given day. The attendance record process involves one manager being responsible for inputting attendance directly into LFC's computer system. Attendance information is verified by that manager from a number of sources each day, including his own contemporaneous visual verification of which consumers are attending a program, conversations with managers and program staff, program log-in sheets, ISP's [individual service plans], fire logs, block schedules, progress notes, triage data and other consumer-specific records used by LFC. While written records related to consumers' assessments, improvements and concerns are maintained, LFC did not retain attendance-only, paper source documents because its daily electronic records are sufficient for purposes of verifying attendance at programs.

OSA reviewed only one type of written document, block schedules, in order to evaluate attendance at programs during the review period. Block schedules are designed and are used to inform a consumer's activities for a particular day, but they are not intended to be an attendance record for a particular program. As such, OSA has based its finding on inadequate and inappropriate information. As noted above, attendance was recorded electronically but OSA rejected those records without any basis for doing so.

An example of how the approach of OSA in considering only block schedules is inappropriate and inaccurate is where the Draft Report cites that there are 230 instances "where consumers were clearly indicated as being absent from the program in the block schedule, but were billed as being present in the program by LFC." . . . A consumer's absence from an activity planned in a day's block schedule does not necessarily mean a consumer's absence from the program on that day. For example, a consumer may have had a medical appointment or a behavioral issue that prevented participating in an activity, or simply may have decided that day to participate in a different activity. In each case, LFC billed for activities that are part of the same program for billing purposes. DDS has commended LFC in its QUEST [Office of Quality Management/Office of Quality Enhancement] reports for having its programs allow consumers to choose their activities.

LFC's procedures for verifying and recording attendance discussed above have been in place for many years. While such procedures are not reduced to a written policy, they do, in fact, constitute a "policy" that has been consistently followed and attended to for the entire time LFC has been contracting with the Commonwealth.

LFC's procedures were evaluated by DDS as part of LFC's most recent QUEST review from June 2010, which was conducted under DDS's new, more comprehensive audit-like procedures where documentation and internal control systems were specifically evaluated. No mention of such concerns was raised by DDS in that report or by any of the three DDS agents who spent nearly a month in LFC's offices looking at the same materials, procedures and records that OSA reviewed. This 2010 DDS review included interviews with approximately 50% of LFC's consumers, who were selected at random on any given day and all of whom were present in the program when their names were selected. In addition, in 2008, DDS praised LFC's "infrastructure and culture" as "holding true to core beliefs... [while it] had evolved and matured to keep pace with the changing needs of individuals and their families as well as those of their funding sources." (From the Executive Summary.) Certainly in these reviews DDS measured LFC's outcomes and verified that consumers were, in fact, being serviced appropriately and actually attended the programs.

Both the 2008 and 2010 QUEST reports cited LFC's efforts to improve the use of technology in its operations and gave LFC the highest level assessment and the longest license and certification renewals available. . . . It is notable that the 2008 QUEST review was conducted immediately before and, in particular, the more comprehensive 2010 QUEST review was conducted during the period covered by the Draft Report, indicating that DDS was satisfied with the record-keeping and overall operations of LFC for the programs and period evaluated by the Draft Report. . . .

In order to address OSA's concerns, LFC has begun the process of formalizing its procedures and creating a written policy regarding documentation of attendance at programs. This policy will include, at a minimum, that a standard attendance form be used by all programs; submission of attendance forms on a daily basis; process[es] for verifying any questions or abnormalities reflected on such forms; documenting late-arrivals and all off-site services provided to consumers customarily served at a facility; [and] requiring program directors to review and approve attendance documentation on a monthly basis prior to billing for such programs. A management level staff person at each LFC facility will be designated to oversee this process at that facility, and a manager will also be responsible for separately documenting services provided to consumers who are stationed outside of an LFC facility

Auditor's Reply

In its response, LFC contends that it maintained daily attendance records in electronic form in its Special Solutions, E.Z., Inc., and CompuChallenge programs. However LFC has been unable to demonstrate that any of its systems contain the necessary controls to ensure that the Commonwealth is being billed only for services actually performed, as required by state law and regulations. Further, this is not the process that was described to the OSA staff during our audit engagement and, in fact, directly conflicts with both verbal representations provided to us by various LFC staff and a written memorandum provided to us by LFC's Deputy Executive Director during our audit in which he specifically told to us that program attendance in these programs is actually inputted in LFC's computer system from hard-copy attendance binders maintained by program staff.

We acknowledge that an electronic attendance system could be an acceptable way of maintaining program attendance information. However, such a system would need to have adequate internal controls over its operation, such as formal, written policies and procedures; operating controls to restrict access to data; and other documented data integrity checks, to ensure the accuracy and completeness of program attendance information. However, as noted in our report, during our audit period LFC had no formal, written procedures relative to the documentation of program attendance or the retention of program attendance records, a fact not disputed by LFC. Consequently, even if such an electronic system were in place at LFC during our audit period,

LFC had clearly not established adequate controls to ensure the integrity of such a system, and therefore it could not be relied upon to produce accurate and complete program attendance and billing information.

It should be noted that, subsequent to the end of our audit field work, OSA staff held an exit interview with LFC officials as well as with an attorney from a law firm and an accounting consultant representing LFC. At this meeting, LFC officials gave the OSA a description of how it maintained and communicated the program attendance information it used to generate the billings for its state-funded services. Given the fact that this description was different than the one provided to the OSA and observed by the audit team during the conduct of the audit, OSA staff questioned LFC officials about this process. During this questioning, LFC officials were unable to demonstrate that adequate controls existed to ensure the integrity of the data so that it could be used as a reliable basis for billing the Commonwealth.

In its response, LFC contends that it “kept daily, contemporaneous attendance records at its programs in electronic form, on the basis of a variety of sources within the agency.” However, LFC officials did not show or provide us with any electronic records to substantiate this assertion. Further, LFC was unable to provide us with any documentation either in written or electronic form to substantiate all of its billings to DDS for program services that we reviewed. Accordingly, our report correctly points out that, in accordance with OSD regulations, all undocumented billings such as these are subject to recoupment by the Commonwealth.

Contrary to what LFC asserts in its response, we did not reject LFC’s electronic attendance data. Given the lack of internal controls (e.g., policies and procedures) over this process, the audit staff determined it was necessary to assess the accuracy of the bills submitted by LFC during the audit period for the program services in question. We first intended to reconcile program attendance records to LFC’s monthly billings. However, LFC officials stated that the manual attendance records that were used to support the information used to produce the summary attendance records that LFC submitted with its billings were destroyed. We did in fact review the summary electronic records that LFC submitted with its billings, and these records showed daily attendance for each client by day of the month for each separate program. However, there was no documentation provided that substantiated the accuracy of the information in these summary attendance records and, accordingly they could not be relied upon to be accurate.

Clearly, DDS's approval of LFC's increased use of technology in no way mitigates LFC's responsibility to ensure that there is adequate documentation to support all of the services for which it bills the Commonwealth.

Contrary to what LFC claims in its response, our report clearly explains why we used the block schedules being maintained by staff in LFC's programs to assess LFC's billings for program services. Specifically, LFC officials claimed that the program attendance records for our audit period were destroyed, so we instead reviewed the block schedules maintained by program staff because LFC's Deputy Executive Director specifically told us that these schedules should present an accurate representation of daily attendance. As noted in this audit result, our review of these block schedules indicated significant variances between the information contained therein and the billings LFC submitted to the agencies from which it receives state funding. Contrary to what LFC states in its response, the agency's block schedules do not simply indicate a consumer's absence from a planned activity. Rather, although these schedules identify the planned activities for all students in a given day, the section of the schedule marked "attendance" and "in and out" is not recorded by activity but appears to indicate a consumer's actual attendance at the agency for that particular day. In its response, LFC implies that its two most recent QUEST reviews should be used as a basis for accepting the accuracy of LFC's billing system. However, our review of these QUEST reports indicated that these reviews did not comment on internal controls and financial recordkeeping procedures at LFC. Based on its response, LFC is taking measure to address our concerns relative to this matter, including requiring program staff to document in writing program attendance.

2. QUESTIONABLE CREDIT CARD EXPENSES TOTALING \$28,436 AND AS MUCH AS \$123,173 CHARGED BY LFC AGAINST ITS STATE CONTRACTS

During fiscal years 2009 and 2010, LFC's Executive Director and Deputy Director charged 1,291 expenses totaling \$123,173 against LFC's corporate credit cards. However, we found that LFC has not established any policies and procedures relative to the use of these credit cards. We reviewed the documentation LFC maintained relative to 189 of these expenses totaling \$28,436 and found that all of these expenses were questionable in that they were either inadequately documented or did not appear to be directly related to LFC's program activities. For example, numerous purchases were made by the Executive Director at various restaurants, many that were out-of-state, located close to the town in which he lives and/or were for purchases made

on weekends with no documentation that identified the business nature of these expenses. Examples of questionable purchases include a \$52 purchase at a New Hampshire liquor store and 13 expenses totaling \$610 that appear to have been incurred during a vacation that the Executive Director took in Florida. Further, many of these purchases, including those for restaurants, were improperly charged as program supply expenses against LFC's state contracts. According to state regulations, expenses such as these that are inadequately documented and/or non-program-related are nonreimbursable under state-funded contracts.

The state's Operational Services Division (OSD) regulations identify the following costs as being nonreimbursable costs under state contracts:

1.05(26) Undocumented Expenses. Costs which are not adequately documented in the light of the American Institute of Certified Public Accountants statements on auditing standards for evidential matters.

(1) Unreasonable Costs. Any costs not determined to be Reimbursable Operating Costs as defined in 808 CMR 1.02 or any amount paid for goods or services which is greater than either the market price or the amount paid by comparable Departments or other governmental units within or outside of the Commonwealth.

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

Further, 808 CMR 1.04 establishes the following recordkeeping and reporting requirements with which all contracted human service providers such as LFC must comply:

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

During the period covered by our audit, LFC provided three members of its administrative staff with a corporate credit card. We determined that one of these credit cards, used by the agency's Staff Director, was only used to pay for transportation expenses (primarily the MBTA Ride Program) totaling \$10,026 for LFC consumers and therefore appeared to be reasonable. On the other two credit cards, which were used exclusively by LFC's Executive Director and Deputy Executive Director, the agency paid for 1,291 expenses totaling \$123,173 during the two-year period covered by our audit, as indicated in the following table:

	<u>Fiscal Year 2009</u>		<u>Fiscal Year 2010</u>		<u>Total for Two-Year Period</u>	
	<u>Number of Charges</u>	<u>Amount</u>	<u>Number of Charges</u>	<u>Amount</u>	<u>Total Number of Charges</u>	<u>Total Amount</u>
Executive Director	477	\$41,913	629	\$69,118	1,106	\$111,031
Deputy Director	<u>87</u>	<u>5,360</u>	<u>98</u>	<u>6,782</u>	<u>185</u>	<u>12,142</u>
Total	<u>564</u>	<u>\$47,273</u>	<u>727</u>	<u>\$75,900</u>	<u>1,291</u>	<u>\$123,173</u>

During our audit, we asked LFC officials to provide us with the policies and procedures the agency had established over the use of these credit cards. In response, LFC officials told us that there were no formal, written policies and procedures relative to the use of these cards. Consequently, we judgmentally selected six months' worth of credit card expenditures (July 2008, August 2008, April 2009, July 2009, February 2010, and May 2010) and reviewed all the documentation the agency maintained relative to these expenses. The following table summarizes the number and dollar values of the transactions we selected for our review:

	<u>Executive Director</u>		<u>Deputy Director</u>		<u>Total Expenses Reviewed</u>	
	<u>Number of Charges</u>	<u>Amount</u>	<u>Number of Charges</u>	<u>Amount</u>	<u>Total Number of Charges</u>	<u>Total Amount</u>
Total Expense Charges Reviewed for FY 2009:	88	\$16,948	11	\$983	99	\$17,931
Total Expense Charges Reviewed for FY 2010:	<u>101</u>	<u>8,988</u>	<u>13</u>	<u>1,517</u>	<u>114</u>	<u>\$10,505</u>
Total	<u>189</u>	<u>\$25,936</u>	<u>24</u>	<u>\$2,500</u>	<u>213</u>	<u>\$28,436</u>

Based on our review of this information, we noted a number of problems. First, with one exception, none of the transactions we reviewed were adequately documented. The only documentation the agency had relative to these expenses were the monthly credit card statements, but no charge receipts or vouchers were maintained to document the business nature of these expenses. We also noted a number of highly questionable expenses that appeared to be

personal rather than business in nature. For example, a significant number of expenses were incurred in the state of New Hampshire, where LFC's Executive Director informed us that he has a residence. During fiscal year 2010 alone, we found that the Executive Director used his credit card to make 629 purchases totaling \$69,118, of which 153 totaling \$26,934 (39% of total dollars) were for out-of-state purchases made primarily in New Hampshire. Many of these expenses were for purchases at restaurants, or retail stores on weekends such as Staples, Home Depot, BJ's Wholesale Club, or at various gasoline stations. Other than the expense for computer equipment discussed below, there is no documentation to substantiate the nature of the purchases or their relation to LFC's business activities. Moreover, all of the out-of-state stores where these items were purchased have locations within six miles or less from LFC's office in Charlestown, making these New Hampshire expenditures unnecessary. Examples of some of the questionable expenses we identified include the following:

- On July 25, 2008, the Executive Director purchased two laptop computers at Best Buy in Salem, New Hampshire at a cost of \$3,650. However, these computers were not added to the LFC inventory until we inquired about them in 2011, almost three years after they were purchased.
- A July 25, 2008 purchase totaling \$51.98 at the New Hampshire Liquor Store in Salem, New Hampshire, charged to program supplies.
- An August 8, 2008 purchase in the amount of \$87.26 at Mahoney's Too Garden Center in Tewksbury, charged to program supplies.
- A May 26, 2010 purchase in the amount of \$48.33 at Wilson Farms Lexington, Massachusetts, charged to program supplies for the Zelma Lacey House.
- A February 10, 2010 purchase in the amount of \$52.44 at Wilson Farms Lexington, charged to program supplies.
- A February 11, 2010 purchase in the amount of \$75.12 at Wilson Farms Lexington, charged to program supplies.
- A May 24, 2010 purchase in the amount of \$99.97 from Griffin Greenhouse Supply via the internet, charged to repair and maintenance.
- Numerous restaurant purchases in various communities, some on weekends and as far away as New Hampshire, for which the business relation was not documented. Examples include the following:

- A May 14, 2010 purchase in the amount of \$23.82 at Cracker Barrel in Tewksbury, charged to program supplies.
- A May 15, 2010 (Saturday) purchase in the amount of \$63 at Pizzeria Regina in Medford, charged to program supplies.
- A July 16, 2008 purchase in the amount of \$62.86 at the 99 Restaurant in Tewksbury, charged to program supplies.
- A July 16, 2008 purchase in the amount of \$68.48 at Café Anatolia Cambridge, charged to program supplies.
- An August 12, 2008 purchase in the amount of \$42.75 at Harrows Chicken Pies Reading, charged to program supplies.
- An August 16, 2008 (Saturday) purchase in the amount of \$12.79 at Panera Bread in North Andover, charged to program supplies.
- A September 1, 2008 purchase in the amount of \$74.68 at Alton Circle Groceries in Alton, New Hampshire, charged to office expenses.
- An April 15, 2009 purchase in the amount of \$12.36 at Cracker Barrel in Tewksbury, charged to program supplies.
- An April 17, 2009 purchase in the amount of \$30.16 at the 99 Restaurant in Charlestown, charged to program supplies.
- A February 4, 2010 purchase in the amount of \$201.97 at the S&S Restaurant in Cambridge, charged to program supplies.
- A July 7, 2009 purchase in the amount of \$64.66 at Polcari's of Salem, in New Hampshire, charged to program supplies.
- A May 22, 2010 (Saturday) purchase in the amount of \$87.45 at the Mandarin Restaurant in Reading, charged to program supplies.
- An August 5, 2008 purchase in the amount of \$56.62 at the Warren Tavern in Charlestown, charged to program supplies.
- An August 27, 2008 purchase in the amount of \$19.43 at Cracker Barrel in Tewksbury, charged to program supplies.
- An April 1, 2009 purchase in the amount of \$16.40 at Cracker Barrel in Tewksbury, charged to program supplies.
- An April 7, 2009 purchase in the amount of \$81.70 at Joe's American Bar and Grill in Woburn, charged to program supplies.

- A number of weekend purchases at outlet stores in New Hampshire; including the following:
 - An April 11, 2009 purchase in the amount of \$90.79 from Hoffman Seal Stamp & Engraving via the internet, charged to office expenses.
 - A July 18, 2009 purchase in the amount of \$99.99 at a Brookstone Store at the Settler's Green Outlet in North Conway, New Hampshire, charged to program supplies.
 - A July 18, 2009 purchase in the amount of \$21.85 at Harry & David Settler's Green Outlet in North Conway, New Hampshire, charged to program supplies.
 - A July 18, 2009 purchase in the amount of \$23.00 at Beggar's Pouch North Conway, New Hampshire, charged to program supplies.
- The Executive Director informed us that during February 2010, he took a trip to Florida. We found 13 credit card purchases totaling \$610 for gasoline and food purchases that were made in cities to and from Florida, as well as the following two items:
 - A February 16, 2010 purchase in the amount of \$52.19 at the Apple Store in Orlando, Florida, charged to program supplies.
 - A February 20, 2010 purchase in the amount of \$44.63 at Pooh Corner, Lake Buena Vista, Florida, charged to program supplies.

Regarding this matter, LFC officials could not explain the questionable credit card charges, but stated that it is the agency's informal policy to only maintain credit card statements as documentation of these expenses.

Recommendation

LFC should establish and implement effective internal controls over the use of credit cards by staff members. At a minimum, these controls should require staff members who use corporate credit cards for business expenses, when possible, to obtain prior authorization for these expenditures and to maintain and submit to LFC adequate documentation relative to the business purpose of each expense. The documentation relative to each expense should be reviewed by independent members of LFC's administrative staff for approval prior to LFC's paying for these expenses. Also, DDS should recover the \$28,436 in inadequately documented and non-program-related expenditures that LFC charged against its state contracts in fiscal years 2009 and 2010. Finally, DDS, in conjunction with OSD, should perform a review of the credit

card expenditures made by LFC for at least the last five fiscal years that were not reviewed by us during our audit and, based on this review, recover whatever funds they deem appropriate.

Auditee's Response

In response, LFC provided the following comments, excerpted below:

LFC acknowledges that, in hindsight, its policy of not keeping backup for credit card purchases was not the best policy, and LFC now understands how someone from the outside inspecting LFC's books and records would find it difficult to understand the nature and purpose for some of the purchases. To remedy this problem, LFC is in the process of developing new policies to improve record keeping for credit card purchases, which will include requirements that vendor invoices and receipts be kept in support of all credit card purchases and that proper approvals and verifications are obtained.

LFC acknowledges that the documentation for credit card purchases could have been better. However, LFC asserts that these expenses are directly related to LFC's program-related activities, with the minor exception of certain expenses during a trip to Florida This was an inadvertent human error, in that the Executive Director mistakenly used the LFC credit card for gas purchases on this personal trip. . . .

The Draft Report cites a pattern of out of state purchases, primarily in New Hampshire, where the Executive Director has a residence, as being a source of concern. LFC does not have a purchasing agent. Purchasing for program services often does take place in New Hampshire, which is convenient to the Executive Director's primary residence, and often takes place on weekends and evenings. While the Executive Director does in fact have a vacation home in northern New Hampshire, a converted trailer in a condominium campground, purchases for program and agency needs are sometimes made in transit because it is convenient to the agency to do so. Major retailers the agency typically does business with are en route. This will often occur on weekends and during off-hours, which is reflective of how the Executive Director is typically taking care of LFC business every day, at all hours.

While LFC concedes that many purchases on the credit card could be better documented, LFC points out that many of the items purchased are on-site and used in regular program and administrative functions on a daily basis. Such items include, but are not limited to computers, computer software and accessories, cameras, GPS's, printers, scanners, telephone accessories, kitchen ware and accessories, coffee and tea pots, small appliances, flavored oils, spices, aprons, potholders, cookbook collections, DVDs, games, Wii accessories, televisions, furniture, carpets, lamps, office accessories, desks, chairs, pictures, power and hand tools, handyman accessories such as nails and screws, and many other items which are readily observable and in use by program staff and consumers on a daily basis. LFC directed the OSA auditors to these items when asked during the audit, and the auditors could, as an audit step, verify by visual inspection that items being questioned were in fact being used for their intended purpose and for the benefit of LFC.

Additionally the credit card is used to purchase an array of consumable supplies for LFC. Such consumables include food, ink, paper, a wide array of arts and crafts supplies from a number of vendors, particularly AC Moore and Michael's, BJ's Wholesale Club, Borders, Craigslist, Grossman's, Home Goods, Lowe's, Staples and to a lesser degree [from]

specialty vendors like Wholly Scrap and Creative Memories. Again, though poorly documented, the delivery and use of these consumables was integrated into the activities of the day. For instance, purchase of groceries [are] associated with specific projects like the "Red Hats," the LFC chapter of the woman's organization, which has supper club associated with its evening bi-monthly meetings[;] TeaTime, a mid day social module for consumers hosted by consumers[;] daily and weekly meal preparation programs in multiple sites, administration lunches, coffees, receptions and meetings. . . .

Multiple references . . . cite gardening and farm centers. . . . These purchases relate to the landscaping contract LFC maintained with Peabody Properties to provide and maintain garden[ing] and planting for the Zelma Lacey House. The contract was an employment contract for the consumers of LFC.

Since the draft narrative focuses on vacation, it is appropriate to give context to any vacation taken by the Executive Director, which is always "working vacation." A sample of emails from the audit period . . . show that the Executive Director always worked on LFC business while on vacation, holidays and other designated absences from being on site. These emails show specific issues the Executive Director worked on with LFC staff on a daily basis. Additionally, while on vacation the Executive Director has attended teleconferences with LFC development partners and the Board of Directors. Expenditures cited in the Draft Report relative to purchases at Apple stores and Disney stores are in fact business-related purchases, relating to the Apple devices the Executive Director uses for business communication and the latter Disney purchases relating to holiday decorating items for various LFC sites, items maintained onsite and used in season.

A founding principle of the LFC is the integration of people with developmental disabilities into the larger community and the sensitizing of "normal" residents to the disabled population. To this end, LFC is continuously engaged in finding outlets of interest to expose to its consumers. LFC sees its mission not just to be Boston-bound, and is, in fact, pointedly expanding its model to the communities to the north, noting that Charlestown is the northernmost section of Boston. LFC has long-term programming interests in northern communities with a gym in North Andover, MA where twenty consumers are trained twice a week by certified instructors, and quilting, sewing and knitting classes in Salem, NH for aging, less active consumers.

The Executive Director has as a primary business responsibility to facilitate the expansion of the agency's programs, reputation, and the growth of LFC as a whole. Over the past several years, the northern suburbs of Boston have been targeted as one of LFC's growth areas. In the execution of his business development responsibilities, the Executive Director will spend time and effort on behalf of LFC in the cities and towns north of Boston. Initiatives that expose communities to LFC consumers in normalizing situations increases the exposure and reputation of LFC and generates referrals for information, facility tours and placement. The credit card was used during the audit period to purchase gasoline and meals in the normal course of business while conducting such activities.

It is a goal of LFC to continue to engage the Executive Director in activities that will increase the agency's presence in these communities. The result of these actions to date is an increase in agency revenue and program services. During the audit period, LFC increased revenues from this area from \$140,000 in 2008 to \$211,000 in 2010 -- an increase of 31% [sic]. Additionally, in 2011 there was a further increase to \$241,000, effectively posting a 58% [sic] increase in business and revenue. LFC believes that this investment of time and resources is central to the responsibilities of the Executive

Director, in order to expand LFC's operations base and, as such, is a legitimate use of agency resources.

It is completely appropriate and necessary for the Executive Director and the Deputy Director to be engaged in attending to the business of LFC seven days a week. The Executive Director travels throughout northern Massachusetts and NH seeking off-site excursions and normalizing cultural events such as craft fairs, village celebrations, art in the park, apple picking, farm excursions, unique museums, foliage viewing, etc. Many such events yield ideas for arts and craft projects, a substantial agency activity, as well as providing resources for day excursions into non-urban settings and interesting social interactions and exercise. Many of the destinations pursued in this model are only available on weekends and not available on business days.

Auditor's Reply

In its response, LFC asserts a number of reasons as to why it believes the credit card expenses in question are business-related and therefore represent allowable expenses under its state contracts. However, by its own admission, LFC did not have formal, written policies and procedures relative to the use of these credit cards and did not maintain any documentation to support the business nature of these expenditures. Consequently, in accordance with OSD regulations, these credit card expenses clearly represent unallowable and nonreimbursable costs against LFC's state contracts. A particular concern is that, as noted above, many of the expenses in question appear to be personal in nature (e.g., for meals and other items) and were not properly accounted for in LFC's financial records. For example, many restaurant charges for which there was no documentation to substantiate the business purpose of the expense were misclassified in LFC's financial records as "program supplies." Regarding the purchases made in New Hampshire, there was no documentation to substantiate that these purchases were made by the Executive Director in transit to LFC's office or that these purchases in any way were used for business purposes related to LFC's activities. In its response, LFC states that the many purchases at farm stands and garden centers we questioned "relate to the landscaping contract LFC maintained with Peabody Properties." However, LFC's agreement with Peabody Properties does not require LFC to supply any goods or services.

Finally, regarding questionable expenses we identified relative to LFC's Executive Director's vacation, it is irrelevant whether the Executive Director chose to continue to communicate with his office during his vacation. The Commonwealth should not have to pay for any personal expenses such as the gasoline and food purchases associated with this vacation. Further, contrary to what LFC claims in its response, it did not provide us with any documentation to substantiate

that the purchases paid for with state funds during this vacation at the Apple Store and Pooh Corner were used in LFC's programs.

3. QUESTIONABLE AND INAPPROPRIATE CONTRACT BILLINGS TOTALING \$48,809

During our audit period, LFC billed and received payments totaling \$48,809 for services it did not provide. Specifically, LFC requested and received funding totaling \$48,809 from DDS for the procurement of "unanticipated emergency services" for consumers, but LFC used this funding to purchase an agency van and two SMART Tables¹. DDS officials admitted that they were aware that LFC was going to use the funds to purchase these items and agreed that it was a mistake to provide this funding to LFC for these purposes.

OSD, the state agency responsible for regulating and overseeing the activities of contracted human service providers, has promulgated regulations with which all contracted human service providers such as LFC must comply. In this regard, 808 CMR 1.05 promulgated by OSD identifies the following expenses as being nonreimbursable under state contracts:

1.05(12) Non-Program Expenses. Expenses of the Contractor which are not directly related to the social service program purposes of the Contractor.

1.05(26) Undocumented Expenses. Costs which are not adequately documented in the light of the American Institute of Certified Public Accountants statements on auditing standards for evidential matters.

Further, 801 CMR 21.08, promulgated by OSD, states the following:

(1) The Contractor shall only be compensated for performance delivered to and accepted by the Department in accordance with the specific terms and conditions of a properly executed Contract. All Contract payments are subject to Available Funding, as described in 801 CMR 21.06(2), and shall be subject to automated intercept pursuant to M.G.L. c. 7A, § 3 and 815 CMR 9.00. Contract payments for Human and Social Services are also subject to the provisions of 808 CMR 1.00. A Department shall be under no legal obligation to compensate a Contractor, or to obtain additional funding for any performance, costs or other commitments, which are made outside of the scope of a Contract.

The OSC has established what it calls an "open order" encumbrance process that state agencies can use to encumber and utilize funds that are included in their current fiscal year budgets but not yet spent. According to DDS and OSC officials with whom we spoke, these funds should

¹ A SMART Table is an electronic multitouch, multiuser interactive learning center that allows students to work simultaneously on one surface.

have been used to provide unanticipated emergency services to consumers. On July 1, 2010, LFC submitted a payment voucher to DDS requesting \$48,809 in additional fiscal year 2010 funds through an open order encumbrance. In order to provide these additional funds to LFC, DDS had to submit to OSC a Request for Approval Form, which it did on May 13, 2010. According to this form, these funds were going to be used by LFC for “emergency day, work, support or residential services.” However, LFC submitted a payment voucher with attachments to DDS that indicated that LFC was in fact not planning to use these funds to purchase services for its consumers but rather to purchase a 2010 Ford E 250 wheelchair van at a cost of \$35,051 and two SMART Tables at a cost of \$13,758. LFC ultimately received these funds and purchased the items indicated in the attachment to the payment voucher it submitted to DDS.

During our audit, we spoke about this transaction with LFC’s Personnel Director, who is also responsible for most of the contract administration activities of LFC. The Personnel Director told us that at the end of fiscal year 2010, she received a phone call from DDS’s Business Manager, who asked her whether LFC needed additional funds. The Personnel Director responded by telling the Business Manager that LFC could use additional funds to purchase the items in question. We also spoke with DDS’s Business Manager and its Northeast Regional Contract Manager regarding this matter. During this meeting on March 24, 2011, these officials stated that they were not confident that LFC’s fiscal year 2010 budgeted funds would last through the end of the fiscal year. As a result, the DDS Northeast Regional Contract Manager set aside funds that LFC could access through the open order process to cover any of LFC’s end-of-year emergencies. These DDS officials confirmed that the purpose of these open order funds was to cover the cost of unanticipated emergency services that vendors provide to consumers. They added that the process for determining who gets these funds is as follows: at the end of each fiscal year, the Metro North Area Office is instructed by the Central Office to contact all of the area office’s contracted human service providers and ask whether they have any emergency needs. Based on the vendors’ responses, the area office then decides which vendors will receive these funds and the amounts that they will receive. In this case, these officials claimed that the decision came from the Metro Regional Contract Manager. These officials added that they agree it was a mistake to pay for capital items such as the van and the SMART Tables rather than for unanticipated emergency services to consumers under this contract.

Recommendation

DDS should recover from LFC the \$48,809 in questionable and inappropriate contract billings for services that it did not provide. In addition, LFC should work with DDS to ensure that it uses its state funds for their intended purposes.

Auditee's Response

In response, LFC provided the following comments, excerpted below:

OSA's concern with DDS for permitting LFC to use \$48,809 of certain designated funds for other purposes is not a failing of LFC and has no relevance to OSA's assessment of LFC's operations or programs.

The Draft Report correctly cites . . . that DDS approached LFC in 2010 to see if the agency needed additional funds, and DDS permitted LFC to apply for \$48,809 of consumer program emergency funds knowing that LFC would purchase a wheelchair van and two Smart Tables instead of using the funds for emergency services. This proposed use of the funds was disclosed verbally to DDS and in writing via the payment voucher submitted by LFC. LFC is grateful to DDS for these funds, as these items are used daily by LFC in working with its consumers. LFC believes the offer to utilize such funds was made to LFC because of DDS's long-standing respect for the high quality programs conducted by LFC. . . . However, it is inappropriate for OSA to cite as a Finding against LFC the actions of DDS. OSA's concern on this matter is with DDS and not with LFC

Auditor's Reply

We disagree with LFC's assertion that using funds received from DDS for inappropriate purposes was not a "failing of LFC and has no relevance to OSA's assessment of LFC's operations or programs." To the contrary, LFC knew it was not appropriate to use these funds for these purposes and therefore should not have requested these funds for inappropriate purposes. Consequently, we again recommend that LFC work with DDS to ensure that it uses its state funds for their intended purposes.

4. QUESTIONABLE ADMINISTRATION OF \$200,644 IN CONSULTANT AND MAINTENANCE SERVICES

During calendar years 2008 through 2010, LFC paid the husband of its Staff Director a total of \$183,008 for consultant services. In addition, during fiscal years 2009 and 2010, LFC made payments totaling \$6,600 to a brother-in-law of LFC's Executive Director and \$11,036 to a brother-in-law of LFC's Deputy Director for various maintenance services. Based on our review of the records LFC maintained relative to these services, we noted a number of problems. First, contrary to state regulations, there was no evidence that LFC used any type of competitive

procurement process in procuring these services. We also found that LFC failed to enter into formal, written agreements with these consultants that clearly define their duties and responsibilities. As a result, LFC lacked a mechanism to monitor the performance of these contractors and to protect itself from any legal issues (e.g., claims for nonperformance of services, liability claims for any property damage or personal injury) that could arise. In addition, LFC did not require the husband of LFC's Staff Director to submit any supporting documentation to substantiate the services he provided. In fact, this consultant told us that he worked from home, and we noted that he would simply submit an invoice by email to LFC's Payroll Department each week indicating that he worked 25 hours per week (five hours per day) without indicating the specific hours he worked or what LFC-related tasks he performed. Moreover, it is not clear what services this consultant was hired to perform, given that his payment record indicated he was hired as a grants writer but, according to his job description, he was to function as a Grants Developer and Contract Administrator. Finally, contrary to requirements established by the Internal Revenue Service (IRS) and the state's Department of Revenue (DOR), LFC did not report to these tax oversight agencies the compensation that it provided to the two individuals who provided maintenance services. As a result of these issues, LFC and the Commonwealth cannot be assured that all of the \$200,644 in payments that LFC provided to these consultants and charged against its state contracts during the period covered by our audit were proper or that the \$17,636 in compensation that LFC provided to the two individuals who performed maintenance services was properly reported to the IRS and the DOR by these individuals.

OSD promulgated regulations that require entities contracting with the Commonwealth to use a competitive bidding process when procuring goods and services. Specifically, 808 CMR 1.03(8) states:

(8) Procurement of Contractor Furnishings, Equipment and Other Goods and Services. All procurements of furnishings, equipment and other goods and services by or on behalf of a Contractor shall be conducted in a manner to provide, to the maximum extent practical, open and free competition. Capital Items, as defined in 808 CMR 1.02, shall be acquired through solicitation of bids and proposals consistent with generally accepted accounting principles.

Additionally, OSD promulgated regulations that define certain costs as unallowable and non-reimbursable costs to the Commonwealth. Specifically, 808 CMR 1.05(26) and (22) define the following costs as non-reimbursable program costs:

(26) Undocumented Expenses. Costs which are not adequately documented in the light of the American Institute of Certified Public Accountants statements on auditing standards for evidential matters.

(22) Unallowable Costs under OMB Circular A-122 and A-21, or Successor Provisions. Costs which are not allowed under OMB Circular A-122 and A-21, or successor provisions, are nonreimbursable to Programs which receive federal financial assistance.

During our audit, we noted that during calendar years 2008 through 2010, LFC paid one consultant a total of \$183,008. When asked to provide all the information maintained relative to this consultant, LFC officials provided us with a folder that contained a description of this consultant's duties, a copy of his resume, and his payroll record showing his hire date of March 2008 and rate of compensation of \$50 per hour, for a total of \$65,000 per year. Based on our review of the information LFC maintained relative to this consultant, we identified a number of problems, as follows:

- As referenced above and contrary to 808 (CMR) 1.03(8), this procurement was not awarded using a competitive bidding process. LFC officials told us that that this individual is the husband of LFC's Staff Director. LFC's Personnel Director initially told us that LFC used a recruiter to hire this consultant, but subsequently told us that he was hired off of Craigslist.
- Contrary to 808 CMR 1.05(26), LFC did not maintain adequate documentation to support the payments it made to this consultant. Specifically, each week this consultant would simply send an e-mail to LFC's payroll department indicating that he had worked five hours each day each week. The e-mail did not indicate the actual hours worked or the services provided. Further, LFC did not receive any invoices from this consultant detailing his services or time spent on agency matters. This consultant told us that he primarily worked from home and communicated with the agency via telephone and e-mail. Subsequent to the end of our audit field work, LFC officials did provide us with some records (e.g., copies of emails and references to other documents) that indicated that this individual did provide some services to LFC. However, we were not provided with any records that indicated the number of hours he worked on these activities. Consequently, LFC could not document all of the actual services the consultant provided during the employment period and therefore could not substantiate whether the \$183,008 provided to the consultant represents a reasonable cost to the Commonwealth as defined under 808 CMR 1.02.

- There was no documentation that indicated that this individual provided many of the services specified in his job description. According to this individual's job description, he had 23 job-related duties involving grants and contract administration activities. However, we spoke with this individual, who stated that he does not perform all of the duties identified in his job description, but rather spends 25% of his time on grants, 50% of his time on staff development, and 25% of his time on strategic planning. LFC only received a total of \$9,284 in grants between fiscal years 2008 and 2010. According to LFC's Deputy Director, although this consultant's name was listed as a contact person on some of LFC's contracts, state contracts are for multi-year periods, so the majority of the contract work each year involves preparing the annual contract amendments or extensions, which is performed by LFC's Personnel Director. In terms of staff development, the consultant told us that he was responsible for hiring one person during his three years of employment and also mentored two other LFC staff members, but there was no documentation to substantiate this assertion.

In addition to the problems we found with the consultant services noted above, we also found that during fiscal years 2009 and 2010, LFC paid a total of \$17,636 for maintenance services (e.g., carpentry, painting) at its central office and at its Zelma Lacey House program site. These payments included \$6,600 to a brother-in-law of LFC's Executive Director and \$11,036 to a brother-in-law of LFC's Deputy Director, as indicated in the following table:

Questionable Maintenance Services

	Fiscal Year 2009	Fiscal Year 2010	Total
	<u>Dollar Amount</u>	<u>Dollar Amount</u>	<u>Dollar Amount</u>
Executive Director's Brother-In-Law	\$1,800	\$ 4,800	\$ 6,600
Deputy Director's Brother-In-Law	<u>4,863</u>	<u>6,174</u>	<u>11,036</u>
Total:	<u>\$6,663</u>	<u>\$10,974</u>	<u>\$17,636</u>

However, as was the case with the husband of LFC's Staff Director, LFC did not conduct a competitive procurement process for these services and did not enter into a formal, written contract with these individuals for these services. LFC's Executive Director indicated that these services were not procured through a competitive process because he believed that they would be less expensive than other contractors.

Further, according to IRS and DOR requirements, the income provided by LFC to these two individuals should have been reported to these tax oversight agencies. For example, the IRS

requires that businesses issue an IRS Form 1099-MISC to anyone who is paid \$600 or more during a calendar year. Despite this requirement, we found that although LFC issued an IRS Form 1099-MISC to the husband of its Staff Director, it did not issue these forms to the other two individuals.

Recommendation

In order to address our concerns relative to this matter, LFC should ensure that it conducts all futures procurements, including those for consultant services, in accordance with OSD regulations and federal guidelines; enters into formal, written contracts with all contractors; and ensures that all consultant services paid for with state funds are necessary and properly documented. Furthermore, LFC should issue IRS Forms 1099-MISC to the two individuals in question for calendar years 2009 and 2010 and, in the future, take measures to ensure that it issues appropriate income information forms as required to all consultants/contractors as well as tax oversight agencies.

Auditee's Response

In response, LFC provided the following comments, excerpted below:

The Draft Report states simply that LFC did not use a "competitive procurement" or "competitive bidding" process to engage this one consultant However, . . . OSA is incorrect in citing 808 CMR 1.03(8) as requiring competitive procurements for services. Under this regulation, the standard for the purchase of services is that the process be conducted "to provide, to the maximum extent practical, open and free competition." LFC has met that standard by conducting an appropriate process that included posting the position on Craigslist; reviewing the eight or nine electronic responses it received; selecting and interviewing the candidate. . . . In addition, services were adequately documented as required by audit standards set forth in Audit Section 326 because [there was] sufficient competent evidence to form a reasonable basis for an audit opinion. . . .

LFC acknowledges that it did not retain sufficient records from this hiring process and will change that procedure going forward. The Executive Director led the process, and the Deputy Director and Personnel Director were also involved. The Staff Director was not involved in the process in any way. Written procedures associated with the process of hiring employees will be included in the LFC Internal Controls Manual. . . .

The fact that [the consultant] was already personally familiar with LFC programs was a benefit to LFC, in that he was more quickly able to get up to speed on issues and jump in to help on areas where LFC had needs; this gave him a unique qualification to provide the services in question.

Regardless of his familial connection to LFC, [the consultant] was and is amply qualified to perform the services for which he was hired and the additional services that have

been requested of him. In terms of evaluating whether LFC made an appropriate choice in selecting [the consultant], LFC submits that it has met the standards applicable to the Commonwealth itself in making its own procurements of services. Regulation 808 CMR 21.00 governs the procurement of commodities or services, including human and social services, by the Commonwealth. Section 21.01 states as follows:

Procurements will be considered in the best interests, or the Best Value, to a Department and the State when a Procurement supports and balances the following Procurement Principles: the achievement of required outcomes, generates the best quality economic value, is performed timely, minimizes the burden on administrative resources, expedites simple or routine purchases, allows flexibility in developing alternative Procurement and business relationships, encourages competition, encourages the continuing participation of quality Contractors and supports State and Department Procurement planning and implementation. . . .

LFC did focus on obtaining "the best quality economic value" in selecting [the consultant] for this consulting work, and it followed a reasonable process without adding undue administrative burden on its resources by advertising in a nationally-known, easily accessible online job board. [The consultant]'s resume . . . and the decision to hire [the consultant] was based on the depth and variety of his professional experience, including executive leadership, strategic planning, program development and proposal writing at both the state and non-profit levels.

As the Draft Report indicates, 808 CMR 1.05(26) provides that undocumented expenses, as determined under AU Section 326, are not reimbursable. The general rule of the applicable standard set out in AU Section 326 is that there is to be "sufficient competent evidence" to provide a "reasonable basis" for a given position. [The consultant]'s invoices -- in writing, delivered to LFC from an outside source, prepared to indicate hours worked per day -- are sufficient competent evidence under AU Section 326.

The Draft Report also indicates that OMB Circular A-122 and A-21 apply in determining whether a cost is unallowable. LFC notes that Circular A-21 applies to universities. Circular A-122 specifically states that "no single factor or any special combination of factors is necessarily determinative" when determining whether the costs of professional and consultant services are allowable In fact, such costs are allowable when "reasonable, subject to [itemized factors] when reasonable in relation to the services rendered." . . .

While LFC made available the evidence specifically requested by OSA in its conduct of the audit, LFC submits that there is sufficient competent evidence to support the scope of work actually performed by [the consultant]; the facts of ongoing oversight of his work by the Executive Director and interactions with other staff; and the daily awareness of [the consultant]'s activities at LFC.

The Draft Report correctly states that LFC did not have a written agreement with [the consultant] and that his job description did not reflect all the duties assigned to him over time. In the future, LFC will enter into written agreements with consultants and more regularly update job descriptions for consultants that it hires. However, there is no regulatory requirement that a consultant contract be in writing or that a bill have a particular level of detail. LFC was satisfied that the consultant's work was satisfactory in nature and amount. LFC was fully familiar with the consultant's services in the form of meetings, phone calls, written work and email messages and other reasonable evidential

matter. As discussed further below, supporting material was provided to the OSA Auditors to the extent requested.

LFC submits that the lack of a written agreement allowed LFC to assign to [the consultant] additional duties it felt he was capable of performing on an as-needed basis. This flexibility would have been unavailable if a written agreement needed to be re-negotiated at each change and, more importantly, would have opened up the possibility of renegotiating fees. LFC has benefited from the lack of a written agreement in that it has been able to tap [the consultant]'s capabilities and to utilize his presence at the agency without having to seek out, train and oversee additional consultants. LFC is appreciative of the flexibility [the consultant] has demonstrated in serving the agency and an effective working relationship has been developed over the years. Further, as evidenced by the materials provided with this response, the Executive Director and other staff were in regular, substantive contact with [the consultant] regarding the scope and performance of his duties. Such evidence, taken together, is sufficient to comprise the core elements of an agreement to which LFC held [the consultant] accountable. Finally, having a formal written agreement would not have better protected LFC from any of the potential legal exposures cited in Draft Report.

The Draft Report also claims that LFC did not have detailed invoices or other proper documentation to support the consultant's claims for payment. As noted above, the invoices were sufficient under AU Section 326. In addition to the written invoices, the Executive Director and other staff had notes, emails and other documentation outlining the work the consultant was performing and, as indicated in the Draft Report, were in regular telephone and personal contact with [the consultant] regarding the projects he staffed. . . .

[The consultant] reported directly to, and interacted daily with, the Executive Director. However, LFC notes that the Executive Director does not recall the OSA auditors asking him questions regarding [the consultant], his role at the agency or any of the oversight described above. [The consultant] also had regular contact with other management so that LFC was well aware of his work, which included expanding programs, mentoring and training staff, researching and preparing funding applications and grant reporting, and evaluating programs to develop through a planned affordable housing project. . . .

The Draft Report states that "during the three fiscal years this consultant was employed by LFC, the agency received only a total of \$9,284 in grants."

The term "grant" in the job description refers to any public or private monies LFC is able to access as a result of [the consultant]'s activities. [The consultant] has been successful in bringing in new funding to LFC and retaining existing funding. Copies of funding proposals researched, prepared and overseen by [the consultant] were made available to the OSA auditors during the audit.

For example, during the audit period [the consultant] designed, and developed a new Day Habilitation program and obtained \$442,250 in annual funding from the Massachusetts Office of Long Term Care. [The consultant] led the development team that retained \$533,768 in annual revenue from a contract with a program at Bunker Hill Community College that was put in jeopardy by a competitive bidding process. And, when DDS redesigned its support services programs in FY 2010, [the consultant] researched and obtained alternative funding of \$82,940 for the Social Focus program. . . .

The Draft Report states that "although this consultant's name was listed as a contact person on some of LFC's contracts, state contracts are for multi-year periods, so the majority of the contract work each year is preparing annual contract amendments or extensions, which is done by the Personnel Director."

LFC believes there is some confusion around this issue. All of the (then) Department of Mental Retardation's contracts expired on June 30, 2009. In February of 2009, DMR initiated a new, competitive procurement process that substantially restructured the services it purchases from provider agencies. These redesigned services were solicited through four separate issuances in 2009, and [the consultant] developed, wrote, and submitted responses to these solicitations so he was identified as the contact person.

[T]he Draft Report states that "in terms of staff development, the consultant told us that he was responsible for hiring one person during his three years of employment and also mentored two other LFC staff members, but there was no documentation to substantiate this assertion."

LFC advised the OSA auditors that "staff development" includes professional development and not just hiring. [The consultant] worked with LFC staff on many training and mentoring activities, and that evidence was provided to the OSA auditors. A selection of emails is included . . . that document [the consultant]'s participation in the hiring process for the Registered Nurse in the Day Habilitation program, and his mentoring and training activities with two of LFC's Job Coaches, the Director of LFC's Social Focus program, and the staff of the Day Habilitation program.

LFC . . . has already agreed to make, and has already made, appropriate changes to its Policy & Procedure and Internal Control documents -- as approved by the Board of Directors - to address OSA's concerns. These changes assure that LFC conducts future procurements in accordance with OSD and federal guidelines, including those related to the IRS. As you know, LFC recognizes the contribution that the OSA team has made to LFC's refining its procurement practices, thus protecting LFC from the varied legal issues already noted in the original draft report. . . .

Further, LFC believes it is important to clarify to OSA that the two laborers identified in the revised Finding have a long history of providing substantial volunteer work at LFC dating back a quarter of a century. It was with this level of pro bono contributions in mind that -- when the agency became more financially mature and could pay for work -- as the need for services arose that both gentlemen were contacted.

It should also be noted that both gentleman have worked at a reasonable and prevailing wage, that they consistently were willing to perform work on off-hours, such as weekends and evenings. There was no overtime ever involved, no surprise billings or any increase in the going rate. In addition, both have on multiple occasions over the years spent time with our individuals showing them tricks of the trades; that is, they have provided free training opportunities to LFC staff and consumers. Additionally, both have successfully solicited multiple, substantial product donations that have offset the costs of projects for which they were hired; they support LFC's fundraising efforts; come to LFC holiday events; and visit with individuals that we serve, thereby sustaining relationships that are critical to the successful achievement of LFC's charitable mission. LFC has certainly received more than its dollar value in services from these contractors.

Auditor's Reply

In order to ensure that public funds are being properly safeguarded against loss, theft, and misuse, it is imperative for entities that purchase consultant and other services, particularly from related parties such as LFC did in these instances, to establish adequate internal controls over the administration of these services. For example, it is essential to enter into formal, written contracts with consultants/contractors that establish such items as their rate of compensation; term of employment; and specific job responsibilities, including when and where they will work, who they will report to, how they should bill for their services, a specific list of deliverables, and how their services will be evaluated. Although we do not dispute that the consultant and contractors in question provided some services to LFC during our audit period, because LFC did not establish adequate controls over these services, there is inadequate assurance that all the payments LFC made to these individuals were necessary and proper.

The 808 CMR 1.03(8) clearly applies to procurement of goods and services; consequently, LFC was obligated to comply with this regulation when procuring the consultant services in question. LFC indicates that it believes it met the requirements of 808 CMR 1.03(8) because it advertised for this position on Craigslist. However, 808 CMR 1.03(8) states that all contracted human service providers such as LFC should conduct all procurements “in a manner to provide, to the maximum extent practical, open and free competition.” We question whether simply advertising for this position on Craigslist effectively met the requirement of ensuring open and free competition to the maximum extent possible for these consultant services. LFC acknowledges that it did not retain sufficient records relative to this hiring process and also acknowledges that it did not have any policies or procedures relative to the procurement of goods and services during the period of our audit.

Contrary to what LFC asserts in its response, the invoices submitted by the consultant in question were insufficient in that they did not indicate any services that may have been provided during the hours billed. Further, LFC did not establish a work plan for this consultant that identified specific tasks and deliverables. Finally, there was no formal documented supervisory review and approval of this consultant's billings to ensure that they were appropriate.

We do not see how LFC benefited in any way from not entering into a formal, written agreement with the consultant. In its response, LFC contends that this lack of agreement

allowed LFC the flexibility to perform additional duties on an as-needed basis. However, this argument is clearly flawed, because job flexibility, including the ability to require consultants to perform other tasks as assigned, can be included in any written agreement. Moreover, the written agreement would ensure that the consultant performs in accordance with the duties included in the written agreement and facilitates supervisory review.

LFC provided a number of emails that refer to projects that the consultant was involved in a number of activities within the agency. However, this documentation is inadequate because it only documents a selective sample of activities worked on and does not indicate the number of hours that the consultant spent working on each activity.

Regarding the two contractors who provided maintenance services, as noted in our report, LFC did not conduct a competitive procurement process for these services and did not enter into a formal, written contract with these individuals for these services. This is particularly significant given the relationship between these contractors and LFC officials. Further, contrary to IRS and DOR requirements, the income provided by LFC to these two individuals was not reported to these tax oversight agencies. In its response, LFC states that these two individuals worked at a reasonable wage and have also solicited donations for the LFC. However, these factors clearly do not mitigate LFC's responsibility to exercise sound business practices in its administration of state contract revenues and to comply with applicable state regulations.

5. INADEQUATE INTERNAL CONTROLS OVER TIME, ATTENDANCE, AND PAYROLL ACTIVITIES RESULTING IN UNDOCUMENTED PAYROLL EXPENSES OF \$1,150,801

We found that LFC has not established adequate internal controls over its staff attendance and payroll-related activities. Specifically, contrary to the terms and conditions of its state contracts, six members of LFC's administrative staff, including the agency's Executive Director and Deputy Executive Director, do not document their attendance or the activities on which they worked. As a result, there is inadequate assurance that all of the \$1,150,801 in compensation provided to these six staff members during the period covered by our audit was proper. We also found a number of issues with LFC's payroll activities (e.g. approximately 42% of the timesheets submitted by staff for fiscal year 2010 were not signed by their supervisors).

According to the Terms and Conditions for Human and Social Service Contracts (General Contract Conditions) promulgated by the Executive Office for Administration and Finance

(EOAF), the Office of the State Comptroller, and OSD, contracted human service providers such as LFC are required to maintain accurate and complete financial records, including payroll records, in order to receive reimbursement for these costs. Specifically, these General Contract Conditions state, in part:

The Contractor shall maintain records, books, files and other data as required by 808 CMR 1.00 and as specified in a Contract and in such detail as shall properly substantiate claims for payment under a Contract.

Moreover, 808 CMR 1.04(1) states:

The Contractor and its Subcontractors shall keep on file all data necessary to satisfy applicable reporting requirements of the Commonwealth (including DPS [now OSD], the Division of Health Care Finance and Policy and Departments), and financial books, supporting documents, statistical records, and all other records which reflect revenues associated with and costs incurred in or allocated to any Program of services rendered under the Contract. The Contractor and its Subcontractors shall maintain records of all types of expenses and income or other funds pertaining to the Program paid to the Contractor by every source, including from each Client. Books and records shall be maintained in accordance with generally accepted accounting principles as set forth by the American Institute of Certified Public Accountants (AICPA); which for not-for-profit Contractors shall be the Industry Audit Guide for Audits of Voluntary Health and Welfare Organizations, unless otherwise provided in the UFR. . . . If the Contractor or a Subcontractor receives any federal funds from the Commonwealth directly or through subcontract, the Contractor or Subcontractor shall also keep data necessary to satisfy Federal Office of Management and Budget (OMB) Circular A-133, or successor provision and shall also maintain books and records in accordance with OMB Circular A-110 and OMB Circular A-122, or successor provisions.

Finally, the UFR Auditor's Compliance Supplement states, in part:

Contractor organizations must maintain a system of documenting each full- and part-time employee's attendance, hours worked, program assignments and payroll expenses to enable the organization to prepare an accurate schedule of full-time equivalent employees and associated payroll expenses by job category and program.

According to 808 CMR 1.05 (26), the following expenses are nonreimbursable program costs:

Undocumented Expenses. Costs which are not adequately documented in the light of the American Institute of Certified Public Accountants statements on auditing standards for evidential matters.

LFC's Personnel Director told us that the agency uses the services of Paychex, Inc., (Paychex) to help administer its payroll. Specifically, LFC has four Paychex electronic time clocks: two at its child care and education centers located at the Chelsea and Charlestown campuses of Bunker Hill Community College; one at the June Reilly Center, which is located at 9 West School Street

in Charlestown; and one at its main office located at One City Square in Charlestown. The Paychex time clocks are not configured for direct access by Paychex but rather are stand-alone systems. LFC employees are assigned a number code from one to 100 to punch in at the beginning of their shifts and at the end of their work day. Since the time clocks are not linked to Paychex directly, LFC's Personnel Director prints out timesheets (on a bi-weekly basis) that are created from the time clocks and makes adjustments for vacation, sick, holidays, other time off, and situations in which an employee may not have properly punched in or out. The Personnel Director distributes the timesheet records to the appropriate program managers to give to the employees and their supervisors for authorization and approval. The approved timesheets are then returned to the Personnel Director, who inputs this information onto an Excel spreadsheet that lists all employees' regular, holiday, vacation, sick, or other hours for the pay period. The Personnel Director then transfers this information into Paychex's data entry system and electronically sends it to Paychex, which processes the payroll.

The payroll information for a pay period stays in the Paychex system until information for the next period is entered into the system. Once the new pay period information is entered, the prior pay period information is deleted, and the only records on hand are the hard copy timesheets maintained by LFC. Paychex processes LFC payroll on a bi-weekly basis, and all LFC employees except for one use direct deposit. The pay stubs and checks are delivered to the Personnel Director on Thursday following the submission of payroll documentation by LFC to Paychex.

During our audit, we assessed the internal controls that LFC had established over time and attendance and related payroll processes and noted a number of problems. First, LFC has not established any formal, written policies and procedures relative to the maintenance of time and attendance records, contrary to the terms and conditions of its state contracts. In fact, our review of LFC's records revealed that six members of the agency's administrative staff did not maintain any time and attendance records that showed their attendance or where they worked. During the period of our audit, LFC incurred a total of \$1,150,801 in payroll expenses associated with these six individuals that it charged to its state contracts, as indicated in the following table:

	<u>Fiscal Year 2009</u>	<u>Fiscal Year 2010</u>
Executive Director		
Salary:	\$133,175	\$133,971
Fringe Benefit:	<u>40,613</u>	<u>37,081</u>
Total:	<u>\$173,788</u>	<u>\$171,052</u>
Deputy Director		
Salary:	\$104,054	\$104,456
Fringe Benefit:	<u>35,062</u>	<u>32,978</u>
Total:	<u>\$139,116</u>	<u>\$137,434</u>
Community Services Director		
Salary:	\$73,284	\$73,749
Fringe Benefit:	<u>10,791</u>	<u>12,186</u>
Total:	<u>\$84,075</u>	<u>\$85,935</u>
Staff Director		
Salary:	\$64,514	\$64,972
Fringe Benefit:	<u>22,011</u>	<u>23,886</u>
Total:	<u>\$86,525</u>	<u>\$88,858</u>
Child Focus Director		
Salary:	\$39,130	\$51,761
Fringe Benefit:	<u>12,047</u>	<u>20,225</u>
Total:	<u>\$51,177</u>	<u>\$71,986</u>
Accounting Clerk		
Salary:	\$26,702	\$26,411
Fringe Benefit:	<u>3,910</u>	<u>3,832</u>
Total:	<u>\$30,612</u>	<u>\$30,243</u>
Total All Staff		
Salary:	\$440,859	\$455,320
Fringe Benefit:	<u>124,434</u>	<u>130,188</u>
Total:	<u>\$565,293</u>	<u>\$585,508</u>

In addition to a lack of documentation to support the \$1,150,801 in payroll expenses associated with the six administrative staff members in question, our review of timesheets maintained by LFC revealed the following problems:

- None of the timesheets we reviewed indicated the programs in which the staff member worked. Consequently, it could not be determined whether the program expenses associated with each program were accurate.
- We found many instances in which timesheets were not signed by either the employee or supervisor. For example, for fiscal year 2010, we reviewed all of the timesheets for 12 of

LFC's 51 employees. We found that 40 of the 308 timesheets were not signed by the employees and 129 out of the 308 timesheets were not signed by the employees' supervisors.

- LFC's Personnel Director has the ability to change payroll data, and her work is not supervised or reviewed by any other LFC official. Furthermore, there are no policies or procedures in place regarding what changes to the payroll information she can make. In addition, LFC's Personnel Director is not required to document any changes, which is particularly concerning because it appears that the Paychex system that LFC is using is not designed to detect input errors. For example, we noted at least seven instances in which the payroll information inputted by the Personnel Director was incorrect (e.g., the date and day of the week was incorrect), but this information was not detected by the system.
- LFC has policies that provide for staff to accrue vacation leave depending on their length of service with the agency. However, we found there is inadequate documentation to substantiate that LFC properly accrued and provided paid leave compensation for at least the six administrative staff members who did not document their time and attendance. Specifically, during fiscal year 2009, the agency did not maintain any accrued leave balances for its Executive Director and Deputy Executive Director, but did so for its Community Services Director, Staff Director, Child Focus Center Director, and Accounting Clerk even though there were no timesheets to substantiate the accuracy (i.e., days earned and used) of these accrued balances. In fiscal year 2010, LFC only maintained vacation accruals for its Child Focus Center Director. Given this lack of documentation, there is inadequate assurance that any vacation time these six individuals may have taken during our audit period was appropriate.

Recommendation

In order to address our concerns relative to this matter, LFC should immediately establish adequate internal controls over its time and attendance and payroll-related activities. At a minimum, all staff should be required to document their attendance and the activities in which they worked on a daily basis, and all weekly attendance records or timesheets should be signed by the employee and reviewed and properly authorized by the employee's supervisor. Further, LFC should establish controls over its payroll activities, including formal, written policies and procedures as to what changes, if any, the Personnel Director can make to payroll data with and/or without supervisory approval, and assigning an independent staff person to periodically reconcile the Paychex data to the payroll data submitted by the Personnel Director to ensure the integrity of the payroll information. Finally, LFC should take the measures necessary to maintain accurate paid leave balances for all staff.

Auditee's Response

In response, LFC provided the following comments, excerpted below:

LFC believed that its procedures in this area were satisfactory and has no reason to suspect that any abuses of LFC policies occurred. However, LFC welcomes OSA's suggestion in the Draft Report to improve its internal controls regarding time and attendance on payroll-related activities, and LFC has begun the process of developing the policies and procedures recommended.

In order to respond to some of the particular issues raised in the Draft Report, LFC acknowledges that it did not require the six senior staff members identified [in the report] to record their hours, as it was determined that a better measure of their employment performance was the success of LFC's programs and the growth and development of consumers. Given the size of the agency and the critical roles these individuals play, LFC is confident that all vacation time was appropriately accrued regardless of the lack of time sheets maintained by these staff members (in accordance with the LFC policy noted).

Auditor's Reply

For reasons previously noted, we do not agree with LFC's assertion that the internal controls it had established over its payroll-related activities were adequate. Further, the number of issues that we identified with the timesheets indicates that LFC cannot reasonably rely on the success of its programs as an accurate indicator of hours worked and compensatory time accrued. Although the success of LFC's programs is important, LFC is contractually required to maintain personnel and payroll records for all of its staff to ensure that all billings for staff time is appropriate. Consequently, we again recommend that LFC immediately establish adequate internal controls over its time and attendance and payroll-related activities. Based on its response, LFC is taking some measures to address our concerns in this area.

6. INADEQUATE OVERSIGHT BY LFC'S BOARD OF DIRECTORS

We found that during the period covered by our audit, LFC's Board of Directors was not composed of required members as promulgated by the OSD. We also found that LFC's board was not meeting all of its oversight responsibilities. For example, according to the terms and conditions of LFC's state contracts, the agency's board is required to annually review the performance of its Executive Director and, based on this review, set the Executive Director's compensation by formal vote. Despite this requirement, we found that LFC's board never formally evaluated the Executive Director's performance or established his annual rate of

compensation. Because LFC's board is not meeting all of its oversight responsibilities, it cannot be assured that LFC is meeting all of its objectives in the most economical and efficient manner.

The Board of Directors of a human service provider is the primary organizational body that ensures that an agency meets its operational objectives in the most effective and efficient manner. Board members perform a variety of key fiduciary functions, including overseeing the overall operation of the agency, setting policies and procedures to ensure that agency objectives are met, and hiring the agency's top executive. Section 6A of Chapter 180 of the General Laws, commonly referred to as the Public Charities Law, empowers a not-for-profit organization such as LFC to make, amend, and repeal by-laws that prescribe the number, term, powers, and responsibilities of its Board of Directors, officers, and Executive Director. Additionally, General Contract Conditions state the following:

11. *Human and Social Services Contracting Provisions a) Board of Directors Standards. If a non-profit organization, the Contractor shall comply with the principles in the Massachusetts Attorney General's "Guide for Board Members of Charitable Organizations" [Guide] and with the standards for boards contained in the American Institute of Certified Public Accountants (AICPA)'s statements on auditing standards, as may be amended from time to time. Further, the Contractor specifically agrees that: i) members of the Contractor's management and immediate family (as defined in the AICPA's Financial Accounting Standards Board Statement number 57) will not comprise more than 30% of the voting members of the Contractor's board or any of the board's committees or subcommittees; and, ii) the Contractor's Board of Directors will approve the selection of the Contractor's audit firm, will annually review its executive director's or other more senior manager's performance and set that person's compensation by formal vote, and will meet as frequently as necessary to fulfill the Contractor's obligations under this section. Where the board meets less than two times during its fiscal year, the Contractor shall submit a description of its board structure and the dates of each board and subcommittee meeting with its Uniform Financial Statements and Independent Auditor's Report (UFR).*

The Massachusetts Office of the Attorney General's Guide for Board Members of Charitable Organizations (OAG Guide) identifies the following financial responsibilities of charitable organizations' board members:

As a board member you have primary responsibility for making sure that the charity is financially accountable, has mechanisms in place to keep it fiscally sound, operates in a fiscally sound manner, and is properly using any restricted funds it may have. The board shall be involved in all aspects of the finances of the charity

The budget should be developed early enough so that the entire board can be involved in its review and approval before the beginning of the fiscal year.

The board should be sure that the charity has adequate internal accounting systems.

Board members should expect management to produce timely and accurate income and expense statements, balance sheets and budget status reports and should expect to receive these in advance of board meetings.

The board should require periodic confirmation from management that all required filings (such as tax returns and the Massachusetts Form PC) are up-to-date and that employee withholding taxes and insurance premiums are being paid when due.

Despite the aforementioned requirements, during our audit we reviewed all of the minutes of the meetings of LFC's Board of Directors and noted the following problems:

- LFC bylaws require a seven-member board, but during our audit period the board consisted of only five members, two of which were the Executive Director and Deputy Executive Director. As a result, the board consisted of 40% (2/5) management personnel, rather than 30% maximum allowed by the General Contract Conditions.
- Contrary to the General Contract Conditions, we found only one instance between fiscal years 2002 through 2010 in which LFC's board formally established and approved the Executive Director's salary, and we were not provided with any documentation that the Executive Director's performance was evaluated during these fiscal years.
- Contrary to the General Contract Conditions, there was no documentation to substantiate that LFC's Board of Directors participated in the selection of LFC's audit firm.
- Contrary to the General Contract Conditions, although LFC's board met less than two times per year, it failed to submit a description of its board structure and the dates of each board and subcommittee meeting with its 2009 UFR.

Because LFC's board is not meeting all of its oversight responsibilities, the Commonwealth cannot be assured that LFC is meeting all of its objectives in the most economical and efficient manner.

Recommendation

In order to address our concerns relative to this matter, LFC should take the measures necessary to ensure that the composition and activities of its Board of Directors complies with the requirements of its corporate bylaws, General Contract Conditions, and the guidelines issued by the Office of the Attorney General.

Auditee's Response

In response, LFC provided the following comments, excerpted below:

LFC is confident that its Board of Directors was regularly informed of financial and operational matters at LFC. LFC developed and maintained open and active communications with the Board through direct conversations between management and individual directors. However, LFC understands the recommendations for more formal meetings and oversight mechanisms contained in the Draft Report and has already started implementing those recommendations. . . .

LFC has been fortunate to have had a very committed and dedicated Board of Directors since LFC was founded in 1979. LFC management has maintained regular, substantive contact with the Board, with more frequent contact with the Board President, through updating the directors and officers directly about LFC activities and programs. These frequent interactions were informal, in the sense that they were one-on-one meetings and phone calls rather than meetings of the full Board. LFC staff did not maintain written records of these conversations, but LFC is confident from these ongoing interactions that its Board was aware of LFC's general operations, management events such as when audits were being performed, when the agency was impacted by budget cuts, when licenses were being evaluated for renewal and when there were issues of material concern to address. In addition, annual meetings were held every year, at which full financial reports were presented and tax filings were reviewed in detail. Other formal meetings were held from time to time, but the Draft Report is correct that the Board did not hold formal meetings as often as recommended.

LFC takes seriously and welcomes the recommendations of OSA contained in the Draft Report regarding the composition and activities of its Board of Directors. In response to feedback received during the course of the audit review, LFC has already implemented, or is in the process of implementing, changes that address most of the concerns identified [in] the Draft Report:

- The Board has met regularly in 2011, with meetings being held in March, April and July, and meetings are scheduled for September, October and November.*
- In March, the Board voted to elect two additional directors to the Board, bringing the total number of directors to seven as required under LFC's By-Laws. Discussion and candidate searching began in the fall of 2010 after receiving feedback from OSA auditors on-site at LFC.*
- With seven directors, management personnel comprise 30% of the Board membership as permitted under General Contract Provisions cited by the Draft Report. While not objecting to this contract requirement, LFC respectfully notes that management personnel were always a minority of Directors on the Board.*
- The Executive Director has tendered his resignation as a Director to the Board President, such resignation to be effective as of the September Board meeting. The other Directors are searching for candidates to elect a Director to fill [the Executive Director's] vacancy at that same September meeting. After filling the vacancy, there will be only one member of management remaining as a director out of seven, i.e., approximately 14% of the total Board membership.*
- At the September meeting, the Board will schedule at least six regular meetings for the coming year.*
- At the July Board meeting, Administration and Finance and Program Review Committees of the Board were established, and initial members were appointed.*

Additional members of these committees will be elected by the Board in accordance with its By-laws as soon as practicable.

- *The Board will evaluate its independent auditor engagement and formally approve the firm selected. If the membership of the Administration and Finance Committee can be expanded timely, it is expected that this committee will carry out this work and report to the Board accordingly. If the committee does not have sufficient membership before the audit work must begin to meet reporting deadlines, the full Board will be responsible for this engagement decision.*
- *As noted throughout this response, the Board will be evaluating and approving the final LFC Internal Controls Manual and, as such, will be formally informed of the internal systems and processes of LFC in carrying out its day-to-day operations.*
- *LFC is consulting with its audit firm to verify that it should amend its fiscal year 2009 UFR to add the required disclosure regarding Board meetings.*

At the July meeting, the Board authorized the Program Review Committee to conduct a performance evaluation of the Executive Director and to report back to the Board at the October meeting. The full Board will use this review to evaluate and approve the Executive Director's compensation at the annual meeting in November.

Auditor's Reply

In its response, LFC asserts that, in its opinion, its board was meeting all of its oversight responsibilities. However, there was no documentation to substantiate this assertion, and the board was clearly not composed in a manner consistent with OSD regulations. However, based on its response, LFC is taking measures to address our concerns relative to this matter.

7. QUESTIONABLE ADMINISTRATION OF EMPLOYEE BONUSES TOTALING \$35,100

According to OSD regulations and guidelines, bonuses can be provided to employees only if: (1) they are a fixed amount paid according to the terms of a written contract or (2) the bonuses are part of an agency's written employee morale, health, and welfare policy that makes bonuses available to all employees based on exceptional employee performance. During fiscal years 2010 and 2011, LFC awarded employees bonuses totaling \$35,100 (\$21,100 paid in December 2009 and \$14,000 paid in December 2010) that ranged from \$100 to \$2,000 per employee per year. However, during fiscal years 2010 and 2011, LFC did not execute employment contracts that provided for bonuses or an employee morale, health, and welfare policy that provided for this compensation. Since LFC met neither of these provisions, it did not properly administer the \$35,100 that it expended on these employee bonuses. The 808 CMR 1.05(9)(a), promulgated by OSD, identifies the following as nonreimbursable under state contracts:

Fringe benefits determined to be excessive in light of salary levels and benefits of other comparable Contractors and fringe benefits to the extent that they are not made available to all employees under an established policy of the Contractor. Disparities in benefits among employees attributable to length of service, collective bargaining agreements or regular hours of employment shall not result in the exclusion of such costs.

In August 1997, OSD provided the following additional guidance concerning staff bonuses and fringe benefits:

Bonuses are not considered a fringe benefit; rather, they are properly classified as a salary allowance when attributable to services rendered by an employee. Bonuses are a negotiable item, which are added to salaries in the budget and in the financial statements. The net salary amounts must not exceed what is considered reasonable compensation to be reimbursable. There are two ways to furnish bonuses to employees: one is a fixed bonus as part of an employee's salary based on terms incorporated into his or her written employment agreement and the second is through a Contractor's written employee morale, health and welfare policy, which makes available bonuses to all employees based on exceptional employee performance. See section 162 of the Internal Revenue Code and 808 CMR 1.05(20) for further guidance.

A Contractor's employee morale, health and welfare policy is also frequently confused with and inappropriately budgeted and/or reported as fringe benefits. Costs associated with the Contractor's employee morale, health and welfare policy are not budgeted and/or reported on the UFR separately, as fringe benefits, but rather under Administrative Support, Direct Care or Occupancy costs, as applicable. However, unlike fringe benefits, the Contractor's employee morale, health and welfare policy may exclude members of management from benefiting or participating in the employee morale, health and welfare activities of the Contractor. Bonuses that are provided to management in addition to a fixed bonus awarded pursuant to the terms of an employment agreement and not as part of a Board approved employee morale, health and welfare plan are not reimbursable.

Finally, OSD has established guidelines for the proper reporting of nonreimbursable costs by human services providers such as LFC. Specifically, OSD's Uniform Financial Statements and Independent Auditors' Report (UFR) Audit and Preparation Manual states, in part:

The existence of nonreimbursable costs, as contained in 808 CMR 105 (Effective 2/1/97, 808 CMR 105) and OMB Circulars A-21 and A-122, must be itemized by natural classification and disclosed in the component and program as applicable. Nonreimbursable costs that exist and have not been disclosed are presumed to have been defrayed using Commonwealth and Federal funds. . . .

This information, taken together with the auditor's compliance testing of nonreimbursable costs, provides UFR report users with a measure of assurance that all nonreimbursable costs have been defrayed with revenues not derived from public funds or designated by donors for other purposes.

As previously stated, during fiscal years 2009 and 2010, LFC provided various members of its staff with bonuses totaling \$35,100 that ranged from \$100 to \$2,000 per employee per year. However, LFC did not have written employee contracts that provided for such bonuses or an employee morale, health, and welfare policy providing bonuses to all employees based on exceptional employee performance. Furthermore, the minutes of the meetings of LFC's Board of Directors did not indicate that LFC's board was aware of and had approved these bonuses. As such, this \$35,100 in compensation represents questionable expenses against LFC's state contracts. LFC's Executive Director told us that he established the amount of bonuses each employee would receive but that there was no pre-approved formula used to award these bonuses. This type of situation can result in bonuses being provided in a discriminatory manner. In this regard, we did note that some staff members received no bonuses, whereas LFC's Executive Director, Deputy Executive Director, and their family members received 36% of all the bonuses provided by the agency during the two fiscal years covered by our audit.

Recommendation

The OSA recognizes that staff bonuses, if properly administered, are an effective means of recognizing exceptional performance and improving staff morale. However, in the instances discussed above, LFC did not adhere to OSD requirements in its administration of these bonuses. Accordingly, OSD should review this matter and determine whether the funds that LFC used to provide these bonuses should be recovered by the Commonwealth. In the future, if LFC wants to award employee bonuses, its Board of Directors must develop and implement a policy that is consistent with OSD's UFR Audit and Preparation Manual allowing for the provision of these payments.

Auditee's Response

In response, LFC provided the following comments, excerpted below:

The Draft Report incorrectly characterizes bonuses as a form of fringe benefit within the meaning of 808 CMR 1.05(a)(9). Bonuses are an adjustment to compensation, and in all cases cited by the Draft Report, compensation levels were reasonable. . . . The Draft Report characterizes bonuses as fringe benefits within the meaning of 808 CMR 1.05(9), however, the Report itself quotes the following guidance from OSD: "Bonuses are not considered a fringe benefit; rather they are properly classified as a salary allowance when attributable to services rendered by an employee." The Draft Report should be revised to eliminate references to 808 CMR 1.05(9) and any discussion of OSD's rules

*regarding fringe benefits, especially in light of the confusion within the regulations on this issue**

The Draft Report does not challenge the reasonableness of amounts paid by LFC as bonuses in fiscal years 2009 and 2010. The Draft Report nonetheless criticizes LFC's payments on the grounds that they were not approved by LFC's Board of Directors. In this connection, the Draft Report cites no authority for such a requirement, and indeed there is no basis for it. It is perfectly appropriate for the Board of Directors of LFC to leave to management the award of salary adjustments and bonuses, especially in the ranges involved in this case. For all intents and purposes, these payments amounted to modest compensation adjustments that did not have the longer-term effects of salary increases. The key consideration is whether the dollar amounts in question were reasonable, and the Draft Report does not raise any issue in that regard.

LFC notes that DDS has praised LFC's staff development and compensation in the past, including citing compensation as a "strength of the agency" and a reason LFC has been able to retain qualified staff. Specifically, the 2008 QUEST Report states on page 7 that "the agency's commitment to pay salaries far beyond the average for similar work also promotes the retention of qualified staff." This endorsement from DDS gives further comfort that compensation paid to LFC employees is reasonable.

To reach the \$35,100 figure, LFC believes the Draft Report includes payments made to employees in fiscal years 2010 and 2011, which were paid during periods outside the scope of the Draft Report. Payments actually paid within the period covered by the audit amount to a total of \$30,590. Employees with the same role at the agency each received the same payment, including any payments made to the family members of the Executive Director and Deputy Director, so no special treatment was given. Payments to these Directors and their family members represented 25% of the total payments made and not 36%.

The Draft Report cites guidance from OSD in 1997 (DPS-A035-97 (Revision 3)), to the effect that a bonus that is not a "fixed bonus as a part of an employee's salary based on terms incorporated into his or her written employment agreement" must be provided for in a written employee morale, health and welfare policy." OSD's regulation 808 CMR 1.00 contains no reference at all to such a policy or a cost item of that type. To the extent that OSD's guidance treats payment of a cash item such as a bonus as encompassed within a policy governing employee morale, health or welfare, that guidance conflicts with OSD's own regulation 808 CMR 1.00. As noted above, that regulation makes federal Circular A-122 applicable to providers such as the Center. That Circular characterizes incentive compensation as a type of compensation, while in Attachment B(3), it treats employee morale, health and welfare costs as a quite different, non-cash, item. The long and the short of it is that OSD has created a muddle on the subject of the proper treatment of bonuses. This muddle is no basis for claims against the Center.

Auditor's Reply

As stated in our report, OSD has determined that there are two allowable ways to furnish bonuses to employees: (1) via a fixed bonus as part of an employee's salary based on terms incorporated into his or her written employment agreement and (2) through a contractor's written employee morale, health and welfare policy that makes available bonuses to all

employees based on exceptional employee performance. Since the bonuses provided by LFC during the period covered by our audit report did not meet either of these criteria, they are therefore unreasonable and clearly represent unallowable costs against LFC's state contracts.

In its response, LFC asserts that our audit does not challenge the reasonableness of amounts paid by LFC as bonuses. However, this is incorrect; in fact, the report challenges the reasonableness of these bonuses because these bonus payments were not made in accordance with OSD's regulations and guidance. In this regard, LFC's bonus distribution plan does not constitute a written employee morale, health, and welfare policy that makes available bonuses to all employees based upon exceptional employee performance as required by the OSD. To meet this requirement, LFC's board would have had to vote to adopt the plan, and incorporate the adopted plan into the LFC's operating policies and procedures. Consequently, the plan of distribution of these bonuses neither represents an established policy as required by OSD, nor provides a valid basis for the bonus awards.

The \$35,100 figure is correct and is the amount of bonus payments made by LFC during the period in question. We acknowledge that individuals with the same role received the same bonus payment. However, the higher administrative positions—many of which were held by individuals related to LFC's Executive Director—received the highest bonus payments.

8. UNALLOWABLE VEHICLE COSTS TOTALING \$38,072

During our audit period, LFC provided two vehicles that were used by its Executive Director and Deputy Executive Director and charged \$38,072 in expenses associated with these vehicles against its state contracts. However, LFC did not have any formal, written policies and procedures that provided for the provision of this fringe benefit to these individuals. According to state regulations, fringe benefits such as these that are not provided under an established policy of the agency are unallowable and nonreimbursable under state contracts. Additionally, we found that LFC did not require its Executive Director or the Deputy Executive Director to document the business and personal use of these vehicles, and did not report the value of any personal use of these vehicles as a taxable fringe benefit on the Forms W-2 that it issued to its Executive Director or Deputy Executive Director.

OSD has promulgated regulations that define certain costs that are unallowable and nonreimbursable under state contracts. In this regard, 808 CMR 1.05(9) identifies the following expenses as nonreimbursable under state contracts:

Fringe benefits determined to be excessive in light of salary levels and benefits of other comparable Contractors and fringe benefits to the extent that they are not available to all employees under an established policy of the Contractor.

Furthermore, IRS and DOR regulations require employers to furnish employees, the IRS, and DOR with accurate wage and earnings information amounts. Specifically, IRS Regulation 713, Fringe Benefits, which discusses the tax effect of personal use of company automobiles, states, in part:

The benefits may be included as income to the extent the employee uses them for personal purpose.

During our audit period, LFC owned two vehicles provided to its Executive Director and Deputy Executive Director. During our audit period, the agency incurred expenses including depreciation, car insurance, and gasoline for these vehicles, as follows:

	Fiscal Year 2009	Fiscal Year 2010	Total
Depreciation	\$5,703	\$10,133	\$15,836
Insurance	3,734	4,679	8,413
Gasoline	<u>6,235</u>	<u>7,588</u>	<u>13,823</u>
Total	<u>\$15,672</u>	<u>\$22,400</u>	<u>\$38,072</u>

We reviewed the internal controls that LFC established over the use of these vehicles, as well as the documentation of associated expenses. Based on our review, we noted the following issues:

- During our audit period, LFC did not have policies and procedures that required its Executive Director or Deputy Executive Director to maintain a record of the business and personal use of these vehicles. Moreover, LFC could not provide supporting documentation (e.g., travel logs or work schedules) regarding the business and personal use of these vehicles. Therefore, it was not possible to determine the extent to which these vehicles were used for business and non-business purposes. Also, the Executive Director's and Deputy Executive Director's Forms W-2 for calendar years 2009 and 2010 did not include any amount for their personal use of these vehicles as required by IRS regulations.

- LFC's policies and procedures did not provide for the provision of this fringe benefit. Consequently, LFC's expenses associated with the provision of this fringe benefit are nonreimbursable in accordance with 808 CMR 1.05(9).

We brought this matter to the attention of LFC officials, who stated that they were unfamiliar with the tax requirements in this area and did not keep appropriate records.

Recommendation

In order to address our concerns relative to this matter, LFC should remit to the Commonwealth the \$38,072 in unallowable vehicle expenses we identified during our audit. In the future, LFC should take measures to ensure that it does not charge any unallowable vehicle expenses against its state contracts.

Auditee's Response

In response, LFC provided the following comments, excerpted below:

The Executive Director and Deputy Director each required transportation to perform their services on behalf of LFC. Making a vehicle available to each of them for agency travel needs rather than reimbursing for using his own vehicle was an administrative expense for LFC, not a fringe benefit for either Director except to the extent the use was personal. Each Director owns their own personal vehicle, and the sole personal use of the LFC vehicles was for commuting purposes. . . .

The Executive Director and Deputy Director are on-call staff, responsible to be available and present on a twenty four hour basis, seven days a week, for any safety or operational needs and security crises that affect the interests and consumers of LFC. Each of these Directors owns their own car for personal use. The LFC vehicles in question are provided to the Directors for the direct benefit of LFC and, as such, are primarily reimbursable administrative expenses. . . .

LFC did not have any formal, written policy and procedures that provided for use of company vehicles because the LFC vehicles are utilized to ensure key personnel are available at all times for a full array of agency business and emergencies. Additionally the LFC vehicles in question are used by many LFC staff each business day for daily operations and transport.

As noted above, LFC disagrees with the Finding in the Draft Report that all of the vehicle use is a fringe benefit to either Director. LFC acknowledges that the use by these Directors to commute from their homes to LFC's office was a personal use and should have been recorded as such. Assuming that each Director commuted to and from his home every business day during fiscal 2009 and 2010, and using the applicable IRS reimbursement rates, the amount of non-allowable costs should be as set forth below. The calculation assumes 250 business days in a year, reflecting 10 annual holiday days, and that no sick, personal, vacation or other days were taken in order to present a conservative figure:

*Fiscal 2009:**Executive Director: 40 miles x \$0.525 x 250 days = \$5,250**Deputy Director: 24 miles x \$0.525 x 250 days = \$3,150**Fiscal 2010:**Executive Director: 40 miles x \$0.5675 x 250 days = \$5,675**Deputy Director: 24 miles x \$0.5675 x 250 days = \$3,405**Total nonreimbursable vehicle costs: \$17,480*

LFC takes very seriously the recommendations of OSA contained in the Draft Report and appropriate policies and procedures regarding vehicle use and documentation will be included in the revised LFC Internal Controls Manual. . . . Additionally, at the July 20, 2011 meeting of the LFC Board of Directors, the Board formally voted to approve the use of company vehicles by the Executive Director and the Deputy Director as a necessary provision for the safety and integrity of the agency and its mission.

However, LFC disagrees with the Draft Report's characterization of the value of the vehicle use being excessive in light of salary levels and fringe benefits of other comparable contractors under 808 (CMR) 1.05(9). For example, LFC staff looked at the four Boston DDS providers with annual budgets of approximately one million dollars or more. Among these four contractors, Executive Director compensation ranged from a low of \$96,000 to a high of \$193,000. Adding his portion of the vehicle expense to his \$133,000 annual salary plus the \$2,000 salary adjustment paid in fiscal year 2010, the LFC Executive Director's total compensation is well within the range of comparable agencies in Massachusetts.

Auditor's Reply

In its response, LFC states that it "did not have any formal, written policy and procedures that provided for use of company vehicles because the LFC vehicles are utilized to ensure key personnel are available at all times for a full array of agency business and emergencies." However, by its own admission these two vehicles were provided to the staff members in question for their personal as well as business use. Accordingly, LFC is clearly responsible for having adequate controls in place to properly document and account for any personal use of these vehicles to ensure the accuracy of its tax reporting and accounting records. Further, because there was no documentation to substantiate that these vehicles were provided to these individuals for business purposes and were available for their personal use, they were clearly a fringe benefit to these individuals. According to state regulations, fringe benefits such as these that are not provided under an established policy of the agency are unallowable and nonreimbursable under state contracts.

LFC contends that the only personal use of these vehicles was for commuting. However, because these individuals did not maintain a record of the business versus personal use of these vehicles, there is no documentation to substantiate this assertion. LFC also contends that the

vehicles in question were available for use by other staff during the day. However, there are no records to substantiate this assertion, and our audit staff did not observe any other staff persons using these vehicles. Further, it should be noted that LFC has seven other vehicles available for staff use during work hours.

In its response, LFC contends that the actual nonreimbursable amount for these vehicles should be \$17,480. However, this figure is based on the assumption that the only personal use of these vehicles by these two individuals was for commuting. Because there are no records to substantiate this assumption, it is unreasonable for us to accept this figure as the unallowable amount.

Our report does not question the provision of these benefits on the basis of their being excessive in light of salary levels and fringe benefits of other comparable contractors but rather on the basis of their not being available to all employees under an established policy of LFC, contrary to state regulations. Therefore, in accordance with OSD regulations, these benefits represent unallowable expenses against LFC's state contracts.

APPENDIX

Programs Operated by LFC

Community-Based Day Support and Employment Programs

Special Solutions

LFC's Special Solutions program provides employment opportunities for people with disabilities through subcontracting with local businesses for a variety of services. LFC utilizes these subcontracts to offer job training, situational assessment venues, and employment options to individuals who are unable to work in a competitive environment. Subcontracts include:

- Interior and exterior cleaning services for Bunker Hill Community College
- Dog walking services
- Grounds cleaning for local businesses
- Can and bottle recycling

LFC considers the Special Solutions program successful when consumers achieve the following:

- Enhanced earning power and social independence
- Fuller integration into the larger community
- Increased self-confidence and job satisfaction

LFC's goal is to continue the enhancement of employment options for persons with disabilities by solidifying existing service contracts and developing new employment opportunities within community businesses.

CompuChallenge

LFC's CompuChallenge is an on-site computer-based employment program within the community for people with severe physical disabilities. The primary goal of the program is to enhance the quality of life of the consumer, to promote integration into the community, and teach new skills. This program is conducted in a small, office-like environment with appropriate adaptive renovations, furnishings, and computer stations. Each consumer's functional living skills and social

skills development are supported through a variety of programs with trained staff to assist the individuals. Skills acquisition and personal growth is maximized by a safe environment for learning and growing from past mistakes to greater growth and self-confidence. Lastly, life enhancement is achieved by identifying areas through an Individual Service Plan to improve the quality of life of the consumer.

E.Z., Inc.

LFC's E.Z., Inc. is a community-based day support program designed to serve older individuals with medical issues. This program provides support and opportunities for individuals to enrich their lives and enjoy a full range of activities. Individuals in this program engage in leisure and learning activities such as spending time in the community, volunteering, attending community-sponsored events, and taking frequent local restaurant trips. The E.Z., Inc. program also maintains an exercise component for its members, which meets twice a week with a qualified instructor.

Residential and Day Habitation Programs

LFC Community Residence

LFC provides residential services to eight individuals with mental disabilities. These individuals reside at the Zelma Lacey House for Assisted Living at 9 West School Street in Charlestown. Clients are supervised by trained staff 24 hours a day. The primary goal of this program is to enhance the quality of life of the consumer, to promote their integration into the community, and to teach new skills.

June Reilly Center

LFC runs a day habitation program known as the June Reilly Center, located at 9 West School Street, Charlestown. This program combines engaging, challenging, and varied activities with physical, occupational, speech/language, and behavioral therapeutic intervention that provide the consumer with specialized and individualized attention. Transportation services are provided to recreational and community outings and events.

Other LFC Programs***Social Focus***

The Social Focus program provides social, recreational, and cultural activities to adults with disabilities that help promote emotional well-being. Because the program provides a respite for those who care for these clients, Social Focus is classified as a family support program. LFC attempts to establish a strong line of communication with the caregivers and acknowledges their need for support.

Child Focus Center

The Child Focus Center is an early childhood educational program located at the Charlestown and Chelsea campuses of Bunker Hill Community College. The program, which serves 59 children, also provides employment for consumers with disabilities and helps train future teachers and nurses.