Southeastern Massachusetts Educational Collaborative (SMEC) was established in 1975 as a governmental organization under Chapter 40, Section 4E, of the Massachusetts General Laws, which allows school districts, with the approval of the Commonwealth’s Department of Elementary and Secondary Education (DESE), to enter into intergovernmental agreements establishing cooperative public entities referred to as educational collaboratives. During the period covered by our audit, SMEC operated various programs within the three different service components that serve both school-age children and adults with disabilities: the Local Education Authority (LEA), Supporting Adults for Inclusive Living (SAIL), and Adult Day Health (ADH) service components. The LEA service component specializes in the development of regional programs for school-age children with low-incidence handicapping conditions. SAIL is SMEC’s adult service component that offers a broad range of specialized support services to adults with developmental disabilities. In its ADH service component, SMEC provides adult day health services to individuals aged 22 and over.

In accordance with Chapter 11, Section 12, of the General Laws, the Office of the State Auditor (OSA) has conducted an audit of certain activities of SMEC for the period July 1, 2008 through October 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 to provide 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 objectives consisted of a review and assessment of the system of internal controls over certain activities, including accounting, budgeting, financial reporting, contract administration, professional licensure, staff evaluations, and credit card expenses, and an evaluation of SMEC’s management practices and its compliance with relevant laws, rules, regulations, policies, and grant and contract requirements.

Our audit identified that SMEC was using the majority of its funding to provide various human services to adults rather than children in SMEC’s member districts, which may not be consistent with the purposes of an educational collaborative. Moreover, SMEC’s provision of these services may be unnecessarily increasing the state’s pension liability by millions of dollars. Also, contrary to state regulations, SMEC had not filed annual audited financial statements with the Commonwealth; was not maintaining its accounting records in accordance with generally accepted accounting principles; and received unnecessary and, in some instances, not properly authorized payments totaling $53,063 under its state contracts.
AUDIT RESULTS

1. SMEC IS PRIMARILY PROVIDING ADULT HUMAN SERVICES, WHICH MAY BE INCONSISTENT WITH THE PURPOSES OF AN EDUCATIONAL COLLABORATIVE AND MAY UNNECESSARILY INCREASE THE STATE’S PENSION LIABILITY

Chapter 40, Section 4E, of the General Laws allows two or more school committees to form a collaborative “to conduct education programs and services which shall complement and strengthen the school programs of member school committees and charter schools and increase educational opportunities for children.” SMEC receives over 50% of its revenue from contracts with state human service agencies to provide various human services, including employment support and residential and adult day health services, to adults over the age of 21 years. These adult services appear to be inconsistent with the legislatively stated purposes of an educational collaborative because they do not directly strengthen school programs or increase the educational opportunities for children in the communities SMEC serves. Further, although SMEC disclosed to DESE in its Collaborative Agreement that it was providing services to adults, DESE officials were unaware of the extent to which SMEC was providing these services. SMEC’s provision of these services may not only be inconsistent with the purposes of an educational collaborative, but may also be allowing employees to accrue pension benefits and unnecessarily increase the state’s pension liability. Specifically, SMEC uses approximately 95 individuals to provide these adult-centered human services, and these employees participate in the state retirement system as collaborative/public employees. If these services were instead provided by a separate private human service organization, these 95 individuals would not be eligible to participate in the state retirement system.

2. CONTRARY TO STATE REGULATIONS, SMEC HAS NOT FILED ANNUAL AUDITED FINANCIAL STATEMENTS WITH THE COMMONWEALTH

According to state regulations, agencies such as SMEC that provide human services under contracts with state agencies must file an annual financial report, the Uniform Financial Statements and Independent Auditor’s Report (UFR), with the Commonwealth. Contrary to this regulation, we found that during our audit period, SMEC did not file the required UFRs with the Commonwealth. Because SMEC did not file these reports, state funding and oversight agencies and other interested parties, such as the school districts for which SMEC provides services, did not have the ability to adequately assess SMEC’s activities and its performance in providing services.

3. CONTRARY TO STATE REGULATIONS, SMEC IS NOT MAINTAINING ITS ACCOUNTING RECORDS IN ACCORDANCE WITH GENERALLY ACCEPTED ACCOUNTING PRINCIPLES

Contrary to state regulations, SMEC was not maintaining all of its accounting records in accordance with generally accepted accounting principles (GAAP). Maintaining financial records in accordance with GAAP is essential for SMEC to properly manage and oversee all of its activities. However, during our audit period, SMEC did not properly account for hundreds of thousands of dollars in expenses in its accounting records. As a result, SMEC could not document whether the funding it requests and receives under the state contracts that fund its SAIL program is based on the actual costs of running this program and is not excessive. Moreover, because of these accounting deficiencies, it was
not possible for SMEC to establish prices for its program services that are consistent with guidelines established by the Massachusetts Department of Revenue’s Division of Local Services (DLS) and the state’s Office of the Attorney General (OAG) relative to the amount of fees governmental agencies such as SMEC can charge for their services.

4. UNNECESSARY AND INAPPROPRIATE CONTRACT BILLINGS TOTALING $53,063

During our audit period, SMEC entered into annual contracts with DDS called Limited Unit Rate Service Agreements (LUSA). According to DDS’s policies, the funding provided under these contracts was to be used by SMEC to purchase unanticipated intermittent, as-needed services for developmentally disabled individuals needing limited-time placements. However, during fiscal years 2009 and 2010, SMEC inappropriately received LUSA funding totaling $53,063, of which $21,721 was for services that were not properly authorized and all of which was not used for the intended purposes of LUSA. Rather, according to SMEC’s records, these funds were used to retroactively pay for additional services to consumers who were already receiving services under SMEC’s state contracts. SMEC officials stated that SMEC voluntarily provided these additional services but did not expect to be reimbursed for any of these services because they were in excess of that which was required under SMEC’s state contracts. These officials further stated that DDS contacted SMEC at the end of each fiscal year and told SMEC to submit a bill for any additional services it had provided to consumers in DDS-funded programs. Because the billings for these expenses in many cases were not properly authorized; covered services in excess of what SMEC was required to provide under its state contracts; and were not used for their intended purposes of providing as-needed services for developmentally disabled individuals needing limited-time placements, these additional payments to SMEC were unnecessary, unallowable, and inappropriate.

APPENDIX A

SMEC MEMBER DISTRICTS

APPENDIX B

PROGRAMS OPERATED BY SMEC
INTRODUCTION

Background

Southeastern Massachusetts Educational Collaborative (SMEC) was established in 1975 as a governmental organization under Chapter 40, Section 4E, of the Massachusetts General Laws, which allows school districts, with the approval of the Commonwealth’s Department of Elementary and Secondary Education (DESE), to enter into intergovernmental agreements establishing cooperative public entities referred to as educational collaboratives by stating, in part:

Two or more school committees of cities, towns and regional school districts and boards of trustees of charter schools may enter into a written agreement to conduct education programs and services which shall complement and strengthen the school programs of member school committees and increase educational opportunities for children.

SMEC, which is located in New Bedford, operates under the control of a Board of Directors composed of school committee members from each of its eight member districts (see Appendix A). SMEC’s Collaborative Agreement, authorized by DESE, identifies the following activities to be conducted by SMEC:

Provide educational resources to support and augment the educational programs and services of the Member Public School Committees.

Provide educational programs and services which shall complement and strengthen the public school programs of the Member School Committees and to increase educational opportunities for students.

Develop and administer educational programs for public school students, including students, ages 3 through 21 years, having special needs, and adults above age 21 with special needs and/or disabilities.

During the period covered by the audit, SMEC operated a number of programs within three different service components that served both school-age children and adults with disabilities: the Local Education Authority (LEA), Supporting Adults for Inclusive Living (SAIL), and Adult Day Health (ADH) components. The LEA service component specializes in the development of regional programs for school-age children with low-incidence handicapping conditions. SAIL is SMEC’s adult services component that offers a broad range of specialized support services to adults with developmental disabilities. In August of 2009, SMEC introduced its ADH service component, which services individuals aged 22 and over who have been found eligible for Medicaid-funded ADH services. A detailed description of the programs operated by SMEC in each service component during our audit period appears in Appendix B.
During the period covered by our audit, SMEC employed approximately 158 individuals, including part-time employees. On average, there were 63 employees working in its LEA program, 89 employees working in its SAIL service component, and six employees working in its ADH component. SMEC’s revenue is derived primarily from tuition charged to both member and non-member school districts based on a per-student basis and through state contracts with the Department of Developmental Services (DDS). A summary of the funding SMEC received during the period covered by our audit appears in the table below:

<table>
<thead>
<tr>
<th>Revenues</th>
<th>Fiscal Year 2009</th>
<th>Fiscal Year 2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tuition, Member</td>
<td>$2,151,866</td>
<td>$2,269,566</td>
</tr>
<tr>
<td>Tuition, Non-Member</td>
<td>176,182</td>
<td>156,366</td>
</tr>
<tr>
<td>DDS</td>
<td>2,513,882</td>
<td>2,499,867</td>
</tr>
<tr>
<td>MassHealth (ADH)</td>
<td>-</td>
<td>168,194</td>
</tr>
<tr>
<td>DESE</td>
<td>-</td>
<td>9,242</td>
</tr>
<tr>
<td>Grants</td>
<td>57,300</td>
<td>-</td>
</tr>
<tr>
<td>Professional Development</td>
<td>42,665</td>
<td>48,231</td>
</tr>
<tr>
<td>Consumer Self-Pays</td>
<td>20,438</td>
<td>3,797</td>
</tr>
<tr>
<td>Investment Income</td>
<td>519</td>
<td>493</td>
</tr>
<tr>
<td>Miscellaneous</td>
<td>6,912</td>
<td>11,616</td>
</tr>
<tr>
<td>Total Revenues</td>
<td>$5,098,036</td>
<td>$5,295,644</td>
</tr>
</tbody>
</table>

**Audit Scope, Objectives, and Methodology**

In accordance with Chapter 11, Section 12, of the General Laws, the Office of the State Auditor has conducted an audit of certain activities of SMEC for the period July 1, 2008 through October 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 to provide 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 objectives consisted of the following:

a. Review and assess the system of internal controls over certain activities, including accounting, budgeting, financial reporting, contract administration, professional licensure, staff evaluations, and credit card expenses.
b. Conduct audit testing in the selected areas for the purposes of evaluating SMEC’s management practices and its compliance with relevant laws, rules, regulations, policies, and grant and contract requirements.

In order to achieve our objectives, we first assessed the internal controls established and implemented by SMEC in the following areas: accounting, budgeting, financial reporting, contract administration, professional licensure, staff evaluations, and credit card expenses. The purpose of this assessment was to obtain an understanding of management’s attitude, the control environment, and flow of transactions through SMEC’s accounting system. We used this assessment in planning and performing audit tests. We then held discussions with officials from DESE, DDS, and SMEC’s administrative staff and reviewed internal policies and procedures. We examined all applicable laws, rules, and regulations, and other guidance relative to educational collaborative activities that have been issued by various state agencies. We also examined SMEC’s financial statements, invoices, and other pertinent financial records to determine whether expenses incurred were reasonable; allowable; allocable; properly authorized and recorded; and in compliance with applicable laws, rules, regulations, and grant and contract requirements.

Our audit was not made for the purpose of forming an opinion on SMEC’s financial statements. Our audit also did not assess the quality and appropriateness of all program services provided by SMEC. Rather, the report is intended to report findings and conclusions on the extent of SMEC’s compliance with applicable laws, rules, regulations, and contractual agreements, and to identify services, processes, methods, and internal controls that could be made more efficient and effective.

Our audit identified that SMEC was using the majority of its funding to provide various human services to adults rather than children in SMEC’s member districts, which may not be consistent with the purposes of an educational collaborative. Moreover, SMEC’s provision of these services may be unnecessarily increasing the state’s pension liability by millions of dollars. Also, contrary to state regulations, SMEC has not filed annual audited financial statements with the Commonwealth; was not maintaining its accounting records in accordance with generally accepted accounting principles; and received unnecessary and, in some instances, not properly authorized payments totaling $53,063 under its state contracts.
AUDIT RESULTS

1. SMEC IS PRIMARILY PROVIDING ADULT HUMAN SERVICES, WHICH MAY BE INCONSISTENT WITH THE PURPOSES OF AN EDUCATIONAL COLLABORATIVE AND MAY UNNECESSARILY INCREASE THE STATE’S PENSION LIABILITY

Chapter 40, Section 4E, of the Massachusetts General Laws allows two or more school committees to form a collaborative “to conduct education programs and services which shall complement and strengthen the school programs of member school committees and charter schools and increase educational opportunities for children.” The Southeastern Massachusetts Educational Collaborative (SMEC) receives over 50% of its revenue from contracts with state human service agencies to provide various human services, including employment support and residential and adult day health services, to adults over the age of 21 years. These services appear to be inconsistent with the legislatively stated purposes of an educational collaborative because these services to adults do not directly strengthen school programs or increase the educational opportunities for children in the communities SMEC serves. Further, although SMEC disclosed to the Department of Elementary and Secondary Education (DESE) in its Collaborative Agreement that it was providing services to adults, DESE officials were unaware of the extent to which SMEC was providing these services. SMEC’s provision of these services may not only be inconsistent with the purposes of an educational collaborative, but may also be allowing employees to accrue pension benefits that unnecessarily increase the state’s pension liability. Specifically, SMEC uses approximately 95 individuals to provide these adult-centered human services, and these employees participate in the state retirement system as collaborative/public employees. If these services were instead provided by a separate private human service organization, these 95 individuals would not be eligible to participate in the state retirement system.

As noted in the Background section of this report, in addition to providing the educational services for school districts as provided for in Chapter 40, Section 4E, of the General Laws, SMEC operates two other programs—a Supporting Adults for Inclusive Living (SAIL) program and an Adult Day Health (ADH) program—that provide various support services to adults with developmental disabilities over the age of 21. These programs, which are funded through human service contracts with the Department of Developmental Services (DDS) and MassHealth, account for over 50% of SMEC’s annual revenue.
The adult human services being provided by SMEC appear to be outside the scope of the services that the Legislature intended an educational collaborative to provide as described in Chapter 40, in that they neither serve to strengthen the school programs of member school committees and charter schools nor increase educational opportunities for children in the school district served by SMEC. The vast majority of comprehensive human services such as these are provided by private human service organizations that contract with state purchasing agencies. One financial consequence of providing these services through an educational collaborative versus a private human service agency is that SMEC may be substantially increasing the state’s pension liability. Specifically, SMEC uses approximately 95 individuals to provide these adult-centered human services, and these employees participate in the state retirement system as collaborative/public employees. If these services were instead provided by a separate private human service organization, these 95 individuals would not be eligible to participate in the state retirement system, which would save the Commonwealth millions in potential future retirement benefits.

SMEC’s Collaborative Agreement, approved by DESE, indicates that SMEC provides adult services. In this regard, this agreement states that the purposes for establishing the collaborative are, in part, as follows:

To develop and administer educational programs for the public school students, including students, ages 3 through 21 years, having special needs, and adults above 21 with special needs and/or disabilities. Such programs shall include, but not be limited to the following:

**Early Childhood Programs**

Programs providing for the instruction of students having emotional and behavioral disorders

Career exploration and work experience programs for regular class students and those having special educational needs

Developmental education, prevocational training and social development programs for students having special needs

**Adult Service Programs**

DESE officials indicated that they were not aware that SMEC generated the majority of its revenues from adult human services being purchased by state agencies rather than services purchased by school districts. Additionally, on April 7, 2011, DESE’s Associate General Counsel provided the OSA with an email, stating, in part:
To the best of my knowledge public school districts are not precluded from providing educational services to adults. In fact, there is no Massachusetts law or regulation that establishes a maximum cut-off age for admission to public schools. Although the Board of Elementary and Secondary Education (ESE) is authorized under G.L. c. 69, § 1B to “establish the permissible and mandatory ages for school attendance,” it has not done so. This determination is a matter of local policy. It should be noted that the statute that establishes the right to attend public school, G.L. c. 76, § 5, provides that every “person shall have the right to attend the public schools of the town where he actually resides.” Prior to legislative amendment in 1973, this statute provided that “every child” shall have the right to attend the public schools.

If the law does not preclude school districts from enrolling adults as students, it certainly does not preclude school districts from providing educational services to adults. It should also be noted that G.L. c. 69, § 11, which sets forth school district reporting requirements, lists “adult education programs.” Therefore, we believe that school districts may provide educational services to adults.

With respect to the approval of collaborative agreements, the agreement is usually reviewed by both program staff as well as the legal office. The legal office reviews the agreement for compliance with the law. I reviewed the revised SPEC [sic] agreement, and not finding anything that was inconsistent with the law, I recommended its approval.

DESE’s Associate General Counsel states that because public school systems are not precluded from providing educational services to adults, Chapter 40 does not preclude an educational collaborative from providing educational services to adults. We would agree with DESE’s assertion that it is appropriate for school districts to offer adult education services in their communities. However, the services that SMEC provides in its SAIL and ADH programs are comprehensive human services that an adult could not obtain from the strictly educational services of a public school system. In fact, many of the services provided to adults in these programs, such as residential and adult day health services, are supportive rather than educational in nature. Accordingly, as previously stated, the human services being provided by SMEC in its SAIL and ADH programs do not appear to be consistent with the purposes of an educational collaborative as defined by Chapter 40 in that they are neither for children nor designed to complement and strengthen the school programs of member school committees.

Recommendation

DESE should determine the extent to which, if any, it wants to allow educational collaboratives to provide adult human services under state contracts. DESE should formally communicate this determination to all educational collaboratives and, depending on its determination, consider taking additional measures such as proposing an amendment to Chapter 40, Section 4E to clarify
the extent to which these services can be provided by educational collaboratives. One factor that DESE needs to consider in this determination is its impact on the state pension system.

**Auditee’s Response**

In response to this issue, SMEC provided the following comments:

> Despite the auditors’ statement that the purpose of the audit was not to “assess the quality and appropriateness of all program services provided by SMEC,” the auditor has chosen to call into question whether an educational collaborative should be providing services to persons over the age of 22. With all due respect, this finding displays a misunderstanding of the nature of educating persons with disabilities. The auditors’ judgment is premised on the assumption that education should stop upon a certain date for these individuals or that schools should be completely uninvolved in this continuing process. While it is true that approximately 51% of the collaborative’s revenue in recent years is attributed to our provision of adult disability services, this is due to the fact that many of our students and their families require a continuum of services that in many cases is lifelong, as well as the fact that despite the availability of many private human service agencies in our membership area approximately 98% of the students who receive transitional services through SMEC up to age 22 and who are eligible for adult service funding choose to stay with SMEC for adult services. The budgets for our adult programs are developed and approved separately from the school aged program budgets and no school district funds are used by the collaborative in the provision of services to persons over the age of 22.

The offering of adult services through the collaborative does not negatively impact our member school districts in any manner, financially or otherwise, but ultimately strengthens the educational programs of our member and surrounding communities by providing their students with a high quality program continuum and seamless transition from school to adult services. The continuation of services by the collaborative after students attain the age of 22 also ensures that the districts’ financial and educational investment on behalf of these individuals is safe-guarded and will be continued through the financial and programmatic resources of other public agencies such as the Department of Developmental Services (DDS), Massachusetts Commission for the Blind (MCB), Mass Rehabilitation, etc. In addition, our contracts with the Commonwealth for adult services fund a portion of the administrative overhead costs required to maintain and operate an agency such as ours, thereby reducing the financial liability that would otherwise be attributed solely to the member districts.

> The mission of public educational agencies in Massachusetts is to educate. That mission has never been confined to those under a certain age. Public educational agencies, including city and town school systems, regional school districts, regional vocational technical high schools and public and community colleges have offered educational and training resources to adults in many areas including GED classes, classes to obtain U.S. citizenship, vocational training, job training, technical and trade certification and licensure courses, to name a few. Some public educational collaboratives, including SMEC, have the expertise and training to offer similar educational offerings to adults with disabilities efficiently and cost effectively. Rather than limiting the provision of these services through the state institutions of the past, SMEC works in concert with its participating school systems to provide specialized educational services in a community setting to assist students with developmental disabilities with the transition from school to work and from home to community. The auditors’ assertion that “the services that SMEC provides its SAIL and ADH programs are comprehensive human services that an adult could not obtain from the strictly educational services of a public school
system” essentially validates the purpose and need for a collaborative to provide programs and services to this population on behalf of the districts, their students and the community.

As noted in the auditors’ report, the SMEC Articles of Agreement, which is approved by the Commissioner of DESE and the SMEC Board of Directors, clearly indicates that SMEC provides adult human services. SMEC has a Board of Directors comprised of school committee members from each of our member districts each of whom reports back to his or her respective district. The SMEC Board voted long ago to offer services to individuals over the age of 22, and continues to approve and support the adult service budgets, programs and services at least annually.

The DESE Associate General Counsel gives an excellent response to the state auditors’ assertion that collaboratives should be precluded from providing adult educational services by explaining that neither Chapter 40, section 4E, nor any other Massachusetts law or regulation prevents school districts or collaboratives from providing adult education, that there is no maximum age for public school education in Massachusetts and in fact adult education programs are an important element of many school district offerings. Many DESE and EOE initiatives are currently targeting and encouraging the continuity of services from birth through adult education, a reflection of the fact that learning is lifelong and a shared responsibility among providers for all age groups.

Despite the auditors’ statement that this “report is intended to report findings and conclusions on the extent of SMEC’s compliance with applicable laws, rules, regulations, and contractual agreements…” the auditor has chosen to opine on the appropriateness of the collaborative’s adult services and goes on to describe our adult services as “supportive rather than educational in nature.”

In response to the auditors’ assertion that our adult program employees are “unnecessarily increasing the state’s pension liability,” Chapter 40 Section 4E, the DOR, IRS and every other state and federal authority specifically and clearly identify collaboratives as public entities. Therefore all of our employees are public employees and are eligible and required to participate in the public pension system. Also, the fact that the auditor has used the term “unnecessarily” displays a misunderstanding of the social and economic benefit of the services that we provide to the Commonwealth and its most vulnerable citizens.

Auditor’s Reply

As stated in our report, the scope of our audit did not include testing specifically designed to assess the quality or appropriateness of services provided by SMEC to its consumers. However, as stated in our report, our review of SMEC’s financial records identified that over 51% of the revenue that SMEC receives annually is from state human service agencies that are purchasing comprehensive human services for adult consumers with developmental disabilities and not from school districts purchasing special education services for their students. Further, contrary to what SMEC suggests in its response, the OSA does not misunderstand the nature of educating persons with disabilities. The OSA clearly recognizes that there is a need to provide education and other support services to consumers who are developmentally disabled. However, our concern is whether it is appropriate to provide this level of human services (over
50% of total revenue) through an education collaborative as opposed to a contracted human service agency. In fact, during fiscal year 2010, SMEC provided school-district-sponsored services to 73 students (during the school year), while during the same period provided services to 111 adult consumers under state contracts. Our concern is based strictly on the statutory purpose of an education collaborative as stated in Chapter 40 of the General Laws, which is “to conduct education programs and services which shall complement and strengthen the school programs of member school committees and charter schools and increase educational opportunities for children.” Clearly, SMEC’s adult services do not directly serve to strengthen the school programs of member school committees, since adults who reach the age of 22 are no longer the responsibly of member school districts. Moreover, these services do not increase the educational opportunities for children, since they are being provided to adults and not children in school districts. Further, contrary to what SMEC states in its response, our judgment was not premised on the “assumption that education should stop upon a certain date for these individuals or that schools should be completely uninvolved in this continuing process.” To the contrary, we clearly do not question the need to provide adult education services, but rather question whether this level of human services should be provided by an education collaborative rather than a human service provider.

Our report does not conclude that SMEC used school district funds to pay for its adult services or state that the adult services being provided by SMEC have negatively impacted its member school districts. As stated in our report, the most significant consequence of allowing education collaboratives to provide this level of adult programming, which we want to bring to DESE’s attention, is the potential unnecessary increase in the state’s pension liability.

The OSA recognizes the mission of public educational agencies within the Commonwealth and the fact that the provision of educational services should not be discontinued at a certain age. However, we again recommend that DESE review this issue and determine the extent to which, if any, it wants to allow educational collaboratives to provide adult human services under state contracts. Contrary to what SMEC’s asserts in its response, the provision of human services by the Commonwealth is not limited to “state institutions of the past.” To the contrary, for decades the Commonwealth’s human service agencies have been contracting with hundreds of private human service organizations that are fully capable of providing all types of high-quality human services to Massachusetts consumers in need of these services.
In its response, SMEC points out that both DESE and its board have approved its provision of adult services. In terms of DESE, our report clearly acknowledges that SMEC’s Collaborative Agreement that was approved by DESE does in fact indicate that SMEC will be operating adult service programs. However, as noted in Audit Result No. 2, during our audit period, SMEC did not file financial reports (UFRs) with the Commonwealth that would have disclosed the extent to which it was providing these adult services, and DESE officials were not aware of the level at which SMEC was providing these adult services. In terms of SMEC’s board, it is understandable that it would approve SMEC’s provision of these adult services, since there was no negative financial consequence to the member districts for doing so.

As stated in our report, we agree with DESE’s assertion that it is appropriate for school districts to offer adult education services in their communities. However, the services that SMEC provides in its SAIL and ADH programs are comprehensive human services that an adult could not obtain from the strictly educational services of a public school system. In fact, many of the services provided to adults in these programs, such as residential and adult day health services, are supportive rather than educational in nature. Again, we do not question whether these services are necessary. However, we do question whether it is consistent with the stated purposes of an education collaborative to provide the majority of its services to adults with developmental disabilities rather than to children in its member school districts.

In its response, SMEC takes issue with the OSA’s observation that the majority of the services SMEC was providing during our audit period were for adults and not children in the districts it serves. As stated in our report, based on our review, it appeared that some of the adult services that SMEC is providing (e.g., residences for consumers, adult day health services) are designed to be more supportive than educational in nature. We have not made a determination or expressed an opinion that these services are inappropriate but rather correctly state that these types of services do not appear to be consistent with the legislatively stated purposes of an educational collaborative because they do not directly strengthen school programs or increase the educational opportunities for children in the communities SMEC serves. In fact, the OSA’s recommendation is not that SMEC discontinue providing these services, but rather that DESE determine the extent to which, if any, it wants to allow education collaboratives to provide these services and to clarify its position on this matter.
Finally, the OSA does not dispute that employees of collaboratives, which are public entities, are allowed to participate in the state pension system. However, as stated in our report, the issue is that having a public entity such as SMEC provide these adult services, which are typically provided by private human service organizations, unnecessarily increases the state’s pension liability. This is important information for DESE to consider when making an informed decision on this matter.

2. CONTRARY TO STATE REGULATIONS, SMEC HAS NOT FILED ANNUAL AUDITED FINANCIAL STATEMENTS WITH THE COMMONWEALTH

According to state regulations, agencies such as SMEC that provide human services under contracts with state agencies must file an annual financial report, the Uniform Financial Statements and Independent Auditor’s Report (UFR), with the Commonwealth. Contrary to this regulation, we found that during our audit period, SMEC did not file the required UFRs with the Commonwealth. Because SMEC did not file these reports, state funding and oversight agencies and other interested parties, such as the school districts for which SMEC provides services, did not have the ability to adequately assess SMEC’s activities and its performance in providing services.

The state’s Operational Services Division (OSD), the state agency responsible for regulating and overseeing the activities of all contracted human service providers such as SMEC, has promulgated regulations that require government organizations such as SMEC and private organizations that receive $100,000 or more in funding from state human service agencies to annually file a UFR with OSD. In this regard, 808 Code of Massachusetts Regulations (CMR) 1.04 (2), promulgated by OSD, states the following:

**(2) Annual Audit.** Each Contractor and Subcontractor shall, on or before the 15th day of the fifth month after the end of its fiscal year, submit electronically to DPS a UFR or a certification of exemption, in accordance with the standards and instructions contained in the UFR. The UFR and related materials submitted by a Contractor to DPS shall be certified under pains and penalties of perjury as true, correct and accurate by a Massachusetts independent public accountant engaged by the Contractor or by an authorized signatory for the Board of Directors or officers of the corporation, the Executive Director, or Chief Financial Officer of the Contractor.

As noted in the Background section of this report, SMEC receives approximately $2.5 million annually in human service contracts from state agencies; therefore, it is required to file an annual UFR with OSD. The UFR, which is required to be prepared in accordance with generally
accepted accounting principles (GAAP), provides state funding and oversight agencies and other interested parties with information on SMEC’s financial and programmatic performance during the audit period. This information is used by these funding and oversight entities for many purposes, including to establish appropriate funding levels for SMEC’s programs and to monitor SMEC’s compliance with various state regulations and the terms and conditions of its state contracts.

SMEC’s Executive Director stated that she believed SMEC was exempt from the UFR filing requirement because it is a government agency. However, OSD’s UFR Audit and Preparation Manual gives the following guidance as to which government organizations are required to file a UFR, as follows:

*Other government organizations, including committees, education collaboratives, public entities or quasi-government agencies that are not considered agencies of the Commonwealth that do not qualify for other exemptions and exceptions and are NOT required to file financial statements audited in accordance with GAGAS and OMB Circular A-133 with the Bureau of Accounts (of the Division of Local Services) in the Commonwealth’s Department of Revenue (DOR) do not qualify for this exemption as a government agency.*

SMEC’s Executive Director stated that SMEC does not submit audited financial statements to the Department of Revenue’s Bureau of Accounts of the Division of Local Services. Therefore, in accordance with OSD’s guidelines, SMEC is not exempt from filing an annual UFR.

During our audit we spoke with OSD’s Director of Audit and Quality Assurance, who confirmed that SMEC should not have been exempt from the UFR filing requirement. In fact, our audit work alerted OSD to this issue, and OSD sent a letter to SMEC and the Department of Developmental Services (DDS) formally notifying them of SMEC’s responsibility to file a UFR. OSD’s Director of Audit and Quality Assurance stated that OSD subsequently received a letter from a law firm representing SMEC that challenged SMEC’s need to file a UFR. As a result of this challenge, on March 28, 2011, OSD issued a letter to SMEC and its law firm that stated, in part:

*The Operational Services Division (OSD) has reviewed your position on the UFR reporting exemption for Southeastern Massachusetts Educational Collaborative (SMEC) and has determined that exemption #4 Governmental Agencies as found on page 25 of the FY2010 UFR Audit and Preparation Manual is not applicable to SMEC.*
In fiscal year ended 6/30/2010, SMEC received in excess of $2.6 million dollars in Purchase of Service (POS) contract revenue from state purchasing agencies. The Commonwealth Contract Terms and Conditions for Human and Social Services for the contracts [SMEC] executed with state agencies, specifically identifies under section c: [the] Annual Financial Reporting Requirements which obligates [SMEC] to file a UFR.

After receiving the OSD's determination, SMEC dropped its legal challenge and agreed to begin filing UFRs.

**Recommendation**

SMEC should annually file a UFR in compliance with state regulations.

**Auditee's Response**

In response to this issue, SMEC provided the following comments:

*Prior to the auditors’ visit, SMEC was viewed as exempt from the UFR filing provision under Exemption #4 in the UFR Audit and Preparation manual as a “Government Entity.” School districts and municipalities are exempt from the UFR filing provisions. It was the opinion of our legal counsel and independent auditor that this exemption applied to SMEC and our state contracts have been submitted each year indicating this exemption. These contracts are processed and approved through the state comptroller’s office, EOHHS and DDS regional and statewide offices and have been approved and executed indicating this exemption for over 17 years. Only after employees of the state auditor’s office voiced their opposition to the Executive Director of OSD did we receive a letter, dated January 5, 2011, indicating that we are now expected to comply with the UFR submission process or face sanctions.*

*The state auditors refer to SMEC as a "local government entity” … and refer to guidance to "municipal government agencies” as something that SMEC should be aware of and following. However, they feel that we do not qualify for the same exemption afforded to other local government entities. Although we feel that a double standard is being applied whereby collaboratives are expected to comply with all of the laws and regulations of a public/government entity, are described as public entities and "arms of municipalities" by the DESE, DOR, IRS, the state auditor and other authorities, as well as the fact that we have a legal opinion stating that we fit the government exemption standard, we are not being granted the same exemptions afforded to other public/government organizations. The collaborative is not in a financial position, nor would it be an appropriate use of public funds to begin legal action on this finding at this time, therefore, although we object, we intend to comply with the recommendation that we file an annual UFR and have in fact done so as requested for FY10.*

**Auditor’s Reply**

In order for OSD to make a determination that an organization is exempt from filing a UFR, OSD guidelines state that the organization has to submit a request for an exemption to OSD. However, contrary to what SMEC asserts in its response, it never provided the OSA staff with any documentation that indicated that it ever sought or received a determination from either
OSD or its legal counsel that it was exempt from filing a UFR. As stated in our report, OSD does allow exemptions to filing UFRs to certain organizations, as follows:

*Other government organizations, including committees, education collaboratives, public entities or quasi-government agencies that are not considered agencies of the Commonwealth that do not qualify for other exemptions and exceptions and are NOT required to file financial statements audited in accordance with GAGAS and OMB Circular A-133 with the Bureau of Accounts (of the Division of Local Services) in the Commonwealth’s Department of Revenue (DOR) do not qualify for this exemption as a government agency.*

However, even if SMEC had submitted a request to OSD for an exemption to UFR filing, since SMEC does not submit audited financial statements to the Department of Revenue’s Bureau of Accounts of the Division of Local Services, in accordance with OSD’s guidelines, it clearly would not have been granted an exemption by OSD. It is relevant to point out that the OSA has identified at least one other education collaborative regularly files UFRs even though it receives less funding under human service contracts than SMEC.

Although we cannot comment on why no governmental agency has questioned SMEC’s failure to file UFRs, we must note that the Office of the State Comptroller is not responsible for verifying any provider’s statement of exemption. As stated in our report, once SMEC solicited guidance from OSD regarding this matter, OSD promptly informed SMEC that it was in fact not exempt and was required to file a UFR. Contrary to what SMEC states in its response, the Commonwealth is not applying a double standard. Rather, in requiring SMEC to annually file a UFR, OSD is simply holding SMEC to the same standard it holds all other entities, including collaboratives, that receive funds under state human service contracts.

In its response, SMEC states that it intends to comply with OSD’s determination that it annually file a UFR. We believe this decision is appropriate and will serve to provide the transparency necessary for DESE and OSD to effect proper oversight of its activities.

3. **CONTRARY TO STATE REGULATIONS, SMEC IS NOT MAINTAINING ITS ACCOUNTING RECORDS IN ACCORDANCE WITH GENERALLY ACCEPTED ACCOUNTING PRINCIPLES**

Contrary to state regulations, SMEC was not maintaining all of its accounting records in accordance with GAAP. Maintaining financial records in accordance with GAAP is essential for SMEC to properly manage and oversee all of its activities. However, during our audit period, SMEC did not properly account for hundreds of thousands of dollars in expenses in its
accounting records. As a result, SMEC could not document whether the funding it requests and receives under the state contracts that fund its SAIL program is based on the actual costs of running this program and is not excessive. Moreover, because of these accounting deficiencies, it was not possible for SMEC to establish prices for its program services that are consistent with guidelines established by the Massachusetts Department of Revenue’s Division of Local Services (DLS) and the state’s Office of the Attorney General (OAG) relative to the amount of fees governmental agencies such as SMEC can charge for their services.

As previously noted, since SMEC receives the majority of its funding under state human service contracts, it must comply with OSD regulations. In terms of agency records, OSD regulations require all contracted human service providers such as SMEC to maintain their records in accordance with GAAP. Specifically, 808 CMR 1.04(1), promulgated by OSD, states, in part:

_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. 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..._

As noted in Audit Result No. 2, during our audit period SMEC did not file UFRs with OSD annually. However, each year, including those covered by our audit, SMEC hired an accounting firm to prepare unaudited financial statements that SMEC could use to oversee and manage its operations. During our audit, we reviewed SMEC’s financial records, including its unaudited financial statements, and noted a number of problems. First, contrary to GAAP, administrative expenses in the amount of $324,461 and $326,587 in fiscal years 2009 and 2010, respectively, were incurred by SMEC relative to the operation of all of its activities, but were inappropriately expensed solely to SMEC’s LEA-related activities. Also, occupancy costs that benefitted all of SMEC’s activities totaling over $100,000 annually were similarly expensed only to SMEC’s LEA activities. This inappropriate allocation of expenses inflated the expenses associated with SMEC’s LEA activities and understated the expenses associated with SMEC’s other activities.
As a result, these accounting practices have affected SMEC’s ability to effectively manage its activities, as discussed below:

a. **Inadequate Assurance That Negotiated Contract Budgets Are Reasonable**

As previously noted, SMEC receives approximately $2.5 million annually in SAIL program funding under contracts with DDS, the maximum obligations for which are based on detailed program budgets that are negotiated between SMEC and DDS. The program budgets are designed to reflect SMEC’s total expected annual program costs and revenues associated with the operation of the SAIL program. Our review of these contracts noted that the budgets included amounts for the administrative costs that SMEC estimated it would incur in operating each activity in its SAIL program, as follows:

<table>
<thead>
<tr>
<th>SAIL Contract Activity</th>
<th>Fiscal Year 2009</th>
<th>Fiscal Year 2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>DDS Residential Support</td>
<td>$71,781</td>
<td>$58,600</td>
</tr>
<tr>
<td>DDS Employment Support</td>
<td>110,519</td>
<td>102,000</td>
</tr>
<tr>
<td>DDS Individual Support</td>
<td>27,887</td>
<td>30,932</td>
</tr>
<tr>
<td>DDS Community Habilitation</td>
<td>42,500</td>
<td>35,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$252,687</strong></td>
<td><strong>$226,532</strong></td>
</tr>
</tbody>
</table>

As shown in the table, SMEC received a total of $479,219 in funding for fiscal years 2009 and 2010 under its contracts with DDS for its SAIL program to pay for the administrative expenses it anticipated incurring in this program. This amount represented approximately 73% of the total administrative expenses incurred by SMEC during our audit period for all of its activities. Although the funding for these administrative expenses was received by SMEC under the contracts that funded its SAIL program, as noted above, we found that all of the agency’s administrative expenses, including those associated with the SAIL program, were expensed and reported in SMEC’s financial records as expenses associated with its LEA activities. As a result, there is no way for SMEC to accurately determine the results of its operations in its SAIL and other programs or to use the historical program costs in its accounting records to negotiate reasonable program budgets and contracts for its SAIL program.
b. SMEC Is Not Using an Acceptable Methodology to Price Its Program Services

As a local governmental entity, SMEC is required to establish systems that allow it to accurately account for revenues and expenses and to develop detailed budget estimates so that it can establish accurate prices or fees for its program services. Accurate budget estimates and accounting of revenue and expenses are also essential for board oversight purposes. DLS and the OAG have issued guidance relative to the amount of fees governmental agencies such as SMEC can charge for their services. This guidance effectively states that the amount of fees a governmental agency should charge for services should not exceed its actual cost of providing the services. However, the OSA found that SMEC’s accounting and pricing systems do not afford management or the board proper oversight of the agency and ensure proper accountability.

Municipal government agencies in Massachusetts have been advised on different occasions by DLS and the OAG that service fees may be used to offset the costs of providing services but may not be used to produce a surplus or profit in excess of the costs of the program, a constitutionally prohibited action. For example, on December 24, 2003, the then Massachusetts Attorney General responded to an inquiry from the Town Clerk of Bridgewater regarding the implementation of a fee by the town, stating, in part:

In approving the fees established in Article XXXIII, we remind the town that fees cannot exceed the limits imposed on local government by the Constitution and the statutes of the Commonwealth. Valid fees are distinguishable from invalid taxes by three criteria: (i) the fee is assessed for a particular government service benefiting the party paying the fee in a manner not shared by other persons; (ii) the person assessed has the option to decline the service and thus avoid the charge; and (iii) the amounts paid compensate the town for its costs and expenses of providing the services rather than raising revenues. Emerson College v. Boston, 391 Mass. 415, 427-28 (1984). Moreover, a lawful fee is one that covers only the permit granting authority’s reasonably anticipated costs of providing the services for which the fee is assessed. Southview Cooperative Housing Corp. v. Rent Control Board of Cambridge, 396 Mass. 395, 402 (1985) . . . .

Similar guidance has also been promulgated by the Commonwealth’s Executive Office for Administration and Finance (EOAF) for use by state agencies. Specifically, EOAF Bulletin No. 6 states, in part:

Fees may not be used purely as a tool to raise revenue, but should reflect the government’s expense in providing the service associated with the fee. Expenses may be defined as the reasonable costs imposed on an agency for providing a service or regulating an activity, including administrative and enforcement costs.
In order to ensure that their established prices or fees are consistent with the aforementioned guidance, entities such as SMEC must ensure that they utilize effective budgeting and cost-accounting practices to establish their fees. In this case, SMEC does have detailed policies within its own Collaborative Agreement. Article XII - Annual Appropriations mandates how SMEC is to set its tuition rates, as follows:

12:2 Member appropriations shall be defined as tuition revenues, service fees and all other locally appropriated monies received by the Collaborative from Member Committees.

12:3 Member appropriations to the Collaborative shall be determined annually as follows:

Each Member Committee shall indicate to the Collaborative by May 1 of each fiscal year, the number of student enrollments in each Collaborative program it will require for the succeeding fiscal year.

The Executive Director shall determine the total number of student enrollments required by the Member Committees for each Collaborative Program, define the budgetary requirements for each program for the succeeding fiscal year and determine the projected per pupil cost by program to be assessed the Member Committees.

The per pupil cost by program shall be determined by dividing the total number of student enrollment requests received for each program into the overall operational costs of the program.

The overall operating costs of each program shall consist of all direct and indirect costs to the Collaborative for the continued operations of the program, including pro-rate administrative costs.

However, SMEC’s cost-accounting and pricing systems are not effective in ensuring compliance with its own Collaborative Agreement because SMEC does not track the operating costs of each of its programs as described in its Collaborative Agreement. Rather, all costs associated with the six LEA programs are lumped together in one cost center. Because SMEC does not track individual program costs or accurately account for its administrative and occupancy expenses, it is not possible for SMEC to set tuition rates as required in its Collaborative Agreement or guidelines established by the DLS and OAG.

Regarding how SMEC established the tuition for its services, SMEC’s Executive Director stated that the agency sets rates based upon their historical pricing, with increases based upon informal estimates of projected costs. Further, the Executive Director stated that although the collaborative does not maintain its financial records in accordance with GAAP,
she is aware of what programs are operating at a surplus or deficit. The Executive Director added that some programs only have a few students and, if SMEC based the tuition for these services on the predicted student level in these programs, the fees it would have to charge would not be affordable to school districts.

**Recommendation**

SMEC should immediately begin maintaining its records in accordance with GAAP and use this information to establish its contract budgets and the tuition rates it will charge for its program services in accordance with guidelines established by DLS and the OAG.

**Auditee’s Response**

In response to this issue, SMEC provided the following comments:

*As mentioned in our response to Issue #2, prior to the auditors’ visit, SMEC was considered exempt from the UFR filing process and therefore also exempt from the GAAP provisions in the UFR regulations. . . . Therefore it is extremely disturbing that the report does not include any of the positive findings that were noted and instead includes such an inaccurate, inflammatory statement that SMEC did not “account for hundreds of thousands of dollars in expenses in its accounting records.” . . .

In addition to fully funding the operational costs of the specific, direct adult program activities and obligations of a particular contract, state approved vendors are allowed to designate up to 15% of the total funding on a state contract as administrative expenses including indirect costs. Using the state’s own language for contract budget development and the UFR manual this administrative allocation is “for resources related to administration and support activities that are both directly related to the program (direct costs) and those related to the overall direction of the agency. Cost(s) associated with the overall direction of the agency may cross all agency programs and are not directly associated with any one program or a combination of programs but provide indirect benefit to those programs (indirect administration).”

Despite a much higher permissible agency standard, SMEC designates an average of 10% or less of the total funding on each state contract as administrative expenses and uses that amount to partially fund the agency’s administrative overhead, including administrative salaries, administrative office rent and other indirect costs associated with operating the agency. This, in turn, decreases the financial liability that the school districts would otherwise incur for these administrative costs. The collaborative’s main budget has historically been designated as our “LEA” budget, with separate budgets for our SAIL and ADH programs. The issue here is one of presentation rather than accountability. We can and do account for each and every expense born by the collaborative, all of which were found to be reasonable and appropriate by the auditors. The on-site audit team acknowledged this but recommended that we formulate a more specific cost allocation plan for the 10% administrative allocation. We intend to comply with this recommendation but strongly refute the language in the report that states that we did not or cannot account for these funds.*
While on site, the audit team confirmed that we did not overcharge the districts or charge the member districts for the same administrative costs that were funded by the state contracts, however the language used in the report would lead one to believe that this was the case. Rather than "inflate the expenses associated with SMEC’s LEA activities" the auditors verbally acknowledged that the administrative costs in the state contracts significantly lowered the overall administrative costs allocated to the districts . . . .

Prior to the recent OSD decision that SMEC is no longer exempt from the UFR filing provisions, SMEC had hired an independent auditor to complete a full audit of all collaborative financial activities every third fiscal year. In addition, the independent auditor completed a full review of SMEC’s financials every year in between. In fact, our independent auditor was physically on site during the state auditors’ visit and the state audit team was aware that a full independent audit was being conducted, as it was in FY07 and every third year prior to that; however the report implies that we were never fully audited. These audits and review reports, as well as our internal end of the year financial statements and corresponding documentation, clearly account for every dime received by the Collaborative for all fiscal years.

The auditor indicates that "SMEC does not track the operating costs of each of its programs...rather, all costs associated with the six LEA programs are lumped together in one cost center." While it is true that we compile all costs associated with running our school aged programs into one "LEA" budget, we clearly track the operating costs of each program, use the information to set tuitions and adjust the budget with Board approval and reflect actual costs/expected revenues during budget development. Children are not widgets. We cannot set a cost/budget and expect that it will remain the same for every student and every program for the entire year, particularly when we’re referring to students with significant special needs. Children move in and out of our service area and their needs change. However, our entire budget process is transparent and fully Board approved, and we have never increased tuitions or fees charged to our districts mid-year. The auditors found all expenses charged to the districts to be reasonable and proper and our practices to be efficient, but this is not mentioned in the state audit report. A comparison with private special education programs and human service agencies in the area will very clearly show that the amounts charged by SMEC to both our member districts for school aged services and to the state for adult services are appropriate and generally lower than any other program of similar quality.

SMEC will change the presentation of the collaborative budget(s) and general ledger to comply with GAAP, however we strongly take exception to the statements that we do not track individual program costs, accurately account for administrative and occupancy expenses or set reasonable and appropriate tuitions based on program costs.

Auditor’s Reply

The fact that SMEC erroneously believed that is was exempt from filing a UFR in no way mitigates its responsibly to fully comply with all applicable state regulations and the terms and conditions of its state contracts. As noted in our report, since SMEC receives millions of dollars each year under state human service contracts, it clearly must comply with all OSD regulations. In terms of agency records, OSD regulations require all contracted human service providers such as SMEC to maintain their records in accordance with GAAP. Even if it were determined
that SMEC was exempt from filing a UFR, this would in no way relieve it from its responsibility to maintain its records in accordance with GAAP as required by state regulations.

Our report does not say, as SMEC contends in its response, that it did not “account for hundreds of thousands of dollars in expenses in its accounting records.” Rather, our report states that SMEC did not “properly account for hundreds of thousands of dollars in expenses in its accounting records.” In this regard, the OSA determined that many of the expenses incurred by SMEC during our audit period were not properly accounted for in SMEC’s financial records in accordance with GAAP. This condition resulted in the expenses in various programs being substantially misrepresented in SMEC’s financial records.

Our report specifically details that, during fiscal years 2009 and 2010, SMEC’s state contracts included over $479,219 for administrative expenses. This amount represents approximately 73% of the total administrative expenses incurred by SMEC during our audit period for all of its activities. Our problem is not with the fact that SMEC requested funding for administrative expenses but with the way in which it accounted for these administrative expenses. Specifically, as stated in our report, although the funding for these administrative expenses was received by SMEC under the contracts that funded its SAIL program, as noted above, we found that all of the agency’s administrative expenses, including those associated with the SAIL program, were expensed and reported in SMEC’s financial records as expenses associated with its LEA activities. As a result, there is no way for SMEC to accurately determine the results of its operations in its SAIL and other programs or to use the historical program costs in its accounting records to negotiate reasonable program budgets and contracts for its SAIL program. Therefore, we again stress the importance of establishing an acceptable cost allocation plan for these administrative (indirect) costs so that the Commonwealth can be assured that it is being properly charged in the contracting process for human services.

In its response, SMEC contends that a full audit of all of its financial activities is conducted every three years. However, SMEC does not dispute the fact that, during the period covered by our audit, it was not maintaining its financial records in accordance with GAAP. As stated in our report, our concern is not that SMEC did not account for all of its expenses, but rather that SMEC did not account for its expenses in accordance with GAAP as required by state regulations.
In its response, SMEC asserts that “we clearly track the operating costs of each program, use the information to set tuitions and adjust the budget with Board approval and reflect actual costs/expected revenues during budget development.” However, this statement conflicts with all of the records we reviewed and the verbal representation regarding this matter that we were provided during the conduct of our audit field work. As stated in our report, we determined that SMEC does not track operating costs of each LEA program either in its budgetary process or its accounting records. Rather, as correctly stated in our report, all operating costs for all of SMEC’s LEA programs, including administrative expenses, are grouped together under one cost center. In contrast, SMEC’s SAIL program’s operating expenses are tracked separately in SMEC’s general ledger, with distinct cost centers for each program.

During our audit, we repeatedly asked SMEC officials to provide us with any documentation that reflects the actual operating costs it incurred in its LEA programs. In response to our requests, SMEC officials informed us that the Executive Director and Business Manager do perform cost projections for budgetary reasons but that these projections are informal and the collaborative does not maintain any documentation relative to these projections. Consequently, given the clear absence of an effective cost accounting system that properly records expenses incurred in each of SMEC’s LEA programs, there is no way that SMEC’s tuition pricing can accurately reflect the operating costs of each program. Because SMEC does not track individual program costs or accurately account for its administrative and occupancy expenses, it is not possible for SMEC to set tuition rates as required in its Collaborative Agreement or guidelines established by the DLS and OAG.

4. UNNECESSARY AND INAPPROPRIATE CONTRACT BILLINGS TOTALING $53,063

During our audit period, SMEC entered into annual contracts with DDS called Limited Unit Rate Service Agreements (LUSA). According to DDS’s policies, the funding provided under these contracts was to be used by SMEC to purchase unanticipated intermittent, as-needed services for developmentally disabled individuals needing limited-time placements. However, during fiscal years 2009 and 2010, SMEC inappropriately received LUSA funding totaling $53,063, of which $21,721 was for services that were not properly authorized and all of which was not used for the intended purposes of LUSA. Rather, according to SMEC’s records, these funds were used to retroactively pay for additional services to consumers who were already
receiving services under SMEC’s state contracts. SMEC officials stated that SMEC voluntarily provided these additional services but did not expect to be reimbursed for any of these services because they were in excess of that which was required under SMEC’s state contracts. These officials further stated that DDS contacted SMEC at the end of each fiscal year and told SMEC to submit a bill for any additional services it had provided to consumers in DDS-funded programs. Because the billings for these expenses in many cases were not properly authorized; covered services in excess of what SMEC was required to provide under its state contracts; and were not used for their intended purposes of providing as-needed services for developmentally disabled individuals needing limited-time placements, these additional payments to SMEC were unnecessary, unallowable, and inappropriate.

According to DDS’s Purchase of Service (POS) Manual, LUSA contracts are “for purchasing intermittent, as-needed services for developmentally disabled individuals needing limited time placements.” According to this manual, the LUSA’s purpose is to provide a contract that can be accessed at any time during its term to pay for unexpected services for consumers authorized by DDS. In order to obtain funding to pay for LUSA services, DDS and SMEC have to execute an “Authorization for Services” form that establishes the specific types of service, dates of service, and amount of LUSA funding that will provided. According to this form, “LUSA/MA billing is for additional services on an intermittent, as-needed limited time service that clients need due to specific circumstances that are not included in [an] existing state-funded program contract.” This form must be authorized by DDS prior to any services rendered by one of its human service providers.

During fiscal years 2009 and 2010, DDS provided SMEC with $76,183 and $40,412, respectively, in LUSA funding. During our audit, we reviewed all the documentation SMEC maintained relative to these payments, including the LUSA contracts, purchase vouchers, service delivery reports, and Authorization for Services forms. Based on our review, we identified issues with LUSA billings totaling $31,342 and $21,721, respectively, in fiscal years 2009 and 2010, as follows:
<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Service Type</th>
<th>Amount</th>
<th>Dates of Service</th>
<th>Purchase Voucher Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009</td>
<td>Individual Support</td>
<td>$7,532</td>
<td>July 1, 2008 to June 30, 2009</td>
<td>July 21, 2009</td>
</tr>
<tr>
<td>2010</td>
<td>Employment Support</td>
<td>$15,412</td>
<td>July 1, 2009 to June 30, 2010</td>
<td>August 30, 2010</td>
</tr>
<tr>
<td>2010</td>
<td>Individual Support</td>
<td>$6,309</td>
<td>July 1, 2009 to June 30, 2010</td>
<td>August 30, 2010</td>
</tr>
</tbody>
</table>

Contrary to DDS requirements, SMEC did not have executed Authorization for Services forms on file for the identified $21,721 in LUSA payments that it received during fiscal year 2010. For 2009, SMEC did have the executed Authorization for Services forms on file for the $31,342 LUSA funding in question; however, the authorization did not occur until the end of the year (the form was signed June 30, 2009). In addition to not having properly executed Authorization for Service forms, we also found that all of these funds were not being used for their intended purposes. Specifically, this funding was not used to purchase unanticipated intermittent, as-needed services for developmentally disabled individuals needing limited-time placements who were not currently receiving services under state contracts. Rather, according to SMEC’s records, these funds were used to retroactively cover additional services to consumers who were already placed and being served in SMEC’s state-funded programs.

SMEC’s Executive Director stated that in July 2009 and August 2010 she was contacted by DDS officials and asked to send DDS a bill for any additional services SMEC may have provided to consumers in DDS programs during the past fiscal year. The Executive Director stated that the additional services, for which she requested LUSA payments during both fiscal years, were for consumers already placed in DDS programs and were in excess of what was required by SMEC’s DDS contracts and that, accordingly, SMEC never anticipated being paid for these services.

We contacted DDS officials regarding this LUSA funding, and they were able to subsequently provide an executed Authorization for Service form for SMEC’s fiscal year 2010 funding in question. However, they were in agreement with our assertion that this funding was inappropriately provided through a LUSA. In this regard, on March 25, 2011 DDS sent the OSA correspondence that stated, in part:
Our review of the FY10 LUSA agreements of $15,411.50 for employment supports and $6,308.96 for individual supports for identified SMEC individuals has concluded that, in agreement with your assertion, these extra units should have been included in each respective contract with SMEC at the beginning of the fiscal year. The Region will make a stronger effort to continue following our internal controls with the use of Limited Use Services Agreements and will be vigilant in monitoring the duration and appropriate use of LUSA’s in the future.

As noted in Audit Result No. 3, SMEC does not maintain its accounting records in accordance with GAAP. Accordingly, it was not possible to determine whether this additional LUSA funding resulted in surpluses in SMEC’s DDS-funded programs. However, given that these funds were provided to SMEC after the end of each fiscal year, were used to pay for additional services to consumers who were already receiving services under DDS contracts, and were for services that were unnecessarily in excess of what was required by SMEC contracts, the $53,063 in LUSA payments represents unnecessary and unallowable payments that should be refunded to the Commonwealth.

**Recommendation**

DDS should recover from SMEC the $53,063 in funding provided to SMEC under LUSA contracts during fiscal years 2009 and 2010. In the future, SMEC and DDS should take measures to ensure that LUSA contract funding is only used for its intended purposes.

**Auditee’s Response**

In response to this issue, SMEC provided the following comments:

*During the years covered by the audit, SMEC provided reasonable and necessary services to certain clients above and beyond the stated contractual obligations in our adult service contracts. We did this knowing that there was a possibility that we may not be paid for these services; however as previously stated, these are services to human beings that we provide, not goods for sale, and there are times when rapid and significant changes in services are unavoidable and necessary. Contrary to the report language that we did “not anticipate being paid for these services,” my statements to the auditors indicated that we were aware of the possibility that we may not have been reimbursed for these additional units due to the fiscal situation at the state level. There is a distinct difference between not anticipating something and being aware that it might not happen.*

*Late in the relevant fiscal years, beyond the deadline for amending the state contracts (generally mid-April), we were notified by the purchasing authority that we could submit invoices for any additional services to individuals if we could clearly document that these services had been provided in excess of 100% of the units allocated for these individuals in the contract. The state auditors reviewed our documentation of service provision and are not challenging that the additional services were in fact provided to these individuals by SMEC. Authorization for services forms for these additional service units were signed by the DDS*
area director, and the regional DDS office instructed us to use the LUSA payment voucher forms to submit the invoices for the additional authorized service units.

SMEC does not determine the method of invoice submission for any of our state contracts or services. It is the purchasing agency that makes that determination and directs the vendor as to the type of invoice to submit for particular services rendered. If the method used by the purchasing authority to pay us for these services was not in accordance with their own internal controls or approved methods, it does not change the fact that the services were provided, service authorizations were signed and SMEC incurred the costs associated with providing these services. DDS concedes in its response to the SAO that these extra units should have been included in the contracts at the start of the fiscal year and that it "will make a stronger effort to continue following (their) internal controls with the use of Limited Use Services Agreements and will be vigilant in monitoring the duration and appropriate use of LUSA’s in the future.” To this end, SMEC will work with DDS to ensure that proper contracting and invoicing methods are followed with regard to all services provided by our agency, however we strongly oppose the recommendation that DDS seek reimbursement of these funds as the services were provided and properly documented by SMEC and approved by DDS officials therefore the collaborative should not be penalized for using the invoicing format directed by the state purchasing agency.

Auditor’s Reply

We do not dispute that SMEC provided additional services to the consumers in question or suggest that such services should not have been provided. However, as stated in our report, according to DDS’s policies, the funding provided under these LUSA contracts was to be used by SMEC to purchase unanticipated intermittent, as-needed services for developmentally disabled individuals needing limited-time placements. Based on our review of the SMEC’s records, during fiscal years 2009 and 2010, SMEC received inappropriate payments totaling $53,063 in LUSA funding, $21,721 of which was for services that were not properly authorized and all of which was not used for the intended purposes of LUSA funding. Rather, according to SMEC’s records, these funds were used to retroactively pay for additional services to consumers who were already receiving services under SMEC’s state contracts for service such as allowing consumers to spend additional time in a program over and above what is contractually called for. Consequently, we believe that these additional payments to SMEC were unnecessary, unallowable, and inappropriate.

Although, as SMEC asserts, the collaborative may have been well intentioned in providing these additional services, if SMEC determined that it wanted to provide these additional services to the consumers in these programs, it should have appropriately negotiated funding for these additional services either in the original contracts that funded these programs or through properly executed contract amendments and not attempt to recover the cost of these services
through LUSA contracts, which is clearly an inappropriate use of these funds. DDS agrees with our position on this matter and in fact provided its opinion on this matter to us during our audit by stating, “Our review of the FY10 LUSA agreements of $15,411.50 for employment supports and $6,308.96 for individual supports for identified SMEC individuals has concluded that, in agreement with your assertion, these extra units should have been included in each respective contract with SMEC at the beginning of the fiscal year.”

Also, contrary to SMEC’s assertion in its response, SMEC does “determine the method of invoice submission” for their state contracts. In this regard, SMEC is the entity that prepares the invoice for these services and is responsible for ensuring that the amounts billed for services are accurate and appropriate and were provided in accordance with contractual terms, laws, and regulations. Invoice submissions for all of SMEC’s services are prepared by SMEC staff on a standard Commonwealth of Massachusetts Payment Voucher Input Form (PV), which requires SMEC’s Executive Director to sign a Vendor’s Certification that states, “I certify that the goods were shipped or the services as set forth below.” Moreover, this PV requires a signature by the preparer (SMEC) that obligates them to “hereby certify under the penalties of perjury that all laws of the Commonwealth governing disbursements of public funds and the regulation thereof have been complied with and observed.” Consequently, regardless of SMEC’s assertion that the purchasing agency directs the vendor as to what type of bill to submit, SMEC is clearly responsible for ensuring that all the invoices it submits for program services are in compliance with all applicable laws, rules, regulations, and terms and conditions of state contracts.

Regardless of any conversations that may have taken place between DDS and SMEC, the fact is that during fiscal years 2009 and 2010, SMEC received inappropriate payments totaling $53,063 in LUSA funding. Because the billings for these expenses in many cases were not properly authorized; covered services in excess of what SMEC was required to provide under its state contracts; and were not used for their intended purposes of providing as-needed services for developmentally disabled individuals needing limited-time placements, we believe that these additional payments to SMEC were unnecessary, unallowable, and inappropriate.
APPENDIX A

SMEC Member Districts

Acushnet

Dartmouth

Fairhaven

Marion

Mattapoisett

New Bedford

Rochester

Old Rochester Regional
APPENDIX B

Programs Operated by SMEC

1. LOCAL EDUCATION AUTHORITY (LEA) SERVICE COMPONENT

LEA services are offered to students with special needs ages three to 21. The LEA offers the following locally based and locally directed programs and services, which are designed to supplement the special education resources of member districts:

- **Early Childhood Program**: This program is designed to serve students ages three through six years with social/emotional, communication, and/or developmental disabilities. (Located at the Acushnet Elementary School, 800 Middle Road, Acushnet.)

- **Primary Language Program**: This program supports students in elementary grades with a variety of learning needs, including autism spectrum disorders and cognitive-, sensory-, and language-based differences with a 3:1 student staff ratio. A licensed special education teacher, along with experienced paraprofessionals, speech language pathologists, occupational therapists, and an autism consultant, work together to address the student's needs. (Located at the East Fairhaven Elementary School, 2 New Boston Road, Fairhaven.)

- **Integrated Services Program**: This program supports students in grades five through eight with a variety of learning needs, including autism spectrum disorders and cognitive-, sensory-, and language-based differences with a 3:1 student staff ratio. A licensed special education teacher, along with experienced paraprofessionals, speech language pathologists, occupational therapists, and an autism consultant, work together to address the student's needs. (Located at the Ford Middle School, 708 Middle Road, Acushnet.)

- **Specialized Elementary Educational Development (SEED) Program**: This program is designed to meet the academic, behavioral, and social/emotional needs of students in grades one through four, focusing on improving social/emotional skills and self-esteem. (Located at the Sippican Elementary School, 16 Spring Street, Marion.)

- **Alternative Learning Classroom (ALC) Program**: This program services the needs of middle school students with social/emotional disabilities, Attention Deficit Hyperactivity Disorder, specific learning disabilities, and/or behavioral issues. (Located at the Ford Middle School, 708 Middle Road, Acushnet.)

- **Transitional Services Program**: This program is designed to facilitate the transition of students ages 14 through 21 years from school to work and from home to the community. This program provides school districts with an array of services and resources for students with developmental disabilities to prepare and promote their movement from school to post-school activities. (Located at 12 Welby Road, New Bedford and 271 Alden Road, Fairhaven.)
2. **SUPPORTING ADULTS FOR INCLUSIVE LIVING (SAIL) SERVICE COMPONENT**

Clients referred to SAIL have been identified as having required service needs in one or more of the following areas: individual support, employment support, and residential support. SAIL provides clients with instruction in functional life skills, job skills, community experiences, and independent living skills to enable persons with disabilities to secure gainful employment, participate in their community, and live as independently as possible as adults. The adult services at SMEC include the following: Community Inclusion Program, Evening Program, Life Skills Training Apartment, Employment Program, Job Development, Residential Program, and Case Management Services. This component is located at 693 Purchase Street, New Bedford.

3. **ADULT DAY HEALTH (ADH) SERVICE COMPONENT**

This service component began operating in August 2009 and serves individuals ages 22 years and older who have been found to be eligible for Medicaid-funded ADH services. The program offers age-appropriate activities throughout the day as well as recreational activities and transportation services for participants in the program.