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NO. 2001-4429-3

INDEPENDENT STATE AUDITOR'S REPORT ON CERTAIN ACTIVITIES OF TURNING POINT, INC.

OFFICIAL AUDIT REPORT
DECEMBER 12, 2002

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Turning Point, Inc. (TPI), located in Newburyport, Massachusetts, was incorporated on May 21, 1971 as a private, nonprofit, community-based human services agency. Since its inception, TPI has provided human services programs in Newburyport and surrounding communities. Today, these programs include support services for individuals with intellectual disabilities or illnesses; family services for victims of domestic abuse; counseling services for substance abusers and their families; and education services.

The scope of our audit included various administrative and fiscal activities of TPI from July 1, 1999 to June 30, 2001. The audit had the following objectives: (1) to determine whether TPI has established and implemented adequate and effective management controls, and (2) to assess TPI'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.

Our audit identified the following: unallowable costs totaling $222,618; noncompliance with procurement requirements regarding $279,657 in contracted goods and services; needed improvements for the management and safeguarding of assets; unallowable salary-reserve expenses totaling $38,075; undocumented accounting adjustments totaling $42,500; improper allocation of indirect expenses totaling $964,732; and unallowable administrative expenses totaling $9,959.

To operate two of its programs, during fiscal years 2000 and 2001 TPI billed and received $976,708 in payments from the Department of Mental Retardation and the Department of Social Services. Our review of these billings identified at least $222,618 in duplicative, undocumented, or non-program-related expenditures. According to state regulations, such expenses are unallowable and nonreimbursable under state contracts.

Our review determined that TPI had not established adequate written policies and procedures for the procurement of goods and services. We found a number of resulting deficiencies concerning $279,657 in goods and services that TPI procured between July 1, 1999 and May 31, 2001. Specifically, TPI was unable to document that it used a competitive procurement process; some of its consultant contracts and vendor invoices did not clearly delineate the scope of services to be performed and the actual services provided; and TPI did not maintain sufficient documentation to demonstrate its need for the services and the qualifications of the consultants.

Consequently, there is inadequate assurance that TPI obtained the best possible goods and services at the lowest possible cost, or that the $279,657 in expenses that consultants billed under the contracts we reviewed were actually provided in full.

We found that TPI had inadequate controls over its inventory of fixed assets (worth $2,398,005 as of June 30, 2000). Specifically, TPI did not have written inventory policies and procedures; did not identify the source of funds (state, federal, or private) used to purchase each asset; and did not conduct regular physical inventories of its assets at least every two years, contrary to federal regulations. As a result, the Commonwealth cannot be assured that TPI's inventory of furnishings and equipment was properly safeguarded against loss, theft, and misuse. We also found that during the fiscal year ended June 30, 2000, TPI expensed the purchase of $33,649 in fixed assets that according to state regulations should have been depreciated over several years. Accordingly, TPI overcharged its state contract $24,791 ($33,649 in expenses, less $8,858 in allowable depreciation) during that fiscal year.

During fiscal years 2000 and 2001, TPI received $196,909 in funding under contracts with two state agencies, the Department of Mental Health and the Department of Mental Retardation, to provide salary increases to the lowest-paid members of its staff. However, TPI could not provide documentation to substantiate that $38,075 of these funds were distributed in accordance with the terms and conditions of the contracts. As a result, TPI owes $38,075 to the Commonwealth.

We determined that TPI had not established adequate controls over the approval and documentation of changes to its accounting records. We found that during fiscal year 2000 TPI made at least two adjustments (charges) , totaling $42,500, to two of its programs for salary expenses; however, TPI had no documentation substantiating that the expenses were incurred in those programs. According to state regulations, such undocumented expenses are unallowable and nonreimbursable under state contracts.

Our audit determined that TPI had not established adequate policies and procedures for the allocation of indirect costs. We found several resulting problems regarding TPI's allocation of indirect costs during fiscal year 2000, including its using an allocation method not consistent with OSD guidelines and inappropriately charging to its state contracts unallowable direct costs as indirect expenses. We also noted instances of indirect administrative expenses being charged to programs with budgets that did not allow for such charges. As a result of these deficiencies, TPI incorrectly allocated administrative costs totaling $964,732 to its state and federal programs.

INTRODUCTION

Background

Turning Point, Inc. (TPI), located in Newburyport, Massachusetts, was incorporated on May 21, 1971 as a private, nonprofit, community-based human-services agency. Since its inception, TPI has provided human-services programs in Newburyport and surrounding communities. Today, these programs include support services for individuals with intellectual disabilities or illnesses; family services for victims of domestic abuse; counseling services for substance abusers and their families; and education services.

During the audit period, TPI received funding from various state, federal, local, and private sources, as detailed in the following table:

Turning Point, Inc.
Revenue Sources and Amounts
Fiscal Years 2000 and 2001

Revenue Source	Fiscal Year 2000	Fiscal Year 2001
Department of Mental Retardation	$5,546,770	$5,601,306
Department of Mental Health	996,009	374,315
Department of Social Services	492,104	429,604
Department of Youth Services	15,830	0
Massachusetts Rehabilitation Commission	147,340	153,066
Department of Education	51,613	21,243
City of Lawrence	130,126	25,327
Non-Massachusetts Sources/Local Governments	86,707	22,350
Federal Government	325,411	338,861
Client Fees and Resources	502,050	433,706
Donations	15,390	23,040
Other Unrestricted Revenue	144,642	76,920
Total	$8,453,992	$7,499,738

Audit Scope, Objectives, and Methodology

The scope of our audit included various administrative and fiscal activities of TPI from July 1, 1999 to June 30, 2001. However, in some instances, we found it necessary to extend our examination to prior and subsequent periods. Our audit was conducted in accordance with applicable generally accepted government auditing standards for performance audits and included audit procedures and tests considered necessary to meet these standards.

The following were our audit objectives:

1. To determine whether TPI has established and implemented adequate and effective management controls, including the following:

    - Policies and procedures to ensure internal administrative and accounting controls over revenues, expenses, and fixed assets

    - Resource use consistent with laws and regulations

    - Safeguarding and efficient use of resources

    - Process for planning, organizing, directing, and controlling program operations

2. An assessment of TPI'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

To achieve our audit objectives, we first assessed TPI's system of management controls over its operations. The purpose of this assessment was to determine management's attitude, the control environment, and the flow of transactions through TPI's accounting system. We used this assessment in planning and performing our audit tests. We then held discussions with TPI officials and reviewed organizational charts, internal policies and procedures, and all applicable laws, rules, and regulations. Finally, we examined TPI's financial statements, budgets, cost reports, invoices, and other pertinent financial records to determine whether expenses incurred under TPI's state contracts were reasonable, allowable, allocable, properly authorized and recorded, and in compliance with all applicable laws, rules, and regulations.

Our review was not conducted to form an opinion on TPI's financial statements. We also did not assess the overall quality and appropriateness of program services provided by TPI under its state-funded contracts. Rather, our audit intended to report findings and form conclusions on the extent of TPI's compliance with applicable laws, rules, and regulations; determine the adequacy of TPI's financial management; and identify specific processes, methods, and internal controls that could be made more efficient and effective.

AUDIT RESULTS

1. UNALLOWABLE COSTS TOTALING $222,618 CHARGED TO STATE CONTRACTS

To operate two of its programs, during fiscal years 2000 and 2001 Turning Point, Inc. (TPI) billed and received $976,708 in payments from the Department of Mental Retardation (DMR) and the Department of Social Services (DSS). Our review of these billings identified at least $222,618 in expenditures that were duplicative, undocumented, or non-program-related. According to state regulations, such expenses are unallowable and nonreimbursable under state contracts. The cost-reimbursement contracts that those state agencies awarded to TPI to provide a variety of services in two programs were as follows:

Turning Point, Inc.
Selected Cost-Reimbursement Contracts
Fiscal Years 2000 and 2001

Fiscal Year	State Agency	Name of Program	Maximum Obligation
2000	Department of Mental Retardation	Urban Youth Collaborative	$ 55,000
2000	Department of Social Services	Safe and Stable Living	492,104
	Fiscal Year 2000 Total		547,104
2001	Department of Social Services	Safe and Stable Living	32,500
2001	Department of Social Services	Safe and Stable Living	397,104
	Fiscal Year 2001 Total		429,604
	Total		$976,708

The state's Operational Services Division (OSD) is the agency responsible for regulating and overseeing the activities of contracted human-services providers such as TPI, and 808 Code of Massachusetts Regulations (CMR) 1.00 sets forth contract-compliance, financial-reporting, and auditing requirements with which all contracted human-services organizations must comply. Paragraphs 12 and 26 of Section 1.05 of these regulations identify the following costs as 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) <u>Undocumented Expenses</u>. Costs which are not adequately documented in the light of the American Institute of Certified Public Accountants statements on auditing standards for evidential matters.*

OSD defines a cost-reimbursement contract as follows:

> *A payment arrangement under which the purchasing agency reimburses the provider for budgeted costs actually incurred in rendering the services specified in the agreement, up to the stated maximum obligation.*

Our audit reviewed the internal controls that TPI had established over its administration of cost-reimbursement contracts and found them to be inadequate. Specifically, the TPI staff does not perform reconciliations or analyses to ensure that all costs TPI is billed for under cost-reimbursement contracts were actually incurred and accurately recorded in the agency's financial records.

We also found journal entries, particularly relating to payroll, that TPI charged to its programs but which lacked detailed analyses to explain or provide a rationale for the adjustments. For example, on January 26, 2000, TPI made an adjusting entry of $752 that made the actual program costs equal to budgeted program costs in its Environmental Science Program. However, TPI officials could not provide documentation to substantiate the reasonableness of this adjustment. TPI's Vice-President of Finance stated that the agency routinely makes adjusting journal entries so that payroll expenses billed to the Commonwealth agree with each contract's budgeted amount and that, consequently, the agency's financial records did not necessarily reflect actual program costs.

Based on these control deficiencies, we reviewed TPI's documentation of $976,708 in expenses ($547,104 and $429,604 in fiscal years 2000 and 2001, respectively) that it charged against the cost-reimbursement contracts that funded the two programs. Our review found that $222,618 (23%) of those expenses were duplicative, inadequately documented, or not clearly related to the social-service purposes of TPI's state-funded programs. The following table summarizes those nonreimbursable expenses:

Turning Point, Inc.
Unallowable Costs on Cost-Reimbursement Contracts
July 1, 1999 through June 30, 2001

State Agency	Inadequately Documented	Non-Program-Related	Duplicative	Total
Department of Mental Retardation	$ 20,605	$1,758	$ 1,005	$ 23,368
Department of Social Services	184,699	0	14,551	199,250
Total	$205,304	$1,758	$15,556	$222,618

Inadequately documented expenses included those for which TPI had no invoice or substantiation that the expense was incurred, properly authorized, and allowable and allocable under the contracts to which they were charged. The non-program-related costs were for personal items, such as T-shirts, staff meals, and staff gifts, that did not appear related to the contracts to which they were charged. The duplicative charges were for expenses that had already been reimbursed to TPI. For example, TPI billed for and received under its state contracts the full salary and related fringe-benefit costs of its Vice-President of Operations. However, the agency also billed its Safe and Stable Living Program cost-reimbursement contract with DSS an additional $14,551 for a five-month period for the services of the Vice-President of Operations. TPI contends that this person was simultaneously functioning as a "supervising professional" in the program. Since the salary was already being fully reimbursed to TPI, the $14,551 represents a double billing. Moreover, according to guidelines published by OSD, a "supervising professional" must meet the following qualifications:

> *A credentialed professional (Physician, Psychiatrist, Social Worker, Nurse, etc.) whose primary responsibility is the supervision of fellow credentialed professionals in the daily performance of their programmatic functions….*

Our review of the Vice-President of Operation's personnel file revealed that the Vice-President did not meet the qualifications for this position.

TPI representatives stated that state officials told them that cost-reimbursement billings should be at budgeted amounts and that revenue and expenses should equal the amounts budgeted in each contract. Consequently, the TPI representatives stated, the agency made adjusting entries at the end of the year to make sure budgeted revenues and expenses in each program were equal. However, TPI officials did not provide documentation to substantiate that state officials told them to account for program expenses in this manner. Regarding the undocumented and non-program-related costs, TPI officials stated that the agency's inability to prepare and maintain detailed records on program costs was the consequence of high staff turnover and untrained staff. TPI officials maintained that the audit firm they hire to conduct annual audits—rather than TPI management—was responsible for ensuring the adequacy of TPI's financial records, but added that they have begun to take measures to address our concerns.

Recommendation

To address our concerns, TPI's principal state purchasing agency, DMR, should recover from TPI the $222,618 in duplicative, undocumented, and non-program-related costs charged against its state contracts during the audit period. Furthermore, DMR should conduct its own review of expenses that TPI charged against the cost-reimbursement contracts during prior and subsequent periods. Based on that review, DMR should recover from TPI any additional funds it deems appropriate. Also, TPI should establish and implement better controls over the administration of cost-reimbursement contracts. At a minimum, such policies and procedures should require that all program expenses be adequately documented and that TPI staff conduct independent reviews to ensure that expenses are reasonable, allowable, and allocable to their respective programs.

Auditee's Response

In response to this audit result, TPI provided comments, which are excerpted below:

> *[As of early 2001,] Turning Point now follows the following procedures:*
>
> - *Turning Point bills for cost-reimbursement program expenses based on copies of the actual bills (including ADP payroll sheets) incurred during the billing month;*
> - *For each month, there are checks in place to ensure that all billable expenses are recorded in the financial records;*
> - *Administrative costs are distributed according to the modified direct allocation method per the Uniform Financial Report regulations….*

In regards to the $55,000 Department of Mental Retardation (DMR) Urban Youth Collaborative contract, your staff disallowed $20,589.59 of journal entries that were made to the Urban Youth Collaborative program during FY 2000. They may have been misinterpreted due to lack of detail. For instance,

A. $4,322.15 of these entries was for month-end accruals of payroll that are made to all programs that are reversed in the following month.... Since Turning Point is on a two-week payroll schedule, often times, a payroll period will cover days that fall within two different months. Specifically, this adjustment was for June 2000 payroll that was paid in July.

B. $3,215.93 was a journal entry and $4,456.60 was an adjustment as direct care line items that were made in June 2000 to accurately reflect the appropriate responsibility of the staff for the summer-only Urban Youth Collaborative program....

C. $1,000 was adjusted at year-end from administration to fringe benefits to cover the workers' compensation costs assigned to this program.

D. $1,500 was adjusted from administrative expense to program charges to reflect the portion of the business office that was used by the Collaborative's staff throughout the program.

E. The administrative cost of $6,665 allocated to this program was a budget number versus an actual number. If this expense was allocated on the "modified direct method," a state approved plan that Turning Point later adopted, this allocated expense would actually be $5,861.28 (a difference of $803.72).

F. There is a remaining $425.74 which we cannot address because we did not have sufficient back-up from the auditors to identify what the costs were....

The auditors stated that some of these [non-program-related] costs [$1,758] were for staff meals for $819 and staff gifts $200 when they were, in fact, to support the student interns that were staffing the program. The student interns were provided meals during their training and were given coffee mugs for their participation. These are allowable under the contract. The T-shirt expense of $739 that the auditors questioned was for T-shirts are considered to be uniforms for the students for the duration of the program. In fact, these T-shirts are worn by the 200 participants from 10 different agencies statewide that were participating in the Urban Youth Collaborative program in an annual meeting at the State House as well as throughout the program....

As to the line item of $1,005 of "duplicative costs," this cost was listed on the back-up provided the auditors as a variance and, at this point, Turning Point does not have enough information to explore this....

For the Department of Social Service contracts for the Safe and Stable Living Program, the audit objected to $184,699 in costs charged to the program as being inadequately documented. We do have documentation to support the following:

a. $8,290.72 is an allowable advertising expense.... These costs are for an advertising agency that placed a Boston Globe ad for a supervisor for this program.

b. $2,000 was an allocation cost for the Program's share of the centrally charged expenses that cover the supplies and maintenance for their copier and printers.

c. $5,000 was a rent payment adjustment to the landlord of the property where the Program resides.

d. As to payroll adjustments, the following were made:

- *An adjusting entry was made for $10,000 for the time that a substance abuse counselor spent with the clients in the Safe and Stable Living Program. The adjustment was required because the parameters of the program changed mid-contract from victims of domestic violence to victims of domestic violence AND substance abuse.*

- *The adjustment of $5,040 for a Supervising Professional was because of a promotion, which required a change from one line item to another....*

- *In reviewing the adjustment of $10,775 in payroll taxes, the amount adjusted should have actually been $1,382.00. The adjustment of $13,462 in fringe benefits ($6434 in workers' compensation and $7,119 in health insurance) should actually have been $6,570.98. There is $7,952.98 in allowable adjustments, therefore the total unallowable of $24,237.00 ($10,775 plus $13,462) should be reduced to $16,284.02. Note that the adjustments were made at the year end due to a change in single source allocation to a centralized system.*

e. In the back up papers provided by the auditors, there was $64,654 in administrative costs that was being challenged. At the time this charge was allocated, Turning Point was not using the modified direct method; had this method been used, the actual amount should have been $49,943.49. Therefore, the amount unallowable is actually $14,710.51....

Of the $14,551 that according to the audit represents a double billing, the back up documentation suggests that $7,400 was a double billing. Since these amounts do not match up accordingly, we are unable to address this discrepancy.

Auditor's Reply

As stated in our report, during the audit period the internal controls TPI had established over its administration of cost reimbursement contracts were inadequate. In its response, TPI asserts that it has taken measures to improve the controls in this area. However, we cannot substantively comment on this assertion, since those controls were not fully implemented during the time of our audit.

In its response, TPI provides explanations regarding $23,368 in expenses that it charged against its DMR contract that funded its Urban Youth Collaborative Program and suggests that the audit team may have "misinterpreted [journal entries] due to lack of detail." As stated in our report, during our audit we requested from TPI officials all documentation the agency was maintaining regarding these expenses. Based on the documentation TPI provided, we found that $20,605 of these expenses was inadequately documented, $1,758 was non-program-related, and $1,005 was duplicative. In fact, during our audit we discussed these expenses with the TPI's Vice-President of Finance, and she acknowledged that there was no documentation to substantiate these expenses. Although TPI attempts to provide explanations in its response regarding the nature of these expenses, to date it has been unable to provide documentation to substantiate that they are reasonable and allowable.

Regarding the $1,758 in non-program-related expenses charged by TPI to its DMR contract, TPI in its response contends that this was for staff meals and T-shirts. However, the budget for this program did not provide for staff meals; if in fact these funds were expended by TPI for that purpose, they are clearly unallowable because they were not budgeted. Regarding the purchase of 228 T-shirts, during our audit TPI's Vice-President of Finance did not state that they were used by staff as uniforms in this program. Rather, the Vice-President stated that although some of the T-shirts were used in the program, the majority were sold. It should be noted that during our audit we did not see any members of the program staff wearing the T-shirts.

Regarding the $184,699 in unallowable costs that TPI billed against its contracts with DSS, although TPI in its response provides explanations for the expense allocations and adjustments, during our audit it did not provide documentation to substantiate that these amounts were reasonable and allowable. If TPI had explanations and adequate documentation to substantiate these expenses, they should have provided them to the audit team during the audit fieldwork. Without such documentation, the reasonableness of the assertions in TPI's response regarding these expenses cannot be determined.

Finally, in its response TPI states that it can find documentation for only $7,400 of the $14,551 that we found represented double billings by TPI against its state contracts. We would like to point out to the agency that this $14,551 was for two fiscal years, $7,400 for fiscal year 2000 and $7,151 for fiscal year 2001. This matter has been fully discussed with TPI officials on numerous occasions and we question why TPI cannot find the documentation to comment on the $7,151 in fiscal year 2001 expenses in question.

2. NONCOMPLIANCE WITH PROCUREMENT REQUIREMENTS REGARDING $279,657 IN CONTRACTED GOODS AND SERVICES

Our review determined that TPI had not established adequate written policies and procedures for the procurement of goods and services. We found a number of resulting deficiencies regarding $279,657 in goods and services that TPI procured between July 1, 1999 and May 31, 2001. Specifically, TPI was unable to document that it used a competitive procurement process; certain consultant contracts and vendor invoices did not clearly delineate the scope of services to be performed and the actual services provided; and TPI did not maintain sufficient documentation to demonstrate its need for the procured services and the qualifications of the consultants. Consequently, there is inadequate assurance that TPI obtained the best goods and services at the lowest cost or that the $279,657 in expenses that consultants billed under the contracts we reviewed were actually provided in full.

The state's Executive Office for Administration and Finance, the Office of the State Comptroller, and OSD have jointly promulgated the "Commonwealth Terms and Conditions for Human and Social Services" (General Contract Conditions), with which all contracted human-services providers, such as TPI, must comply. Regarding the procurement of goods, services, and subcontracts, the General Contract Conditions state, in part:

> *The provider shall establish and maintain written procedures for the procurement of goods, services (including personal services) and subcontracts.*

Furthermore, according to federal guidelines, agencies that receive federal funds, as TPI does, must use a competitive-bidding process when procuring goods and services. Specifically, Office of Management and Budget (OMB) Circular A-110, Appendix A, Subpart B, Section 43, states, in part:

> *All procurement transactions shall be conducted in a manner to provide, to the maximum extent practical, open and free competition....*

Additionally, Section 39(b), Attachment B, of OMB Circular A-122, titled "Cost Principles for Non-Profit Organizations," with which TPI must comply, states, in part:

> *In determining the allowability of costs in a particular case, no single factor or any special combination of factors is necessarily determinative. However, the following factors are relevant:*
>
> - *The nature and scope of the service rendered in relation to the service required.*
> - *The necessity of contracting for the service, considering the organization's capability in the particular area....*
> - *Whether the service can be performed more economically by direct employment rather than contracting.*
> - *The qualifications of the individual or concern rendering the service and the customary fees charged....*
> - *Adequacy of the contractual agreement for the service (e.g., description of the service, estimate of time required, rate of compensation, and termination provisions)....*

From July 1, 1999 to May 31, 2001, TPI procured goods and services totaling $279,657 for management, auditing/accounting, and other miscellaneous goods and services, and it charged the expenses against its state contracts. The following table summarizes those costs:

Turning Point, Inc.
Summary of Procured Goods and Services
July 1, 1999 through May 31, 2001

Management and Organizational Consulting	$180,201
Accounting	60,915
Job Coaching	2,490
Copiers and Computers	33,650
Miscellaneous (e.g., Employee Handbooks and Press Releases)	2,401
Total	$279,657

We reviewed the documentation TPI was maintaining regarding the procurement and use of these goods and services and noted several deficiencies.

Contrary to the state's General Contract Conditions and the requirements of OMB Circular A-110, TPI could not provide documentation to substantiate that it used a competitive-bidding process to procure these goods and services. TPI's Vice-President of Operations acknowledged that only one of these services was procured through competitive bidding. Accordingly, there is inadequate assurance that TPI obtained the best services at the lowest possible cost.

Also, we reviewed the contract files of the management, organizational, and job-coaching consultants whom TPI hired for $182,691 (65.3% of the $279,657 in expenses that we reviewed). In all cases, the consultants' invoices lacked detailed descriptions of the services rendered and included only the date and number of hours for each consultation. Moreover, none of the consultant files contained resumes disclosing qualifications. As a result, neither TPI nor the Commonwealth can be assured that the consultants' services were necessary or that the consultants were qualified to provide the services.

TPI officials stated that they were aware of the need to establish a written procurement policy and were in fact developing such a policy. However, they did not comment on the lack of documentation in the consultant contract files.

Recommendation

To address our concerns, TPI should establish written policies and procedures that require (1) competitive procurement procedures be used for the purchase of goods and services, and

(2) the files of contractors and consultants include sufficient documentation, such as resumes, to substantiate that they are qualified. TPI should also ensure that all contractors submit detailed invoices to substantiate the services or products that they have provided.

Auditee's Response

In response to this audit result, TPI provided comments, which are excerpted below:

> *In the draft of the audit report, it states that your staff's review determined that Turning Point had not established adequate written policies and procedures for the procurement of goods and services. This statement is correct, since prior to their recommendations only construction projects, landscaping, and vehicles went out to bid. During the audit, when these points were brought to our attention, we immediately rectified the situation by:*
>
> - *Developing a written policy for procuring goods and services in accordance with State recommendations.... Your staff...was instrumental in helping us to develop this policy.*
> - *Changing our bid threshold to $5,000....*
> - *We have increased our requirements for detail on invoices.*
> - *We now require all consultants sign a written contract...and provide a resume of their qualifications. In addition, we have established files containing the signed contracts and resumes contained within our Human Resources department....*
>
> *In fact, it is our [competitive bidding-related] philosophy to follow the guidelines as laid out in* ***801 CMR: Executive Office for Administration and Finance, section 21.02: Definitions,*** *from the "Commonwealth Terms and Conditions for Human and Social Services" (General Contract Conditions) of which states under Best Value**:***
>
> > ***Best Value:*** *The result of common sense Procurement decision-making consistent with the States Procurement Principles, which are to balance and support the achievement of: required outcomes, best quality economic value, timely performance, minimizing the burdens on administrative resources, relationships, encouraging competition, encouraging the continuing participation of quality Contractors and supporting State and Department Procurement planning and implementation....*
>
> *Based on that, please consider the following...*
>
> *The fees of $180,201 are for consultants that are either unique in their field and therefore are the only choice for "best value" or they have been working with Turning Point for long periods of time and therefore once again are considered "best value."*

For instance, Turning Point was awarded a contract to develop and implement a highly structured program to de-institutionalize a specific sole source client. The awarding agency, the Department of Mental Retardation, suggested that Turning Point use [name of individual] to design the program because of his unique capabilities, as the only forensic mental health expert in the state of Massachusetts…. There is no competition for his services. The total for his services for the period in question is $77,777.50.

This same argument holds true for the other two consultants in this category…. Their services total $102,423.47, the remainder of the $180,201….

Turning Point uses the same policy in regards to the questioned accounting costs. The two firms/consultants in question have been with Turning Point for over 15 years and so we believe continuing to work with them is "Best Value" as they intimately know Turning Point's accounting history….

Under Chapter 30B, purchases under $5,000 require only sound business practice and not formal competition. By this reasoning, the amount spent on job coaching ($2,490) and miscellaneous ($2,401) should be eliminated from the list of procured goods and services….

As to the remaining $33,650 [for copiers and computers], we did not receive sufficient back-up documentation to understand the true nature of the auditors' questioning of these costs. Upon receipt of that, we would be happy to provide a response….

Auditor's Reply

As stated in our report, during our audit we found that TPI had not established adequate written policies and procedures for the procurement of goods and services. In its response, TPI acknowledges this and the fact that it did not utilize competitive procurement procedures relative to the $279,657 in question. Rather, the agency contends that it used "best value" as defined by 801 CMR 21.02 as the basis for these procurements. However, 801 CMR 21.02, titled "Definitions," merely defines the term best value in the context of these regulations—which apply to procurements by state agencies, not contracted service providers such as TPI. That this regulation defines "best value" does not mitigate or eliminate the need for contracted service providers such as TPI to comply with the requirements of OMB Circular A-110 or the state's General Contract Conditions, which require providers such as TPI to establish and maintain such procurement procedures.

During our audit, TPI could not provide documentation to substantiate that it had complied with competitive-procurement requirements or the state's "best value" concept when making procurements.

Regarding the use of consultants, DMR suggested, but did not insist, that TPI use certain consultants. However, DMR's suggestions do not release TPI from its responsibility to comply with applicable regulatory and contractual obligations regarding the use of competitive-procurement procedures. Further, contrary to what TPI asserts in its response, the agency could not provide documentation to substantiate that "no competition" existed for the services it sought.

Regarding the procurement of accounting services, having the same consultant in this position for 15 years is not a reason to noncompetitively procure these services. On the contrary, seeking competitive bids for these services would better ensure that TPI was being charged an equitable price for these services.

Regarding the $2,490 that TPI spent on job coaching and $2,401 for miscellaneous goods and services, TPI contends that because they fell below the $5,000 required bid limit of Chapter 30B of the General Laws, the agency did not have to competitively procure these services. Clearly, however, the state's General Contract Conditions and OMB Circulars A-110 and A-122 require competitive procurements, and Chapter 30B does not apply in this situation.

3. IMPROVEMENTS NEEDED IN THE MANAGEMENT AND SAFEGUARDING OF FIXED ASSETS TOTALING $2,398,005

We found that TPI had inadequate controls over its inventory of fixed assets (worth $2,398,005 as of June 30, 2000). Specifically, TPI did not have written inventory policies and procedures; did not identify the source of funds (state, federal, or private) used to purchase each asset; and did not conduct regular physical inventories of its assets at least every two years, as required by federal regulation. As a result, the Commonwealth cannot be assured that TPI's inventory of furnishings and equipment was properly safeguarded against loss, theft, and misuse.

We also found that during the fiscal year ended June 30, 2000, TPI expensed the purchase of $33,649 in fixed assets that according to state regulations should have been depreciated over several years. Accordingly, TPI overcharged its state contracts $24,791 ($33,649 in expenses, less $8,858 in allowable depreciation) during that fiscal year.

According to 808 CMR 1.04(5), contracted service providers who purchase fixed assets with state funds must adhere to certain requirements:

> *Inventory of Equipment and Furnishings and Other Goods. Any Contractor in possession of Capital Items, as defined in 808 CMR 1.02 shall label, maintain and keep on file a written inventory of the property in accordance with generally accepted accounting principles.*

Furthermore, Appendix A, Subpart C, Section 34(f)(3), of OMB Circular A-110, with which TPI must comply, states:

> *A physical inventory of equipment shall be taken and the results reconciled with the equipment records at least once every two years. Any differences between quantities determined by the physical inspection and those shown in the accounting records shall be investigated to determine the causes of the difference. The recipient shall, in connection with the inventory, verify the existence, current utilization, and continued need for the equipment.*

During our audit, we attempted to locate a sample of TPI's furnishings and equipment to verify that they were properly tagged and accurately included in TPI's inventory listings. In the process, our audit revealed the following deficiencies in TPI's controls over its inventory of furnishings and equipment:

- Although TPI maintained a manual list of fixed assets, including the acquisition cost, depreciation method, and useful life, it did not maintain a detailed inventory listing of each item's description, serial or model number, location, and the source of funds used to purchase it.

- TPI does not have a policy requiring that a physical inventory of its fixed assets be conducted at least once every two years. (TPI officials stated that they had not taken a physical inventory for at least five to six years.)

State regulations 808 CMR 1.00 also require that certain furnishing and equipment or capital items be depreciated over a specified time period rather than expensed against state contracts in the year of purchase. The 808 CMR 1.05(4) identifies the following as a nonreimbursable cost:

> *Current Expensing of Capital Items. All costs attributable to the current expensing of a capital item.*

The 808 CMR 1.02 defines a capital item as follows:

> *(a) an asset or group of assets of nonexpendable personal property having a useful life of more than one year and an acquisition cost which equals or exceeds the capitalization level established and certified by the Contractor in accordance with generally accepted accounting principles for financial statement purposes; or*
>
> *(b) a repair, betterment or improvement or a group of repairs, betterments or improvements of non-movable assets which costs more than $500 in aggregate and which adds to the permanent value of an asset or prolongs its useful life for more than one year.*

Our audit reviewed TPI's records of its fixed assets and found at least 11 fixed-asset items that should have been depreciated in accordance with OSD guidelines rather than expensed in fiscal year 2000 at their acquisition cost of $33,649 against state contracts. The result was an unallowable expense of $24,791, as indicated in the following table:

Turning Point, Inc.
Summary of Unallowable Capital Expenses
Fiscal Year 2000

Item	Amount Expensed	Allowable Expense*	Excessive Expense
Computers	$15,964	$5,321	$10,643
Leasehold Improvements	13,685	2,737	10,948
Architectural Fees	4,000	800	3,200
Total	$33,649	$8,858	$24,791

* According to OSD guidelines, computers are to be depreciated in equal amounts over a five-year period, whereas the others items in the sample are to be depreciated in equal amounts over a three-year period.

Regarding these matters, TPI officials stated that they were not aware of the federal requirements that a physical inventory and reconciliation be conducted at least once every two years, or of the state requirement that the source of funds used to purchase each fixed asset be identified. The officials further stated that they were not aware that certain items could not be expensed in the year of purchase.

TPI officials indicated that as a result of our audit, they would prepare written procedures regarding the acquisition, disposition, and recording of fixed assets. In addition, the officials stated that they would computerize their records by using their current accounting software. Prior to the end of our audit, we determined that TPI had established written policies and procedures regarding fixed assets. However, we noted that these policies and procedures did not include procedures for conducting the required physical inventory once every two years.

Recommendation

TPI should continue its efforts to establish a fixed-asset inventory system consistent with applicable state and federal requirements. This system should include written policies and procedures as well as controls to ensure that they are adhered to. Furthermore, TPI should complete a physical inventory of its fixed assets and ensure that each fixed asset is identified and tagged. Every tagged asset should then be reconciled with the fixed-asset inventory listing, which should include the asset tag number, the asset location, the source of funding used to purchase the asset, and the date of the last physical inventory.

Auditee's Response

In response to this audit result, TPI officials provided comments, which are excerpted below:

- *All of the equipment currently on the books has been purchased through private funds.*
- *The land, buildings, and vehicles have been purchased either through bank loans or a Massachusetts bond issue. The use of these items is charged to programs by means of interest and depreciation expense. Turning Point has been fortunate to have been granted HUD loans to payoff loans on property. In that case, the property is removed from Turning Point's books and put into a separate corporation as required by Federal law.*
- *Turning Point has no federally purchased assets on the books. This would probably preclude the agency from being subject to the Federal law requiring an inventory of fixed assets every two years, but nevertheless we intend to inventory our fixed assets as a safeguard.*

We understand that the remaining fixed assets of $26,613 are the only fixed assets that fall under the concern of written inventory policies and procedures and regular physical inventories at least every two years, as required by federal regulation.…

Regarding the $26,613, it may not have been clear at the time of the audit that of the $26,613 which is equipment portable enough to be subject to loss, theft or misuse, the majority is located at Turning Point's offices. As stated in the audit report, Turning Point did have an inventory system that accounted for each and every item. However, it was a manual system that had not been updated for some time. Upon being told of this deficiency, Turning Point did the following:

- *We have prepared written procedures and policies for the acquisition, disposition and recording of fixed assets. This step was completed prior to the auditors' exit. We have established a floor of $1,000 for capitalization. Items below this amount will be expensed. We have amended our policies to provide for a physical inventory once every two years….*

- *Turning Point is now using an integrated electronic fixed asset inventory system to computerize its fixed assets. We have completed a physical inventory and the equipment has been tagged and reconciled to the listing….*

The audit staff questioned the expensing of 11 items totaling $33,649. Here is our review of the items that Turning Point feels justified in expensing versus capitalizing.

A. *A Dell computer for $2,971.40 was ultimately returned….*

B. *The payment of $4,310 to Merrimac Glass was to repair the damage to the administrative offices as a result of a car driving through the window of Turning Point's building….*

C. *The expense for $3,500 to Morrison Paving to pave the driveway at Gregory Street was expensed as Turning Point neither owns title to the property nor do they pay rent so we are not a lessee.*

D. *There were two invoices…of $3,700 for hot topping driveways in what we consider a repair as it does not substantially lengthen the life of the driveway and is merely maintenance….*

E. *The charge for $6,500 from On Site Computers was for multi-user licenses, which is an expensible item.*

Auditor's Reply

During our audit, we requested from TPI officials all records regarding the agency's inventory of fixed assets. Further, we spoke with TPI officials regarding the inventorying of these assets. TPI officials never stated that the majority of the assets being maintained in the accounting records were purchased with private funds, nor did they provide documentation to substantiate such a claim. However, even if TPI's assertion is true, it does not preclude the agency from having to establish appropriate controls over these assets. As stated in our report, TPI had an inadequate inventory system. According to its response, TPI has taken measures to address our concerns in this area. We will review those measures during our next audit of this agency.

As stated in our report, the proper accounting for the Dell computer would have been to capitalize its cost and then adjust the accounting records appropriately when the asset was returned. In its response, TPI also contends that $4,310 of the leasehold improvements in question was for repairs needed as a result of a car driving through the window of TPI's administrative building. However, during the audit the agency did not provide any documentation to substantiate this claim. With its response, the agency provided a copy of an invoice for this amount, but the invoice states that the service provided was for repairs to a garage at an unspecified location. If the repairs were done to TPI's administrative office as a result of an automobile accident, we question why the agency did not provide appropriate documentation (e.g., a police report or an insurance claim) to substantiate this claim. In its response, TPI also contends that $3,500 of the leasehold improvements in question was for paving for property it does not own or rent. However, during our audit TPI could not provide any documentation to substantiate this assertion. Moreover, we question why the agency would use state funds to make improvements to property that it does not own. Regarding the $3,700 for the paving of a driveway at another location, the process of repaving does in fact extend the life of driveways; accordingly, as required by OSD guidelines, these costs should have been depreciated rather than expensed. Regarding onsite computers, in its response TPI states that multiuser licenses should be expensed. However, proper accounting requires the costs of computer peripheral equipment and components such as those in question to be depreciated over the useful life of the assets. Consequently, we again recommend that TPI fully implement our recommendation regarding this matter.

4. UNALLOWABLE SALARY RESERVE EXPENSES TOTALING $38,075

During fiscal years 2000 and 2001, TPI received $196,909 in funding under contracts with two state agencies, the Department of Mental Health (DMH) and DMR, to provide salary increases to the lowest-paid members of its staff. However, TPI could not provide documentation to substantiate that $38,075 of these funds were distributed in accordance with the terms and conditions of the contracts. As a result, TPI owes $38,075 to the Commonwealth.

During fiscal years 2000 and 2001, TPI entered into salary reserve contracts with DMH and DMR, for amounts indicated in the following table:

Turning Point, Inc.
Summary of Salary Reserve Funding
Fiscal Years 2000 and 2001

Fiscal Year	DMH	DMR
2000	$24,012.43	$102,507.14
2001	1,836.51	68,553.00
Total	$25,848.94	$171,060.14

The salary reserve initiative began in fiscal year 1984, when the state Legislature appropriated $5 million to DMH to provide cost-of-living increases to direct-care staff working in community-based programs for the mentally disabled. Since then, the Legislature has appropriated funds to provide pay increases to eligible direct-care staff members of contracted service providers, specifically those who meet the following criteria:

1. Earn less than the statutory amount per year, which is calculated on base pay (without overtime); part-time employees who earn the statutory per-hour rate are also eligible. The statutory rate and amount change every year.

2. Work in human and social services contracted within the Executive Office of Health and Human Services (EOHHS) or the Executive Office of Elder Affairs (EOEA).

Under the terms and conditions of its salary reserve contracts, TPI was to have provided salary increases to eligible personnel who worked within specified state contracts. Specifically, for fiscal year 2000, TPI's salary reserve contracts with DMR and DMH in part stated the following:

> *(2) All funds received through this agreement will be used only for salary increases and the employer portion of payroll and fringe benefits programs funded by the above cited contracts....*
>
> *(3) The Contractor may set aside up to 15% of its allocation...for increases in the employer portion of payroll and fringe benefit obligations....*

(10) The Contractor must maintain until June 30, 2007 detailed data to support the salary survey submission or review and documentation describing how the funds were actually distributed for all fiscal year 2000 Salary Reserve agreements….

(13) Should the Contractor fail to comply with any of the terms of this agreement the funds are subject to immediate recoupment, through repayment by the Contractor, intercept through the Office of the State Comptroller, or such other actions as may be necessary to recover such funds, costs or damages for breach of this agreement….

During fiscal year 2001, TPI's salary reserve contracts with DMH and DMR in part stated the following:

(2) All funds received through this agreement will be used only for salary increases and the employer portion of payroll and fringe benefit obligations directly associated with the salary increases for eligible personnel earning less than $25,000 in annual compensation in programs funded by the above cited contracts….

(3) Based on the actual allocation received, the Contractor must give each eligible employee…earning less than $20,000 at least a 3% increase in salary….

(4) The Contractor may use up to 15% of the remaining allocation of 2.88% of the wages of eligible employees…earning between $20,000 and $25,000 for the increase in employer payroll and fringe benefit obligations….

Salary reserve contracts impose the following requirements on entities such as TPI that receive these funds:

The Contractor must maintain…detailed data to support the salary survey submission or review and documentation describing how the funds were actually distributed for all fiscal year…Salary Reserve agreements….

Should the Contractor fail to comply with any of the terms of this agreement the funds are subject to immediate recoupment, through repayment by the Contractor, intercept through the Office of the State Comptroller, or such other actions as may be necessary to recover such funds, costs or damages for breach of this agreement….

We found that despite these requirements, TPI did not maintain accurate and detailed records regarding the disbursement of its salary reserve funds. Specifically, TPI was unable to provide documentation to substantiate the actual amount of salary reserve funds it received under these contracts or how the funds were disbursed.

TPI officials provided what they said was a reconciliation of salary reserve funding and disbursements. We reviewed the reconciliation and other agency documents (e.g., staff time sheets and payroll records) and found that at least $38,075 in salary reserve funding during the audit period was not used in a manner consistent with the contracts, as follows:

	Fiscal Year 2000	Fiscal Year 2001	Total
DMH			
Clerical Error	$ 84	$ 0	$ 84
Promotion Not Salary Reserve	388	0	388
Inadequate Documentation/Unsupported	5,192	657	5,849
DMH Total	5,664	657	6,321
DMR			
Clerical Error	909	(90)	819
Promotion Not Salary Reserve	3,266	8,589	11,855
Inadequate Documentation/Unsupported	13,392	5,688	19,080
DMR Total	17,567	14,187	31,754
Combined Total	$23,231	$14,844	$38,075

TPI could not provide documentation to substantiate that $24,929 in salary reserve funding was disbursed to the individuals who were supposed to have received those funds. We also found that $12,243, which according to TPI's reconciliation was distributed to staff in the form of promotions, was not provided to those individuals. Regarding these matters, TPI officials attributed the lack of supporting documentation to the significant turnover of accounting staff during the audit period.

Recommendation

DMH and DMR should recover from TPI the $38,075 in undocumented and inappropriate salary reserve expenses that TPI charged against its state contracts during the audit period. Furthermore, DMH and DMR should conduct their own reviews of TPI's use of salary reserve funding for the periods prior and subsequent to those covered by our audit and recover additional funds, if appropriate. TPI should also take measures to ensure that in the future it fully complies with the terms and conditions of its salary reserve contracts.

Auditee's Response

In response to this audit result, TPI officials provided comments, which are excerpted below:

> *The question in this point concerns…funds that Turning Point received to provide salary increases to the lowest-paid members of its staff and as to whether or not $38,075 of these funds were distributed in accordance with the terms and conditions of the contracts.*
>
> *The auditors felt that Turning Point was unable to provide documentation to substantiate the actual amount of salary reserves it received or how the funds were disbursed. When Turning Point provided documentation, the auditors found at least $38,075 was not used in a manner consistent with the contracts. A large part of this number ($12,243) was attributed by the auditors to "promotion, not salary reserve." In fact, the salary reserve contracts do not specifically exclude promotions of lower-paid individuals as a viable distribution method (see attachment 4A).*
>
> *In addition, Turning Point used part of the salary reserve money to supplement the rate at which they could hire new employees. Turning Point also used the money to retain employees that we considered key to our various programs.*
>
> *No employee eligible for compensation under the salary reserve was paid over the levels of $25,000 in FY 2001 or $30,000 in FY 2000 as proscribed in the salary reserve contracts.*
>
> *Confidential personnel documents to support this are available upon request if so desired.*
>
> *Other support to this point:*
>
> *A. In the documentation that Turning Point provided, several lines were lines marked vacant and with dollar amounts that might be possibly misinterpreted. In fact, this line was used for a number of employees that only worked once in that program and were too numerous to detail.*
>
> *Of the $38,075, there were errors [on the part of Turning Point] that total $18,017.41. One was a posting of a salary reserve twice to the general ledger in May 2000 for a total of $11,504.85. The second was made by including subcontracted relief staff and accrued vacation pay in the calculation of salary reserve (a total of $6,512.56).*

Auditor's Reply

As stated in our report, contrary to the terms and conditions of its state contracts, TPI did not provide adequate documentation to substantiate either the actual amount of salary reserve funds it received or how these funds were disbursed. In its response, TPI contends that it used some of its salary reserve funds to provide promotions to lower-paid individuals, and that this practice is not specifically prohibited by the language in TPI's salary-reserve contracts. That promotions to individuals are not specifically prohibited in salary-reserve contracts does not mean they are allowable. On the contrary, the manner in which these funds are to be utilized under salary-reserve contracts is clearly delineated and agreed to by both TPI and its state purchasing agencies. These funds are to be used to provide temporary pay increases to the lowest-paid direct-care workers who have been specifically identified by the agency. If TPI wanted to give permanent promotions to lower-paid members of its staff, including non-direct-care workers, it should have used other funds for that purpose.

In its response, TPI suggests that we may have "misinterpreted" some of the salary-reserve information it provided. As noted in our report, TPI was not maintaining the information required by its state contracts. Instead, the agency provided the audit staff a reconciliation of the amount of salary-reserve funds TPI says it received and distributed to staff. Since TPI prepared the reconciliation and provided it to the audit staff, it had sufficient opportunity to ensure that the information was complete and not subject to misinterpretation. It should be noted that none of the funds associated with "vacant" positions was included in the amounts we question.

5. UNDOCUMENTED ACCOUNTING ADJUSTMENTS TOTALING $42,500 CHARGED TO STATE CONTRACTS

We determined that TPI had not established adequate controls over the approval and documentation of changes to its accounting records. We found that TPI made at least two adjustments (charges), totaling $42,500, during fiscal year 2000 to two programs for salary expenses; however, TPI had no documentation substantiating that the expenses were incurred in those programs. According to state regulations, such undocumented expenses are unallowable and nonreimbursable under state contracts.

According to OSD regulations, contractors such as TPI are required to maintain their financial and other records to adequately support all expenses billed to state contracts. In this regard, 808 CMR 1.04(1) in part states:

> *<u>Recordkeeping</u>. The Contractor and its Subcontractors shall keep on file all data necessary to satisfy applicable reporting requirements of the Commonwealth… 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….*

Furthermore, 808 CMR 1.05(26) identifies the following as nonreimbursable costs under state contracts:

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

During our audit, we assessed the controls that TPI had established regarding the authorization and recording of adjustments to its accounting records, and we found that the agency had no written policies and procedures for this purpose. Consequently, we reviewed two adjusting accounting entries that TPI staff made during fiscal year 2000, charging them to the contracts regarding TPI's residential programs funded by DMH and DMR. We found that for the period ending June 30, 2000, TPI added, by adjusting accounting entries, a total of $42,500 ($34,800 to the DMR contract and $7,700 to the DMH contract) in salary expenses to these programs.

We asked TPI officials to provide documentation to substantiate the reasonableness of these additional charges. However, agency officials could not provide such documentation. Accordingly, the additional expenses are nonreimbursable in accordance with 808 CMR 1.05(26).

Regarding this matter, TPI officials indicated that they were unaware that their policies and procedures were inadequate. However, they also stated that they would take measures to improve controls.

Recommendation

DMH and DMR should recover from TPI the $42,500 in inadequately documented costs charged against its state contracts during the audit period. Furthermore, to improve controls over accounting practices, TPI should ensure that adequate internal controls are in place to support and record evidential documentation for all accounting transactions.

Auditee's Response

Regarding this matter, TPI officials provided comments, which are excerpted below:

> *The auditors have a valid concern regarding this and although Turning Point's documentation might be less than adequate, the reasons for the adjustment were valid and in no way were the funds misspent.*
>
> *Our justification for these adjustments as legitimate is as follows:*
>
> *Turning Point routinely establishes an allocation policy at the beginning of the year that allocates nursing expense to each of the residential programs.*
>
> *At the end of fiscal year 2000, we reviewed this expense and determined that the nursing staff spent more of their time at the residences that fall under the Merrimac Valley contract from DMR than those that fall under the North Shore contract from DMR. This was due to some severe medical conditions that developed in the Merrimac Valley clients….*
>
> *To accommodate this demand for more nursing care, Turning Point made adjustments to the DMR contracts. Therefore, an entry was made shifting $30,000 in nurses' salaries from North Shore to Merrimac Valley and a corresponding 9% in payroll taxes or $2,700 and 7% in fringe benefits or $2,100. This makes up the total of $34,800 that was moved from one DMR contract to the other.*
>
> *In addition, the auditors questioned an adjusting entry for $7,700 made to DMH. This was due to a turnover in personnel falling under the DMH contract where a staff nurse took over the position of supervising professional after the previous supervisor left Turning Point. Thus, the $7,700 was moved from the nurse category to the supervising professional category to reflect this change.*

Auditor's Reply

During the course of our audit, we requested from TPI officials documentation to support the reasonableness of the adjustments in question. To date, TPI has been unable to provide any documentation relative to these expenses. As stated in our report, according to state regulations, costs that are not adequately documented are unallowable and nonreimbursable under state contracts.

Although in its response TPI presents what it says are the reasons for the adjustments, the agency is obligated to maintain documentation to substantiate all expenses billed against state funded programs. Since TPI failed to meet this obligation, the $42,500 in inadequately documented expenses that it charged against its state contracts during our audit period should be refunded to the Commonwealth.

6. IMPROPER ALLOCATION OF INDIRECT EXPENSES TOTALING $964,732 AND UNALLOWABLE ADMINISTRATIVE EXPENSES TOTALING $9,959

Our audit determined that TPI had not established adequate policies and procedures for the allocation of indirect costs. We found several resulting deficiencies in TPI's allocation of $964,732 in indirect costs during fiscal year 2000. These deficiencies included using an allocation method inconsistent with OSD guidelines and inappropriately charging $9,959 in unallowable and undocumented indirect expenses to its state contracts. Consequently, TPI incorrectly allocated administrative costs totaling as much as $964,732 to its state and federal programs.

The following guidelines regarding the allocation of indirect costs are delineated in OSD's UFR *Audit & Preparation Manual:*

> *Allocation of Program Support expenses…must be made using a written cost allocation plan in accordance with GAAP as described in the sections covering Administration Costs and Costs Which Pertain to Various Functions…. Allocation of Administrative expenses that pertain to the "Overall Direction" of the organization to programs…must also be made by utilizing a written costs allocation plan using the same principles as noted above or as described in the Direct Method for allocating indirect costs to federal programs of OMB Circular A-122.*
>
> *Administration and support (management and general) costs include expenditures for the "Overall Direction" of the organization, general record keeping, business management, budgeting, general board activities, and related purposes. Direct supervision of program services and of fund-raising should be charged to those functions. "Overall Direction" will usually include the salaries and expenses of the chief officer of the organization and his or her staff. If they spend a portion of their time directly supervising fund-raising program service activities, such salaries and expenses should be prorated among those functions….*

Generally Accepted Accounting Principles prohibit administrative and fund-raising expenses from being charged or allocated to program services on the Statement of Functional Expenses. The UFR furnishes report users with a general understanding of the benefit derived by program services from administrative expenses by charging and allocating all administrative expenses to program on line 42 of Expense Schedule B. These administrative expenses are reimbursed through the contractor's contract with the Commonwealth as administrative support costs. The Commonwealth reimburses the contractor for actual administrative support costs incurred, as documented in a written cost allocation plan, up to the level of the Cap for administrative support as set forth in the negotiated program budget.

The usage methods recommended by the AICPA guide should be used to allocate the individual expenses that make up administration on line 42 to programs. Usage reports and time studies are utilized when the usage basis is used to determine the amount of time and effort that administrative staff devote to the overall direction of the agency and the extent of benefit (administrative salaries and expenses) derived by fund-raising and program service activities.

When it is not possible to utilize usage reports and time studies, other simplified methods are acceptable for allocating administrative expenses on line 42 as follows:

- *A basis of allocation (allocation percentage) previously established for non-salary expenses that benefit all programs (i.e., centralized telephone system that benefits all programs) is acceptable for expense items other than salaries.*

- *Use of a basis that utilizes experience levels established for salary costs. The executive director's and other administration salaries must be allocated using the percentage of direct care salaries incurred in each program.*

Methods of allocating administrative expenses that utilize budgeted revenue, received revenue, budgeted costs, anticipated contract reimbursements or received contract reimbursements or total program expenses are not acceptable or in accordance with generally accepted accounting principles….

The existence of non-reimbursable costs, as contained in 808 CMR… 1.05…must be disclosed… and the non-reimbursable administration portion in line 44a in each program as applicable (non-reimbursable costs and must be disclosed and itemized in Subsidiary Schedule B-1). Social services contract and agreement reimbursements and federal assistance may not be used to defray non-reimbursable costs. Non-reimbursable costs that exist and have not been disclosed are presumed to have been defrayed using Commonwealth and federal funds.

During our audit, we asked TPI officials to provide a copy of the agency's cost allocation plan. Agency officials informed us that they did not have a written plan and that they instead use budgeted revenue as a basis for allocating administrative expenses. Clearly, that method is not allowable under OSD guidelines. We also found that contrary to OSD guidelines, TPI did not establish a system for identifying nonreimbursable costs. TPI officials stated that in their opinion, all agency costs were program-related and therefore reimbursable.

We also noted numerous examples of expenditures that lacked an adequate description and supporting documentation; thus, the proper allocation of those costs could not be determined. For example, we selected a sample of 30 administrative expenses, totaling $12,374, charged against TPI's state contracts. Of those, 23 (77%), totaling $9,959, lacked adequate descriptions to substantiate the nature of the expenses. A number of them also appeared to be for items not related to the social service purposes of TPI's state-funded programs. For example, on December 13, 1999, TPI expended $370 for the rental of a limousine, and on October 8, 1999, TPI staff expended $278 for concert tickets. Furthermore, available supporting documentation often lacked proof that the agency received the goods or services.

We also noted numerous large adjusting journal entries that reclassified expenditures from administrative expenses to specific program expenses. In addition, we found that TPI was unable to provide usage reports, time studies, or analyses relating to payroll taxes or fringe benefit costs. We found, as well, that many state payment vouchers included expenses that could not be traced into the agency's general ledger.

Regarding these matters, TPI officials indicated that they were unaware of OSD's guidelines regarding the allocation of administrative expenses and that they will be taking measures to address the deficiencies we identified.

Recommendation

To address our concerns, DMR should recover from TPI the $9,959 in unallowable administrative expenses that TPI charged against its state contracts during the audit period. Furthermore, the agency should develop and document in writing a comprehensive plan, consistent with OSD regulations, for allocating all of its indirect costs and accounting for all nonreimbursable costs.

Auditee's Response

In this matter, TPI officials provided comments, which are excerpted below:

> *The audit report states that there were several deficiencies in the allocation of $964,732 because of inadequate policies and procedures. The title of this section suggests "improper allocation of indirect expenses totaling $964,732"; these funds were allocated properly under the procedures Turning Point used at the time, which have since changed to be more compliant to OSD requirements.*
>
> *During the audit period, Turning Point changed its procedures to an approved OSD plan.... Specifically, in FY 2001 we began allocating indirect expenses under the modified direct method by using the automatic feature on the UFR. The resulting changes to the allocation used throughout the year were then journalized and recorded in the general ledger.*
>
> *During this same time period, we also became aware that there were expenses that were charged as administrative expenses that were chargeable to specific programs. Since then, we review expenses monthly in order to make more timely adjustments.*
>
> *We also have set up an account in the general ledger to track unallowable costs. Any invoice that is submitted for payment and considered unallowable is assigned to this account.*
>
> *Of the $9,959 that lacked adequate descriptions, we offer the following justifications:*
>
> - *$22: mileage for staff for specific trips to shelter from the staff's normal place of work (Attachment 6B)*
> - *$21: for Belmont Springs water cooler expenses for Turning Point office (Attachment 6C)*
> - *$2,323: for plastic gloves used by program staff as required by universal health precautions (Attachment 6D).*
> - *$1,500: the Elite Staffing & Associates charge is a buy-out contract for when a relief staff person became a permanent employee (Attachment 6E).*
> - *$88.44 of the $147.73 is allowable as Federal Express shipping charges for program related charges (Attachment 6F).*
> - *$49.14 of the $88.14 is allowable as Federal Express shipping charges for program related charges (Attachment 6G).*
> - *$369 is for Countable Substance Books that are required by the Department of Public Health in all group homes to count medications. (Attachment 6H).*
>
> *Therefore, the above $4,372.58 of the $10,204 "unallowable administrative expenses" (or, using the 97.6% which is allocated to state programs, $4,267,64 of the $9,959) is actually allowable.*

Auditor's Reply

In its response, TPI admits that it was using an allocation method inconsistent with OSD guidelines when it states that it allocated funds based on the procedures the agency had in place at that time, but had to change them to make them more consistent with OSD requirements. Further, our report correctly states that TPI officials could not provide a copy of any cost-allocation plan and that they allocated their administrative expenses based on budgeted revenue, which is unallowable according to OSD guidelines.

As stated in our report, during our audit we found numerous examples of expenditures that lacked an adequate description or adequately supporting documentation. According to state regulations, inadequately documented expenses are unallowable and nonreimbursable under state contracts. In its response, TPI contends that some of these expenses are in fact allowable; however, without adequate supporting documentation, the reasonableness of these assertions cannot be determined. Moreover, the documentation TPI provided subsequent to the end of our audit appears to indicate that many of the expenses in question should have been charged directly to a program and should not have been made part of the agency's administrative-cost allocation.