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INDEPENDENT STATE AUDITOR'S REPORT ON CERTAIN ACTIVITIES OF GROW ASSOCIATES, INC.

JULY 1, 2001 THROUGH NOVEMBER 30, 2003

OFFICIAL AUDIT REPORT

OCTOBER 12, 2004

TABLE OF CONTENTS/EXECUTIVE SUMMARY

GROW Associates, Inc. (GROW) was originally organized in Massachusetts on November 9, 1973 as a charitable nonprofit organization under the name of Randolph Occupational Workshop, Inc. The agency was formed by a group of parents to provide continuing education, occupational training, and extended employment for individuals with developmental disabilities who cannot function independently in the employment market. On November 15, 1996, the agency changed its name to GROW. Currently, GROW operates two Supported Workshop programs serving over 125 adults and adolescents in Southeastern Massachusetts.

The scope of our audit was to examine various administrative and operational activities of GROW during the period July 1, 2001 to November 30, 2003. Our audit, conducted in accordance with applicable generally accepted government auditing standards for performance audits issued by the Comptroller General of the United States, had the following objectives: (1) to determine whether GROW had implemented effective internal controls and (2) to assess GROW's business practices and its compliance with applicable laws, rules, and regulations and the various fiscal and programmatic requirements of its state contracts.

Our audit identified unallowable salary expenses for GROW's former Executive Director totaling at least $28,830. The agency also overstated its fiscal year 2003 revenues in the amount of $75,016 and had inadequate documentation to substantiate the allocation of payroll expenses in the amount of $1,465,897, unallowable fringe benefits expenses totaling $10,401 paid to selected GROW employees, and inadequate administrative and internal controls over certain aspects of its operations.

During fiscal year 2001, GROW billed its state contracts for $72,075 in salary and related expenses for its former Executive Director to function as a full-time employee of GROW. However, we found that during this same time period the former Executive Director was also being paid as a part-time employee of the Town of Randolph School Department. As a result, $28,830 of the compensation expenses billed by GROW against its state contracts during this fiscal year for its former Executive Director represented unallowable billings that should be remitted to the Commonwealth.

We found that GROW had not established an adequate system of internal controls over its revenue to ensure that it is properly recorded and reported. Specifically, GROW did not have any written policies or procedures relative to revenue, and rather than recording the actual reimbursements it received from state agencies as state contract revenue, GROW simply recorded the amounts it billed to state agencies as the revenue it actually received in its financial records. As a result, during fiscal year 2003, GROW overstated the state revenues it received in the financial report it submitted to the Commonwealth by $75,016.

We found that GROW has not established adequate controls over the allocation of wages paid to its employees as required by state regulations and the terms and conditions of its state contracts. Specifically, GROW does not require its salaried staff to document the hours worked or the functions benefited (e.g., specific program, cost center) and GROW does not follow its own policies and procedures to document non-exempt staff hours charged to state programs. As a result, there is inadequate assurance that all of the $1,465,897 in wages paid to its employees and allocated against state contracts during our audit period was accurate.

We found that during fiscal years 2002 and 2003, GROW awarded fringe benefits totaling $10,401 to certain members of its administrative staff that were not available to all staff members under GROW's formal written personnel policies and procedures. These benefits included $3,849 in fully paid family health care to GROW's Executive Director and $6,552 in extra vacation time provided to GROW's Executive Director and Assistant Executive Director/Program Director. Fringe benefits such as these that were not available to all employees under an established formal written policy are nonreimbursable expenses under state contracts.

We found that GROW had not developed and implemented an adequate system of internal controls over various aspects of its operations. For example, GROW had no written accounting policies and procedures or an accounting manual to ensure the accuracy of its financial transactions, reports, and recordkeeping. As a result, GROW and the Commonwealth cannot be assured that GROW's financial assets and Commonwealth funds were being properly safeguarded or that transactions relative to these accounts were properly authorized, recorded, and reported.

INTRODUCTION

Background

GROW Associates, Inc. (GROW) was organized in Massachusetts on November 9, 1973 as a charitable nonprofit organization under the name of Randolph Occupational Workshop, Inc. The agency was formed by a group of parents to provide continuing education, occupational training, and extended employment for individuals with developmental disabilities who cannot function independently in the employment market. On November 15, 1996 the agency changed its name to GROW. Currently, GROW operates two Supported Workshop programs designed to teach a variety of job related skills to over 125 adults and adolescents in Southeastern Massachusetts.

During the audit period, GROW received funding primarily from the state's Department of Mental Retardation (DMR). DMR and other funding sources are indicated in the following table:

GROW Associates, Inc.
Summary of Revenue
July 1, 2001 through June 30, 2003

	Fiscal Year	
Revenue Source	2003	2002
Contributions, Gifts, Legacies, Bequests	$ 8,681	$ 3,907
Department of Mental Retardation (DMR)	1,141,652	1,138,188
Massachusetts Local Government	41,664	21,652
Client Resources	12,547	-
Private Client Fees	3,333	2,442
Commercial Activities*	83,461	97,623
Investment Revenue	2,554	6,464
Other Revenue	22,243	6,300
Total	$1,316,135	$1,276,576

* During the audit period, GROW's clients performed various labor-related tasks through agreements made with private businesses, which resulted in commercial revenue being realized by the agency.

Audit Scope, Objectives, and Methodology

The scope of our audit was to examine various administrative and operational activities of GROW during the period July 1, 2001 to November 30, 2003. However, in one instance (see Audit Result

No. 1) it was necessary for us to extend the period covered by our audit in order to adequately examine certain transactions that were selected for testing during our review.

Our audit was conducted in accordance with applicable generally accepted government auditing standards for performance audits issued by the Comptroller General of the United States and included audit procedures and tests considered necessary to meet those standards.

Our audit objectives were to:

- Determine whether GROW had implemented adequate internal controls over all aspects of its operations.

- Assess GROW's business practices and its compliance with applicable laws, rules, and regulations and the various fiscal and programmatic requirements of its state contracts.

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

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

AUDIT RESULTS

1. UNALLOWABLE SALARY EXPENSES FOR GROW'S FORMER EXECUTIVE DIRECTOR TOTALING AT LEAST $28,830

During fiscal year 2001, GROW Associates, Inc. (GROW) billed its state contracts for $72,075 in salary and related expenses for its former Executive Director to function as a full-time employee of GROW. However, we found that during this same time period, the former Executive Director was also being paid as a part-time employee of the Town of Randolph School Department. As a result, $28,830 of the compensation expenses billed by GROW against its state contracts during this fiscal year for its former Executive Director represented unallowable billings that should be remitted to the Commonwealth.

The state's Operational Services Division (OSD), the agency responsible for regulating and overseeing the activities of contracted human service providers such as GROW, has promulgated regulations that identify expenses that are nonreimbursable under state contracts. In this regard, 808 Code of Massachusetts Regulations (CMR) 1.05 (26) identifies the following as nonreimbursable costs:

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

Additionally, regarding payroll expenses, OSD regulations require contracted human service providers to maintain a system of documenting each full and part-time employee's attendance, hours worked, program assignments, and payroll expenses to enable the organization to prepare an accurate schedule of full-time equivalent employees and associated payroll expenses by job category and program. Specifically, 808 CMR 1.04 (1) states as follows:

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

During our audit, we reviewed GROW's financial and administrative records and noted that the fiscal year 2001 Uniform Financial Statements and Independent Auditor's Report (UFR), which GROW filed with OSD, stated the following:

> *For many years GROW has had an arrangement with the Town of Randolph whereby the Town of Randolph paid a portion of (the executive director's salary) in exchange for program participants from Randolph paying a reduced rate to participate in the Program (GROW).*

We also noted that during fiscal year 2001, GROW reported in its UFR that the Town of Randolph made an in-kind contribution totaling $7,812. Based on this information, we held discussions with GROW officials and officials from GROW's private accounting firm to discuss this matter. On February 9, 2004, a representative of GROW's private accounting firm provided us with a written explanation of this situation as detailed by the former Executive Director, which stated, in part:

> *The program began as a part of the public schools development of alternatives for their special needs population. As the students "graduated" from school, they were allowed to stay in this program. The corporation [GROW] was formed initially as a vehicle to pay student workers for the piece rated work they were engaged in, as any funds coming directly to the town had to go into the general funds. A board was established when the corporation began. As time went on, there were fewer students enrolled in the school system with an increasing number of adults. The school system, which had been the sole funding agent, began to look for more support from the corporation. They continued to allow the use of the Pauline St. School and provided the utilities, maintenance, etc. The full-time teacher position eventually was reduced to a part-time (.40) position. The expectation was that approximately 25% of the .40 position would be utilized as in-kind payment for the students who would be placed in the program, with the remainder of the time utilized for the students placed there as well as assistance in the system as necessary. This is where the reported amount came from. This ended up on consultation time, observations, sporadic instruction, and other requests from the system. There was never a formal requirement for time sheets or accounting for these hours as the "agreement" was verbally given to the teacher . . . and corporation. It was not written out, and there was an understanding that as long as everyone was satisfied with the arrangement then it would continue to go on…..*
>
> *When this change from a full-time to a part-time position went into effect, I was made the Director of the program by the board of directors. They were told of the pay from the school system, the in-kind understanding and the salary was set as less than would be expected of that position, since there would be payments from the Town of Randolph as well. It was expected that the Director position was a full-time, with other time made available to the system as necessary. This was a natural growth from the informal arrangements that had been in place previously. There was no contract written, nor was there ever one. This reduction in salary never changed. From time to time I would determine what others in the Director's position in the area were making, and it was clear that the salary was significantly lower than theirs. When the position title changed to Executive Director, again there was no change in salary. The changes in salary came*

> *as a result of percentage increases that were made available to the entire staff. To the best of my recollection, there was no increase for the last two to three years as there was no sufficient funding to support it. Salary increases were given to direct care and other staff members at those times. At my request, the salary remained the same.*
>
> *The program provided services to students from the Randolph Public Schools in a variety of ways. There were full-time and part-time placements, vocational evaluations, short-term placements, and intermittent placements. Because there was specific agreement as to time, costs, etc., there was no problem to address, as both parties were satisfied. The corporation shared a feeling that the town of Randolph needed to be "repaid" for all they had done for the program. It was they who started it, nurtured it, and funded it for a long time. They did not have to allow the "graduated" students to remain, yet they did. It was this thought process that allowed the flow of students in response to the needs of the system.*
>
> *When the program began renting space in Avon, eventually moving out of the Pauline School due to space requirements, the financial needs of the program grew considerably. DMR funding was never sufficient to cover costs as the program needs increased, and we looked for other sources of revenue. At some point we agreed to a charge for some students as the result of these fiscal pressures, and the lessening of support from the system, as they no longer provided building space and the supporting costs and services for it. We began with one student as the first invoiced student…. There were more students in the program than there was billing for as the salary had continued, and the goal of supporting the system needs remained.*
>
> *I worked an average of 60-70 hours per week over the time that you have asked me to comment on….*

During our audit, we attempted to substantiate the representations made by the former Executive Director regarding GROW's relationship with the Randolph Public Schools. However, GROW officials stated that GROW's agreement with Randolph was informal in that there was no written contract identifying the scope of services to be provided by GROW or compensation to be paid by Randolph. Additionally, we determined that GROW did not maintain records to document the students serviced or the amounts billed by GROW. GROW officials stated that the former Executive Director arranged this agreement with the Randolph School Department and that they could not identify or document the specific services provided by the former Executive Director for the Randolph students while attending GROW's state-funded programs.

Based on this, we held discussions with the Town of Randolph School Department officials, including the Department's Director of Special Education and its Financial Manager, and determined that GROW's former Executive Director was employed by the Town of Randolph during fiscal year 2001 as a part-time .40 Full Time Equivalent (FTE) pre-vocational teacher and received compensation totaling $20,724 during this fiscal year. These officials provided us with a written description of the services provided by GROW and its former Executive Director, as follows:

> *Placement at the Pauline St. School in conjunction with the Randolph Occupational Workshop program (GROW's former Executive Director). Assignment as needed within the school system for vocational instruction, consultation, or other duties. Approximately ¾ of the hours in service to the school system, with the remainder in kind to the Randolph Occupational Workshop, Inc.*

These officials added that GROW's former Executive Director had functioned in this position since the 1993-1994 school year. However, the Randolph School Department could not document the hours worked by GROW's former Executive Director or the services provided to students in this program during the audit period. It should be noted that, according to these officials, in August 2001 the former Executive Director resigned from GROW and accepted a full-time teaching position with the Town of Randolph School Department.

Because GROW's former Executive Director was being paid by the state to work full-time in GROW's state-funded programs while at the same time being paid for part-time work by the Town of Randolph (.40 FTE), $28,830 of the compensation expenses for the former Executive Director that GROW billed against its state contracts during fiscal year 2001 represented unallowable billings, as indicated in the table below:

Excessive Salary for Former Executive Director in Fiscal Year 2001

Salary Payments	Fringe (20%)	Car Allowance	Total Compensation	Allowable (.60)	Excessive Compensation
$58,812	$11,762	$1,500	$72,075	$43,245	$28,830

According to GROW officials and the aforementioned February 9, 2004 explanation prepared by the former Executive Director, the hours the former Executive Director worked as a teacher for the Randolph School Department were worked outside GROW's normal business hours. However, since neither GROW nor the Town of Randolph required the former Executive Director to maintain payroll records to document the hours worked or the functions benefited, the assertions made by GROW officials and its former Executive Director could not be substantiated.

Recommendation

GROW's principal state purchasing agency, the Department of Mental Retardation (DMR), should recover from GROW the $28,830 in unallowable compensation expenses for GROW's former Executive Director that GROW billed against its state contracts. Furthermore, DMR, in conjunction with OSD, should conduct its own review of the reasonableness of the compensation provided to GROW's former Executive Director for the seven-year period prior to that covered by our audit and take whatever measures they deem necessary to resolve this matter.

Auditee's Response

In response to this audit result, GROW provided the following comments:

> *We disagree with this finding on several counts. The GROW Board of Directors was aware that [the] former executive director…provided services and received compensation from the Town of Randolph. The Board fully recognizes that the arrangement should have been formalized with a written agreement documenting each party's obligations and that the arrangement should have been reviewed annually. However, at no time did the Board feel that GROW was receiving less than a full-time equivalent from the executive director's position. We concur that better record keeping should have taken place.*
>
> *Additionally, we had expressed our position that [the former executive director] typically worked a 60-70 hour week, which was supported with affidavits from several Board members and employees of GROW. The adjustment proposed by the State Auditor does not appear to take [the former executive director's] schedule and workweek into account. For example, if [the former executive director] worked an average of 65 hours per week, the .6 FTE he allegedly worked at GROW would be very close to the 40 hour workweek that was required under the state contracts that GROW had with the Department of Mental Retardation ("DMR"). The fact that we have provided evidence that [the former executive director] worked more than 40 hours per week appears to have not been considered. The State Auditor seems to be relying on a "budget sheet" from the Town of Randolph to support its contention that [the former executive director] worked a .4 FTE at Randolph. Conversely, the State Auditor has disregarded evidential documentation from GROW that supports our position that [the former executive director] was a full-time employee at GROW. GROW maintains that [the former executive director] was present and working in a full-time position at GROW during his entire tenure at GROW.*
>
> *In any event, the Organization has significant offsetting revenue from <u>non-state</u> sources during the audit period to cover these costs should the amounts be considered non-reimbursable.*

Auditor's Reply

Our audit was conducted in accordance with applicable generally accepted government auditing standards for performance audits issued by the Comptroller General of the United States and included audit procedures and tests considered necessary to meet those standards. Contrary to GROW's assertion in its response, we did not disregard documentation or other evidential matter made available to us during our audit work. To the contrary, we reviewed and analyzed all the information made available by GROW and the Randolph School Department. Moreover, because of the lack of sufficient documentation regarding this matter, as detailed in our report, we also interviewed various GROW and Randolph School officials to obtain a more complete understanding of the issue. In its response, GROW contends that its former Executive Director and other GROW officials provided affidavits in which they asserted that the Executive Director had worked 60-70 hours per week. However, the agency was unable to provide any documentation other than those statements and representations. OSD regulations require contracted human service providers to maintain a system of documenting each full- and part-time employee's attendance, hours worked, program assignments, and payroll expenses to enable the provider to prepare an accurate schedule of full-time equivalent employees and associated payroll expenses by job. Since GROW did not comply with those requirements, we could have reasonably made a determination that the entire salary paid to the former Executive Director during the period under review was unallowable in accordance with OSD relegations. However, because we saw evidence that the former Executive Director performed agency-related tasks during the review period, we took a more lenient approach and questioned only the remaining portion of time (.60 FTE) that he was not working for the town of Randolph School Department (.40 FTE, according to the Department's records) while he was being paid as a full-time employee under GROW's state contracts.

2. INADEQUATE CONTROLS OVER REVENUE RESULTED IN A $75,016 OVERSTATEMENT OF STATE CONTRACT REVENUE ON GROW'S FISCAL YEAR 2003 AUDITED FINANCIAL STATEMENTS

We found that GROW had not established an adequate system of internal controls over its revenue to ensure that it is properly recorded and reported. Specifically, GROW did not have any written policies or procedures for recording revenue in its financial records, and rather than recording the actual reimbursements it received from state agencies as state contract revenue, GROW simply recorded the amounts it billed to state agencies as its actual state contract revenue in its financial records. As a result, during fiscal year 2003, GROW overstated the state revenues it received in the financial reports it submitted to the Commonwealth by $75,016.

According to Generally Accepted Accounting Principles (GAAP), as set forth by the American Institute of Certified Public Accountants (AICPA), entities such as GROW are required to establish an adequate system of internal controls over all aspects of their operations to ensure that their financial transactions are properly authorized, recorded, and reported. However, during our audit, we found that GROW had not established adequate controls over many aspects of its operations, including the receipt and recording of revenue. Specifically, GROW had not developed any formal written policies and procedures for recording and reporting revenue. Also, we found that GROW officials would bill the agency's state contracts for services and that these billings would often be adjusted either up or down by GROW's state purchasing agencies to account for such things as nonreimbursable expenses. However, rather than recording the actual reimbursements it received from state agencies as state contract revenue, GROW would simply record the amounts it billed state agencies as state contract revenue and not account for any adjustments made by state purchasing agencies relative to these billings.

During our audit, we reconciled GROW's billings against its state contracts during fiscal year 2003 with the amounts it actually received from state purchasing agencies and noted that the amounts it billed and recorded as revenue exceeded what it actually received by $75,016, as detailed below:

GROW
Fiscal Year 2003
Reported vs. Actual State Contract Revenue

Reported Revenue by 2003 UFR	Actual State Contract Revenue	Overstated Revenues
$1,141,652	$1,066,636	$75,016

On December 1, 2003, GROW's Business Manager provided us with the following written comments on this matter:

> *Since DMR receipts do not specify which bill they are paying for there is no way to positively tell which invoice to apply it to.... When the ready pay comes in, it is always applied toward the most recent bill. Then the next payment that comes in is usually in the amount of the difference between the ready pay and the original billing amount. Thus, it is reasonable to believe that the billings and receipts match. Sometimes DMR will send a payment that intermittently varies from the total amount remaining and/or amount due. That time I will put the payment toward the previous billing.*

These comments continue by stating that GROW's independent accountants were "successful in tracing all of the fiscal year 2003 billings and receipts within their accounting system," and that "everything was properly recorded."

On September 19, 2003, GROW's private accounting firm forwarded a memorandum relative to their fiscal year 2003 audit of GROW to GROW's Board of Directors and senior management entitled *Memorandum of Other Matters Involving the Internal Control over Financial Reporting, Immaterial Instances of Noncompliance with Laws, Regulations, Contracts and Grants and Advisory Comments*. This memorandum stated, in part:

> *During our June 30, 2003 audit, we noted that employees who use the Peachtree accounting system do not have a thorough understanding of the system.*
>
> *We recommend that all employees who use this software undergo training to be proficient in the operation of the system. This would include the ability to properly record daily transactions and reconciliations, as proper transaction posting is crucial to the financial reporting process.*

During our audit, we informed GROW's private accounting firm of this matter. In response, representatives from the firm indicated that they were going to restate and reissue the fiscal year 2003 UFR filed by GROW to ensure its accuracy.

Recommendation

GROW should immediately develop and implement effective internal controls over revenue. At a minimum, GROW should ensure that formal written policies and procedures relating to the reconciliation of contract billings to the actual receipt of revenues are developed and implemented and agency staff members are trained to ensure that all revenues are properly recorded and reported.

Auditee's Response

In response to this audit result, GROW provided the following comments:

> *We agree that an overstatement of revenue in the amount of $75,016 occurred during 2003. This error was subsequently corrected in GROW's accounting system. We disagree with the reasons for the overstatement. GROW's new business manager did not have experience in dealing with DMR and thought billing was under an MSA, rather than a DMR contract with a maximum obligation. The State or DMR did not pay GROW on that billing, so there are no funds to be returned. Essentially, an accounting mistake took place, which affects the financial statement presentation, but does not have a significant, deleterious effect to GROW.*

We also disagree with the finding that GROW did not have written policies or procedures relative to the recording of revenue. The Organization did have written policies and procedures that described its billing process. These procedures were provided to the field auditors when requested in October or November 2003. As a result of the audit, the Organization's business manager has received training in the use of GROW's business and accounting software. Additionally, with the assistance of the Organization's outside accounting firm, additional procedures have been developed to enhance and track state billing and assist GROW's business manager more fully understand its billing cycle and procedures.

Auditor's Reply

GROW's response states that the reason for the overstated revenues was the inexperience of its new Business Manager with DMR's billing process and that this overstatement was subsequently corrected in GROW's accounting system. As stated in our report, our audit determined that this discrepancy in fact resulted from the agency's recording of the revenues that it billed against its state contracts as having been received despite the fact that this was not always the case. This fact is supported by a memorandum dated December 4, 2003 from GROW's private accounting firm that states, in part:

The amount that appears in the current UFR is a total of all amounts billed by the organization. However, these amounts are in excess of the maximum obligation amounts per the DMR contracts. As such, we have adjusted both the revenue and the accounts receivable to reflect the correct amount of FY 2003 revenue and the correct amount due the organization from DMR as of June 30, 2003.

Contrary to GROW's assertion that written policies and procedures existed regarding its billing process, during our audit we reviewed all of the agency's policies and procedures and noted that those regarding revenue were deficient in that they did not require reconciliations of the amounts billed to the amounts actually received. As stated in our report, GROW is required by GAAP and AICPA standards to establish an adequate system of internal controls over all aspects of its operations, including the receipt and recording of revenue, to ensure that its financial transactions are properly authorized, recorded, and reported. Such controls not only serve to maintain the integrity of the accounting process and its continuity in case of staff turnover but also establish accountability for various operational activities.

In its response, GROW states that it is taking steps to address our concerns regarding this matter. Such measures are necessary, and they are responsive to our concerns.

3. INADEQUATE DOCUMENTATION TO SUBSTANTIATE THE ALLOCATION OF $1,465,897 IN WAGES PAID FOR FISCAL YEARS 2002 AND 2003

We found that, contrary to state regulations and the terms and conditions of its state contracts, GROW had not established adequate controls over the documentation and allocation of staff compensation expenses. Specifically, GROW did not require its salaried administrative staff members to document the hours worked or the functions benefited (e.g., specific program, cost center) and GROW did not follow its own policies and procedures relative to documenting the hours its non-salaried employees worked in state programs. As a result, there is inadequate assurance that all of the $1,465,897 in compensation expenses paid to GROW employees and allocated by GROW against state contracts during our audit period was accurate.

OSD has promulgated Terms and Conditions for Human and Social Service Contracts (General Contract Conditions), with which all human service providers, such as GROW, that contract with state agencies must comply. According to these General Contract Conditions, contracted human service providers such as GROW are required to maintain accurate and complete financial records, including payroll records, in order to receive reimbursement of these costs. Specifically, these General Contract Conditions state, in part:

> *The provider will maintain personnel records for each employee. These records shall include but not be limited to…payroll records, and…attendance records or effort reports, documentation program and assignment and hours and days worked.*

Furthermore, 808 CMR 1.04 (1), promulgated by OSD, states:

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

During fiscal years 2002 and 2003, GROW charged its state contracts $1,666,788 in payroll-related expenses. We reviewed the documentation GROW maintained relative to these payroll and payroll-related expenses and found that expenses totaling $200,891 that were billed by

GROW against its state contracts for staff members who provided transportation services to GROW's state-funded clients were adequately documented. However, the remaining $1,465,897 in payroll and payroll-related expenses was inadequately documented. Specifically, for three members of GROW's administrative staff (Executive Director, Assistant Executive Director/Program Director, and Business Manager), there were no time sheets to document the hours worked or the programs benefited by these individuals. For other staff members, time records were incomplete (e.g., indicated an arrival time but not a departure time and were not signed by the staff person's supervisor.)

Regarding these matters, GROW officials stated that they have taken corrective action and are in the process of implementing new policies and procedures that require all employees to complete weekly payroll records documenting the hours worked and functions benefited.

Recommendation

GROW should develop and implement policies and procedures regarding the maintenance of payroll records for its employees, as required by OSD. These policies and procedures should require all employees to complete weekly payroll records documenting hours worked and functions benefited (e.g., program, cost center, contract). In the case of administrative compensation, the allocation of wages (including salaried employees) should be adequately documented and based on an allocation methodology consistent with OSD regulations.

Auditee's Response

In response to this audit result, GROW provided the following comments:

> *We believe that the Organization did maintain adequate documentation to substantiate its allocation of payroll. While it is true that the administrative employees (executive director, assistant executive director and business manager) did not maintain time sheets, we believe the allocations made between the two programs and administrative functions are reasonably accurate. The allocations between GROW's only two programs (both state funded) were based on employee estimates of their recurring day-to-day activities and were reviewed by management for reasonableness.*
>
> *As a result of the audit, all employees are completing timesheets/cards on a contemporaneous basis so that accurate payroll information can be reflected in GROW's general ledger. Employees now allocate their time to specific programs or administration. Until 2002, GROW operated with only one program so the need for allocating payroll was not as significant as it became in 2002.*

Auditor's Reply

Contrary to GROW's assertion, the agency did not maintain adequate documentation to substantiate the allocation of its payroll. As noted in our report, according to the state's General Contract Conditions, contracted human service providers such as GROW are required to maintain accurate and complete financial records, including payroll records, in order to receive reimbursement for expenses. We found, however, that for three members of GROW's administrative staff (the Executive Director, Assistant Executive Director/Program Director, and Business Manager), there were no time sheets to document hours worked or the programs that benefited. For other staff members, time records were incomplete (for example, they indicated an arrival time but not a departure time, or they were not signed by the staff person's supervisor.) That both of GROW's programs are state funded does not mitigate GROW's responsibility to establish adequate internal controls and maintain its records in accordance with the terms and conditions of its state contracts.

In its response, GROW states that it is taking measures to address our concerns regarding this matter. Such measures are necessary and will serve to ensure that state funds are properly safeguarded against abuse and misuse.

4. UNALLOWABLE FRINGE BENEFIT EXPENSES TOTALING AT LEAST $10,401 PAID TO SELECTED GROW EMPLOYEES

We found that during fiscal years 2002 and 2003, GROW awarded fringe benefits totaling $10,401 to certain members of its administrative staff that were not available to all staff under GROW's formal written personnel policies and procedures. These benefits included $3,849 in fully paid family health care to GROW's Executive Director and $6,552 in extra vacation time provided to GROW's Executive Director and Assistant Executive Director/Program Director. Fringe benefits such as these that were not available to all employees under an estalished formal written policy are nonreimbursable expenses under state contracts.

The 808 CMR 1.05 (9), promulgated by OSD, identifies the following as being nonreimbursable expenses under state contracts:

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

During our audit, we reviewed the fringe benefits provided to various members of GROW's administrative staff and found instances where staff members were provided with fringe benefits that exceeded the amount allowed by GROW's policies. Specifically, according to GROW's policies and procedures, GROW offers group health insurance to its staff members, paying 75% of single coverage and 50% of family coverage. However, we found that GROW paid 100% of the premiums for family health care coverage for its Executive Director, which totaled $7,698 during fiscal year 2002. Of this amount, $3,849 (50%) was allocated to GROW's state-funded programs.

Additionally, GROW's vacation policy as outlined in its Employee Handbook is as follows:

> *Full-time employees are eligible for paid vacation time. Immediately upon hire, you accrue .83 days of vacation for each month worked, up to a maximum of 10 days of vacation.... After 2 full anniversary years, you accrue 1.25 days of vacation for each month worked up to a maximum of 15 days of vacation.... After 10 full anniversary years, you accrue 1.67 days of vacation for each month worked, up to a maximum of 20 days of vacation....*

However, we found that during fiscal year 2002, GROW provided its Executive Director and its Assistant Executive Director/Program Director vacation time in excess of the those amounts allowed by its vacation policy. The Executive Director was awarded one additional week (five days) totaling $1,265, and the Assistant Executive Director/Program Director was awarded two additional weeks (10 days) totaling $1,982. During fiscal year 2003, GROW awarded the Executive Director and the Assistant Executive Director/Program Director the same level of additional vacation time above that allowed by GROW's policies as they provided in fiscal year 2002. This additional vacation benefit totaled $3,305 in fiscal year 2003.

Recommendation

DMR should recover from GROW the $10,401 in non-reimbursable fringe benefit expenses that GROW charged against its state contracts during the period covered by our review. In addition, GROW should take measures to ensure that only allowable fringe benefit expenses are charged against its state contracts.

Auditee's Response

In response to this audit result, GROW provided the following comments:

We are in agreement that the executive director and assistant executive director received additional vacation time. However, we contend that the additional vacation time is warranted since each employee generally works well in excess of 40 hours per week and over the course of the year their additional hours more than compensate for the extra 40 hours they were awarded as vacation.

With regard to the family health coverage, the executive director did receive 100% family coverage, while other employees received only 50% coverage. However, this was considered when determining the executive director's compensation package, which is fairly modest (less than $58,000 in 2002). There is no effective difference between a salary of $58,000 and $3,849 in additional health benefits and a salary of $61,849. In either case, the compensation is well within state limits.

Based on discussions with the (auditors) and a review of Commonwealth regulations, such amounts of discriminately fringe benefits should be considered non-reimbursable. GROW has more than sufficient non-Commonwealth offsetting revenue reported on its UFR to cover these amounts.

Auditor's Reply

In its response, GROW states that the additional vacation time provided to two staff members was warranted because they worked more than 40 hours per week and were therefore entitled to additional paid leave as compensation. However, GROW did not maintain supporting documentation to substantiate that the individuals worked extra time.

Regarding the unallowable health insurance payments for the Executive Director, GROW states that the payments were considered when determining the executive director's fairly modest compensation package (less than $58,000 in 2002). Although GROW may have considered paying for 100% of the Executive Director's health insurance as part of a package, it did not establish such payments as a policy of the agency and therefore did not make its state purchasing agencies aware that this level of benefits was going to be provided to a staff member. Accordingly, the $3,849 that GROW charged against its state contracts for this fringe benefit is clearly unallowable in accordance with state regulations.

In its response, GROW asserts that it has sufficient non-state revenue to pay for the unallowable fringe benefits. However, GROW did not identify the questionable fringe benefit expenses as being non-reimbursable in the UFRs that it filed with the Commonwealth; nor did it identify that non-state revenues were used to pay for these expenses. Rather, GROW used state funds to pay for these expenses during each fiscal year. Consequently, we again recommend that DMR recover from GROW the $10,401 in non-reimbursable fringe benefit expenses that GROW charged against its state contracts during the period covered by our review. GROW should also take measures to ensure that only allowable fringe benefit expenses are charged against its state contracts.

5. INADEQUATE ADMINISTRATIVE AND INTERNAL CONTROLS OVER VARIOUS AGENCY OPERATIONS

We found that GROW had not developed and implemented an adequate system of internal controls over various aspects of its operations. For example, GROW had no written accounting policies and procedures or an accounting manual to ensure the accuracy of its financial transactions, reports, and recordkeeping. As a result, GROW and the Commonwealth cannot be assured that GROW's financial assets and Commonwealth funds were being properly safeguarded or that transactions relative to these accounts were properly authorized, recorded, and reported.

According to Generally Accepted Accounting Principles (GAAP), entities such as GROW should establish and implement an adequate internal control system within the organization to ensure that goals and objectives are met; resources are used in compliance with laws, regulations, and policies; assets are safeguarded against waste, loss, and misuse; and financial data is maintained, reported, and fairly disclosed in reports.

In order to comply with GAAP, GROW should have a documented, comprehensive plan of internal controls describing its goals and the means by which these goals and objectives could be achieved. An effective internal control system would establish clear lines of authorization and approval for its various business functions, such as purchasing, contracting, asset management, payroll, and personnel. In addition, an entity's internal control system should be backed up with a set of detailed subsidiary policies and procedures that would communicate responsibilities and expectations to subordinate staff by providing employees direction to complete various business operations such as accounting, billing, cash receipts, accounts payable, human resources, and payroll.

GROW did have a personnel policy manual, but our audit revealed that these policies were not fully developed or integrated in the operation of GROW. We found that in addition to the internal control problems discussed in Audit Results No. 1 though 3, GROW had not established adequate internal controls over several other aspects of its operations, as discussed below.

- Accounting System Not Documented: Sound business practices advocate that entities such as GROW establish a proper accounting system that is documented in formal policies and procedures and a written accounting manual, which describes the accounting system and the policies and procedures that are utilized in GROW's accounting process. Such a manual not only maintains the integrity of the accounting process and its continuity in case of staff turnover, but also establishes accountability for various operational activities. However, we noted that GROW had not established formal written accounting procedures or an accounting manual.

- Financial Records Not Maintained in Accordance with State Regulations: According to 808 CMR 1.04 (1) promulgated by OSD, entities such as GROW are required to maintain all financial records relative to revenue and expenses in accordance with GAAP as set forth by the American Institute of Certified Public Accountants for a period of seven years. However, during our audit, GROW officials were unable to provide us with various documentation, including time and attendance records for its salaried, exempt employees and GROW's fiscal year 2001 general ledger.

- Expenses Associated with Commercial Income Not Segregated: According to 808 CMR 1.02 and 1.04, entities such as GROW are required to separately identify in their financial records the revenues and expenses associated with their commercial activities (e.g., the operation of workshops doing contracted work for private businesses) from non-commercial activities. However, we found that although GROW's accounting system properly classifies commercial income, it does not separately identify the expenses associated with it.

GROW officials acknowledged that better controls were needed in these areas and that they were in the process of taking action to address these matters.

Recommendation

GROW should continue its efforts to immediately develop and implement adequate internal controls over all aspects of its operations.

Auditee's Response

In response to this audit result, GROW provided the following comments:

> *The (auditors) determined that the Organization's internal controls were not adequate and we disagree with this assessment. The Organization had experienced significant changes in its management during the period under audit. The Organization's long-term executive director and business manager had both terminated their employment and were replaced with a new program director and new business manager. With these departures, there was a significant loss of institutional memory. We believe that the former business manager answered many of the State Auditor's questions during the audit. Obviously, the documentation of the various accounting and operating policies at GROW could have been more formal and more elaborate. However, it is important to note that GROW operated with a very limited administrative budget and manpower. We*

believe the Organization had adequate internal controls and disagree with your findings. We believe the following to be true:

- *That the accounting system is documented*
- *That the financial records are maintained in accordance with state regulations*
- *Commercial expenses are properly segregated*

Additionally, the Organization has worked with its private accounting firm to strengthen its internal controls to the extent that it can. GROW must still deal with the reality that it has only a three person administrative staff and limited budget. An agency of $1m certainly cannot have the same internal control structure that a multi-million dollar agency possesses. However, GROW does have proper segregation of duties, safeguards to protect its and the Commonwealth's assets, and its financial activity is properly recorded to produce accurate financial statements. GROW's auditors have worked with management to increase the effectiveness of the internal controls at GROW since the State audit.

Auditor's Reply

We disagree with GROW's assertion that its internal controls were adequate. As stated in our report, GROW's accounting system is not adequately documented, its financial records are not maintained in accordance with state regulations, and its commercial expenses are not properly segregated. In its response, GROW contends that due to turnover in key staff positions the agency lost institutional knowledge. For internal controls to be effective, they must be documented and communicated to all staff. Otherwise, there is inadequate assurance that adequate internal controls exist—or, if they do exist, that there will be continuity in the application of these controls in the case of staff turnover. GROW contends that it had adequate internal controls to ensure that its records are being maintained in accordance with state regulations; however, that assertion contradicts the comments that GROW provided regarding other Audit Results. For example, regarding Audit Result No. 2, GROW agrees that due to internal control problems it was not maintaining accurate records of its revenue, and regarding Audit Result No.1, the agency acknowledges that it was not maintaining adequate attendance records for certain members of its administrative staff as required by state regulations. In fact, our audit identified several significant internal control problems that warrant the immediate attention of GROW's management. Although we agree that the small size of an organization affects the types of internal controls that it can efficiently and effectively implement, it does not excuse the organization from having adequate internal controls over all aspects of its operations, as required by GAAP, to ensure that state funds are being properly safeguarded.

The agency states that it is working to strengthen its internal controls. Such measures are necessary and should serve to better ensure that GROW fully complies with the terms and conditions of its state contracts.

APPENDIX

DESCRIPTION OF GROW'S WORKSHOP PROGRAMS

Employment Support

This program provides support in a variety of ways to individuals who desire to work and are looking to develop skills and opportunities for that purpose. Jobs are developed and designed based on the needs and interests of each individual. Assistance is provided in job skills training, job seeking, placement, and retention. In cooperation with family members, the employment support staff assists with the placements at every step.

Community-Based Support

This program provides support to individuals who chose to have work play a minor role in their lives. Although contract work is offered daily, it is the individual's choice to decide if they are going to participate and how long their involvement lasts each day. The program is flexible and directed by the individual's needs and abilities. The support staff helps to develop and reinforce the individual's practical skills, including communication, money management, personal care and safety, and training.