

# STATE OF CONNECTICUT

**PERFORMANCE AUDIT  
MONITORING OF STATE FINANCIAL ASSISTANCE  
DEPARTMENT OF MENTAL RETARDATION**

**August 9, 2002**

**AUDITORS OF PUBLIC ACCOUNTS  
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## EXECUTIVE SUMMARY

In accordance with the provisions of Section 2-90 of the Connecticut General Statutes, we have conducted a performance audit of some aspects of financial assistance monitoring for programs of the Department of Mental Retardation.

The Department of Mental Retardation administers programs and policies to provide a wide range of support and services for citizens of Connecticut with mental retardation. The Department is responsible for the planning, development, and administration of complete, comprehensive, and integrated statewide services for over 16,500 persons. These services include residential placement, day programs, early intervention, family support, respite, and case management.

The conditions noted during the audit, along with our recommendations, are summarized below.

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**Reports are not filed in a timely manner.**

The Consolidated Operational Reports and the State Single Audit reports are used by the Department of Mental Retardation to monitor its payments to private providers. Although these two reports are central to the Department's control system, they are not filed within the time allowed by law or within the provisions of the contracts between the Department and the providers. (See Item No. 1.)

**The Department of Mental Retardation should establish a tracking system for the receipt of the State Single Audit reports to ensure that these reports are received within the time allowed by law. In addition, the State Single Audit reports and the Department's Consolidated Operational Reports should be available when they are needed for the Department's analytical reports, reconciliation processes, decision making, as well as, the resolution of problems before new contracts are issued.**

Testing, performed on the State Single Audit reports filed at the Office of Policy and Management, disclosed that only 44 percent of the reports due on or before December 31, 1999, and 43 percent of the reports due on or before December 31, 2000, were submitted within the time allowed by law. In some instances extensions had been given. The receipt of the Consolidated Operational Reports was tested at two regional offices. In one regional office seven out of 21 reports were received by the October 15 deadline; eleven others had been granted waivers. Ten out of the 21 reports were not sent to the Central Office until after January first. At the other regional office 71 percent and 63 percent of the reports were received by October 15 for the two years tested. The late filing of

the reports delays the cost settlement process, the preparation of the analytical reports on the provider's financial activity, and correction of reporting and compliance issues addressed in the reports. These delays limit the information that the contract managers have available to them when contracts for the following year are negotiated.

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**Audit Report  
Collection and  
Review**

The Department of Mental Retardation does not have standardized procedures for the collection and review of the State Single Audit reports. (See Item No. 2.)

**Minimally, the Department should develop criteria and standardized procedures for the collection and review of the State Single Audit reports at the regional offices. The Department should consider centralizing the collection and initial review process of the State Single Audit reports.**

The Department of Mental Retardation has not provided the regional offices with specific procedures relating to the collection or review of the State Single Audit reports. The Department looks to its cognizant agent to ensure that reports are complete and in compliance with the Statutes. Because there have been no instructions or procedures issued to the regional offices, each of the five regional offices has taken a different approach to the collection and review of the State Single Audit reports.

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**Audit Report  
Findings**

The Department does not have standard procedures or require documentation for the resolution of audit report findings. (See Item No. 3.)

**Procedures for processing the State Single Audit report concerns and issues should be standardized and put into writing. Some type of tracking system should be developed to ensure that all of the reports issued by the Department's providers that are subject to the State Single Audit provisions are reviewed for findings and that the findings are resolved.**

According to the Regulations of Connecticut State Agencies, the resolution of audit findings that relate to the programs of a single grantor agency are the responsibility of the recipient and the agency. Although identified issues are addressed, the Department does not have a system to ensure that all findings are identified, that all the identified audit report findings are resolved, or that resolved issues are documented.

**Management Letters**

Management Letters, issued by the independent auditors, were, generally, not used by the Department to spot problems. (See Item No. 4.)

**Compliance with the terms of the contracts and the provisions of the State Regulations, relating to the submission of management letters, should be addressed. A summary of the letters should be incorporated in the providers' Financial Profile Reports produced by the Internal Audit Unit. In addition, when the Department sends out audit requirement reminders to the providers, it should include a reminder about the management letter requirements.**

Although the State Single Audit Regulations and the Department's contracts require that the providers or their independent auditor file management letters, if issued, with the Financial Statements, neither staff at the Central Office, nor staff at three out of the five regional offices determines if a management letter has been issued or reviews the letters for concerns that might affect the Department's programs or investments.

**Internal Audit Staff**

Historically the Internal Audit Unit at the Department of Mental Retardation has been understaffed. (See Item No. 5)

**Management should not lose sight of how the shift from government-managed facilities to facilities run by private providers has weakened their controls, and therefore, the need for a stronger internal audit function has increased.**

Although an active internal audit function is an important internal control tool for large, decentralized organizations, the Internal Audit Unit at the Department has been understaffed for many years. It was estimated in 1990, that the Department could net a savings of between \$1,000,000 and \$2,000,000 by increasing its audit activity. The use of private providers has increased since that time. As of August 2001, the staffing level of the audit unit was still below the 1990 budgeted level.

**Financial Profiles of the Private Providers**

Financial Profiles, prepared from the June 30, 2000, reports, were not timely or complete. (See Item No. 6)

**For the computerized program and database that produce Financial Profile reports to meet all the requirements of a review of the State Single Audit report, the input of data would have to be done on all their reports, and as close to the time that the reports are received as possible. In order to fulfill the State Single Audit requirements and to make the report a useful control tool, the Financial Profile needs to be expanded.**

The Department's most standardized, in-depth report review is found in the use of a computerized database system. Reports produced with the information entered into the database provide the staff with useful information, which can be used to monitor the financial health of the providers; in addition they help fulfill many of the Department's grantor agency responsibilities. For the period ending June 30, 2000, the database review and reports were not issued for all of the providers and those that were issued were not issued in time to be useful to the contract managers.

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**Related Party  
Transactions**

Related party transactions are considered by the Department to pose the greatest risk. (See Item No. 7.)

**The Department needs to find a way to ensure that the providers comply with its new related party procedures found in the Department's Protocol Compliance Manual. If after all efforts fail and compliance is still not met by the providers, the Department could consider not paying for related party transactions or limiting the payment to a small percent of the provider's total expenditures.**

The one area of expenses, which the Department feels that controls are not strong enough to prevent misuse, involved the payments made by the private providers to related parties. The Department has taken several steps to reduce, if not eliminate, this risk. All related party transactions are to be reported in the Consolidated Operational Reports and in the footnotes of the financial statements. In addition, the Internal Audit Unit has performed several audits relating to these expenses. The results of these reviews have not quelled the staffs' concerns. In July 2000, an Ethics Committee was formed within the Department and the Ethics Committee Protocol was issued. All related party transactions that fall under the threshold as provided by the terms of the Protocol are to be reported to the Committee each year. As of March 2001, very few providers have complied with this new procedure.

**Quality Control  
Reviews of the  
Working Papers**

Can the grantor agencies, such as the Department of Mental Retardation, look to the State Single Audit reports to provide assurance that the State's funds are used in accordance with the laws and to accomplish the mission of the Department? (See Item No. 8.)

**The Department's Internal Audit Unit should increase the number and frequency of provider audits it performs to review specific compliance issues and thereby strengthen controls. Also, quality control reviews of independent auditors' working papers would give the Department more assurance that program compliance is being addressed by the independent auditors in the State Single Audit reports. Although the Office of Policy and Management, the cognizant agency for most of the Department of Mental Retardation's private providers, has not performed any quality control reviews, the prospect of that agency performing such reviews in the near future appears to be increasing. New regulations, relating to the quality control reviews, were issued in April 2001.**

The reason, most frequently offered by the grantor agencies, as to why their systems of processing the State Single Audit reports are somewhat lax, is that they don't think the reports provide them with sufficient control over their program expenditures to justify the cost to the agency of actively collecting and reviewing the reports and following up on audit finding. Is this lack of confidence warranted? The grantor agencies need some guarantee that these audit reports are adequate and that sufficient testing has been performed to ensure that the reporting of the providers' financial records is accurate and that the grantor agencies' funding has been used for the purpose for which it was intended and in compliance with the relevant laws and regulations. This assurance can only be provided by determining that the underlying work supporting the audit report is not substandard and that the audit was conducted in accordance with applicable audit standards and the requirements of the State Single Audit Act.

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**Cost Principles**

Allowable and unallowable costs and cost allocation plans are not defined in the State's statutes or regulations. (See Item No. 9.)

**The Department in conjunction with the Office of Policy and Management and the other State grantor agencies should participate in the development of cost principles. Until Statewide cost principles are instituted, the Department should develop a list of specifically allowable and unallowable costs and**

**an acceptable cost allocation plan to be included in its contract with the private providers.**

Unlike the Federal government, the State has not established cost standards for the financial assistance that it dispenses to non-State entities. The lack of uniform cost standards or principles has resulted in the Department of Mental Retardation relying on its own standards, which are limited to “reasonable and appropriate” costs. Because the standards are ill defined, the providers funded by the Department interpret what is “reasonable and appropriate” differently than the staff in the Department. Because there are no standards defined in the State’s statutes or regulations, the Department has a weakened position when differences have to be settled.

## **BACKGROUND**

### STATE SINGLE AUDIT ACT

One of the functions of State government is to provide financial assistance, through State grants and loans, to entities that serve the needs of the State's citizens, either to improve the State's economy, to assist persons in need, to carry out specific programs mandated by the Legislature, or to assist municipalities. Prior to 1991, a separate audit of each financial assistance award was required to assure that State funding was being spent appropriately. Consequently, several different State agencies were often conducting audits of the same recipient's financial records. To reduce the duplication of effort and to establish uniform standards for financial audits, the State Single Audit Act (Act) was created and became effective July 1, 1991, through passage of Public Act 91-401 (codified as Chapter 55b of the Connecticut General Statutes). Municipalities and municipal agencies were to comply with this Statute beginning July 1, 1992; non-profit entities were given until July 1, 1994 before they were expected to comply. These reports are to be prepared by independent public auditors hired by the municipal, non-profit, governmental, or hospital recipient of State funding.

The Act was modeled after the Federal Single Audit Act, which requires all entities receiving Federal grants over a specified amount to be audited under the Federal Single Audit guidelines. Also similar to the Federal Single audit, one audit satisfies the requirements for all grant funds that are received. Originally the State Single Audit Act set a minimum dollar requirement of \$100,000 in combined Federal and State funding before an audit was required. With the passage of Public Act 98-143 the basis that determines when an audit pursuant to the Act has to be performed was changed. For fiscal years beginning on or after July 1, 1998, the requirement was changed from the receipt of \$100,000 of combined Federal and State funding to expenditures by the recipient of \$100,000 or more of State funding.

The Secretary of the Office of Policy and Management is responsible for the administration of the State Single Audit Act. Certain responsibilities, assigned to the Secretary, are described in Chapter 55b of the General Statutes. Those duties include the adoption of State Regulations to implement provisions of the Act and the designation of cognizant agencies for audits filed under the Act. The Office of Policy and Management is the cognizant agency for the municipalities, hospitals, private colleges and universities, and all other governmental and non-profit entities. The Municipal Finance Services Unit of the Office of Policy and Management's Intergovernmental Policy Division has been assigned the responsibility for assisting those entities in carrying out the requirements of the State Single Audit Act.

The responsibilities of the cognizant agencies are outlined in Section 4-235, subsection (b) of the General Statutes and Section 4-236-6 (effective August 20, 1993) and 4-236-21 (effective April 1, 2001) of the Regulations. They include the following:

- Provide technical advice and liaison to non-state entities and independent auditors.
- Promptly inform other affected State agencies and appropriate State and local law enforcement officials of any direct reporting of irregularities or illegal acts.

- Advise the independent auditor of any deficiencies found in an audit report when the deficiencies require corrective action by the independent auditor.
- Obtain or conduct quality control reviews of selected audits made by independent auditors of non-state entities.
- Ensure the resolution of audit findings that affect the programs of more than one State agency.
- Coordinate audits made by or for State agencies that are in addition to the audits made pursuant to Sections 4-236-23 and 4-236-26 of the State Regulations.
- Inform a State-awarding agency of an extension granted to an auditee for report submission.

In accordance with Section 4-236 of the General Statutes, the Secretary of the Office of Policy and Management has issued State Single Audit Regulations. The Regulations provide for the grantor agencies to participate with their assigned cognizant agency in order to fulfill the cognizant agency's State Single Audit responsibilities. The Office of Policy and Management has issued a desk review checklist to assist State agencies in carrying out their duties under the Act. The responsibilities of the grantor agencies, such as the Department of Mental Retardation, are outlined below:

- Ensure that their grantees are aware of and meet the Act filing requirements.
- Review the Schedule of State Financial Assistance or State awards to determine that the Agency's grants are properly reported on the Schedule and if any of the agency's grant programs are identified as major State programs.
- Review the Report on Compliance with specific requirements applicable to major State programs and determine if the specific requirements of the agency's major programs are listed.
- Review the independent auditor's report on the financial statements and notes to the financial statements to determine the existence of an explanatory paragraph or qualified opinion regarding the auditee's ability to continue as a going concern.
- Review the cognizant agency's Summary of Audit Findings for compliance findings, questioned costs, and internal control weaknesses for which the grantor agency is responsible, and evaluate their effect on the agency's programs.
- Evaluate Corrective Action Plans and follow-up to ascertain that they have been implemented.
- Determine the need for the recovery of any grant funds.

There are a number of programs exempt from the provisions of the Act. They are described in Section 4-230, subsection (20) of the General Statutes. State assistance provided to for-profit companies is not subject to provisions of the Act.

#### REVIEW OF STATE SINGLE AUDIT REPORTS

The Municipal Finance Services Section of the Office of Policy and Management, in conjunction with an outside contractor, reviews the State Single Audit reports for compliance with the Act. Full desk reviews, which entail a review of the audit report itself, are performed on approximately ten percent of the audit reports received. The purpose of the desk review is to

determine whether the report is in compliance with the terms outlined in Section 4-233 of the General Statutes. If deficiencies are found, the independent auditor is contacted and corrections are made. Limited desk reviews, known as finding reviews, are done on all reports. The finding review consists of listing all the problems with the grantee's systems that were listed in the Findings Section of the report by the independent auditor. When the desk reviews, findings reviews, and corrections are complete, the results of the findings reviews are sent out to the grantor agencies. If the findings affect more than one agency, the Office of Policy and Management becomes responsible for overseeing that findings are resolved. If the findings affect only one agency, the grantor agency is responsible for follow-up on the auditor's findings.

#### DEPARTMENT OF MENTAL RETARDATION

The Department of Mental Retardation is funded by the State of Connecticut to purchase or provide a wide range of supports and services for citizens of Connecticut with mental retardation. Unlike other agencies, its supports and services (with the exception of the Birth to Three Program) are not an entitlement for people with mental retardation. The Department is responsible for the planning, development, and administration of complete, comprehensive, and integrated statewide services for over 16,500 persons.

The philosophy, structure, and priorities of the Department have changed significantly over the years. Recognition of the right of mentally retarded individuals has grown, and the department has increased its emphasis on community placement for such persons. Many of the decisions made and actions undertaken have been the result of two federal court cases *CARC v. Thorne* (1984) and *USA v. State of Connecticut* (1986). Today the majority of its services are provided by private organizations in local communities with which the Department contracts. These services include residential placement, day programs, early intervention, family support, respite and case management.

Since the Department started to move away from government managed to privately managed facilities and programs, expenditures for contracts with independent non-profit and for-profit providers have expanded. In the past ten years expenditures for contracts has grown from \$106,045,961 (fiscal year 1989/1990) to \$293,161,860 (fiscal year 1999/2000) or a 176 percent increase. During this same period, expenditures for contracts had gone from approximately 31 percent of the total budget for the Department to 53 percent of the total budget.

#### **AUDIT OBJECTIVES, SCOPE, AND METHODOLOGY**

The Auditors of Public Accounts, in accordance with Section 2-90 of the Connecticut General Statutes, are responsible for examining the performance of State entities to determine their effectiveness in achieving expressed legislative purposes. Our assignment was to review the systems used to monitor the State financial assistance program. The review was to include the State Single Audit Program, as well as other monitoring tools at several agencies. As part of this review, a report was issued on August 2, 2000, for the Office of Policy and Management, as the administrator of and cognizant agency for the majority of recipients receiving State financial assistance. In addition, reports relating to the monitoring of the State's financial assistance have been issued for the Department of Economic and Community Development (issued July 3,

2001), the Judicial Department (issued September 25, 2001) and the Department of Mental Health and Addiction Services (issued February 26, 2002).

This report, as part of the larger audit mentioned above, is limited to a review of the Department of Mental Retardation and its role as a grantor agency of State financial assistance. This review focused on the Department's financial monitoring tools. Although program monitoring is a major function of the Department, it is organized as a separate function and therefore the system(s) used to monitor program performance was not included in this review. The audit covered economy, efficiency, and effectiveness issues, all of which are types of performance audits.

We conducted this performance audit of the Department of Mental Retardation's monitoring of State financial assistance in accordance with Generally Accepted Government Auditing Standards. Our purpose was to determine if the level of monitoring for State financial assistance provided by the Agency is adequate to ensure that State funds are expended appropriately.

Our audit objectives were as follows:

- To determine if the goals of the State Single Audit Act, as it applies to the Department of Mental Retardation, are being achieved.
- To determine if procedures, which have been instituted by the Department of Mental Retardation as a State grantor agency to oversee the expending of the State financial assistance, are adequate.

To accomplish our objectives, we conducted interviews at the central and regional offices and reviewed applicable statutes and regulations, procedures, contracts, reports, files, and documents. In addition, we reviewed prior audit reports including the Thomas Commission Report, issued July 1990, the Legislative Program Review and Investigation Committee Report, Department of Mental Retardation, issued January 1990, and the Auditors of Public Accounts financial audits for fiscal years ending June 30, 1995 through June 30, 1999. Although we used some data that came from automated systems, computer processed data were not an important or integral part of this audit. We did, however, confirm information that we used with other resources whenever possible. Nothing came to our attention to indicate that data produced from the automated systems were flawed.

The majority of the audit fieldwork was completed between March and July 2001, by Carolyn Z. Newell, a member of the staff of the Auditors of Public Accounts. Work was performed at the Department of Mental Retardation.

A discussion of our conclusions can be found in the Results of Review Section of this report. The discussion in Item No. 1 through Item No. 4 relates to the Department's processing of the State Single Audit reports and the grantor agency responsibilities outlined in the State Single Audit Statutes and Regulations. Items No. 5, 6, and 7 relate to other internal controls. Items No. 8, 9, and 10 explore how the State Single Audit function could be improved to make it

more useful for the Department and to provide better controls over the State's funding of private entities that provide services for the State.

### **NOTEWORTHY ACCOMPLISHMENTS**

- The Department has a comprehensive monitoring system over the payments made to private providers. Prior to the passage of the State Single Audit by the Legislature in 1991, the Department of Mental Retardation was moving away from government-managed to privately-managed facilities and programs. The Department realized that it needed a method to monitor the money that it was paying to the private providers. It hired a consultant to assist it in the change and to help it develop monitoring tools. The Operational Plan (OP), Audited Consolidated Operational Reports (COR), Completeness Review, Cost Settlement Calculations, and their accompanying instruction manuals resulted. These controls were specifically designed to address expenditures made by the providers of the Department of Mental Retardation's services and have made up the basis of the Department's controls system since their inception. During the past decade, up-dates to the system, as well as the addition of other monitoring systems, including the State's Single Audit, have been, more or less, successfully incorporated into this system. Our review of the process showed that the staff at regional offices had been trained and were familiar with the use of the Operational Plan and the Consolidated Operational Report. The review and process procedures appeared to be applied consistently.
- Staff within the Internal Audit Unit designed a computerized analytical review system called the "Financial Profile" system. After data is entered into the system from the State Single Audit reports and the Consolidated Operational reports, the system analyzes key economic indicators relating to the entity and compares any change in expenditures from year to year. It also aids in assuring that all the aspects of the reports have been reviewed and helps to assure that the Department has carried out its statutory duties as a grantor agency.
- In 1997, the staff in the Internal Audit Unit wrote narrative summaries on twenty-two different providers using the analytical data produced by the Financial Profile program, historical information, as well as data collected from other sources. The focus of these reports was to provide the contract managers with an overview of the strengths and weaknesses of the providers, in addition to pointing out areas that need further review or improvement. This effort proved to be too time consuming for the small staff and was discontinued. In the spring of 2001, another effort called the Program Integrity Team was organized with the hopes of coordinating information from several related, but unconnected programs and to evaluate the providers. The team was comprised of staff from several program areas within the Department, in addition to the Internal Audit Unit. Eleven providers were reviewed. Although dates have not been set, the program is to be implemented for all providers in the near future.
- One of the major weaknesses, identified by the Department, is that of related party transactions. The Department has tried to develop controls to minimize the risk in this area. Recently the Department established an Independent Contractor/Consultant Ethics Compliance Protocol, which was effective July 1, 2000. This protocol was to establish an internal process to address compliance with the State of Connecticut Statutes and State Ethics

Commission Advisory Opinions regarding ethics as they relate to the use of Department of Mental Retardation's contracted funds. In conjunction with this protocol, the Department also established an internal Ethics Committee, whose sole responsibility is to review and approve or disapprove submission regarding ethics interpretations as detailed in the State Ethics commission Advisory Opinion Letter pertaining to the use of State and individual client's funds. All related party transactions are to be reviewed by this committee either prior to the contract, services performed, or payment. The restrictions are dependent on the amount of the expenditure and/or the position in question. Compliance with these provisions is included in the State Single Audit Compliance Manual. The Department has established the control, but compliance by the providers has been minimal. A further discussion of this issue can be found in Item No. 7.

### **AREAS FOR FURTHER REVIEW**

While performing our review, we noted several areas, relating to the State's financial assistance program at the Department of Mental Retardation that are beyond the scope of our audit, but stand out as areas that require further review. The most important are noted below.

- As described in the Objectives, Scope, and Methodology Section, this report was limited to a review of controls over payments to private providers for the Department's programs with a focus on the compliance with, and the effectiveness of the State Single Audit. We did not review the controls used by the Department to ensure that their program goals are met.
- Because the Department is operating on a highly decentralized basis, it often lacks sufficient management control to ensure that it is operating in a uniform, efficient, and effective manner. Some changes have been made recently. Contracts with the providers are now standardized. In addition, there is some consistency in the program review process and some standardization of review forms. In spite of improvements, it was our observation that the regions within the Department remain decentralized. The lack of standardization could result in redundancy of effort, as well as other inefficiencies. A review of the Department's processes and procedures might be beneficial.
- The lack of quality control reviews by the cognizant agency is an issue that has been addressed in each of the reports issued on the State Single Audit. Quality control reviews of the independent auditors' working papers can provide additional assurance that the audit work performed meets the standards for reliability. The cost involved in performing this task, in addition to whom and how this task should be performed needs further review.
- It was brought to our attention that the Department's regulations are very out-of-date. Regulations are often the basis for procedures to instruct agency personnel as to how things are to be done. Some staff have found that controls are weakened. Minimally, it is very confusing when regulations aren't coordinated with the statutes to which they are related and when departments mentioned in the regulations are no longer in existence. Further study needs to be made to determine how out-dated the regulations are and what can be done to make them more useful.

## RESULTS OF REVIEW

### Item No. 1. Reports are not filed in a timely manner.

The Consolidated Operational Reports and the State Single Audit reports are used by the Department of Mental Retardation to monitor its payments to private providers. Although these two reports are central to the Department's control system, they are not filed within the time allowed by law or within the provisions of the contracts between the Department and the providers. The State Single Audit Act states that copies of the State Single Audit report shall be filed not later than six months after the end of the audit period unless an extension has been granted. According to the State regulations and Agency contracts, the Consolidated Operating Reports are to be submitted by October 15. Again, extensions or waivers can be granted. Testing, performed on the State Single Audit reports filed at the Office of Policy and Management, disclosed that only 44 percent of the reports due on or before December 31, 1999, and 43 percent of the reports due on or before December 31, 2000 were submitted within the time allowed by law. In some instances extensions had been given. The receipt of the Consolidated Operational Reports was tested at two regional offices. In one regional office seven out of 21 or 33 percent were received by the October 15 deadline; eleven others had been granted waivers. The regional offices review the reports to ensure that they are complete. More often than not, the reports have to be sent back to the providers for corrections. Ten out of the 21 reports filed with this regional office were not sent to the Central Office until after January first. At another regional office 71 percent and 63 percent of the reports were received by October 15 for the two years tested. It is not known when these reports were sent to the Central Office.

### STATE SINGLE AUDIT REPORTS

Section 4-232, subsection (b)(1) of the Connecticut General Statutes (State Single Audit Act) states that "copies of the report shall be filed...not later than six months after the end of the audit period. The cognizant agency may grant an extension of not more than 30 days." Section 4-235, subsection (b)(1) of the General Statutes further states that the cognizant agency shall ensure through the coordination with the State grantor agency that audits are made in a timely manner.

As part of our review of the of the State Single Audit process, we tried to determine if all audit reports that were required to be filed under the State Single Audit Act, were filed and if the required reports were filed within the time allowed by law. The Department of Mental Retardation has a Central Office and five regional offices. Many of its functions are fully or partially decentralized. The review and processing of the State Single Audit reports filed with the Department is decentralized and is primarily a function of the regional offices. In addition to filing the State Single Audit reports with the Office of Policy and Management, non-profit or governmental recipients of State funding through the Department of Mental Retardation are required to file State Single Audit reports with the regional offices of the Department. The regional offices then forward copies of the reports to the Central Office. On occasion, the Central Office may receive a copy directly from the recipient or its auditor.

The Department relies on the Office of Policy and Management to ensure that the State Single Audit reports are filed within the time allowed by the law. The understanding held by the staff is that their responsibility is to assist the Office of Policy and Management obtain any missing reports, when requested. Unfortunately, unless the grantor agency supplies the staff at the Office of Policy and Management with a listing of entities that are required to file State Single Audit reports for any given year, the Office of Policy and Management's staff does not know if, or when, a report is due. If a report is not filed, they may assume that the entity has not received funding for the year in question.

A randomly selected sample of State Single Audit reports for which the Department of Mental Retardation was a grantor agency was tested for fiscal year ending June 30, 1999. Out of the 25 reports selected only eight were submitted within the time allowed by law. Three of the providers had been granted extensions. Fourteen of the 25 were submitted an average of 48 days late with a range of between two and 136 days. Only 44 percent had been filed on or before the December 31, 1999 deadline.

As of May 2, 2001, the Office of Policy and Management had received 92 reports for the period ending June 30, 2000, for the Department of Mental Retardation providers. Twenty-one non-profit providers that had received funding during this period had not submitted reports to the Office of Policy and Management. Of the 92 that had been received 49 were received within the time period allowed by law. Again, less than 50 percent of the reports were received on time.

Because the State Single Audit reports are sent to the regional offices and then forwarded to the Central Office, the Central Office at the Department of Mental Retardation makes no attempt to determine whether the reports are filed on time. Both the Central Office staff and the regional office staff see this issue as the responsibility of the cognizant agency. Only one of the five regions track the date that the State Single Audit reports are received. At this regional office, we found that 35 and 52 percent of the State Single Audit reports were filed within the six months allowed by the Statutes for the two years ending June 30, 1999 and June 30, 2000.

#### NEW STATE SINGLE AUDIT REGULATIONS

Pursuant to the Connecticut General Statutes and Regulations in effect during the audited period, the cognizant agency was responsible for ensuring that the State Single Audit reports were filed within the time allowed. The grantor agencies are to cooperate in this effort. On April 2, 2001, Section 4-236-1 through 4-236-17 of the Connecticut Regulations were repealed and new regulations relating to the State Single Audit Act, Section 4-236-18 through 4-236-29, were put into effect. These new regulations shift most of the responsibility of ensuring that the State Single Audit reports are filed in a timely manner from the cognizant agency to the grantor agency. Section 4-236-21, subsection (b) of the State Regulation states that "A state agency that provides state financial assistance shall...(3) Work with the cognizant agency to ensure that audits are completed and reports are received in a timely manner; (4) Promptly notify the cognizant agency if audit reports are not submitted by the due date."

CONSOLIDATED OPERATIONAL REPORT

Prior to the enactment of the State Single Audit Act, the Department of Mental Retardation was moving away from government-managed to privately-managed facilities and programs. It hired a consultant to help them construct a method to monitor the money that they were paying to the private providers. The Operational Plan and the Audited Consolidated Operational Reports resulted. These financial controls only address expenditures for the Department of Mental Retardation's largest programs. These reports are incorporated into the contracts between the providers and the Department and are described in detail in the State Regulations Section 17-313b. Procedure manuals and guidelines support the collection, review, and use of these reports. In addition, standardized forms document the review, resolution, and cost settlement process.

Prior to July 1, 1994, when the State Single Audit Act took effect for non-profit entities, the Consolidated Operational Reports were audited statements. These reports constituted the core of the Department's control system over payments to the providers. When the State Single Audit Act became effective, the Department could not longer require the providers to have audited reports in addition to the State Single Audit report. To provide some assurance that the report was accurate, the Department decided to reconcile the audited financial statements, which are one of the required elements of the State Single Audit report, with the Consolidated Operational Reports.

In general, the Department's Central Office and regional offices take the filing of the Consolidated Operational Reports very seriously. The Central Office and most of the regional offices have a system to track the receipt of the reports. The October 15 filing deadline was found to be closely monitored by most of the regional offices. Any extension was documented. If an extension had not been granted, the reason as to why a report was filed late was resolved.

Our testing indicated that the forwarding of these reports to the Central Office for further processing was not as timely. One regional office tracked the date that reports were forwarded to the Central Office. Of the 21 reports tracked 11 were given extensions; ten reports were not sent to the Central Office until after January 1, 2001. We identified two reasons for the delays in forwarding the reports. One reason was that the Commissioner of the Department might give the provider an extension to the filing date. The extensions for the region tested ranged from 30 to 84 days. The other reason was that after staff at the regional offices receives the reports, they are responsible for ensuring that the reports are complete. This process may require staff to contact the provider several times before they are ready to be forwarded to the Central Office for further processing.

EFFECT OF LATE FILING AND PROCESSING OF REPORTS

The last step in the contract process is a cost settlement calculation statement. This process is performed at the Central Office. In addition, the Department's Internal Audit Unit produces an analytical report called a Financial Profile based on information gathered from the Consolidated Operational Reports and the State Single Audit reports. The State Single Audit Report financial statements are reconciled with the Consolidated Operational Report expenditures. Also, the State Single Audit reports address concerns that the auditors have with

internal control or compliance issues relating to the providers' controls and records. Beginning in late February or early March the contract managers review the successes and failures of the current contracts as the beginning of the contract process for the coming period. Before the contract managers begin this process they need to know results of the cost settlement process, if the provider has any problems with accounting or compliance issues, or if there are other financial issues (such as going-concern or related party issues) that should be addressed. When the reports are not filed on time or forwarded to the Central Office on time, the analytical reports based on the information provided by the reports cannot be processed. In addition, problems identified in the audit reports or analytical reports cannot be addressed before new contracts are signed.

#### RECOMMENDATIONS

Although the Department's conclusion that the Office of Policy and Management is responsible for ensuring that the State Single Audit reports are submitted within the time allowed by law, does seem to be supported by the Statutes, it may not have resulted in the most effective or reliable system of ensuring that it has all the information that it needs to make good decisions. In practice, the current State accounting system makes it difficult, if not impossible, for the Office of Policy and Management to collect all the State Single Audit reports without the help of the State grantor agencies. To comply with the new State Regulations, effective April 2001, the grantor agencies, such as the Department of Mental Retardation, will be responsible for notifying the Office of Policy and Management if the State Single Audit reports issued for the recipients of their funds have not been received within the six months allowed by law.

To comply with the new regulations the Department of Mental Retardation should establish its own tracking system for the receipt of the State Single Audit reports to ensure that these required reports are received within the time allowed by the provisions of the General Statutes. In addition, the importance of the timely receipt of these reports, as well as the Department's own Consolidated Operational Reports, should be recognized and additional effort made to ensure that the reports are available when they are needed for the Department's analytical reports, reconciliation processes, decision making, as well as, the resolution of problems before new contracts are issued. (See Recommendation No. 1.)

#### **Agency Response:**

"The Department agrees with the Auditors of Public Accounts regarding the importance of contractor compliance with State regulations and compliance with contract requirements requiring the timely submission of State Single Audit reports, and the timely receipt of the Consolidated Operational Reports. They are important reports required in the Department's financial analytical reviews, and in the Department's contract decision making.

The Department will develop standardized policies and procedures that will be followed by all DMR Regions. The procedures will require monitoring the submission of financial statements submitted in compliance with the State Single Audit Act, and will require monitoring the submission of Consolidated Operational Reports. Monitoring will review compliance to the contractual terms and conditions contained in the individual awards with organizations funded by the Department of Mental Retardation. In addition, monitoring will assure all reporting

requirements have been met. These procedures will be implemented to monitor financial reporting required beginning with fiscal year 2001 awards. Audit reports that have not been received and audit reports received late will be reported to the Office of Policy and Management. In addition, the Department's Internal Audit Unit will be monitoring the submission of these reports to identify organizations that are late filing these reports, and to identify organizations that have not filed the required reports. The annual contract negotiation process will address late filing and non-filing of financial reports during the annual contract negotiation process."

**Item No. 2. The Department of Mental Retardation does not have standard procedures for the collection and review of the State Single Audit reports.**

**The Department of Mental Retardation has not provided the regional offices with specific procedures or expectations regarding the collection or review of the State Single Audit reports. As stated in Item No. 1, the Department looks to the Office of Policy and Management, their cognizant agency, to ensure that reports are received within the time allowed by law. They also look to their cognizant agency to ensure that the State Single Audit reports are complete and are in compliance with the Statutes. The Office of Policy and Management does provide the grantor agencies with limited assurances. In addition, that Office provides an Audit Review Questionnaire to be used by the grantor agency. The Central Office of the Department does not use this form, nor does it perform any review of the audit reports for deficiencies or agreement with the Department's accounting records. Because there have been no instructions or procedures issued to the regional offices, each of the offices has taken a different approach to the collection and review of the State Single Audit reports for which they are responsible.**

#### BACKGROUND

Prior to the enactment of the State Single Audit Act in 1991, the Department of Mental Retardation found itself moving away from government-managed to privately-managed facilities and programs. As stated in Item No. 1, the Operational Plan and the Audited Consolidated Operational Reports were developed to monitor the increasing number and amount of payments by the Department to private providers. Procedures, review checklists, guidelines for the providers and the Agency staff were designed. These financial controls, incorporated into the contracts between the providers and the Department, are specific to the Department of Mental Retardation's expenditures and compliance issues. Procedure manuals and guidelines support the collection, review, and use of these reports. The review process is standardized and well documented. The Department's staff largely depends on this control system to ensure that the expenditures made by the providers are in accordance with the Department's mission and laws.

In contrast to the processing of the Consolidated Operational Reports, the Department has no written procedures, review checklists, or clear expectations for the processing of the State Single Audit reports. There is some confusion as to which State agency is responsible for what and even within the Department, whether certain tasks are the responsibility of the central or the regional offices.

The staff at the Department of Mental Retardation considers the Consolidated Operational Reports to be the core of their monitoring system over the payments to private providers. Because many members of the staff hold the opinion that the State Single Audit reports do not provide much in the way of additional control, the Department has not developed systems to collect or review the State Single Audit reports.

In addition to their lack of confidence in the report, the Department has decided that like the Federal cognizant agencies, the Office of Policy and Management is responsible for ensuring that the reports are filed on time and that the reports are in compliance with the State Single Audit Statutes. The Office of Policy and Management does provide some assurance that the

State Single Audit reports are timely and complete, but not full assurance. Each year auditing consultants, contracted by the Office of Policy and Management, perform full desk reviews on approximately ten percent of the State Single Audit reports received for all the State agencies. The reports that do not receive full desk reviews are reviewed to determine if there are findings in the audit reports, which have to be resolved, and which agency or agencies are responsible for the resolution of such findings. Neither the auditing consultant nor the Office of Policy and Management list lesser concerns that are discussed in management letters, footnotes, or other parts of the audit report. If the grantor agency does not provide the Office of Policy and Management with a listing of entities that are required to submit an audit report for a given year, that Agency does not know for sure who is supposed to file. They depend on the grantor agencies to notify them if a report is not filed.

#### CONDITION

Interviews were held with management at each of the five regional offices and at the Central Office. When State Single Audits reports are received, staff at all of the regional offices file one copy of the report and send the additional copies to the Central Office. Two out of the five regions maintained a log, which tracked the receipt of the Consolidated Operating Reports and the State Single Audit Reports. The contract manager interviewed in one other region kept a log of the reports for which he was responsible and assumed that all the other managers in his region did also. Two regions did not keep a log or record of the reports received. Staff at two of the regions were assigned the duty of carefully reviewing the audit reports, making sure that the expenditures in the reports agreed with the amounts reported in their accounting records and that all required elements of the report were submitted. These two regional offices made sure that management letters were submitted, if applicable, and reviewed the information in the management letters and footnotes. One of the two offices documented the review. Neither office had written procedures. Staff at the other regional offices did not record the receipt of the report nor review its contents.

Our review showed that the requirements for filing the Consolidated Operational Report and the State Single Audit Report were included in the contract between the providers and the Department. In addition, the Operational Unit in the Central Office sent reminders to the providers for the Consolidated Operational Reports and for the State Single Audit reports. The Operational Unit kept a record of the reports received from the regional offices for the Community Living Arrangement Programs and the Day Programs. Because the reports go to the regional offices first, the timeliness of the reports was not an issue and was not tracked. The log also tracks the receipt of Schedule D reports. Some providers may file this report instead of the Consolidated Operational Report. It was not possible to tell from the log at Central Office, which report was due, or if all the reports due, had been filed.

Our testing showed the following: (1) not all reports received had been entered into the log; (2) not all reports due had been received; (3) not all reports due to the Department were on the log; (4) the Department had received some reports that had not been filed with the Office of Policy and Management; and (5) the Office of Policy of Management had received some reports for which the Department of Mental Retardation was the grantor agency that had not been filed with the Department. As of February 1, 2001, the Central Office had received 65 of the possible 113 reports due December 31, 2000. Ten of these reports were not found on the Office of Policy

and Management's listing of reports due or received. By May 2, 2001, 81 percent of the reports due by December 31, 2000, from the Department's providers had been received by the Office of Policy and Management; twenty-two of these reports had not been entered into the Department of Mental Retardation's receipt log. At this time eighteen additional providers had not submitted reports to either the Department of Mental Retardation or the Office of Policy and Management.

#### EFFECT

The lack of clear expectations and written procedures has resulted in an uneven processing of the State Single Audit reports within the Department. Some reports were reviewed more than once and some not at all. The receipt of some reports was carefully monitored, but others were not monitored at all.

#### RECOMMENDATIONS

Minimally, the Department should develop criteria and standardized procedures for the collection and review of the State Single Audit Reports at the regional offices. These standards and procedures need to be in writing and the results of the collection and review should be documented. The Central Office should revise its report log so that it is evident which reports are due and which are missing. In addition, the log should be kept up to date. The Central Office report log should ensure that all reports due to the Department are received. To comply with the State Single Audit requirements, the Department should aid the cognizant agency by compiling and submitting a listing of all of the providers that are required to submit a State Single Audit report and notify that Office when reports are not filed.

Furthermore, the Department should consider centralizing the State Single Audit report collection and initial review process. All reports would be sent to one collection point; the timeliness of receipt could be tracked and the report reviewed for agreement with the Department's records, in addition to report deficiencies. The reports would then be available for further analysis at the Central Office in addition to being forwarded to the regional offices. If the Department were to consider this option, the reports receipt tracking system at the Central Office would need to be improved, as mentioned above. (See Recommendation No. 2.)

#### **Agency Response:**

"The Department agrees with the recommendation made by the Auditors of Public Accounts. As indicated in the response to the previous finding on *Reports not filed timely*, the Department will develop standardized policies and procedures to monitor compliance to the financial reporting requirements. These procedures will be followed by all DMR Regions to review timely submission of audited financial statements in compliance with the State Single Audit Act, and the timely submission of the Consolidated Operational Report. The Department's monitoring will assure compliance to all other financial and contractual compliance requirements. The monitoring will include reporting to OPM organizations that have filed late, or have not filed a State Single Audit. Additionally, at the end of each fiscal year the Department will submit a report to OPM identifying the non-profit organizations it contracts with, and the amount of the awards in order for OPM to be aware of the organizations it should expect State Single Audit Reports.

The development of monitoring procedures will include centralizing the submission of State Single Audit reports to the Department's Internal Audit Unit located in the Central Office. The Audit Unit will be more involved in the overall monitoring of compliance to all the financial reporting requirements."

**Item No. 3. The Department of Mental Retardation does not have standard procedures or require documentation for the resolution of audit findings.**

**According to State Regulations, the resolution of audit findings that relate to the programs of a single grantor agency are the responsibility of the recipient and the agency. At the Department of Mental Retardation there is no system to ensure that all findings are identified, that the identified audit report findings are resolved, or that resolved issues are documented. The system in place is informal. Because there are no written procedures or standardized documentation, the resolution of the audit findings may vary from year to year and from region to region; some findings are unresolved and are repeated.**

CRITERIA

Section 4-236-16, subsection (a) of the State Regulations provide that “the resolution of findings that relate to the programs of a single state agency shall be the responsibility of the recipient and the agency...” Furthermore, Section 4-236-29, subsection (c), states, “State grantor agencies shall follow up on audit findings to ensure proper resolution. Follow up procedures regarding a current year or prior year audit finding may include, but are not limited to, communication with the non-state entity and review of the non-state entity’s records...”

CONDITION

Like the other aspects of the State Single Audit reports, discussed in Item No. 1 and No. 2, the process used for the resolution of the audit report findings reflects the general opinion that many members of the staff at the Department hold regarding the relevance of the reports. There are no consistent policies, tracking log, or consistent documentation related to the resolution of the State Single Audit report findings. This is not to say that when findings are identified and considered significant, steps are not taken or that there is no communication between the Central Office and the regional offices concerning the findings.

When various members of the staff were questioned about the follow up process, there was a general consensus that there were few findings and those that were reported were insignificant. Initially we were told that there was no follow up. Neither of these statements proved to be accurate. Nineteen out of 100 reports reviewed by the Office of Policy and Management for the Department for fiscal year ending June 30, 2000, had findings. Seventeen reports with findings were identified from the reports on file at the Central Office for fiscal year ending June 30, 1999.

After the Office of Policy and Management reviews the reports, which can take anywhere from three to five months after the report-filing deadline, finding letters are batched and sent to the grantor agencies. These letters are sent to document the receipt of the reports, to identify audit reports that contain findings, and to assign responsibility to the agency that will make sure that the finding is resolved. In contrast to what was reported by the Agency, it was observed that the Internal Audit Director reviewed these finding letters.

Finding letters were received from the Office of Policy and Management in May 2001, for reports due December 31, 2000. We noted that the Office of Policy and Management did not

send finding letters for 17 providers that had filed reports with the Department. In addition, 16 providers had not filed reports with either the Office of Policy and Management or the Department of Mental Retardation. Furthermore, 12 letters were sent from the Office of Policy and Management for providers that had not sent reports to the Central Office. One of these missing reports had 21 findings.

After letters were received from the Office of Policy and Management, the Department made a determination as to what the response would be. If the recipient was required to submit a Corrective Action Plan, the Internal Audit Unit appeared to take over the Department's response. If a Corrective Action Plan was not required, the Internal Audit Unit made a determination as to whether the findings were serious enough to require follow up by the Internal Audit Unit. If the findings were not considered serious, suggestions are offered to the regional offices as to how they should respond. If the Internal Audit Unit was going to review the records of the provider the Internal Audit Director notified the affected regions, that a review would take place and the region would receive any resulting report. If the reported findings were turned over to the regional office, it might or might not include a request to report or document any resolution.

We observed that the Department of Mental Retardation's staff does review the letters from the Office of Policy and Management. Although this is a very quick and efficient way to process, evaluate, and assign responsibility, it may not prove to be the most timely or comprehensive method. Although the letters from the Office of Policy and Management were unusually late this year due to staffing problems at that Agency, letters from the Office of Policy and Management are not usually received until after they would be most useful. The regional staff would prefer to respond to the findings by incorporating them into the terms of the new provider contract. The findings can be included in the provider's objectives that are part of the contract. When more serious findings are involved, the length of the contract may be affected.

The contract renewal process starts in early March and negotiations should be completed before May. Because the Department did not review the audit reports prior to receiving the letters from the Office of Policy and Management, the response to the audit findings was delayed and the information was not useful for the contract process.

Historically the Internal Audit Unit has been understaffed. Consequently, the audit staff has had to choose the most efficient way to complete a task. The Office of Policy and Management did not send letters for all of the reports due to the Department of Mental Retardation. If the director doesn't get a letter from the Office of Policy and Management the findings are not reviewed. It is very possible that there are findings, which have not been addressed.

There are some findings, such as "segregation of duties" that neither the audit staff nor the regional managers consider important. This finding is usually found in reports of entities with small business offices where one person is responsible for all the tasks. It is difficult to embed internal controls in the organization of the office staff without adding additional staff. It usually means that management has to take on more responsibility for some aspects of the process and alternate controls need to be substituted as much as possible. To disregard the warning is not prudent. Some of the Department's providers, like many other small business

offices, are susceptible to the misuse of funds due to the fact that there is no oversight and one person has control or access to both the financial records and the financial assets.

Again, as seen in the collection and review of the State Single Audit reports, each of the regional offices responds to the audit findings in a variety of ways. Two offices do not review the reports. One office reviews the reports for “going concern” issues only. These three regional offices wait until they hear from the Central Office before they do anything relating to the audit report findings. The staff at the other two regional offices do a fairly extensive review of the audit findings, which include, in addition to reviewing the findings, a review of the management letter, if issued, the footnotes accompanying the financial statements, and other reported, but not material, issues. The policy at one of these two regions is to address all issues with the provider as soon as possible. The policy at the other regional office is to address the minor issues, but to wait until they hear from the audit unit director before they address the actual findings.

RECOMMENDATION

Procedures for processing the State Single Audit report concerns and issues should be standardized and put into writing. Some type of documentation should be developed to ensure that all of the reports issued by the Department’s providers that are subject to the State Single Audit Statutes are reviewed for findings, and that the findings are resolved. The review and evaluation of the impact of the findings on the Department’s funding should be performed before the contract negotiations begin. This information could not only help in decisions about specific providers, but also be used to develop data on problems, possible solutions, and perhaps even identify some early warning signals. (See Recommendation No. 3.)

**Agency Response:**

“The Department agrees with the recommendation made by the Auditors of Public Accounts. Standardizing the review of State Single Audit Reports will be included in the development of standardized procedures to ensure compliance with financial reporting requirements. As indicated in the response to *standard procedures for the collection and review of the State Single Audit reports*, submission of the State Single Audit will be centralized and submitted to the Department’s Internal Audit Unit. The Internal Audit Unit will enhance its procedures as recommended in a subsequent recommendation. The enhancements will include identifying findings contained in the State Single Audit reports, and include follow up with individual organizations to determine and evaluate their corrective actions(s). Timely submissions of State Single Audit reports should result in reviews of these reports prior to the contract review and negotiation process.”

**Item No. 4. Management letters, issued by the independent auditors, were generally not used by the Department to spot problems.**

**State Single Audit Report requirements, including management letter submission, were included in the provisions of the Department of Mental Retardation's contracts with the private providers. Neither staff at the Central Office nor staff members at three of the five regional offices established whether a management letter had been issued. If management letters were included in the audit package, these same offices did not review the letters for concerns that might affect the Department's programs or investments.**

#### BACKGROUND

Management letters are somewhat informal reports issued by the independent auditors when they detect deficiencies in internal controls that are not reportable conditions, but are of concern. These letters are often the first sign that there are control weaknesses, which if not corrected, may develop into findings or effect the financial health of the provider. Two areas of concern relating to the collection and review of the letters were noted.

As stated in Items No. 1, 2, and 3, the Department's review of the State Single Audit reports were not standardized. Procedures varied from regional office to regional office. The policy at two offices was to make sure that the management letters were included in the report package, if they had been issued. The filing of the management letters is one of the terms in the contracts between the Department and the providers. Both the old State Regulations, Section 4-235-12, subsection (d), and the new State Regulations, Section 4-236-21, subsection (b)(3), require that the management letter be filed with the State Single Audit Report, if issued. Section 4-236-12, subsection (d) of the State Regulations states that non-material findings reported in a separate communication shall be forwarded to the cognizant and grantor agencies.

#### CONDITION

The policy at these same two regional offices was to review and address any problems that related to the Department's programs. The Central Office and the other three regions did not review the management letters at any point. If the Office of Policy and Management performed a full desk review on a report, the staff in that Office would make sure that the letter was included in the audit package, if it had been issued, although the concerns mentioned in the letters would not be included in the finding letters sent out to the grantor agencies.

In addition to the fact that the letters were only read at two regional offices, sometimes it was difficult to tell by reading the audit report whether a letter had been issued or not. Section 5.28 of the Governmental Auditing Standards (Yellow Book), 1994 Revision, states, "When auditors detect deficiencies in internal controls that are not reportable conditions, they should communicate those deficiencies to the auditee... If the auditors have communicated...in a management letter, they should refer to that management letter when they report on controls." Management letters were found or a reference was made in 16 out of the 125 reports issued for fiscal year ending June 30, 1999. The sixteen reports were reviewed. Six reports had issued management letters, but the letters were not included in the audit report package at the Central

Office. One management letter was included in the reporting package, but it was not mentioned in the report on controls as required by the “Yellow Book.”

One regional office reported that on occasion the providers were reluctant to provide the Department with copies of their management letters. This requirement is very clear in the terms of the contracts and in the provisions of both the old and the new State Regulations.

#### RECOMMENDATION

Compliance with the terms of the contracts and the provisions of the State Regulations, relating to the management letter submission, should be addressed. All of the letters should be reviewed and the concerns weighted for importance. The Internal Audit Unit produces an analytical report called the Financial Profile Report. A summary of the concerns raised in the management letters should be included in this analysis. When reminders about the State Single Audit reporting requirements and deadline are sent to the providers, a further reminder about the provisions of the contract and State regulations relating to the management letter might improve the number of letters submitted.

In addition, the Department of Mental Retardation should suggest to the Office of Policy and Management that the State Single Audit Report Summary indicate whether or not a management letter was issued. (See Recommendation No. 4.)

#### **Agency Response:**

“The Department agrees with the recommendation made by the Auditors of Public Accounts. As formalized procedures are developed to address this report, the review to identify and collect management letters will become a part of the procedures to be followed by the Department’s Internal Audit Unit.”

**Item No. 5. Historically the Internal Audit Unit at the Department of Mental Retardation has been understaffed.**

**Although an active internal audit function is an important internal control tool for large, decentralized organizations, the Internal Audit Unit at the Department has been understaffed for many years. In a 1990 audit report, it was estimated that the Department could net a savings of between \$1,000,000 and \$2,000,000 by increasing its audit activity. At that time payments to private providers were approximately \$106,046,000. Programs have continued to shift toward the private sector and accordingly, payments have also increased. In fiscal year 1999-2000, payments to private providers amounted to approximately \$308,500,000 and have increased from 31 percent to 49 percent of the total budget. As of August 2001, the staffing level of the audit unit was still below the 1990 budgeted level.**

An internal auditing function improves internal control for large, decentralized organizations. It assists higher-level management in fulfilling its oversight responsibility of ensuring that fiscal operations are in compliance with management's objectives, policies and other requirements.

The Department of Mental Retardation manages a budget in excess of \$600,000,000, which includes funding of approximately \$308,500,000 for about 150 private providers. The Department is organized on a decentralized basis. The Department maintains a small audit unit. Although the unit's main function is to follow up on complaints and perform special reviews, it is also responsible for overseeing capital improvement expenditures for the Community Living Arrangement program. In addition, the Internal Audit Director performs several other duties, unrelated to the auditing function. The unit has not had the resources to perform routine and periodic reviews of the Department's operations or provide systematic oversight for the increased funding of contracted services.

The Thomas Commission Report, issued in 1990, recommended that the Internal Audit Unit staff be increased. It stated that there were significant opportunities to improve the Department's program by establishing systematic program oversight, which would include utilization review and periodic operational and financial audits. In addition, between \$1,000,000 and \$2,000,000 could be saved each year by increasing the audit activity. The 1990 budget provided for four staff auditors, one supervising auditor, and one secretary. At that time the Internal Audit staff consisted of two auditors.

Reports issued by the Auditors of Public Accounts for fiscal years ending June 30, 1995, 1996, and 1997, recommended that the Agency expand its internal audit function to include routine financial and compliance audits of its operations. The recommendation was dropped in 1998, because the Department was in the process of expanding the staff in its internal audit unit. This expansion did not take place. As of August 2001, the Internal Audit Unit consisted of two staff auditors and one supervising auditor and the Department was again in the process of expanding the unit. Management was planning to reach the 1990-budgeted level of four staff auditors and one director.

In March 2001, the Internal Audit Unit issued a report on one of its providers. Related party overpayments were reported to be in excess of \$1,300,000. The risks imposed by related party transactions and actions taken by the Department to mitigate these risks are further discussed in item #7 of this report.

The philosophy, structure, and priorities of the Department have changed significantly since its establishment in 1959. Many of the changes have been the result of two federal court cases *CARC v. Thorne* (1984) and *USA v. State of Connecticut* (1986). Today the majority of its services are provided by private non-profit organizations in local communities with which the Department contracts. Prior to the move away from government-managed facilities, the State's Auditors of Public Accounts performed systematic financial and compliance reviews on the majority of the Department's programs and expenditures. When the Thomas Commission report was issued in 1990, the payments to private providers of \$106,045,961 had increased to 31 percent of the Department's total budget, of approximately \$345,000,000. Since that time the expenditures for contracts with independent non-profit and for-profit providers have expanded. These expenditures have increased 190 percent to \$308,500,000 (fiscal year 1999/2000). Expenditures for contracts have increased from 31 to 49 percent of the total budget. Meanwhile, the Internal Audit Unit has stayed about the same size.

#### EFFECT

Based on our observation, this small unit appeared to complete the tasks that it perceived to be necessary; reviews were often in reaction to a crisis instead of a systematic plan. Hopefully, with more staff there will be more consistent and comprehensive reviews of the control tools in place such as the required reports. In addition, the internal audit staff will be able to assist management in fulfilling its oversight responsibility of ensuring that fiscal operations are in compliance with management's objectives, policies and other requirements.

#### RECOMMENDATION

Management should respond to the need for a stronger internal audit function and increased oversight due to the shift from government-managed facilities to privately managed facilities and services. (See Recommendation No. 5.)

#### **Agency Response:**

"The Department agrees with the recommendation made by the Auditors of Public Accounts. Over the last three years the Department has made significant progress toward re-staffing its Audit Unit. In June 1998, two financial auditors were added to its Central Office staff. In addition, in September and October 2001, the Department added two auditors. The Department's Internal Audit Unit is now comprised of a Director of Audit, a Supervisory Auditor and three Field Auditors. The Internal Audit Unit's Audit Plan for the next twelve months includes becoming more involved in monitoring State Single Audit reports."

#### **Auditors' Concluding Comment:**

The additional staff and resources in the Internal Audit Unit should allow for a more systematic approach to monitoring State financial assistance.

**Item No. 6. Financial Profiles prepared from the June 30, 2000, reports were neither timely nor complete.**

**The Department's most standardized, in-depth report review is found in the use of a computerized database system. Reports produced with the information found on the database provide the staff with useful information, which can be used to monitor the financial health of the providers; in addition they help fulfill many of the Department's grantor agency responsibilities. These reports were not performed on all the providers or in time to be useful to the contract managers for the period ending June 30, 2000.**

#### BACKGROUND

The Department has other control systems that supplement or enhance the key controls found in the Consolidated Operational Reports, the Internal Audit Unit and to some degree the State Single Audit reports. Two of these systems were reviewed: (1) the Financial Profile Reports, a computerized analytical review process based on the Consolidated Operational Reports and the State Single Audit reports and (2) the Department of Mental Retardation's Ethics Commission and Related Party Reports. The latter is discussed in Item No. 7.

Financial Profiles provided the staff with financial ratios, economic comparisons and trends, as well as other useful comparisons. The Financial Profile database and reports were designed to provide the Department with additional assurances that its funding was being used to accomplish its stated goals. Although the Central Office of the Department does not review the State Single Audit reports for deficiencies, findings, and agreement with the Agency records, it does enter information from these reports and from the Consolidated Operational Reports into a database. Analytical reports, produced from this data, are sent to the regional offices, and on occasion have been used as the basis for in-depth narrative reviews of some of the Department's providers. Our review indicated that the analytical report was an effective and useful tool. According to the regional contract managers, the report is used extensively when they are negotiating with the providers for new contracts. The analytical report, produced with information from the June 30, 2000 reports, was not issued in time for it to be useful.

The State Single Audit Statutes and Regulations require that grantor agencies, such as the Department of Mental Retardation, assist in ensuring that all required reports are received and are in compliance with the laws. As reported in Items No. 1, 2, and 3, the Department does not have standardized procedures for processing and reviewing the State Single Audit reports. Some of the regional offices review the reports that they are responsible for and others do not. Although the Central Office does not perform any type of review, the audit staff does enter information from both the State Single Audit reports and the Consolidated Operational Reports into a database. This computerized database was created by the Department and has been used to review the reports starting with reports issued for the fiscal year ending June 30, 1994. The system was developed to compare financial and disclosure information from one period with the two prior periods. Trends were to be identified, as well as any change. Entering data into the database also accomplishes a comparison between the information provided in the Consolidated Operational Report and the information in the audited financial statements accompanying the State Single Audit Reports. Reports called Financial Profiles are produced with this information. This process becomes the only review that is to be performed on all of the financial statements,

both the ones accompanying the State Single Audit reports and those filed by the for-profit entities.

#### CONDITION

Two aspects of the Financial Profiles were tested. One analysis was done to determine whether the Financial Profiles helped the Department fulfill its statutory obligations relating to the State Single Audit Act and provide additional oversight for the funding paid to private providers. The second review was to determine if the Financial Profile was actually produced and if so, whether it was used by the Agency. By entering the information into the computerized database, the Department fulfills many of its statutory obligations relating to the State Single Audit. If information is missing or doesn't match the Agency's information, data will be rejected by the system. The Financial Profile Reports were compared with the Office of Policy and Management's desk review form and the form provided by that Office to the grantor agencies. In addition, we compared the Financial Profile Report with the review form used by the Department of Mental Health and Addition Services to review its audit reports. The Financial Profile alone does not accomplish all of the objectives of a grantor agency desk review, but between the Financial Profile, the reconciliation of the Consolidated Operational Report, the "Completeness Review" performed at the regional offices, and the cost settlement calculations many of the objectives are covered. The following issues were not included in any review process:

- To assure that all programs funded by the State that are at or above the minimum dollar threshold for audit review (or in conjunction with other State programs reach the threshold) are in compliance with the State Single Audit Act.
- To inform providers of any new State and Federal Single audit provision.
- To review for compliance regarding completion of reports.
- To post the date of receipt in report tracking log.
- To keep track of providers that did not submit their audit reports on the due date.
- To send reminders to those providers that did not submit reports and to notify the Office of Policy and Management promptly when not submitted.
- To track corrective plan if the independent public accountant's findings were material and reportable.
- To determine if recipient has received funding from another State agency.

In general, the Financial Profile provides the Internal Audit Unit and the contract managers with a fairly extensive analysis of the financial statements, Consolidated Operational Reports, and the financial statement notes. In addition to tracking related party transactions, it forces, at least the person entering the data to review the audit and expense reports in detail. If any calculation or event stands out as a major change or problem, it can be brought to the attention of the Director of the Internal Audit Unit.

Our testing of the Financial Profiles showed that for financial reports with fiscal years ending June 30, 1999, 121 providers or 97 percent of the Department's contracts were processed. This represented 99 percent of the funding provided to the contractors. In contrast, for reports with fiscal years ending June 30, 2000, only 87 providers or 58 percent of the reports issued by

the providers had been reviewed as of July 19, 2001. This represented 71.5 percent of the contracted dollars. The reports for 62 providers, representing \$94,955,025, had not been reviewed. Only the information from the reports that had been received by the Central Office were entered into the database. Although a lot of information is found in the audited financial statements and notes, the staff chose not to enter the information for providers that did not submit Consolidated Operational Reports. In the prior year, the Financial Profile Reports were not limited to providers that submitted the Consolidated Operation Reports. The Department's Birth to Three Program was not reviewed; it had not received several reports at the time the data was entered into the system. The Department had not received several other reports.

Regional managers were interviewed to determine whether they felt that the Financial Profiles were helpful. In general the regional managers thought that the reports were very helpful. The reports were found to be most helpful at the offices where the audit reports had not already been reviewed. It was reported at several of the regions that the main problem with the Financial Profiles was that the regional offices had not received them in time for the contract negotiations. This is, in part, a result of the delay in the Central Office receiving the Consolidated Operational Reports and State Single Audit reports from the regional offices and the private providers. In addition, the Internal Audit Unit waits until most of the reports have been received and the information has been entered into the database, before it produces and distributes the reports to the regional offices.

In 1997, the Internal Audit Unit carefully analyzed the information provided by the Financial Profile Reports, in addition to other historic data, for 24 providers. Narrative analytical reports were produced. These reports made the financial information, ratios, and disclosures easy to understand. In addition to providing some projections for the future, weaknesses in the systems were identified, providing a good basis for planning future audits by the Department and warning signals for the regional managers. Areas, which required further study or were of concern, were identified for 22 of the 24 providers. Although the Central Office maintains the information in the database, it has not continued to do the in-depth analysis and written narratives.

The Director of the Internal Audit Unit stated that producing these reports was tremendously time consuming. In early 2001, the Department formed the Program Integrity Team whose job it is to put together comprehensive summaries of each of the providers. Representatives from several related, but unconnected, programs within the Department, in addition to the Internal Audit Unit, the contract managers, and caseworkers, have met to gather information on the providers for one region. It is planned to accumulate the data on all the providers from the other regions in the near future. The Internal Audit Unit provides this committee with some financial information, but, as stated above, has not attempted to repeat the narrative reports issued in 1997.

EFFECT

If the Central Office received the State Single Audit reports and the Consolidated Operational Reports, the source of the data for the Financial Profile Reports, when they were due, these analytical reports could be produced earlier in the year and would provide the contract managers with pertinent information prior to the contract negotiations. In addition, the process of creating the Financial Profile, with some minor modifications and documentation, would fulfill the Department's responsibilities regarding the State Single Audit. Because financial and statistical data is not static, perhaps simplified narrative reports could be done annually for a couple of providers in each region. This would up-date the completed narratives, as well as the reports that have resulted from the Program Integrity Team. In addition, the narratives would help the managers understand how to interpret the statistical data and what are some possible ramifications.

RECOMMENDATION

For the Financial Profile to meet all the requirements of a review of the State Single Audit, the input of the data would have to be done on all the reports and as close to the time that the reports are received as possible. Instead of issuing the Financial Profiles in a single batch, the Internal Audit Unit staff should issue them in smaller batches. In order to fulfill the State Single Audit requirements and to make the report a more useful control tool, the Profile needs to be expanded. In addition to what is already entered, the Profiles should also include the following: (1) a review of the management letter, if issued, (2) indication that the State Single Audit was received and is on file, if due, (3) a review of the footnotes, which are part of the financial statement, (4) documentation of the receipt and review of the finding letter from the Office of Policy and Management, (5) a positive or negative statement as to whether the report received a full desk review by the cognizant agency, (6) documentation of a Corrective Action Plan required and, if applicable, that it is resolved, (7) documentation of findings and any resolutions, (8) that the State Single Audit report is complete, and (9) that there are no non-material concerns reported in the Internal Control and Compliance Reports. Copies of the Financial Profiles, as well as any narrative reports, should be filed with the audit reports. (See Recommendation No. 6.)

**Agency Response:**

"The Department agrees with the recommendation made by the Auditors of Public Accounts. The 9 additional areas contained in this recommendation have been added to the Financial Profile. The organizations that are contracted by the Birth to Three Program will be added effective with the collection of financial data beginning with reports submitted for the 2001 fiscal year. As the Auditor's report stated, the submission of the Financial Profiles to Regions was not timely for the 2001 fiscal year contract negotiation process. Effective with the review of fiscal year 2001 financial data, the Financial Profiles will be submitted to the Regions in advance of the contract negotiation process.

For clarification purposes, the Financial Profiles were developed by the Department's Internal Audit Unit to provide DMR Regions with a comprehensive financial report to be used in the evaluation of organizations the Department contracts with. The evaluation of private

agencies by Regional Contract Managers is a process that is ongoing throughout the year and is not limited only to the contract negotiation period. While these reports are useful in the contract negotiation process, the reports include three years of historical information. Therefore, the reports can be used by Regions during their contract reviews and evaluations as they are conducted of individual agencies during the fiscal year. In addition, the Financial Profile was not created to comply with State Single Audit monitoring requirements. As the Auditors correctly report throughout their report, there was an assumption that State Single Audit compliance monitoring was the Cognizant Agency's responsibility. The Department recognizes the Financial Profile report can be enhanced and utilized in State Single Audit monitoring process, and as indicated in this response, the Financial Profile Report has been modified to include the financial items recommended by the Auditors."

**Item No. 7. Related party transactions are considered by the Department to pose the greatest risk.**

**In general, the Department feels that it has reasonable control over the expenses incurred by the providers and, in turn, reimbursed by the Department. The one area of expenses, which the Department feels that the controls are not strong enough to prevent misuse of its funding, involves the payments made by the providers to related parties. The Department has taken several steps to try to reduce, if not eliminate, the risk. All related party transactions are supposed to be reported in both the Consolidated Operational Reports and in the footnotes accompanying the financial statements. The Department has performed several extensive audits related to these expenses. The results of these reviews have not dispelled these concerns. In July 2000, the Ethics Committee was formed to establish an internal process to address compliance with the State of Connecticut Statutes and Ethics Commission Advisory Opinions regarding ethics as they relate to independent contractor's use of the Department of Mental Retardation's contracted funds. All related party transactions that fall under the threshold, as provided by the Ethics Committee Protocol, are to be reported to the Committee. As of March 2001, very few providers have complied with this new control procedure.**

#### BACKGROUND

Department of Social Services' rate setting regulations, found in Section 17-313b-5 of the State Regulations, limit the amount of the related party's allowable cost. That definition is: "Whenever costs are incurred between related parties, allowable cost shall be defined as and limited to the cost to the related party. Findings of relatedness may be made in the absence of majority stock ownership of the related parties in respective organizations. The related party principle applies to any transaction between a provider and a related party, including but not limited to, one-time or multiple transactions involving services or supplies and one-time sales or lease of the facility itself. Related party transactions must be identified as such in the Consolidated Operational Report and the unallowable portion excluded in the appropriate section of this (report)."

Section 17-313b-1, subsection (19) of the State Regulations defines the term related party. That definition is, "Related Parties means person or organizations related through marriage, ability to control, ownership, and family or business association. Past exercise or influences of control need not be shown, only the potential or ability to directly, or indirectly, exercise influence or control."

In addition to the State Statutes and Regulations, the Ethics Compliance Protocol, which was designed to provide stronger controls over these expenses, is based on the State Ethics Commission's Opinions. The Department obtained opinion letters from the State's Ethics Commission that relate to the payment of related parties by the private providers. Advisory Opinions are official written rulings, by the State Ethics Commission, interpreting Connecticut General Statutes relating to ethics. Advisory Opinion 99-14, issued July 9, 1999, relates to the hiring of relatives by independent contractors; Advisory Opinion 99-15, issued July 9, 1999, relates to the acceptance of expense payments to accompany Department of Mental Retardation clients to events; Advisory Opinion 99-17, issued July 9, 1999, relates to gift restrictions to

employees of private agencies under contract with the Department of Mental Retardation; and Advisory Opinion 99-19, issued July 9, 1999, relates to independent contractors' use of State funds to benefit related parties.

The Department's Ethics Committee for Independent Contractors/Consultants is responsible for reviewing and approving or disapproving requests relating to the above mentioned Advisory Opinions. Although all related party transactions are to be reported in the Consolidated Operational Reports and the footnotes to the financial statements, the following transactions are to be approved by or reported to the Department's Ethics Committee:

- Hiring of relatives – Prior approval of the Department's Ethics Committee is required before hiring an immediate family member of a board member as Executive Director or equivalent of the agency or hiring an immediate family member of a Board member or Executive Director into an exempt employee position at the agency. The Committee is to be notified when any immediate family member of any current employee is hired.
- The acceptance of expense payments to accompany Department of Mental Retardation clients to events – Prior approval is required for any event costing over \$2,000. For events costing more than \$100, but less than \$2,000, post review is required.
- Related party transactions costing less than \$2,500 do not need prior approval, but must be reported in the Consolidated Operational Report and disclosed in the footnotes to the financial statements. These payments are subject to review and remain subject to the regulatory requirement that the allowable cost will be the related party's actual cost.
- Related party transactions costing \$2,500 or more must be presented to the Committee for approval. In addition, these transactions must be reported in the Consolidated Operational Report and disclosed in the footnotes to the financial statements. In addition, these payments are subject to review and remain subject to the regulatory requirement that the allowable cost will be the related party's actual cost.

The criteria used by the Committee, as well as the documentation required, are clearly defined in the manual. Acceptance by the Ethics committee does not preclude that the Department of Social Services or the Department of Mental Retardation will not conduct an audit or post review of the related party transactions. If substantial changes are contemplated to arrangements previously approved, the Department's Ethics committee is to be informed.

#### CONDITION

The Internal Audit Unit compiled a report, based on the financial reports issued for the period ending June 30, 1999, of all related party transactions for all the private providers. The report compiled for the Ethics Committee was intended to include related party transactions that would be contracted for in the upcoming year even though they had been in existence prior to July 1, 2000, when the provisions of the Ethics Committee were issued. Fifty-one providers had reported related party transactions for the period ended June 30, 1999. Most providers, reporting related party transactions, had multiple transactions. As of March 12, 2001, twenty-three

providers had submitted requests for 47 transactions. Thirteen of the requests were for transactions that did not require prior approval and were for notification only, five requests were denied, and 29 were approved. Only two of the 51 providers requested approval for related party activities that were reported in the June 30, 1999, reports.

#### RECOMMENDATION

Compliance with the requirements outlined in the Ethics Compliance Protocol by the private providers has been added to the State Compliance Manual and is to be audited as part of the State Single Audit, beginning with reports issued for fiscal years ending June 30, 2001. In addition, terms, relating to compliance with the related party issues, have been added to the contracts between the Department and the private providers. The Department has expended an enormous amount of energy and time to developing and establishing a strong control over related party transactions. Now the Department has to find a way to ensure that the control is used. Other options, which the Department might consider, are to limit the amount of the State's funding or the percent of costs per provider that can be used for related party expenditures; to expand the Consolidated Operational Report to include a detailed listing of exactly what the management fees represent; and as mentioned earlier, to expand the number of reviews done by staff in the Internal Audit Unit. As a last resort, the Department could consider not paying for related party transactions unless the terms of the Ethics Compliance Protocol are followed. (See Recommendation No. 7.)

#### **Agency Response:**

“The Department agrees with the recommendation made by the Auditors of Public Accounts. As the Auditors indicate, the implementation of the Department's Ethics protocols and requirements, and the State Single Audit compliance requirements were effective beginning with fiscal year 2001. The Internal Audit Unit's reviews of agency financial statements conducted as part of the process to collect data for the Financial Profile already include the review for related party transactions. Future reviews will include determining whether related party transactions have been approved by the Department's Ethics Committee, as required by the Department's Ethics Protocols. To the extent the Internal Audit Unit's reviews identify related party transactions that have not been approved by the Department's Ethics Committee, Regional Contract Managers will be advised and follow-up with the agency conducted to ensure compliance. Issues relating to non-compliance may be included in the annual contract negotiation process. As part of the annual contract negotiation process, the Department has already limited funding of the related party transactions of one private agency. These limitations were put into effect in advance of the implementation of the DMR Ethics Protocols.

Reviews for compliance to the DMR Ethics Protocols related to the hiring of relatives and related to the expenditure of client personal funds on staff will be included as routine audit steps by the Department's Internal Audit Unit when field reviews are conducted of organizations that contract with the Department.”

**Item No. 8. Can the grantor agencies, such as the Department of Mental Retardation, look to the State Single Audit reports to provide assurance that the State's funds are used in accordance with the laws and to accomplish the mission of the Department?**

**The reason, most frequently offered by the grantor agencies, as to why their systems of processing the State Single Audit reports are somewhat lax, is that they don't think the reports provide them with sufficient control over their program expenditures. Is this lack of confidence justified? Can these audit reports be relied on to identify inaccurate financial reporting and/or noncompliance with State laws and regulations? Are there ways in which the State Single Audit program can be developed into a better monitoring tool? These are questions, which were asked and are addressed in this discussion, as well as in Item No. 9.**

#### BACKGROUND

This performance audit, as described in the Audit Objective, Scope, and Methodology section of this report, is part of a larger audit to examine the systems used to monitor the State financial assistance program, with a focus on the State Single Audit Program. This report is the fifth and final part of the series. It was noted in three of the reports that have been issued that there is a need for assurance that the State Single Audits performed by the independent auditors are adequate. This assurance can only be provided by determining that the underlying work supporting the audit report is not substandard and that the audit was conducted in accordance with applicable auditing standards and the requirements of the Single Audit Act. The grantor agencies need some guarantee that these audit reports are adequate and that sufficient testing has been performed to ensure that the reporting of the providers' financial records is accurate and that their funding has been used for the purpose for which it was intended and in compliance with the relevant laws and regulations. This function is assigned to the cognizant agency at the Federal level, and although the Auditors of Public Accounts have recommended it in the past, the Department of Mental Retardation, as well as other grantor agencies, considered quality control reviews to be the responsibility of the Office of Policy and Management, the cognizant agency.

#### CONDITION

Because quality control reviews are not done by the Office of Policy and Management, the Department's cognizant agency, a comparison of reports issued by the independent auditors under the State Single Audit Act were compared with audits of the same providers performed by the Internal Audit Unit of the Department of Mental Retardation. It is to be acknowledged that any results would not be conclusive. This is true because audits performed under the State Single Audit Act have a general focus on the financial statements and general, as well as specific, compliance issues. Materiality is a key component of all general financial statement audits. The audits performed by the Internal Audit Unit are focused on specific issues relating to the Department's programs. Consequently, the expectation is that there would be more testing in a focused area.

The Department's Internal Audit Unit scheduled forty-four audits during the period between January 1999, and December 2000. Twelve were reviews of "Client Funds." Four reviews were not finished or no report was issued. A sample of 19 reports was chosen; fifteen of the 19 had corresponding State Single Audit reports issued by independent auditors.

Six reviews (five performed by the Department of Mental Retardation and one performed by the Department of Education) agreed with the audit reports issued by the independent auditors. The Department performed one review because the recipient had not submitted a State Single Audit report, as required, for two years. One independent audit report disclosed weaknesses in the provider's accounting system. The Internal Audit Unit reviewed record systems from the same provider and determined that they were acceptable. The Department's staff performed three different reviews on "Client Funds" at different sites for one provider. Weaknesses were reported in all three reviews. One independent report was available for the period. No findings or weaknesses relating to the "Client Funds" were reported. Three reports were issued for one provider and the Department issued one report for another provider. There were corresponding State Single Audit reports issued by independent auditors. There were no compliance issues or questioned costs reported in any of the reports issued by independent auditors. The Department found weaknesses in all four reports. Questioned costs exceeding \$1,300,000, were calculated for one of the providers.

#### EFFECT

This small review does not provide conclusive evidence that there is a problem, but provides the grantor agencies some reason to question how much assurance the State Single Audit reports offer and to consider strongly which agency should take on the responsibility of providing for some assurance on the quality of the working papers of the independent auditors. Although the Department does not think that its staff should perform quality control reviews, the finding provides enough reason to increase the number of financial and compliance audits by the Internal Audit Unit.

#### RECOMMENDATION

Although there is no doubt that quality control reviews by the cognizant agency of the independent auditors' working papers would give the grantor agencies more confidence that their concerns are being addressed, controls, not necessarily confidence, could also be strengthened by increasing the number of audits performed by the Department. Although the Office of Policy and Management, the cognizant agency for the Department of Mental Retardation's non-profit providers, has not performed any quality control reviews, the prospect of that Agency performing such reviews in the near future appears to be more likely. New regulations, related to the State Single Audit Act, were issued in April 2001. Section 4-236-21, subsection (a)(4) states that "A cognizant agency shall: (4) Obtain or conduct quality control reviews of selected audits made by independent auditors of non-state entities, at its discretion..." (See Recommendation No. 8.)

#### **Agency Response:**

"The Department has no specific response to the issue raised by the Auditors of Public Accounts finding concerning whether grantor agencies can look to the State Single Audit reports to provide assurance that the State's funds are used in accordance with the laws and to accomplish the mission of the Department. This finding appears to be directed to the cognizant agency, not the Department of Mental Retardation. The Department's Internal Audit Unit will continue to conduct the broad spectrum of quality desk reviews and field audits in response to the Department's needs. As indicated in previous responses to audit recommendations contained

in this report, the Internal Audit Unit will enhance its procedures in order to address the areas applicable to State Single Audit that have been identified by the Auditors.”

**Office of Policy and Management Response:**

The following is the response of the Office of Policy and Management (OPM), to this recommendation as presented in our review of Monitoring of State Financial Assistance, State Single Audit, Office of Policy and Management, dated August 2, 2000:

“OPM agrees with this recommendation, but does not have adequate staff nor the expertise or training for conducting working paper reviews. There are other State agencies that have been designated as cognizant for the State Single Audit. They may have staff that is expertise in this area, which they may be willing to share with OPM. We will explore this issue with other cognizant agencies.”

**Item No. 9. Allowable and unallowable costs are not defined by the State Statutes or Regulations.**

Unlike the Federal government, the State has not established cost standards for the financial assistance that it dispenses to non-State entities. The lack of uniform cost standards or principles in the State has resulted in the Department of Mental Retardation developing its own standards, which are limited to “reasonable and appropriate” costs. Because the standards are ill defined, sometimes the private providers funded by the Department interpret what is “reasonable and appropriate” differently than the Department does. On occasion, this difference of opinion has led to lawsuits. Because there are no provisions in the State Statutes or Regulations relating to allowable or unallowable costs, the Department does not have strong legal footing and has had to pay for expenses that it does not think are reasonable.

BACKGROUND

The Federal government has published cost-principles in several circulars. The objective of the Federal circulars is not to dictate the extent of the Federal participation but only to determine what costs may or may not be reimbursed under a Federal award. Cost principles require that both direct and indirect costs meet certain criteria to be eligible for reimbursement. The total amount of costs that can be claimed is equal to the total direct costs plus the allocable portion of indirect cost minus applicable credits. In the Federal Office of Management and Budget Circular A-122, 55 separate cost issues are identified as to whether they are allowable or unallowable.

CONDITION

The Office of Policy and Management, the cognizant agency for most of the State Single Audit recipients, was the first agency reviewed in this series of reports on the State Single Audit. It was stated in that report that because cost principles had not been established, the State’s control over its administration of State awards had been weakened. In the Judicial Department Report, issued September 25, 2001, confusion as to which cost allocation plan to use was reported due to the lack of cost principles.

In April 2000, Public Act 00-125 was enacted. This Act would permit the Office of Policy and Management to adopt regulations that would establish uniform cost principles. Shortly thereafter a workgroup of State agency personnel, led by a staff member of the Office of Policy and Management Budget Division, was formed to develop such standards. Because the development of State cost standards seemed inevitable, no recommendation was made when the Office of Policy and Management report was issued. The workgroup was disbanded during fiscal year 2000-2001, due in part to the loss of staff at the Office of Policy and Management, and consequently the much needed cost standards have not been developed.

In April 2001, Section 4-236-1 through 4-236-17 of the State Regulations were repealed and were replaced by Section 4-236-18 through 4-236-30. The new Regulations provide a definition of Questioned Costs, which follows: (1) Results from a violation or possible violation of a provision of a law, regulation, contract, grant or other agreement or document governing the

use of State financial assistance, including funds used to match, (2) costs that are not supported by adequate documentation, or (3) costs that appear unreasonable, unrelated, or do not reflect the actions a prudent person would take in the circumstances.

The new Regulations provide some definition of questioned costs, but do not address the issue or establish a foundation for costs that are specifically allowable or unallowable. In addition, they do not give the grantor agencies or the State funding recipients a guide to follow regarding an acceptable, standard cost allocation plan.

#### EFFECT

Developing cost standards for the State would give the grantor agencies legal standing, when required, in addition to providing the recipients some guideline regarding what costs will not be reimbursed and what method they can use to allocate their indirect costs.

The lack of cost standards is a major weakness in the State's monitoring system over funding provided to non-State entities. The State Single Audit reports will not provide the grantor agencies with a useful monitoring tool without some changes. One of the most important changes which needs to occur is the development of cost standards, which would include a listing of allowable and unallowable costs and a cost allocation plan, Under the guidance of the Office of Policy and Management, the grantor agency should participate in the development of such a plan. The grantor agencies should make their needs known to the cognizant agency.

#### RECOMMENDATION

Because the Department of Mental Retardation cannot take action on developing Statewide cost standards by themselves and until standardized State Cost Principles are developed, the Department should develop a list of specifically allowable and unallowable costs and an acceptable cost allocation plan to be included in its contracts with the private providers. (See Recommendation No 9.)

#### **Agency Response:**

“The Department strongly agrees with the recommendation made by the Auditors of Public Accounts. The lack of statewide cost standards is a major weakness in the State's monitoring system for funding provided non-State entities. The Department is in the process of drafting cost principles that will be applicable to the Department's awards to non-State entities effective fiscal year 2003.”

## RECOMMENDATIONS

- 1. The Department of Mental Retardation should establish its own tracking system for the receipt of the State Single Audit reports to ensure that these required reports are received within the time allowed by Section 4-232 of the General Statutes.**

Comment:

The Department should establish a tracking system for the receipt of the State Single Audit reports to be in compliance with the new State Single Audit Regulation and to ensure timely receipt of the reports, as well as the Consolidated Operational Reports, so that the information contained in the reports is available for further analysis, processing, and decision-making.

- 2. Minimally, the Department should develop criteria and standardized procedures for the collection and review of the State Single Audit reports at the regional offices. In addition, the Department should consider centralizing the State Single Audit report collection and review process.**

Comment:

The Central Office has not provided the regional offices with specific procedures regarding the collection or review of the State Single Audit reports; consequently, each of the regional offices has taken a different approach to the collection and review of the reports for which they are responsible.

- 3. Procedures for processing the State Single Audit report findings and concerns should be standardized. The resolution of these findings should be documented.**

Comment:

Findings and concerns identified in the State Single Audit reports and accompanying management letters vary from possibly having a serious impact on the Department's programs or use of funds to being insignificant and having no effect at all. Although the resolutions of the issues are different, the process should be similar. All findings and concerns should be identified. In addition, confirmation that issues have been addressed and/or resolved should be in writing and should be kept with the audit report in which the finding was reported

- 4. Compliance with the terms of the contracts and the provisions of the State Regulations relating to the submission of management letters, should be addressed. A review and summary of the letters should be incorporated in the Internal Audit's Financial Profile Reports. In addition, when the Department sends out audit requirement reminders to the providers, it should include a reminder about the management letter.**

Comment:

Management letters, issued by the independent auditors, were, generally not used by the Department to spot problems.

- 5. Management should respond to the need for a stronger internal audit function and increased oversight due to the shift from government- managed facilities to privately managed facilities and services.**

Comment:

An active internal audit function is one of the key elements of an internal control system for large, decentralized organizations. Historically, the Internal Audit Unit at the Department of Mental Retardation has been understaffed. As of August 2001, the internal audit staff remains at the 1990-level when the payment to private providers was \$106,046,000; the Department's expenditure for private providers was approximately \$308,500,000 in the 2000-2001 fiscal year.

- 6. The Internal Audit Unit should issue the Financial Profile Reports for all providers and every effort should be made to issue these same reports prior to the contract negotiations. If the Department is going to use the Financial Profile Reports to fulfill its State Single Audit requirements as grantor agency, the Report should be expanded.**

Comment:

Financial Profile Reports, prepared from the June 30, 2000, reports issued by the providers were not timely or complete.

- 7. The Department should ensure that the providers comply with its new related party procedures found in the Department's Ethics Compliance Protocol.**

Comment:

Related party transactions by the private providers are considered by the Department to be the area of their program that poses the highest risk. The Department has put controls into place, but they are not being followed by the providers nor enforced by the Department.

The following recommendations cannot be carried out by the Department of Mental Retardation alone. The subsequent changes need to be addressed before the grantor agencies will look to the State Single Audit as an effective monitoring tool and provide them with assurance that their funds are used to complete their mission in the most efficient and economic manner.

- 8. Quality control reviews, an examination of the working papers of the independent auditors issuing State Single Audit reports, should be performed by the State. The logical agency to perform or to coordinate the review is the cognizant agency. In this case, the cognizant agency would be the Office of Policy and Management.**

Comment:

The grantor agencies, like the Department of Mental Retardation, are reluctant to look to the State Single Audit reports as a reliable monitoring tool. This ambivalence impacts the Department's collection, review, and follow up policies or lack thereof.

- 9. The Department of Mental Retardation, in conjunction with the Office of Policy and Management and the other State grantor agencies, should participate in the development of cost principles for the State of Connecticut.**

Comment:

Allowable and unallowable costs and cost allocation plans are not defined in the State's Statutes or Regulations. The lack of uniform cost standards has resulted in the Department relying on its own standards. Because there are no authoritative standards, the Department has a weakened position when differences have to be settled.

**CONCLUSION**

In conclusion, we wish to express our sincere appreciation for the cooperation and courtesies extended to our representatives by the officials and staff of the Department of Mental Retardation.

Thomas Willametz  
Administrative Auditor

Approved:

Kevin P. Johnston  
Auditor of Public Accounts

Robert G. Jaekle  
Auditor of Public Accounts