COUNTY OF LOS ANGELES
DEPARTMENT OF AUDITOR-CONTROLLER

KENNETH HAHN HALL OF ADMINISTRATION
500 WEST TEMPLE STREET, ROOM 525
LOS ANGELES, CALIFORNIA 90012-2766
PHONE: (213) 974-8301 FAX: (213) 626-5427

J. TYLER McCAULEY
AUDITOR-CONTROLLER

September 19, 2003

To: Supervisor Yvonne Brathwaite Burke, Chair
Supervisor Gloria Molina
Supervisor Zev Yaroslavsky
Supervisor Don Knabe
Supervisor Michael D. Antonovich

From: J. Tyler McCauley
Auditor-Controller

Subject: **FISCAL REVIEW OF KEDREN COMMUNITY MENTAL HEALTH CENTER - A MENTAL HEALTH SERVICES CONTRACTOR**

Attached is our audit report on Kedren Community Mental Health Center (Kedren) fiscal operations. The Department of Mental Health (DMH) contracts with Kedren to provide Mental Health services to the public. The Agency receives funding from DMH on behalf of various State and federal programs, including in-patient, out-patient and day treatment programs for qualifying adults and children. During fiscal year 1999-00, Kedren received $16,271,963 from DMH for services provided.

Our review was conducted at the DMH's request, as a result of alleged fiscal improprieties raised by Kedren's former Chief Financial Officer (CFO). Specifically, it was alleged that Kedren's former President/Chief Executive Officer (CEO) fraudulently inflated program costs and transferred Mental Health funds to a for-profit subsidiary company that does not provide Mental Health services. The Auditor-Controller's Special Investigations Unit conducted a preliminary review of the allegations and, in its July 2000 report, concluded that there was sufficient evidence to justify a full audit of the agency.

Scope

The purpose of our review was to evaluate whether Kedren has complied with the terms of its contract with DMH and has appropriately accounted for and spent Mental Health funds on allowable and reasonable expenditures in providing Mental Health services to clients. We also evaluated the adequacy of Kedren's accounting records, internal controls, and compliance with applicable federal, State and County guidelines governing the disbursement of Mental Health funds.

Our review primarily covered fiscal year 1998-99 as this was the period addressed in the allegations. However, because of the significance of the findings, certain expenditures (primarily loans and salary payments to a former CEO) were reviewed through calendar year 2000. We also traced the transfer of Mental Health funds back to 1996 to KIMSCO, Kedren's for-profit biomedical supplies firm.

Summary of Findings

We noted serious deficiencies in Kedren's use of and accounting for Mental Health funds. We were also able to substantiate two of the key allegations made by a former CFO.

In total, we identified $1,412,687 in inappropriate/unallowable transfers to non-mental health accounts and unallowable, unsupported or inadequately supported costs. This includes $285,611 transferred from Mental Health accounts to Kedren's Corporate accounts and $281,723 transferred from Mental Health accounts to KIMSCO, Kedren's for-profit biomedical supplies firm. In addition, $490,585 in Mental Health funds was used to pay for Corporate loans and lines of credit. The remaining $354,768 consists of unsupported and inadequately supported payroll expenditures, vehicle and travel related costs, and a number of credit card purchases that appear to be personal in nature.

In addition, we determined that the Agency had inflated its 1998-99 cost report (used to develop the Agency's reimbursement rates) by including over $330,000 that was actually a required payback of excess profits. We also noted areas where Kedren needs to correct other contract compliance deficiencies and strengthen internal controls over its disbursements and payroll.

Review of Report

We discussed our report with Kedren management on September 18, 2003. Kedren management indicated that they have already begun to take corrective action on a number of the issues addressed in our report and has agreed to provide a written response with a corrective action plan to DMH within 30 days. In addition, DMH has agreed to provide the Board with a written response within 60 days, outlining the resolution of all the findings and questioned costs contained in our report.

Because of the seriousness of the matters disclosed, we will be conducting a review of Kedren for subsequent periods.

We thank Kedren management and staff for their cooperation during our review.

JTM:DR:MM
Attachment

c: David E. Janssen, Chief Administrative Officer
Lloyd W. Pellman, County Counsel
Department of Mental Health
Dr. Marvin J. Southard, Director
Gurubanda Singh Khalsa, Finance Specialist
Miguel Rico, Chief Contracts Development & Administration Division

Kedren Community Mental Health Center, Inc.
John H. Griffith, Chief Executive Officer
Board of Directors
Violet Varona-Lukens, Board of Supervisors Executive Office
Public Information Office
Audit Committee Members

KEDREN COMMUNITY MENTAL HEALTH CENTER
FISCAL AUDIT OF MENTAL HEALTH SERVICES CONTRACT

BACKGROUND

Kedren Community Mental Health Center (Kedren) is a non-profit agency that provides Mental Health services to the public. The Agency receives funding from the Department of Mental Health (DMH) on behalf of various State and federal programs, including in-patient, out-patient and day treatment programs for qualifying adults and children. During fiscal year 1999-00, Kedren received $16,271,963 from DMH for services provided.

Kedren is reimbursed by DMH on either a cost reimbursement or a fee-for-service basis, depending on the program. Annually, Kedren submits a cost report to document all allowable expenditures incurred during the previous year. After review by DMH's Cost Support Section for accuracy and reasonableness, the cost report is forwarded to the State. Annually, the State calculates/negotiates the reimbursement rates based on the Agency's cost report. It is vital that the cost report is accurate since it can significantly impact the amount of funding the Agency receives.

Kedren maintains three separate cost centers for accounting and reporting purposes: Corporate (discretionary funding, not program related), Mental Health (DMH-funded) and Headstart (State-funded school program). Each cost center has a separate general ledger and one or more bank accounts. The Mental Health cost center includes those costs that are included in the annual cost report to the State.

APPLICABLE REGULATIONS AND GUIDELINES

Kedren is required to operate its facility in accordance with certain federal, State and County regulations and guidelines. We referred to the following applicable regulations and guidelines during our audit:

- DMH Contract (Contract)
- Auditor-Controller Contract Accounting and Administration Handbook (A-C Handbook)
- Federal Office of Management and Budget Circular A-122 (Circular), Cost Principles for Non-Profit Organizations
- United States Department of Health and Human Services Provider Reimbursement Manual (Provider Reimbursement Manual)
- California Department of Mental Health Short Doyle/Medi-Cal Manual for the Rehabilitation Option and Targeted Case Management

SCOPE AND OBJECTIVES

The purpose of our review was to evaluate whether Kedren has complied with the terms of its contract with DMH and has appropriately accounted for and spent Mental Health funds on allowable and reasonable expenditures in providing Mental Health services to clients. We also evaluated the adequacy of Kedren's accounting records, internal controls, and compliance with applicable federal, State and County guidelines governing the disbursement of Mental Health funds.

Our review was conducted at DMH's request, as a result of alleged fiscal improprieties raised by Kedren's former Chief Financial Officer (CFO). Specifically, it was alleged that Kedren's former President/Chief Executive Officer (CEO) fraudulently inflated program costs and transferred Mental Health funds to a for-profit subsidiary company that does not provide Mental Health services. The Auditor-Controller's Special Investigations Unit conducted a preliminary review of the allegations and, in its July 2000 report, concluded that there was sufficient evidence to justify a full audit of the agency.

Our review primarily covered fiscal year 1998-99 as this was the period addressed in the allegations. However, because of the significance of the findings, certain expenditures (primarily loans and salary payments to a former CEO) were reviewed through calendar year 2000. Also, we traced the transfer of Mental Health funds back to 1996 to KIMSCO, Kedren's for-profit biomedical supplies firm.

SUMMARY OF FINDINGS

We noted serious deficiencies in Kedren's use of and accounting for Mental Health funds. We were also able to substantiate two of the key allegations made by a former CFO.

In total, we identified $1,412,687 in inappropriate/unallowable transfers to non-mental health accounts and unallowable, unsupported or inadequately supported costs. This includes $285,611 transferred from Mental Health accounts to Kedren's Corporate accounts and $281,723 transferred from Mental Health accounts to KIMSCO. In addition, $490,585 in Mental Health funds was used to pay for Corporate loans and lines of credit. The remaining $354,768 consists of unsupported and inadequately supported payroll expenditures, vehicle and travel related costs, and a number of credit card purchases that appear to be personal in nature.

In addition, we determined that the Agency had inflated its 1998-99 cost report (used to develop the Agency's reimbursement rates) by including over $330,000 that was a required payback of excess profits. We also noted areas where Kedren needs to correct other contract compliance deficiencies and strengthen internal controls over its disbursements and payroll.

REVIEW OF EXPENDITURES

We identified a total of $1,412,687 in inappropriate/unallowable transfers to non-mental health accounts and unallowable, unsupported or inadequately supported costs as discussed in the sections below.

Inappropriate/Unallowable Transfers to Non-Mental Health Accounts

Transfers to Corporate Accounts

Kedren maintains several bank accounts. Of these accounts, one (Broadway Federal) is for the initial deposit of funds received from the Department of Mental Health. Funds deposited into the Broadway Federal account are then transferred into one of two other Mental Health accounts, general or payroll. Kedren also maintains two Corporate bank accounts where "discretionary funds" are deposited. Although Kedren maintains separate bank accounts for Mental Health and Corporate funds, we noted numerous transfers between these accounts and adjusting entries in Kedren's accounting records.

Kedren's Contract specifies that all fees paid by, or on behalf of, patients/clients receiving services shall be utilized by Kedren only for the delivery of Mental Health service units specified in the Contract. However, in reviewing activity in Kedren's Mental Health and Corporate bank accounts from February 1996 through December 2000, we noted that a total of $623,400 in Mental Health funds had been transferred into Corporate accounts. During the same period, we identified transfers from the Corporate accounts into the Mental Health accounts totaling $337,789.

On the basis of the transfers between the Mental Health and Corporate accounts, an excess of $285,611 ($623,400 less $337,789) in Mental Health funds was inappropriately transferred from the Mental Health program to the Corporate accounts. Kedren management asserts that, in actuality, the Corporate accounts are owed additional Mental Health funds. Kedren Management claims that expenditures related to the Mental Health program paid through the Corporate accounts exceeded funds transferred in. However, Kedren management did not produce any documentation in support of this assertion. Further, management's assertion seems doubtful since the Mental Health program has its own dedicated accounts for payment of payroll and operating expenses. Kedren management subsequently advised us that they had hired a Certified Public Accountant (CPA) to provide them with technical assistance and develop prior year financial statements. According to Kedren's management, their CPA determined that the Corporate accounts were owed approximately $1.7 million by the Mental Health program for periods prior to 1996. This pre-dates the period covered by our fieldwork. Accordingly, we have no basis for assessing the accuracy of Kedren's claim.

Transfers to KIMSCO

Kedren has been transferring funds to the Kedren International Medical Supply Corporation (KIMSCO), a for-profit distributor of bio-medical supplies that was incorporated in February 1996. Kedren made payments totaling $886,093 to KIMSCO during the period covered under our audit. Management indicated that these payments were made from its Corporate accounts, not from its Mental Health accounts. However, we reviewed the activity in the Mental Health bank accounts between February 1996 and December 2000 and determined that a net of $281,723 in Mental Health funds were transferred to KIMSCO. (A total $351,723 in Mental Health funds were transferred to KIMSCO and $70,000 was transferred from KIMSCO to the Mental Health accounts, leaving a balance owed to the Mental Health program of $281,723.)

As noted previously, Kedren's Contract states that all fees paid by or on behalf of patients/clients receiving services shall be utilized by Kedren only for the delivery of Mental Health service units specified in the Contract. We are questioning the $281,723 in transfers to KIMSCO that were not repaid to the Mental Health program.

Unallowable Costs

Property Loans and Lines of Credit

Our review of Kedren's bank accounts and accounting records disclosed that between February 1996 and December 2000, $490,585 in Mental Health funds were inappropriately used to pay for two Corporate loans and two Corporate lines of credit.

- $327,750 in lease, purchase deposits, principal and interest payments and an appraisal fee for a building located at 1776 E. Century Boulevard in Los Angeles. Kedren management indicated that the building was purchased with the intention of using it for the Children and Youth Services Program, a Mental Health program. However, the Circular specifies that capital expenditures for land or buildings are unallowable unless the agency receives prior approval from the awarding agency. Kedren never obtained authorization from DMH to purchase the building. In addition, we were told the property was never utilized because management decided that the property was located in an unsafe area.

  The $327,750 consisted of:

• Two purchase deposit payments	$206,000
• Principal & interest payments on a $418,000 loan (from 11/98 to 12/00)	$108,083
• A building appraisal fee	$1,667
• Lease payments (prior to purchase)	$12,000

- $96,821 for the purchase of a building located at 605 E. 42nd Street in Los Angeles, for principal and interest payments on a loan to renovate the building, and for the appraisal fee on the building. Kedren management indicated the building was to be used as a rehabilitation clinic for Mental Health services. However, as of August 2002, management indicated that the building was still being renovated. The building was originally purchased in February 1998 and had never been utilized to provide Mental Health services.

In addition, Kedren management did not obtain prior authorization from DMH to purchase the building, or to renovate the building. As noted above, capital expenditures for land or buildings are unallowable unless the agency receives prior approval from the awarding agency. The Circular also specifies that capital expenditures for improvements to land, buildings, or equipment, which materially increase its value or useful life are unallowable as a direct cost except with the prior approval of the awarding agency.

The $96,821 consisted of:

• Building purchase	$81,251
• Principal and interest payments from 11/98 to 12/00 on a $53,000 renovation loan	$13,903
• Appraisal fee	$1,667

- $55,171 which consisted of $55,100 in principal and interest payments on a $100,000 line of credit established in January 1999 and $71 to obtain credit history information related to the line of credit. This line of credit was established to serve as a revolving cash account by which Kedren could obtain cash advances. A total of $154,000 was advanced to Kedren; $139,000 was deposited into Corporate accounts and $15,000 to Mental Health accounts. However, Mental Health funds totaling $70,100 were used to pay for the principal and interest payments on this line of credit. The $55,100 difference between the principal and interest payments and the amount advanced to the Mental Health accounts is unallowable.

- $10,843 in principal and interest payments and credit history report fees for a second line of credit established in November 2000. This line of credit was used solely to pay off the remaining balance from the previous line of credit, which as previously discussed, was for the benefit of the Corporate accounts.

Note: Kedren continued to use Mental Health funds until December 2001 when making payments on the loan to purchase the property at 1776 E. Century Boulevard and the loan to renovate the property at 605 E. 42nd Street. In addition, Kedren continued to use Mental Health funds for payments on its line of credit until the line of credit was paid off in September 2001. The Mental Health funds used for payment on the loans and the line of credit during calendar year 2001 are not included in our totals. DMH management needs to identify and pursue collection of the Mental Health funds used to make payments on these loans subsequent to the close of our audit period.

Unsupported, Inadequately Supported and Unallowable Costs

Payroll Expenditures

We have identified $219,190 in unsupported, inadequately supported and unallowable payroll related expenditures, as follows:

- $170,000 in salary payments made to Kedren's former CEO during calendar year 2000. The former CEO performed duties for both Kedren and KIMSCO. However, her timecards indicated that she worked exclusively for Kedren. According to the Contract, only those expenditures that are needed to carry out the purposes and activities of the approved program are allowable. Because we are unable to determine what portion of her time was spent on Mental Health related activities, we are questioning the entire salary amount paid to the former CEO.

- $29,712 in payments to a former Kedren employee. Kedren issued $29,712 in salary payments to this individual during calendar year 2000. We met with this individual in March 2001 and she stated that she was a founding member and former Board member of the Kedren Mental Health program. She alleges that although she was forced off the Board in 1985, she has continued to receive payroll checks. She acknowledged that she had performed only one six week assignment since 1985 and could not explain why she continued to be paid. Kedren management also could not explain what the payments were for.

- $19,478 in unsupported salary payments made to three Kedren employees. In these instances, the Agency did not provide timecards or other appropriate documentation to support the salary payments made.

Vehicle Related Costs

We have identified $97,034 in unsupported/inadequately supported vehicle related costs, as follows:

- $41,058 for gas, oil and vehicle repairs charged to the Agency's gasoline credit cards, or paid to various vendors during FY 1998-99. The Provider Reimbursement Manual states that travel costs incurred in conjunction with non-patient care related employee travel are not allowable. Kedren did not maintain mileage records or other appropriate supporting documentation, as required in the A-C Handbook. Therefore, we could not determine the extent to which the Agency's travel expenses are allowable.

- $54,276 in payments for the President's then current vehicle, a 1998 Land Rover, and former vehicle, a 1993 Cadillac Allante. Since Kedren did not maintain mileage records or other appropriate supporting documentation, we could not determine whether the vehicles were used for personal or patient care related purposes. Both the Circular and the Provider Reimbursement Manual state that the portion of the cost of organization-furnished automobiles that relate to personal use by employees (including transportation to and from work) is unallowable as a fringe benefit or indirect cost, regardless of whether the cost is reported as taxable income to the employees. If Kedren is ultimately able to provide documentation supporting vehicle usage, DMH will need to further evaluate the reasonableness of these expenses, since both the Cadillac and Land Rover are luxury vehicles whose cost may be excessive.

- $1,700 in travel related expenses during calendar year 2000. The former CEO received approximately $100 per month for travel-related expenses. According to management, these payments were for parking fees incurred by the former CEO during business hours. However, we were not provided with documentation (i.e., receipts) to support these expenditures. The A-C Handbook states that all expenditures must be supported by original vouchers, invoices, receipts, or other documentation.

Personal Expenditures of Agency Executives

In May 1994, Kedren's Medical Director was given an expense account of $1,300 per month in addition to his salary. The Medical Director's employment agreement states that expenses are to be substantiated with a monthly expense report, including receipts. However, the Agency was only able to provide adequate supporting documentation for $193 of the $15,970 paid to the Medical Director during our review period. The remaining $15,777 consists of $4,222 in unallowable costs and $11,555 in unsupported costs, outlined below.

- $4,222 for entertainment expenses ($1,740 for theater tickets and $2,482 for restaurant meals). The Provider Reimbursement Manual Section 2105.8 states that entertainment expenses are not allowable. In addition, these expenses were not supported by itemized receipts, or other appropriate documentation.

- $5,705 in mileage reimbursements and automobile maintenance expenses. The Agency did not maintain mileage or travel logs to support the reimbursements, or maintenance expenses charged to the Mental Health program. The A-C Handbook Section 3.014 requires agencies to maintain vehicle mileage logs showing dates, destination and headquarters, purposes of trips and mileage driven.

- $5,850 for insurance related costs. Management could not provide us with invoices or a description of the type or nature of the insurance. Since the Agency did not provide supporting documentation for these expenses, we could not determine if they were Mental Health program related.

Other Costs

We have identified $22,767 in miscellaneous costs that were either unallowable or unsupported:

- $17,702 in American Express charges made on behalf of KIMSCO. Charges included trips to Las Vegas, New Orleans, Georgia, Washington D.C., and London, and car rental, gasoline and credit card membership fees. Since the payments are not program-related, they are unallowable.

- $600 for two gift certificates purchased as a wedding gift for a Kedren doctor. The expenditures are not program-related and are unallowable.

- $4,465 in American Express card charges including payments for flowers, gasoline, a wedding gift for a Kedren employee, office supplies, a car repair for the President's personal vehicle, and truck rentals. Kedren did not provide documentation to support these expenditures.

Recommendation

1. **DMH management resolve the $1,412,687 in inappropriate/unallowable fund transfers to non mental health accounts and unallowable, unsupported or inadequately supported costs and collect all disallowed amounts.**

CONTRACT COMPLIANCE AND INTERNAL CONTROLS

Our audit disclosed serious contract compliance and internal control weaknesses. These deficiencies contributed to the questioned expenditures discussed above. DMH must ensure that Kedren management takes appropriate corrective actions to address each of the internal control weaknesses noted in this report. DMH should also monitor this Agency to ensure that the corrective actions result in permanent changes.

Inadequate Accounting Procedures

We reviewed Kedren's accounting procedures and noted the following:

- In its FY 1998-99 cost report, Kedren inappropriately recorded a "contract expense" of $331,334. This amount appears to represent the Agency's Federal Funds Participation giveback (FFP giveback), which is the amount of profit earned by the contractor (i.e., actual costs were lower than the negotiated rate) that must be returned to the federal government. This amount should not have been recorded as an expense in its financial records and included in the cost report. Reporting this amount as an expense inappropriately inflated the cost report used by the State to develop the Agency's reimbursement rates.

- Kedren permits Executive staff to use the Agency's American Express card for personal use. We noted $2,583 in reimbursements from employees, where the checks were made payable to "Kedren." However, management only reduced the amount of the American Express expense in the general ledger by $1,593. Therefore, the expenses in the cost report were overstated by $990.

- Certain transactions were miscoded in the Agency's general ledger. For example, all payments for the Mobil gasoline cards were coded to "Executive Office Gas & Oil". However, at least 75% of the Mobil invoices we reviewed were for gasoline charges incurred by the Agency's Transportation Department. In addition, all but one American Express charge was included in the travel account, regardless of the nature of the costs incurred. The remaining American Express charge was coded to mileage. We also noted an employee advance coded to the mileage account and building lease costs coded to the equipment lease account.

Agency management has indicated that they are aware of their accounting deficiencies and are working toward remedying these problems.

<u>Recommendations</u>

Kedren management:

2. **Ensure the Agency cost report accurately reflects the cost of providing Mental Health services and is supported by the Agency's accounting records.**

3. **Ensure transactions are properly classified in the general ledger.**

<u>Disbursement Procedures</u>

We noted several deficiencies in the Agency's disbursement procedures:

- Agency employees are allowed to charge personal expenses to Kedren's American Express card and then reimburse Kedren. We noted $6,321 in such charges. Although the employees subsequently reimbursed Kedren, the temporary use of Mental Health funds for personal expenditures should be discontinued.

- Charge cards are not adequately accounted for. Management did not know who was using three of the Agency's 12 Mobil gasoline cards.

- The Agency does not maintain adequate supporting documentation (vendor receipts) for credit card purchases. According to the A-C Handbook, all credit card disbursements must be supported by original invoices or receipts indicating the item purchased and the purchaser. Kedren did not maintain all American Express receipts or any receipts for the Mobil gasoline purchases.

- The Agency does not consistently write or stamp "Paid" on vendor invoices. Only one of 16 items reviewed was appropriately cancelled. In addition, cancelled checks were not referenced to supporting documentation. To prevent duplicate payments and facilitate the identification of payments to supporting documents, all invoices should be cancelled upon payment and referenced to cancelled checks.

Without proper disbursement controls in place, Kedren cannot ensure Mental Health funds are spent on reasonable and allowable expenditures in providing the necessary care and services to clients.

Recommendations

Kedren management:

4. **Establish a policy which prohibits Kedren employees from using the Agency American Express card for personal use.**

5. **Ensure that Agency credit cards are adequately safeguarded and accounted for.**

6. **Maintain original, itemized vendor receipts for all credit card purchases.**

7. **Ensure all vendor invoices and receipts are appropriately cancelled and referenced to check numbers upon payment.**

Bank Reconciliations

Bank reconciliations are a primary control for the detection of errors and irregularities. Without bank reconciliations, the Agency's financial records cannot be relied upon to be accurate and complete. A-C Handbook Section 4.011 states that monthly bank reconciliations should be prepared within 30 days of the bank statement date and reviewed by management for appropriateness and accuracy. Both the preparer and the reviewer should sign and date the bank reconciliations. In reviewing Kedren's banking records, we noted the following weaknesses that require corrective action.

- Kedren's accounting department performs the bank reconciliations, but does not sign and date the reconciliations upon completion. Accordingly, we were unable to determine whether the reconciliations were performed timely. Furthermore, the reconciliations are not approved in writing by management.

- Thirteen journal entries were made in the February 1999 general ledger to adjust the balance in the Mental Health account. The Agency did not provide documentation to explain the adjustments, although Agency management indicated that bank reconciliations had not been performed for several months. Accordingly, when the accounts were reconciled in February, many adjustments were necessary.

Recommendations

Kedren management:

8. **Ensure the Agency's bank accounts are reconciled timely and the reconciliations are signed and dated by both the preparer and the reviewer.**

9. **Maintain appropriate documentation to support adjustments made to Agency accounting records.**

Payroll/Personnel Controls

Kedren's payroll and personnel procedures controls are not in compliance with the Circular and the A-C Handbook. Specifically, we noted the following:

- Kedren's former CEO did not accurately account for her time by program. She performed duties for both Kedren and KIMSCO, but her timecards indicated that she worked exclusively for Kedren.

- At least 22 Kedren employees are not required to submit timecards. The Circular and the A-C Handbook states that time and attendance records are required as supporting documentation for payroll expenditures. Also, when employees are not required to submit timecards, the Agency cannot ensure employees are paid for actual hours worked.

- Personnel files did not always contain authorized salary rates or pay history as required by the A-C Handbook Section 3.2.

- A formal policy for the awarding of Retroactive Salary increases had not been developed by Kedren. The Circular states that compensation for services shall be made for reasonable and actual personal services rather than a distribution of earnings in excess of costs.

- Hours reported on the payroll register did not consistently match the hours reported on the employee's timecard. Nine (60%) of 15 timecards we reviewed contained variances. Reasons for the variance were not documented and we were unable to determine whether the salary paid was accurate.

Recommendations

Kedren management:

10. **Ensure timecards reflect actual time spent on each Agency program.**

11. **Ensure that timecards are maintained for each employee and that management documents their review and approval of the timecards in writing.**

12. **Ensure personnel files contain authorized salary amounts or hourly rates of pay approved by management.**

13. **Develop a formal policy governing the awarding of retroactive salary increases.**

14. **Ensure hours reported on the payroll register agree with hours reported on employees' timecards.**

Compliance with Federal and State Payroll Tax Regulations

A-C Handbook Section 2.6 states that the Agency is responsible for ensuring compliance with all applicable federal and State requirements for withholding payroll taxes. During our review, we noted the following compliance issues with federal and State payroll regulations:

- A Kedren secretary receives $100 per meeting to transcribe Kedren's Board minutes. Payments totaling $1,000 for FY 1998-99 were made separately from payroll and no taxes were withheld. If the work is performed after normal work hours, then the employee should be paid overtime and appropriate taxes should be withheld.

- Kedren's Medical Director received $4,222 for entertainment related expenses. It appears that these expenditures were additional compensation and should have been reported as such.

Recommendations

Kedren management:

15. **File correct W-2 Forms that encompass all salaries and wages paid to the individuals mentioned above, and ensure that all salaries and wages paid are reported to the appropriate taxing agencies.**

16. **Ensure all salaries and wages are processed through payroll and that all appropriate payroll taxes are withheld.**