



# The Commonwealth of Massachusetts

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INDEPENDENT STATE AUDITOR'S REPORT ON  
CERTAIN ACTIVITIES OF THE  
CLARENDON FAMILY DAY CARE, INC  
OCTOBER 1, 2004 THROUGH AUGUST 31, 2007

OFFICIAL AUDIT  
REPORT  
DECEMBER 13, 2007

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Clarendon Family Day Care, Inc. (CFDC), located in Bedford, Massachusetts, was incorporated on July 20, 1978 as a non-profit community service organization specializing in inner city and community benefit activities. CFDC provides childcare services to parents, family childcare providers, and children in various communities within Massachusetts. CFDC's services include support and technical assistance, transportation services, childcare services, and provider training. In addition, CFDC has a nutrition program that monitors the nutritional content of meals served to children in licensed daycare providers' homes.

The scope of our audit was to examine various administrative and operational activities of CFDC for the period October 1, 2004 through August 31, 2007. Our audit was conducted in accordance with applicable generally accepted government auditing standards for performance audits issued by the Comptroller General of the United States. The objectives of our audit were to (1) determine whether CFDC had implemented effective internal controls; and (2) assess CFDC's business practices and its compliance with applicable laws, rules, and regulations and the various fiscal and programmatic requirements of its state contracts.

Our audit identified \$80,459 in unallowable expenses that CFDC billed against its state-funded contracts during the audit period. We also noted inadequate internal controls over certain aspects of CFDC's operations.

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We found that during fiscal year 2005, CFDC gave its employees bonuses totaling \$93,990, of which \$73,286 was charged to its state-funded daycare program. However, the agency did not have a formal written policy that provided for staff to receive this benefit. According to state regulations, benefits such as these that are not provided under an established policy of an agency are unallowable and non-reimbursable under state contracts. We also noted that the agency did not properly disclose this benefit in the financial statements it filed with the Commonwealth.

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We found that during fiscal year 2006, CFDC gave its Executive Director a bonus of \$11,522, of which \$5,761 was charged to the CFDC's state-funded programs. However, CFDC did not have an established personnel policy that provided this fringe benefit to its Executive Director. According to state regulations, fringe benefits that are not available to all employees under an established agency policy are unallowable and non-reimbursable under state contracts.

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We found that during fiscal year 2005, CFDC improperly allocated \$1,412 of expenses associated with its federal nutrition program to its state contracts. According to state regulations, expenses that are not directly related to the program purposes of state-funded programs are unallowable and non-reimbursable to the state.

## INTRODUCTION

### *Background*

Clarendon Family Day Care, Inc. (CFDC), located in Bedford, Massachusetts, was incorporated on July 20, 1978 as a non-profit community service organization specializing in inner city and community benefit activities. CFDC provides childcare services to parents, family childcare providers, and children in various communities within Massachusetts. CFDC's services include support and technical assistance, transportation services, childcare services, and provider training. In addition, CFDC has a nutrition program that monitors the nutritional content of meals served to children in licensed daycare providers' homes.

The scope of our audit was to examine various administrative and operational activities of CFDC for the period October 1, 2004 through August 31, 2007. The objectives of our audit were to (1) determine whether CFDC had implemented effective internal controls; and (2) assess CFDC's business practices and its compliance with applicable laws, rules, and regulations and the various fiscal and programmatic requirements of its state contracts. During our audit period, CFDC received funding that totaled \$20,211,686. The table below details CFDC's funding during fiscal years 2005 through 2007.

#### October 1, 2004 through August 31, 2007<sup>1</sup>

Revenue Source	2005	2006	2007 (Through 8/31/07)	Total
Gifts and Contributions	\$1,331	\$549	\$353	\$2,233
Childcare –Vouchers	552,516	549,043	455,539	1,557,098
DOE	2,397,754	2,348,803	2,099,855	6,846,412
POS subcontract	3,357,440	3,731,964	3,573,309	10,662,713
Private client fees	246,481	293,018	290,920	830,419
Investment Revenue	1,694	1,969	1,284	4,947
Other Revenue	<u>304,446<sup>2</sup></u>	<u>-</u>	<u>3,418</u>	<u>307,864</u>
Total Revenue	<u>\$6,861,662</u>	<u>\$6,925,346</u>	<u>\$6,424,678</u>	<u>\$20,211,686</u>

<sup>1</sup> CFDC's fiscal year runs from October 1 through September 30.

<sup>2</sup> CFDC received a lawsuit settlement in fiscal year 2005 of \$197,343.

***Audit Scope, Objectives, and Methodology***

The scope of our audit was to examine various administrative and operational activities of CFDC during the period October 1, 2004 through August 31, 2007. Our audit was conducted in accordance with applicable generally accepted government auditing standards for performance audits issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence that provides a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Our audit procedures consisted of the following:

1. A determination of whether CFDC had implemented effective internal controls, including:
  - Processes for planning, organizing, directing, and controlling program operations; and
  - Policies and procedures to ensure that resource use is consistent with Massachusetts laws, regulations, policies, and procedures to ensure that resources are safeguarded and efficiently used.
2. An assessment of CFDC's business practices and its compliance with applicable laws, rules, and regulations, as well as the various fiscal and programmatic requirements of its state contracts.

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

Our audit was not made for the purposes of forming an opinion on CFDC's financial statements. We also did not assess the quality and appropriateness of all program services provided by CFDC under its state-funded contracts. Rather, our report was intended to report findings and conclusions on the extent of CFDC's compliance with applicable laws, regulations, and contractual agreements,

and to identify services, processes, methods, and internal controls that could be made more efficient and effective.

During the conduct of our audit work, we determined that CFDC received a substantial amount of its funding (approximately 60%) through vouchers it received from its consumers that are funded by the federal Child Care and Development Fund (CCDF) provided by the United States Department of Health and Human Services. According to guidelines published by the US Office of Management and Budget (OMB), any non-profit organization that receives these funds through voucher agreements is required to comply with the cost principles within OMB Circular A-122.

Based on this, during our audit we met with Department of Early Education and Care (EEC) officials to discuss this matter and on May 29, 2007, a member of EEC's legal counsel provided us with a letter on behalf of the agency, which stated, in part, the following:

*Voucher providers who ... hold one or more contracts with EEC to provide subsidized child care are bound to the Commonwealth Terms and Conditions for Human and Social Services and 808 CMR 1.00 et. seq. These regulations and terms apply to all human and social service monies the provider receives, including voucher funds. If the agency receives \$100,000 or more in Commonwealth funds, it will have to file a Uniform Financial Report (UFR) and disclose voucher and contracted funds and follow the provisions of 808 CMR 1.00 (including those for non-reimbursable expenses and surplus revenue retention) and the audit preparation manual.*

However, during our audit we also met with federal officials, and on July 6, 2007, the Acting Regional Grants Officer of the US Office of Grants Management Administration for Children and Families provided us with the following information he had received from the federal Child Care Bureau, which conflicts with EEC's position, by stating:

*CCDF regulations give Lead Agencies specific responsibilities to ensure that CCDF is administered consistent with the regulations and State Plans. This includes ensuring that providers meet licensing requirements... At 45 CFR 98.67, CCDF regulations also provide that "Lead Agencies shall expend and account for CCDF funds in accordance with their own laws and procedures for expending and accounting for their own funds." Thus, once a State receives its CCDF grant, State cost principles govern the funds rather than the Federal principles. States may audit child care providers to ensure that providers are in compliance with relevant State regulations.*

*We remind the State that in interpreting Federal and State regulations, CCDF funds provided through certificates or vouchers are considered assistance to the parent rather than a grant or contract to a provider (45 CFR 98.30(c)(6)). Additionally, Section 98.60(d)(6) provides that when CCDF funds are administered through vouchers or certificates, such funds will be considered obligated when a voucher or certificate is issued in writing to a family. Once the parent has submitted the voucher to a provider and received child care services, the funds have been both obligated and liquidated and have, thereby, lost their Federal character. As such, the funds are no longer subject to the statutory restrictions imposed by the Child Care and Development Block*

*Grant Act, and may be used in any (lawful) manner that the provider chooses. Thus, when providers receive payment for child care services through a CCDF voucher or certificate from a parent, they are not subject to the requirements of OMB Circular A-133 or Federal limitations on the use of CCDF funds (e.g., restrictions pertaining to construction and renovation).*

*CCDF funds are designed to provide low-income families with access to the child care market comparable to privately paying families. The State should carefully consider the impact of any additional State fiscal requirements or regulations applied to financial operations of providers who accept certificates or vouchers as payment for serving CCDF subsidized children. Stringent fiscal requirements could disadvantage providers or represent additional costs related to the care of subsidized children, which could have the effect of restricting parental access and choice in the CCDF program. If the State wishes to adopt such policies we would suggest that they consider applying them to all providers, not just those serving subsidized families.*

Given the positions of the federal funding agency and EEC relative to the applicability of state regulations to these voucher funds, for the purposes of our audit, after each audit result we recommend the recoupment of only the state contract funds that we identified as being expended for non-reimbursable expenses. However, we also identify voucher funds that were expended for expenses which would be non-reimbursable if they are subject to Operational Service Division (OSD) regulations, so that if EEC believes, as it stated in its May 29th letter to us, that OSD regulations do in fact apply to these funds, then it can seek reimbursement of these additional monies. At the conclusion of our audit fieldwork, a copy of our draft audit report was sent to CFDC for the agency's review and comments. Subsequently, the agency provided us with its specific comments which have been included after each audit result. In addition, CFDC officials provided us with some general comments, as follows:

*Since our previous State Audit, CFDC Management and Board has strived for excellence in program management by making tremendous management and program upgrades, including.*

- A new expanded Board with dedicated professionals actively involved in the agencies leadership.*
- Established an experienced non-profit out sourced Accounting Department. The Accounting Department that establishes fiscal policies and provides oversight on all CFDC financial matters.*
- Developed operations and procedures manuals for all the agencies departments and programs, Accounting, Human Resources, Computers, Child and Adult Care Food Program (CACFP) and Family Day Care System, Transportation and for the family day care providers.*
- Upgrades all the agencies technology equipment and software including, new accounting software, CACFP software. CFDC has recently developed a*

*comprehensive family day care operations and accounting software to improve performance and accountability.*



## AUDIT RESULTS

### 1. UNALLOWABLE AND IMPROPERLY RECORDED BONUSES TOTALING \$93,990, OF WHICH \$73,286 WAS CHARGED TO THE COMMONWEALTH

We found that during fiscal year 2005, CFDC gave its employees bonuses totaling \$93,990, of which \$73,286 was charged to its state-funded daycare program. However, the agency did not have a formal written policy that provided for staff to receive this benefit. According to state regulations, benefits such as these that are not provided under an established policy of an agency are unallowable and non-reimbursable under state contracts. We also noted that the agency did not properly disclose this benefit in the financial statements it filed with the Commonwealth.

The state's Operational Services Division (OSD), the state agency responsible for regulating and overseeing the activities of all contracted human service providers such as CFDC, has established guidelines for the proper reporting of non-reimbursable costs by human service providers. Specifically, OSD's Uniform Financial Statements (UFRs) and Independent Auditor's Report Audit and Preparation Manual states, in part:

*The existence of non-reimbursable costs, as contained in 808 CMR 1.05 (Effective 2/1/97, 808 CMR 1.05) and OMB Circulars A-21 and A-122, must be itemized by natural classification and disclosed in the component and program as applicable. Non-reimbursable costs that exist and have not been disclosed are presumed to have been defrayed using Commonwealth and Federal funds...*

*This information, taken together with the auditor's compliance testing of non-reimbursable costs, provides UFR report users with a measure of assurance that all non-reimbursable costs have been defrayed with revenues not derived from public funds or designated by donors for other purposes.*

Further, 808 CMR 1.05 promulgated by OSD identifies the following as non-reimbursable costs:

*(9) Certain Fringe Benefits.*

*(a) Fringe benefits determined to be excessive in light of salary levels and benefits of other comparable Contractors and fringe benefits to the extent that they are not available to all employees under an established policy of the Contractor. Disparities in benefits among employees attributable to length of service, collective bargaining agreements or regular hours of employment shall not result in the exclusion of such costs.*

Contrary to OSD regulations, we determined that CFDC had not established a written policy regarding staff bonuses and the agency did not properly report these costs as non-reimbursable expenses on its fiscal year 2005 UFR that if filed with OSD. CFDC's Executive Director told us that she had discussed these bonuses with CFDC's state funding agency and had not thought to establish a health and morale policy or obtain written approval for these bonuses because they were going to be paid for with non-state funds. She added that she had sought and received approval from the agency's Board of Directors for these bonuses, and added that the bonuses were provided in an equitable manner to all staff, based on each person's salary. Finally, CFDC officials told us that no state funds were used to pay for these bonuses. These officials stated that during fiscal year 2005, the agency received a \$197,343 lawsuit settlement and used these funds to pay for the bonuses. However, we reviewed the agency's financial records and noted that the bonuses were processed through the agency's accounting system as regular payroll expenses, rather than being identified as one-time bonus expenses. Further, in its fiscal year 2005 UFR that it filed with OSD, the agency did not identify these bonus expenses as being non-reimbursable, and did not indicate that any non-state revenues such as an insurance settlement were used to pay for these bonuses. CFDC officials acknowledge that the agency should have reported these bonuses as being non-reimbursable to the Commonwealth in its fiscal year 2005 UFR.

### ***Recommendation***

To address this matter, CFDC should amend its fiscal year 2005 UFR to identify the \$73,286 in state funds that were used to fund these bonuses as non-reimbursable expenses. In the future, if CFDC wants to provide bonuses to its staff members, it should establish a formal written employee morale, health, and welfare policy that is consistent with OSD guidelines.

### ***Auditee's Response***

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

*In 2005 the CFDC had received a retroactive rate increase from the Department of Early Education and Care. The administrative portion of the rate increase was required to be used for "staff salary, professional development stipends and/or benefits". In addition CFDC had received a settlement for \$197,343.00.*

*The then CFDC CFO... worked with the CFDC Board president and board membership to approve the plan for all CFDC staff to be given a bonus. The CFO's financial plan, utilized a combination of EEC retroactive funds and settlement funds eligible for the staff eligible*

*to receive EEC retroactive funds. The staff not eligible to receive EEC funds would be paid completely from the settlement funds.*

*CFDC had in several previous years received EEC retroactive payments for staff. The EEC required all agencies receiving the funds to provide EEC with a written plan for the disbursement of funds. CFDC had previously disbursed EEC retro payments to eligible staff in a one time payment.*

*The 2005 UFR was prepared assuming all of the mentioned costs were allowable as they were paid under a Board approved plan. Given the State Audit position, we will restate the 2005 UFR to reflect these costs as non-reimbursable expenses.*

*CFDC Management agrees with the State Audit and the funds used were posted incorrectly. CFDC will ensure the 2005 is adjusted to reflect the correct allocation.*

### **Auditor's Reply**

We believe that the actions taken by CFDC relative to this matter were appropriate, and we reiterate that in the future, if CFDC wants to provide bonuses to its staff members, it should establish a formal written employee morale, health, and welfare policy that is consistent with OSD guidelines.

## **2. INADEQUATE CONTROLS OVER EMPLOYEE PAYROLL ADVANCES**

During our audit period, CFDC's Executive Director routinely issued payroll advances to herself and other CFDC employees. As of August 31, 2007, there were four employee advances outstanding totaling \$6,334, including a \$2,100 advance to CFDC's Executive Director. However, we found that CFDC had not established adequate internal controls over these advances and loans. Specifically, the agency's Executive Director has the ability to authorize advances to herself without any independent oversight. In addition, there were no formal written policies or procedures relative to these advances. Agency funds used in this manner increases the likelihood of abuse and/or misuse.

During our audit, we noted that CFDC routinely provided payroll advances to members of its staff. We reviewed documentation relative to \$49,169 in payroll advances made by CFDC staff members from October 1, 2004 through August 31, 2007. Based on our review, we determined that many of these payroll advances were paid back by staff members within the agency's payroll cycle (two weeks). However, we noted the following outstanding payroll advance balances as of August 31, 2007:

Employee	Balance at July 1, 2007	Advanced August 2007	Repaid August 2007	Balance at August 31, 2007
Executive Director	\$ 350.00	\$2,250.00	(\$500.00)	\$2,100.00
Special Project Manager	3,462.76	450.00	(375.00)	3,537.76
Regional Director	0.00	1,787.01	(1,187.01)	600.00
Staff member	<u>0.00</u>	<u>96.55</u>	<u>0.00</u>	<u>96.55</u>
Totals:	<u>\$3,812.76</u>	<u>\$4,583.56</u>	<u>(\$2,062.01)</u>	<u>\$6,334.31</u>

We requested that CFDC officials provide us with documentation regarding staff advances. Based on our review of this information, we noted the following internal control problems with CFDC's administration of these advances:

- There are no standard forms used to request advances that document who requested the advance and when it was actually provided.
- There is no established policy or criteria for requesting these advances such as a maximum advance amount or repayment guidelines. Most of the memos we reviewed relative to payroll advance requests stated the advance was needed because of a personal emergency with no further details.
- There is no established approval process other than CFDC's Executive Director signing the payroll advance check. Further, the Executive Director is able to sign her own payroll advances and frequently received monthly advances during our audit period.
- These advances are not interest bearing, so in those cases when they are not repaid within one payroll cycle they become interest-free loans to staff.

Subsequent to our bringing this matter to the attention of CFDC officials, the agency's Board voted to establish policies and procedures to govern these advances in April 2007. These procedures limit the salary advances to an amount not exceeding an employee's next weekly payroll and/or outstanding earned time off. However, as of the end of our audit fieldwork, the agency had not implemented this policy and had not taken measures to address our other concerns relative to these advances, including the internal control problem regarding the Executive Director's salary advances.

***Recommendation***

In order to address our concerns relative to this matter, CFDC should establish comprehensive formal written policies and procedures relative to payroll advances. At a minimum, all advance

requests should be documented in writing and formally approved by the appropriate agency staff. Payroll advances should be repaid within one payroll period and should not exceed compensation that an employee has earned but not yet received. Further, the agency should require its Executive Director to obtain formal written Board approval for her payroll advances.

### ***Auditee's Response***

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

*The CFDC Management feels it's important to note the following points*

- *All payroll advances have always been paid back in full. The agency has never experience a financial loss from any employee failure to provide repayment.*
- *All advances are required to be submitted in writing and signed.*
- *All advances are tracked by the payroll department and the outsourced Bookkeeper conducts a secondary review of all the payroll records. The CFDC Bookkeeper and CFO track the Executive Directors advances.*
- *CFDC has a pay advance policy ... that was revised by the board in 2007.*
- *The CFDC Board, CFO and Management will address the recommendation.*

### ***Auditor's Reply***

We believe CFDC's decision to address our recommendation was appropriate. As previously stated, any policy adopted by the agency should ensure that all salary advance requests be documented in writing and formally approved by the appropriate agency staff. Payroll advances should be repaid within one payroll period and should not exceed compensation that an employee has earned but not yet received. Further, the agency should require its Executive Director to obtain formal written Board approval for her payroll advances.

### **3. UNALLOWABLE BONUS PROVIDED TO CFDC'S EXECUTIVE DIRECTOR TOTALING \$11,522, OF WHICH \$5,761 WAS CHARGED TO THE COMMONWEALTH**

We found that during fiscal year 2006, CFDC gave its Executive Director a bonus of \$11,522, of which \$5,761 was charged to the CFDC's state-funded programs. However, CFDC did not have an established personnel policy that provided this fringe benefit to its Executive Director. According to state regulations, fringe benefits that are not available to all employees under an established agency policy are unallowable and non-reimbursable under state contracts.

808 CMR 1.05, promulgated by OSD, identifies the following as non-reimbursable costs under state contracts:

*(9) Certain Fringe Benefits.*

*(a) Fringe benefits determined to be excessive in light of salary levels and benefits of other comparable Contractors and fringe benefits to the extent that they are not available to all employees under an established policy of the Contractor. Disparities in benefits among employees attributable to length of service, collective bargaining agreements or regular hours of employment shall not result in the exclusion of such costs.*

During our audit, we found that on October 17, 2005, CFDC's Executive Director received a payroll advance of \$11,522 (\$8,349 net of taxes). We asked CFDC's Executive Director about this advance and she told us that this was a one-time settlement amount for health insurance costs. She indicated that upon assuming the role of Executive Director, she was promised verbally by the agency's Board of Directors that the agency would provide her with 100% agency-paid health insurance coverage. However, from the time she assumed the position of CFDC's Executive Director in 2001 through October of 2005, she had not received this benefit. She brought this matter to the attention of the agency's Board and the Board determined, based on legal consultation, that it was not appropriate to provide her with this level of benefit (100% payment). However, in order to settle this matter, the Board calculated an amount equal to what the additional costs would have been for CFDC to provide this benefit to the Executive Director from the day she assumed the position through October 2005 and provided this amount to her as a one-time bonus. However, during our audit CFDC officials could not provide us with the copies of any Board minutes that indicated that the agency's entire Board was aware of and approved the provision of this bonus to the Executive Director. The Executive Director did provide us with three supporting emails; one from a Board member giving approval, another from a Board member indicating that the Board should meet to approve the provision of the bonus, and one from a CFDC employee that includes the bonus in the final numbers per year but provides no support concerning the approval process of granting this bonus. In addition, there was also a copy of a current email received from the agency's legal counsel indicating that although he has no prior emails saved, he has "some recollection of a conversation with [the Executive Director] on [the bonus], but [does not] have any detail in documents." Without Board minutes, there is inadequate documentation to support the assertions made by the Executive Director.

***Recommendation***

In order to address our concerns regarding this matter, we recommend that CFDC amend its UFR to reflect the amount of state contract funds that were used to pay for this bonus, which totals \$5,761. (Her salary was charged 50% to the federal program and 50% to the state program as a non-reimbursable expense.) If, however, the Department of Early Education and Care (EEC) believes that OSD regulations do in fact apply to CFDC's voucher funds, then EEC should require CFDC to identify all of the \$11,522 in question as non-reimbursable.

***Auditee's Response***

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

*The CFDC board gave the bonus to try and make good on a commitment made. The board sought legal council trying to address the matter in the best way possible.*

*CFDC accepts the decision in this matter*

***Auditor's Reply***

We believe CFDC's decision to address our recommendation was appropriate.

**4. \$1,412 IN FEDERAL NUTRITION PROGRAM EXPENSES INAPPROPRIATELY CHARGED TO THE COMMONWEALTH**

We found that during fiscal year 2005, CFDC improperly allocated \$1,412 of expenses associated with its federal nutrition program to its state contracts. According to state regulations, expenses that are not directly related to the program purposes of state-funded programs are unallowable and non-reimbursable to the state.

808 CMR, promulgated by OSD, identifies the following as non-reimbursable costs under state contracts:

*(12) Non-Program Expenses. Expenses of the Contractor which are not directly related to the social service Program purposes of the Contractor.*

During our audit, we reviewed a judgmental sample of 138 program and administrative expenditures incurred by CFDC during fiscal years 2005 and 2006 totaling \$213,487. Based on our review of the documentation CFDC was maintaining relative to these expenses, we found that CFDC improperly allocated to its state funded daycare program \$1,412 in non-program expenses for training that was directly related to its federal food program.

Regarding this matter, CFDC officials stated that this misallocation was an isolated incident and that employees have been trained to prevent the recurrence of misallocations.

***Recommendation***

In order to address our concerns, CFDC should amend its fiscal year 2005 UFR to properly record the \$1,412 of federal nutrition expenses.

***Auditee's Response***

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

*The CFDC management made an error in the allocation and accepts the decision in this matter.*

***Auditor's Reply***

We believe CFDC's decision to address our recommendation was appropriate.