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INDEPENDENT STATE AUDITOR'S REPORT

ON CERTAIN ACTIVITIES OF THE

CLARENDON FAMILY DAY CARE, INC.

OCTOBER 1, 1999 THROUGH JUNE 30, 2001

**OFFICIAL AUDIT
REPORT**

APRIL 5, 2002

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Clarendon Family Day Care, Inc. (CFDC) is a private, not-for-profit corporation that was incorporated in 1978 to provide child care services to eligible families through a provider network servicing the communities of Boston, Springfield, Lawrence, and Lowell. The agency is also a statewide sponsor of the United States Department of Agriculture (USDA) Child and Adult Care Food Program (CACFP). This program provides nutritious meals and snacks to infants and children who receive daycare in CFDC's provider network. Our audit had the following objectives: to determine whether CFDC had implemented effective management controls, including processes for planning, organizing, directing, and controlling program operations; to determine whether CFDC followed policies and procedures to ensure that resource use is consistent with laws and regulations and that resources are safeguarded and efficiently used; and to assess 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.

Our audit identified problems, including CFDC engaging in questionable related party transactions totaling \$63,965, the agency not establishing adequate internal controls over all aspects of its operations, and inadequate oversight by the agency's Board of Directors.

AUDIT RESULTS

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1. QUESTIONABLE RELATED PARTY TRANSACTIONS TOTALING \$63,965

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During our audit period, CFDC paid a related party, Business Resources Services, Inc., a total of \$63,965 in lease payments for various office equipment, including fax machines, photocopiers, a 10-station computer network, and related software. Our review of the documentation maintained by CFDC relative to this equipment lease identified several discrepancies. Specifically, contrary to state and federal requirements, the contract for the lease of this equipment was non-competitively awarded to a company owned by CFDC's Financial Manager, who was also Treasurer of the agency's Board of Directors and the son of the agency's Executive Director. CFDC could have saved approximately \$43,865 over the life of the lease had it purchased this leased equipment.

2. INADEQUATE INTERNAL CONTROLS OVER CERTAIN OPERATIONS

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CFDC has not established adequate internal controls over various aspects of its operations. For example, we found that CFDC has no written accounting/finance policies and procedures and had inadequate segregation of duties in its finance and

accounting department. In addition, CFDC did not establish adequate controls over the use of corporate credit cards, which resulted in \$737 in undocumented and unallowable credit card expenses. Furthermore, contrary to state and federal requirements, CFDC was not maintaining an accurate inventory of its \$29,004 in furnishings and equipment items. As a result, there is inadequate assurance that CFDC's assets were being properly safeguarded or that the transactions relative to these accounts were properly authorized, recorded, and reported.

3. INADEQUATE ASSURANCE THAT CFDC IS BEING OPERATED IN AN EFFECTIVE AND EFFICIENT MANNER **14**

The Board of Directors of a human service provider agency is the primary organizational body that ensures that the agency meets its operational objectives in the most effective and efficient manner. Board members perform a variety of key functions, including overseeing the overall operation of the agency, setting policies and procedures to ensure that agency objectives are met, and hiring the agency's top executive. However, we found that contrary to the terms and conditions of its state contracts, during our audit period CFDC's board had as few as four members, two of which were related and were also employees of the agency. We also found instances in which significant agency transactions were not formally approved by the board. Based on the composition of CFDC's board, we question its ability to perform all of its responsibilities in an effective and efficient manner.

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INTRODUCTION

Background

Clarendon Family Day Care, Inc. (CFDC) is a private, not-for-profit corporation that was incorporated in 1978 to provide child care services to eligible families through a provider network servicing the communities of Boston, Springfield, Lawrence, and Lowell. The agency is also a statewide sponsor of the United States Department of Agriculture (USDA) Child and Adult Care Food Program (CACFP). This program provides nutritious meals and snacks to infants and children who receive daycare in the CFDC sponsored network. CFDC's corporate offices are located in Bedford, and the agency also operates programs in Boston, Lowell, Lawrence, and Springfield.

During the two fiscal years ending September 30, 2000, CFDC received funding from various sources as detailed in the following table:

Clarendon Family Day Care Inc.

Summary of Program Income

Fiscal Years 1999 Through 2000

Revenue Source	Fiscal Year 1999	Fiscal Year 2000
Department of Education (DOE)	\$4,789,069	\$4,898,695
Office of Child Care Services (OCCS)	4,350,789	4,648,672
Private Payments	257,555	376,636
Other Income	<u>29,990</u>	<u>23,700</u>
Total Revenue	<u>\$9,427,403</u>	<u>\$9,947,703</u>

In addition to operating CFDC, the agency's executive director is also the president of the Board of Directors of the New England Child and Adult Care Food Program and the president of the Massachusetts Child and Adult Care Food Program, both of which are non-profit human service organizations involved in promoting child and adult food care programs and related services.

On July 5, 2000, the state's Department of Education (DOE) hired a private accounting firm to perform a review of CFDC involving various agreed-upon procedures between the accounting

firm and DOE. The scope of this review was to assess CFDC's compliance with the requirements of the United States Department of Agriculture's Child and Adult Care Food Program during the 18-month period ended June 30, 2000. On August 16, 2000, the firm issued its report to DOE, which identified 52 deficiencies relative to various administrative and operational activities within CDFC. Examples of some of the most significant deficiencies identified during this review include the following:

- CFDC does not have a management plan or maintain written operational policies and procedures.
- CFDC is not following procurement standards for goods and services.
- There is no arms-length agreement between CFDC and a company owned by the treasurer of the board.
- The accounting system is inadequate.
- CFDC's board is partly composed of family members who make decisions relating to their own compensation and the compensation of other employees.

During our audit, we conducted tests to determine the status of these deficiencies and reported on any unresolved deficiencies.

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, 1999 to June 30, 2001. Our audit was conducted in accordance with applicable generally accepted government auditing standards for performance audits issued by the Comptroller General of the United States and included such audit procedures and tests as considered necessary to meet these standards.

Our audit procedures consisted of the following:

1. A determination of whether CFDC had implemented effective management controls, including:
 - Processes for planning, organizing, directing, and controlling program operations,

- Policies and procedures to ensure that resource use is consistent with laws and regulations; and
 - 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 management controls established and implemented by CFDC over its operations. The purpose of this assessment was to obtain an understanding of management's business practices, 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, members of CFDC's board, and officials from DOE, and reviewed organization charts, internal policies and procedures, and all applicable laws, rules, and regulations. We also examined CFDC's financial statements, budgets, cost reports, invoices, and other pertinent financial records to determine whether expenses incurred under its state contracts were reasonable, allowable, allocable, properly authorized and recorded, and in compliance with applicable laws, rules, and regulations.

Our audit was limited to a review of the activities of CFDC. Although we reviewed various documents relative to certain activities conducted by CFDC's related party, we did not conduct any audit work onsite at this entity. 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; the adequacy of CFDC's performance; and services, processes, methods, and internal controls that could be made more efficient and effective.

AUDIT RESULTS

1. QUESTIONABLE RELATED PARTY TRANSACTIONS TOTALING \$63,965

During our audit period, Clarendon Family Day Care, Inc. (CFDC) paid a related party, Business Resources Services, Inc. (BRS) a total of \$63,965 in lease payments for various office equipment, including fax machines, photocopiers, a 10-station computer network, and related software. Our review of the documentation maintained by CFDC relative to this equipment lease identified several discrepancies. Specifically, contrary to state and federal requirements, the contract for the lease of this equipment was non-competitively awarded to a company owned by CFDC's financial manager, who was also treasurer of the agency's Board of Directors and the son of the agency's executive director. Furthermore, CFDC could have saved approximately \$43,865 over the life of the lease had it purchased this leased equipment.

During fiscal year 1999, CFDC awarded a three-year equipment lease contract with an annual cost of \$27,900 to BRS. Under the terms and conditions of this lease agreement, BRS provided the following:

- Four MITA 720 facsimile (fax) transceivers
- One MITA 3255 photocopier
- Four MITA 1860 photocopiers
- One 10-station network, software, cables, and a custom program for CFDC's Child Care Food Program to track billings, payments, and year-to-date records.

In return, CFDC was to pay BRS a flat rate of \$2,325 per month (\$27,900 annually) and pay any and all costs associated with any repairs or service to this equipment.

The costs associated with this lease, which CFDC billed against its state contracts, totaled \$63,965 during fiscal years 1999, 2000, and 2001 (through December 31, 2001), as indicated in the table below:

CFDC

Summary of Equipment Lease Expenses

Fiscal Years 1999 Through 2001

	1999	2000	2001*	Totals
Computer equipment	\$12,000	\$11,370	\$2,150	\$25,520
Office equipment	<u>15,900</u>	<u>16,140</u>	<u>6,405</u>	<u>38,445</u>
Total	<u>\$27,900</u>	<u>\$27,510</u>	<u>\$8,555</u>	<u>\$63,965</u>

*CFDC terminated its contract with BRS as of January 1, 2001.

The state's Operational Services Division (OSD), the state agency responsible for regulating and overseeing the activities of contracted human service providers, such as CFDC, has promulgated regulations 808 Code of Massachusetts Regulations (CMR) 1.05 with which all contracted service providers must comply. According to CMR 1.05(1), the following costs are unreasonable and non-reimbursable under state contracts:

Any costs not determined to be Reimbursable Operating Costs as defined in 808 CMR 1.02 or any amount paid for goods or services which is greater than either the market price or the amount paid by comparable Departments or other governmental units within or outside of the Commonwealth.

Further, the federal Office of Management and Budget (OMB) has developed rules regarding procurement of goods and services. Because CFDC receives funds from both the Commonwealth and the federal government, it must also comply with these federal requirements. In this regard, OMB Circular A-110 entitled Uniform Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals, and Other Non-Profit Organizations, requires vendors such as CFDC who receive federal funds to utilize competitive-procurement procedures by stating, in part:

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

During our audit we reviewed the documentation maintained by CFDC relative to this lease agreement and noted the following deficiencies:

- Contrary to federal and state requirements, CFDC did not utilize a competitive procurement process when procuring these equipment items. Rather, CFDC non-competitively awarded this contract to BRS, which is 50% owned by CFDC's Financial Manager who is also the Treasurer of CFDC's Board of Directors and the son of the agency's Executive Director. As a result, neither CFDC nor the Commonwealth can be assured that CFDC received the best products and services at the lowest possible price.
- Our review of the \$63,965 in costs associated with this lease determined that some of these costs appeared to be unreasonable in that the amount paid for these services was significantly greater than the market price. Specifically, during our audit we spoke with a Boston-area representative for Kyocera MITA corporation, which is the manufacturer of the fax machines and photocopiers listed on the lease agreement between BRS and CFDC. We contacted this company for the purpose of identifying costs associated with this equipment, such as their original purchase price and lease costs, and their current market value. According to this representative:
 - a. The MITA 3255 protocopier was last manufactured in 1988, was obsolete, and had effectively no market value as of 1999 when CFDC's lease with BRS began. The original cost of this machine would have been approximately \$4,800.
 - b. The four MITA 1860 copiers were last manufactured in 1997 when the purchase price would have been approximately \$4,000 each or \$16,000 total. At the time, the representative told us that these machines would lease for approximately \$120 each per month, or \$480 per month and \$5,760 annually for all four machines. The representative stated that the current market value of these machines would vary depending on their usage but that their average life is five years.
 - c. The four MITA 720 facsimile machines were last manufactured in 1996 when the purchase price would have been approximately \$2,000 each or \$8,000 for the four machines. The lease costs would have been approximately \$240 (\$60 each) per month or \$2,880 annually. The average life of these machines is five years.

On October 24, 2001, we spoke with five Boston area computer hardware and software dealers in order to attempt to determine the value of the 10-station network, software, cables, and other items included in CFDC's lease with BRS. According to their representatives, the equipment in this 10-station network was last manufactured in 1995 and would have had an original cost of between \$2,000 and \$2,500. However, these representatives stated that by 1999, the time when this equipment was leased, it essentially had no market value.

In our opinion, the costs incurred by CFDC are unreasonable since, based on information we obtained from the dealer representatives, and using the original estimated purchase costs for the obsolete equipment (the MITA 3255 copier and the 10-station network) as purchase costs in 1999, CFDC could have purchased this equipment for less than it paid to lease this equipment during the 1999 fiscal year, as detailed below:

CFDC

Equipment Purchase Analysis

Item	Estimated Purchase Cost (1999)
Four MITA 3255 Copiers	\$ 4,800
Four MITA 1860 Copiers	9,600*
Four MITA Fax Machines	3,200*
10 Station Networks and Related	<u>2,500</u>
	<u>\$20,100</u>

* Residual market value as of 1999, based on straight-line depreciation over a five-year period. For example, the MITA 1860 Copiers (\$16,000 original cost; \$6,400 [2 years] of depreciation).

As shown above, CFDC could have saved at least \$43,865 (\$63,965 total lease costs less \$20,100 purchase cost) over the life of the lease had it purchased this equipment.

Regarding this matter, CFDC's Financial Manager and owner of BRS stated that many upgrades were made by his company over the years to this leased equipment, such as upgrading from a 286 processor to a 386 processor in the computer system as well as changes in the software used in the system. Therefore, in his opinion, these lease costs were reasonable. However, the agency did not provide us with any documentation (e.g., an amended lease agreement) to substantiate that any of this lease equipment was upgraded or any analysis that indicated that the lease expenses under this agreement were reasonable. CFDC officials did not comment as to why the agency did not utilize a competitive procurement process when procuring these equipment items.

Recommendation

In order to address our concerns relative to this matter, CFDC's principal state purchasing agency (DOE) should recover from CFDC the unreasonable equipment lease costs it charged against its state contracts during the audit period. Our analysis indicates that this amount is at least \$43,865. However, DOE should conduct its own analysis to determine an appropriate recoupment amount. In the future, CFDC should adhere to OSD and OMB requirements and utilize, to the extent possible, a competitive procurement process when awarding contracts for goods and services.

Auditee's Response

In response to this audit result, CFDC Chief Executive Officer (CEO) provided the following comments:

- *CFDC concurs with audit findings in regards to BRS.*
- *CFDC has established a competitive procurement of services plan that is now a part of the revised CFDC Operations Manual.*
- *In addition, CFDC has established guidelines for the procurement of goods and services in accordance with state and federal regulations.*

Auditor's Reply

We believe that the actions taken by the current management relative to these matters are appropriate. However, we recommend that DOE conduct an analysis to determine an appropriate recoupment amount for the unreasonable lease costs CFDC charged against its state contracts during our audit.

2. INADEQUATE INTERNAL CONTROLS OVER CERTAIN OPERATIONS

CFDC has not established adequate internal controls over various aspects of its operations. For example, we found that CFDC has no written accounting/finance policies and procedures; had inadequate segregation of duties in its finance and accounting department; and did not establish adequate controls over the use of corporate credit cards, which resulted in \$737 in undocumented and unallowable credit card expenses. Furthermore, contrary to state and federal requirements, CFDC did not maintain an accurate inventory of \$29,004 in

furnishings and equipment items. As a result, there is inadequate assurance that CFDC's financial assets were being properly safeguarded or that the transactions relative to these accounts were properly authorized, recorded, and reported.

It is the responsibility of management to establish and maintain an effective internal control structure. Internal controls are essential in maintaining full accountability for resources and in achieving management objectives in the most effective and efficient manner. Details of CFDC insufficient internal controls are listed below:

a. No Written Accounting/Finance and Personnel Policies and Procedures

During our audit we found that CFDC had no written policies and procedures relative to its accounting/finance related activities. Without such formal written policies and procedures, CFDC is increasing the probability of inconsistent and incorrect accounting practices and errors, particularly in the case of staff turnover. In fact, we found several instances of incorrect accounting practices, as follows:

- CFDC purchased two buses for use in its Family Day Care program. The first bus was purchased on January 1, 1997 in the amount of \$28,139, and the second bus was purchased on January 27, 1998 in the amount of \$30,218. During our audit, we found that the depreciation expenses for these buses taken by CFDC was not consistent with what is allowed by OSD regulations. Specifically, according to the UFR Audit and Preparation Manual under 808 CMR 1.00 issued by OSD, the costs of such motor vehicles are to be depreciated at a rate of 20% per year over a five year period. We found, however, that CFDC depreciated the costs of these vehicles over different time periods than the mandated 60 months (five years) required by OSD guidelines, which resulted in incorrect depreciation expenses being reported on CFDC's financial statements, as indicated in the table below:

Depreciation Analysis

Fiscal Years 1997 Through 2000 (September 2000)

Bus No.	Depreciation Taken Through September 30, 2000	Allowable Depreciation	Difference
1	\$22,266	\$21,104*	\$1,162
2	\$16,257	\$16,620**	(\$363)

* $\$28,139 \div 60 \text{ months} \times 45 \text{ months through September 30, 2000}$

** $\$30,218 \div 60 \text{ months} \times 33 \text{ months through September 30, 2000}$

- CFDC had no documentation to support the value of its inventory of fixed assets, which, according to the agency's financial statements, had a value of \$29,004 as of September 30, 2000. In fact, we found that the agency did not maintain any fixed-asset records but relied solely on its private accounting firm's preparation of the agency's financial statements and tax reports to determine the value of its fixed assets and related depreciation expenses.
- An accounting system should consist of a methodology to identify, classify, and record an entity's transactions and maintain accountability for its assets and liabilities. An effective accounting system should also identify and record transactions at initial entry; describing the transaction in sufficient detail to allow for the proper classification of the transactions at financial reporting time; and determine that the transactions are properly authorized and are in compliance with laws and regulations. However, we found that CFDC's accounting system required extensive adjusting of its journal entries at year end. One of the reasons for this adjustment is that CFDC's accounting transactions are posted to the agency's general ledger on a monthly basis from 123 Lotus spreadsheets, which are taken from a manually maintained one-write bookkeeping system. CFDC's financial manager performs all of the spreadsheet and summary postings. The manually maintained one-write bookkeeping system is partially completed by two individuals, the agency's Financial Manager and a contractor working in the accounting department. Since there are no agency policies and procedures as to how to record transactions, these two individuals inconsistently recorded transactions, which required them to be adjusted at year end.
- CFDC does not maintain any leased equipment records to determine the balances remaining on the leases. Without such information, it is not possible for CFDC to properly administer its lease agreements. For example, CFDC leased three automobiles at a monthly cost of \$476 each from Enterprise Fleet Services for the 36-month period beginning September 1998 to September 2001. These lease agreements for two of these vehicles were terminated by CFDC in May 2001 and in July 2001 for the remaining vehicle. However, since the leases for these vehicles were terminated prior to their expiration, CFDC owed \$6,677 in settlement fees to Enterprise Fleet Services. CFDC terminated the leases before their expiration because CFDC's management determined that the automobiles were no longer needed. However, had CFDC maintained proper records for its leased equipment, based on our estimations, the remaining lease payments would have totaled \$6,191 which is significantly less than the early termination fee of \$6,677.

b. Inadequate Controls Over Corporate Credit Cards

CFDC does not have any written policies and procedures relative to the procurement and use of corporate credit cards. As a result, during our audit we found that the former director of CFDC's Nutrition Program applied for and received a corporate credit card in both her and CFDC's name without the knowledge and consent of the agency. During the period

April 1999 to February 2000, the former director used this credit card to purchase \$737 in items which appear to be personal in nature, and charged these expenses against CFDC's state contracts. CFDC officials told us that they discovered this credit card and have taken measures, including dismissing the former director from her position, to resolve this matter.

c. Lack of Segregation of Duties

An effective internal control structure ensures adequate segregation in the duties and responsibilities of individuals involved in the custody of assets, the authorization and recording of transactions, and the reconciliation of records. Specific areas that should be addressed in this area are as follows:

- Individuals preparing checks should not be signing them.
- Persons signing checks should not be reconciling checking accounts.
- Individuals receiving revenue should not reconcile checking accounts.
- Individuals responsible for hiring, terminating, and approving promotions should not prepare the payrolls.

However, during our audit we found that CFDC had not adequately segregated the duties and responsibilities of its financial manager. Specifically, the agency's financial manager is responsible for sending invoices to and receiving payments from vendors, reconciling agency bank statements, and processing payroll information.

d. Inadequate Internal Controls over Furnishings and Equipment Totaling \$29,004

The American Institute of Certified Public Accountants (AICPA) Codification of Statements on Auditing Standards (SAS) defines an adequate internal control structure and what is required to properly safeguard the assets of the organization. Specifically, SAS No. 55 states:

Establishing and maintaining an internal control structure is an important management responsibility. In establishing specific internal control structure policies and procedures concerning an entity's ability to record, process, summarize, and report financial data that is consistent with management assertions embodied in the financial statements, some of the specific objectives management may wish to consider include the following:

- *Access to assets is permitted only in accordance with management's authorization.*
- *The recorded accountability for assets is compared with the existing assets at reasonable intervals, and appropriate action is taken with respect to any differences.*

Also, 808 CMR 1.04 (5), Inventory of Equipment and Furnishings and Other Goods, states, in part:

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

However, we found that, contrary to SAS and state requirements, CFDC was not maintaining detailed records of its inventory to clearly list the description and location of each item, its historical cost or fair market value if donated, the date of purchase, or the source of acquisition of each asset (e.g., state, private, or donated). Finally, CFDC did not have any policies and procedures in place to restrict access to these assets; did not perform annual physical counts of items, such as furniture and equipment, for comparison to inventory records; and did not affix identifying tags to furniture and equipment items. Because of these deficiencies, there was inadequate assurance that CFDC's inventory of furnishings and equipment, which as of September 30, 2000, had a value of \$29,004, was properly safeguarded against loss, theft, or misuse.

CFDC officials have advised us that the agency recently contracted with an independent financial consultant; policies, procedures, and accounting systems are being reviewed; and a new accounting system will be implemented to include a fixed-asset system.

Recommendation

We recommend that CFDC immediately develop adequate controls over all aspects of its operations that are consistent with applicable state and federal requirements.

Auditee's Response

In response to this audit result, CFDC's CEO provided the following comments:

Since August 2001, CFDC's management has been diligently working towards improving the internal controls over all aspects of CFDC's operations. Two independent financial consultants were hired to help guide management in this process and to aid in the implementation of policies and procedures desperately needed for the efficient and effective management of CFDC.

CFDC has established an accounting policies and procedures manual to assist the accounting/finance department in the standardized performance of all accounting duties and functions. This manual sets forth policies and procedures surrounding all accounting transactions as well as procedures for all other functions that the business office performs. This manual defines accounting methods and systems used and assigns responsibilities for performing and reviewing various tasks in the business office.

The accounting policies and procedures manual is still in draft format. Management believes that the manual will be finalized in the spring of 2002 once it has had an opportunity to address and implement all proper procedures required for strong internal controls.

Beginning fiscal year 2002, CFDC implemented an automated accounting system. The manually maintained one-write bookkeeping system was used temporarily during the implementation phase to ensure that cash disbursements were paid in a timely and effective manner and that cash receipts were recorded properly and accurately. As part of the new accounting system, CFDC developed a chart of accounts, which allows for tracking and separation of expenditures by functional activity and allows for preparation of programmatic financial statements on a monthly basis. Currently, all cash receipts, disbursements, and all required journal entries are posted to the accounting system monthly. All general ledger accounts are then reconciled monthly and adjusted to their proper balances. Supporting schedules for major accounts are also prepared monthly documenting activities and transactions that occurred during the month.

CFDC has established an agency-wide policy disallowing the procurement and use of corporate credit cards. Any employee of CFDC who obtains a corporate credit card in the name of CFDC will be terminated immediately from his/her employment upon CFDC becoming aware of it. The accounts payable clerk is not allowed to generate any checks payable to a credit card company without the consent of both the executive director and the fiscal director of CFDC.

CFDC has modified its internal accounting functions and responsibilities so that no one person has excessive control over any specific task. Adequate segregation in the duties and responsibilities of individuals involved in the custody of assets, the authorization and recording of transactions, and the reconciliation of records has been established as follows:

- A part-time accounts payable clerk was hired in November 2001 to handle vendor's invoices and related cash disbursements.*
- A part-time bookkeeper/accountant was hired in November 2001 to handle certain cash receipts and general ledger functions.*

- *A full-time human resources/payroll function was established to handle payroll and related human services functions.*
- *The billing function is done by four full time individuals currently on staff.*
- *A part-time Chief Financial Officer was hired on a consultant basis in November 2001 to oversee the daily accounting and financial operations of CFDC and to ensure adequate review of all financial activity and provide supervision to all fiscal staff.*

Management believes that the above measures will ensure adequate internal controls and will allow for segregation of duties amongst staff.

CFDC has set up as part of its policies and procedures manual an inventory system to track all CFDC's fixed assets maintained at all locations. Detailed records will be maintained for all new purchases in an automated spreadsheet. The spreadsheet will list all inventory items by the purchase date, item description, historical cost, its physical location, depreciable life, and source of funds used to purchase the item. An annual physical count of these items will be done to ensure proper safeguarding from theft or loss and to determine obsolescence. Management will eventually affix identifying tags to each item in order to better track and identify. Management believes that these procedures will ensure proper safeguarding of CFDC's assets.

Auditor's Reply

We believe that the actions taken by CFDC's current management relative to these matters were appropriate and necessary.

3. INADEQUATE ASSURANCE THAT CFDC IS BEING OPERATED IN AN EFFECTIVE AND EFFICIENT MANNER

The Board of Directors of a human service provider agency is the primary organizational body that ensures that the agency meets its operational objectives in the most effective and efficient manner. Board members perform a variety of key functions, including overseeing the overall operation of the agency, setting policies and procedures to ensure that agency objectives are met, and hiring the agency's top executive. However, we found that, contrary to the terms and conditions of its state contracts, during our audit period CFDC's Board of Directors had as few as four members, two of which were related and were also employees of the agency. We also found instances in which significant agency transactions were not formally approved by CFDC's board. Based on the composition of CFDC's board, we question its ability to perform all of its responsibilities in an effective and efficient manner.

The state's Executive Office for Administration and Finance and OSD have established Commonwealth Terms and Conditions for Human and Social Services (General Contract Conditions) with which all contracted human service organizations, such as CFDC, must comply. Regarding an organization's Board of Directors, these General Contract Conditions state:

. . . Further, the Contractor specifically agrees that: i) members of the Contractor's management and immediate family (as defined in the AICPA's Financial Accounting Standards Board Statement number 57) will not comprise more than 30% of the voting members of the Contractor's board or any of the board's committees or subcommittees; and, ii) the Contractor's Board of Directors will approve the selection of the Contractor's audit firm, will annually review its executive director's or other more senior manager's performance and set that person's compensation by formal vote. . .

Despite these requirements, we found that during our audit period, CFDC's board, which comprised four individuals, contained two members that were related and were also employees of the agency, which is in direct violation of the General Contract Conditions, as indicated below:

Board Position	Agency Position	Family Relationship
President	Executive Director	Mother of Financial Manager
Treasurer	Financial Manager	Son of Executive Director
Clerk	None	None
Member	None	None

We question the board's ability perform all of its responsibilities in an independent manner during our audit period, particularly the ability to subjectively review the performance and establish compensation for the executive director, since she herself is the president of the board.

We also found several instances in which the board did not approve or was even aware of significant agency transactions. For example, on January 16, 2001, the executive committee of the board approved a loan from CFDC's executive director to CFDC in the amount of \$100,000 for the period January 19, 2001 through July 19, 2001 at an interest rate of 8%. On

February 20, 2001, the executive committee approved a second loan in the same amount and interest rate from the agency's executive director to CFDC due on August 20, 2001. Although the executive committee approved these loans, they were not brought to the attention of the full board of directors for approval. Moreover, the president of the board was also a member of the executive committee and did not recuse herself from this vote, despite the fact that she was involved in and benefited from these transactions.

Recommendation

CFDC should take the necessary measures to ensure that the composition and activity of its board of directors complies with state laws and that the board meets on a regular basis to execute its duties and advise CFDC of its financial and operational responsibilities.

Auditee's Response

In response to this audit result, CFDC's CEO provided the following comments:

- *Expanding and diversifying the CFDC Board membership is a primary objective of CFDC management. CFDC has consulted a variety of professionals including the United Way Board Bank to assist in this pursuit.*
- *Over the past year, the Board of Directors has expanded to include 10 members and continues to recruit new potential members. The Board represents a variety of diverse professionals expertise and perspectives to enhance CFDC's operations and services.*
- *CFDC's Board of Directors meetings are held monthly throughout the year. Additional special or committee meetings are scheduled as necessary.*

Auditor's Reply

Based on its response, CFDC has taken measures to address our concerns relative to this matter.

Additional Auditee Comments

In addition to providing comments specific to each audit result, CFDC's CEO provided the following general comments:

Clarendon Family Day Care was a willing participant in the state audit conducted by the Commonwealth. The staff has great confidence in the quality of services we

provide to the Commonwealth and we believed the audit would serve as an effective guide to assess the agency's strengths and any areas needing improvements. Prior to the audit, CFDC had contracted the services of fiscal/management consultants to evaluate and restructure CFDC management and fiscal operations and policies. Overall CFDC accepts the findings and the report. CFDC will incorporate the audit report findings and recommendations within CFDC's revised accounting and operating manuals and revised policies and procedures.

APPENDIX**Programs Operated By Clarendon Family Day Care**

1. Nutrition Program: Clarendon's childcare providers offer nutritious meals and snacks daily to children in their care. Food quantities and varieties are set in accordance with recommendations set by the USDA. CFDC provides nutrition reimbursement for daycare providers, sponsored by the Department of Food and Agriculture (DFA), through the Commonwealth's Department of Education.
2. Family Day Care: Clarendon's Family Day Care Program provides childcare services to income eligible families. Services are available to parents who pay privately, have community partnership scholarships, and have Department of Transitional Assistance vouchers. Clarendon's services support technical assistance to parents, providers, and children.