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INDEPENDENT STATE AUDITOR'S REPORT ON
CERTAIN ACTIVITIES OF THE
COMMONWEALTH FAMILY CHILDCARE, INC.
JULY 1, 2004 TO MAY 31, 2006

OFFICIAL AUDIT
REPORT
MAY 2, 2007

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Commonwealth Family Childcare, Inc. (CFC) was incorporated in July 1984 as a for-profit organization. CFC offers support to families in search of childcare and assists families in securing comprehensive daycare services for pre-school-aged children residing in Taunton, Brockton, New Bedford, and several surrounding communities.

The scope of our audit was to examine various administrative and operational activities of CFC during the period July 1, 2004 to May 31, 2006. Our audit objectives were to (1) determine whether CFC had implemented effective internal controls over its operations and (2) assess CFC's business practices and its compliance with applicable laws, rules, regulations, and the various fiscal and programmatic requirements of its state contracts.

Our audit identified that CFC billed the Commonwealth a total of \$102,158 in unallowable and nonreimbursable expenses during our audit period. We also found that CFC had not established adequate internal controls over certain aspects of its operations.

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In accordance with policies established by the Department of Early Education and Care (DEEC), CFC's contracted service providers are allowed to bill CFC for the actual service days on which they are open for operation, and for up to 14 approved days when they are closed, such as on holidays. CFC submits invoices to DEEC based on these billings, and upon receiving payment from DEEC, CFC is required to pay the invoices submitted by its contracted service providers. However, we found that during fiscal years 2005 and 2006 (through May 2006) CFC billed and received from DEEC a total of \$75,902 in reimbursements for 2,333 service days on which its service providers were closed, days in excess of the 14 days allowed by DEE policies. CFC's service providers did not bill CFC for these days, but CFC still requested and received reimbursement for the excess days from DEEC. Furthermore, CFC did not pass these payments on to its service providers, but rather used these funds for its own purposes. As a result, these reimbursements totaling \$75,902 represent unallowable payments from DEEC which should be remitted to the Commonwealth.

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During our audit period, CFC owned a vehicle that was used exclusively by its Executive Director for which it charged \$25,050 in expenses against its state contracts. However, CFC did not have any formal written policies and procedures providing for the provision of this fringe benefit to the Executive Director. According to state regulations, fringe benefits such as these that are not provided for under an established policy of the Agency are unallowable and nonreimbursable under state contracts. Additionally, we found that CFC did not require its Executive Director to document the business and personal use of this vehicle, and did not report the value of her personal use as a taxable fringe benefit

on the Executive Director's Form W-2s, contrary to Internal Revenue Service and Department of Revenue regulations.

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We found that during our audit period, CFC had not established adequate internal controls over the use of corporate credit cards, which resulted in \$1,206 in expenses charged against its state contracts for which there was no documentation. According to state regulations, expenses such as these that are not properly documented are nonreimbursable under state contracts.

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During our audit, we found that CFC had not developed and implemented an adequate system of internal controls over various aspects of its operations. Specifically, CFC did not maintain all of its records in accordance with state regulations, and did not establish an effective inventory system for fixed assets. These conditions reduce the Commonwealth's assurance that CFC's financial assets are being properly safeguarded and that all transactions are properly authorized, recorded, and reported.

INTRODUCTION

Background

Commonwealth Family Childcare, Inc. (CFC) was incorporated in July 1984 as a for-profit corporation for the purposes of acting as a human services referral agency and support network for a network of human services providers, including family daycare providers. Currently, CFC offers support to help families locate childcare for preschool-aged children in private homes which are licensed by the state's Department of Early Education and Care (DEEC). CFC coordinates the procurement of these childcare services for its eligible consumers residing primarily in Taunton, Brockton, New Bedford, and several surrounding communities.

During our audit period, CFC had four contracts with DEEC to coordinate the provision of three types of childcare services: Income Eligible Childcare, Teen Parent Childcare, Supportive Services Childcare Attleboro, and Supportive Services Childcare Brockton. These services are offered to families based upon certain eligibility criteria, as follows:

- Income Eligible Childcare: This program provides subsidized childcare for low-income parents who are employed, are attending school, or meet DEEC guidelines for special circumstances. During fiscal years 2005 and 2006, the maximum obligation of the contract that funded this program was \$681,510 and \$710,755, respectively.
- Teen Parent Childcare: This program provides childcare for parents less than 20 years of age who are working or attending school. The contract has two components: one for childcare services and the other for transportation. The maximum obligation of these contract components was \$120,510 (childcare) and \$49,198 (transportation) in fiscal year 2005 and \$129,221 (childcare) and \$49,198 (transportation) in fiscal year 2006.
- Supportive Services Childcare Attleboro/Brockton: This program provides childcare for families and children who have open cases with the state's Department of Social Services. The childcare services are designed to meet the needs of families that are experiencing a high degree of stress and disorganization. Supportive Child Care is used in a transitional, time-limited manner in order to stabilize the family and ensure the safety and well-being of the child. The Supportive Services Childcare Attleboro contract has two components: one for childcare services and the other for transportation. The maximum obligation of these contract components was \$145,690 (childcare) and \$59,840 (transportation) in fiscal year 2005, and \$151,145 (childcare) and \$59,840 (transportation) for fiscal year 2006. The Supportive Services Childcare Brockton contract also has two components: one for childcare services and the other for transportation. The maximum obligation of these contract components was \$135,269 (childcare) and \$56,100 (transportation) in fiscal year 2005, and \$142,937 (childcare) and \$56,100 (transportation) in fiscal year 2006.

Under its contracts with DEEC, CFC is responsible for coordinating childcare services for over 100 infants, toddlers, and preschool-aged children. CFC does not directly provide any childcare services to consumers, but provides families in need of childcare with various administrative services such as referrals, provider/parent education, and other supports. CFC recruits licensed childcare providers to provide the actual program services to families. The Agency recruits its providers by advertising in newspapers and from provider lists established by DEEC. CFC assesses the providers to determine whether they meet current DEEC licensure requirements for home-based daycare. If a provider meets these requirements, CFC will enter into a contract for services to be provided to CFC consumers and will establish a rate for these services. According to CFC's policies, the providers it utilizes for daycare services are required to submit monthly attendance invoices by the fifth of the month following the inception of service. These attendance invoices document the arrival and departure times, absences, and other schedule changes of the children in the program and are signed by both the parent and a representative of the provider. The attendance invoices are reviewed by CFC's Program Director and forwarded to the CFC's Business Manager, who bills DEEC. All DEEC billings must be completed and forwarded to DEEC by the 10th of the month. DEEC processes the billings and reimbursements for each billing made directly to CFC. CFC is responsible for reimbursing its providers and in return retains an administrative fee of up to 30% of the payments made by DEEC to CFC's contracted service providers.

During fiscal year 2005, CFC received funding as indicated in the table below. Of these amounts, the Agency passed through \$1,047,477 to its service providers to pay for daycare services.

Summary of Revenue - Fiscal Year 2005

Revenue Source	Amount
DEEC Contract	\$ 1,277,027
Mass Gov't. Grant	79,993
Client Resources	122,542 *
Mass. Publicly Sponsored Client Offsets	210,979 **
Investment Revenue	<u>3,247</u>
Total Revenue	<u>\$ 1,693,788</u>

*Families are responsible for a portion of the childcare costs for their child. The fees are based upon a sliding fee scale published by DEEC that is based upon the family's income levels.

**Massachusetts Publicly Sponsored Client Offsets are funds received by CFC under vouchers from non-state sources such as other human service agencies for child care services provided by CFC to clients of these agencies.

Audit Scope, Objectives, and Methodology

The scope of our audit was to examine various administrative and operational activities of CFC during the period June 1, 2004 to May 31, 2006.

We conducted this performance audit in accordance with generally accepted government auditing standards. 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 CFC had implemented effective internal controls, including:
 - Processes for planning, organizing, directing, and controlling program operations;
 - Policies and procedures to ensure that resource use is consistent with Massachusetts laws and regulations; and
 - Policies and procedures to ensure that resources are safeguarded and efficiently used.
2. An assessment of CFC 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 CFC 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 CFC's accounting system. We used this assessment in planning and performing our audit tests. We then held discussions with CFC officials and reviewed organization charts; internal policies and procedures; and all applicable laws, rules, and regulations. We also examined CFC'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 conducted for the purposes of forming an opinion on CFC's financial statements. We also did not assess the quality and appropriateness of all program services provided by CFC

under its state-funded contracts. Rather, our report was intended to report findings and conclusions on the extent of CFC's compliance with applicable laws, regulations, and contractual agreements, and to identify services, processes, methods, and internal controls that could be made more efficient and effective.

AUDIT RESULTS

1. UNALLOWABLE BILLINGS TOTALING \$75,902 CHARGED TO STATE CONTRACTS

In accordance with policies established by the Department of Early Education and Care (DEEC), Commonwealth Family Childcare's (CFC) contracted service providers are allowed to bill CFC for the actual service days that they are open for operation, and for up to fourteen approved days when they are closed, such as on holidays. CFC submits invoices to DEEC based on these billings, and once CFC receives payment from DEEC, it is required to pay the invoices submitted by its contracted service providers. We found, however, that during fiscal years 2005 and 2006 (through May 2006) CFC billed and received from DEEC a total of \$75,902 in reimbursements for 2,333 service days on which its service providers were closed, in excess of the 14 days allowed by DEEC policies. CFC was not billed by its service providers for these days, but still requested and received reimbursement for the excess days from DEEC. Furthermore, CFC did not pass these payments on to its service providers, but rather kept these funds and used them for its own purposes. As a result, these reimbursements totaling \$75,902 represent unallowable payments from DEEC which should be remitted to the Commonwealth.

As noted in the background section of this report, several DEEC contracts fund CFC's childcare programs. In this regard, DEEC established Reimbursement Policies with which all contracted daycare agencies such as CFC must comply when providing any type of daycare services. Regarding payment for days of service, DEEC policies state the following regarding Income Eligible and Supportive Childcare services:

Programs that hold an Income Eligible Child Care contract will be reimbursed at the contracted (daily) rate, less required fees, for actual utilization. Utilization is the number of enrolled slots multiplied by the number of service days in a given month. . . . The child care provider must be paid the sub-unit rate for every day that the system [CFC] receives payment from DEEC (including vacations, holidays and vacation days). . . .

Supportive Child Care providers will be reimbursed for child care and support services provided, including transportation and social services. Child care services will be reimbursed at the contracted (daily) rate for the prototype that the child is actually using times the number of enrolled days. . . . Providers will not be reimbursed for unscheduled closings that are within the provider's control.... Family childcare systems must reimburse family child care providers for every day that they are reimbursed by DEEC, at a rate equal to or greater than the regional rate for the Tier for which the System has qualified.

In addition to being paid for the days that children are actually provided services in a program, DEEC's policies allow agencies such as CFC and its contracted providers to be paid for up to 14

days when they are closed. These “closure” days would include holidays, days for staff training, and days when there are improvements being made to the provider’s facilities. Based on DEEC’s policies, CFC developed its own policy on provider closures, which it maintains in its Provider Resource Guide, as follows:

Provider Closures: Providers may charge up to 14 state-approved closures per year. CFC, Inc. state contracts permit the agency to reimburse Providers for these days. Providers will not be reimbursed for other days when their businesses are closed (i.e. sick days, vacations, or personal days).

During our audit, we reviewed all of the documentation CFC maintained relative to the invoices submitted by CFC’s providers. Based on our review of this information, we determined that CFC’s providers did not bill CFC for any unapproved closures (i.e., sick, vacation, or personal days) during this period. However, our review of CFC’s corresponding billings to DEEC indicated that CFC routinely overbilled DEEC for service days. Specifically, during our audit period, CFC billed and received payments from DEEC in the amount of \$75,902 for 2,333 closure days over and above the 14 closure days allowed by DEEC’s policies. Moreover, although CFC received these payments from DEEC, it did not reimburse its providers for “every day that they [were] reimbursed by DEEC” as required by DEEC’s policies. The table below summarizes, by month, the number of days above the allowable closure days that CFC billed and received payments from DEEC and did not remit these funds to its providers:

Month	Fiscal Year 2005		Fiscal Year 2006		Total	
	No. of Days	Amount	No. of Days	Amount	No. of Days	Amount
July	201	\$6,294	203	\$6,854	404	\$13,148
August	191	5,913	385	12,735	576	18,648
September	36	1,256	78	2,578	114	3,834
October	46	1,448	29	990	75	2,438
November	53	1,723	89	2,835	142	4,558
December	139	4,455	165	5,524	304	9,979
January	17	524	33	1,037	50	1,561
February	16	506	96	3,154	112	3,660
March	89	2,939	69	2,314	158	5,253
April	71	2,256	66	2,000	137	4,256
May	72	2,231	77	2,654	149	4,885
June	<u>112</u>	<u>3,682</u>	n/a	n/a	<u>112</u>	<u>3,682</u>
Totals	<u>1,043</u>	<u>\$33,227</u>	<u>1,290</u>	<u>\$42,675</u>	<u>2,333</u>	<u>\$75,902</u>

We brought this matter to the attention of CFC officials, who indicated that the DEEC Contract Manager told them that the billings in question were appropriate under DEEC's policies, which state, in part:

In cases where alternate care is offered and not used by the client, the system [CFC] may bill DEEC and retain the revenue. . . .

However, as we pointed out to CFC officials, despite this policy, none of the days we identified as being unallowable in our analysis included days where alternate care was offered but not used by a client of one of CFC's subcontractors.

Recommendation

DEEC should recover the \$75,902 in unallowable reimbursements CFC received from DEEC during the period covered by our audit. In the future, CFC should take measures to ensure that accurate billings are submitted for all program services and that it remits appropriate reimbursements to its contracted service providers.

Auditee Response

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

CFC has made every effort to adhere to regulations as they apply to both the Internal Revenue Service and the Department of Early Education and Care. Since FCC providers are not employees, CFC has adopted a contractual agreement that is consistent with a contractual relationship as defined by the IRS. Reimbursing FCC providers for days that they are not in operation would increase their qualifications as employees. In order to benefit service providers in a manner that is consistent with EEC policies, CFC not only employed additional staff, but also conducted site visits to service FCC providers in excess of standard FCC System practices. Documentation of these visits is on file at the CFC office. These benefits to FCC providers, in lieu of direct payments, have been approved by EEC ...

In addition, in a letter dated January 25, 2007, the Contract and Monitoring Coordinator in DEEC's Southeastern and Cape Office provided the following comments at the request of CFC:

As you requested I have reviewed your FY2005 and FY2006 UFR filings, specifically for support services provided by CFC to its subcontracted family childcare providers. Based on the following information noted below, I have determined that the FCC support services provided by CFC are a benefit to FCC providers and far exceed EEC requirements.

FCC systems are allowed to bill EEC for services when a client chooses not to use alternate care, and their regular FCC provider is unavailable as long as the funding is

expended in a way that benefits the FCC provider. EEC's practice has been to review and determine if the funds benefit FCC providers.

I have reviewed and allowed CFC the use of these funds on at least three occasions for the following reasons.

CFC has noted that they provide support beyond the contract requirement as a benefit to the FCC provider. Family childcare systems are required to provide a home visitor assigned to the home of the family childcare provider. At a minimum the home visitor must be Lead Teacher qualified under EEC Group Day Care Licensing Standards. The home visitor is required to make one visit per month to each contracted FCC provider.

The average EEC home visitor to FCC provider ratio is 1:25. Based on that average, during FY05 and FY06, CFC employed an additional 3 FTE beyond the typical FCC system and made at least two visits per month to its FCC providers. Based on information noted in the provider's UFRs, additional wages paid by CFC for this higher ratio were \$107,212 annually. This amount far exceeds the revenue in question.

Auditor's Reply

In its response, CFC contends they are allowed to bill for the days in question because they “not only employed additional staff, but also conducted site visits to service FCC providers in excess of standard FCC System practices.” Further, the comments provided by DEEC’s Regional Contract and Monitoring Coordinator in its Southeastern and Cape Office relative to this matter support CFC’s contention. However, the Agency did not provide us with any documentation to support the fact that it had to hire “additional staff” or conduct additional site visits as a result of any actions taken by its state-funding Agency. Moreover, the argument made by CFC in this matter is irrelevant because, as stated in our report, DEEC’s regulations regarding reimbursement clearly state that “Providers will not be reimbursed for unscheduled closings that are within the provider’s control... Family childcare systems must reimburse family child care providers for every day that they are reimbursed by DEEC.”

In support of this, we contacted DEEC’s Assistant Director of Audit Resolution regarding this matter. In response, the Assistant Director provided the following written comments:

The Language states when the system gets paid- the provider gets paid. The System can only bill if alternative care is provided. Alternative care needs to be offered, as the RFR requires the System to have a written policy for alternative back-up care. If the system does not pay the provider they cannot bill the Commonwealth, as no childcare was provided.

Further, DEEC’s legal counsel, in a letter dated March 15, 2007, provided the following comments to us regarding this issue:

... EEC was not aware that [name of DEEC's Regional Contract and Monitoring Coordinator in its Southeastern and Cape Office] wrote or sent the letters until EEC had been notified by your office. The letters are not an accurate reflection of EEC policy governing reimbursement. The contract monitor exceeded her authority and misrepresented EEC's position on this matter.

EEC policy states that the childcare provider must be paid the sub-unit rate for every day that the family childcare system receives payment from EEC. EEC contract monitors are not authorized to provide elaboration beyond this policy position without their supervisor's express authorization. [name of DEEC's Regional Contract and Monitoring Coordinator in its Southeastern and Cape Office] had no such authorization and was therefore in error.

Clearly, CFC's reasoning that the days in question should be allowable because they purportedly provided additional staff and services is unfounded and contrary to DEEC regulations. Consequently, we again recommend that DEEC recover from CFC the \$75,902 in unallowable reimbursements CFC received from DEEC during the period covered by our audit.

2. UNALLOWABLE VEHICLE COSTS TOTALING AT LEAST \$25,050 AND PERSONAL USE OF VEHICLE NOT REPORTED AS A TAXABLE FRINGE BENEFIT

During our audit period, CFC owned a vehicle that was used exclusively by its Executive Director for which it charged \$25,050 in expenses against its state contracts. However, CFC did not have any formal written policies and procedures providing for this fringe benefit. According to state regulations, fringe benefits such as these that are not provided for under an established policy of the Agency are unallowable and nonreimbursable under state contracts. Additionally, we found that CFC did not require its Executive Director to document the business and personal use of this vehicle and did not report the value of the vehicle's personal use as a taxable fringe benefit on the Form W-2s that it issued to its Executive Director, contrary to Internal Revenue Service (IRS) and Department of Revenue (DOR) regulations.

The state's Operational Services Division (OSD), the state agency responsible for regulating and overseeing the activities of contracted service providers such as CFC, has promulgated regulations that define certain costs that are unallowable and nonreimbursable under state contracts. In this regard, 808 Code of Massachusetts Regulations (CMR) 1.15 (9) identifies the following expenses as nonreimbursable under state contracts:

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.

Furthermore, IRS and DOR regulations require employers to furnish employees, the IRS, and DOR with accurate wage and earnings information amounts. Specifically, Section 713 of the US Master Tax Guide states, in part:

All compensation for personal services, no matter what the form of payment, must be included in gross income. Wages, salaries, commissions, bonuses, fringe benefits, which do not qualify for statutory exclusionsare income in the year received.

Also, IRS Regulation 713, *Fringe Benefits*, which discusses the tax effect of personal use of company automobiles, states, in part:

The benefits may be included as income to the extent the employee uses them for personal purpose.

During our audit period, CFC owned a 1999 Mercedes Benz and provided it to its Executive Director for her exclusive use. The vehicle was purchased in FY03 (3/17/03) for the amount of \$33,515. The purchase was financed in its entirety through Compass Bank at an annual percentage rate of 6.75% for a term of 60 months, resulting in monthly payments of \$558. The vehicle is a CFC asset and is being depreciated using the straight-line method over five years, for \$4,429 per year with a \$10,000 salvage basis. CFC expensed loan interest, depreciation, car insurance, repairs, and gasoline against its state contracts for this vehicle during the audit period as follows:

Summary of Executive Director's Vehicle Costs

	<u>FY 2005</u>	<u>FY 2006</u>	<u>Total*</u>
Loan Interest	\$ 1,331	\$ 957	\$ 2,288
Depreciation	4,429	4,429	8,858
Insurance	2,187	2,638	4,825
Repairs	2,591	1,363	3,954
Gasoline	<u>3,579</u>	<u>3,431</u>	<u>7,010</u>
Total	<u>\$14,117</u>	<u>\$12,818</u>	<u>\$26,935</u>

*CFC was 93% state funded, and therefore (\$26,935 x 93% = \$25,050) of these expenses can be attributable to the Commonwealth.

We reviewed the internal controls that CFC established over the use of this vehicle as well as the documentation of expenses associated with this vehicle. Based on our review, we noted the following issues:

- CFC did not have policies and procedures that required CFC's Executive Director to maintain a record of the business and personal use of this vehicle, and the Executive Director could not provide supporting documentation (e.g., travel logs or work schedules) regarding the business and personal use of this vehicle. Therefore, it was not possible to determine the extent to which this vehicle was used for business and non-business purposes. Also, the Executive Director's Form W-2s for calendar years 2004 and 2005 did not include any amount for her personal use of the vehicle as required by IRS regulations.
- Neither CFC's policies and procedures nor an employment contract provided for the provision of this fringe benefit. Consequently, CFC's expenses associated with the provision of this fringe benefit are nonreimbursable in accordance with 808 CMR 1.15 (a).

Based on these facts, the \$25,050 in expenses associated with the Executive Director's vehicle that CFC charged against state contracts during the period of our audit is clearly unallowable in accordance with 808 CMR 1.15.

It should be noted that after discussing this matter with CFC officials, they did take corrective action regarding the lack of a formal written policy and implemented a policy regarding Agency vehicles, as follows:

Use of Agency Vehicles:

Employee use of agency vehicles will be documented using CFC, Inc. travel and expense forms. Expenses associated with agency vehicles, including operation and maintenance costs, must be authorized and allocated to either business or personal use and kept on file for annual budgeting and auditing purposes. Documentation will include mileage, location, and business purpose.

Recommendation

DEEC should recover from CFC the \$25,050 in unallowable vehicle expenses that CFC charged against its state contracts during our audit period. In the future, CFC should not charge any expenses associated with unallowable fringe benefits such as these against its state contracts. Furthermore, CFC should comply with IRS and DOR regulations in determining and reporting the proper amount of the personal use of this vehicle as a taxable fringe benefit on the employee's Form-W2. As noted in the report, CFC has taken measures to address this issue by implementing a formal written vehicle policy that requires mileage, location, and business purpose to be documented.

Auditee Response

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

If a vehicle was used personally it would not be a fringe benefit, but a taxable wage compensation. Accordingly, no written procedures would be applicable, as it is not a fringe benefit.

The Executive Director did document the business use of the company vehicle. Internal Revenue regulations require documentation of business use, mileage and business purpose. The regulations do not spell out a required form or content. The auditor may have questioned the form and content, but should have inquired into the business purpose, which was contained in a daily diary and which is an appropriate form of documentation.

Again, any de minimis personal use of the vehicle and would not be a taxable fringe benefit; rather it would be additional wage, and since the principal officer's total compensation is well below the approved threshold for the organization's Executive Director, the state auditor's disallowance of cost appears to be unreasonable.

Auditor's Reply

Contrary to the assertions made by CFC in its response, an employer-provided vehicle is considered a fringe benefit. Specifically, according to Internal Revenue Service code IRC 132 (d)

the business use of an employer-provided vehicle is defined as a working condition fringe benefit and is a nontaxable fringe benefit. However, according to this IRS code, the personal use of this vehicle is considered a taxable fringe benefit and should have been reported on the Executive Director's IRS Form W-2 as a taxable benefit.

Furthermore, contrary to what CFC states in its response, our audit report correctly states that the Executive Director could not provide any documentation to substantiate the business versus the personal use of this vehicle. While we acknowledge the fact that the Agency's Executive Director had a daily diary, during our audit we reviewed this diary and determined that it did not contain adequate information relative to the Executive Director's business versus personal use of this vehicle.

Finally, CFC's contention that "Again, any de minimis personal use of the vehicle and would not be a taxable fringe benefit" by CFC is erroneous. The Internal Revenue Service's "*Taxable Fringe Benefit Guide*" (dated January 2007) defines De minimis Fringe Benefits as follows:

Property or service provided by an employer for an employee that has a small value and accounting for it is unreasonable or administratively impractical.

This guide also gives specific examples of "Benefits Not Qualifying as De minimis Fringe Benefits" which included the following:

...Commuting use of employer's vehicle more than once a month...

Since the Executive Director admittedly uses the vehicle in question to commute to work on a regular (daily) basis, the term De minimis clearly does not apply in this situation and thus is irrelevant to this issue. Consequently, we again recommend that DEEC recover the \$25,050 in unallowable vehicle expenses that CFC charged against its state contracts during our audit period.

3. UNALLOWABLE CREDIT CARD EXPENSES TOTALING \$1,206

During our audit period, we found that CFC had not established adequate internal controls over the use of corporate credit cards. As a result, our review of CFC's credit card expenses identified \$1,206 in undocumented expenses charged against its state contracts. According to state regulations, expenses such as these that are not properly documented are nonreimbursable under state contracts.

The 808 CMR 1.05 (26), promulgated by OSD, defines the following as being nonreimbursable program costs:

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

During the period between July 2004 and June 2006, CFC incurred corporate credit card expenses totaling \$13,917. Our audit revealed that CFC had not established adequate internal controls over the use of these corporate credit cards. Specifically, there were no written policies and procedures that required individuals who utilize these credit cards to document the date, place, amount, and nature of each expense, or to submit original receipts to substantiate the reasonableness and appropriateness of these expenditures.

Based on these internal control deficiencies, we reviewed the documentation maintained by CFC relative to all of the 104 expenditures totaling \$10,823 during our audit period charged against state contracts. This testing excludes the credit card expenses related to the Executive Director's vehicle which were accounted for in Audit Result No. 2. Based on our review, we found that expenses totaling \$1,297 were undocumented, as detailed in the table below:

**Summary of Undocumented and Questionable Credit Card Expenses
Fiscal Years 2005 and 2006 (through March 2006)**

Fiscal Year	Undocumented
2005	\$ 958
2006	<u>339</u>
Total	<u>\$1,297</u>

* CFC was 93% state funded; therefore, only that percentage of expenses could be attributable to the Commonwealth ($\$1,297 \times 93\% = \$1,206$).

We brought this matter to the attention of CFC officials, who agreed that the credit card expenses in question were inadequately documented and therefore nonreimbursable under its state-funded contracts. In order to address this problem, CFC subsequently adopted a credit card policy that states the following:

Credit Cards: Employees will make authorized purchases of materials and supplies that benefit the agency. Such purchases may be paid via use of the agency credit card. All credit card

purchases will be accompanied by a receipt, statement of purpose, and will be allocated to programs for which costs were incurred.

Recommendation

DEEC should recover from CFC the \$1,206 in undocumented expenses that it charged against its state contracts. As noted above, CFC has recently developed a credit card policy that requires expenses to be properly documented, and only allowable program expenses will be billed against its state contracts. We believe that this is a positive step, and that CFC officials should ensure that its staff complies with this policy.

Auditee Response

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

CFC has been obligated to continuously upgrade its technology and computer capabilities in order to comply with the increased technology applications instituted by the state agencies administering the respective childcare programs. The corporation upgraded its computer file server, its fax capabilities, and built an area to store the equipment. The individual vendors were paid by credit card. The individual credit card purchases were not attached to the statement. The company should have obtained duplicate copies of the original bills and can obtain copies, if given sufficient time to retrieve them from vendors, given that substantial research for this retroactive time period will be required.

Much of the work was performed by the company treasurer, who has been a non-compensated administrative advisor.

Internal controls are implemented to create a system of controls designed to ensure that companies comply with laws and regulations. They are furthermore designed to ensure that material misstatements in financial reporting are eliminated and to provide for the safeguarding of assets. Credit card payments totaling [\$1,297] for a company with over \$1,800,000 in expenses does not constitute material non-compliance. Lack of one form of documentation should not prevent auditors from seeking alternate methods to verify the appropriateness of any expenditure.

CFC did not incur credit card debt ... as an expense of the company; rather, it paid a portion of its \$1,800,000 expense obligations to administer its programs with funds advanced by a third party credit agency. Any review of expenditures should be identified as a percentage of costs incurred, not as a percentage of an advance for the immediate payment of a vendor.

Auditor's Reply

As noted in our report, OSD regulations require that all contracted human service providers, including CFC, maintain adequate documentation to support all of their expenses, and any expenses which were undocumented are non-reimbursable under state contracts. Regardless of the circumstances, the Agency is obligated to maintain adequate documentation to support all

the expenses it charges against its state contracts. While the amount in question may, in CFC's opinion, not be material in terms of the total amount of annual revenue the Agency receives, this fact does not mitigate the Agency's responsibility to properly document all of its expenses. It should be noted that the Agency was given additional time to produce documentation relative to the expenses we questioned, and to date has been unable to produce such documentation for the expenses detailed in this Audit Result.

4. INADEQUATE ADMINISTRATIVE AND INTERNAL CONTROLS OVER CERTAIN AGENCY OPERATIONS

During our audit, we found that CFC had not developed and implemented an adequate system of internal controls over various aspects of its operations. Specifically, CFC did not maintain all of its records in accordance with state regulations, and did not establish an effective inventory system for fixed assets. These conditions reduce the Commonwealth's assurance that CFC's financial assets are being properly safeguarded and that all transactions are properly authorized, recorded, and reported.

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

In order to comply with GAAP, CFC is required to have a documented comprehensive plan of internal controls describing its goals and the means by which these goals and objectives can be achieved. An effective internal control system would establish clear lines of authorization and approval for its various business functions, such as purchasing, contracting, asset management, payroll, and personnel. In addition, an entity's internal control system should be backed up with a set of detailed subsidiary policies and procedures that would communicate responsibilities and business operations such as accounting, billings, cash receipts, accounts payable, human resources, and payroll. CFC did have a personnel policy manual; however, our audit found that these policies were not fully developed or integrated in the operation of CFC. We found that, in addition to the internal control problem discussed previously in this report, CFC had not

established adequate internal controls over several other aspects of its operations. The following is a summary of the additional internal control issues we identified during our audit.

- **Records Not Maintained in Accordance with State Regulations:** According to 808 CMR 1.04 (1) promulgated by OSD, entities such as CFC are required to maintain all financial records relative to revenue and expense in accordance with GAAP, as set forth by the American Institute of Certified Public Accountants, for a period of seven years. However, as noted throughout this report, CFC officials were often unable to provide specific documentation requested during the audit. In addition to the previously noted examples (credit card documentation and the Executive Director's personal vehicle usage), CFC was also unable to provide documentation of its Executive Director's vacation, sick, and personal time accruals and usage. We brought this matter to the attention of the Agency's Executive Director, who stated that she believed that as the "owner" of the business she did not have to keep such records. However, subsequent to our bringing this matter to the Executive Director's attention, CFC began maintaining these records for its Executive Director.
- **Accurate Inventory System Not Maintained:** The 808 CMR 1.04, promulgated by OSD, states the following with regard to inventory of equipment and furnishings and other goods: "Any Contractor in possession of Capital Items . . . shall label, maintain and keep on file a written inventory of the property in accordance with generally accepted accounting principles." However, our audit disclosed that CFC did not maintain a current listing of its fixed assets, which as of the end of our audit period totaled \$260,379. We brought this matter to the attention of CFC officials, who immediately updated CFC's fixed asset inventory.

Recommendation

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

Auditee Response

In response to this Audit Result, CFC provided the following comments:

The only assets purchased specifically with Commonwealth funds occurred in June 1999 and were from a grant for certain program-specific assets. All other assets have been acquired with the general revenues earned by the company from its program service revenues.

The Company may not have had an inventory of property and equipment in its principal office, but a physical inventory is maintained under the custody of the outside accounting firm. Since auditors are allowed to assist in the computation of annual depreciation expense, a complete compendium of all assets is maintained by that firm. The state auditors could have reviewed this documentation in order to satisfy their concerns, and to ensure compliance with the company's safeguarding of assets and proper authorization and/or reporting.

Auditor's Reply

Regardless of what funds are used to purchase fixed assets, it is important that agencies such as CFC establish adequate internal controls over all aspects of its operations, including its fixed assets. Further, it should be noted that during our audit we reviewed the fixed asset listing maintained by the Agency's accounting firm and found that some of the information on this listing was outdated and inaccurate. For example, several items on this list were not in the location identified, and several additional items were no longer being utilized, and had in fact been disposed of by CFC, but were still on this listing. However, as stated in our Audit Report, when we notified CFC officials of this matter, they took adequate measures to address our concerns.