



A. JOSEPH DeNUCCI
AUDITOR

The Commonwealth of Massachusetts

AUDITOR OF THE COMMONWEALTH

ONE ASHBURTON PLACE, ROOM 1819

BOSTON, MASSACHUSETTS 02108

TEL. (617) 727-6200

NO. 2002-4450-3C

INDEPENDENT STATE AUDITOR'S REPORT

ON CERTAIN ACTIVITIES OF

FRIENDLY HOUSE, INC.

JULY 1, 1999 TO DECEMBER 31, 2001

**OFFICIAL AUDIT
REPORT**

JULY 24, 2002

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Friendly House, Inc. (Friendly House), began operation in 1920 as a settlement house in Worcester to provide educational, social, and family-betterment services to Worcester residents. In 1928, Friendly House incorporated as a not-for-profit corporation, and has grown into a multiservice neighborhood center working in conjunction with outreach centers such as Centro Las Americas and the Henry Lee Willis Community Center. Friendly House operates 17 programs, including social, human, and neighborhood development; recreation and day camp; basic daycare; school-lunch and summer food programs; emergency and transitional housing/shelter; elderly outreach; and assistance to Albanian immigrants.

The purpose of our audit was to examine certain administrative and fiscal activities of Friendly House from July 1, 1999 through December 31, 2001. Our objectives were (1) to determine whether Friendly House had established an adequate system of management controls over revenue, expenses, and fixed assets and (2) to assess Friendly House's business practices and its compliance with applicable laws, regulations, and policies and the various fiscal and programmatic requirements of its state contracts.

Our audit identified that internal control deficiencies resulted in undocumented payroll costs totaling \$43,423, inadequately documented billings to state agencies totaling \$94,677, and unallowable fringe benefits charged to the state totaling \$3,190.

AUDIT RESULTS

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1. EXECUTIVE DIRECTOR'S UNDOCUMENTED PAYROLL COSTS TOTALING \$43,423 CHARGED AGAINST STATE CONTRACTS

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We found that Friendly House had not established adequate controls over the maintenance of its payroll records as required by state regulations and the terms of its state contracts. Specifically, because the agency's Executive Director does not prepare weekly attendance records, no documentation exists to support salary and related payroll costs totaling \$43,423 charged against state contracts and paid to the agency's Executive Director during the period covered by our audit.

2. INADEQUATE DOCUMENTATION TO SUPPORT CONTRACT BILLINGS TOTALING \$94,677 CHARGED AGAINST THREE STATE CONTRACTS

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We found that contrary to state regulations, Friendly House does not maintain documentation to support all of its billings to state agencies for various services it provides. Specifically, during our audit Friendly House was unable to substantiate at least \$94,677 in expenses that it billed against three state contracts during fiscal years 2000 through 2002 (partial, as of December 31, 2001). According to state

regulations, such as undocumented expenses are unallowable and nonreimbursable under state contracts.

3. UNALLOWABLE FRINGE BENEFITS TOTALING \$3,190 CHARGED AGAINST STATE CONTRACTS

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During our audit period, Friendly House paid \$11,498 in tuition costs for three employees; of that amount, \$3,190 was charged to state contracts. However, the agency's personnel policies and procedures have no provision for these fringe benefits. Moreover, according to state regulations, fringe benefits that are not part of an established policy of the agency are unallowable and nonreimbursable under state contracts.

INTRODUCTION

Background

Friendly House, Inc. (Friendly House), began operation in 1920 as a settlement house in Worcester to provide educational, social, and family-betterment services to Worcester residents. In 1928, Friendly House incorporated as a not-for-profit organization, and has grown into a multiservice neighborhood center working in conjunction with outreach centers such as Centro Las Americas and the Henry Lee Willis Community Center. Friendly House operates 17 programs, including social, human, and neighborhood development; recreation and day camp; basic daycare, school-lunch and summer food programs; emergency and transitional housing/shelter; elderly outreach; and assistance to Albanian immigrants. It is a United Way agency and also receives funds from various federal, state, local, and private grants. During the fiscal years 2000 and 2001 (ended June 30), Friendly House revenue sources were as follows:

Friendly House Inc. Summary of Funding Revenue Fiscal Years 2000 and 2001

Revenue Source	2000	2001
Department of Transitional Assistance (DTA)	\$370,496	\$437,203
Office of Child Care Services (OCCS)	341,755	370,326
Department of Social Services (DSS)	39,760	18,240
Department of Education (DOE) Federal Food	470,404	442,314
Massachusetts State and Local Government Fees	899,681	898,549
Private Grants	33,398	73,767
Federated Fundraising Org. Unrestricted	251,225	262,238
In-Kind Contributions	214,152	201,078
Contributions, Gifts, Donations	41,888	96,410
Private Client Fees	43,002	54,089
Other Unrestricted Revenue	7,691	63,786
Client Resources	<u>33,112</u>	<u>42,357</u>
Total	<u>\$2,746,564</u>	<u>\$2,960,357</u>

Note: Funding amounts are from agency UFRs and independent auditor's report, supplement revenue schedule.

Audit Scope, Objectives, and Methodology

Our review was initiated at the request of the state's Office of Child Care Services (OCCS). In September 2001, OCCS conducted an audit of the income-eligible and supportive services contracts administered by Friendly House for OCCS during July and August 2001. As a result of its audit, OCCS found instances of noncompliance with eligibility and procedural requirements set forth in its contractual agreements with Friendly House. Consequently, effective November 6, 2001, OCCS canceled its contracts with Friendly House. In addition to addressing the concerns raised by OCCS's audit, our review included an assessment of Friendly House's system of administrative and accounting controls from July 1, 1999 to December 31, 2001. We did not conduct any transaction testing relative to OCCS's contracts for July 2001 through November 6, 2001, since OCCS's audit covered that period. Our audit was conducted in accordance with applicable generally accepted government auditing standards issued by the Comptroller General of the United States for performance audits and included such audit procedures as we considered necessary to meet our audit objectives.

Our specific objectives were to:

- Determine whether Friendly House had implemented effective management controls, including processes for planning, organizing, directing, and controlling program operations, and policies and procedures to ensure that resources are safeguarded and efficiently used.
- Assess Friendly House's business practices and compliance with applicable laws, rules, and regulations and its own internal practices and procedures as well as the various fiscal and programmatic requirements of its state contracts.

To achieve our objectives, we assessed Friendly House's system of management controls. The purpose of that assessment was to obtain an understanding of management's attitude, the control environment, and the flow of transactions through Friendly House's accounting system. We also used that assessment to plan and perform our audit tests. We then examined billings, invoices, and other pertinent financial records to determine whether expenses Friendly House incurred under its state contracts were reasonable, allowable, allocable, properly authorized and recorded, and in compliance with applicable laws, rules, and regulations.

Our special-scope review was not intended to form an opinion on Friendly House's general-purpose financial statements nor to assess the overall quality and appropriateness of program services provided under its state-funded programs.

AUDIT RESULTS

1. EXECUTIVE DIRECTOR'S UNDOCUMENTED PAYROLL COSTS TOTALING \$43,423 CHARGED AGAINST STATE CONTRACTS

We found that Friendly House had not established adequate controls over the maintenance of its payroll records as required by state regulations and the terms of its state contracts. Specifically, because the agency's Executive Director does not prepare weekly attendance records, no documentation exists to support salary and related payroll costs totaling \$43,423 charged against state contracts and paid to the agency's Executive Director during the period covered by our audit.

The state's Executive Office for Administration and Finance, Operational Services Division (OSD) has promulgated "Terms and Conditions for Human and Social Services," with which all human-services providers (such as Friendly House) that contract with state agencies must comply. These terms and conditions require that to receive reimbursement of costs, contracted human-services providers maintain accurate and complete financial records, including payroll records.

Furthermore, 808 Code of Massachusetts Regulations (CMR) 1.04 (1) states, in part:

The Contractor and its Subcontractors shall keep on file all data necessary to satisfy applicable reporting requirements of the Commonwealth (including DPS [OSD], the Division of Health Care Finance and Policy and Departments), and financial books, supporting documents, statistical records, and all other records which reflect revenues associated with and costs incurred in or allocated to any Program of services rendered under the Contract. The Contractor and its Subcontractors shall maintain records of all types of expenses and income or other funds pertaining to the Program paid to the Contractor by every source, including from each Client. Books and records shall be maintained in accordance with generally accepted accounting principles as set forth by the American Institute of Certified Public Accountants (AICPA); which for not-for-profit Contractors shall be the Industry Audit Guide for Audits of Voluntary Health and Welfare Organizations, unless otherwise provided in the UFR.

During our audit, we reviewed the internal controls that Friendly House had established over its payroll expenses. We also reviewed the billing information that it maintained related to payroll and associated costs charged against its state contracts during our audit period. We obtained and reviewed specific payroll records (e.g., time and attendance records) for all

agency employees for biweekly pay periods ending in December 1999, June 2000, and February 2001.

We found that Friendly House, despite state regulations and terms and conditions of its state contracts, has not established adequate controls over the maintenance of its payroll records. Although the agency does not have a formal written policy that requires members of its staff to submit timesheets showing the hours they worked and the programs they worked in, Friendly House's staff informally requires this to be done. However, the agency's Executive Director does not prepare weekly attendance records. During our audit period (July 1, 1999 to December 31, 2001), Friendly House billed \$157,329 in salary and related payroll costs for the services of the Executive Director; of that amount, \$43,423 was charged to state contracts, as indicated in the following table:

Fiscal Year	Salary amount per UFR	Fringe Benefits*	Total Compensation	Amount Allocated to State Contracts
2000	\$ 50,457	\$ 5,047	\$ 55,504	\$15,319
2001	50,458	5,550	56,008	15,458
2002**	<u>41,277</u>	<u>4,540</u>	<u>45,817</u>	<u>12,646</u>
Total	<u>\$142,192</u>	<u>\$15,137</u>	<u>\$157,329</u>	<u>\$43,423</u>

*Fringe benefit rates are calculated based on information in agency UFRs.

**Salary is for the period July 1, 2001 through December 31, 2001 and is based on agency payroll documents.

However, because of the lack of weekly attendance records, no documentation exists to substantiate these \$43,423 in payroll costs that Friendly House charged during our audit period against its state contracts for the agency's Executive Director. Regarding this matter, Friendly House's staff member in charge of payroll stated that the Executive Director does not consistently submit timesheets due to his busy schedule and various commitments. Friendly House's Comptroller informed us that he has periodically submitted written reminders to the Executive Director requesting documentation for hours worked, but that the Executive Director did not always comply with the Comptroller's requests.

Although we do not question whether the Executive Director provided services during the period, without the appropriate documentation the Commonwealth cannot be assured that all of the \$43,423 in administrative payroll costs was appropriate.

Recommendation

Friendly House should establish written policies and procedures regarding employee attendance, including for its Executive Director. All employees should be required to submit timesheets documenting hours worked on administrative and specific program activities, and their respective supervisors should approve the timesheets prior to payment.

Auditee's Response

In response to this audit result, Friendly House's Executive Director provided comments, as follows:

On April 24, 2002, the Friendly House Board of Directors formally adopted ... payroll procedures, which specifically addresses the employee attendance issue. In addition, all of the Executive Director's time sheets have been prepared, signed and filed. The sheets were based upon the Executive Director's personal daily activity book. All employees, including the Executive Director must submit a signed time sheet prior to receiving his/her paycheck.

Auditor's Reply

Based upon its response, Friendly House has taken measures to ensure that adequate payroll records exist for all employees. However, we again recommend that Friendly House make sure that timesheets document hours worked on administrative and specific program activities and that each employee's supervisor approves their timesheet prior to payment.

2. INADEQUATE DOCUMENTATION TO SUPPORT CONTRACT BILLINGS TOTALING \$94,677 CHARGED AGAINST THREE STATE CONTRACTS

We found that contrary to state regulations, Friendly House does not maintain documentation to support all of its billings to state agencies for various services it provides. Specifically, during our audit it was unable to substantiate at least \$94,677 in expenses that it billed against three state contracts during fiscal years 2000 through 2002 (partial, as of

December 31, 2001). According to state regulations, such undocumented expenses are unallowable and nonreimbursable under state contracts.

According to the state's "Terms and Conditions," contracted human-services providers must maintain accurate and complete financial (including payroll) records, to receive reimbursement for such costs.

Additionally, 808 CMR 1.05 identifies as nonreimbursable under state contracts those "costs which are not adequately documented in light of the American Institute of Certified Public Accountants statements on auditing standards for evidential matters."

During our audit we reviewed the documentation being maintained by Friendly House regarding certain expenses the agency charged against three state contracts, one with the Department of Social Services (DSS) and two with the Office of Child Care Services (OCCS), and found several problems.

During fiscal year 1996, DSS awarded Friendly House a five-year contract, with annual obligations of \$28,800, to run a closed-referral summer day camp for DSS children. The camp is run for six weeks at a YWCA camp in Leicester. During our audit, we reviewed the documentation friendly House was maintaining regarding the expenses it charged against this contract, and we found the following discrepancies, totaling \$38,170:

- For fiscal year 2000, Friendly House was unable to provide us the payment vouchers it submitted to DSS for \$29,760 in program expenses for children who attended the camp. Consequently, because it was not possible to reconcile these missing payment vouchers with program attendance records, it could not be determined whether the billings were accurate.
- For fiscal year 2001, Friendly House received \$18,240 from DSS for 87 children who attended the camp. We were able to confirm through attendance records all but \$3,802, including expenses billed for 24 children who were not listed on any attendance records we received from Friendly House.
- During fiscal year 2002, Friendly House billed DSS \$17,280 for 90 children who attended this program. However, no documentation existed to substantiate \$4,608 of these expenses, including expenses for five children who were not listed on the

agency's attendance records and for two children who were listed on the agency's attendance record but for whom no record existed of days attended.

Moreover, Friendly House entered into a contract with OCCS during fiscal year 1997 to provide supportive school-aged childcare services. Additionally, Friendly House entered into a three-year price-agreement contract with OCCS in fiscal year 1999 to provide income-eligible children daycare services, with a maximum obligation of \$172,352.

We reviewed the documentation Friendly House was maintaining regarding the expenses it submitted to OCCS for reimbursement for the period July 1, 1999 to June 30, 2001 (\$341,755 in fiscal year 2000 and \$370,362 in fiscal year 2001).

During our audit we found discrepancies totaling \$56,507, as follows:

- For both daycare programs, Friendly House did not have attendance records for three of the four months (August 1999, November 1999, and March 2000) we tested.
- For the one month (March 2001) for which Friendly House could provide attendance records, the number of days that children attended were 12 fewer than what Friendly House billed for on its payment voucher.

Regarding this matter, Friendly House officials acknowledged that they have no written policies or procedures for record retention and do not regularly retain program attendance records for a specified period.

Recommendation

Friendly House's principal purchasing agencies (PPA) should recover from Friendly House the \$94,677 that it charged against the three contracts during our audit period. Furthermore, the PPAs should consider conducting a review of contract billings for the periods before and after our audit.

Finally, Friendly House must establish a written policy for the retention of records as mandated in the terms and conditions of all contracts with the state.

Auditee's Response

In response to this audit result, Friendly House's Executive Director provided comments, as follows:

Friendly House is in the process of developing a written policy for the retention of records, as mandated in the terms and conditions of all state contracts. This policy will be reviewed and adopted by the Board on their scheduled June 20, 2002 meeting.

Regarding the missing documentation in connection with the D.S.S. Day Camp 2000 Program, we have scheduled a meeting to address the fiscal year 2000 findings. This meeting will be held at the Department of Social Services area office on Tuesday, June 18, 2002 – 11:00 AM.

Regarding the missing documentation cited for the Day Camp FY 2001 and 2002 and the OCCS's attendance records for the four months August 1999, November 1999, March 2000 and March 2001, Friendly House staff is currently in the process of retrieving these records.

Auditor's Reply

Based upon its response, Friendly House indicated that it has taken measures to ensure that in the future, adequate documentation exists to support contract billings, and that it is currently working with DSS and OCCS to resolve the questioned prior contract billings.

3. UNALLOWABLE FRINGE BENEFITS TOTALING \$3,190 CHARGED AGAINST STATE CONTRACTS

During our audit period, Friendly House paid \$11,498 in tuition costs for three employees; of that amount, \$3,190 was charged to state contracts. However, the agency has no personnel policies and procedures that provide for these fringe benefits; accordingly, by state regulation, they are unallowable and nonreimbursable. Specifically, according to 808 CMR 1.05 (9a), the following is a nonreimbursable cost under state contracts:

Fringe benefits determined to be excessive in light of salary level and benefits of other Contractors and fringe benefits to the extent that they are not available to all employees under an established policy of the Contractor...

The following table summarizes these college-related expenses:

**Friendly House
Summary of College Tuition Expenses for Staff
Fiscal Years 2000 through 2002**

	2000	2001	2002*	Total
Total College Expenses Paid	\$ 1,751	\$ 7,228	\$ 2,519	\$11,498
Amount charged to State Contracts**	\$ 479	\$ 2,016	\$ 695	\$ 3,190

* Partial: July 1, 2001 to December 31, 2001

** 27.6% based on state contract funding percentages of 27.38% and 27.89% for fiscal years 2000 and 2001.

We reviewed Friendly House's personnel policies and procedures and noted that it does not have a policy for the reimbursement of the cost of college courses. Additionally, we reviewed the minutes of the agency's Board of Directors meetings held during our audit period; there was no indication in them that the agency's Board was aware of or approved these tuition costs. Consequently, these \$3,190 in tuition costs charged against state contracts are clearly unallowable and nonreimbursable.

Regarding this matter, Friendly House officials told us that the majority of these tuition expenses were for one staff member, as an incentive for her to accept a position with the agency. These officials stated that they are aware of the need for a written policy regarding this fringe benefit and are in the process of creating one. Nevertheless, since there is no established policy, this \$3,190 represents an unallowable expense against Friendly House's state contracts.

Recommendation

Friendly House's PPAs should recover from Friendly House the \$3,190 in nonreimbursable fringe benefit expenses it charged against its state contracts during our audit period. In the future, if Friendly House wants to provide this benefit to its staff, it should develop a formal written policy approved by its Board of Directors.

Auditee's Response

In response to this audit result, Friendly House's Executive Director provided comments, as follows:

Although the Board minutes did not reflect the specific tuition reimbursement, members of the Executive Committee were aware of the tuition reimbursement arrangement. Board members with signatory powers signed the tuition checks.

The Board, on April 24, 2002, formally adopted a tuition reimbursement policy...

Auditor's Reply

Based upon its response, Friendly House has developed and formally adopted personnel policies and procedures that provide for employees tuition reimbursements. However, we again recommend that Friendly House's PPAs should recover from Friendly House the \$3,190 in nonreimbursable fringe benefit expenses it charged against its state contracts during our audit period.