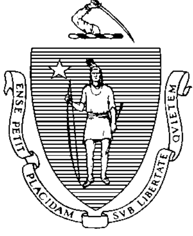

The Commonwealth of Massachusetts

AUDITOR OF THE COMMONWEALTH

ONE ASHBURTON PLACE, ROOM 1819
BOSTON, MASSACHUSETTS 02108

A. JOSEPH DeNUCCI
AUDITOR

TEL. (617) 727-6200

NO. 2007-4506-3C

INDEPENDENT STATE AUDITOR'S REPORT ON CERTAIN ACTIVITIES OF L.P. COLLEGE, INC. JANUARY 1, 2004 THROUGH JUNE 30, 2007

OFFICIAL AUDIT REPORT

MARCH 11, 2009

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L. P. College, Inc. (LPC) was organized and incorporated on May 1, 1981 as a for-profit corporation under Chapter 156B of the Massachusetts General Laws to engage in the operation of a day care center providing childcare services. LPC is currently licensed by the Department of Early Education and Care (EEC), formerly known as the state's Office of Child Care Services, to provide childcare services for over 900 children through three programs that are based on a child's developmental stage: Infant/Toddler, Pre-School, and School-Age.

The scope of our audit was to examine various administrative and operational activities of LPC during the period January 1, 2004 to June 30, 2007. However, in some instances it was necessary for us to extend the period covered by our audit in order to adequately examine certain transactions that were selected for testing during our review.

Our audit was conducted in accordance with generally accepted government auditing standards for performance audits issued by the Comptroller General of the United States. Our audit procedures consisted of a determination of whether LPC had implemented effective internal controls and an assessment of LPC'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 review identified that during our audit period, LPC retained profits totaling $39,427 in excess of what it was allowed under its state contracts; did not disclose two related-party transactions totaling $44,298; paid $57,107 in questionable rental and other operating expenses; incurred $25,369 in unnecessary related-party lease expenses; provided $120,626 in unallowable employee fringe benefits; and inappropriately expensed capital items totaling $53,591.

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According to Operational Services Division (OSD) regulations, contracted human service providers such as LPC are required to report all related-party transactions in the financial statements they file with OSD. We found, however, that during the period covered by our audit, LPC conducted transactions totaling $44,298 with two related parties that it did not report in its financial statements. Because these related-party transactions were not disclosed by LPC in its UFRs, LPC failed to provide the

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We found that during our audit period, LPC expensed $53,591 in capital assets against is state contracts rather than depreciating the cost of these assets over their useful lives as required by state regulations. Consequently, the $53,591 in expenses represent nonreimbursable costs under LPC's state contracts.

INTRODUCTION

Background

L.P. College, Inc. (LPC) was organized and incorporated on May 1, 1981 as a for-profit corporation under Chapter 156B of the Massachusetts General Laws to engage in the operation of a day care center providing childcare services. LPC is currently licensed by the Department of Early Education and Care (EEC), formerly known as the state's Office of Child Care Services, to provide childcare services for over 900 children through three programs based on a child's developmental stage: Infant/Toddler, Pre-School, and School-Age. LPC's stated mission is "to provide the best possible program of early education and care available [in] a program where children are loved and where children and families feel safe, secure, and respected, enabling children to grow to their fullest potential physically, emotionally, socially and cognitively."

LPC is headquartered at 100 Spring Street in the City of New Bedford and operates several daycare facilities located in the greater New Bedford area. LPC's New Bedford facilities are located at 360 Dartmouth Street, 321 Rockdale Avenue, 374 Rockdale Avenue, 4241 Acushnet Avenue, and 850 Church Street. In addition, LPC operates a daycare facility in Dartmouth located at 52 Donald Street, which also serves as a summer camp.

During our audit period, LPC derived its revenues from various sources, including the state's Department of Early Education and Care (EEC), as follows:

Revenue Source	Fiscal Year 2004	Fiscal Year 2005	Fiscal Year 2006
Mass. Gov. Grant	$349,838	$312,750	$272,265
Other Grant	456,992	439,005	467,274
EEC – Contract	1,759,917	1,856,815	1,937,255
EEC – Voucher	3,745,998	3,466,778	3,706,779
Private Client Fees	1,100,987	1,151,340	0
Commercial Activities	0	0	1,233,958
Investment Revenue	0	0	20,596
Other Revenue	70,995	41,773	20,456
Total Revenue	$7,484,727	$7,268,461	$7,658,583

* This information was extracted from LPC's Uniform Financial Statements and Independent Auditor's Reports (UFRs) that it filed with OSD. Further, unlike the state's fiscal year, LPC's fiscal year runs from January 1st through December 31st of each year.

Audit Scope, Objectives, and Methodology

The scope of our audit was to examine various administrative and operational activities of LPC during the period January 1, 2004 to June 30, 2007. However, in some instances it was necessary for us to extend the period covered by our audit in order to adequately examine certain transactions that were selected for testing during our review.

We conducted this performance audit in accordance with generally accepted government auditing standards issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence that provides a reasonable basis for our findings and conclusions based on our audit objectives.

Our audit procedures consisted of the following:

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

In order to achieve our objectives, we first assessed the internal controls established and implemented by LPC 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 LPC's accounting system. We used this assessment in planning and performing our audit tests. We then held discussions with LPC officials (one of whom was also a member of LPC's Board of Directors) and officials from the state's Operational Services Division (OSD) and the state's Department of Early Education and Care (EEC). In addition, we reviewed organization charts and internal policies and procedures, as well as all applicable laws, rules, and regulations. We also examined LPC's financial statements, cost reports, invoices, and other pertinent financial records to determine whether the expenses it incurred during the period covered by our audit were reasonable, allowable, properly authorized and recorded, and in compliance with applicable laws, rules, and regulations. Finally, we reviewed various documents that were provided to us by LPC

officials relative to certain activities conducted by eight of LPC's related-party organizations: Acushnet Avenue, LLC; Church Street Massachusetts, LLC; DCDC, LLC; Dartmouth Street, LLC; Donald Street, LLC; Rockdale-June Street, LLC; PEI, Inc.; and Spring Street, LLC.

Our audit was limited to a review of certain activities of LPC. Although we reviewed various documents relative to certain transaction conducted between LPC and the eight related-party organizations, we did not conduct any audit work on site at these entities. Our audit was not made for the purposes of expressing an opinion on LPC's financial statements. We also did not assess the quality and appropriateness of program services provided by LPC in its programs. Rather, our report was intended to report findings and conclusions on the extent of LPC's compliance with applicable laws, rules, regulations, and contractual agreements, and to identify any operational and administrative processes, methods, and internal controls that could be made more efficient and effective.

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AUDIT RESULTS

1. UNALLOWABLE PROFITS OF AT LEAST $39,427

According to state regulations, for-profit contracted service providers such as L. P. College, Inc. (LPC) are required to negotiate the amount of commercial fees or profits they can make on their state contracts. However, we found that LPC generated and retained profits totaling $157,706 in excess of its negotiated commercial fee, of which $39,427 was charged by LPC against its state contracts.

The Operational Services Division (OSD), the state agency responsible for regulating and overseeing the activities of all the state's contracted human service providers, has promulgated regulations relative to the amount of profit a for-profit organization such as LPC can earn under state contracts. In this regard, 808 Code of Massachusetts Regulations (CMR) 1.03(6), states, in part:

> *Commercial Fee: Departments are permitted to prospectively negotiate a for-profit earnings allowance for the purpose of furnishing a Commercial Fee to for-profit Contractors, which is in excess of the contract reimbursable operating costs for the services being procured. Departments are not required or expected to furnish a Commercial Fee, which is in excess of contract reimbursable operating costs to for-profit Contractors. Each contract executed between a department and a for-profit contractor must either a) explicitly indicate when a Commercial Fee has not been established by indicating that the earnings allowance is zero, or b) clearly indicate the amount of negotiated earnings allowance, by percentage or dollar amount, in the contract. If a contract contains language that does not establish either an earnings allowance of zero or a specific negotiated earnings allowance, then the for-profit contract may not retain a Commercial Fee from such a contract… The provisions of this also apply to M.G.L. c.71B approved private special education programs and contracts that utilize non-negotiated unit rates established by Departments… Department shall monitor the amount of Commercial Fee from the net surplus from Contract Revenues and reimbursable costs retained by each for-profit Contractor in any given year and recoup funds or reduce future prices when appropriate . . ..*

During our review of the contracts between LPC and the state's Department of Early Education and Care (EEC), which covered the period fiscal year 2004 through fiscal year 2007 (through March 31, 2007), we noted that there was no language in any of these contracts that established a commercial fee. However, our review of LPC financial records indicated that between fiscal years 2004 and 2006, LPC generated and retained a total of $1,696,098 in net profits, including its commercial fee income, as indicated in the following table:

Operating Results for Fiscal Years 2004 through 2006

Fiscal Year	Total Revenue	Total Expenses	Net Profits
2004	$7,484,727	$6,986,734	$497,993
2005	7,268,461	6,764,163	504,298
2006	7,658,583	6,964,776	693,807
Total	$22,411,771	$20,715,673	$1,696,098

We brought the matter to the attention of LPC's Executive Director, who provided us with two letters that LPC had received from EEC. The first letter, sent by EEC's Director of Contracting on August 26, 2004, stated, in part:

> *The Office of Child Care Services (OCCS) has considered your request for a nine (9) percent earnings factor for your OCCS funded child care programs. OCCS has reviewed your agency's financial statements to assess your agency's financial position. Based on this review, we have approved a seven (7) percent earnings factor for your agency . . . .*

The second letter, which was sent by EEC's Commissioner on June 20, 2007, stated, in part:

> *I recently became aware that L.P. College, Inc. (L.P. College) has a commercial fee earnings factor of seven percent (7%) related to its Department of Early Education and Care (EEC) funded child care programs. This earnings factor exceeds the five percent (5%) cap that applies to all of EEC's for-profit and not-for-profit income eligible contracted child care providers. In the interest of fairness and consistency, L.P. College's earnings factor will be reduced to five percent (5%) going forward. This change will apply immediately and thus must be reflected in your UFR for the year ended 12/31/07.*

As noted above, even though LPC's contracts with EEC were not amended to include a commercial fee, it does appear that EEC had authorized a commercial fee for LPC during fiscal years 2004 through 2007. However, we found that LPC actually exceeded this verbally agreed-upon commercial fee during fiscal year 2006 by $157,706, ($693,807 actual profit - allowable profit of $7,658,583 x 7% earnings factor).

Recommendation

In order to address our concerns relative to this matter, LPC should amend its fiscal year 2006 Uniform Financial Statements and Independent Auditor's Report (UFR) and identify as nonreimbursable expenses the excessive commercial fees that it realized under its state contracts during fiscal year 2006, which we calculate to be $39,427, as follows:

Income above Approved Commercial Fee	Percentage of State Funding	Excessive Profits
$157,706	25%	$39,427

In the future, LPC should take measures to ensure that it remits to the Commonwealth any excess commercial fees that it realizes during each fiscal year.

Auditee's Response

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

The Executive Director does have an overall issue with the percentage of revenue that the audit shows that LPC receives from state revenue... LPC cares for many children in an EEC flex pool. These are children who age out of a particular prototype and siblings of children in care. Prior to the audit, LPC listed these children in the contract line item of the UFR because the payment from EEC for flex pool children is combined with contract revenue. LPC now lists these separately. The amount of revenue from the flex pool is nearly half of the money listed as contract revenue. The flex pool is actually identical to a voucher and there are some providers and R&Rs who elect to put these children into vouchers, rather than contracts...

LPC employs two full-time individuals who work exclusively with contracted clients and oversee the contractual programs. These individuals are:

[individual's name]: $39,427

[individual's name]: $22,078 plus $2,912 in insurance

LPC charged their salaries directly to EEC because they are only involved in this program. The auditors charged only 25% of their salaries, or $16,104, to the EEC program. The difference of $48,313 should have been charged to the contracted program and would have nullified the excess profit.

In addition, rates in other programs were higher than the contracted rates:

- *Private school age students paid $15.25 more PER DAY during the summer than did school age children in contracts and $4.40 higher per day than preschool children in contracts.*
- *CPC children paid $4.40 higher per day than preschool children in contracts.*
- *LPC received $18,687.50 MORE from school age vouchers during the summer than it did from EEC contracted children for the same type of care.*
- *During the time in question, LPC provided FREE before school care for contracted EEC school age children, when all other children were paying for school age before school care at the rate of $7.00 every morning. In 2006, LPC received $115,122.65*

from school age vouchers for before school care. LPC received nothing during the school year from school age children in contracts

Clearly, LPC's profits did not come from the EEC contracted programs, but from the other programs whose costs are lower and revenue is higher.

Auditor's Reply

Contrary to what LPC states in its response, flex funding received from EEC is state funding and is therefore subject to OSD regulations. As such, our calculation of the percent of state funding to total funding correctly includes as state funds all flex funds received by LPC during our audit period. Regardless of how LPC lists these funds in its financial records, clearly since these funds come directly from a state funding agency, they are state funds and were included as such in our calculations.

In its response, LPC contends that we incorrectly calculated the amount of excess profits the agency realized during our audit period because we did not consider in our calculation the fact that two of the agency's staff members worked full-time under state contracts. We disagree with this assertion. Our calculation was based on the information presented in LPC's UFRs. This information is prepared by LPC management, is audited by an independent auditing firm, and its accuracy is also attested to by LPC's Board of Directors. Consequently, we believe our calculation of LPC's excess profits during the period covered by audit is accurate based on this information.

2. UNDISCLOSED RELATED-PARTY TRANSACTIONS TOTALING AT LEAST $44,298

According to OSD regulations, contracted human service providers such as LPC are required to report all related-party transactions in the financial statements they file with OSD. We found however, that during the period covered by our audit, LPC conducted transactions totaling $44,298 with two related parties that it did not report in its financial statements. Because these related-party transactions were not disclosed by LPC in its UFRs, LPC did not provide the Commonwealth and other users with all the information necessary to properly monitor and evaluate LPC's fiscal, operational, and programmatic activities conducted during the audit period and may be subject to fines and other actions by OSD.

OSD, which has promulgated regulations relative to related-party transactions, defines a related party in 808 CMR 1.02 as follows:

> *Related Party. Any person or organization satisfying the criteria for a Related Party published by the Financial Accounting Standards Board in Statement of Financial Accounting Standards No. 57 (FASB 57).*

Further, OSD's UFR Audit & Preparation Manual provides the following FASB 57 guidance concerning related-party transactions:

> *Examples of related party transactions include transactions between (a) a parent company and its subsidiaries; (b) subsidiaries of a common parent…Transactions between related parties commonly occur in the normal course of business. Some examples of common types of transactions with related parties are: sales, purchases, and transfers of realty and personal property, services received or furnished, for example, accounting, management, engineering, and legal services; use of property and equipment by lease or otherwise; borrowing and lendings, guarantees; maintenance of bank balances as compensating balances for the benefit of another; inter-company billings based on allocations of common costs; and filings of consolidated tax returns. Transactions between related parties are considered to be related party transactions even though they may not be given accounting recognition. For example, an enterprise may recover services from a related party without charge and not record receipt of the services.*

OSD has also published various documents that provide guidance to human and social service organizations such as LPC and their private accounting firms on how to assess an entity's compliance with applicable laws, rules, and regulations. Regarding the disclosure of related-party relationships, the UFR Auditor's Compliance Supplement Under 808 CMR 1.00 (UFR Auditor's Compliance Supplement) states, in part:

> *All material related-party relationships or transactions, as defined by 808 CMR 1.02 and SFAS [FASB] No. 57, that are associated with programs that are purchased by the Commonwealth are considered material and must be disclosed in current year program budgets and the UFR.*

Finally, OSD has established penalties for organizations that do not comply with its regulations regarding the disclosure of related-party transactions. Specifically, 808 CMR 1.04(11) (C) states:

> *Failure to Comply With 808 CMR 1.04(4), 1.04(5) or 1.05. If, after a hearing, DPS [now OSD] finds a violation of 808 CMR 1.04(4), 1.04(5) or 1.05, DPS may order that the contract(s) directly affected by such violation be terminated or may assess a civil penalty of not more than $2,000 or 10% of the Contractor's annual Maximum Obligation under such contract(s), whichever is greater. If DPS determines after a hearing that a Contractor has committed repeated willful violations of 808 CMR 1.04(4), 1.04(5) or 1.05, DPS may debar the Contractor for a period not to exceed five years.*

During our audit, we determined that LPC conducted related-party transactions with two entities that it did not disclose in the UFRs it filed with OSD, as discussed below.

a. Unreported Related-Party Training Expenses Totaling $19,125

During our audit period, we found that an LPC affiliate, P.E.I., Inc., provided training services to members of LPC's staff. P.E.I. Inc. is a for-profit corporation that was organized on December 28, 1993 by LPC's Executive Director to provide professional development services. According to this organization's annual report for fiscal year 2006, LPC's Executive Director was the sole board member of this corporation. As such, these services constitute related-party transactions and are subject to the applicable OSD regulations.

In its fiscal year 2005 UFR, LPC identified related-party transactions with this affiliate totaling $38,013. However, contrary to state regulations, LPC did not report related-party transactions for training programs provided to staff members that occurred during fiscal years 2004 and 2006, which totaled $19,125 ($5,970 for fiscal year 2004 and $13,155 for fiscal year 2006).

We brought this matter to the attention of LPC officials who stated that the cost of the training sessions conducted by LPC's affiliate during fiscal year 2006 was not disclosed in LPC's fiscal year 2006 UFRs because LPC believed the amount was immaterial. These officials added that LPC stopped utilizing the services of this affiliate in fiscal year 2006.

b. Undisclosed and Inadequately Documented Related-Party Home Office Expenses Totaling $25,173

We found that during fiscal years 2005 and 2006 LPC incurred expenses to operate an office at a home owned by LPC's Executive Director that was located in the state of Florida. Contrary to state regulations, LPC did not report in its UFRs the expenses involved in this related-party transaction, which totaled $25,173 during this period.

LPC's Executive Director maintains an office in her home located in Florida, and during our audit we noted that LPC was paying for some of the expenses associated with the operation of this space. We brought this matter to the attention of LPC officials, who provided us with the following written explanation:

> *Office space in FL consists of 1/6 square footage of FL home. Nothing is charged to LPC for this space, so LPC pays a minimal amount of expenses. In 2007, LPC will pay 1/6 of the cost in lieu of paying these expenses.*

During our audit period, LPC and its Executive Director had not entered into a lease agreement for this space that required LPC to pay for these expenses. Further, in most instances, LPC did not maintain sufficient documentation to support the costs attributed to this office. As a result, our analysis was limited to a review of a schedule of expenses relative to this Florida property provided to us by LPC officials, LPC credit card expenses for charges incurred in Florida, and LPC's petty cash expenses. Based on our review, we determined that LPC paid for the following expenses relative to the operation of this space:

Type of Expense	Fiscal Year 2005	Fiscal Year 2006	Total
Supplies and Expenses	$4,853	$3,044	$7,897
Furniture and Equipment	3,844	84	3,928
Dues/Subscriptions	186	168	354
Services (Landscaping, Painting, Pest Control)	3,725	2,246	5,971
Transportation	1,437	2,586	4,023
Improvement (Windows)	3,000	0	3,000
Total	$17,045	$8,128	$25,173

Because these related-party transactions were not disclosed by LPC in its UFRs, LPC failed to provide the Commonwealth and other users with the information necessary to properly monitor and evaluate LPC's fiscal, operational, and programmatic activities conducted during the audit period.

Recommendation

To address our concerns regarding this matter, LPC should amend its fiscal years 2004 through 2006 UFRs to properly disclose the related-party transactions in question. In the future, LPC should take measures to ensure that all related-party transactions are disclosed in accordance with OSD regulations.

Auditee's Response

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

> *...LPC disclosed the amount spent in 2005 but felt that the amounts for 2004 and 2006 were insignificant, so did not disclose them. In the future, LPC will disclose this amount, regardless of how small the amount is.*

> *…LPC's executive director works more than full-time when in Florida and incurs expenses there, just as all administrators incur expenses while working. …*
>
> *Supplies and expenses: ink, paper, printer, postage, telephone bills and internet expenses incurred during this time, totaling $7,897*
>
> *Furniture and equipment: computer, office chair, fax machine needed to work in the office, totaling $3,928*
>
> *Dues/subscriptions: paid from the FL office but used exclusively for LPC, totaling $354*
>
> *Services in Florida which should be charged to excess profits in other programs and unrestricted revenue, totaling $5,971 (Audit calculation at 25% = $1,493 Calculation at 13% = $776)*
>
> *Transportation: which consists totally of the flights from Florida to MA to oversee the operations at LP College, Inc. The executive director's family all lives in Florida and flights to MA are solely for the purpose of her work at LP College. This totals $4,023*
>
> *Improvements: should be charged to excess profits in other programs and unrestricted revenue, totaling $3,000. (Audit calculation at 25% = $750 Calculation at 13% = $390)*
>
> *In the future, LPC will disclose these amounts as related party transactions.*

Auditor's Reply

In its response, LPC contends that it did not disclose the related-party transactions with P.E.I. Inc. during fiscal year 2005 because the agency believed that these transactions were insignificant. However, the agency did not provide an explanation as to what criteria it used to determine that these related-party transactions were "insignificant" and therefore were not subject to disclosure. As a contracted service provider for the Commonwealth, LPC is obligated to ensure that it fully complies with all state regulatory and contractual requirements as well as guidance issued by OSD. Regarding the disclosure of related-party transactions, the UFR Auditor's Compliance Supplement under 808 CMR 1.00 (UFR Auditor's Compliance Supplement) issued by OSD states, in part:

> *Generally, OSD recommends that all related party relationships and transactions, as defined by 808 CMR 1.02, associated with contractors receiving funding for the operation of social service programs from the Commonwealth (state agencies and local education authorities) be considered material related party transactions in accordance with GAGAS. These material related party transactions should be disclosed in the notes to the financial statements of the UFR.*

In our opinion, LPC should have been aware of these requirements and properly disclosed the related-party transactions in question.

In this Audit Result, we do note the fact that during our audit period, LPC and its Executive Director had not entered into a lease agreement for the office in Florida that required LPC to pay for its associated expenses. Further, in most instances, LPC did not maintain sufficient documentation to support the costs attributed to this office. However, we did not recommend reimbursement for these expenses but rather appropriately stated that these transactions should have been disclosed as related-party transactions in the agency's UFRs.

Based on its response, in the future, LPC is going to take measures to address our concern relative to the disclosure of related-party transactions

3. QUESTIONABLE PAYMENTS TO A RELATED PARTY FOR PROGRAM RENT, UTILITIES, AND RENOVATION COSTS TOTALING $57,107 WHEN THE PROGRAM WAS NOT OPERATIONAL

During fiscal year 2006, LPC entered into a lease agreement with a company in which LPC's Executive Director has a financial interest to lease space for operating one of its day care facilities. Under the terms and conditions of this lease agreement, LPC agreed to pay rent in the amount of $13,000 per month, all utility costs, and any real estate taxes associated with this property for the period September 15, 2006 through December 31, 2006, during which time such expenses totaled $46,350. In addition, LPC expensed $10,757 in renovation costs associated with this property. However, this property was not approved by EEC to operate as a daycare facility until June 25, 2007, over nine months after LPC began paying rent and the other expenses associated with this property. Since this program did not house any of the Commonwealth's consumers and was unable to operate as a daycare facility for over nine months after LPC began paying rent and the other expenses associated with this property, the $57,107 in expenses was unnecessary and non-program-related. Consequently, the portion of these expenses that LPC charged against its state contracts, which we calculate to be $14,277, was nonreimbursable under LPC's state contracts.

The 808 CMR 1.05 (12), promulgated by OSD, identifies the following expenses as being nonreimbursable under state contracts:

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

On September 1, 2006, LPC entered into an agreement with DCDC, LLC (DCDC) a company in which LPC's Executive Director has an ownership interest, to lease a building located at 374

Rockdale Avenue, New Bedford in which it was going to operate a daycare facility. The property was purchased on September 20, 2006 by DCDC, five days after entering into the lease agreement with LPC, which commenced on September 15, 2006. Under the terms and conditions of this lease agreement, LPC agreed to pay rent in the amount of $13,000 per month, all utilities costs, and any real estate taxes on this property for the period September 15, 2006 through December 31, 2006. During the period of this initial lease, the expenses incurred by LPC relative to this property totaled $46,350, as indicated in the table below:

Type of Expense[1]	Amount
Rent	$45,500
Utilities (Electric, Water, Gas)	850
Real Estate Taxes	0
Total	$46,350

Subsequent to the execution of this lease agreement, LPC's Executive Director authorized significant renovations to this property including sprinklers, heating, air-conditioning installations, and handicapped bathrooms. In fact, LPC also expensed $10,757 in renovation costs associated with this property. Consequently, this property could not be licensed as a daycare facility by EEC until June 25, 2007, over nine months after the initial lease period began. Since no consumers could have used this facility during this initial nine-month period, we believe that the $46,350 in expenses that LPC incurred relative to the operation of this property during this period were clearly non-program-related expenses and therefore nonreimbursable under LPC's state contracts.

Recommendation

In order to address our concerns relative to this matter, LPC should amend its fiscal year 2006 UFR and identify as nonreimbursable expenses the non-program-related expenses charged to its state contracts for the operation of the facility in question during fiscal year 2006, which we calculate to be $14,277 ($57,107; 25% state funding). If during this fiscal year LPC does not have sufficient non-state revenues to pay for these nonreimbursable expenses, it should remit

[1] LPC and DCDC extended the terms and conditions of this lease through December 2007; however, LPC had not yet filed its 2007 UFR as of the end of our audit fieldwork.

this amount to the Commonwealth. In the future, LPC should take measures to ensure that it does not use any state funds to pay for non-program-related expenses.

Auditee's Response

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

> *...This property was purchased in order to expand the services that LP College offers to the families in southeastern MA. The property cannot be licensed by EEC until all renovations and inspections are completed. The expenses to operate the property are a valid expenses to LP College, as commercial renters need "build-out" time before opening a business. The time and money spent to renovate space is clearly a cost to the renter, and DCDC LLC and LP College are fully aware that build-out time and expense is charged to the renter, not to the owner, of the property.*
>
> *OMB Circular A-87, Part 225, 21. (4)c listed in the Federal Register/Vol. 70, No. 168 states: "The costs of idle capacity are normal costs of doing business and are a factor in the normal fluctuations of usage or indirect cost rates from period to period. Such costs are allowable, provided that the capacity is reasonably anticipated to be necessary ..." This was certainly the case.*

Auditor's Reply

Our report acknowledges the fact that the property in question was purchased in order to expand the services that LP College offers to the families. We also acknowledge the fact that the property could not be licensed by EEC until all renovations and inspections were completed. However, the owner of this property was DCDC, LLC (a related party) and not LP College; therefore, we do not agree with LPC's assertion that "The time and money spent to renovate space is clearly a cost to the renter, and not to the owner, of the property." Our position is supported by the fact that LP College's Executive Director, and not LP College, ultimately paid for the majority of the renovation costs for this property, which contradicts the assertion that LP College was still required to pay for operating expenses such as rent during a time when the program was not operational at this location. In our opinion, it was not prudent for LPC to pay rental expenses for property for over nine months when it could not be used for its business purposes. However, because LPC decided to pay for these rental and other expenses, none of the costs associated with these unnecessary expenses should be charged to the Commonwealth, since no state-funded children were being served in this program at this location during our audit period.

Furthermore, it its response, LPC referenced language from the Federal Register that cites what expenses are allowable under federally funded programs. Although the criteria listed are not applicable to the unallowable costs in question, this page makes a clear distinction between what it calls idle capacity and idle facilities. Specifically, this section of the federal register defines idle capacity as "unused capacity of partially used facilities." This page defines idle facilities in part as "completely unused facilities that are excess to the governmental unit's current needs." LPC is correct in pointing out that this section of the federal register seems to allow, under certain circumstances, the costs of idle capacity. However, in terms of idle facility costs, this page of the federal register states:

> *(4) b. The costs of idle facilities are unallowable except to the extent that:*
>
> *(1) They are necessary to meet fluctuations in workload; or*
>
> *(2) Although not necessary to meet fluctuations in workload, they were necessary when acquired and are now idle because of changes in program requirements, efforts to achieve more economical operations, reorganization, termination, or other causes which could not have been reasonably foreseen.*

Since the facility in question was completely empty and by LP College's own admission was being used to expand services rather than meeting fluctuations in workload, this facility clearly falls within the federal government's definition of an idle facility. Therefore, even if the criteria cited by LPC in its response were applicable, the costs in question under federal standards would still not be allowable

4. UNNECESSARY INSURANCE PREMIUMS TOTALING $25,369

During our audit period, we found that LPC paid a total of $25,369 in property insurance premiums, $6,342 of which was charged against LPC's state contracts. LPC was not required to provide or pay for this insurance coverage as a condition of these leases. Therefore, this $6,342 represents an unreasonable, non-program-related cost that is nonreimbursable under LPC's state contracts.

The 808 CMR 1.05 (12) and (1), promulgated by OSD, identifies the following costs as being nonreimbursable under state contracts.

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

(1) Unreasonable Costs. 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.

During our audit, we reviewed LPC's insurance policies and found that LPC was paying premiums for commercial insurance coverage on 10 buildings leased by LPC from seven limited liability companies in which LPC's Executive Director holds a financial interest (i.e., related-parties), as detailed in the following table:

Summary of Premiums Paid by LPC to Insure Leased Premises

	Policy Year FY06	Policy Year FY06	Policy Year FY07	Policy Year FY07 (through 12/31/06)	
Facility Address	Building Value*	Premium Paid	Building Value	Premium Paid	Total Premiums Paid
52 Donald Street	$328,655	$1,318	$355,933	$1,150	$2,508
321 Rockdale Avenue	169,342	621	183,397	673	1,182
4241 Acushnet Avenue	845,089	2,447	915,231	2,650	4,655
850 Church Street	1,405,181	4,960	1,521,811	5,372	9,436
100 Spring Street	296,583	1,355	321,199	1,469	2,579
360 Dartmouth Street	630,530	2,315	682,864	2,506	4,403
374 Rockdale Avenue**	N/A	N/A	391,900	604	604
Total	$3,675,380	$13,016	$4,372,335	$12,400	$25,369

* The properties located at Donald Street, Acushnet Avenue, and Spring Street contain more than one structure, and building values and premiums paid have been combined.

** Coverage for 374 Rockdale Avenue was amended into policy effective September 20, 2006.

We reviewed the lease agreements between LPC and the owners of these 10 buildings and noted that LPC was not required to provide or pay for this insurance coverage as a condition of these leases. Therefore, these lease payments, which totaled $25,369, represent unreasonable, non-program-related costs that should not have been charged by LPC against its state contracts.

Recommendation

In order to address our concerns relative to this matter, LPC should amend its fiscal years 2004 through 2006 UFRs to identify the state funds that were used to pay for these nonreimbursable

expenses, which we calculate to be $6,342 ($25,369 times 25% state funding). If during any fiscal year, LPC does not have sufficient non-state revenues to pay for these nonreimbursable expenses, it should remit this amount to the Commonwealth. In the future, LPC should take measures to ensure that it does not use any of its state funds to pay for these expenses.

Auditee's Response

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

> *LP College has a triple net lease with these LLCs and pays for all costs associated with the operation of these properties. It is quite common for the lessee to pay all insurance costs associated with the operation of the leased sites.*

Auditor's Reply

Contrary to what LPC states in its response, the language in the leases we reviewed for these properties did not use the term " triple net" and did not state or indicate that LPC would be responsible for these insurance premiums. Consequently, we again urge LPC to fully implement our recommendations relative to this issue.

5. UNALLOWABLE FRINGE BENEFITS TOTALING $120,626 PROVIDED TO CERTAIN LPC EMPLOYEES

We found that during fiscal years 2005 and 2006, LPC provided fringe benefits totaling $120,626 to certain members of its staff that were not available to all staff members under LPC's formal written policies and procedures. These benefits included at least (a) $101,934 in full health insurance coverage, (b) $13,563 for full dental insurance coverage, and (c) $5,129 in salary advances, of which $29,374 was charged by LPC against its state contracts. According to OSD regulations, fringe benefits such as these, which are not available to all employees, are nonreimbursable expenses under state-funded contracts.

OSD has promulgated regulations relative to fringe benefits provided for selected employees. In this regard, OSD defines certain fringe benefits in 808 CMR 1.05 (9) (a), which states, in part:

> *Certain Fringe Benefits. 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….*

Further, OSD's Auditor's Compliance Supplement provides the following guidance in this area:

> *To be reimbursable, fringe benefits must be available to all employees under an established written policy (in accordance with GAP) of the Contractor and must not be excessive in comparison to salary and benefit levels of other similar Contractors. The policy may include provisions that permit the available of different levels and types of fringe benefits for employees based upon the employee's length of service, collective bargaining agreements or regular hours of employees.*
>
> *The provider's employee morale, health and welfare activities must be available to all employees and not operated in discriminatory manner. Disparities in the availability of these activities may occur based on the employees status as a member of management, length of service, collective bargaining agreements or regular hours of employment. Disparities may not occur within classes of employees. The costs of the program must be equitably apportioned to all activities of the organization.*
>
> *The costs associated with the employee morale, health and wealth activities must be adequately supported through written documentation.*

During our audit, we reviewed the fringe benefits LPC provided to various members of its staff and found several instances in which staff members were provided with fringe benefits in excess of those allowed by LPC's policies and procedures, as follows:

a. Heath Insurance

According to LPC's personnel policies, group health insurance is available for all staff members who meet certain criteria, which includes length of service and whether the person is a permanent, full-time, or part-time staff member, as follows:

LPC Monthly Subsidy for Group Health Insurance Coverage

Length of Service	Subsidy Per Month
90 Days	$120
3 Years	$150
6 Years	$185
9 Years	$225
12 Years	$250

However, we found that during our audit period, LPC paid 100% of the premiums for certain agency employees, including LPC's Executive Director, two of the Executive Director's family members who provided part-time administrative and curriculum assistance, the Chief of Internal Operations, the Director of Program Operations, three center directors,

two teacher trainers, two coordinators (who also served on LPC's Board of Directors), and a part-time maintenance employee, as follows:

Excess Health Insurance Subsidies Paid for Select Staff Members

May 1, 2005 through December 31, 2006

Staff Position	Excess Subsidy Fiscal Year 2005	Excess Subsidy Fiscal Year 2006* (8 months)	Total
Executive Director	$2,732	$2,463	$5,195
Chief of Internal Operations	6,406	7,737	14,143
Director of Program Operations	6,406	4,270	10,676
Center Directors	17,994	7,473	25,467
Teacher Trainers	1,606	1,070	2,676
Coordinators	3,010	877	3,887
Maintenance Staff	1,306	871	2,177
Administrative & Curriculum Assistants	21,202	16,511	37,713
Total	$60,662	$41,272	$101,934

* Our review was based upon health insurance policy fiscal years 2006 and 2007 (May 1, 2005 through April 30, 2007). Insurance premiums reflected above represent a partial year to coordinate with LPC's fiscal year end and its 2006 UFR filing.

As can be seen from the table above, LPC paid a total of $101,934 in health insurance premiums for these staff members above what was allowed by its own policies and procedures. Therefore, this $101,934 represents nonreimbursable expenses under LPC's state contracts.

b. Dental Insurance

According to LPC's staff handbook, although dental coverage is available to all staff, the cost is to be fully paid for by the employee; however, we found that, during our review, 10 employees, including LPC's Executive Director, received dental insurance and, in many instances, family coverage, that was fully paid for by LPC, as follows:

Fully Paid Dental Insurance Premiums for Select Staff Members and Certain Staff Members' Families

May 1, 2005 through December 31, 2006

Staff Position	Fiscal Year 2005 (8 months)	Fiscal Year 2006	Total
Executive Director	$226	$325	$551
Director of Program Operations	654	939	1,593
Center Directors (5)	3,269	4,697	7,966
Teacher Trainers	226	325	551
Administrative & Curriculum Assistants (2)	1,023	1,879	2,902
Total	$5,398	$8,165	$13,563

Regarding these matters, LPC's Executive Director stated that the staff handbook was not reflective of the health and insurance and other benefits paid for certain staff members. She added that LPC's staff handbook will be revised to reflect the benefits received by these employees.

c. Staff Salary Advances

We found that during fiscal years 2004 through 2005, LPC provided three interest-free loans totaling $5,129 to its Activities Director and a Teen Parenting Program staff member who for a period of time also served on LPC's Board of Directors. However, LPC did not have any policies or procedures that allow for the provision of these advances. One of these employees, the Activities Director, repaid her advance totaling $3,129 through payroll deductions. However, the other employee had her entire $2,000 loan forgiven by LPC 15 months after the advance was given, and the expense associated with this loan was charged by LPC to its state contracts.

Regarding this matter, LPC's Executive Director stated that although there is no formal agency policy in this area, she sometimes agrees to provide salary advances or loans to certain staff members.

Recommendation

In order to address our concerns relative to this matter, LPC should amend its fiscal years 2005 and 2006 UFRs to identify the state funds that were used to pay for these nonreimbursable fringe benefit expenses, which we calculate to be $29,374 ($115,497 plus the $2,000 in forgiven salary advances, times 25% state funding). If, during any fiscal year, LPC does not have sufficient non-state revenues to pay for these nonreimbursable expenses, it should remit this amount to the Commonwealth. In the future, LPC should take measures to ensure that it does not use state funds to provide fringe benefits to certain staff member that are in excess of LPC-established levels.

Auditee's Response

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

> *a. Health Insurance: The draft report cites OSD's Compliance Supplement as: "Disparities in the availability of these activities may occur based on the employees status as a member of management, length of service, collective bargaining agreements or regular hours of employment. Disparities may not occur within classes of employees." LP College takes issue with this because ALL employees who receive extra health insurance benefits are members of management—administrators and directors (supervisors). The draft report lists the individual's titles and they are all management. Furthermore, all administrators are offered this same fringe benefit. LP College was following the guidelines in the Compliance Supplement by offering extra insurance benefits to all individuals in the class of administrators.*
>
> *The auditor may question the insurance paid to the maintenance person, who has worked at LP College for thirteen years and who supervises the other three maintenance persons. One can see, by his hourly pay rate, that he is a supervisor of maintenance.*
>
> *b. Dental Insurance: Same as above explanation*
>
> *c. Staff Salary Advances: Two administrators received interest free loans during the period in question. The activities director had been working at LP College for 25 years and needed an advance in pay. She later paid back the entire loan. The other administrator's loan of $2,000 was forgiven in lieu of a yearly bonus because of her outstanding performance.*

Auditor's Reply

As noted in our report, LPC's approved health insurance policy does in fact establish different levels of benefits based on a staff member's length of service, with which we did not take exception. These policies also say that administrative and certain personnel may also receive health benefits as a portion of their pay; however, nowhere in the agency's policies does it state

that LPC will pay 100% of the premiums for certain agency employees. Further, according to LPC's staff handbook, although dental coverage is available to all staff, the cost is to be fully paid for by the employee. Consequently, since these benefits were available to all employees under an established policy of the agency, they are not allowable expenses under LPC's state contracts. Further, as noted above, we found that during fiscal years 2004 through 2005, LPC provided three interest-free loans totaling $5,129 to its Activities Director and a Teen Parenting Program staff member. However, LPC did not have any policies or procedures that allow for the provision of these advances. One of these employees, the Activities Director, repaid her advance totaling $3,129 through payroll deductions. However, the other employee had her entire $2,000 loan forgiven by LPC 15 months after the advance was given, and the expense associated with this loan was charged by LPC to its state contracts. In its response, LPC gave its reasons as to why these two individuals were provided with these loans; however, since the agency did not have a policy that provided for this fringe benefit, in accordance with OSD regulations, all costs associated with these loans are non-reimbursable to LPC's state contracts.

6. CAPITAL ITEMS TOTALING $53,591 EXPENSED RATHER THAN DEPRECIATED AS REQUIRED BY STATE REGULATIONS

We found that during our audit period, LPC expensed $53,591 in capital assets against its state contracts rather than depreciating the cost of these assets over their useful lives as required by state regulations. Consequently, the $53,591 in expenses represent nonreimbursable costs under LPC's state contracts.

OSD has promulgated 808 CMR 1.05, which applies to all contracted human services providers such as LPC and identifies the following costs as nonreimbursable under state contracts:

> *(4) Current Expensing of Capital Items. All costs attributable to the current expensing of a Capital Item.*

OSD also provides the following guidance in its UFR Audit and Preparation Manual:

> *Generally accepted accounting principles require that purchases having a future economic benefit and life beyond one year be capitalized and depreciated over a certain time period. In addition, the provisions of FASB No. 116 indicate that the revenue should not be recorded in a temporary or permanently restricted class as these classifications are restricted for donations. Depreciation of an asset furnished under a Commonwealth Capital Budget is considered non-reimbursable and should be reported on Supplemental Schedules A and B. The obligation to report funds not derived for Commonwealth revenue to offset the non-reimbursable cost of depreciation from the*

asset furnished by the Capital Budget Contract is met by indicating on Schedule A and B that the depreciation is offset by revenue derived from the Capital Budget Contract (in essence, no offsetting revenue is necessary). Contractors with programs that are supported by funding from the Commonwealth must record depreciation for those programs in accordance with the Massachusetts Code of Regulation 808 CMR 1.00 and Federal Single Audit requirements of OMB Circular A-l22 and/or A-21. Programs which are not supported by funding from the Commonwealth or Federal Assistance must record depreciation in accordance with ANPO recommendations, but may utilize reasonable service lives that may differ from the 808 CMR 1.00 and OMB Circular A-122 lives. The Massachusetts Code of Regulation 808 CMR 1.00 subscribes to the above but requires that depreciation be reported on the supplemental schedules on a straight-line basis over a service life not less than the periods given as follows:

Schedule of Service Lives of Assets

ASSET CATEGORY	YEARS OF LIFE	YEARLY RATE
Buildings: Type 1 - Fireproof Construction and Type 2 - Non-Combustible Construction (as classified by the State Board of Building Regulations and Standards in accordance with 780 CMR 400.00)	40	2.5%
Type 3 - External Masonry Wall Construction and Type 4 - Frame Construction (as classified by the State Board of Building Regulations and Standards in accordance with 780 CMR 400.00)	27.5	3.6%
Building/Improvements	20	5.0%
Leasehold Improvements	5 (or term of lease, whichever is greater)	20.0%
Equipment	10	10.0%
* Computer Equipment	3	33.33%
** Other Office and Other Program Equipment: Includes items such as copiers, ovens, washers, dryers, office files, and capitalized office and program supplies.	5	20.0%
Life Safety Improvements: Building or leasehold improvements or equipment acquisitions made solely to satisfy the requirements of any Department regarding life safety or physical environment. Purpose must be documented.	5	20.0%
Motor Vehicles	5	20.0%
Used Motor Vehicles	3	33.33%
Residential Furnishings	3	33.33%
Office Furnishings	7	14.2%

* Denotes decreased years of life, effective January 1, 1997.
** Denotes additional category, effective January 1, 1997.

During our audit, we found that LPC had no formal written policies and procedures in place relative to the capitalization, depreciation, and disposal of its capital assets. Further, although LPC had not reported having made any leasehold improvements in its UFRs since 1996, based on our review of agency records, we determined that LPC made a number of leasehold improvements during fiscal years 2005 and 2006, as indicated below.

Fiscal Year 2005 Leasehold Improvements

Date	Description of Leasehold Improvement	Amount	LPC Recorded Expense
1/20/05	Gas Furnace	$2,400	Repairs & Maintenance
4/4/05	Epoxy Floor	2,904	Repairs & Maintenance
4/11/05	Windows	5,810	Operating & School Supplies
4/25/05	Commercial Door	1,225	Operating & School Supplies
7/20/05	Roof, Deck, Stairs, and Rails	10,965	Office Supplies & Expenses
7/25/05	Roof	8,200	Operating & School Supplies
8/7/05	Heat/Cool Split Unit	2,300	Cleaning & Supplies
9/2/05	Epoxy Floor	1,807	Operating & School Supplies
10/26/05	Asphalt	8,800	Operating & School Supplies
Total		$44,411	

Fiscal Year 2006 Leasehold Improvements

Date	Description of Leasehold Improvement	Amount	LPC Recorded Expense
1/5/06	Epoxy Floor	$1,750	Operating & School Supplies
10/29/06	Windows/Doors (Film)	2,090	Repairs & Replacements
11/15/06	Safety Glass	3,340	Repairs & Replacements
11/27/06	Cabinetry	2,000	Operating & School Supplies
Total		$9,180	

However, rather than depreciating these assets as required by OSD regulations, LPC expensed these capital improvements during the year in which they were made.

Recommendation

LPC should amend its fiscal years 2005 and 2006 UFRs to identify the state portion of the $53,591, which we calculate to be $10,718 (see table below) in unallowable capital asset expenses charged against its state contracts during our audit period, as being nonreimbursable expenses. If, during any fiscal year, LPC does not have sufficient non-state revenues to pay for these nonreimbursable expenses, it should remit this amount to the Commonwealth. In the future, LPC should establish a formal policy with written procedures and internal controls for the purchasing of fixed assets and have it approved by its Board of Directors.

Fiscal Year	Expense Claimed	Allowable Deprecation (20%)	Unallowable Expense Claimed	State Portion of Unallowable Expense (25%)
2005	$44,411	$8,882	$35,529	$8,882
2006	$9,180	$1,836	$7,344	1,836
Total				$10,718

Auditee's Response

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

LPC's policy has always been to capitalize items with a useful life of more than one year and exceeding $5,000. Because L.P. College is such a large corporation, many of the repairs include several items, thus increasing the total cost of the bill. The following are explanations of the expenses in the draft report:

- *Epoxy floors (three bills totaling $6461) includes material and labor for 20 separate bathrooms (3 different sites) and one storage shed, which averages $307 per floor.*
- *Windows, film for windows and safety glass ($11,240) includes 31 windows at three different locations and protective film for 17 windows. Windows are expensed because we are continuously replacing them and cannot consider them to have a useful life, even though they are all safety glass.*
- *Roof, including deck, stairs and rails ($19,165) were repairs to two different sites. This was expensed because it was all repairs to previously existing property. In both cases, the entire roof was not replaced with a new one. An automobile crashed into the porch at our central office and we had to repair the deck, stairs and rails.*
- *The cabinetry bill of $2,000 was for 18 different cabinets, or $111 per cabinet and was expensed.*
- *The gas furnace ($2,400) and the heat/cool split unit ($2300) were expensed because of the cost.*

In short, the only item on this list that LPC failed to depreciate is the asphalt for a playground at one of the sites. The cost was $8800. (Audit Calculation @ 25% = $2,200 Calculation @ 13% = $1144)

Auditor's Reply

As noted above, regardless of the cost of each item, all of the expenses in question made by LPC would fall into the categories of either leasehold or building improvements and should have been capitalized and depreciated in accordance with OSD guidelines and recorded as such in the agency's financial records rather than expensed. Consequently, we urge LPC to implement our recommendations relative to this matter.