Commonwealth of Massachusetts
Office of the State Auditor
Suzanne M. Bump
Making government work better

Official Audit Report – Issued May 6, 2014

New England Farm Workers' Council Inc.

For the period July 1, 2009 through March 31, 2012

State House Room 230 ■ Boston, MA 02133 ■ auditor@sao.state.ma.us ■ www.mass.gov/auditor

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May 6, 2014

Mr. Heriberto Flores
Chairman, President, and CEO
New England Farm Workers' Council Inc.
11-13 Hampden Street
Springfield, MA 01103

Dear Mr. Flores:

I am pleased to provide this performance audit of the New England Farm Workers' Council Inc. This report details the audit objectives, scope, methodology, findings, and recommendations for the audit period, July 1, 2009 through March 31, 2012. My audit staff provided a draft copy of this report to management of the agency, whose pertinent comments are reflected in this report.

I would also like to express my appreciation to the New England Farm Workers' Council Inc. for the cooperation and assistance provided to my staff during the audit.

Sincerely,

Laura Marlin
First Deputy Auditor of the Commonwealth

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EXECUTIVE SUMMARY

In accordance with Chapter 11, Section 12, of the Massachusetts General Laws, the Office of the State Auditor (OSA) has conducted a performance audit of certain activities of the New England Farm Workers' Council Inc. (NEFWC) for the period July 1, 2009 through March 31, 2012.[1] The objectives of our audit were to (1) assess NEFWC's control environment and determine whether the internal controls that it has established over its operations ensure that the various administrative expenses NEFWC charged against its state contracts are reasonable and allocable to those contracts, (2) analyze selected transactions conducted between NEFWC and its related parties to determine whether they were reasonable and allowable, and (3) determine whether expenditure information reported by NEFWC to the Commonwealth was in accordance with guidance issued by the state's Operational Services Division (OSD).

Summary of Findings

Our audit identified significant weaknesses in the control environment at NEFWC. Specifically, NEFWC and its related organizations share common board members and two common executive-level employees, resulting in inadequate checks and balances or controls to ensure that the non-arm's-length transactions that are conducted between itself and these related-party organizations are conducted in a sufficiently transparent manner and in compliance with state regulations. These weaknesses in NEFWC's control environment resulted in its directly, or through a related organization, using as much as $782,224 in Commonwealth funds to pay for nonreimbursable expenses and not properly reporting these expenses as nonreimbursable in the financial statements it filed with OSD as required by OSD guidelines.

The following are the issues we identified during our audit.

- NEFWC paid two firms and one individual $162,590 for what NEFWC said were consultant services. However, contrary to OSD regulations, NEFWC did not use a competitive procurement process when procuring these services, and the agency could not provide us with any documentation (e.g., invoices or deliverables) to show what services, if any, these consultants provided under their contracts. Further, the scope of services the consultants were required to provide under these contracts was not adequately established, and we found evidence that some

[1] Before the start of this audit, State Auditor Suzanne Bump determined that she had an independence impairment and delegated to the First Deputy Auditor all direction and decision-making authority for this audit. This disclosure is made for informational purposes only, and this circumstance did not interfere with our ability to perform our audit work and report the results thereof impartially.

of these payments may have been for lobbying services, which OSD regulations specifically prohibit charging to state contracts.

- During fiscal years 2010 through 2012, NEFWC's affiliate Partners for Community Inc. (PfC) paid NEFWC's chief executive officer (CEO) a total of $454,871 for working full time at NEFWC. On its annual Uniform Financial Statements and Independent Auditor's Reports (UFRs) submitted to OSD, NEFWC reported $419,251 of this amount as paid by NEFWC and $35,620 as management fees charged by PfC to NEFWC. However, based on our review of NEFWC's records and other publicly available information, we found several problems with this compensation:

    - There were no timesheets or other records that adequately supported the hours the CEO worked at NEFWC during this period.

    - The CEO was reported as a full-time employee for more than one affiliate, and his combined salaries, as reported, exceeded the maximum reimbursable salary amount established by OSD.

    - NEFWC did not report all of the compensation its CEO received from related organizations when filing UFRs with OSD.

- NEFWC used $32,377 in state funding for travel allowance costs for the CEO (which it gave him in lieu of a company-provided car) that were nonreimbursable according to OSD regulations. In addition, the provision of travel allowance in lieu of a car was not supported by an employment contract approved by NEFWC's board of directors. Further, this benefit was erroneously not reported to the Internal Revenue Service (IRS) in calendar years 2009 and 2010 as required by the IRS.

- NEFWC used $35,750 in state funding for expenses associated with a $250,000 unsecured loan that it obtained from an individual that were nonreimbursable in accordance with OSD regulations. The $35,750 is the interest on the portion of the loan that was used to purchase a building that was not used in any of NEFWC's state-funded programs.

- NEFWC used $11,692 in state funding to pay for restaurant charges that were nonreimbursable according to OSD regulations because they were inadequately documented or non-program-related.

- NEFWC used $41,495 in state funding for what was identified on NEFWC's general ledger as repair and maintenance costs. These items were nonreimbursable according to OSD regulations because they were inadequately documented, not related to NEFWC's state-funded programs, or not properly accounted for in the agency's accounting records.

- NEFWC used $20,261 in state funding for conference and lodging costs that were nonreimbursable according to OSD regulations because they were either not documented or not directly related to NEFWC's social-service program purposes.

- NEFWC used $23,188 in state funding for legal costs that were nonreimbursable according to OSD regulations because there was inadequate documentation to substantiate that they were related to NEFWC's social-service program purposes.

- The composition of NEFWC's board did not meet the requirements of the terms and conditions of its state contracts. As a result, NEFWC's board may have been unable to perform its oversight duties and responsibilities in an independent and effective manner.

Recommendations

- NEFWC should cooperate with OSD in resolving the issues regarding nonreimbursable costs identified in this report and should reimburse the Commonwealth for any such costs that OSD determines must be repaid.

- NEFWC should ensure that it does not use any state funding to pay for costs that are considered nonreimbursable under OSD regulations. Any costs paid for with state funds should be adequately documented and be related to the agency's state-funded activities. All nonreimbursable costs incurred by NEFWC should be disclosed as such in its UFRs in accordance with OSD requirements.

- NEFWC should ensure that, to the extent practicable, it uses a competitive procurement process for all consultant services and should ensure that contracts for such services contain a clearly stated scope of services. It should also identify and prevent lobbyist costs being charged to state contracts.

- NEFWC should ensure that it maintains adequate documentation to substantiate the time its CEO spends working at the agency and comply with OSD's compensation-disclosure requirements when filing its annual UFR. NEFWC, in collaboration with its affiliated agencies, should ensure that the amount of compensation provided to the CEO and reported as paid in its UFRs does not exceed the limit established by OSD regulations.

- NEFWC should ensure that any benefits provided to its CEO are provided consistently with OSD regulations and that any taxable benefits are properly reported.

- NEFWC should comply with the terms and conditions of its state contracts related to the composition of its board of directors. NEFWC and its related parties should consider whether to maintain the current structure, wherein top management employees are voting members of the companies' boards of directors. They should also explore the possibility of expanding each company's board of directors to include more independent members on each individual board, members who are not affiliated with NEFWC or its related parties.

Agency Progress

In its written response, NEFWC stated that it was taking the following measures (excerpted from its response) to address some of the issues OSA identified during this audit. Other specific responses provided by NEFWC are summarized or excerpted after each finding:

- *NEFWC agrees with many of the recommendations you have made. NEFWC intends to make changes to its current operating system to incorporate such recommendations. A process of review of our financial systems is already underway.*

. . .

- *NEFWC agrees that it should identify and prevent lobbying costs being charged to government contracts. NEFWC will establish a procedure to ensure accurate reporting.*

- *NEFWC is currently revising its financial accounting system including the process for UFR filings. However, NEFWC disputes that it does not now adequately support the CEO's salary.*

. . .

- *The Board of Directors of NEFWC shall be asked to review the practice of paying the CEO a monthly payment in lieu of a car. NEFWC shall seek guidance on this issue from OSD and legal counsel and present all relevant information to the Board for consideration. . . . Whatever determination the Board makes shall be formalized by a written agreement with the CEO.*

- *NEFWC is in the process of revising its accounting and reporting system and intends to incorporate the Auditor's recommendations in that process.*

OVERVIEW OF AUDITED AGENCY

Background

The New England Farm Workers' Council Inc. (NEFWC), located in Springfield, Massachusetts, was incorporated as a Connecticut not-for-profit corporation in 1971 and registered to do business in Massachusetts in 1982. During our audit period, NEFWC provided a variety of services, including the following:

- Voucher day care, which consists of receiving referrals for daycare services from the Massachusetts Department of Transitional Assistance (DTA); providing counseling and before- and after-school childcare services; and paying the various childcare providers for services provided.
- Employment and job training, which involves providing economically disadvantaged adults and youths with work experience situations throughout the year by determining participants' eligibility and placing participants in positions in the community.
- Emergency shelter assistance, which involves providing shelters for homeless families who are referred by DTA while they engage in search and placement activities for safe, affordable, sustainable housing.
- Low-income home energy assistance, which involves determining client eligibility and providing assistance in paying home heating bills.
- Youth employment, which involves providing youths with opportunities for personal and professional growth through paid and unpaid work experience, education and General Equivalency Degree preparation, tutoring, mentoring, job placement, and other supportive service programs.

NEFWC is one of a group of companies affiliated with an organization called Partners for Community Inc. (PfC). PfC, located in Springfield, Massachusetts, was incorporated in 1997 under the provisions of Chapter 180 of the Massachusetts General Laws as a not-for-profit organization. PfC was established to function as a management-services organization and is the umbrella agency that provides certain centralized administrative services (executive management, accounting, information technology, and human resources) to its affiliated organizations, including NEFWC, Corporation for Public Management Inc., and Corporation for Justice Management Inc. PfC develops a budget for itself at the beginning of each fiscal year; during our audit period, the budget averaged about $2 million annually. During the course of the year, PfC incurs expenses and charges these expenses back to the three affiliated organizations as a management fee. NEFWC's share of the total management fees assessed by PfC averaged 46% of the total management fees that PfC assessed during our audit period and were included in the administrative costs we audited. Similarly to the way PfC provides centralized administrative services to its affiliates, NEFWC is the owner of all the real estate used by the affiliated companies, administers all the real-estate activity related to these properties, and charges expenses related to the operation of these properties as it deems appropriate to affiliated companies as well as renting property to some outside entities.

In terms of revenue, NEFWC is the largest of the PfC-affiliated companies, with operations in Massachusetts, Connecticut, and New Hampshire and a staff of 76 employees. Below is a summary of NEFWC's revenue for the three fiscal years ended June 30, 2012.

NEFWC Summary of Revenue[2]
Three Fiscal Years Ending June 30

Revenue Source	Fiscal Year 2012	Fiscal Year 2011	Fiscal Year 2010
Department of Early Education and Care—Voucher	$36,743,672	$41,252,322	$36,258,029
Department of Housing and Community Development	15,651,678	19,305,878	20,994,134
Department of Transitional Assistance	2,738,479	4,202,731	3,726,920
Department of Early Education and Care—Contract	588,446	706,344	977,827
Other Grants	1,098,975	735,118	1,581,275
Non-Charitable Revenue	795,759	737,901	885,494
Purchase of Service Subcontract	66,795	66,970	60,260
Direct Federal Grants	1,353,427	–	–
Non-Massachusetts State/Local Government	116,740	1,954,900	1,881,083
Other Revenue	880,822	1,134,743	56,670
Total Revenue	$60,034,793	$70,096,907	$66,421,692

[2] This information was taken from the Uniform Financial Statements and Independent Auditor's Reports that NEFWC filed with the Commonwealth.

AUDIT OBJECTIVES, SCOPE, AND METHODOLOGY

In accordance with Chapter 11, Section 12, of the Massachusetts General Laws, the Office of the State Auditor has conducted a performance audit of certain activities of the New England Farm Workers' Council Inc. (NEFWC) for the period July 1, 2009 through March 31, 2012. In some instances, it was necessary to go outside this period to gather pertinent cost information included in this report. The objectives of our audit were to (1) assess NEFWC's control environment and determine whether the internal controls that it has established over its operations ensure that the various administrative expenses NEFWC charged against its state contracts are reasonable and allocable to those contracts, (2) analyze selected transactions conducted between NEFWC and its related parties to determine whether they were reasonable and allowable, and (3) determine whether expenditure information reported by NEFWC to the Commonwealth was in accordance with guidance issued by the state's Operational Services Division (OSD).

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 to provide 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.

To accomplish our audit objectives, we:

- Gained an understanding of NEFWC and its affiliated organizations, including the composition of their board of directors, and identified the key officers and senior-level employees. We also interviewed various other members of NEFWC's staff and staff from other, outside organizations such as OSD and NEFWC's audit firm that we considered pertinent to our objectives.

- Identified and reviewed applicable laws, rules, or regulations pertinent to our audit objectives.

- Reviewed the board of directors' meeting minutes.

- Obtained, reviewed, and analyzed the annual Uniform Financial Statements and Independent Auditor's Reports[3] filed by NEFWC during our audit period.

- Obtained accounting record data, in hardcopy and electronic forms, for review and analysis.

[3] Each year, agencies such as NEFWC that operate social programs and contract with various Commonwealth departments must prepare financial statements called Uniform Financial Statements and Independent Auditor's Reports and file them electronically with the state's Operational Services Division.

- Selected certain transactions, primarily by using a judgmental sample selection, for further examination to determine whether they were adequately supported, reasonable, allowable, and allocable to state contracts. We used judgmental sampling because it permits the auditor to take into account the relative materiality and risk of various costs. Because we used non-representative judgmental samples, we were not able to project the sample results to the population.

- Determined the reliability of data from NEFWC's electronic accounting records by selecting source documents and tracing them through NEFWC's electronic accounting system. We determined that the data from the system were sufficiently reliable for purposes of our audit.

- Examined the records related to certain NEFWC-owned property to determine compliance with OSD criteria related to the rents being charged to the Commonwealth for the use of these properties.

We determined that the following internal controls were relevant to our audit objective:

- Controls over consultant expenses
- Controls over payroll expenses
- Controls over legal expenses
- Controls over real-estate expenses
- Controls over repairs, maintenance, and other expenses
- Controls over related-party transactions

We assessed the relevant controls identified above and identified deficiencies related to these controls, particularly with the control environment, that are discussed in detail in this report.

At the conclusion of our audit, we provided a copy of our draft report to NEFWC for its review and comments. In addition to NEFWC's comments, which were provided by a law firm representing the agency, NEFWC also provided a binder of additional information that included copies of documents for our consideration. Because the information in this binder was not provided during the conduct of our audit fieldwork, we could not perform sufficient audit testing to verify its accuracy and completeness; however, we did review the information and considered it in drafting our final report.

DETAILED AUDIT RESULTS AND FINDINGS WITH AUDITEE'S RESPONSE

1. The New England Farm Workers' Council Inc. charged as much as $782,224 of nonreimbursable costs against its state contracts.

During our audit period, the New England Farm Workers' Council Inc. (NEFWC) used as much as $782,224 in Commonwealth funds to pay—either directly or indirectly through the management fee assessed by its related party, Partners for Community Inc. (PfC)—for nonreimbursable expenses and did not properly report these expenses as nonreimbursable in the financial statements it filed with the state's Operational Services Division (OSD) as required by OSD guidelines.

Since NEFWC and its affiliated companies share common board members, transactions made between NEFWC and its affiliated companies are referred to by accounting and auditing standards as "related-party transactions." Related-party transactions are of special concern for auditors, funders, and oversight agencies because the use of related parties may facilitate the misappropriation of assets; fraud; or violations of law, regulation, policy, or contract requirements and may be used to generate undue benefit to individuals or to other entities. Because of these concerns, federal and state laws, regulations, and accounting standards have been established to control the use and reporting of related-party transactions. Depending on the circumstances, multiple standards, definitions, and regulations apply; however, the primary standard that applies to these types of situations is the Financial Accounting Standards Board's Accounting Standards Codification 850-10-05-3, which defines a related party as follows:

> *Affiliates of the enterprise; entities for which investments are accounted for by the equity method by the enterprise; trusts for the benefit of employees, such as pension and profit-sharing trusts that are managed by or under the trusteeship of management; principal owners of the enterprise; its management; members of the immediate families of principal owners of the enterprise and its management; and other parties with which the enterprise may deal if one party controls or can significantly influence the management or operating policies of the other to an extent that one of the transacting parties might be prevented from fully pursuing its own separate interests. Another party also is a related party if it can significantly influence the management or operating policies of the transacting parties or if it has an ownership interest in one of the transacting parties and can significantly influence the other to an extent that one or more of the transacting parties might be prevented from fully pursuing its own separate interests.*

According to OSD regulation 808 Code of Massachusetts Regulations (CMR) 1.05(8), costs associated with a related-party transaction that would not be reimbursable operating costs to a contractor such as NEFWC under 808 CMR 1.02 and 808 CMR 1.05 cannot be charged to state contracts.

During our audit, we identified a number of instances in which NEFWC used state funding to pay for nonreimbursable expenses or made payments to a related-party organization for expenses that would not have been allowable if NEFWC had directly incurred them. The issues were the result of previously mentioned weaknesses in the control environment at NEFWC.

Auditee Response

NEFWC provided overall comments on this report as well as comments specific to each finding. NEFWC's overall comments are excerpted below.

> *NEFWC has experienced significant growth while becoming a more sophisticated and diverse non-profit organization. It has transitioned from a solely grant based human services organization to an organization that owns, operates and develops real estate, creates economic development, and endeavors to establish independent sources of revenue. These additional operating activities have more complex financial reporting requirements. Accordingly, the current accounting systems require modification. NEFWC is now in the process of revising its general ledger accounting and financial system in recognition of the growing complexity of its operations. It welcomes the advice and input of the Auditor in this process.*
>
> *. . .*
>
> *NEFWC had revenues of $66,421,692 in FY 2010, $70,096,907 in FY 2011 and $60,034,793 in FY 2012. . . . These revenues included monies from non-state grants and independent sources also. Our analysis is focused on "funds received from departments" and therefore subject to 808 CMR. Reported state revenues and expenses are as follows:*

State Contract Expenses and Revenues

	FY2010	*FY2011*	*FY2012*	*Total*
Expenses	*64,061,945*	*67,588,439*	*57,731,098*	*189,381,482*
Revenue	*63,689,974*	*66,446,940*	*56,774,404*	*186,911,318*
Deficit	*371,971*	*1,141,499*	*956,694*	*2,470,164*

> *Expenses exceeded revenues for NEFWC state contracts during the three year period by $2,470,164. These operating deficits were not paid for by the Commonwealth. NEFWC had to raise funds not received from departments to pay these costs. NEFWC was not reimbursed by the Commonwealth for making such payments. Thus, during FY 2010, FY 2011 and FY 2012, NEFWC paid approximately $2,470,164, with funds not received from departments, to administer state programs, without reimbursement by the Commonwealth. Therefore, any questioned charges totaling approximately [$782,224][4] are off-set by such payments and NEFWC does not owe any money to the Commonwealth.*

[4] After review of NEFWC's response to our draft report, the Office of the State Auditor revised some of the dollar amounts in the draft. We have also revised some dollar amounts in NEFWC's reply, as shown in brackets, to reflect the revised amounts.

Operating deficits exist in the non-state contract programs also. In FY 2010-2012 the total operating deficits for such non-state programs was approximately $899,539. Thus, in order to keep the programs running NEFWC raised, and provided, approximately $3,369,703 during this period.

. . .

During FY 2010, FY 2011 and FY 2012 NEFWC had total state contract expenses of [$189,381,482]. The preliminary report challenges approximately [$782,224] of these reported expenses. For purposes of analysis we treat these costs as non-reimbursable. Subtracting that amount from the total of reported expenses, the remainder is [$188,599,258]. The auditor has not challenged any of these remaining costs and they are therefore reimbursable. The Commonwealth only paid, or reimbursed, NEFWC in the amount of $186,911,318 for reimbursable expenses. This amount was not enough to pay for all allowable costs.

Unpaid Reimbursable Expenses

	FY 2010-2012
Total expenses	*[189,381,482]*
Questioned expenses	*[782,224]*
Reimbursable Expenses	*[188,599,258]*
Revenues	*186,911,318*
Unpaid reimbursable expenses	*[1,687,940]*

. . .

The revenues provided by the Commonwealth to pay for allowable costs were exhausted by paying for $186,911,318 of reimbursable expenses only. The total amount of revenue provided by the Commonwealth was insufficient to pay for all of the reimbursable expenses. Once the allowable costs were paid there were no surplus funds available. There was nothing left to pay for [$1,687,940] of additional reimbursable expenses reported. Thus, the Commonwealth did not pay, or reimburse, NEFWC for [$1,687,940] of reimbursable expenses. Further, any assumption that the questioned costs included in the preliminary report were paid by the Commonwealth is incorrect. Once the Commonwealth paid a portion of the reimbursable expenses, there was nothing left to pay for any of the questioned costs. Thus, there is nothing to recover or recoup and the Commonwealth is owed nothing.

. . .

During FY 2010, FY 2011 and FY2012 NEFWC had expenses in excess of $195,000,000. NEFWC made every effort to report all of these expenses accurately. To the extent any non-reimbursable expenses were reported as reimbursable such reporting was the result of mistakes in bookkeeping and not improper motives. . . . We have, as a result of your preliminary report, made extensive efforts to provide you with documents that may have been overlooked or unavailable at the time. . . .

In a follow-up response to our draft report, NEFWC also stated,

NEFWC will file amended [Uniform Financial Statements and Independent Auditor's Reports] for FY 2010, 2011, and 2012 in order to clarify and establish that funds received from the Commonwealth of Massachusetts were not used to pay specific operating costs identified by the auditors as non-reimbursable and to ensure that financial reports are consistent with OSD guidelines and regulations.

Lastly, in its response, NEFWC also asserted that some of the expenses in question were charged to accounts that did not contain any state revenues.

Auditor's Reply

NEFWC contends that it was not reimbursed for the $782,224 of nonreimbursable costs that the Office of the State Auditor (OSA) identified during our audit because of the deficits it says it incurred in its state-funded programs that were funded by non-state sources. However, this analysis is inaccurate because, while the deficit cited by NEFWC includes the real-estate expenses associated with NEFWC's state contracts, it does not include all of the corresponding revenues associated with the operation of its state-funded programs. Specifically, NEFWC's analysis includes real-estate expenses (primarily occupancy costs related to state programs but also some costs for non-state programs) while excluding the state-reimbursement-related revenues. When the related revenues are added back or matched as is required by generally accepted accounting principles, NEFWC's state program deficit in total for the three years is minimal, as follows:

Deficit as presented above	$ 2,470,164
Less associated revenues not included in NEFWC's analysis	2,421,314
Net three-year deficit	$ 48,850

Moreover, NEFWC is required by OSD guidelines to identify any nonreimbursable costs it incurs in the Uniform Financial Statements and Independent Auditor's Reports (UFRs) it annually has to submit to OSD. According to OSD guidelines included in OSD's UFR Audit and Preparation Manual, if, during an audit, an auditor identifies any nonreimbursable costs that were not reported in an entity's UFRs, the following applies:

> *The existence of non-reimbursable costs, as contained in 808 CMR 1.05 (effective 2/1/97, 808 CMR 1.05) and OMB Circular A-122, must be disclosed on lines 54E and 55E and must also be disclosed and itemized in Subsidiary Schedules A and B. Social services contract and agreement reimbursements and federal assistance may not be used to defray non-reimbursable costs. It is presumed that Commonwealth and Federal funds have been used to defray non-reimbursable costs when those costs are not appropriately disclosed.*

Under the terms and conditions of its state contracts, NEFWC is required to accurately report all of its revenues and expenses in its UFRs in a prescribed manner. The information in all of the UFRs that OSA used in its analysis was audited by NEFWC's private accounting firm. Based on our review of NEFWC's UFRs, NEFWC did not identify any of the expenses we question in our report as nonreimbursable. Therefore, in accordance with OSD guidelines, OSA has presumed that state funds were used to pay for these expenses.

NEFWC states that it charged some of the questioned expenses against accounts that did not contain any state revenues. However, this assertion is questionable because it appears that some of NEFWC's accounts may have been maintained incorrectly, including expenses but not all of the revenues associated with a particular program or activity and classifying some of the revenue that should have been credited to these accounts as unrestricted.

Finally, although NEFWC indicated that it is going to re-file its UFRs in an attempt to establish that funds received from the Commonwealth were not used to pay specific operating costs identified by our audit as nonreimbursable, it is up to OSD to determine whether NEFWC has sufficient non-state revenues to pay for these expenses, and NEFWC is still responsible for properly accounting for these nonreimbursable expenses in its financial records and reports.

The following are the specific issues we identified during our audit.

a. Nonreimbursable Consultant Expenses Totaling $162,590

NEFWC paid two firms and one individual a total of $162,590 for what NEFWC said were consultant services. However, contrary to OSD regulations, NEFWC did not use a competitive procurement process when procuring these services, and the agency could not provide us with any documentation (e.g., invoices or deliverables) to show what services, if any, these consultants provided under their contracts. Further, the scope of services the consultants were required to provide under these contracts was not adequately established, and we found evidence that some these payments may have been for lobbying services, which OSD regulations specifically identify as nonreimbursable expenses.

During our audit period, NEFWC paid two firms and one individual a total of $162,590 either directly ($97,500) or through management fees ($65,090) for consultant services as detailed in the table below.

Summary of Consulting Fees Billed and Paid by NEFWC

Firm	Paid From	Paid Directly by NEFWC	Paid by NEFWC through Management Fees	Total Nonreimbursable Paid by NEFWC
Firm 1	PfC and NEFWC	$52,500	$31,970	$ 84,470
Firm 2	PfC		19,320	19,320
Individual	PfC and NEFWC	45,000	13,800	58,800
Total		$97,500	$65,090	$162,590

Under each contract, NEFWC established an annual rate of compensation for the consultant and would provide a payment to the consultant each month in an amount equal to 1/12 of this annual rate.

Based on our review of NEFWC's records related to these consultant services, we noted a number of problems. First, OSD regulations require entities contracting with the Commonwealth to use a competitive process when procuring goods and services. Specifically, 808 CMR 1.03(8) states,

> *All procurements of furnishings, equipment and other goods and services by or on behalf of a Contractor shall be conducted in a manner to provide, to the maximum extent practical, open and free competition. Capital Items, as defined in 808 CMR 1.02, shall be acquired through solicitation of bids and proposals consistent with generally accepted accounting principles.*

However, contrary to these regulations, there was no evidence that NEFWC used a competitive procurement process in procuring these services. In fact, NEFWC and PfC officials told us that these services were not competitively procured, but that instead they awarded these contracts based on industry referrals, since the work is uncommon and only certain firms do the type of work involved.

Additionally, under 808 CMR 1.05(26) the following costs are nonreimbursable program costs:

> *Costs which are not adequately documented in the light of the American Institute of Certified Public Accountants statements on auditing standards for evidential matters.*

Each consultant contract contained the following scope of services, which was vague and unclear as to the nature of the types of services that were to be provided.

> *Upon the request of NEFWC or a subsidiary, [the consultant] will provide to NEFWC those services necessary to act as a consultant on various matters affecting NEFWC and any matter NEFWC feels [the consultant] can be helpful.*

Sound business practice requires the development of a detailed scope of services for contracts so that all parties are fully aware of, and agree to, the services to be provided and the method and rate of compensation. The Commonwealth itself supports this practice in its own policies for procuring contract work; the "Procurement/Contracts" policy issued by OSD and the Office of the State Comptroller requires contract scopes of work to contain sufficient detail to "identify the expected performance." However, NEFWC officials could not provide us with any documentation (e.g., invoices, deliverables) to show what services, if any, these consultants provided. Moreover, NEFWC paid these consultants without having received any monthly invoices or justification as to what services were being billed.

Finally, it appears that some of these costs were for lobbying services, which are nonreimbursable under 808 CMR 1.05(18). Specifically, according to the Secretary of the Commonwealth's Lobbyist Reporting System, two of these three consultants were registered lobbyists; Firm 1 from the table above reported $111,000 and Firm 2 reported $12,000 of lobbyist fees to the Secretary of the Commonwealth during the period July 1, 2009 through March 31, 2012.

Auditee Response

NEFWC's comments on this specific finding (Nonreimbursable Consultant Expenses Totaling $162,590) are excerpted below.

> 1. *Type of services.*
>
> *During the audit period NEFWC incurred expenses for lobbyist services (Firm 1 and Firm 2). Many non-profit corporations hire lobbyists and it is lawful, appropriate and understandable that they do. . . . These groups need persons with the skills and knowledge necessary to monitor and promote their issues before the General Court.*
>
> *NEFWC also incurred expenses for one consultant. The consultant did not promote, oppose or attempt to influence legislation and was not a lobbyist. He was hired only to promote NEFWC's interests in economic development matters pertaining to the City of Springfield.*
>
> 2. *Procurement.*
>
> *Lobbying and consulting services are not capital items so the solicitation of bids and proposals is not required. Further, an open and free competition is not required,*

pursuant to 808 CMR 1.03(8), to procure services if it is not practical to do so. A contract with a lobbyist or consultant, much like a contract with a lawyer, an accountant or a doctor, involves a relationship of trust, confidence, discretion, dependability and compatibility. It demands special skills, knowledge and ability. When obtaining such personal services, it would not be practical to have a competitive bidding process. Such hiring decisions are best left to the reasonable judgment of the contractor.

3. Scope of Services.

The scope of services was not vague or unclear and has been well-documented consistent with 808 CMR 1.05(26). Firm One and Firm Two were hired to lobby the General Court and the Executive Branch on matters important to NEFWC. During the audit period, the scope of services provided by Firm One involved lobbying on matters relating to fuel assistance, day care, housing, job training, economic development in Western Massachusetts and general budgetary issues. Each year, as required by law, Firm One filed a public document with the Secretary of State which described the scope of services provided to NEFWC. Each of the specific bills before the legislature that Firm One lobbied on is specifically identified. . . .

During the audit period, the scope of services provided by Firm Two involved lobbying to obtain additional funding for Partners for Community and the affiliated companies from the state budget. Firm Two, as required by law, filed public documents with the Secretary of State which described the scope of services provided. Each of the specific bills before the legislature that Firm Two lobbied on is specifically referenced. . . .

The consultant was hired to work exclusively on matters pertaining to economic development in the City of Springfield because of his unique history and knowledge of the issues including the Paramount Theater, the Union Station renovation project, real estate development and other economic initiatives. The consultant signed a memo of agreement defining his services. Partners for Community and NEFWC are at the heart of efforts to renovate, rebuild and rejuvenate the City of Springfield in general and the North End in particular and needed the advice, good judgment and experience that the consultant uniquely possessed in order to promote its mission. . . .

. . .

NEFWC agrees with your recommendation that it identify and prevent lobbying costs from being allocated to state contracts in the UFR. In future UFR filings, lobbying costs will be reported as non-reimbursable. In this case, payments made by Partners for Community, which does not file a UFR, may have inadvertently been reported as reimbursable. The details of the payments and the Firm names were publicly disclosed and no attempt was made to conceal the nature of the transactions.

Auditor's Reply

OSA acknowledges that in the hiring of a lobbyist, the individual's or firm's special skills, knowledge, and ability should be considered. However, 808 CMR 1.03(8) not only applies to the purchase of capital items, but also applies to the purchase of goods and services and encourages free and open competition whenever possible. Consequently, we believe that NEFWC should have adhered to OSD regulations and attempted to competitively procure these services to ensure that it was receiving the best price possible.

In its response, NEFWC asserts that the scope of services provided by these consultants was well documented, that the two lobbying firms disclosed the scope of their work in public filings with the Secretary of State, and that the other consultant signed a memo of agreement defining his services. While the two firms in question may have provided a description of their services in their public filings, this does not substitute for a formally established, well-defined scope of services within a legally binding contract that can be properly administered. As noted above, the scope of services included in each of these contracts was vague, and NEFWC did not provide us with any additional documentation to substantiate its assertion to the contrary. Further, in addition to a poorly defined scope, NEFWC officials could not provide us with any documentation (e.g., invoices, deliverables) to show what services, if any, these consultants provided and paid these consultants without having received any monthly invoices or justification as to what services were being billed. Without specific information in the contract on the services to be provided (e.g., deliverables) and the method and rate of compensation, there is no way for OSA to determine whether these services were necessary or whether the payments made for these services were reasonable and applied to state contracts.

In its response, NEFWC acknowledges that two of the consultant contracts were for lobbying services, which are specifically nonreimbursable costs against NEFWC's state contracts. NEFWC also acknowledges that the individual consultant worked on matters of economic development, which, based on NEFWC's description, appear to be unrelated to NEFWC's state contracts and therefore also represent nonreimbursable costs in accordance with 808 CMR 1.05(12). Based on its response, NEFWC is taking measures to ensure that in the future it will not charge any lobbying expenses against its state contracts.

b. Nonreimbursable Salary Expenses Totaling $454,871

During fiscal years 2010 through 2012, PfC paid NEFWC's chief executive officer (CEO) a total of $454,871 for working full time at NEFWC. On its annual UFRs filed with OSD, NEFWC reported $419,251 of this amount as paid by NEFWC and $35,620 as a portion of the management fees charged by PfC to NEFWC. However, based on our review of NEFWC's records and other publicly available information, we found several problems with this compensation. First, contrary to OSD regulations and NEFWC policies, neither NEFWC nor PfC had any timesheets or other records that adequately supported the hours the CEO worked at NEFWC during this period. Second, the CEO was reported as a full-time employee for more than one affiliate (NEFWC and Corporation for Public Management Inc. [CPM]), and his combined salaries, as reported, exceeded the maximum reimbursable salary amount established by OSD. Finally, contrary to OSD guidelines, NEFWC did not correctly report all of the compensation its CEO received from related organizations when filing its UFR with OSD.

As previously noted, under 808 CMR 1.05(26) any costs that are not adequately documented are nonreimbursable program costs. Despite this requirement and despite NEFWC policies that time records must be kept, NEFWC's CEO did not have any records (e.g., timesheets or activity reports showing how he allocated time to specific functions or organizations) that indicated the hours he worked at NEFWC or the state-funded programs where he provided services. PfC also did not have these records. We asked NEFWC officials about the lack of time records for the CEO and they told us that the CEO did not keep any such records, but they did not provide us with a reason.

Further, we examined the annual UFR filings made by one of NEFWC's related companies, CPM. These documents disclosed that NEFWC's CEO worked full time for CPM and received a total salary of $452,267 as CPM's CEO for the three fiscal years 2010 through 2012. We then examined the NEFWC UFR filings and related records for the same period and determined that the CEO received $454,871 for working full time for NEFWC during this same three-year period. The maximum reimbursable cost for officers and managers at human-service providers is established by OSD in 808 CMR 1.05(24). The maximum to be reimbursed in fiscal years 2010 and 2011 is $149,025.74 and $153,496.51 for fiscal year 2012, a total of $451,548 for the three-year period. Based on the information reported by these two companies, the total of the CEO's reported salaries from CPM and NEFWC during the period in question was $907,138, which exceeds the maximum reimbursable amount.

Finally, we found that contrary to OSD guidance, the total compensation provided to NEFWC's CEO was not properly disclosed in NEFWC's UFRs. Specifically, according to the UFR Audit and Preparation Manual, compensation paid to principals from all related parties and affiliates should be disclosed in the UFR as described below:

> *Compensation to Principals*
>
> *Enter the name, title and all compensation furnished to the filing entity's principals from the filing organization and its parent organization, related parties, and affiliates (most senior individuals first). Hospitals, Colleges and Universities should disclose compensation for the twenty five (25) highest paid and compensated principals.*

However, the UFR filings related to this required compensation disclosure were incomplete because NEFWC's filing for the fiscal years covered by our audit did not disclose the additional compensation the CEO was paid from CPM or any other sources. NEFWC management did not provide an explanation of why the UFRs were filed with the incomplete disclosures.

Auditee Response

NEFWC's comments on this issue are excerpted below.

> *The CEO directs the activities of numerous entities and oversees the administration of numerous programs.*
>
> *. . .*
>
> *1. Documentation of activity*
>
> *Prior to FY 2010 the CEO did use timesheets to help document his time. However, the time sheets did not adequately reflect his activity. The CEO works with community leaders, government officials and religious leaders on multiple interests and projects at all hours of the day and evening. In addition, the CEO is an administrative employee and he is not directly charged to any Federal, State or local grant item. The CEO's activities cannot be broken down and separated into discreet one entity only time periods. To prepare a timesheet under these circumstances did not seem appropriate. Therefore, in FY 2010, based on guidance from an independent Certified Public Accountant, the process of documenting his activity was changed. The CEO now has a very detailed daily schedule that is maintained by employees of PFC. It documents most of his meetings, appointments and destinations. It documents 10 to 14 hour days and additional time worked on weekends. In addition, because a significant issue with administrative personnel is time not worked through vacation and sick time, including the ability to accumulate compensatory time and receive large payments upon separation, the CEO is required to sign off on all time not worked and to submit a written memo to the personnel department. . . .*
>
> *2. Full time work.*
>
> *The CEO did not work full time for NEFWC. The CEO worked full time for PFC. PFC provided management services for NEFWC and all the affiliated companies. The CEO's duties included managing and directing the affairs of both NEFWC and CPM and the other affiliated entities. His responsibilities can be compared to a Superintendent of Schools who supervises many schools at the same time. The CEO's duties to NEFWC and to CPM are concurrent. He discharges them simultaneously. His time devoted to each entity cannot be dissected or split apart. His efforts are coterminous.*

The CEO is paid directly by PFC. The CEO receives no direct compensation from NEFWC or CPM or the other companies. . . .

. . .

3. Disclosure of Compensation

As discussed above, Partners for Community, the entity that actually pays the CEO, does not file a UFR because it is a management services organization. NEFWC adopted a process for filing the UFRs and disclosing CEO compensation after consultation with OSD. If this process is inadequate, NEFWC will revise its reporting in this area. The total compensation provided to the CEO was fully disclosed in the combined UFRs filed by NEFWC and its affiliated companies. Further, the related IRS Form 990 filed by Partners For Community disclosed the full compensation.

Auditor's Reply

As noted above, under 808 CMR 1.05(26) any costs that are not adequately documented are nonreimbursable program costs to NEFWC's state contracts. Despite this requirement, during our audit, NEFWC did not provide OSA with any records that adequately supported the one full-time equivalent position it that it reported that the CEO filled for NEFWC. PfC also did not have these records. With its response, NEFWC provided examples of various appointment calendars maintained for the CEO to support the time he worked at NEFWC during our audit period. However, these calendars were incomplete; they only accounted for partial activity (e.g., only accounting for two hours per day of meetings or meetings pertaining to non-state-related business), not the actual hours he worked at NEFWC, and therefore were inadequate. Further, with its response, NEFWC also provided timesheets for the CEO covering the period July 2009 through December 2009, as well as documents that NEFWC said were his activity logs. However, the timesheets provided only indicated a time in / time out for the CEO and did not indicate the number of hours he worked for NEFWC. The activity logs were also incomplete.

While we acknowledge that NEFWC's CEO was an employee of PfC, this did not relieve NEFWC of its responsibility to adequately document the time this individual worked at the agency either through the use of a timesheet or through some other form of attendance record, particularly since NEFWC was being billed for this individual's services by a related party and charging these expenses to its state contracts.

Based on its response, NEFWC is taking measures to address some of these problems. In order to do so, NEFWC needs to ensure that it maintains adequate documentation to substantiate the time its CEO spends working at the agency and that it complies with OSD's recordkeeping, executive compensation payment, and reporting requirements.

c. Nonreimbursable Travel Allowance Payments Totaling $32,377

NEFWC used $32,377 in state funding for travel allowance costs for the CEO (which it gave him in lieu of a company-provided car) that were nonreimbursable according to OSD regulations. In addition, we determined that the provision of travel allowance in lieu of a car was not supported by an employment contract approved by NEFWC's board of directors. Further, this benefit was erroneously not reported to the Internal Revenue Service (IRS) in calendar years 2009 and 2010 as required by the IRS.

The CEO received a flat monthly travel allowance of $1,400 per month for the three fiscal years 2010 through 2012, for a total of $50,400. Of this total amount, NEFWC paid $32,377 ($16,800 directly and $15,577 as part of PfC management fees) of this expense.

According to 808 CMR 1.05(9), fringe benefits that are either excessive or not available to all employees under an established policy are nonreimbursable. Additionally, 808 CMR 1.05(26) states that undocumented costs are nonreimbursable.

We determined that this benefit was not available to all of NEFWC's employees under an established agency policy, that it was not provided for in the CEO's employment contract, and that there was no documentation (e.g., board minutes) to substantiate that it was formally approved by NEFWC's or PfC's board of directors. Therefore, this $32,377 represents nonreimbursable charges against NEFWC's state contracts.

In addition, IRS Publication 15-B, the Employer's Tax Guide to Fringe Benefits, states, in part,

> *Any fringe benefit you [the employer] provide is taxable and must be included in the recipient's pay unless the law specifically excludes it.*

Therefore, NEFWC should have reported this benefit to the IRS.

Auditee Response

NEFWC's comments on this issue are excerpted below.

> *The monthly allowance was reasonable and not excessive and was consistent with benefits provide[d to] other CEOs across the country.*
>
> 1. *Executive Compensation review.*
>
> *In 2008 Partners For Community commissioned a study by Grant Thornton, LLP to help determine reasonable compensation for the CEO. This study included recommendations for base salary and supplemental benefits such as travel allowances, club memberships, home office equipment and other items. Thereafter it was decided to provide a monthly allowance to the CEO to reimburse him for his expenses including not just travel, but club memberships, home office equipment and other supplemental benefits. For example, the CEO pays for a membership in the Colony Club and at Springfield Country Club. At these locations he can meet with business leaders and potential donors and economic developers. The PFC compensation committee considered such an allowance to be reasonable and consistent with comparable compensation practices elsewhere in the country. Although other employees are not provided a similar monthly allowance, no other employee has similar demands and responsibilities. However, other employees are allowed reimbursement for travel and other expenditures. . . .*
>
> 2. *Allowance in lieu of a car.*
>
> *The decision to have a monthly allowance, rather than a car, was based in part on the fact that the allowance provided is more extensive than mere travel and more consistent with the demands made on the CEO. Another consideration was the difficulty frequently encountered in deciding how to divide business from personal use of a car. Another factor was the audit done by the Office of the Auditor in 2002 and the concerns expressed about providing cars to administrative staff.*

Auditor's Reply

The issue with this benefit, as stated above, is that contrary to 808 CMR 1.05(9), the benefit was not available to all of NEFWC's employees under an established agency policy, it was not provided for in the CEO's employment contract, and there was no documentation (e.g., board minutes) to substantiate that it was formally approved by NEFWC's or PfC's board of directors. Therefore, this $32,377 represents nonreimbursable charges against NEFWC's state contracts. If NEFWC wants to provide this benefit to its CEO because of the additional demands placed upon him, it should make sure that it does so in accordance with OSD regulations or does not use state funding to pay for this benefit.

d. Nonreimbursable Loan Expenses of $35,750

NEFWC used $35,750 in state funding for expenses associated with a $250,000 unsecured loan that it obtained from an individual that were nonreimbursable in accordance with OSD regulations. This $35,750 is the interest on the portion of the loan that was used to purchase a building that was not used in any of NEFWC's state-funded programs.

OSD regulation 808 CMR 1.05(12) states that expenses not directly related to a contractor's social-service program purposes are nonreimbursable.

On September 29, 2008, NEFWC borrowed $250,000 from a private individual at a rate of 10% on an unsecured[5] loan. During our audit, NEFWC management did not comment on why they did not seek out lower-cost bank financing. NEFWC used $130,000 of the loan to help purchase a building at 1665 Main Street, Springfield (known as the Board of Trade Building), and used the remaining $120,000 for working capital. NEFWC paid a total of $68,750 in interest costs associated with this loan, $52,250 of which it charged to its state contracts.

Based on the uses of the borrowed funds, we determined that of the amount charged to state contracts, $35,750 was attributable to purchasing the building, which was not related to NEFWC's social-service programs, so this $35,750 represents nonreimbursable costs.

Auditee Response

NEFWC's comments on this issue are excerpted below.

> *This transaction was a joint venture with the Latino Chamber of Commerce and helped to promote the economic development of the City of Springfield in general, and the North End in particular, consistent with NEFWC's mission. The unsecured loan was needed to cover the 20% down payment and some improvements (paving the parking lot). Originally, the seller was going to provide the 20%. Hampden Bank was going to provide 80% of the purchase price, but no more than 80%, as a secured loan. However, at the last moment the seller would not provide the 20%. Therefore, NEFWC had to obtain an unsecured loan in order to save the deal.*

[5] An unsecured loan is a loan that does not have specific collateral (e.g., real estate, vehicles) that the lender can take in case of nonpayment of the loan.

Auditor's Reply

As noted above, we determined that $35,750 of the amount we are questioning was attributable to purchasing a building, which was not related to NEFWC's social-service programs, so this $35,750 represents nonreimbursable costs.

e. Nonreimbursable Restaurant Expenses of $11,692

NEFWC charged $11,692 of costs to the Commonwealth for charges at a local restaurant that were nonreimbursable according to OSD regulations because they were inadequately documented and/or non-program-related. NEFWC paid $726 of this amount directly, and the remaining $10,966 was paid through NEFWC's portion of management fees.

According to 808 CMR 1.05(26), undocumented costs are nonreimbursable; in addition, 808 CMR 1.05(12) states that non-program-related expenses are nonreimbursable.

According to PfC and NEFWC records, during our audit period 67 monthly invoices, totaling $45,499, were paid for this local restaurant. The monthly invoices provided a summary of each restaurant check total and date charged, but other source-document support (e.g., what was purchased, who was present, and what was the purpose of the charge) was not available. We judgmentally selected 15 transactions, totaling $26,554, to determine whether the disbursements had proper authorization, had supporting documentation, and were related to NEFWC's social-service programs. Our testing determined that no supporting documents were available to show what was purchased, what the time of the purchase was, and who attended. Instead, payments are made based on monthly invoices provided by the vendor, but neither PfC nor NEFWC reconciles these monthly invoices to original source documents (restaurant checks). As a result, these transactions are nonreimbursable, since they are not sufficiently documented and NEFWC cannot prove that they are program related.

Auditee Response

NEFWC's comments on this issue are excerpted below.

> *NEFWC agrees with the preliminary report that the monthly invoices are not reconciled to the original source documents. NEFWC intends, therefore, to revise its procedure to ensure that all future transactions are sufficiently reconciled and documented.*

1. <u>Monthly Invoices.</u>

The charges at the local restaurant were documented by the monthly invoices which provide a summary of each restaurant check total and the date charged. NEFWC agrees that additional documentation with other source documents was not recorded.

2. <u>Program related.</u>

In order to survive in a challenging financial environment non-profit companies have to develop independent sources of revenue. To promote economic development NEFWC must establish relationships with business leaders and private donors. A great deal of time and effort pursuing these goals occurs in non-business locales. The CEO often conducts business over lunch or after hours as necessary. . . . Such public relations activities are an important part of the job and can result in successful fundraising opportunities. . . .

Auditor's Reply

Summaries of expenses do not provide adequate documentation because they lack the detail necessary to document that the expenses were reasonable and allowable in accordance with OSD regulations. While we recognize that some restaurant-related expenses may be appropriate, NEFWC should ensure that it maintains adequate documentation to substantiate that expenses such as these represent reimbursable expenses under NEFWC's state contracts.

f. Nonreimbursable Repair and Maintenance Expenses Totaling $41,495

NEFWC used $41,495 in state funding for what was identified on NEFWC's general ledger as repair and maintenance costs. These items were nonreimbursable according to OSD regulations because they were inadequately documented, not related to NEFWC's state-funded programs, or not properly accounted for in the agency's accounting records.

According to 808 CMR 1.05(26), undocumented costs are nonreimbursable; in addition, 808 CMR 1.05(12) states that non-program-related expenses are nonreimbursable.

Part of the $41,495 was reimbursement for six disbursements that NEFWC made in fiscal year 2010, totaling $15,000, that were undocumented and therefore nonreimbursable. NEFWC made these payments to its related party Brightwood Development Corporation (BDC) and classified them in its accounting records as janitorial services, rent, and staff vehicle fees. We asked for additional supporting documents and were told that nothing more was available and that these payments were related to a grant agreement NEFWC had with BDC to help BDC to continue its mission of economic development in the Brightwood section of Springfield. However, according to NEFWC's chief financial officer (CFO), no written grant agreement exists and NEFWC does not monitor BDC's use of the funding.

The remaining $26,495 pertains to four items that were each valued at over $5,000 and were expensed when they should have been capitalized in accordance with OSD regulations and PfC policies. According to supporting documents, these were expenses for items such as roof repairs, air-conditioning replacement, and bathroom renovations. OSD has defined a capital item in 808 CMR 1.02 as an item or group of related items costing $500 or more with a useful life of more than one year. Capital items must be capitalized and depreciated over their useful lives rather than expensed in the year in which they were purchased. PfC policies set that dollar limit at $2,500 rather than the state-required $500, but these items still should have been capitalized under either criterion.

Auditee Response

NEFWC's comments on this issue are excerpted below.

> *1. Brightwood Development Corporation (BDC).*
>
> *BDC is a Community Development Corporation located in the North End of Springfield. The North End is comprised of two neighborhoods: Memorial Square and Brightwood. Both of these neighborhoods are distressed areas with over 40% of the population living below the poverty level. . . .*
>
> *When the City of Springfield CDBG funding for BDC was substantially reduced and then eliminated, NEFWC believed that it was imperative to help Brightwood in order to keep the doors of the agency open. Other public service agencies, such as the Spanish American Union and the Hungry Hill CDC, lost funding and did not survive and no longer exist. Therefore, to assist BDC to survive, NEFWC agreed to provide a small amount of monetary support. NEFWC would normally provide that support under its economic development activities funded in part by the Commonwealth of MA Earmark funds. The Scope of Service for this contract refers to a subcontract agreement between NEFWC and BDC. Unfortunately, NEFWC did not receive these funds during FY 10 and FY 11 and as a result any support to BDC was funded through regular NEFWC accounts. These payments were classified as janitorial services, rent and vehicle expenses when it would have been more accurate to report such costs under the account for Subcontracts. . . .*
>
> *The support provided to BDC is consistent with the NEFWC's lawful purposes as set forth in the Articles of Incorporation. Such purposes include ". . . to form, aid, assist, direct and/or support other organizations, institutions, agencies, societies, corporations. . . ." NEFWC's support of BDC allowed it to continue as a much needed organization and positioned it to participate with NEFWC in the $14 million Borinquen low income housing project and the proposed Memorial Square low income housing project.*

2. <u>Repairs and renovations.</u>

NEFWC believes that the $26,495 in expenses for repairs and renovations did not need to be capitalized because they did not contribute to the extension of the useful life of the asset. $9,750 of these costs related to a tenant (Springfield Fuel Assistance Program) build-out expense for new space in a different location to provide a more convenient and improved location for program participants. This build-out was approved and funded by Federal LIHEAP funds administered by the MA Department of Housing and Community Development. The program services over 10,000 families. The renovations were necessary to be in compliance with program regulations relating to the Americans with Disabilities Act. The renovations were made to make the bathrooms handicapped accessible. These expenses, while necessary and helpful to the tenant, are not betterment to the property and should not be capitalized. Additionally, they are funded with a grant and could not be allocated through depreciation to the program because that would be a duplication of costs.

Auditor's Reply

We do not dispute NEFWC's assertion that providing funding to this project may have been a good business decision. However, it was not appropriate to use state funds for this purpose, since state-funded consumers were not directly benefiting from this activity. We are not questioning the lawful purpose of the transactions, but rather stating that because these transactions were either undocumented or not related to NEFWC's state-funded programs, they are nonreimbursable in accordance with OSD regulations.

Regarding the accounting for these costs, based on the nature and amount of these expenses, OSA believes that the cost of these items should have been capitalized and depreciated over their useful lives in accordance with OSD regulations and PfC policies.

g. Nonreimbursable Conference and Lodging Expenses Totaling $20,261

NEFWC used $20,261 in state funding for conference and lodging costs that were nonreimbursable according to OSD regulations because they were either not documented or not directly related to NEFWC's social-service program purposes.

According to 808 CMR 1.05(26), undocumented costs are nonreimbursable; in addition, 808 CMR 1.05(12) states that non-program-related expenses are nonreimbursable.

Our audit testing identified $10,640 of expenses that were undocumented and $9,621 of expenses that did not appear to be program related. Examples of the latter include $2,375 for a trip to North Carolina; $2,325 for the CEO and another individual to go to Puerto Rico; and

$2,491 for a trip to Grand Rapids, Michigan. NEFWC officials were unable to provide us with documentation showing why these expenses should be reimbursable.

Auditee Response

NEFWC's comments on this issue are excerpted below.

> 1. *Expenses were related to NEFWC's lawful purposes.*
>
> *Two of the charges the auditor suggests were not program related were for travel to North Carolina and Grand Rapids, Michigan. These two trips were part of the Greater Springfield's City 2 City initiative. City 2 City is an initiative where leadership in one metropolitan area of the United States visits another metro area, linking with their counterparts and learning how they address similar issues with the goal of returning with new tools to advance their home community. The initiative began in November, 2009 with the support of the Community Foundation and the Federal Reserve of Boston. The planning committee was comprised of 14 members including PFC/NEFWC's Chairman, the Executive Directors of the Pioneer Valley Planning Commission and the United Way, the Mayor's Office and representatives from the financial community. PFC/NEFWC participated in the first two city visits: in 2010 to Winston-Salem, North Carolina and in 2011 to Grand Rapids, Michigan. . . . Participation in this initiative is consistent with PFC/NEFWC's mission and social and economic development activities.*
>
> *One expense that was questioned was for travel to Puerto Rico. NEFWC was originally founded in response to the problems facing Puerto Rican farm workers who migrated to the Connecticut Valley to work in the tobacco fields. NEFWC became an outspoken advocate for these migrants and worked to better the living conditions on the farms. While NEFWC's service area and client groups have become more diverse over the years, NEFWC is still known as a Puerto Rican organization and is involved with the issues of this minority group. There is a strong connection between Western MA and the island of Puerto Rico with PFC, CPM (another PFC affiliate) and NEFWC certified to do business in Puerto Rico. NEFWC and its affiliates have been active in development work in Puerto Rico. The trip questioned was part of that development work and certainly program related to PFC/NEFWC's activities. Through this development work, in 2009 PFC received a U.S. Department of Health and Human Services (HHS) JOLI grant for Puerto Rico to develop employment for low income individuals. The development work has also resulted in three HHS grants for Brightwood Development Corporation in Puerto Rico and a Commonwealth of Puerto Rico contract with CPM. . . .*
>
> *. . .*
>
> *PFC's role as a management services organization is to administer programs and provide development activities to its affiliates of which NEFWC is one. Therefore, many of the PFC activities are development oriented and are program related to all affiliates as the affiliates reap benefits from the work.*
>
> 2. *Expenses were documented.*
>
> *The specific cost of $2,471.76 (our AMEX bill indicates $2413.78) relates to AMEX charges associated with the Chairman's trip to Puerto Rico from 5/16/2010 through 5/20/2010 which included work in San Juan meeting with government advisors and*

> *development work with local officials in Caguas and Mayaguez. The outcome was the identification of more opportunities in Mayaguez which is where we have concentrated our efforts. In fact, NEFWC in concert with a private investor purchased a building in Mayaguez which houses the BDC HHS programs. The meetings in San Juan resulted in CJM making a presentation to the PR Department of Corrections for a transitional housing program for incarcerated adults and resulted in Puerto Rican officials visiting Springfield, MA and touring the Hampden County House of Corrections with Sherriff Michael Ashe. A subsequent trip with two Hampden County Sherriff's Department high ranking personnel was made to Puerto Rico to provide technical assistance to the Puerto Rico Department of Corrections. . . .*

Auditor's Reply

We are not questioning whether these expenses are consistent with NEFWC's mission; rather, these costs are nonreimbursable because they were undocumented and, in OSA's opinion, not related to NEFWC's state program activities.

h. Nonreimbursable Legal Fees Totaling $23,188

NEFWC used $23,188 in state funding for legal costs that were nonreimbursable according to OSD regulations because there was inadequate documentation to substantiate that they were related to NEFWC's social-service program purposes. NEFWC paid $20,000 of these expenses directly, and $3,188 was allocated to NEFWC through management fees.

OSD regulation 808 CMR 1.05(26) identifies expenses not directly related to the social-service program purposes of the contractor as nonreimbursable.

We selected 10 disbursements for legal services, totaling $69,248, and identified two questionable payments. The first payment we question was made by NEFWC on March 8, 2012; according to the invoice, it represented $20,000 paid to a Connecticut law firm for services dating back to February 27, 2009, related to "Legal/Tax Advice and the Choice of Entity regarding the purchase of Real Estate." The remainder of the invoice related to providing information regarding allegations made in an anonymous letter about the operations of PfC and its affiliates. The second item we question is $3,188 for a payment, made by PfC and charged to NEFWC, of an invoice dated April 26, 2011 for legal services provided for the purchase of real estate in Mayaguez, Puerto Rico. The invoices for these expenditures only showed total hours and amount paid; they did not indicate that the real estate was used for program purposes.

When we requested justification for the payments, NEFWC's CFO told us he authorized the NEFWC $20,000 payment because it related to the allegations against the companies and the

CEO and that he believed it to be allowable because it affected the general administration of the entities. We were not given an explanation regarding the other payment.

Auditee Response

NEFWC's comments on this issue are excerpted below.

> *[With regard to the $20,000 payment,] NEFWC/PFC properly engaged legal counsel regarding several matters including NEFWC's designation as a 501(c)(3) tax exempt organization, the impact of possible undue compensation or lobbying activities upon such designation, the legality of NEFWC's involvement in for-profit activities such as the Hippodrome and the Hampden Entertainment District, Inc., and the propriety of various real estate transactions. These matters are clearly related to the existence and lawful purposes of NEFWC and its federal tax designation. As your preliminary report references, some of these matters were raised in an anonymous letter. NEFWC would have been derelict in its responsibilities if it failed to consult legal counsel on such matters.*
>
> *. . .*
>
> *[With regard to the $3,188 payment,] In March 2011 NEFWC purchased a building in Mayaguez, Puerto Rico to house several federally funded programs. The law firm based in San Juan provided legal services and advice regarding this purchase. This transaction . . . is part of PFC/ NEFWC's development efforts in Puerto Rico and helps to establish the on-going relationship between Western Massachusetts and Puerto Rico.*

Auditor's Reply

We do not question the need for NEFWC to procure the legal service in question; however, we determined that these costs were not reimbursable because there was inadequate documentation to substantiate that they were directly related to NEFWC's state-funded activities. NEFWC provided some additional documents with its response for our review. However, these documents indicated that these expenses were related to NEFWC's non-state-funded economic development, agency development, or federally funded activities.

Recommendations

- NEFWC should cooperate with OSD in resolving the issues regarding nonreimbursable costs identified in this report and should reimburse the Commonwealth for any such costs that OSD determines must be repaid.

- NEFWC should ensure that it does not use any state funding to pay for costs that are considered nonreimbursable under OSD regulations. Any costs paid for with state funds should be adequately documented and be related to the agency's state-funded activities. All nonreimbursable costs incurred by NEFWC should be disclosed as such in its UFRs in accordance with OSD requirements.

- NEFWC should ensure that, to the extent practicable, it uses a competitive procurement process for all consultant services and should ensure that contracts for such services contain a clearly stated scope of services. It should also identify and prevent lobbyist costs being charged to state contracts.

- NEFWC should ensure that it maintains adequate documentation to substantiate the time its CEO spends working at the agency and comply with OSD's compensation-disclosure requirements when filing its annual UFR. NEFWC, in collaboration with its affiliated agencies, should ensure that the amount of compensation provided to the CEO and reported as paid in its UFRs does not exceed the limit established by OSD regulations.

- NEFWC should ensure that any benefits provided to its CEO are provided consistently with OSD regulations and that any taxable benefits are properly reported.

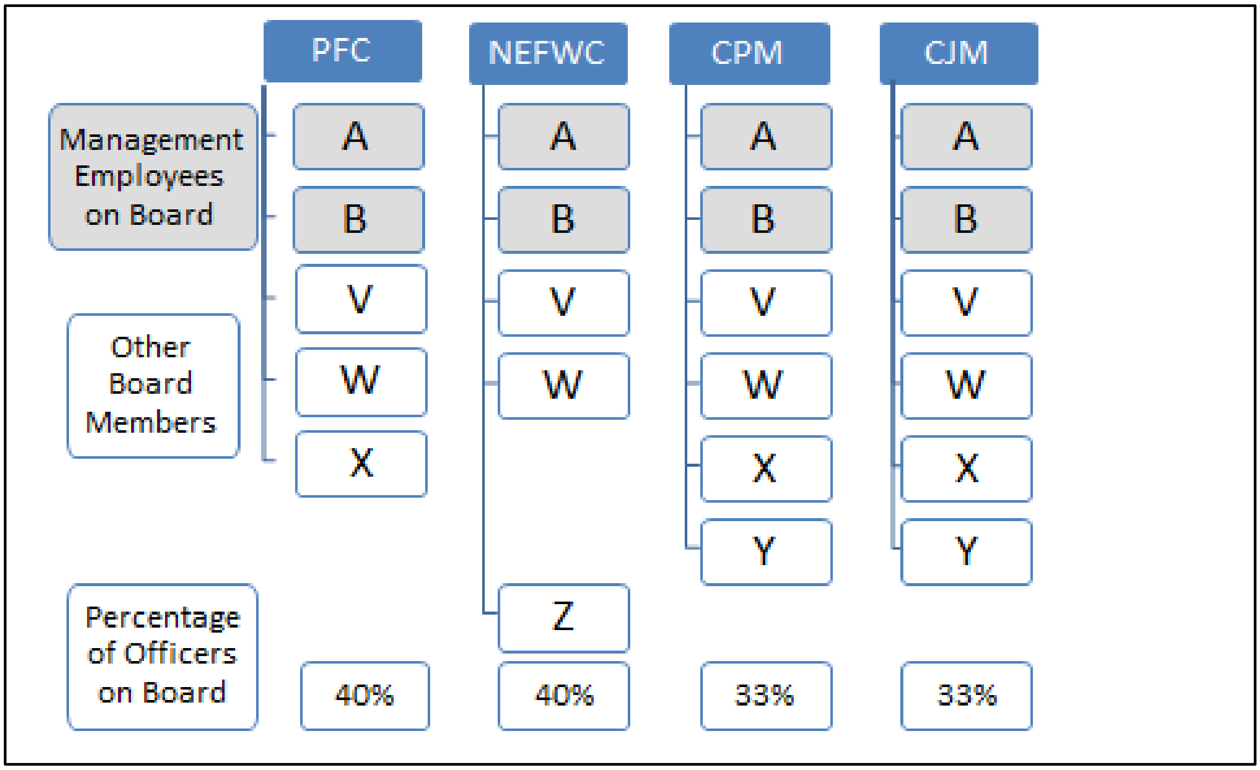
2. NEFWC did not comply with state contract conditions for the composition of its board of directors.

The composition of NEFWC's board of directors did not meet the requirements of the terms and conditions of its state contracts. As a result, NEFWC's board may have been unable to perform its oversight duties and responsibilities in an independent and effective manner.

The board of directors of a human-service provider is the primary organizational body that ensures that an agency meets its operational objectives in the most effective and efficient manner. Board members perform a variety of key fiduciary functions, including overseeing the overall operation of the agency, setting policies and procedures to ensure that agency objectives are met, and hiring the agency's top executive. Chapter 180, Section 6A, of the Massachusetts General Laws, commonly referred to as the Public Charities Law, empowers a not-for-profit organization such as NEFWC to make, amend, and repeal bylaws that prescribe the number, term, powers, and responsibilities of its board of directors, officers, and executive director. Additionally, Section 11(a) of OSD's General Contract Conditions lists the following as standards for a board of directors:

> *. . . the Contractor specifically agrees that: i) members of the Contractor's management and immediate family (as defined in the AICPA's Financial Accounting Standards Board Statement number 57) will not comprise more than 30% of the voting members of the Contractor's board or any of the board's committees or subcommittees. . . .*

Despite this requirement, we found that during our audit period NEFWC's board did not meet the composition requirements of the terms and conditions of its state contracts because 40% of its members were management-level employees of NEFWC. Moreover, we found that our governance concern extended beyond NEFWC's board to its related parties in that all of the related parties shared common board members, with the CEO and CFO of NEFWC also functioning as board members of all NEFWC's related-party organizations, as detailed in the chart below.



KEY:
A: Top management employee who is CEO of the PfC companies
B: Top management employee who is CFO of the PfC companies
V – Z: Various board members

Therefore, NEFWC's board of directors may have lacked the independence necessary to fully meet its oversight responsibilities. In fact, as previously noted, the issues we identified throughout this report are primarily the result of the board's not establishing adequate internal controls over agency activities, particularly those associated with related-party transactions.

Recommendation

NEFWC should comply with the terms and conditions of its state contracts related to the composition of its board of directors. NEFWC and its related parties should consider whether to maintain the current structure, wherein top management employees are voting members of the companies' boards of directors. They should also explore the possibility of expanding each company's board of directors to include more independent members on each individual board, members who are not affiliated with NEFWC or its related parties.

Auditee Response

NEFWC's comments on this issue are excerpted below.

> *NEFWC agrees that it is imperative that it change the composition of the Board to reflect the requirements, terms and conditions of its state contracts. NEFWC will implement this action at the next meeting of its Board of Directors. Also, Partners for Communities will require similar action by all the affiliated companies. In addition, NEFWC, and its affiliated companies, will review and consider the recommendations of the Auditor regarding the practice of shared common board members and take all steps necessary to ensure the independence of the Boards. Further, NEFWC, and the affiliated companies, will explore the possibility of expanding the size of the Board and the composition thereof.*