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INDEPENDENT STATE AUDITOR'S REPORT ON CERTAIN ACTIVITIES OF GOODWILL INDUSTRIES OF THE SPRINGFIELD/HARTFORD AREA, INC. JULY 1, 2000 THROUGH JUNE 30, 2005

OFFICIAL AUDIT REPORT

OCTOBER 31, 2005

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Goodwill Industries of the Springfield/Hartford Area, Inc. (Goodwill) was organized in 1925 to provide for the religious, educational, and industrial welfare of the poor and neglected. In 1942, Goodwill applied for and received Internal Revenue Code Section 501(c)3 status as a not-for-profit organization. Goodwill's current mission is to provide vocational opportunities and independent living skills—through evaluation, training programs, and employment—to people with disabilities and other particular needs. Goodwill provides most of these services at its main location, 285 Dorset Street, Springfield, Massachusetts. During the five-year audit period ended June 30, 2005, Goodwill's operating revenue totaled $44,205,654, of which $13,643,404 (30.8%) was received through contracts with Massachusetts state agencies.

During fiscal year 2005, Goodwill hired a consultant to determine the financial viability of the agency and develop a plan to help the agency achieve fiscal stability. However, after reviewing Goodwill's financial records, the consultant contacted Goodwill's principal state purchasing agency, the Department of Mental Retardation (DMR), regarding issues it had identified during its review. Those issues included (1) the inappropriate use of $1,216,237 in capital funds, which the agency used to cover operating rather than capital expenses, and (2) the agency's approximately $800,000 operating deficit for fiscal year 2004. In response to the consultant's concerns, DMR notified the Office of the State Auditor (OSA) and requested that it conduct an audit of Goodwill. Accordingly, the OSA conducted a limited-scope review of Goodwill.

The scope of our audit included certain administrative and fiscal activities of Goodwill during the period July 1, 2000 to June 30, 2005. Our audit was conducted in accordance with applicable generally accepted government auditing standards for performance audits and included procedures and tests that the OSA considered necessary to meet those standards.

Our objectives consisted of the following:

1. A determination of whether Goodwill has established and implemented adequate and effective management controls over certain selected activities, including policies and procedures to ensure that

   - Internal administrative and accounting controls exist over Goodwill revenues, expenses, and fixed assets
   - Resource use is consistent with laws and regulations
   - Those resources are safeguarded and efficiently used

2. An assessment of some of Goodwill's business practices and activities—including an examination of Goodwill's governance, administrative-compensation and travel expenses, line of credit, staffing patterns, and capital campaign funds—to determine compliance with applicable laws, rules, and regulations, as well as the various fiscal requirements of its state contracts.

We found that during the audit period, two of Goodwill's former Executive Directors received unallowable compensation and fringe benefits totaling $301,217, of which $100,105 was charged against its state contracts.

The consultant hired by Goodwill, independent of our audit, has implemented various operational changes at the agency that have significantly improved its financial condition. As a result, Goodwill projects annual savings from those changes totaling approximately $750,000, and anticipates breaking even on its operations in fiscal year 2005.

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Our audit found that two former Goodwill Executive Directors received unallowable vacation time payments totaling $17,867 during fiscal years 2004 and 2005. These payments, which involved approximately 313 hours of unearned vacation time, were provided immediately following the officials' respective retirement and resignation from the agency. Moreover, these payments, of which $5,961 was allocated to Goodwill's state-funded contracts, violated state regulations and constitute unallowable costs to the Commonwealth.

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Our review found that from July 1, 2000 to July 18, 2003 a former Goodwill Executive Director received unallowable fringe benefit reimbursements totaling $40,591. These reimbursements, which involved employee health, life, dental, and disability insurance and United Way contributions, were provided exclusively to the former Executive Director. Consequently, these payments, of which $11,945 was allocated to Goodwill's state funded contracts, violated state regulations and constitute unallowable costs to the Commonwealth.

3. UNALLOWABLE COMPENSATION TOTALING $242,759 9

Our audit identified that a former Goodwill Executive Director received unallowable compensation totaling $242,759. The payments, which took place from July 1, 2003 to December 31, 2004, resulted from a retirement agreement dated September 26, 2002 between Goodwill and the Executive Director. However, Goodwill was unable to provide documentation to substantiate that the former Executive Director, in return for this compensation, had provided services that directly benefited Goodwill's state-funded programs. As a result, the former Executive Director's retirement compensation, of which $82,199 was allocated to Goodwill's state-funded contracts, constitute a nonreimbursable cost.

INTRODUCTION

Background

Goodwill Industries of the Springfield/Hartford Area, Inc. (Goodwill) was organized in 1925 to provide for the religious, educational and industrial welfare of the poor and neglected. In 1942, Goodwill applied for and received Internal Revenue Code Section 501(c)3 status as a not-for-profit organization. Goodwill's mission is to provide vocational opportunities and independent living skills—through evaluation, training programs, and employment—to people with disabilities and other particular needs. Goodwill provides most of these services at its main location, 285 Dorset Street, Springfield, Massachusetts. During the five-year audit period ended June 30, 2005, Goodwill's operating revenue totaled $44,205,654, of which $13,643,404 (30.8%) was received through contracts with Massachusetts state agencies. The following table details Goodwill's state contract payments during the audit period (fiscal years 2001-2005):

	2001	2002	2003	2004	2005
Dept. of Mental Retardation	$1,569,274	$1,617,410	$1,538,963	$1,548,036	$ 1,624,932
Dept. of Mental Health	29,370	29,568	29,372	29,372	29,980
Mass Commission for the Blind	159,063	104,720	114,519	120,583	106,334
Mass Rehab. Commission	723,580	826,945	665,065	587,543	573,460
Office of Child Care Services	-	211,673	343,233	308,020	288,693
Other MA State Agency POS	265,151	60,000	54,000	54,000	29,165
Dept. of Social Services	100	-	80	-	-
Dept. of Transitional Assistance	-	1,200	-	-	-
Total	$2,746,538	$2,851,516	$2,745,232	$2,647,554	$2,652,564

In 2001, to meet the growing needs of the organization, Goodwill initiated a capital campaign called Pathways to the Future, the purpose of which was to provide necessary capital reserves to support various Goodwill projects, including (1) the expansion, modernization, and reconfiguring of Goodwill's North Campus, 285 Dorset Street, Springfield, Massachusetts, and (2) the renovation of and acquisition of additional equipment for the South Campus, 3580 Main Street, Hartford, Connecticut. The goal of the campaign was to raise $3.2 million, which would enable Goodwill to do the following:

- Construct a 33,000 square foot addition to its North Campus facility

- Modernize, reconfigure, and expand its industrial manufacturing center
- Expand training opportunities for its clients who are among the most disabled and therefore experience barriers to employment
- Create an Education and Training Center, which would allow Goodwill to train 60 additional workers per month
- Increase its facility size by 35% and provide for 110 additional full- and part-time client jobs
- Modernize existing infrastructure—such as the HVAC system, lighting, plumbing, and shipping/receiving—to improve efficiencies and the working environment and achieve a projected 10% in energy savings

Goodwill's fiscal year 2004 independent auditor's review disclosed that the agency's capital campaign funds, rather than being used for purchases of capital items, were being used to bridge cash shortfalls between its operating revenues and operating expenses. Dating to fiscal year 2001, this practice by Goodwill's Executive Director and his predecessor affected capital funds totaling $1,216,237. Following the disclosure, Goodwill's Executive Director resigned from his position effective December 31, 2004. In addition, Goodwill's Board of Directors contracted with an outside consultant to determine the viability of the agency and, if it is found viable, develop a plan to achieve fiscal stability. At the same time, the Board hired an Interim President/CEO to manage the agency's daily activities.

After reviewing Goodwill's financial records, the outside consultant notified the agency's primary state funding agency, the Department of Mental Retardation (DMR), about Goodwill's financial problems, including the inappropriate use of capital funds and approximately $800,000 operating deficit for fiscal year 2004. DMR annually contracts Goodwill to provide residential services, family support, and other services to DMR clients in the Central/Western Massachusetts Region. Goodwill provides residential services to 12 DMR clients, individual support to five clients, employment services to 46 clients, and family-support programs to 124 clients, with an annual maximum obligation of approximately $1.6 million. DMR contracts constitute approximately 22% of Goodwill's revenues.

In response to the consultant's warning, DMR notified the Office of the State Auditor (OSA) about the matter and requested that the OSA investigate or take other appropriate action regarding the management of Goodwill. Accordingly, the OSA conducted a limited-scope review of Goodwill's program operations, including an examination of Goodwill's governance, administrative-compensation and travel expenses, line of credit, staffing patterns, and capital campaign funds.

On June 17, 2005, Goodwill's Board Chairman and Interim President/CEO issued a joint letter to all donors, informing them of Goodwill's situation, stating, in part:

> *The Board of Directors recently learned that, in an attempt to restore cash balances, some fiscal support for operations was allocated from the capital campaign fund. The Board of Directors has taken deliberate actions to strengthen internal controls, has hired an Interim CEO and engaged the services of a Restructuring Officer.*
>
> *The Board is asking if you would consider designating your gift to the capital campaign to be used for programmatic and operational support purposes.*

As of August 11, 2005, Goodwill received responses from 36 donors authorizing Goodwill to use their capital campaign donations totaling $474,916 for programmatic and operational support purposes. After reviewing Goodwill's operations, the consultant instituted changes that significantly improved the agency's financial condition and prospects for survivability. Specifically, the consultant (a) reduced Goodwill's workforce by 28 employees without adversely affecting the level of services purchased by the Commonwealth; (b) consolidated operations and renegotiated existing lease agreements and insurance coverage; (c) eliminated overtime, cell phones and pagers, postage machines, Bingo activities, maintenance service contracts, and certain leased vehicles; and (d) reduced information technology consultants, travel expenses, consumer benefits, and certain maintenance contracts. Moreover, the consultant enhanced Goodwill's revenue streams by (a) increasing tuition and fees, leasing and subletting available office space, and eliminating free clothing vouchers and improving yield on salvage items. According to the consultant's cost-savings and revenue-generating estimates, Goodwill projects annual savings of approximately $750,000.

Audit Scope, Objectives, and Methodology

The scope of our audit included certain administrative and fiscal activities of Goodwill during the period July 1, 2000 to June 30, 2005. Our audit was conducted in accordance with applicable generally accepted government auditing standards for performance audits and included procedures and tests that the OSA considered necessary to meet those standards.

Our objectives consisted of the following:

1. A determination of whether Goodwill has established and implemented adequate and effective management controls, including policies and procedures to ensure that

    - Internal administrative and accounting controls exist over Goodwill revenues, expenses, and fixed assets

    - Resource use is consistent with laws and regulations

    - Those resources are safeguarded and efficiently used

2. An assessment of some of Goodwill's business practices and activities—including an examination of Goodwill's governance, administrative compensation and travel expenses, line of credit, staffing patterns, and capital campaign funds—to determine compliance with applicable laws, rules, and regulations, as well as the various fiscal requirements of its state contracts.

To achieve our audit objectives, we first assessed the system of internal controls established and implemented by Goodwill over its operations. The purpose of that assessment was to obtain an understanding of management's attitude, the control environment, and the flow of transactions through Goodwill's accounting system. We used this assessment in planning and performing our audit tests. We then held discussions with Goodwill officials and reviewed all applicable laws, rules, and regulations. Last, we examined Goodwill's financial statements, budgets, cost reports, invoices, and other pertinent financial records to determine whether expenses incurred under Goodwill's state contracts were reasonable, allowable, allocable, properly authorized, and recorded in compliance with applicable laws, rules, and regulations. Our review of Goodwill's financial activity was limited to the following areas:

- Board of Directors oversight of agency activities

- Compensation, fringe benefits, and travel expenses of the former Executive Director and his predecessor

- Expenditure of capital funds

- Staffing patterns

- Line of credit increases and decreases

Our review was not made for the purpose of forming an opinion on Goodwill's financial statements. We also did not assess the quality of and appropriateness of program services provided by Goodwill through its state-funded contracts. Rather, our report was intended to provide conclusions and recommendations regarding the areas within the scope of our review.

At the conclusion of our audit fieldwork, we provided Goodwill with a copy of our draft audit report for its review and comments. Subsequently, Goodwill's new President and CEO provided us with comments, which are excerpted below:

> *…I have shared the audit findings with our Board of Directors and Senior Management. The audit appears to mirror activities; both programmatic and financial, very closely during the five-year period it covers. I wish to thank you and your team for the concise review, detailed findings and recommendations.*
>
> *I am compiling statements from several members of the Board and the Management Team that led the turn-around effort and subsequent discovery of poor financial and management practices prior to their arrival at Goodwill. We are carefully considering your recommendations of seeking funds from former Presidents, and discussing those options with our legal advisors…*

AUDIT RESULTS

1. UNALLOWABLE VACATION-TIME PAYMENTS TOTALING $17,867

Our audit found that two former Goodwill Executive Directors received unallowable vacation-time payments totaling $17,867 during fiscal years 2004 and 2005. These payments, which involved approximately 313 hours of unearned vacation time, were provided to the officials immediately following the respective officials' retirement and resignation from the agency. Moreover, these payments violated state regulations and constituted unallowable costs to Goodwill's state-funded contracts.

The state's Operational Services Division (OSD), the agency responsible for regulating and overseeing the activities of contracted human-services providers, such as Goodwill, has promulgated 808 Code of Massachusetts Regulations (CMR) 1.00, with which all contracted human-services organizations must comply. The 808 CMR 1.05 (1) and (9), respectively, identify the following costs as nonreimbursable under state contracts:

> *Unreasonable Costs.* *Any costs not determined to be Reimbursable Operating Costs as defined in 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.*
>
> *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. Disparities in benefits among employees attributable to length of service, collective bargaining agreements or regular hours of employment shall not result in the exclusion of such cost.*

Our review of Goodwill's payroll records noted that the agency's Executive Director resigned on December 31, 2004. At that time, his unused vacation time balance, per the agency's records, totaled approximately 294 hours, and he was paid $14,338 for the unused time. However, our review found that his vacation-time balance had been improperly credited approximately 81 hours on January 19, 2001. Without the additional credit, the former Executive Director would have been paid $10,395 for 213 hours of accrued vacation time. Therefore, he was overpaid $3,943.

Similarly, our review found that the former Executive Director's predecessor, who retired from Goodwill effective June 30, 2003, was also compensated for unearned vacation time. According to Goodwill's personnel policies, senior management is allowed to accrue up to four weeks of vacation time per year, or 5.77 hours per pay period. However, contrary to these policies, the former official was accruing vacation time at a rate of 7.23 hours per pay period. In addition, on March 27, 2001, that official's vacation-time balance was improperly credited an additional 150 hours. Therefore, at the time of his retirement, his unused vacation-time balance was overstated by approximately 232 hours, which resulted in an overpayment of $13,924.

According to Goodwill's Director of Human Resources, all vacation time is tracked electronically and employee balances are updated each pay period based on vacation rates specified by the agency's personnel policies and procedures. Moreover, she stated that only the former Vice-President for Financial Services and the agency's former Executive Directors had authority to override the system and manually credit vacation-time balances. However, the Director of Human Resources did not know who had made the questionable credits to the two former Executive Directors' vacation balances.

During fiscal years 2004 and 2005, approximately $5,961 of the $17,867 expended on unallowable vacation payments was allocated by Goodwill to its state programs. Because these payments constitute unreasonable costs and are unallowable fringe benefits, they are costs nonreimbursable by the Commonwealth.

Recommendation

Goodwill should recover from its two former Executive Directors the $5,961 in unallowable fringe benefits provided to them during the period covered by our audit, and should remit that amount to the Commonwealth. Goodwill should take measures to ensure that all agency staff members are provided only the types and level of benefits allowed, in accordance with state regulations and the agency's own policies and procedures.

2. UNALLOWABLE FRINGE-BENEFIT REIMBURSEMENTS TOTALING $40,591

We found that from July 1, 2000 to July 18, 2003, Goodwill's then Executive Director received unallowable fringe benefit reimbursements totaling $40,591. These reimbursements, which involved employee health, life, dental, and disability insurance and United Way contributions, were provided exclusively to the Executive Director. Accordingly, those payments violated state regulations and constituted unallowable costs to Goodwill's state-funded contracts.

The 808 CMR 1.05 (9), promulgated by OSD, identifies the following fringe-benefit costs as nonreimbursable under state contracts:

> *Fringe benefits determined to be excessive in light of salary levels and benefits of other comparable Contractors and fringe benefits to the extent that they are not available to all employees under an established policy of the Contractor. Disparities in benefits among employees attributable to length of service, collective bargaining agreements or regular hours of employment shall not result in the exclusion of such costs.*

According to Goodwill's payroll records, from July 1, 2000 to July 18, 2003 the Executive Director participated in Goodwill's optional fringe benefit plan, which the agency made available to all its employees, and he contributed approximately $510 per pay period toward the cost of his health benefits and charitable contributions. However, unlike all other Goodwill employees, the Executive Director was reimbursed for the costs associated with those fringe benefits, a total of $40,591 during the audit period. Because Goodwill did not provide this benefit to all of its employees, the reimbursements to the Executive Director constituted nonreimbursable costs in accordance with 808 CMR 1.05 (9). The following table details the unallowable fringe-benefit reimbursements:

Fiscal Year	Unallowable Reimbursements
2001	$13,275
2002	13,275
2003	13,275
2004	766
Total	$40,591

Our review of the Executive Director's personnel file found no official authorization for those reimbursements. However, Goodwill's payroll clerk stated that the reimbursements would have occurred only with proper authorization from the agency's Vice-President for Financial Services. In addition, Goodwill's Board Chairman stated that the Executive Director was compensated less than the leaders of other Goodwill agencies, and so Goodwill's Board might have decided to reimburse him for a portion of his benefits. The Board Chairman, however, could not provide documentation to support that possibility.

During the period in question, $11,945 of the $40,591 in unallowable fringe-benefit costs was allocated by Goodwill to its state programs; accordingly, that amount constitutes a cost that is nonreimbursable by the Commonwealth.

Recommendation

Goodwill, at a minimum, should recover from the former Executive Director the $11,945 in state funds that it used to provide unallowable fringe benefits, and should remit those funds to the Commonwealth. Goodwill should also review that Executive Director's payroll records for the periods prior to our audit period and determine whether additional state funds were expended improperly. If so, those funds should also be recovered from the Executive Director and remitted to the Commonwealth. Moreover, Goodwill should amend its personnel policies to ensure that all changes to employee compensation and fringe benefits are properly authorized and documented within the agency's personnel records.

3. UNALLOWABLE COMPENSATION TOTALING $242,759

Our audit found that a former Goodwill Executive Director had received unallowable compensation totaling $242,759 during his tenure. The payments, which took place from July 1, 2003 to December 31, 2004, resulted from a retirement agreement dated September 26, 2002 between Goodwill and the Executive Director. However, Goodwill was unable to provide documentation to substantiate that the Executive Director, in return for this compensation, had provided services directly benefiting Goodwill's state-funded programs. As a result, that compensation constitutes costs that are nonreimbursable by the Commonwealth.

The 808 CMR 1.05 (1), (9), (12), and (26), promulgated by OSD, respectively identify the following as nonreimbursable costs under state contracts:

> *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 the Commonwealth.*
>
> *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. Disparities in benefits among employees attributable to length of service, collective bargaining agreements or regular hours of employment shall not result in the exclusion of such costs.*

> *Non-Program Expenses.* *Expenses of the Contractor which are not directly related to the social service Program purposes of the Contractor.*
>
> *Undocumented Expenses.* *Costs which are not adequately documented in the light of the American Institute of Certified Public Accountants statements on auditing standards for evidential matters.*

During our audit, we found that the Executive Director's compensation, which the agency had billed against its state contracts, was not in compliance with those regulations.

On September 26, 2002, Goodwill's Board of Directors entered into a retirement agreement whereby the Executive Director would be provided a supplemental compensation package upon his retirement on June 30, 2003. Although that agreement required the Executive Director to relinquish his duties as Executive Director, the agreement provided that he be available to the Board of Directors in a consulting/advisory capacity.

Under the "Supplemental Compensation and Benefit Program" provision, the retirement agreement states, in part:

> *On June 23, 2003, a new President/CEO will be engaged, and [the former Executive Director] will retire and be available to the board of directors in a consulting/advisory capacity. He will conduct projects and provide advice and counsel to the Board from time to time….*
>
> *[The former Executive Director] will not be involved in the day-to-day operations of Goodwill and will not maintain an office at the Goodwill facility. He will be retained in this capacity through June 30, 2005. [His] compensation as a consultant/advisor will be $2,917.00 per month and will commence on July 1, 2003. [He] will be provided a supplementary lump sum payment of $175,000.00 payable in equal installments ($87,500.00) in July 2003 and July 2004.*
>
> *Health (family medical/dental, health flexible spending account) and life insurance benefits, commensurate with those in place prior to retirement, utilizing the same cost sharing formula will be provided….*

During our audit, we determined that the compensation and fringe-benefits package provided to the Executive Director violated state regulations and resulted in unallowable charges to the Commonwealth totaling $82,199, as follows:

- From July 18, 2003 to December 17, 2004, Goodwill paid its former Executive Director $50,640 under the terms of his retirement agreement. However, our review found that following his retirement he did not provide any consulting services to the Board and did not work on any special projects for the agency or attend any Board meetings. Moreover, Goodwill's Director of Financial Services could not locate any documentation to support that the former Executive Director had provided any services following his retirement. Consequently, based on state regulations, the $50,640 paid to him was an unreasonable, non-program, and undocumented expense—and thus a nonreimbursable cost to the Commonwealth.

- During fiscal years 2004 and 2005, Goodwill also provided its former Executive Director four lump-sum retirement payments totaling $175,000, as well as $17,119 toward his fringe-benefit costs. Goodwill provided these payments in consideration of his years of service and superior performance. However, under state regulations, such retirement payments, which Goodwill did not make available to all its employees, are considered excessive fringe benefits and are thus costs nonreimbursable by the Commonwealth.

On December 23, 2004, after learning of Goodwill's financial difficulties, the Board Chairman notified the former Executive Director that the agency would no longer honor the financial terms of the retirement agreement. Specifically, Goodwill discontinued all consulting and fringe-benefit payments to its former Executive Director. The Chairman's action resulted in cost savings to Goodwill totaling approximately $21,919.

During the period in question, $82,199 of the $242,759 paid to the former Executive Director under the retirement agreement was allocated by Goodwill to its state programs. Because those payments constitute unreasonable and non-program expenses, they are nonreimbursable by the Commonwealth.

Recommendation

Goodwill, at a minimum, should recover the $82,199 in nonreimbursable costs from its former Executive Director and remit the collected amount to the Commonwealth.