

INVESTIGATIVE AUDIT REPORT

**SOUTHWEST HUMAN RESOURCE AGENCY
JULY 1, 2005, THROUGH JUNE 30, 2006**



State of Tennessee



**Comptroller of the Treasury
Department of Audit
Division of Municipal Audit**



STATE OF TENNESSEE

John G. Morgan

C O M P T R O L L E R O F T H E T R E A S U R Y

Comptroller

STATE CAPITOL

NASHVILLE, TENNESSEE 37243-0260

PHONE (615) 741-2501

September 24, 2007

Mr. Mike Smith, Executive Director
and Members of the Policy Council and Workforce
Investment Act Board Executive Committee
Southwest Human Resource Agency
P. O. Box 264
Henderson, TN 38340

Ladies and Gentlemen:

We have completed our investigative audit of selected records of the Southwest Human Resource Agency related to grants administered by Southwest under the Workforce Investment Act (WIA). The audit focused on the period July 1, 2005, through June 30, 2006, and was limited primarily to an examination of contracts, claims for reimbursement, and other documentation related to Futuristic Concepts, Inc., a private, for-profit service provider receiving WIA grant program funds. However, when warranted, we expanded the scope.

The Comptroller has prescribed a minimum system of recordkeeping for nonprofit agencies, which is detailed in the *Accounting and Financial Reporting for Not-For-Profit Recipients of Grant Funds in Tennessee*. The purpose of our audit was to determine the extent of the entity's compliance with certain laws and regulations, including those in the above-mentioned manual.

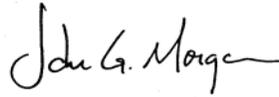
Our investigative audit revealed that Futuristic Concepts, Inc., requested and received grant reimbursements in excess of related amounts actually paid by the contractor. This matter has been referred to the Tennessee Department of Labor and Workforce Development, the local district attorney general, and the state attorney general's office for any additional action they may deem appropriate.

In addition, the findings and recommendations in this report present those conditions that we believe warrant your attention. All responses to each of the findings and recommendations are included in the report.

Members of the Board of Directors
Southwest Human Resource Agency
September 24, 2007

Copies of this report are being forwarded to Governor Phil Bredesen, the State Attorney General, the District Attorney General, certain state legislators, and various other interested parties. A copy is available for public inspection in our office.

Very truly yours,

A handwritten signature in black ink that reads "John G. Morgan". The signature is written in a cursive style. To the right of the signature, there is a vertical red line.

John G. Morgan
Comptroller of the Treasury



**STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF MUNICIPAL AUDIT**

John G. Morgan
Comptroller of the Treasury

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Dennis F. Dycus, CPA, CFE, Director
Division of Municipal Audit

September 24 , 2007

Mr. John G. Morgan
Comptroller of the Treasury
State Capitol
Nashville, TN 37243-0260

Dear Mr. Morgan:

As part of our ongoing process of examining the records of nonprofit organizations, we have completed our investigative audit of selected records of the Southwest Human Resource Agency related to grants administered by Southwest under the Workforce Investment Act (WIA). The audit focused on the period July 1, 2005, through June 30, 2006, and was limited primarily to an examination of contracts, claims for reimbursement, and other documentation related to Futuristic Concepts, Inc., a private, for-profit service provider receiving WIA grant program funds. However, when warranted, we expanded the scope.

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Our investigative audit revealed that Futuristic Concepts, Inc., requested and received grant reimbursements in excess of related amounts actually paid by the contractor. This matter has been referred to the Tennessee Department of Labor and Workforce Development, the local district attorney general, and the state attorney general's office for any additional action they may deem appropriate.

Mr. John G. Morgan
Comptroller of the Treasury
September 24, 2007

Our examination also resulted in findings and recommendations related to the following:

1. Apparent conflicts of interest
2. Failure to determine and enforce performance standards

If after your review, you have any questions, I will be happy to supply any additional information which you may request.

Sincerely,

A handwritten signature in black ink, appearing to read "Dennis F. Dycus". The signature is fluid and cursive, with a large initial "D" and "F".

Dennis F. Dycus, CPA, CFE, Director
Division of Municipal Audit

**INVESTIGATIVE AUDIT OF SELECTED RECORDS OF THE
SOUTHWEST HUMAN RESOURCE AGENCY
FOR THE PERIOD JULY 1, 2005, THROUGH JUNE 30, 2006**

BACKGROUND

History

Southwest Human Resource Agency (SWHRA) entered into various *cost-reimbursement* contracts with Futuristic Concepts Inc., a private, for-profit company based in Lexington, Tennessee, whereby Futuristic Concepts agreed to provide job skills and other training and employment opportunities in Haywood, Henderson, and Decatur Counties. Futuristic Concepts first contracted as a service provider in 2001. The contracts examined during this investigative audit were originally applicable from August 1, 2004, through June 30, 2005, but were extended through September 30, 2006. The terms of the contract set forth certain requirements for recordkeeping, organization, and financial management as presented in the *Financial Management Handbook for Local Workforce Investment Areas*. Included in that handbook was the requirement that all direct costs must be properly classified and reported.

As part of the contract approval process, Futuristic Concepts submitted a budget in which the company indicated that reimbursement would be requested for only certain types of expenses, such as salaries, student books, and supplies. The budget stated that expenses such as the use of classroom facilities, utilities, and equipment would be considered an in-kind contribution.

According to an SWHRA employee and documents reviewed, local workforce investment area (LWIA) contracts with Futuristic Concepts were not renewed after they expired on September 30, 2006, because Futuristic Concepts failed to submit an audit. The audit requirement was an SWHRA policy apparently not previously enforced.

Previous Review by Tennessee Department of Labor and Workforce Development

In April 2005, the Tennessee Department of Labor and Workforce Development, Office of Program Accountability Review, conducted an on-site review of the LWIA program managed by SWHRA. That review resulted in a report with several findings, including the following:

One Youth subcontractor (Futuristic) invoiced the agency for 100% of its monthly personnel cost. Based on information submitted by the subcontractor, only a portion of this cost should have been billed to the agency ... For the period March 2004 through December 2004, LWIA 11, (Southwest Human Resource Agency), paid the subcontractor \$130,433.83. It is likely that fiscal monitoring would have detected billing errors.

In a letter responding to the audit, the LWIA director for SWHRA, Lafayette McKinnie, stated, "We feel no costs are questionable in these subcontracts." Mr. McKinnie further noted in his response that the total salary shown on the copy of the check stub submitted as documentation

was allocated among the several contracts in operation. Mr. McKinnie provided to the Department of Labor and Workforce Development copies of timesheets and check stubs submitted by Futuristic Concepts as backup documentation for the charges incurred. Subsequently, the Department of Labor and Workforce Development allowed the costs previously questioned and approved a plan by SWHRA to improve review of both contractor eligibility and documentation of services delivered.

LEGAL ISSUES

1. **ISSUE:** **Contractor requested and received grant reimbursements in excess of related amounts actually paid by the contractor**

The investigative audit revealed that for the period September 1, 2005, through June 30, 2006, Futuristic Concepts submitted false claims for reimbursement to SWHRA and, as a result, received grant reimbursements in excess of related amounts actually paid. During this period, Futuristic Concepts submitted copies of checks to SWHRA as documentation of payroll expenses claimed for reimbursement. However, none of these checks were processed and charged to the company's bank account. As noted above, the contract was a cost-reimbursement contract, and therefore, only applicable direct and indirect costs should have been claimed.

Apparently false claims related to son of co-owner

The Division of Municipal Audit, Comptroller of the Treasury, obtained information that a Futuristic Concepts employee, whose full-time salary was claimed for reimbursement through LWIA contract grants, was a full-time employee at another private company. We confirmed that the son of one of the co-owners of Futuristic Concepts became a full-time employee of another business on September 6, 2005. According to monthly claims, Futuristic Concepts subsequently requested and received reimbursement from SWHRA for the following net wages purportedly paid to this employee:

| Monthly Claim | Check Date | Check Number | Amount Claimed |
|----------------|------------|--------------|---------------------------|
| September 2005 | 09/16/05 | 4490 | \$ 2,704.37 |
| October 2005 | 10/31/05 | 4526 | 2,704.37 |
| November 2005 | 11/16/05 | 4548 | 2,704.37 |
| December 2005 | 12/15/05 | 4572 | 2,704.37 |
| January 2006 | 01/15/06 | 4607 | 2,033.32 |
| February 2006 | 02/15/06 | 4635 | 2,033.32 |
| March 2006 | 03/31/06 | 4661 | 2,033.32 |
| April 2006 | 04/28/06 | 4700 | 2,033.32 |
| May 2006 | 05/31/06 | 4817 | 2,033.32 |
| June 2006 | 06/30/06 | 4731 | 2,033.32 |
| | | Total | <u>\$23,017.40</u> |

Per statements and documentation offered by Futuristic Concepts owners, the company maintained one bank account for all financial transactions related to the LWIA contracts in Haywood, Henderson, and Decatur counties. Auditors examined copies of bank statements, checks, and other financial records at Futuristic Concepts. These financial records revealed that none of the checks listed above were actually processed and charged to the related bank account of Futuristic Concepts.

Instead, Futuristic Concepts' financial records indicated that for the period September 1, 2005, through June 30, 2006, this employee was actually paid as follows:

| Check Date | Check Number | Net Wages | Gross Wages |
|------------|--------------|-------------------|-------------------|
| 09/01/05 | 4441 | \$ 474.75 | \$ 595.00 |
| 09/09/05 | 4450 | 474.75 | 595.00 |
| 09/19/05 | 4460 | 474.75 | 595.00 |
| 09/24/05 | 4463 | 474.75 | 595.00 |
| 09/29/05 | 4477 | 474.75 | 595.00 |
| 12/07/05 | 4540 | 700.00 | 930.00 |
| 01/25/06 | 4587 | 570.00 | 695.00 |
| 05/17/06 | 4689 | <u>1,200.00</u> | <u>1,679.91</u> |
| | | | |
| | Total | <u>\$4,843.75</u> | <u>\$6,279.91</u> |

Monthly timesheets submitted by Futuristic Concepts throughout this period indicated that the employee worked eight hours per day Monday through Friday, including Memorial Day, Labor Day, and other recognized holidays. His stated duties included those of program trainer and bookkeeper. Several monthly claims also list him as manager.

For the same period, Futuristic Concepts requested and received reimbursement by SWHRA for \$2,450.94 in related payroll taxes. However, bank records indicated that Futuristic Concepts actually paid only \$531.40 in related payroll taxes. Therefore, from September 2005 through June 2006, Futuristic Concepts apparently claimed and received \$18,657.03 more than the company actually paid in salary and payroll tax related to this employee.

Apparently false claims related to co-owners of Futuristic Concepts

Auditors compared payroll-related amounts claimed for reimbursement by Futuristic Concepts with actual checks issued to the two co-owners of the company. For services provided September 2005 through June 2006, Futuristic Concepts apparently claimed and received \$16,603.45 more in grant reimbursements from SWHRA for salaries to the co-owners than the company actually paid. However, as noted previously, Futuristic Concepts was a for-profit company, and as such, it could be argued that the owners chose to leave their "allowable compensation" in the bank account in order to pay expenses.

Other Questioned Reimbursements

Lease of Computer Software

For the period July 2002 through June 2003, Futuristic Concepts requested and received monthly reimbursement of \$1,400 (total of \$16,800) from SWHRA for “lease of computer software.” We were unable to locate any documentation of payment to outside vendors related to this charge. In interviews, the owners of Futuristic Concepts stated that these claims for reimbursement were based on work by Futuristic Concepts staff to adapt previously purchased materials to the LWIA program. However, the audit indicated that related staff salaries were already included in claims for reimbursement.

Student Manuals

A January 2004 claim for reimbursement by Futuristic Concepts for services provided to Henderson County included a \$540 charge for 15 student manuals. The claim included a copy of an invoice from Futuristic Concepts for these manuals and the claim for reimbursement specified that the manuals were purchased from Futuristic Concepts. We were unable to locate any documentation of payment by Futuristic Concepts to outside vendors related to this invoice. In interviews, the owners of Futuristic Concepts stated that the staff of Futuristic Concepts prepared the manuals using the company’s copying machine and binder equipment. However, related staff salaries were apparently already included in claims for reimbursement.

Statements by Futuristic Concepts owners related to false claims for reimbursement

The owners told auditors that SWHRA did not allow Futuristic Concepts to request reimbursement for overhead and other indirect expenses. Therefore, the owners stated they claimed almost all expenses, including the office condo mortgage, dues, and gas for travel, as salaries. The owners insisted that a former employee of SWHRA instructed them to complete claims for reimbursement in this manner. The owners also insisted that the son and other family members donated services to Futuristic Concepts, and that compensation claimed was appropriate even though amounts claimed had not actually been paid to the son.

Futuristic Concepts owners also told auditors that they had previously addressed this issue with SWHRA. The owners provided documentation of grievances filed February 22, 2006, and May 25, 2006. The May 2006 grievance filed with the LWIA board chairman stated:

By directive of the Administrative Staff, Futuristic Concepts can not invoice for items such as employee travel, rent, or expenses. Therefore, this gives an inflated picture of salaries drawn. Futuristic Concepts has pointed out on numerous occasions that this is not a clear indication of the true cost of this program, but due to SWHRA administrative accounting preferences, this is the only way they may pull down the funds. Direct service money is

misrepresented in salaries making the proposed budget appear heavy in salaries. When you consider Futuristic Concepts as a minority owned private business you have to consider that the salaries drawn are then diminished by business expenses.

Conclusion

For the period reviewed, Futuristic Concepts submitted false claims for reimbursement to SWHRA and, as a result, received grant reimbursements in excess of related amounts actually paid. We were unable to obtain adequate information from the grantor as to what amounts were actually eligible to be claimed by Futuristic Concepts for reimbursement. These matters have been referred to the Tennessee Department of Labor and Workforce Development, the local district attorney general, and the state attorney general's office for any additional action they may deem appropriate.

FINDINGS AND RECOMMENDATIONS

1. **FINDING: Apparent conflicts of interest**

The investigative audit revealed that in at least two instances, employees of SWHRA were paid by Futuristic Concepts for agreed-upon work, creating apparent conflicts of interests in violation of SWHRA policy. Documentation examined at SWHRA and Futuristic Concepts indicated that in January 2003, an SWHRA employee signed a contract and received payments totaling \$4,000 from Futuristic Concepts for consulting work though April 2003. The consulting duties included monitoring performance standards and ensuring that all paperwork regarding the LWIA office in Chester County was correct. The owners of Futuristic Concepts said that, at the time, this individual indicated she was performing contract work with SWHRA that was not related to the LWIA program.

The owners of Futuristic Concepts said they terminated their agreement with this individual after April 2003 because the individual did not perform the work according to the terms of the agreement. In October 2003, this individual became youth coordinator at SWHRA and continued to work in that position until she resigned in May 2004. Her duties included monitoring the contract work performed by Futuristic Concepts.

The audit also revealed that in June 2004, another employee of SWHRA was paid \$550 by Futuristic Concepts to enter necessary data to ensure that Futuristic Concepts was credited for all applicable students served by Futuristic Concepts in the Madison County LWIA program. The employee confirmed that she performed data entry for Futuristic Concepts during her off hours because other employees of SWHRA failed to properly enter data into the state computer system.

According to personnel records at SWHRA, both employees signed a statement when hired asserting that they were not employed by any other government entity or agency receiving funds from the state. In that statement, the employees also affirmed:

If during my employment with Southwest Human Resource Agency any circumstances related to any of the above questions change I will immediately disclose such information to my supervisor and immediately submit a new disclosure form indicating that new circumstance.

Auditors located no documentation that these apparent conflicts of interest were addressed by SWHRA management, although the former executive director stated that one of these individual's employment with SWHRA ended after he learned of the apparent conflict.

RECOMMENDATION:

To prevent the "appearance of," as well as possible conflicts of interest that could arise from employees of oversight agencies receiving payments from contractors, SWHRA officials should ensure that all employees are aware of and comply with SWHRA policies and procedures involving outside employment.

MANAGEMENT'S RESPONSE:

SWHRA Policy Council, Executive Committee:

We concur with this finding and in response it is the recommendation of the Southwest Human Resource Agency Board that the conflict of interest policy be enforced by having the board members and all employees sign the conflict of interest form and that it also be a part of each employee's annual job evaluation. At this time, board members have signed the conflict of interest form.

Workforce Investment Act Board, Executive Committee:

In response to the findings and recommendations of the State Comptroller's Office audit, it is the recommendation of the WIA Board that the conflict of interest policy be enforced by having the employees sign the conflict of interest form annually and that a review of conflict of interest become a part of each employee's annual job evaluation.

One executive committee member failed to respond to this finding.

2. **FINDING:** **Failure to determine and enforce performance standards**

SWHRA had insufficient information to determine if Futuristic Concepts or any other contractor fulfilled the performance standards set forth in the grant contracts. The contract extensions covering the period July 1, 2005, through June 30, 2006, specified the number of students to be served by Futuristic Concepts, the number of students expected to complete the training program, and the number of students expected to achieve unsubsidized employment. For the contract period we examined, performance standards were discussed and adopted by the SWHRA LWIA Board. However, SWHRA employees acknowledged that verified performance statistics were never compiled and performance standards were never enforced.

RECOMMENDATION:

To document that contractors are meeting performance standards set forth in grant contract agreements, SWHRA officials should develop and maintain a method to evaluate and document performance results of contracted service providers.

MANAGEMENT'S RESPONSE:

SWHRA Policy Council, Executive Committee:

We concur with this finding and the board has taken steps to evaluate and document services performed by service providers. This will be done quarterly by the WIA Oversight Committee.

Workforce Investment Act Board, Executive Committee:

The board has developed methods to evaluate and document the performance of contracted service providers. This data will be reviewed by the Oversight Committee quarterly.

One executive committee member failed to respond to this finding.

WIA Director:

I agree with the above audit results.