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STATE OF NEW YORK
OFFICE OF THE STATE COMPTROLLER

December 20, 2005

Dr. Virginia Sibbison
Executive Director
Welfare Research, Inc.
112 State Street - Suite 1340
Albany, New York 12207

Re: Internal Controls Over Financial
Operations
Report 2005-S-23

Dear Dr. Sibbison:

Pursuant to the State Comptroller's authority as set forth in Article X, Section 5 of the State Constitution; and Article II, Section 8 of the State Finance Law, we audited the system of internal controls established by Welfare Research, Inc. over its financial operations. Our audit covered the period January 1, 2003 through April 30, 2005.

A. Background

Welfare Research, Inc. (WRI) is a not-for-profit organization that was created in 1967. The primary mission of WRI is to perform research and provide technical assistance for organizations in the human services, health, and education fields. WRI is awarded contracts and grants by these organizations, which include government agencies, not-for-profit entities and private entities. These contracts and grants are WRI's sole source of revenue.

For example, in 2004, WRI had a \$1.1 million contract from the New York City Department of Health and Mental Hygiene (DOHMH) to provide various services in support of mental health programs during that year. This ongoing contract, which was initially awarded in 1994, provides funding for 12 of WRI's 17 staff (all 12 staff are based at DOHMH). WRI also had a contract of nearly \$570,000 from the New York State Office of Children and Family Services (OCFS) to develop program manuals and oversee training consultants over a 15-month period. WRI also had six other small contracts in 2004. WRI is typically paid an administrative fee in its contracts, and this fee revenue is used to cover WRI's administrative costs.

For the year ended December 31, 2004, WRI reported total revenues of \$1,593,768 and total expenditures of \$1,617,516, for a net operating loss of \$23,748. As of December 31, 2004, WRI reported an accumulated deficit of \$192,897. WRI's funding has declined significantly in recent years and in both its 2003 and 2004 audited financial statements, its independent auditor noted that it was uncertain whether WRI would be able to continue as a going concern. WRI's financial prospects improved in 2005 when another large contract was awarded by OCFS. The new contract was approved for \$250,000 and is expected to increase to \$447,000.

WRI is governed by a nine-member Board of Directors (Board). Its day-to-day operations are overseen by an Executive Director, who is also a non-voting member of the Board. Board meetings are scheduled on a quarterly basis. WRI staff are provided with New York State Retirement System benefits. In addition, in accordance with a 1969 amendment to the State Finance Law, WRI and certain other not-for-profit organizations that are closely affiliated with State agencies and whose purposes are essentially to support the functions and programs of those agencies are defined as State agencies in the State Finance Law.

B. Audit Scope, Objective and Methodology

We audited WRI's system of internal control over its financial operations for the period January 1, 2003 through April 30, 2005. The objective of our performance audit was to determine whether the internal controls over basic financial operations are adequate. To accomplish this objective, we interviewed WRI officials and reviewed policies and procedures governing the following significant operations: Board governance, cash management, revenue, payroll, procurement and contracting, budgeting and expenditures, equipment and asset management, and accounting and information systems. We interviewed WRI staff responsible for these financial operations, and performed limited compliance testing to provide assurance that employees are following the established policies and procedures. In particular, we performed tests to determine whether management has established policies and procedures that provide an appropriate level of internal control over basic financial operations, and we performed tests to determine whether WRI employees follow those policies and procedures.

We conducted our audit in accordance with generally accepted government auditing standards. Such standards require that we plan and perform our audit to adequately assess those procedures and operations that are included within the audit scope. Further, these standards require that we understand WRI's internal control structure and its compliance with those laws, rules and regulations that are relevant to the operations included in our audit scope. An audit includes examining, on a test basis, evidence supporting transactions recorded in the accounting and operating records, and applying such other auditing procedures as we consider necessary in the circumstances. An audit also includes assessing the estimates, judgments and decisions made by management. We believe that our audit provides a reasonable basis for our findings, conclusions and recommendations.

In addition to being the State Auditor, the Comptroller performs certain other constitutionally and statutorily-mandated duties as the chief fiscal officer of New York State, several of which are performed by the Division of State Services. These include operating the State's accounting system; preparing the State's financial statements; and approving State contracts, refunds and other payments. In addition, the Comptroller appoints members to certain boards, commissions and public authorities, some of whom have minority voting rights. These duties may be considered management functions for purposes of evaluating organizational independence under generally accepted government auditing standards. In our opinion, these management functions do not affect our ability to conduct independent audits of program performance.

C. Results of Audit

We found that, in the areas of Board governance, cash management, revenue, equipment and asset management, and accounting and information systems, WRI has generally established adequate financial policies and procedures, and WRI employees generally follow those policies and procedures. However, certain procedures need to be improved in the areas of procurement and contracting, payroll, and budgeting and expenditures. Because of weaknesses in these procedures, WRI does not adequately oversee the subcontractors on its two main contracts, does not adequately oversee the 12 employees who are based at DOHMH, and systematically overestimates the administrative fees that are to be earned on its contracts.

1. Procurement and Contracting

In its ongoing contract with OCFS (the Child Welfare Training and Technical Assistance contract), WRI is expected to hire and oversee consultants who provide training programs to case workers in local social services districts statewide. The consultants are to be hired as subcontractors to the Child Welfare and Training Technical Assistance contract. We examined the actions taken by WRI in hiring and overseeing these subcontractors.

We found that WRI hired the subcontractors as expected. However, when selecting subcontractors, we noted that WRI generally accepts at face value recommendations made by OCFS. WRI does not attempt to assess the qualifications of the recommended consultants and does not seek competitive proposals to determine whether the services can be obtained at a lower cost. As a result, we question whether WRI has reasonable assurance the subcontractors are adequately qualified and their prices are the best available.

We also found that WRI does not monitor the performance of the subcontractors to determine whether they are fulfilling their training objectives. The attendees at the training sessions complete evaluations of the sessions, and these evaluations are collected by WRI. However, WRI does not review the evaluations. Rather, WRI passes the evaluations on to OCFS.

OCFS officials told us that they hold WRI responsible for the outcome of the consultant services. We recommend WRI take a more active role in this contract. Specifically, WRI should seek competitive proposals for the training services required under the contract, assess both the quality and the cost of the proposals, and select the proposals that are the best combinations of quality and cost. WRI should then monitor the performance of the subcontractors and take corrective action if it appears that contract objectives are not being adequately met.

In its ongoing contract with DOHMH (the Reinvestment Fund Project contract), WRI is expected to hire and oversee consultants who provide various services in support of mental health programs in New York City. For example, one consultant was hired to provide planning services relating to homeless mentally ill individuals, assist in the application of outcome measures to mental health services, and work with the New York City Police Department to ensure that mentally ill individuals in custody receive appropriate care. The consultants are to be hired as subcontractors to the Reinvestment Fund Project contract. We examined the actions taken by WRI in hiring and overseeing these subcontractors.

We found that WRI hired the subcontractors as expected. However, as was the case with the OCFS contract, WRI generally hired the consultants recommended by DOHMH without assessing their qualifications or seeking competitive proposals. Also, WRI does not monitor the consultants' services to determine whether they are provided in accordance with expectations. We recommend WRI take the same active role in this contract as we recommend for the OCFS contract.

2. Payroll

As was previously noted, 12 of WRI's 17 staff are funded by its contract with DOHMH, and all 12 staff are based at DOHMH. These 12 staff perform various services in support of mental health programs in New York City. They do not hire the subcontractors for the contract, as this is done by WRI staff based in Albany.

We examined WRI's controls over these 12 employees. We found that all 12 were hired by DOHMH and all 12 are managed by DOHMH without WRI review or approval. For example, the employees' time and attendance records are reviewed and approved by DOHMH supervisors, and are sent to WRI only to enable the employees' paychecks to be processed. WRI officials do not review the work that is performed by the employees and are not consulted on the assignments that are given to the employees. In effect, WRI serves only as a payroll service for these 12 employees.

If modifications are not made in the relationship between WRI and these 12 staff positions, we question whether the positions can properly be regarded as belonging to WRI. Rather, the positions appear to belong to DOHMH. If the positions do in fact belong to WRI, we recommend WRI assert some control and authority over the positions. In particular, we recommend WRI arrange with DOHMH to receive regular (e.g., monthly) reports describing the work being performed by the employees, and either approve the assignments or take follow-up action when assignments do not appear to be appropriate. We also recommend that a WRI manager make periodic visits to DOHMH to verify that assignments are being performed as reported.

3. Budgeting and Expenditure Control

In each of its contracts, WRI is paid an administrative fee that is intended cover its administrative and overhead expenses (such as the salary of the Executive Director, the salary of the Financial Manager, office rental expenses, and office equipment). This fee is a certain percentage of the expenditures that are actually made under the contract. For example, in the DOHMH contract, the administrative fee is 10 percent of contract expenditures; in the ongoing OCFS contract, the fee is 8 percent of contract expenditures.

Each year, WRI develops an operating budget. As part of this budgeting process, WRI officials estimate the amount of administrative fee revenue that is likely to be earned in the upcoming year, and budget their administrative expenses accordingly. We found that, in developing this estimate, WRI officials simply apply the administrative fee percentage in each contract to the total budgeted expenses for that contract. However, in 2003 and 2004, the amount expended during the year on WRI's contracts was usually less than the amount that was

budgeted at the beginning of the year. As a result, in those two years, WRI earned significantly less administrative fee revenue than it estimated.

For example, WRI estimated it would receive \$158,837 in administrative fees in 2004, and budgeted accordingly. However, it actually received only \$137,484. Similarly, WRI estimated it would receive \$193,271 in administrative fees in 2003, but received only \$132,072. Thus, for these two years alone, WRI overestimated its administrative fee revenue by a total of \$82,553.

WRI's Financial Manager and Executive Director monitor the progress of each contract. If it appears that the contracting agency is not requesting the full scope of work under the contract, and total expenditures are likely to be less than budgeted, WRI will contact the agency to learn why the funds are not being spent. However, WRI officials are not in a position to mandate full spending on their contracts.

In response to its growing operating deficit, which totaled \$192,897 as of December 31, 2004, WRI's Executive Director retired in August 2004 and was re-hired on a reduced work schedule at 20 percent of her previous salary. WRI officials believe that, with this reduction in administrative costs and the commencement of the new OCFS contract, WRI will begin to reduce its deficit. When WRI's financial position has improved, the Executive Director will retire for good and a new Executive Director will be hired on a full-time basis.

We believe that WRI has taken positive steps to control its operating costs. However, WRI officials in large part attribute the deficit to the frequent shortfalls in administrative fees. To prevent such shortfalls in the future, we recommend WRI develop more accurate estimates for its administrative fees. Specifically, WRI should stop assuming that all budgeted contract amounts will be expended by the contracting agencies. Rather, WRI should review past expenditure levels on each contract and estimate future spending on the basis of past spending. WRI should also attempt to negotiate a minimum guaranteed administrative fee on each contract.

Recommendations

- 1. In the Child Welfare and Training Technical Assistance contract with OCFS and the Reinvestment Fund Project contract with DOHMH, seek competitive proposals for the consultant services required under the contracts, assess both the quality and the cost of the proposals, and select the proposals that are the best combinations of quality and cost. In addition, monitor the performance of the subcontractors and take corrective action if it appears that contract objectives are not being adequately met.*
- 2. Arrange with DOHMH to receive regular (e.g., monthly) reports describing the work being performed by the 12 employees who are based at DOHMH. Review these reports and either approve the employees' assignments or take follow-up action when assignments do not appear to be appropriate. Document both the approval and any follow-up action. In addition, have a WRI manager make periodic visits to DOHMH to verify that assignments are being performed as reported.*

3. *When estimating administrative fees for budgeting purposes, do not assume that all budgeted contract amounts will be expended by the contracting agencies. Rather, review past expenditure levels on each contract and estimate future spending on the basis of past spending. In addition, attempt to negotiate a minimum guaranteed administrative fee on each contract.*

A draft copy of this report was provided to WRI officials for their review and comment. Their comments have been considered in preparing this report, and are included as Appendix A. WRI officials agree with our recommendations and are taking steps to improve internal controls over the administration of its contracts.

Within 90 days after final release of this report, as required by Section 170 of the Executive Law, the Executive Director of Welfare Research, Inc. shall report to the Governor, the State Comptroller and the leaders of the Legislature and fiscal committees, advising what steps were taken to implement the recommendations contained herein, and where recommendations were not implemented, the reasons therefor.

Major contributors to this audit were Richard Sturm, Brian Lotz, Brittany Hayes, Legendre Ambrose, Anthony Calabrese, and Andrew Rosenberry.

We wish to express our appreciation to the management and staff of Welfare Research, Inc. for the courtesies and cooperation extended to our auditors during this audit.

Very truly yours,

William P. Challice
Audit Director

cc: Robert Barnes, Division of the Budget

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December 2, 2005



WRI

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Albany, NY 12236

Re: Internal Controls Over Financial Operations Report 2005-S-23

Dear Mr. Challice:

Welfare Research, Inc. (WRI) has received your audit report covering our financial operations over the period January 1, 2003 through April 30, 2005.

The WRI Board of Directors and staff are pleased that the auditors found that “WRI has generally established adequate financial policies and procedures”; that “WRI employees generally follow those policies and procedures”; and that “WRI has taken positive steps to control its operating costs.”

With regard to the three recommendations contained in the audit report, WRI has the following responses.

Recommendation #1: In the Child Welfare and Training Technical Assistance contract with OCFS and the Reinvestment Fund Project contract with DOHMH, seek competitive proposals for the consultant services required under the contracts, assess both the quality and the cost of the proposals, and select the proposals that are the best combinations of quality and cost. In addition, monitor the performance of the subcontractors and take corrective action if it appears that contract objectives are not being adequately met.

WRI will request OCFS and DOHMH to provide documentation that the entity (local district DSS and/or OCFS and DOHMH) requesting consultant services has either sought competitive proposals when required under State of New York bidding guidelines from at least three well-qualified individuals or organizations, or has provided a substantive sole source justification statement if the competitive bid process is not followed. WRI will review these processes (multiple bids or sole source contract) and advise OCFS and DOHMH if they are not being followed in an appropriate manner and/or if the best combination of quality and cost has not been selected. Currently,

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WRI monitors the performance of the OCFS consultants through the distribution and collection of evaluation forms; these evaluation forms, provided by participants in training and technical assistance sessions, enable WRI to know if the service was actually provided, and OCFS to determine if the service was sufficiently satisfactory to continue use of the consultant.

Recommendation #2: Arrange with DOHMH to receive regular (e.g., monthly) reports describing the work being performed by the 12 employees who are based at DOHMH. Review these and either approve the employees' assignments or take follow-up action when assignments do not appear to be appropriate. Document both the approval and any follow-up action. In addition, have a WRI manager make periodic visits to DOHMH to verify that assignments are being performed as reported.

With regard to individuals funded by the DOHMH contract, DOHMH is now providing WRI with resumes and job descriptions for each person (allowing WRI to assess the experience/competency of each person within the context of the job to be performed). Furthermore, DOHMH has agreed to provide WRI with documentation when/if an individual's job duties change, and to periodically provide WRI with written assurances that staff are 1) performing the job duties for which they were hired, and 2) performing those tasks in a satisfactory manner. WRI will review these written assurances, and note approval and document any follow-up action. In addition, both the WRI Executive Director and the WRI Fiscal Officer will increase the number of visits to DOHMH for further assurances that assignments are being performed as reported.

Recommendation #3: When estimating administrative fees for budgeting purposes, do not assume that all budgeted contract amounts will be expended by the contracting agencies. Rather, review past expenditure levels on each contract and estimate future spending on the basis of past spending. In addition, attempt to negotiate a minimum guaranteed administrative fee on each contract.

WRI will review the past five years of spending patterns on the OCFS contract and the DOHMH contract to determine the average percentages of underspending of contract funds. WRI will use this information in future WRI administrative fund estimations. WRI appreciates the suggestion that we attempt to negotiate a minimum guaranteed administrative fee on each contract; we will raise this issue with each agency.

WRI also wishes to express our appreciation to Richard Sturm, Brian Lotz, Brittany Hayes, Legendre Ambrose, Anthony Calabrese, and Andrew Rosenberry for their courtesies and cooperation during their stay in our offices.

Very truly yours,



Virginia Hayes Sibbison, PhD
Executive Director

cc: Most Rev. Joseph M. Sullivan, President
President, WRI Board of Directors