COMMONWEALTH OF PENNSYLVANIA
DEPARTMENT OF PUBLIC WELFARE
BUREAU OF FINANCIAL OPERATIONS
ROOM 525 HEALTH & WELFARE BUILDING
HARRISBURG, PA 17105-2675

KEVIN M. FRIEL
DIRECTOR

TELEPHONE
(717) 772-2231
FAX
(717) 705-9094

MAY 2 8 2009

Mr. Gregory Zappala, Chief Executive Officer
Western PA Child Care, LLC
12 Dakota Drive
Emlenton, Pennsylvania 16373

Dear Mr. Zappala:

Enclosed is the final review report of your Agency recently completed by this office. Your Agency's response has been incorporated into the final report and labeled Appendix A. While the Exhibits portion of Appendix A has been included in all other transmittals of this report, it has not been included in your copy due to its volume and because it originated with you.

The final report will be forwarded to the Department's Office of Children, Youth and Families to begin the Department's resolution process concerning the report contents. The staff from that office may be in contact with you to follow up on the corrective action actually taken to comply with the report's recommendations.

I would like to express my appreciation for the courtesy and cooperation extended to the DAR staff during the course of the fieldwork.

If you have any questions concerning this matter, please contact Michael Kiely, Audit Manager of the Western Field Office, at (412) 565-2187.

Sincerely,

Kevin M Friel

Kevin M. Friel

Enclosure

c: Mr. Richard Gold

bc: Mr. Crofcheck
WFO File (#W7004)

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FAX
(717) 705-9094

MAY 2 8 2009

Mr. Frank J. Castano, Director
Luzerne County Children and Youth Services
Suite 110
111 N. Pennsylvania Boulevard
Wilkes-Barre, Pennsylvania 18701-3697

Dear Mr. Castano:

Enclosed is the final review report of Western PA Child Care, LLC recently completed by this office. Your Program's response has been incorporated into the final report and labeled Appendix B.

The final report will be forwarded to the Department's Office of Children, Youth and Families to begin the Department's resolution process concerning the report contents. The staff from that office may be in contact with you to follow up on the corrective action actually taken to comply with the report's recommendations.

If you have any questions concerning this matter, please contact Michael Kiely, Audit Manager of the Western Field Office, at (412) 565-2187.

Sincerely,

Kevin M Friel

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Enclosure

c: Mr. Gregory Zappala

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WFO File (#W7004)

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TELEPHONE
(717) 772-2231
FAX
(717) 787-3560

KEVIN M. FRIEL
DIRECTOR

MAY 28 2009

Mr. Richard Gold, Deputy Secretary
Office of Children, Youth, and Families
131 Health and Welfare Building
Harrisburg, Pennsylvania 17120

Dear Mr. Gold:

The Bureau of Financial Operations (BFO) has conducted an audit of Western PA Child Care, LLC (WPACC) for the period July 1, 2007 through June 30, 2008. During this period, WPACC provided secure treatment, shelter and intensive open residential treatment (IORT) services to juveniles referred from various Counties.

Western PA Child Care Executive Summary

ISSUE	SUMMARY
Issue No. 1 – WPACC Expenses Included $1,267,398 of Questioned Costs.	Questioned costs included: • $533,125 in unsupported administrative fees paid to the principals of WPACC. • $202,746 in payments to related parties for management services, rent, office expenses, legal expense, marketing and employee background searches. • Costs associated with meals, travel, and staff vehicles that were not adequately supported with appropriate documentation.

ISSUE	SUMMARY
Issue No. 1 (cont) – WPACC Expenses Included $1,267,398 of Questioned Costs.	Questioned costs included: • Reimbursement for golf outings and donations • $64,686 in mortgage interest paid on construction loan funds paid to companies owned, or controlled by WPACC principals as consulting fees. • $51,482 in interest paid on a line of credit, while WPACC principals received interest free loans and draws on company funds either directly or through their related companies. • The Department also observed a minimum of $84,000 in questionable prior period costs, during the conversion of calendar to fiscal year data. The BFO did not test cost data to determine if other questionable costs were incurred in the prior period. The costs identified included costs for a custom made suit for a partner in a related party company ($3,500), limousine service to the NCAA basketball tournament and a trip to the King of Prussia mall ($5,800), a chartered fishing trip in Florida ($4,500), golf outings, charitable contributions and numerous payments to related parties ($61,380). See Attachment A for examples.

HIGHLIGHTS OF RECOMMENDATIONS
The OCYF should remove the questioned costs from consideration when computing rates eligible for DPW participation. This would result in changes to the daily rates for secure treatment from $314 to $249.84, for IORT from $255 to $194.81 and for shelter from $210 to $205.44. As these rates do not consider any profit, the OCYF must also determine a reasonable profit factor as well.

ISSUE	SUMMARY
Issue No. 2 – WPACC Made Numerous Billing Errors and Did Not Maintain All Required Court Documents. Luzerne County paid for Empty Beds	• County Children and Youth Programs (Counties) were billed for both the day of admission and day of discharge. • Counties were erroneously billed for the wrong WPACC treatment program. • Court orders required for admission, transfer and discharge were missing or incomplete. • Luzerne County contracted with WPACC to reserve nine Shelter program beds. As a result the county paid for 679 unused bed days at a cost of $142,590.

HIGHLIGHTS OF RECOMMENDATIONS
WPACC should: • Cease the practice of billing counties for a child's day of discharge • Provide additional training to billing staff on all rules, regulations and contract requirements pertinent to their duties. • Require and maintain court orders for all admissions, transfers and discharges and assure they are complete and accurate. Luzerne County should: Evaluate and make changes to the contract practices and its decision to reserve emergency shelter beds in a facility that is more than 260 miles away from the County seat.

ISSUE	SUMMARY
Issue No. 3 – Lack of Adequate Documentation Resulted in Internal Control Weaknesses	• Vendor invoices and upper management travel reimbursement requests did not have written approval. • Approximately $2.2 million in interest free loans were made to various companies in which the owners of WPACC have an interest. None of these loans had any formal written documentation. • Paid vendor invoices were not coded so as to identify where they were charged. • Most of the journal entries lacked a description sufficient enough to identify the purpose of the entry.

HIGHLIGHTS OF RECOMMENDATIONS
WPACC Should: • Require written approval for payment of all vendor invoices and upper management travel reimbursement • Require written documentation of all provisions of loans to companies in which the owners of WPACC have an interest. • Assure all paid vendor invoices contain coding to identify the cost center and account to which they are charged. • Assure journal entries contain a sufficient description of the entry's purpose.

ISSUE	SUMMARY
Issue No. 4 – WPACC Did Not Adequately Allocate Costs Between Its Three Programs	• Costs that could have been separately identified as either Shelter or IORT were combined in one cost center. • Costs for doctor visits and x-rays that should have been charged directly to the Shelter and Secure programs were instead allocated between the programs. • Percentages used to allocate overhead costs to the three programs were incorrect.

HIGHLIGHTS OF RECOMMENDATIONS
WPACC should: • Maintain separate cost centers for all programs • Charge costs directly whenever possible • Allocate costs based on criteria that reflect each cost center's usage such as square footage, employees in a department, etc.

OBSERVATION	SUMMARY
Observation No. 1 – WPACC Principals withdrew $1 million of construction loan proceeds as consulting fees.	WPACC Principals withdrew $1 million of construction loan proceeds as consulting fees paid to their respective related companies. WPACC provided no documentation of any services provided for these fees.

OBSERVATION	SUMMARY
Observation No. 2 – Inefficient cash management resulted in lost interest income, unnecessary interest expense, late payment fees and utility shut-off notices	Loans to related companies and individuals were significant enough that available cash reserves were not sufficient to ensure that the facility could continue to pay vendor bills. The depletion of cash reserves resulted in late fees and utility shut-off notices and created a need to borrow money and incur interest expense.

Background

Western PA Child Care (WPACC) is a for-profit Pennsylvania limited liability corporation which owns a juvenile residential treatment center located at 13 Dakota Drive in Allegheny Township, Butler County. WPACC was formed in June 2003 by two individuals; a Luzerne County attorney and an investment banker from Allegheny County, after their development and operation of a similar facility; PA Child Care, LLC, in Luzerne County. WPACC began operations in July 2005.

The facility was initially licensed for 48 secure treatment beds and 26 beds for shelter services and/or intensive open residential treatment (IORT). A subsequent addition to the building resulted in increasing the licensed capacity of secure treatment to 60 beds as of January 1, 2008. However, WPACC did not begin to utilize the additional beds until July 2008. Also, the combined shelter/IORT licensed capacity was increased to 39 beds effective July 1, 2008.

WPACC entered into an agreement in June 2005 with Mid-Atlantic Youth Services (MAYS), a Pennsylvania for-profit corporation located in Pittston, Luzerne County, to manage and operate the facility. A revised 36-month agreement with MAYS went into effect January 1, 2007. The agreement places the responsibility of keeping the facility at or near capacity with MAYS and states that the compensation to MAYS is dependant on maintaining a high occupancy level, although no specific rate was indicated in the agreement.

MAYS has two separate reportable segments; Mays-Butler, which maintains a separate general ledger (G/L) to account for costs related to the management and operations of WPACC, and Mays-Luzerne whose G/L captures similar costs applicable to PA Child Care. MAYS also maintains a separate G/L (MAYS-Corp) to record various shared costs that are then allocated to MAYS-Butler and MAYS-Luzerne.

MAYS was incorporated in 2005 by a sole stockholder and CEO. Stock options were available to the principals of WPACC. In May of 2008 one of WPACC's principals purchased and exercised all of the stock options in MAYS and bought out the original shareholder, thereby taking over control of MAYS. This individual also bought out the other principal's ownership interest in WPACC and PA Child Care. As of the start of our fieldwork, one individual owned WPACC, PA Child Care and all of the issued shares of MAYS. As of the close of our fieldwork, negotiations on a severance package for the original shareholder and former CEO of MAYS were still in process.

Objectives, Scope and Methodology

Our objective was to determine the actual cost of service to residents and determine if the costs were reasonable and consistent with applicable cost principles.

Government auditing standards require that we obtain an understanding of management controls that are relevant to the audit objective described above. The applicable controls were examined to the extent necessary to provide reasonable assurance of the effectiveness of these controls. Based on our understanding of the controls, no material deficiencies came to our attention. Areas where we noted an opportunity for improvement in management controls are addressed in the findings of this report.

Our review was conducted between July 21 and December 11, 2008.

In pursuing our objectives, we reviewed available fiscal/accounting records, audits, contracts, payroll data, census reports, client data, invoices, and billings submitted to the County programs. We also reviewed WPACC, MAYS-Butler and MAYS-Corporate operations for compliance with County contracts, DPW regulations and other applicable cost standards. Our work was conducted in accordance with generally accepted government auditing standards. This report, when presented in its final form, is available for public inspection.

Results of Fieldwork

Issue No. 1 - WPACC Expenses Included $1,267,398 of Questioned Costs

The objective of the audit was to determine the actual cost of service and determine if costs were reasonable and consistent with the PA Code Title 55, Chapter 3170 *Allowable Costs and Procedures for County Children and Youth Social Service Programs* and other applicable cost standards. The BFO identified various questionable costs due to the following reasons:

- Payments to related parties not based on actual costs incurred by the related party;
- Lack of written leases and contracts in place during the audit period;
- Lack of adequate documentation; and
- Costs not necessary or related to facility operations

The costs for WPACC include an allocation of various shared costs assigned, apportioned or allocated from MAYS-Corporate G/L. WPACC costs related to staffing and other operating expenses are recorded in the Mays-Butler G/L. These costs are then included with WPACC's direct costs, primarily related to the building, to arrive at the total costs applicable to the care of WPACC's residents. WPACC, MAYS-Butler and MAYS-Corp accounting records are maintained on a calendar year basis. Therefore, we analyzed each account of the three G/Ls in order to adjust the calendar year balances to the FY07/08 period. Total fiscal year allowable WPACC costs were then allocated or assigned to the three services that receive DPW funding: Secure Residential, IORT and Shelter Care.

To determine WPACC's allowable costs we analyzed costs incurred in FY07/08 for reasonableness and eligibility for DPW participation. Since the costs were reported in three separate G/Ls we analyzed applicable costs recorded on each of the G/L's. The following questioned costs were identified in MAYS-Corporate, MAYS-Butler and WPACC G/Ls.

1. MAYS-Corporate Questioned Costs

The MAYS-Corporate expenses included costs that are ineligible for DPW participation. We are identifying these costs as questionable and have categorized them as related party transactions, unsupported/undocumented costs, expenses not necessary or related to facility operations, expense reimbursement made to a non-employee and questionable interest expense.

These amounts identified below represent the total amount applicable to MAYS-Corporate. Various portions of these totals were applicable to MAYS-Butler. The amount applicable to MAYS-Butler was then stepped-down to each of WPACC's services.

A. Related Party Transactions - $100,671.85

As discussed in the background section of this report, documents on file at the PA Department of State indicate that MAYS was established with a sole shareholder. The individual listed as the sole shareholder was also the Chief Executive Officer (CEO) until May 2008.

The Stockholders Equity section of MAYS consolidated independent audit report balance sheet, as of December 31, 2006, indicates that of the 100,000 shares authorized, only 500 shares were issued and outstanding. The Current Asset section also reflects a corresponding Stock Subscription Receivable. Discussion with MAYS Chief Financial Officer (CFO) revealed that this receivable (and related shares of stock) reflected the former CEO and sole shareholder's investment in the corporation. The CFO also explained that the two principal owners of WPACC held options to purchase equal amounts of the remaining authorized shares of MAYS at any time. By virtue of the stock options agreement, which represented 99.5% of the authorized shares, the principals of WPACC had the ability to exercise significant control over the operations of MAYS and therefore meet the definition of related parties.

To be considered reasonable, transactions between related parties need to be necessary, limited to actual costs, and less than or equal to the amount a non-related party would pay for the same or comparable goods or services. Documentation such as competitive bids should be obtained and maintained to support the reasonableness of related party charges.

Based on our review of transactions recorded on MAYS-Corp general ledger we identified the following related party questionable costs recorded during the FY07/08 period:

1. The Powell Law Group, P.C. – Management Fee $65,000.00
   Office Expense $ 3,557.37

   One of the principal owners of WPACC is also a principal and president of The Powell Law Group, P.C. (PLG).

   WPACC paid PLG a management fee which, according to the MAYS CFO, represented reimbursement for accounting services performed on behalf of MAYS by a full-time employee (and Treasurer) of PLG. The payment was purported to reflect time and activity that the PLG employee spent working on MAYS related activity. However, no formal written agreement existed to document this relationship and no detail of the number of hours, hourly rate, etc., was provided to support these payments.

   Office Expenses paid to PLG were supported by invoices that indicated they were additional charges to MAYS for photocopies, faxes, postage, Fed Ex fees and telephone expenses incurred on specific dates, presumably on behalf of MAYS. However, insufficient detail was provided to support that these were legitimate expenses related to MAYS.

2. Big Kahuna Realty, LLC - Rent $8,600.00

   The PA Department of State business entity filing history lists a principal of WPACC as the president of this limited liability company.

   According to the MAYS CFO, these costs represented reimbursement to Big Kahuna, which is related to PLG through common ownership, for a portion of the office space occupied by the PLG employee who performed accounting services for MAYS. There was no lease or any other documentation to support this cost or the reasonableness of the amount charged. Further, MAYS had sufficient space for this individual at its offices.

3. Gladstone Partners, LP - Legal Fees $20,000.00

   According to this entity's web site and various media sources, both of the principal owners of WPACC and another partner were members of this limited partnership during our audit period. This limited partnership is involved in developing an international cargo airport and transportation center in the Hazleton area. The legal fees were supported by two invoices for $10,000 each that identified Gladstone Partners, LP as the Client and the services provided as government affairs consulting services. No documentation was provided to support how the cost was related under applicable regulations of allowable cost for facility operations.

4. Legal Eye Productions, LLC - Marketing/Public Relations $3,264.48

   The president of PLG, who is also one of the principal owners of WPACC, is listed as the president of this limited liability company. According to Legal Eye Productions web site (*http://legaleyellc.com*), they specialize in creating effective communication tools for the legal community. Invoices supporting these costs indicated the services performed included design and development of brochures and postcards, DVD duplication & postage, and Web updates. They did not however provide documentation to support the amount invoiced.

5. Virtual Legal Assistant, LLC - Marketing/Public Relations $250.00

   According to the Virtual Legal Assistant web site (*http://virtuallegalaid.com*), they perform work of a legal nature under the supervision of an attorney.

   We consider Virtual Legal Assistant, LLC a related party because the president of this LLC is an employee of PLG which as addressed previously is related to WPACC. Also, the secretary and treasurer of Virtual Legal Assistant is the same former PLG employee who performed accounting services for MAYS, was MAYS acting CEO and is now a consultant to MAYS.

   The invoice from this vendor contained a charge for "Travel and Presentation Charges – PPoint Design" with the charge appearing to be for two hours at $125.00/hour. The invoiced rate coincides with the web sites fee schedule for Trial Preparation and Presentation – Exhibit Presentation Preparation (utilizing "Sanctions" and "Powerpoint)", however, the MAYS invoice does not indicate how this service is necessary or related to facility operations.

B. Unsupported Costs - $90,356.23

During our review of MAYS-Corporate accounts we were unable to verify the following expenses to source documents and receipts: Automobile Expense for the CEO and numerous entries in the Office Expense, Meals and Travel Accounts. In addition, we identified travel, meal, and other expense that were not supported as being necessary or related to facility operations.

A summary of these unsupported costs, incurred during FY 07/08, are as follows:

1. Automobile for CEO - $10,020.00

   The CEO drove a vehicle provided to him by MAYS. Maintenance on the vehicle was paid for by MAYS. For six months during our audit period the CEO received monthly checks for automobile expenses in the amount of $1,670.00 for a total of

$10,020.00. According to the owner of WPACC and MAYS the CEO was given a monthly amount so that he could obtain whatever car he wanted and MAYS wouldn't need to be concerned if he used it for his other business. Because these payments did not reflect actual costs incurred by the CEO, these costs are considered unsupported expenses.

2. Lack of Supporting Documentation of Costs -

Office Expense	$14,735.73
Meals	1,569.70
Travel	10,068.56
Travel & Entertainment	9,768.91
Entertainment	37,569.21

WPACC was not able to provide documentation to tie adjusting journal entries for office expense of $12,015.82, travel & entertainment of $9,238.79 and entertainment expense of $35,269.21 charged by MAYS-Corporate back to the original receipts. Therefore the total of these adjusting journal entries has been included in the questioned costs.

Also, WPACC was not able to provide documentation to support additional office expense of $2,719.91, meal expense of $1,569.70 and travel expense of $10,068.56 reflected as charges on credit card monthly statements. MAYS did not provide receipts or other documentation to support that the charges were necessary or related to facility operations.

Additionally, no supporting documentation was on file to support entertainment expense reimbursements of $1,800 to MAYS former CEO and $500 to one of WPACC's principals. Also, no documentation could be located for a $530.12 reimbursement to a WPACC employee that was expensed to the travel & entertainment account.

3. Costs Not Necessary or Related to Facility Operations -

Travel	$2,867.70
Marketing/PR	2,463.86
Dues&Subs.	380.00
Entertainment	312.00
Compensation	308.62
Meals	291.94

The Marketing Director of MAYS was reimbursed a total of $62.97 for golf outings and related mileage that was recorded as travel expense. In addition, MAYS-Corporate marketing/public relations expense included $710 of costs related to golf outings and sponsorship. These costs are questioned because they are not necessary or related to facility operations.

As previously stated in the Related Party section of this report, a full-time employee and Treasurer of PLG performed accounting work for MAYS. During this time, this employee requested reimbursement of $291.94 for Meals, $2,804.73 for Travel and $125 expensed as marketing/public relations, and $25 entertainment expense related to political fundraisers. Also, $380 was paid by Mays-Corporate for two years of his membership dues for a private dining club located in Philadelphia. This amount was recorded as dues and subscriptions expense. There was no formal written agreement to document what costs of this individual if any were the responsibility of MAYS.

Because he was not an employee of MAYS, these costs are not the responsibility of MAYS.

Other costs not necessary or related to facility operations that we identified included a $250 donation to Men of Marian and $1,378.86 of promotional items such as golf towels and tees, shirts, umbrellas, visors and pens expensed to marketing/public relations, and $287 for Pittsburgh Steelers football game tickets charged as entertainment expense.

MAYS-Corporate compensation expense also included a $308.62 payment directly related to PA Child Care. This amount was adjusted out of the MAYS-Corporate books so that a portion of cost was not allocated to MAYS-Butler.

C. <u>Interest Costs</u>:	Loan Interest expense	$51,482.23
	Liability Insurance expense	$ 3,150.29
	Automobile Insurance expense	$ 1,010.94

MAYS maintained a $750,000 line of credit with S&T Bank. During our audit period, the monthly outstanding balance of this debt remained constant at $749,750 after payment of interest. Only interest payments, totaling $51,482.23, were made on the line of credit during the FY07/08 period.

We also identified interest costs in the liability and automobile insurance expense accounts. This interest expense was incurred as a result of MAYS financing annual liability and automobile insurance premiums. Insurance financing interest expense for the FY07/08 period was $3,150.29 for the liability premium and $1,010.94 for the automobile policy premium.

We question the reasonableness and necessity of MAYS incurring these costs and allocating a portion to WPACC. Based on the volume of informal, interest free loans to related parties, draws by the sole shareholder of MAYS, and similar interest free loans made by WPACC to related parties and one of its principals, along with draws taken by WPACC's two principal owners (See Observation No. 2), the amount of these discretionary cash outflows far exceeded the line of credit and insurance premiums financed by MAYS-Corporation.

<u>MAYS-Corporate Summary</u>

The total questioned costs for MAYS-Corporate are $246,671.54. We reduced MAYS-Corporate FY07/08 G/L trial balance by this amount on a line by line basis to arrive at total MAYS-Corporate allowable costs. The allowable costs were then assigned, allocated or apportioned to MAYS-Luzerne and MAYS-Butler based on various allocation methodologies. The total allowable MAYS-Corporate costs allocated to MAYS-Butler was $286,325.27.

2. MAYS-Butler Questioned Costs

MAYS-Butler is the segment of MAYS-Corporation that provides management services to WPACC. Our review of MAYS-Butler expenses identified questionable costs that we categorized as related party transactions, unsupported/undocumented costs and expenses that were not necessary or related to facility operations. These costs are as follows:

A. Related Party Transactions - $20,075

Marsicano Law Investigations (MLI)

As stated in the Related Party section of the MAYS-Corporate questioned costs we identified Gladstone Partners, LP as a related party. According to Gladstone's web site and various media sources, a third partner, who is the principal owner of MLI, and the two principal owners of WPACC were members of Gladstone during our audit period. By virtue of the Gladstone relationship we considered MLI to also be a related party.

During our audit period a total of $20,075 was billed to MAYS-Butler for background searches conducted by MLI. This amount included a $350 monthly fee and a charge of $75 per each background search. There was no formal agreement to support the amounts billed, nor any documentation to show that a competitive bidding process was performed to support the reasonableness of these charges. Furthermore, our review of a sample of background searches submitted by MLI indicated that most of the information provided duplicated the information provided by required Act 33/34 Clearances.

B. Unsupported Costs - $565,442.06

1. Management Fee - $552,500

During the FY07/08 period we identified a total of $552,500 of management fee expense. The MAYS CFO indicated that the fee was a budgeted charge and did not represent actual cost. Furthermore, no documentation or explanation was provided to attempt to support the reasonableness of these charges. Therefore we classified the entire management fee expense as questioned costs.

2. Rent - $6,000

A single adjusting journal entry in the amount of $6,000 was posted to the rent expense account on July 31, 2007. According to the general ledger reference, the credit half of the entry was posted as due to MAYS-Corp. Since MAYS-Butler is a segment of

MAYS-Corp and no lease, rental agreement or other documentation was provided to support this expense as an actual cost we classified this amount as questioned costs.

3. Depreciation Expense - $6,942.06

MAYS-Butler was unable to provide a depreciation schedule to support the $6,942.06 in depreciation expense recorded on their G/L. Our review of MAYS-Corporate depreciation schedules identified various assets as assigned to MAYS-Butler and MAYS-Luzerne. Due to lack of supporting documentation and since MAYS-Butler assets are reflected on MAYS-Corporate depreciation schedules we questioned the depreciation expense recorded on the MAYS-Butler G/L.

C. Costs Not Necessary or Related to Facility Operations - $1,820

During our audit period $1,320 was expensed on golf outings and another $500 posted to the Donations expense account as a charitable donation to the March of Dimes. Neither expense is necessary or related to facility operations.

MAYS-Butler Summary

MAYS-Butler's total questioned costs of $587,337.06 are included in WPACC's questioned costs. The total allowable costs for MAYS-Butler, which include the allowable costs from MAYS-Corporate, are allocated across each of the three programs in WPACC. Each of these allocated costs is then included in WPACC's allowable costs under the respective program which they represent.

3. WPACC Questioned Costs

Our review of costs charged directly to WPACC identified the following questioned costs.

A. Related Party Transactions - $82,000

1. Management Fees - $70,000

A total of $70,000 was paid to reimburse PLG for accounting work that PLG's treasurer performed for WPACC. There was no contract documenting services required by WPACC nor were there invoices submitted to document services actually provided.

2. Rent - $12,000

As stated in the Related Party section of this report, a principal of WPACC is also listed as the president of Big Kahuna Realty, LLC.

According to the MAYS CFO, the $12,000 cost represented reimbursement to Big Kahuna, which is a related company of PLG, for a portion of the office space occupied by the PLG employee who performed accounting services for MAYS and WPACC. No documentation was provided to support this cost or the reasonableness of the amount charged. Further, MAYS had sufficient space for this individual at its offices.

B. Unsupported Costs - $533,375

On December 31, 2007 a single adjusting journal entry was posted to the Administrative Fees expense account for $533,125. The credit side of this journal entry was $266,562.50 to offset A/R- Loans to RJP (one of the principals) and $266,562.50 to A/P-Other. According to the MAYS CFO this entry represents payments to WPACC principals. He indicated that the entry was an error and should not have been made at all.

Also, a charitable donation to the Men of Marian was made in the amount of $250. Charitable contributions are unallowable.

C. Mortgage Interest Expense - $64,686

Our review identified FY 07/08 mortgage interest expense of $905,967 related to WPACC's $14 million construction/mortgage loan.

As explained in Observation No. 1, $1 Million from the proceeds of this loan were paid as fees to companies owned and or controlled by WPACC's principals. WPACC provided no documentation of any services provided for these fees. At our closing conference, WPACC management explained these as consulting fees for developing the property. As the owners of the property, the principals' equity increases as the debt decreases. Additionally, the principals can benefit, over time, by any appreciation in the value of the property. Since these payments could not be adequately supported we added mortgage interest expense of $64,686 related to the $1 million in fees to the questioned costs.

Recommendations

The BFO recommends that the Office of Children, Youth and Families consider the above questioned costs as not being consistent with applicable cost standards and exclude the net effect to WPACC of $1,267,398 from WPACC's FY adjusted costs of $7,400,617 to arrive at FY07/08 audited costs of $6,138,469. Based on our audited, actual units of service provided (See: Issue No.2) we computed per diem rates, without consideration of any profit factor, of $249.84 for secure treatment, $194.81 for IORT and $205.44 for Shelter.

While we recognize that a number of the questioned costs are the types of costs a provider of service could incur, OCYF must determine the reasonableness of those costs moving forward, as well as an agreed upon and reasonable profit.

Issue No. 2 – WPACC Made Numerous Billing Errors, Did Not Maintain All Required Court Documents and Billed Luzerne County for Reserving Empty Beds

In order to compute per diem rates for each type of service based on our audited costs we reviewed WPACC's computerized census database and hardcopies of county billings for the FY07/08 period to determine the actual units of service provided. We also tested a sample of billings by tracing back to the authorizing court orders and reviewed county contracts for compliance. The following concerns were noted:

A. Billing Errors

Our comparison of units of service billed to census records indicated that WPACC routinely billed for service provided on the day of discharge, if the discharge occurred after 12:00 pm. This methodology is not consistent with the standard county contract payment provisions which specify that payment shall be made for the first and all subsequent days of care **excluding the day of discharge** (emphasis added). The effect of incorrectly billing the day of discharge resulted in a decrease of 8 Secure Treatment, 6 IORT and 18 Shelter units of service.

We also noted two instances where Luzerne County was billed for 8 days of Shelter that should have been billed as Secure Treatment and was billed for 4 days for Shelter when the child was not at the facility according to census and discharge records. The net effect of these discrepancies increases the Secure Treatment census by 8 days and decreases the Shelter program by twelve days.

Finally, we discovered that several Erie and Philadelphia County clients were billed to the wrong program when transferred from one program to another within WPACC. The net effect resulted in an increase of 5 Secure Treatment units, an increase to the IORT program of 4 days, and a decrease to the Shelter program of 9 days.

The net effect of the above billing errors was to increase actual, allowable Secure Residential units of service by five days to 17,566; reduce IORT by 2 days to 4,745; and reduce Shelter days by 39 to 4,018.

B. Court Orders

To verify accuracy of billings we traced a sample of billings back to the court order that authorized the service. We were unable to locate some of the court orders for the admission into WPACC and transfers between programs within the facility. Also, many of the court orders for discharges were missing. Title 55 Section 3800.243 paragraph 10 states that each child's record shall include their court orders (if applicable). Without a court order it is not possible to determine when the child should have been admitted, transferred or discharged from a program or the facility. Based on discussions with staff it was learned that court orders were not consistently maintained in one location. Some of the sampled court orders were later located in a central file, while others were in individual children's files. We were also informed that WPACC policy does not require retention of discharge orders.

Another concern we noted was that court orders from the juvenile justice system do not always clearly identify WPACC as the facility of admission or discharge. Our review found orders identifying the facility committed to or released from as "Western PA Shelter Care" or "MAYS", etc. While this is not the fault of WPACC, they should work with the Counties to ensure that court orders specify Western PA Child Care Shelter Facility or Western PA Child Care Secure Treatment Facility.

C. Luzerne County Placement Agreement

WPACC entered into a placement agreement with Luzerne County and the Court of Common Pleas of Luzerne County on July 1, 2007.

A clause in the general provisions of the contract states:

> "The County hereby secures the right to utilize (9) beds for Shelter Care at the Facility, at the rates set forth in Article X, commencing July 1, 2006. The Owner agrees to secure and reserve nine (9) beds on a full-time basis for the County in Shelter Care at the Facility, subject to the provision of Paragraph V. herein."

Our review of Luzerne County monthly billings indicated that WPACC, in accordance with the Luzerne contract, billed the county for unfilled, available Shelter beds, up to a maximum of 9 each day at the regular Shelter rate of $210 per day. For the FY 07/08 period, a total of 679 days of service at a total cost of $142,590 were billed to and paid by Luzerne County for these reserve bed days even though no actual Shelter services were provided.

Recommendation

The BFO recommends that WPACC billing staff be made aware of all pertinent contract payment provisions to ensure that county billings are accurate and in compliance with contract terms.

The BFO also recommends that accurate census records be maintained and compared to billings to ensure accuracy of amounts billed.

The BFO further recommends that WPACC ensure that court orders are received and maintained in a central location to support all admissions, transfers between programs and discharges of juveniles served at the facility.

The BFO finally recommends Luzerne County evaluate and make changes to the contract practices that resulted in the payment for empty beds and the reservation of emergency shelter beds in a facility that is more than 260 miles away from the County seat.

Issue No. 3 – Lack of Adequate Documentation Resulted in Internal Control Weaknesses

During the course of our audit of WPACC, we noted the following internal control weaknesses:

Lack of Payment Authorization

No written authorization or approval was indicated on vendor invoices or upper management travel expense forms prior to payment. Lack of a structured payment approval process could allow payments to be processed without proper authorization.

Lack of Formal Loan Agreements

A number of interest free inter-company loans were made between WPACC, MAYS-Corporate and various companies in which the owners of WPACC have an interest. None of these loans had any formal documentation to state that a loan existed. The only indication that these loans existed were the balance sheet accounts and related entries. Written agreements should be prepared and maintained to support all loans.

Account Coding

A majority of MAYS-Corporate paid invoices were not coded to identify the cost center and expense account to which they should be charged. Account coding should be present on all paid invoices to provide a proper audit trail and assure posting to the correct expense account.

Lack of Explanation of Journal Entries

Our review of the MAYS-Corporate and WPACC general ledgers found that in most cases entries to the general journal lacked sufficient information describing the purpose of the entry. As a result it was often not possible to determine the appropriateness of the entry.

Recommendations

The BFO recommends that a formal payment authorization process be developed. The BFO also recommends that any inter-company loans be supported with formal loan documentation. The BFO further recommends that account coding be written on paid invoices. The BFO finally recommends that an explanation be included with all journal entries indicating where funds are going to or coming from or if split between different accounts what the split/methodology was.

Issue No. 4 – WPACC Did Not Adequately Allocate Costs Among Its Three Programs

WPACC did not maintain separate cost centers on its accounting system for the shelter and IORT programs. For accounting purposes the Shelter and IORT programs were combined into one cost category, listed as Shelter. The Shelter and IORT programs should be separated to allow for tracking of actual costs and proper allocation of overhead costs.

In the case of doctor visits and x-rays, costs that could be directly charged to the Shelter and Secure programs were instead split between the two. Costs that can be identified to a specific program should be charged directly to that program.

The percentages used to allocate overhead costs to the individual cost areas were incorrect. The allocation percentage used for Secure was 67%. The allocation percentage used for Shelter and IORT was 33%. For the purpose of our review we separated overhead costs into multiple categories and allocated the costs based on the most logical base possible, i.e., utilities were allocated based on square footage, Professional Fees are allocated based the number of employees in each department, etc.

Recommendation

The BFO recommends that WPACC and MAYS-Butler segregate costs between the Shelter and IORT programs. The BFO further recommends that costs that are directly assignable to a specific program be assigned to that program. The BFO finally recommends that the percentages used to allocate overhead costs be based on equitable methodologies.

Observation No. 1 – WPACC Principals Withdrew $1 Million of Construction Loan Proceeds as Consulting Fees Paid to Their Respective Related Companies

In June 2004 the principal owners of WPACC obtained a $14 million construction loan to finance the building, land improvements and some of the equipment for the WPACC facility which was completed in September 2005.

According to WPACC's 2005 independent audit report, the capitalized land, building and land improvements, and furniture and equipment cost was approximately $12.7 million. In an attempt to reconcile the difference between the loan amount and the cost basis we reviewed the various loan documents and depreciation schedules.

Our review of the construction loan exhibits included a breakdown of the total project costs and amount of the required financing. We noted that the project costs included consulting fees for Vision Holdings, Inc. ($500,000) and Consulting Innovations & Services, Inc. ($500,000).

Other documents related to the loan reflected that one of WPACC's principals signed as a member of Vision Holdings, Inc. and the other principal signed as President of Consulting Innovations & Services, Inc. Also, both of these companies were identified as members of PA Child Care, LLC, a related juvenile detention center located in Luzerne County.

At our closing conference, WPACC management explained the consulting fees as fees for developing the property. WPACC provided no documentation of any services provided for these fees.

Since the principals essentially withdrew $1 million of the loan proceeds, we reduced the amount required to finance the facility to $13 million. As noted in Issue No. 1 of this report, we questioned the reasonableness of the portion of mortgage interest expense related to the $1 million in consulting fees.

Observation No. 2 – Inefficient Cash Management Resulted in Lost Interest Income, Unnecessary Interest Expense, Late Payment Fees and Utility Shut-off Notices

A review of WPACC, Mays-Butler and Mays-Corp un-audited general ledgers for calendar year 2007 and for the period January 1 through June 30, 2008 reflects net income/ (loss) as follows:

	2007	1/1-6/30/08	Total
WPACC	$1,351,315	$1,077,910	$2,429,225
Mays-Butler	(343,268)	(122,893)	(466,161)
Mays-Corp	525,095	(31,244)	493,851
Total	$1,533,142	$ 923,773	$2,456,915

The above schedule clearly shows that WPACC generated significant net income (Profit), to cover Mays-Butler and Mays-Corp losses, even when including all questioned costs discussed in Issue No. 1 of this report. Yet, our review of Mays-Butler expenses revealed that various WPACC vendor invoices were paid after the due dates and late payment fees were assessed. We also noted that WPACC had received disconnection/shut-off notices from their electricity and natural gas suppliers in June 2008 due to overdue account balances, and as discussed in issue No. 1 of this report, MAYS-Corp had an outstanding line of credit balance of $749,750 on which they paid over $50,000 of interest expense in FY07/08, as well as over $4,000 of interest expense to finance annual insurance premiums.

MAYS management explained that they had experienced significant cash flow problems in April through June 2008 and as a result, they were unable to make timely payment on all of WPACC/MAYS bills. They also claimed that cash flow issues necessitated the financing of insurance premiums and was the reason they were unable to reduce the line of credit balance.

Considering the un-audited net income figures above, WPACC and MAYS should have had sufficient funds available to meet all of their obligations on a timely basis and been able to reduce or even eliminate existing debt. However, our review of their balance sheet accounts indicate that a significant portion of their net income was used for non-WPACC related purposes.

Our review identified several loans, notes and other transfers of funds to related companies. According to management, no formal loan agreements, notes or other documentation is available to support the purpose or necessity of these transfers as it relates to client care. Furthermore, WPACC/MAYS does not receive any interest income from their related companies for these loans.

The following chart indicates the un-audited balances as of December 31, 2007 and June 30, 2008 of the undocumented, interest-free loans, notes and other transfers of funds reflected as receivables on WPACC and MAYS-Corp balance sheets:

WPACC	As of 12/31/07	As of 6/30/08
Note Rec. – 40 Degrees N.	$ 100,000	$ 100,000
Note Rec. - Gladstone	0	150,000
A/R-Loans to R.J.P.	972,238	1,650,701
Prepaid Airtime- 40 Degrees N.	(1,857)	8,143
TOTAL	$1,070,381	$1,908,844
MAYS-Corp.		
Stock Subscription Rec. (J.G.)	$ 10,000	$ 10,000
Due from Fishin	107,000	107,000
Due from PLG	15,000	15,000
Due from Legal Eye Prod.	841	841
Prepaid Airtime-40 Degrees N.	140,000	140,000
Note Rec.-Big Kahuna Realty	129,931	20,860
TOTAL	$ 402,772	$ 293,701

While these transactions did not directly result in additional expense to WPACC during our audit period they did have a negative impact on the cash flow of both WPACC and MAYS-Corp. and reduced cash available to pay obligations as they came due.

Another reduction of cash reflected on the balance sheets of WPACC and MAYS-Corp is draws on equity made by the principals of WPACC and the initial shareholder of MAYS. The combined cumulative balance of WPACC principals draws as of the June 30, 2008 un-audited G/L was $678,343 with $365,343 occurring in FY07/08. MAYS-

While these transactions did not directly result in additional expense to WPACC during our audit period they did have a negative impact on the cash flow of both WPACC and MAYS-Corp. and reduced cash available to pay obligations as they came due.

Another reduction of cash reflected on the balance sheets of WPACC and MAYS-Corp is draws on equity made by the principals of WPACC and the initial shareholder of MAYS. The combined cumulative balance of WPACC principals draws as of the June 30, 2008 un-audited G/L was $678,343 with $365,343 occurring in FY07/08. MAYS-

Corp cumulative balance of draws as of June 30, 2008 was $191,152 with $41,151 occurring in FY07/08.

Subsequent to completion of our fieldwork, an exit conference was held on March 18, 2009 to discuss the contents of this report with WPACC management. Their response to this report is included as Appendix A. Upon review of the response, an Auditor's Commentary was prepared and included in the report. Additionally, Luzerne County Children and Youth Services provided a response to the recommendations addressed to them in Issue No. 2 of this report. Their response is included as Appendix B.

In accordance with the BFO's established procedures, please provide a response within 60 days to the Audit Resolution section concerning actions to be taken to ensure report recommendations are implemented.

Please contact Alex Matolyak, Audit Resolution section, at (717) 783-7786 if you have any further questions concerning this audit or if we can be of any further assistance in this matter

Sincerely,

Kevin M Friel

Kevin Friel

c. Mr. Gregory Zappalla

bc: Mr. Richard Gold
Mr. Thomas Diehl
Mr. Kevin Friel
Mr. Thomas Crofcheck
Mr. Michael Kiely
WFO (W7004)
File

AUDITOR'S COMMENTARY

Auditor's Commentary

The WPACC response to Issue No. 1 of the draft audit report did not provide sufficient additional information or documentation to support any changes to the total costs determined as allowable. As a result no changes were made to the per diem calculations. Furthermore, a number of documents provided in their response contradicted those they previously provided.

Although not specifically addressed in the narrative, a review of the financial computations provided in the response (Schedule#2, B1) indicates WPACC management's acceptance of a number of the BFO cost adjustments. The pre-profit difference between audited allowable costs identified by BFO and the amount identified by WPACC is $406,125 ($6,544,594 vs. $6,138,469). A reconciliation of this difference identified $101,254 in calculation errors and incorrect allocations in the WPACC presentation. The remaining $304,871 represents costs that BFO identified as questionable due to one of the following reasons:

- Payments to related parties not based on actual costs incurred by the related party;
- Lack of written leases and contracts in place during the audit period;
- Lack of adequate documentation; or
- Costs not necessary or related to facility operations.

While we recognize that a number of the costs included in the $304,871, are the types of costs a provider of service could conceivably incur, OCYF must determine the reasonableness of those costs moving forward, as well as an agreed upon and reasonable profit. The BFO is available to assist the OCYF upon their request.

WPACC's response to Issues 2, 3, and 4 of the draft report indicates that they disagree with each issue. However, our review of their response only identified disagreement with parts of Issues No. 2 and No. 3.

- Issue No.2 A. – Billing Errors, WPACC responded that the 2007-2008 contracts did allow for billing for the day of discharge. Our review of their county contracts however, indicated that only the Butler and Luzerne contracts, which were drafted by WPACC, included this wording. The standard payment provision in all of the other contracts that we reviewed expressly excluded the day of discharge from billable days of service.

- WPACC's response to Issue No. 3 regarding Account Coding indicated that almost all of MAYS-Butler and WPACC invoices were appropriately coded. While our draft report did not specify which company's paid invoices were missing cost center and expense account coding, the issue was primarily related to MAYS-Corporate paid invoices. Therefore, we revised the wording of the issue to make that clarification.

Finally, WPACC's response related to Attachment A of the draft report stated in part that the "BFO sought out these expenses that were included before the review period in order to incite a scandal in an effort to harass and embarrass the principal of MAYS and WPAACC ...", The executive summary of the audit report, however, clearly explained that the auditors had observed a minimum of $84,000 of questionable prior period costs during the conversion of calendar to fiscal year data as part of the review, and were obligated to report the finding. In addition, disclosure of these questionable costs was particularly relevant as the practice of funding unallowable personal costs with WPACC revenues was documented to have continued through the audit period.

ATTACHMENT A

STEPHEN KEMPSON

BESPOKE CLOTHIER

Bill To:

Mr. Robert Powell

Ship To:

Stephen Kempson
9 East 53rd Street 4th Floor
New York, NY 10022

Phone: 212.[redacted]
Fax: 203.[redacted]
Email:
[redacted]
Web: www.stephenkempson.com

Invoice

Date	Misc.	Ship Via	Terms
2/20/07			

Quantity	Item	Units	Description	Unit Price	Total
1			Custom Suit for Mr. Marsicano		$3500

Subtotal	$3500
Tax	SOS
Shipping	FOC
Total	$3500
Deposit	$875
Balance Due	$2625

PAYMENT POLICY
75% deposit required at time of placing order. Balance payment due at time of delivery of goods. The goods remain the property of Stephen Kempson LLC until full payment is received. All goods are custom made. Sales are final; no returns or refunds.

Client Signature: **Date:**

WESTERN PA CHILD CARE, L.L.C.

Stephen Kempson — 6/20/2007 — 1553

Date	Type	Reference	Original Amt.	Balance Due	Discount	Payment
6/11/2007	Bill	M. Marsicano	2,625.00	2,625.00		2,625.00
					Check Amount	2,625.00

Checking - S & T Ban M. Marsicano 2,625.00

8208

www.checksforless.com 800-245-5775 Order # 485858-1

ETM

INVOICE

702 East Market St
Scranton, Pa 18509
570-344-[redacted]
570[redacted]

INVOICE # 112
DATE: March 26, 2007

Bill To:
Bob Powell

Comments or special instructions:

Days	DESCRIPTION		AMOUNT
3-23 to 3-25-07	NCAA elite 8 games 31hrs @ 125.00 Fri 12:00pm – 11:00pm Sat 12:00pm – 10:30pm Sun 11:00am – 9:00pm		3875.00
3-23-07	King of Prussia Mall 17.5 @ 110.00		1925.00
			5800.00

Make all checks payable to **Event Transportation Management**
If you have any questions concerning this invoice, contact 570-344-[redacted]

THANK YOU FOR YOUR BUSINESS!

WPACC 1933
PACC 1934
MAYS 1933

ATTACHMENT A, PAGE 3 OF 6

MID-ATLANTIC YOUTH SERVICES CORP.

Pa Child Care, LLC

3/28/2007

333

Date	Type	Reference	Original Amt.	Balance Due	Discount	Payment
3/28/2007	Bill	Reimburse expenses	1,933.00	1,933.00		1,933.00
					Check Amount	1,933.00

Community Banks - C   Reimburse expenses   1,933.00

13272

www.checksforless.com 800-245-5775   Order # 835268-1

Patrick Owens

From: Robert Arrington [redacted]
Sent: Wednesday, May 02, 2007 12:24 PM
Patrick Owens
Subject: Reel Justice

Hey Pat,

Greg Zapalla was in town last week and he fished 3 days, 2 on the Reel Justice and one on a buddy of mine's boat. (Swordfishing) He was here for a week so I hoired the mate for the whole week not knowing exactly when we would fish.

I put the gear we needed on the Reel Justice account at Grand slam. It was like 400 dollars and 200 dollars in fuel. If you charge him 750 for the trip with me swordfishing it will cover all you cost and there is obviously no cost for the boat.

So charge him for 2 days on the Reel Justice and 750 for charges while swordfishing.

I paid the mate 600.00 for the week so I need to get a check from you as soon asa possible thanks.

Robert Arrington
[redacted]
Jupiter, Florida 33458

750 -
1875 -
1875 -
$4500.00 → $1500 each → MAYS
1500 PALC
1500 WPALC

Pd ck# 297

Posted 5/23/07

You Yahoo!?
Tired of spam? Yahoo! Mail has the best spam protection around
http://mail.yahoo.com

WESTERN PA CHILD CARE, L.L.C.

Mid-Atlantic Youth Services - Corp.

Date	Type	Reference	Original Amt.	Balance Due	6/20/2007 Discount	Payment
5/23/2007	Bill	Repay	1,500.00	1,500.00		1,500.00
					Check Amount	1,500.00

1552

Checking - S & T Ban Repay 1,500.00

9209

[illegible].com 800-245-5775 Order # [illegible]

APPENDIX A

BRUCKER SCHNEIDER & PORTER
ATTORNEYS AT LAW

Main Office:

SUITE 320, WEYMAN PLAZA
300 WEYMAN ROAD
PITTSBURGH, PA 15236

(412) 881-6620
(412) 881-6637 (fax)

WILLIAM G. BRUCKER
BERNARD M. SCHNEIDER
CHARLES J. PORTER

Pittsburgh Office:
1715 Gulf Tower
707 Grant Street
Pittsburgh, PA 15219
(412) 261-0363
(412) 261-9036 (fax)

North Hills Office:
1007 Mt. Royal Boulevard
Second Floor
Pittsburgh, PA 15223
(412) 486-2094
(412) 486-2176 (fax)

Reply to: Main Office

March 6, 2009

VIA HAND DELIVERY
Mr. Michael J. Kiely
Division of Audit Review
Bureau of Financial Operations
Department of Public Welfare
701 State Office Building
300 Liberty Avenue
Pittsburgh, PA 15222

Re: Response to WPACC Draft Audit Report dated February 11, 2009

Dear Mr. Kiely:

For any draft audit to be truly beneficial, the parties concerned must have a dialogue designed to resolve open issues or disputes in some meaningful fashion before drawing any conclusions therefrom.

By way of background: by letter dated July 11, 2008, from Richard E. Wessel, CFE, Manager of Western Operations, Bureau of Financial Operations ("BFO"), Department of Public Welfare, to Mr. Michael Cummings, Executive Director of Western PA Child Care, LLC ("WPACC"), which is attached hereto as Exhibit A, Mr. Wessel outlined certain audit procedures in connection with the BFO's audit review of WPACC. Included therein at item 5, Mr. Wessel states: "Draft Report. The draft report is limited in distribution. The purpose of the draft report is to allow those responsible to review the report prior to issuing the final report and also to obtain your written responses." Mr. Thomas Crofcheck was copied on this letter.

In contravention of Mr. Wessel's directive that the "draft report is limited in distribution," the draft report was released on February 11, 2009, with great fanfare to the news media before it was delivered to WPACC. Moreover, simultaneous with the release of the draft report to the news media, Mr. Thomas Keating of the Attorney General's Office, faxed a letter to Geoffrey R. Johnson, Esquire, counsel to PA Child Care, LLC ("PACC"), requesting that the litigation filed by PACC against Mr. Crofcheck and Mr. Leonard Pocius (the "Action"), both of the Department of Welfare, be dismissed. The premature disclosure to the media was the initial factor and basis for the original litigation filed by PACC. A copy of the February 11, 2009 letter is attached hereto as Exhibit B.

We could take the position that the events of February 11, 2009, when coupled with the irregular, inappropriate and unfounded statements contained in the "draft audit" of that date, demonstrate that the draft report was not designed to resolve open BFO review issues or disputes in some meaningful fashion. Rather the "draft audit" was intended to punish the principals of WPACC who BFO believes to be responsible for bringing the Action, and to influence the fact finder therein against the plaintiff. The BFO, along with Mr. Keating and other DPW lawyers, thereby violated BFO's own procedural rules for conducting the review, denied WPACC its right to a fair audit, violated WPACC's principal's First Amendment rights to speak freely and to petition government, and colored all of its review comments. The alternative is to look past these factors and legitimately undertake a reasonable and rational response. The conclusion of these matters satisfactory to all participants is currently our goal. It is in this vein that we respond to the "draft audit" hereinbelow.

Issue 1,
#1 MAYS-Corporate Questioned Costs

A. Purported Related Party Transactions

The mere fact that transactions were with related parties does not render those expenses unallowable.

1. As you are well aware, Robert J. Powell ceased to own any interest in WPACC and MAYS before June 30, 2008. Accordingly, the Powell Law Group, P.C. (PLG) was not a related party as of June 30, 2008. Mr. Pat Owens was an employee of PLG and provided accounting services for WPACC and MAYS. PLG was reimbursed for the costs of such services and other expenses related thereto. Attached as Schedule #1, A1, are documents to substantiate the salary paid by PLG to Mr. Owens for his services and the support for the other expenses and charges of PLG which were reimbursed by WPACC. Mr. Owens is no longer an employee of PLG and a formal agreement now exists for these services and expenses between Mr. Owens and MAYS. It was executed after the BFO review and memorializes and ratifies the charges.

2. Attached as Schedule #1, A2, is the office lease between PLG as the tenant, and Big Kahuna Realty, LLC, as the landlord. The portion of the space used by the PLG employee who provides accounting services to MAYS/WPACC is set forth thereon. A formal agreement now exists for these services and expenses. It was executed after the BFO review and memorializes and ratifies the charges.

3. Legal Eye Productions LLC is not a related party to WPACC or MAYS. It is owned and controlled by Vince Sebal, an unrelated person, and was never owned or controlled by Robert Powell the President of PLG. The listing of the President of PLG as the president of Legal Eye Productions is incorrect. In this connection, attached as Schedule #1, A4 is a letter from the owner of Legal Eye Productions. The expenses of $3,264.48 were for various productions of marketing materials including brochures, DVDs and WEB updates. It is not common business practice for the vendor to provide documentation with their invoicing; it is the responsibility of the payer to be certain the items were received. Copies of the DVDs, brochures, etc. were received by MAYS Corp. and payment was made. We have included copies of the materials with this response and would direct you to the MAYS web site www.midatlanticyouth.com. The expenses are allowed expenses for WPACC's marketing and public relations activities.

4. Virtual Legal Assistant LLC ("VLA") is not a related party to WPACC or MAYS. It is owned and controlled by an unrelated person. In this connection, attached as Schedule #1, A5 is a letter from the President of VLA. The President of VLA is not an employee of PLG and was not at the time of providing services to WPACC. The Principal of Virtual Legal Assistant is self employed and performs paralegal support for a variety of attorneys. The invoice in question was for the preparation of a power point presentation for MAYS. Attached on Schedule #1, A5 is the ownership of Virtual Legal Assistant LLC. The expenses are secretarial expenses for MAYS that were provided by an unrelated third party.

B. Alleged Unsupported Costs - Disagree

1. Because of growing costs associated with automobiles, an agreement was reached between MAYS and the former president of MAYS whereby he would receive a fixed monthly payment to compensate him for his automobile. Since the payment was for use of his automobile it was recorded initially as an automobile expense. It should be properly reclassified as additional employee compensation. In either category it is a bona fide expense of operations.

2. The expenses disallowed in draft report sections #1, B2 and #1, B3 are for MAYS Corp and were expended in order to complete its responsibilities to MAYS-Butler in the area of marketing and public relations for WPACC, as well as for travel expenses for the CEO and other key employees of MAYS incurred while performing their business functions. These expenses constitute part of the MAYS overhead that is reimbursed as part of the Management Fees paid by WPACC to MAYS. The BFO is well aware that these expenses are included in the MAYS overhead and not separately charged. The CEO and other key employees charged these expenses to MAYS credit cards and credit card supporting evidence has been provided to the BFO auditors. Schedule #1, B2 sets forth further explanation of these expenses. WPACC believes that all of these expenses are supported and justified.

C. Interest Costs

Upon commencement of operations and because WPACC was from its inception a fully staffed facility, the revenues were not sufficient to pay expenses. Indeed, as BFO is well aware, WPACC incurred initial operating losses of $53,513 in 2004-2005, and $1,442,458 in 2005-2006. To fund the aggregate operating losses of $1,495,971, a bank line of credit in the amount of $750,000 was fully drawn and funds were provided by various loans from PACC to keep the WPACC operation appropriately functioning. Given that some governmental entities deliberately delay paying providers, WPACC's cash management is a critical function of its operations. The borrowed funds in question were used during the start up of the facility which occurred in 2005 and continued into 2007. Repayment to lenders other than S&T Bank was made first with the Bank being substantially repaid in the 2008-2009 fiscal year of operation. Interest expenses that are incurred for bona fide operational debts are allowable and appropriate expenses. Concerning the matter of insurance premiums, due to the high cost of all insurances for WPACC's business (in excess of $500,000 annually) the premiums are amortized and paid for over the operating year. The ability to pay over time is a cash management tool which helps to even out the cash flow of expenses.

MAYS Corporate Summary

As can be verified from the attached supporting documents, the questioned costs are reasonable and appropriate costs for a company that is charged with managing the facility. The public relations and marketing expenses are ordinary and necessary costs that all companies in this position incur, and in fact from a market prospective we believe that the companies' costs are lower than competing facilities

#2. MAYS-Butler Questioned Costs.

A. Purported Related Party Transactions - Disagree
Marsicano Law Investigations (MLI) is owned by Mr. Michael Marsicano. MLI is not a related party to WPACC or MAYS. Mr. Marsicano is a retired law enforcement official and a licensed private investigator. As such, MLI had been retained to undertake employee background searches. A copy of the agreement between MLI and WPACC for employee background searches is attached as Schedule #2, A. There is no requirement under current law or regulations that requires WPACC to competitively bid these services. The background searches performed, in the opinion of management, went well beyond those that ordinarily accompany Act 33/34 clearances. This provided WPACC and its residents with additional protection.

B. Alleged Unsupported Costs – Disagree

1. Management Fees of $396,000 or twenty-two ($22) dollars per bed were charged by Northwestern Human Services ("NHS"), an unrelated **non-profit** third party, to manage a 48 bed facility for PACC, a WPACC sister company, during the fiscal year 2004-2005, see #2. Schedule B1 attached. Given that WPACC is a 72 bed facility, the NHS Management Fee at $22 per bed for WPACC would have been about $580,000. The Management Fee of $547,000 charged by MAYS Butler to WPACC is about $30,000 less than a comparable third party **non-profit** management fee, and thus the MAYS management fee is unreasonably low. In the County Institutional Facility Per Diem Calculation, WPACC, as a for-profit entity, is permitted a pre-tax profit margin of 16%. Inasmuch as the WPACC aggregate allowed and justified costs and expenses are $6,544,594, as set forth on Schedule #2, B1, the reasonable pre-tax profit per this established methodology should be $1,047,135. We hereby adjust the pre-tax profit in the form of a management fee/pre-tax profit for the 2007-2008 fiscal year to $1,047,135. On an after-tax basis the management fee/profit would be reduced to about $545,000 **which is still less than the comparable non-profit management fee of $580,000** determined above. As you are aware, the purpose of the Management Fee is to pay for the other support costs that MAYS Corp. expends to support its mission of full occupancy and program development/assistance along with retaining a fair after tax annual profit. The Management Fee paid to MAYS Corp. allows MAYS Corp. to expend resources in areas which, while not allowable to be billed to counties, are integral in the continuance of its mission to provide quality programs, competent staff and maximum utilization in order to provide those services to counties at a reasonable per-diem.

2. A copy of a Management Agreement between MAYS-Corp. and MAYS-Butler is attached as Schedule #2, B2. It was executed after the BFO review and memorializes and ratifies the charges.

3. A copy of the supporting depreciation schedule is attached as Schedule #2, B3.

C. Costs Not Necessary or Related to Facility Operations.

We agree that the $1,320 expense part of which is a donation to "March of Dimes" should not have be included for reimbursement.

#3. WPACC Questioned Costs.

A. Purported Related Party Transactions.

1. A copy of the agreement between PLG and WPACC is attached. It was executed after the BFO review and memorializes and ratifies the charges.
2. A copy of the lease between WPACC and Big Kahuna is attached. It was executed after the BFO review and memorializes and ratifies the charges.

B. Alleged Unsupported Costs - Disagree

1. The Administrative Fee was reversed, not accrued and not charged in the 2007-2008 fiscal year.

2. We agree the charitable deduction of $250 to Men of Marian should not be reimbursed.

C. Mortgage Interest Expense

Construction loan proceeds of $1.0 million were for project Consulting Fees that were paid to the principals of WPACC in 2004. The Consulting Fees were paid to the principals to compensate them for services and carrying costs of developing the WPACC project prior to and during the project's construction. The Consulting Fees were fully disclosed to the bank and were budgeted as "Consulting Fees" and approved as part of the construction loan, see Schedule #3, C attached. As such, the Consulting Fees were built into the transaction financing and were contingent on successful completion of the project. The principals spent over 3 years of time and expense in researching suitable sites, negotiating with prospective sellers, conducting other activities associated with the development of the project along with bearing the total risk of the transaction. Inasmuch as the fee and loan are appropriate, the interest component on this portion of the loan is appropriate and should be allowed.

ISSUE 2,
Alleged Billing Errors, Documentation And Luzerne County Billing - Disagree

A. Billing Errors – Billing staff will be made aware of all pertinent contract payment provisions to ensure accuracy. The contracts for 2007-2008 did allow for billing for day of discharge if discharge occurred after 12:00 noon. The rational for this charge is that there are expenditures made on behalf of the youth when they do not leave until later in the day. MAYS is in the finishing stages of designing a data based system which will enable it to accurately track youth through its facility and will prepare appropriate billings for both per diem billings and education billings.

B. Court Orders – All necessary documentation including court orders supporting admissions, transfers between programs and discharges of juveniles have been received and maintained appropriately. In the rare circumstance where a court order or other documentation is not received timely a record of the failure to receive and the steps being taken to correct the situation will be kept

C. Luzerne County Placement Agreement – The County and MAYS have ended the contractual relationship with regard to the Shelter Care Beds. MAYS would, when there were empty beds in Shelter Care, make attempts to fill the beds with other than Luzerne County youth as long as Luzerne County approved giving up those beds. There were a number of occasions where Luzerne County would not give approval and the beds remained unfilled and thus were billed to Luzerne County.

Issue No. 3,
Alleged Lack of Adequate Documentation
Resulted in Internal Control Weaknesses - Disagree

Lack of Payment Authorization – A written expense policy did exist, see Schedules, Issue #3. A more explicit expense policy has been implemented to reinforce the existing expense policy and further delineate the approval process required to process payments.

Lack of Formal Agreements – The Company is transitioning away from the necessity for inter-company loans. Until the transition is completed the company will prepare documentation to support the loans

Account Coding – Almost all MAYS Butler and WPACC invoices were appropriately coded with the G/L account, date of payment and check number used to pay the invoice. An even more rigorous system has been implemented to ensure that all invoices paid will reflect the G/L account code, date of payment and check number used to pay the invoice.

Lack of explanation of Journal Entries – All General Journal entries had explanations. In the future even more detailed explanations of the purpose of the entry and the location of any supporting documentation will be required.

Issue No. 4,
Alleged WPACC Did Not Adequately Allocate Costs Among Its Three Programs- Disagree

WPACC currently only offers Secure Treatment and IORT. Allocations of expenses are based on methodologies that best suit the expense. Costs will be charged to individual programs where the expense can be properly determined. WPACC and MAYS believe the allocation methodologies now in use are appropriate and sufficient.

Attachment A - Improper Audit Matter and Disclosure

The expenses in Attachment A that were heralded by BFO to the news media are not from the fiscal year 2007-2008 under review. Rather, they are from a prior fiscal year. These expenses were recorded by MAYS Corporate as overhead and not charged to the WPACC facility. No effort had been made by WPACC to recover any specific charge for them. Instead, they are items of a compensatory or personal nature that are covered by the MAYS profit distribution structure. BFO sought out these expenses <u>that were incurred before the review period</u> in order to incite a scandal in an effort to harass and embarrass the principal of MAYS and WPACC to dismiss the Action as described on page 1. The BFO's efforts here clearly show that the intent of its audit review of WPACC was not for a bona fide purpose. BFO used this information and the media to violate its own procedural rules for conducting the review, denied WPACC its right to a fair audit, violated WPACC's principal's First Amendment rights to speak freely and to petition government, and colored all of its review comments. We shall address this matter with BFO officials in another forum.

Very truly yours,

William G. Brucker

Enclosures

file

BRUCKER SCHNEIDER & PORTER

ATTORNEYS AT LAW

WILLIAM G. BRUCKER
BERNARD M. SCHNEIDER
CHARLES J. PORTER

Main Office:

SUITE 320, WEYMAN PLAZA
300 WEYMAN ROAD
PITTSBURGH, PA 15236

(412) 881-6620
(412) 881-6637 (fax)

Pittsburgh Office:
1715 Gulf Tower
707 Grant Street
Pittsburgh, PA 15219
(412) 261-0363
(412) 261-9036 (fax)

North Hills Office:
1007 Mt. Royal Boulevard
Second Floor
Pittsburgh, PA 15223
(412) 486-2094
(412) 486-2176 (fax)

Reply to: Main Office

May 18, 2009

VIA TELEFAX AND REGULAR MAIL
Mr. Kevin M. Friel, Director
Bureau of Financial Operations
Department of Public Welfare
Room 525 Health and Welfare Building
Harrisburg, PA 17120

Re: Response to WPACC Audit Report dated February 11, 2009 ~ Second Draft.

Dear Mr. Friel:

At the outset, I wish to thank you for the extension of time to respond to the Second Draft of the Audit Report dated February 11, 2009.

The majority of the issues addressed in the Second Draft were discussed in our response of March 6, 2009, as well as at the conference with you held on March 18, 2009. We offer the following comments to underscore a few of our prior responses to your questioned costs:

1. The proposed administrative fee of $533,125 was never paid and the journal entry had been reversed in the fall of 2008. Hence, we question why this is even an audit item.

2. The narrative on page 8, item 2, indicates that there was no documentation to support the rent paid to Big Kahuna Realty, LLC. Yet, numerous canceled checks bore notations that they were for rent. Hence, documentation did exist for the rental payments.

3. The management fees paid to PLG were for accounting services. The individual who performed these services met with BFO on many occasions and personally described his services. We have documented the management fees as reimbursement for his actual salary that was substantiated by his W-2s.

4. As discussed in our prior response, the efforts to locate the site and build the WPACC facility required enormous development time and efforts by the principals. As we disclosed in our March 6th response, this fee was budgeted into the financing with the bank. The fee reimbursed the principals for years of work to bring the project to fruition. The development/consulting fee was reasonable and was formally evidenced in writing as part of the financing documents executed by the bank and the parties.

5. As you are aware on June 9, 2009, the current owner bought out a former owner's interest in the companies. In accordance with their acquisition agreement, the bulk of the items shown on page 21 were treated as distributions to the former owner. Accordingly, substantially all of such items listed were not of record on June 30, 2008.

6. The audit continues to ignore the profits that MAYS/WPACC were entitled to charge for their services. As illustrated in our March 6th response, the after tax profit component for WPACC/MAYS is less than the fee charged by the nonprofit entity which operated its sister company. The profit component to MAYS/WPACC is reasonable and the manner in which the MAYS' profits were paid to the principals had no impact or bearing on the cost of operating WPACC.

As first stated, these comments are only meant to underscore a few of the comments and extensive documentation we have previously provided to the BFO.

Very truly yours,

William G. Brucker

APPENDIX B

LUZERNE COUNTY COMMISSIONERS
MARYANNE C. PETRILLA, CHAIRMAN
GREGORY A. SKREPENAK
STEPHEN A. URBAN

FRANK J. CASTANO
DIRECTOR

DOUGLAS A. PAPE
Acting County Manager/Chief Clerk

LUZERNE COUNTY

CHILDREN AND YOUTH SERVICES

111 North Pennsylvania Boulevard Suite 110, Wilkes-Barre, PA 18701-3697
(570) 826-8710 · Fax Number: 570-821-7355
TDD (570) 825-1860

March 17, 2009

Mr. Kevin Friel, Director
Bureau of Financial Operations
PA Department of Public Welfare
3rd Floor Bertolino Building
P.O. Box 2675
Harrisburg, Pennsylvania 17105-2675

Dear Mr. Friel,

This letter is to serve as a response to the proposed audit report concerning Western PA Child Care, LLC that was provided together with your letter to me dated February 11, 2009.

In its proposed audit report, the Bureau of Financial Operations ("BFO") recommends that Luzerne County "evaluate and make changes to the contract practices that resulted in the payment for empty beds and the reservation of emergency shelter beds in a facility that is more than 260 miles away from the Luzerne County seat". Luzerne County believes that it has already implemented changes that should satisfy or render moot BFO's recommendations. Specifically, Luzerne County did not contract with Western PA Child Care, LLC for the 2008-2009 Fiscal Year. Furthermore, the agreements dated June 30, 2008 between Luzerne County and PA Child Care, LLC for secure detention beds, treatment beds and sexual offender/fire setter beds at the facility in Luzerne County only require Luzerne County to pay for beds as and when needed by Luzerne County.

Thank you for your review and consideration of this response.

Sincerely,

Frank J. Castano

CC: Commissioner Maryanne Petrilla
Commissioner Gregory Skrepenak
Commissioner Stephen Urban
Mr. Doug Pape
Mr. Thomas Pribula
Mr. Brian Bufalino
Mr. Joseph DeVizia
Mr. John Johnson
Mr. Michael Kiely

CWLA
CHILD WELFARE LEAGUE OF AMERICA
Making Children a National Priority
Member Agency