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OFFICE OF THE COMPTROLLER
CITY OF ST. LOUIS



DARLENE GREEN
Comptroller

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DR. KENNETH M. STONE, CPA
Internal Audit Executive

October 14, 2008

Paul McCarthy, President
NovaSource, Inc.
12166 Old Big Bend
St. Louis, MO 63122

RE: Fiscal Monitoring Review of NovaSource, Inc., Workforce Investment Act
Contract 111-08, CFDA# 17.258 -17.260, (Project #2008-SLATE16)

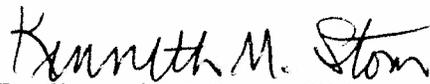
Dear Mr. McCarthy:

Enclosed is a report of our fiscal monitoring review of NovaSource, Inc., Workforce Investment (WIA) programs for the period July 1, 2007 through June 30, 2008. The scope of a fiscal monitoring review is substantially less than an audit, and as such, we do not express an opinion on the financial operations of NovaSource, Inc. Our fieldwork was completed on September 17, 2008.

This review was made under authorization contained in Section 2, Article XV of the Charter, City of St. Louis, as revised, and has been conducted in accordance with the *International Standards for the Professional Practice of Internal Auditing* and through an agreement with the St. Louis Agency on Training and Employment to provide fiscal monitoring to all grant subrecipients.

If you have any questions, please contact Dorothy Middleton at (314) 589-6111.

Sincerely,


Dr. Kenneth M. Stone, CPA
Internal Audit Executive

Enclosure

cc: Michael K. Holmes, Executive Director - SLATE
Kim Neske, Fiscal Manager - SLATE



CITY OF ST. LOUIS

ST. LOUIS AGENCY ON TRAINING AND EMPLOYMENT (SLATE)

*NOVASOURCE, INC.
WORKFORCE INVESTMENT ACT (WIA) PROGRAM*

*CONTRACT #111-08
CFDA# 17.258, 17.259 AND 17.260*

*FISCAL MONITORING REVIEW
JULY 1, 2007 THROUGH JUNE 30, 2008*

PROJECT #2008-SLATE16

DATE ISSUED: October 14, 2008

*Prepared by:
The Internal Audit Section*



OFFICE OF THE COMPTROLLER

Honorable Darlene Green, Comptroller

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WORKFORCE INVESTMENT ACT (WIA) PROGRAM
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INTRODUCTION

Background

Contract Name: NovaSource, Inc.
Contract Number: 111-08
CFDA Number: 17.258, 17.259 and 17.260
Contract Period: July 1, 2007 through June 30, 2008
Contract Amount: \$132,000

This contract provides funds through the St. Louis Agency on Training and Employment (SLATE) to NovaSource (Agency) for its Workforce Investment Act (WIA) programs. The funds are provided to assist ex-offenders in the St. Louis area find meaningful employment.

Purpose

The purpose of this fiscal monitoring review was to determine the Agency's compliance with federal, including OMB Circular A-133, state and local SLATE requirements for the period July 1, 2007 through June 30, 2008, and make recommendations for improvements as necessary.

Scope and Methodology

We made inquiries regarding the Agency internal controls relating to the grant administered by the St. Louis Agency on Training and Employment (SLATE), tested evidence supporting the reports the Agency submitted to SLATE and performed other procedures considered necessary. Our fieldwork was completed on September 17, 2008.

Exit Conference

We conducted an exit conference at the Agency on October 1, 2008. The Agency was represented by Mr. Paul McCarthy, President and Mr. Donald Leonard, company CPA. The Internal Audit Section (IAS) was represented by Dr. Kenneth M. Stone, Internal Audit Executive and Dorothy Middleton, Auditor II.

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INTRODUCTION

Management's Responses

We received management's responses to the observations and recommendations identified in this report from the Agency on October 1, 2008. These responses have been incorporated into this report.

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SUMMARY OF OBSERVATIONS

Conclusion

The Agency did not fully comply with federal, including OMB Circular A-133, state and local SLATE requirements.

Status of Prior Observations

The Agency's previous fiscal monitoring report, issued February 22, 2007, contained two observations:

1. Going Concern Issue (**Unresolved, see observation #1**)
2. Adjusted Payroll Budget Without Approval (**Resolved**)

A-133 Status

According to the Agency's letter, dated February 7, 2008, it did not expend \$500,000 or more for the calendar year ending December 31, 2007; therefore, it was not required to have a single audit in accordance with OMB Circular A-133.

Summary of Current Observations

We made recommendations for the following observations, which if implemented, could assist the Agency in complying with federal, including OMB Circular A-133, state and local SLATE requirements:

1. Going Concern Issues (**Repeated**)
2. Non-compliance with Federal Tax Regulations & Contractual Obligation
3. Lack of Adequate Fiscal Procedures and Accounting Controls

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DETAILED OBSERVATIONS, RECOMMENDATIONS
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1. Going Concern Issues (Repeated)

The Agency provided copies of the December 31, 2007 and June 30, 2008 unaudited financial statements for our review. Based on our analysis, there continues to be doubt about the Agency's ability to operate as a going concern. Going concern measures an entity's ability to realize assets, discharge liabilities in the normal course of business and generate sufficient resources to stay operational.

In the last fiscal monitoring report, dated February 22, 2007, a going concern issue was also reported. The Agency's net working capital, current assets less current liabilities, was (\$371, 237) for the fiscal year ended December 31, 2006.

We considered the following factors in measuring the Agency's ability to function as a going concern:

- a. The Agency's net working capital as of December 31, 2007 was (\$317,031.06) and (\$371,817.33) as of June 30, 2008. The net working capital balance includes \$306,752.43 in current and past due payroll taxes.
- b. The Agency reported a net loss of (\$13,855) in 2007.
- c. The Agency's current /quick ratio, assets to current liabilities, as of June 30, 2008 was (.04) and less than the industry's standard of 1.
- d. The Agency reported a cash balance of (\$27,083.77) as of June 30, 2008 and a current asset balance of (\$12,664.99).
- e. Total capital as of June 30, 2008 was \$(399,556).
- f. Employee loans and advances totaling \$9,170.04 as of December 31, 2007 were still outstanding as of June 30, 2008.
- g. Loan term loans payable included \$146,680 which included \$49,924 for bank obligations, \$25,000 to an investor and \$71,755.70 to related parties.
- h. Bank charges due to overdrafts were approximately \$10,800 for the year of 2007 and \$4,000 for the six months ended June 30, 2008.

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1. Continued... ..

As a result of our analysis, it is apparent that the Agency is not in compliance with its contract and risk bankruptcy based on current obligations. In accordance with Section 14 of the Agency's contract with SLATE, the Agency is required to be a fiscally viable entity without receipt of the SLATE contract.

We learned that the Agency's alternative sources of funding were from a factoring agent on a quarterly basis and a contract with ARCHS for \$299,774. However, the ARCHS contract expired June 30, 2008. The extension is pending approval by ARCHS.

Recommendations

We recommend that the Agency implement an effective budgetary control or working capital management system and seek additional funding sources to achieve a more positive financial outlook.

Management's Response

Funding for FY 2009 is expected from the following sources:

<i>SLATE:</i>	<i>\$217,000 (\$132,000 to NovaSource and \$85,000 to UMC-Parkview)</i>
<i>SLATE One-stop Shop:</i>	<i>\$100,000 (an approximate amount): This program will commence in January 2009.</i>
<i>ARCHS:</i>	<i>\$212,000 (ex-offender transitional employment grant)</i>
<i>ARCHS:</i>	<i>\$300,000 (DOL ex-offender job readiness and placement)</i>
<i>Northrop Grumman:</i>	<i>\$500,000 (computer contract work in Pennsylvania)</i>

Auditor's Comment

Again, we recommend that the Agency implement the recommendations noted above.

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2. Non-compliance with Federal Tax Regulations & Contractual Obligation

IAS' review revealed that the Agency's taxes were not timely filed and paid in accordance with federal tax regulations and its contractual obligation. IAS found that:

- a. The Agency owes the federal government \$295,416.18 for unpaid payroll taxes for the years 2004 and 2005. As a result and effective August 8, 2008, the IRS has placed a six month subordination lien on the Agency's receivables. The lien is subject to expire February 1, 2009.
 - No installment agreement has been executed with IRS to liquidate the outstanding tax liabilities.
 - Although two offers by the Agency's attorney to settle the obligation were rejected by the IRS, another offer is scheduled to be submitted later this fall.
 - According to the IRS' *Notice of Federal Tax Lien*, additional penalties, interest, and costs may accrue on the payroll tax liability.
- b. The Agency underpaid the 2nd quarterly payroll taxes of 2008 by \$6,667.27. Payment is expected to be made upon receipt of funds due from the Agency's factoring agent (LSQ).
- c. Although the Agency has going-concern issues, it appears that payments to related parties for loans and employee advances were made before payroll taxes to the IRS. We observed that as of December 31, 2007:
 - Long term loans payable of \$96,755.70, due to related parties and one investor, were reduced to \$1,000 as of June 30, 2008, and were paid from the Agency's operating account according to the Agency's President.

In addition to the risk of additional IRS assessments, the Agency risk future WIA funding due to Addendum II - *Resolution on Assurances and Certification* of its contract requiring compliance with applicable laws and regulations.

Recommendation

We recommend that the Agency settle its tax problem with the IRS as soon as possible and file and pay all taxes due as required by the applicable taxing authorities.

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2. Continued... ..

Management's Responses

NovaSource owes approximately \$295,000 to the IRS for federal tax payments from late 2004-early 2005. The company currently pays \$6,000 per month to the IRS for that debt and is in negotiations with the IRS for a settlement offer in the hope of reducing the total amount. No formal letter was issued by the IRS for the \$6,000 monthly payment; it was an agreement reached verbally with the Revenue Officer handling our case. We are billed monthly for \$6,000 by the IRS.

Auditor's Comment

Again, we recommend that the Agency implement the recommendations noted above and obtain written documentation of the settlement.

3. Lack of Adequate Fiscal Procedures and Accounting Controls

The Agency does not have written accounting procedures or internal controls in place for the preparation of financial records, and to document the reviews and approvals of changes. As a result, the Agency lacked proper assurances that its financial records are accurate, reliable and properly safeguarded.

In accordance with Section 14 of the Agency's contract, the Agency must assure that program or activities have administrative and accounting controls. In addition, policies must be in place to the effective use of the fund and have accounting and internal control standards that meet *Generally Accepted Accounting Principals (GAAP)*.

IAS observed the following inconsistencies:

- a. The December 31, 2007 balance sheet reported income of (\$13,855.86), yet the income statement reported (\$155,932.62).

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3. Continued... ..

- b. The December 31, 2007 balance sheet reported \$344,738.83 under the classification *current assets* (grants receivables) and under *long-term liabilities* (services payable on grants) that were unsupported. Revised copies of the balance sheet and income statement were provided based on our inquiry. These line items were deleted from the revised financial statements. The Agency's Accountant/CPA stated that the 2007 financial statements were an interim statements and were prepared based on a previous auditor's recommendations. No written approvals for any of the changes were authorized by the president prior to distribution of the financials.
- c. Financial records were not available for review. Section 22 of the Agency's contracts requires that records should be maintained for a period of three years after the final payment under the contract. The contracts with the Northrop Grumman and LSQ could not be located.

Recommendation

We recommend that the Agency comply with the terms of its contract by establishing written fiscal procedures and accounting controls to ensure financial records are accurate, reliable, and assets and records are properly safeguarded. We recommend the controls include:

- a. Preparation of financial records in accordance with *Generally Accepted Accounting Principals (GAAP)*.
- b. Management's review of financial statements for accuracy and reliability.
- c. Written management approval for changes.
- d. Record retention policy acceptable to the grant and WIA regulations.

Management's Response

NovaSource uses OCOMBRA for its accounting procedures (Other Comprehensive Method of Accounting).

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3. Continued... ..

Auditor's Comments

We recommend that the Agency implement the recommendations noted above and obtain written documentation of the IRS agreement or settlement.