



OFFICE OF THE COMPTROLLER  
CITY OF ST. LOUIS



**FILE COPY**

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**DR. KENNETH M. STONE, CPA**  
Internal Audit Executive

November 16, 2009

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

RE: Workforce Investment Act (WIA) (Project #2009-SLATE5)

Dear Mr. McCarthy:

Enclosed is a report of our fiscal monitoring review of NovaSource, Inc., a for-profit organization, WIA Program for the period of July 1, 2008 through November 30, 2008. The scope of a fiscal monitoring review is less than an audit and, as such, we do not express an opinion on the financial operations of NovaSource, Inc. Fieldwork was completed on February 2, 2009.

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 (SLATE) to provide fiscal monitoring to all grant subrecipients.

If you have any questions, please contact the Internal Audit Section at (314) 622-4723.

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 CITY OF ST. LOUIS

**ST. LOUIS AGENCY ON TRAINING AND EMPLOYMENT (SLATE)  
WORKFORCE INVESTMENT ACT (WIA)**

**NOVASOURCE, INC.  
CONTRACT #111-09  
CFDA #17.258, #17.259 AND #17.260**

**FISCAL MONITORING REVIEW**

**JULY 1, 2008 THROUGH NOVEMBER 30, 2008**

**PROJECT #2009-SLATE5**

**DATE ISSUED: NOVEMBER 16, 2009**

**Prepared by:  
The Internal Audit Section**



# OFFICE OF THE COMPTROLLER OFFICE OF THE COMPTROLLER

**HONORABLE DARLENE GREEN, COMPTROLLER**

**CITY OF ST. LOUIS  
ST. LOUIS AGENCY ON TRAINING AND EMPLOYMENT (SLATE)  
WORKFORCE INVESTMENT ACT (WIA)  
NOVASOURCE, INC.  
FISCAL MONITORING REVIEW  
JULY 1, 2008 THROUGH NOVEMBER 30, 2008**

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## INTRODUCTION

### Background

**Contract Name:** NovaSource, Inc.  
**Contract Number:** 111-09  
**CFDA Numbers:** 17.258, 17.259 and 17.260  
**Contract Period:** July 1, 2008 through June 30, 2009  
**Contract Amount:** \$217,000

This contract provides Workforce Investment Act (WIA) funds through the St. Louis Agency on Training and Employment (SLATE) to NovaSource (Agency) 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, state, and local SLATE requirements for the period of July 1, 2008 through November 30, 2008, and make recommendations for improvements, as considered necessary.

### Scope and Methodology

Inquiries were made regarding the Agency's internal controls relating to the grant administered by SLATE. Evidence was tested supporting the reports the Agency submitted to SLATE, and other procedures were performed, as considered necessary. Fieldwork was completed on February 2, 2009.

### Exit Conference

The Agency was offered the opportunity for an exit conference on November 13, 2009, but it was declined.

### Management's Responses

On November 13, 2009, the Agency was provided with our observations and recommendations and a response was requested by November 24, 2009; however, the Agency has declined to respond.

## SUMMARY OF OBSERVATIONS

### Conclusion

The Agency did not fully comply with federal, state, and local SLATE requirements.

### Status of Prior Observations

The Agency's previous fiscal monitoring report, Project #2008-SLATE16, issued October 14, 2008, contained three observations:

1. Going concern issue (**Repeated, see observation #1**)
2. Non-compliance with federal tax regulations & contractual obligation (**Repeated, see observation #1**)
3. Lack of adequate fiscal procedures and accounting controls (**Repeated, see observation #2**)

### 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

Recommendations for the following observations were made, which if implemented, could assist the Agency in complying with federal, state and local SLATE requirements:

1. Opportunity to address going concern issues
2. Opportunity to address inadequate accounting system and controls
3. Opportunity to address inadequate separation of duties
4. Opportunity to address inadequate separation of grant funds

**DETAILED OBSERVATIONS, RECOMMENDATIONS  
AND MANAGEMENT'S RESPONSES**

**1. Opportunity To Address Going Concern Issues (Repeated)**

The Agency did not address any of the going concern issues raised in the prior fiscal monitoring report dated October 14, 2008.

The going concern issues raised in the prior fiscal monitoring report were based on the June 30, 2008 unaudited financial statements, which were the last financial statements the Agency prepared.

The pertinent going concern issues that were raised in the prior fiscal monitoring report, and that remain outstanding as of the date of this report, are as follows:

**1. Working Capital**

- 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 federal, state and city payroll taxes.
- The Agency reported a cash balance of (\$27,083.77) as of June 30, 2008, and a current asset balance of (\$12,664.99).
- Bank charges, due to overdrafts, were approximately \$10,800 for the year 2007 and \$4,000 for the six months ended June 30, 2008.

**2. Loans and Advances**

- Employee loans and advances, totaling \$9,170.04 as of December 31, 2007, were still outstanding as of June 30, 2008.
- Long 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.

**3. Equity**

- The Agency reported a net loss of (\$13,855) in 2007.
- Total capital as of June 30, 2008 was \$(399,556).

#### 4. Outstanding Federal Payroll Taxes

- The Agency owed the Internal Revenue Service \$295,416.18 in unpaid payroll taxes for the calendar years 2004 and 2005. As a result, and effective August 8, 2008, the IRS had placed a six-month subordination lien on the Agency's receivables. The lien was subject to expire February 1, 2009. The Agency reports that they no longer have the lien.
- The Agency underpaid the second quarterly payroll taxes of 2008 by \$6,667.27.
- According to the IRS' *Notice of Federal Tax Lien*, additional penalties, interests, and costs may accrue on the payroll tax liability.

#### 5. General

- Although the Agency had going-concern issues, it appears that payments to related parties for loans and employee advances were made before paying the payroll taxes:
- 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, during the current review, it could not be determined if the Agency remitted the third and the fourth quarter payroll taxes to the IRS, because it did not provide any evidence of the payment of these taxes.

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.

The Agency did not have a system of internal controls in place to alleviate the adverse going concern conditions stated above.

Based on the outstanding going concern issues stated above, there continues to be doubt over the Agency's ability to remain operational beyond the foreseeable future.

#### Recommendation

It is recommended that the Agency:

- Generate additional revenues and reduce its liabilities to attain a positive working capital.
- Negotiate an agreement to with the IRS to pay off delinquent payroll taxes.

1. **Continued...**

**Management Response**

*On November 13, 2009, the Agency was provided with the observations and recommendations and a response was requested by November 24, 2009; however, the Agency has declined to respond.*

2. **Opportunity To Address Inadequate Accounting System And Controls**

The Agency's did not maintain adequate and up-to-date accounting records for the WIA program activities. Current financial statements were requested at the time of the entrance conference. However, the Agency was unable to produce them. Instead, financial statements from June 30, 2008, were provided.

The Agency did not have written accounting procedures or internal controls in place for the preparation and review of financial records, as well as approval of changes to those records. As a result, the Agency lacked proper assurances that its financial records are accurate and reliable.

Not keeping accounting records current could result in errors and irregularities that are not detected in a timely manner by employees in the normal course of business.

Noncompliance with federal, state, and local SLATE requirements may result in the suspension or termination of federal funds to the Agency.

**Recommendation**

It is 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, current, and reliable.

**Management's Response**

*On November 13, 2009, the Agency was provided with our observations and recommendations and a response was requested by November 24, 2009; however, the Agency has declined to respond.*

### **3. Opportunity To Address Inadequate Separation Of Duties**

It was observed that the Agency had inadequate separation of duties, where one person was in charge of the incoming mail, reviewing and approving the invoices, and signing the checks.

Segregation of duties is a basic key internal control. It is used to ensure that errors and irregularities are prevented or detected on a timely basis by employees in the normal course of business. Duties that should be segregated include:

- Authorization of transactions
- Custody of assets
- Recording of transactions
- Reconciliation of accounting records

In those instances where duties cannot be fully segregated, mitigating or compensating controls must be established. Mitigating or compensating controls are additional procedures designed to reduce the risk of errors and irregularities. For instance, if the record keeper also performs a reconciliation process, a detailed review of the reconciliation could be performed and documented by a supervisor to provide additional control over the assignment of incompatible functions.

The Agency did not have sufficient number of staff to segregate incompatible duties

Inadequate segregation of duties or the lack of compensating and mitigating controls may result in:

- Misappropriation of assets
- Misstated financial statements
- Inaccurate financial documentation (i.e., errors and irregularities)
- Improper use of the grant

#### **Recommendation**

It is recommended that, since the Agency could not segregate duties due to the small number of staff, it implement mitigating or compensating controls to reduce the risk of errors and irregularities.

#### **Management's Response**

*On November 13, 2009, the Agency was provided with our observations and recommendations and a response was requested by November 24, 2009; however, the Agency has declined to respond.*

#### **4. Opportunity To Address Inadequate Separation Of Grant Funds**

The Agency's accounting records did not separate the WIA grant funds from the Agency's other funds.

SLATE Contract #111-09 states that the Agency shall maintain such records and accounts, as are necessary, to assure proper accounting for the billing and receipt of grant funds.

The Agency did not have a system of internal controls to ensure separation of WIA grant funds from its other funds.

Lack of separation of funds may result in inadequate accounting of fund revenue and expenditures. In addition, non-compliance with the provisions of the grant agreement may result in the suspension or termination of federal funds to the Agency.

#### **Recommendation**

It is recommended that the Agency establish internal controls to ensure that its accounting records separate WIA grant funds from other funds.

#### **Management's Response**

*On November 13, 2009, the Agency was provided with our observations and recommendations and a response was requested by November 24, 2009; however, the Agency has declined to respond.*