New Castle County Auditor's Office
Review of Financial Statement Audits of Police Athletic League

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To: Paul Clark, County Executive
County Council Members
Gregg Wilson, Acting Chief Administrative Officer
Marcus Henry, General Manager of Community Services Department

Overview

In September 2010, the prior County Executive asked the County Auditor to "review an upcoming independent audit of the Police Athletic League (PAL) … in order to better understand the financial situation of PAL and assist in reaching an agreement fair to the County taxpayers and PAL …" County Council followed up with its own letter asking the County Auditor to "review the results of the PAL audit once it is completed."

The County Auditor met with members of the Administration in October 2010 and suggested, in light of the Administration's objective and because PAL had not yet paid the entire bill from the June 30, 2008 financial statement audit, that his office perform its own operational audit and concentrate more on the effectiveness and efficiency in which PAL has been managing its finances. (A financial statement audit performed by a CPA Firm would not be looking at effectiveness and efficiency.) The Administration agreed with this and, per the County Attorney, obtained the approval of PAL's attorney.

The County Auditor met with PAL's Executive Director and requested various documents/records. However, when the County Auditor requested the detailed transaction information from PAL's accounting system, he received a call from PAL's Board Chairman stating that he was overstepping his authority and that such information would not be provided. It should be noted, as a matter of course, that when an auditor asks for information and does not receive it, this is typically a "red flag" that the entity being audited may be trying to hide something.

In November 2010, the County Auditor sent two separate e-mails to management of the prior County Administration asking for advisement on how to proceed. No response was received; therefore, the County Auditor decided to return to the original request asking for a review of the upcoming financial statement audit.

As the last financial statement audit for PAL was for the fiscal year ended June 30, 2008, the CPA Firm audited PAL's financial statements for the years ending June 30, 2009 and June 30, 2010. The audits were begun in December 2010 and were completed in January 2011.

The County Auditor reviewed PAL's financial statements for the years ending June 30, 2009 and June 30, 2010, and also reviewed the CPA Firm's workpapers. He also reviewed the financial statements for the fiscal years ending June 30, 2006 through June 30, 2008.

Objectives and Scope

The objective of the County Auditor's review was to provide the County Administration and County Council with an independent assessment of PAL's financial condition as of June 30, 2010 and its results of operations for the fiscal years ending June 30, 2009 and June 30, 2010. In the course of this review, the County Auditor did look at some other documents such as the lease agreements between the County and PAL, the contract between PAL and the company it uses for fundraising, Board of Director minutes, etc.

The County Auditor's Office conducted its review in accordance with standards promulgated by the Institute of Internal Auditors and the United States General Accounting Office.

The "Independent Auditor's Report", included with the financial statements, indicates that the audits were performed "to obtain reasonable assurance about whether the financial statements are free of material misstatements." The audit opinion in this report is that "the financial statements … present fairly, in all material respects, the financial position of the Police Athletic League of Delaware, Inc. as of June 30, 2010 and 2009, and the changes in its net assets and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America."

Please note the limitations of a financial statement audit, i.e.,

- ***The auditors do not specifically audit for fraud, waste, or abuse.***
- ***The auditors do not provide an opinion on the system of internal controls.***
- ***The auditors do not analyze the effectiveness and efficiency of operations.***

These limitations are the reasons why the County Auditor had suggested that his office perform its own operational audit and concentrate more on the effectiveness and efficiency in which PAL has been managing its finances.

Reporting

This report provides observations and suggestions based upon our limited scope. These observations and suggestions, starting on page 11, are intended to assist the Administration in making decisions on the path forward with PAL. Many of the suggestions are things we would have performed ourselves had we been given the authority to perform an operational audit of PAL.

Response

A response to this report is not required. However, we would be happy to provide further insights into any of our observations and suggestions if asked.

Cc: Members of New Castle County Audit Committee
Nicole Majeski, Deputy Chief Administrative Officer
Vince Meconi, Deputy Chief Administrative Officer
Ed Milowicki, Acting Chief Financial Officer
Dennis Phifer, Chief of Staff

General Comment

As noted in the report cover letter, we originally proposed to perform our own operational audit of PAL. Below is a list (not all-inclusive) of some of the steps we would have performed on this audit:

- Evaluate PAL's accounting system information and closely analyze how PAL is managing its money, e.g.,
    - Analyze cash inflows and outflows and how PAL makes decisions on paying bills.
    - Analyze whether delinquent bills for certain vendors (e.g., Delmarva) were not paid, with other vendors' non-delinquent bills being paid instead.
    - Analyze the internal controls over the collection, depositing, and recording of funds received at special events.
    - Analyze whether employees were receiving pay increases at a time PAL could not afford to do so.
    - Analyze whether grant funds were spent in accordance with terms of the grantor.
    - Analyze PAL's efforts in ensuring it is receiving the best rates on its insurance policies.
    - Analyze PAL's efforts in ensuring energy usage is optimized.
    - Analyze why interest expense increased from FY '09 to FY '10 when the interest rate on the line of credit actually went down.
- Evaluate PAL's process for formulating its annual financial budget.
- Determine if PAL has a strategic plan and how it is implemented and monitored.
- Evaluate PAL Board's compliance with bylaws and with best practices for nonprofit boards (e.g., fundraising responsibilities of Board).
- Review minutes of Board Committees and evaluate efforts in accomplishing goals.
- Analyze the County's scheduling of its programs as well as PAL's efforts in scheduling program times the County is not there. Analyze whether PAL has performed an analysis of how much it could earn by renting the facility for those program times the County is currently utilizing.
- Perform more research on what other PAL's do and how National PAL could be helping.
- Perform more analysis of what constitute "operating costs" per the leases.
- Determine whether PAL pursued any ARRA grant money for energy improvements.
- Perform more research into the terms of PAL's line of credit with Wilmington Trust and whether anyone personally guaranteed this line of credit.
- Evaluate how PAL sets its program fees.
- Evaluate PAL's process in identifying potential grantors and completing grant requests.
- Evaluate PAL's efforts in developing an Ethics Policy.

- Evaluate PAL's assessments of its 3rd party fundraiser.
- Determine if PAL has entered into any other contracts with "related parties."

Financial Statement Highlights

Introduction

There are many ratios which can be calculated and analyzed when performing an assessment of a nonprofit organization's finances. As CPA's, we chose the following ratios because they are good measures of an organization's liquidity, financial condition, and fundraising effectiveness and efficiency.

Current Ratio = $\dfrac{\text{Current Assets}}{\text{Current Liabilities}}$

Quick Ratio = $\dfrac{\text{Current Assets – Prepaid Items}}{\text{Current Liabilities}}$

Working Capital = Current Assets – Current Liabilities

Defensive Interval = $\dfrac{\text{Cash + Accounts Receivable + Marketable Securities}}{\text{Average Monthly Expenses}}$

Change in Net Assets = Total Support & Revenue - Total Expenses

Fundraising Efficiency = $\dfrac{\text{Fundraising Expense}}{\text{Fundraising Income}}$

Contribution Income Effectiveness = $\dfrac{\text{Contribution Income}}{\text{Total Support \& Revenue}}$

Ratio	Fiscal Year 2009	Fiscal Year 2010
Current Ratio	.09	.10
Quick Ratio	.09	.04
Working Capital	($301,417)	($336,667)
Defensive Interval	.37	.19
Change in Net Assets (cash basis)	($255,467)	($26,950)
Fundraising Efficiency (the higher the %, the less efficient)	67.4%	61.6%
Contribution Income Effectiveness	.56%	.52%

Analysis

- Current assets and current liabilities as of June 30, 2010 were $37,183 and $373,550 respectively. The current and quick ratios indicate that PAL has significant liquidity problems and is not able to meet its short-term obligations from available resources. Though acceptable ratios may vary from industry to industry, a current ratio of 2.0 is considered a good "rule of thumb." The ratio should at least be 1.0. PAL's current ratios as of June 30, 2009 and June 30, 2010 were .09 and .10 respectively.

- The quick ratio is similar to the current ratio but is considered a more reliable indicator of an entity's ability to meet its short-term financial obligations. For PAL, it involves backing out approximately $23,000 in prepaid insurance from the numerator. PAL's quick ratios as of June 30, 2009 and June 30, 2010 were .09 and .04 respectively.

- Working capital, another measure of operating liquidity, has gone from ($81,959) as of June 30, 2006 to ($336,667) as of June 30, 2010. The farther an organization goes below zero in working capital, the more serious its financial condition and liquidity becomes.

- The defensive interval (the # of months an entity could operate if no additional funds were received) was .19 as of 6/30/10. This is basically six days. Ideally, PAL should have reserves to cover three to six months operating expenses.

- The change in net assets, which represents PAL's operating income/(loss) for the year, has improved significantly from FY '09 to FY '10. However, the fact remains that PAL continues to have operating losses and, thus, is neither able to meet its current obligations nor add to its reserves. Revenue has decreased from a high of $934,927 for FY '08 to $688,993 for FY '10. Program income, as a percentage of total revenue, has decreased from 39.6% in FY '08 to 21.1% for FY '10. PAL's Board and Executive Director need to be asked about these decreases.

- Fundraising expense (primarily the amount paid to a 3rd party fundraiser for soliciting individual and corporate contributions) as a percentage of fundraising income (the amount raised by the 3rd party fundraiser plus amounts raised by fundraising events conducted by PAL) was 61.6% at June 30, 2010. This means that approximately 62% of every dollar raised is going to expense. PAL's management and Board should be evaluating the contract with the 3rd party fundraiser each year to determine whether PAL's fundraising objectives are being met efficiently and effectively. In particular, they need to be evaluating ways to decrease these expenses (such as renegotiating the percentage of each contribution received by the fundraiser).

- Contribution income (amount raised from individual and corporate donors by PAL itself) was .52% at June 30, 2010. This is an indication that PAL is making little effort to raise additional funds.

- As of June 30, 2010, PAL had approximately $140,000 in accounts payable over 90 days old. The majority of this was owed to Delmarva Power. In fact, PAL owed Delmarva Power a total of approximately $170,000 at June 30, and Delmarva was threatening to shut off the power to the Hockessin facility. Generally, in the nonprofit arena, the organization first looks to fulfill its payroll obligations and then to pay its utility expenses. Such a large electric/gas bill is an indicator of PAL not being in sound financial condition.

- PAL has a $250,000 unsecured line of credit with Wilmington Trust Company (now M & T Bank). The balance at June 30 for the last five fiscal years has been approximately $129,000. There is a requirement in the line of credit that PAL must reduce the balance to zero for a minimum of 30 consecutive days during the year, which PAL has not been able to do. Because PAL has not met this requirement each year, M & T Bank technically has the ability to "call" the entire balance. If this were to happen, PAL would not have funds to pay this balance and would be in "default."

OBSERVATIONS AND SUGGESTIONS

COUNTY'S OVERSIGHT OF PAL

Observation

The Community Services Department provided us with certain Board Minutes of PAL for calendar years 2005 through 2008, as well as two letters (requesting certain information) sent to PAL by the former Community Services Manager in 2007 and 2009. We have the following observations:

- A County Public Safety employee was Executive Director in 2005 and a portion of 2006, and the Board Minutes reflect that he was providing a very comprehensive report (attached to the minutes), including a financial report. Since the former Community Services Department Manager was on PAL's Board at that time, it appears that the County Administration was obtaining much more information concerning the operations of PAL than it is receiving now.
- We were informed by the Assistant to the former Community Services Department Manager that she attended Board Meetings in 2007 and 2008 but then PAL stopped informing her of the dates of the meetings.
- The November 2007 and January 2009 letters sent to PAL by the former Community Services Department Manager indicate that the County was not being provided with requested information (such as the annual financial statement audit and PAL's annual operating budget) on a timely basis.

The above items are an indication that the County may be hindered in its efforts to provide the proper oversight of PAL.

Suggestion

So long as the County is going to continue to have a relationship with PAL, we believe that the new County Administration must ensure it is receiving the proper information from PAL on a timely basis, so that it is able to provide proper oversight. This should be taken into consideration in any future lease agreements and any future possibilities where the County may need to advance funds to PAL.

COUNTY'S PAYMENT TO DELMARVA ON BEHALF OF PAL

Observation

Council passed an emergency ordinance on February 8, 2011 to make a payment to Delmarva Power towards PAL's delinquent utilities bill. A "Whereas" clause in the ordinance stated "the controlling officers of PAL further agree that if after reviewing the audit, the County Auditor requests further information from PAL, said information must be provided within four calendar days."

We asked the Administration before the ordinance was passed, and again after the ordinance was passed, whether there was going to be a written agreement between the County and PAL regarding:

- The application, in regard to the County's relationship with PAL, of the payment to Delmarva. That is, was the payment considered to be a loan to PAL? Was it considered to be an advance on future lease payments? Other?
- The ability of the County Auditor to perform an operational audit of PAL.

After several e-mails to the Administration, we finally received a response indicating that there is not a formal written agreement. Instead, there is an e-mail received from PAL's attorney stating: "Please accept this e-mail as confirmation on behalf of the PAL Board that PAL considers the payment to Delmarva Power toward PAL's outstanding utility bill as a credit toward the County's contract obligations to PAL. As previously discussed, however, this does not relieve the County of its obligation to make monthly rent payments under the current leases …" Per the County Attorney, the fact that PAL is ensuring credit against the contract preserves the County's ability to make whatever argument and take whatever future action is necessary to enforce its rights based on what the County determines is the best course of action.

Suggestion

We suggest that County Council and its Attorney determine whether they are satisfied with this e-mail as support for the County's future rights against PAL for the payment to Delmarva, or whether they believe there should be a formal written agreement covering this issue as well as the issue of the County Auditor being able to perform an operational audit of PAL.

BUILDING OWNERSHIP

Observation

PAL operates two facilities, one in Hockessin and one in Garfield Park. Originally, we were informed by the County Administration that PAL is the owner of both facilities and we also saw this in writing in letters and other written documentation. PAL's Board Chairman, at an August 2009 Council Executive Committee meeting, stated "there is no doubt that PAL is the owner."

The lease agreements state the following regarding the buildings:

- Hockessin:

- “Title to all structures and capital improvements constructed by PAL shall vest in and belong to the County upon expiration or termination of the lease agreement.”
- “PAL shall not assign, sell, convey, or sublet any of its interests under the lease agreement without receiving the County’s prior written consent.”
- “At the termination or expiration of this lease agreement, or any extensions or renewals thereof, PAL shall promptly remove all of its effects from the leased premises and peacefully yield up the leased premises to the County, together with all structures, fixtures, and capital improvements.”
- “Upon termination of this lease agreement, or any extensions or renewals hereof, PAL shall be liable to the County for any damage to the leased premises, ordinary wear and tear excepted.”

- Garfield Park:
  - “Title to all structures and capital improvements constructed by PAL shall vest in and belong to the County upon expiration or termination of the lease agreement.”
  - “PAL shall not assign this agreement or sublet the leased premises without receiving the prior written consent of the County.”
  - “At the termination or expiration of this lease agreement, or any extension or renewal hereof, PAL shall promptly remove all its effects from the leased premises and peacefully yield up the leased premises to the County, together with all structures, fixtures, and capital improvements.”
  - “Upon termination of this agreement, or any extensions or renewals hereof, PAL shall be liable to the County for any damage to the leased premises, fair wear and tear excepted.”

Based on the language in the lease agreements, we began to question the premise that PAL owned the buildings. As such, we did the following:

- We looked for evidence in the CPA Firm’s workpapers that PAL did indeed hold title to the Hockessin and Garfield Park facilities. We could not find any such evidence.
- We performed research in the Recorder of Deeds Office, trying to find deeds which showed PAL as the owner of the buildings. The only deed we could find was the one in the County’s name for the land.
- We ascertained that the Hockessin facility was built with State, County, and private foundation funds.
- The Hockessin lease agreement states “The Leased Premises shall be revised upon completion of the Activities Center to reflect the ‘as built’ footprint of the completed building.” Therefore, we sent an e-mail to the County Law Department asking “Did this occur? Is there a recorded deed showing PAL as the owner of the property?” An attorney from the Law Department responded “With respect to the issue of revising the description of the ‘Leased Premises’ upon the completion of the Activities Center, I do not believe that it was ever anticipated that a revised deed would be recorded.”

We then sought an opinion from the County Council Attorney as to who owned the Hockessin and Garfield Park facilities and received a legal opinion that the County was the owner of both facilities. The County Attorney concurs with this opinion.

As of the date of this report, PAL disputes this opinion but has not provided any evidence that it owns the buildings.

Suggestion

In light of the fact that the County is apparently the owner of these buildings, the County should research whether it makes more sense to lease building space and program times to PAL rather than vice versa. If this were the case, then the County could be responsible for leasing the building space for those program times when it is not being utilized by PAL.

ETHICAL ISSUES

Observation

We noted issues which could be conflicts of interest or appearances of impropriety:

- A long-time employee of PAL is the wife of a PAL Board Member and former high-level County employee.
- PAL has a contract with a third party fundraiser who apparently, at the time the contract was signed, was a PAL Board Member (and may have also been a County employee).
- The County's Department Manager of Community Services from 2005 through 2010 joined the Board in October 2005, a time when she was employed by the County. (She resigned her position with the Board in Fiscal Year 2009.) PAL's Board in the past has also included several people who were County employees at the time. It is questionable whether representatives of the lessee of the PAL facilities (the County) should be on the Board of Directors of the lessor (PAL). The same question would apply to whether representatives of the lessor of the land (the County) should be on the Board of Directors of the lessee (PAL).

In a memorandum from the County CAO to PAL's Board, dated March 3, 2005, the County offered several recommendations including the following: "The Board should adopt and enforce a strong ethics policy. This policy should, for example, address issues such as the employment of relatives of Board Members and membership on the Board by individuals receiving compensation from PAL. A formalized process for reporting potential conflicts of interest in writing to other Board Members and recusal or resignation should be adopted. We are aware of situations in all of these areas where questionable activities have been tolerated by the Board."

In May 2005, PAL's then Board Chairman responded "… the Board recognizes that a more formal process should be put in place to address concerns such as you have noted. In our draft bylaws that shall be submitted for the Board's review and adoption this month, several new standing committees are being proposed including an Ethics Committee that shall have no less than 3 members who shall develop policy and procedures on corporate governance, ethics, and conflict of interest matters (such as you have noted). They shall make recommendations to the full Board on ethical issues that they identify, and that are brought to their attention by employees and Directors of PAL as well as individuals who have a legitimate interest in the activities of PAL."

The County CAO, in a memorandum dated May 26, 2005, responded "I am concerned that the proposed by-law changes do not yet incorporate specific standards of ethical practices. Establishing a standing committee to address this is a start, but this is an important issue that remains to be resolved."

Our review of Board minutes from October 2009 through June 2010 revealed that there is apparently an Ethics Committee; however, it had little to report on during this timeframe. (Please note that we asked PAL's Executive Director for the Board Minutes from July 2008 through June 2010 but did not receive any prior to October 2009.)

Please note that, because we did not perform our own audit of PAL, we did not pursue whether there is indeed an Ethics Policy and the adequacy of such policy; however, we did locate PAL's Fiscal Year Form 990 on GuideStar and noticed that the question "Does the organization have a written conflict of interest policy" was answered "No." Thus, we'd have to assume an Ethics Policy was never developed.

We asked the current County Administration if anyone ever followed up on PAL's response to the County CAO's letter, and one of the Deputy Chief Administrative Officers told us that apparently no one did.

Suggestions

Ask PAL's Board whether an Ethics Policy was adopted, ask for a copy of the policy, evaluate the adequacy of the policy, and determine whether the policy has been adhered to. If there is no Ethics Policy, the County should pursue why one was not adopted.

LEASE AGREEEMENTS

Observation

We reviewed the lease agreements between the County and PAL for the use of the facilities at Garfield Park and Hockessin. These agreements state the following:

- Garfield Park: "Recognizing the costs associated with the use of the Shared Areas, the County shall pay PAL a monthly user fee of seventy percent (70%) of the operating cost … PAL and the County shall review this on an annual basis to ensure that the costs are reflective of actual usage by the County and are reflective of operating costs. If it is determined that the above use percentages … are not accurate, such percentages shall be modified and the County's corresponding monthly fee shall be adjusted accordingly. Such adjustment shall be valid if in writing and signed by PAL and the County Executive."

  We asked the County Administration if the County and PAL had been performing the annual review of PAL's operating costs and were told that such annual review has not been occurring. However, in reviewing the Board Minutes from a December 2005 meeting, we noted that PAL had apparently invoiced the County for 70% of the operating costs. Also, we listened to the tape of an August 2009 Council Executive Committee Meeting and the former Department Head of Community Services stated that PAL's prior Executive Director invoiced the County for the 70/30 split of the operating costs.

- Hockessin: The lease states the following regarding the shared areas: "As facility costs and/or each party's percentage of use may change, the rate of reimbursement or the percentage of use may be modified by mutual agreement of both parties in writing." The lease does not contain any language, like Garfield Park's lease, which <u>requires</u> an annual review of the operating costs and the use percentages.

<u>Suggestion</u>

If the County will be re-negotiating the Garfield Park lease, the County should consider the language in the Garfield lease regarding the annual review of operating costs and use percentages – such review of which has not been occurring in the past few years.

<u>BOARD OF DIRECTORS ROLE IN FUNDRAISING</u>

<u>Observation</u>

BoardSource, an organization that publishes materials and provides guidance on the responsibilities of nonprofit Boards, indicates "One of the Board's foremost responsibilities is to provide adequate resources for the organization to fulfill its mission." BoardSource also indicates "The Board oversees all the actions and decisions required for financial security. For every Board Member, this includes participation in fundraising efforts … and making a personal donation to underscore his or her commitment to the organization and to encourage others to give … The Board … has chief responsibility over ensuring the organization has adequate resources to function ... Successful fundraising requires that a nonprofit's Board provide strategic guidance for the entire organization … When it comes to fundraising, Board Members must be directly involved as they are personally responsible for carrying out the approved fundraising plan as leaders of committees, as active solicitors, and much more."

In the past few years, the role of Nonprofit Boards in fundraising has become heightened due to the weak economy.

PAL's Board Chairman, at an August 2009 Council Executive Committee meeting, stated that PAL had "done everything they can to generate revenue." However, based on the below items, it appears that PAL's Board may not be adequately fulfilling its fundraising responsibility.

- The amount of contribution income generated by PAL, independent of that raised by a third party fundraiser, has been .52%, .56%, and .52% of total revenues for Fiscal Years 2008, 2009, and 2010, respectively (less than $4,000 each year). This is a strong indication that PAL's Board is not actively involved with soliciting individual and corporate contributions. It could also be an indicator that not every Board Member is making more than a nominal personal financial contribution each year; this could be a problem as many potential grantors ask whether there is 100% Board participation in making a personal financial contribution.

- PAL's Board bylaws require the Board to accept responsibility for fundraising and even specify a Fundraising Committee (called "Development Committee" in minutes). However, our review of Board minutes from October 2009 through June 2010 revealed that this Committee had very little to report on.[1] An item in the Board Meeting minutes from 10/14/09 indicates "New Board members needed since many current members have not appeared at meetings or otherwise contributed." Based on the contribution numbers for Fiscal Year 2010, it does not appear that the Board has improved in its fundraising role.

- PAL's Board bylaws state the "Program Committee shall monitor ongoing PAL programs, identify new program opportunities, and assist in finding grants or other funding opportunities (along with the Finance Committee) to sustain, improve, or add new programs." Our review of Board minutes from October 2009 through June 2010 revealed that there is a Program Committee but it had little to report on.

[1] Please note that we asked PAL's Executive Director for the Board Minutes from July 2008 through June 2010 but did not receive any prior to October 2009. We recently received from the Community Services Department some Board Minutes for 2005 through 2008.

- PAL is not a member of the Delaware Association of Nonprofit Agencies (DANA). Membership in DANA would give PAL's Board and Executive Director some low-cost training opportunities regarding fundraising, marketing, board development, and other areas. (For instance, there was a course recently on Board Excellence.) Being a member of DANA also gives members the chance to interact with other DANA Members on fundraising ideas, and allows members to access a database of potential grantors for PAL. DANA might also be able to assist PAL in providing ideas for things like enhancing the chances of grant applications being approved.

  It should be noted that the March 2008 Board Meeting minutes state "(Name removed)'s deep interest in non-profit work led to various suggestions as to joining DANA (Delaware Association of Non-Profits)." We do not know whether PAL joined DANA at that time and then subsequently terminated its membership.

- The Board Minutes from a November 2006 meeting indicated "Secretary (name removed) raised concerns about our continuing operation at a monthly and quarterly deficit. (Name removed) offered to join the Finance Committee and offered a resolution to conduct a Capital Fundraising Project in the Spring of 2007 to raise substantial corporate funds …" We do not know what happened with this project.

- The March 2008 Board Meeting minutes state "(Name removed) announced plans for an April 7, 2008 Finance meeting to discuss the unlimited fundraising events and rentals to raise money for PAL." We do not know what the results of this meeting were.

- We were informed by Community Services that someone on PAL's Board once suggested that PAL's Board engage someone from "The Nonprofit Center" at LaSalle University's School of Business to speak to the Board about their role and responsibilities. However, the Board did not want to do this.

<u>Suggestions</u>

- As part of any lease re-negotiations, the County should consider whether the Board has been fulfilling its responsibilities with respect to fundraising and should follow up on the above Board Meeting items where fundraising was discussed.
- Obtain and evaluate PAL's Board's strategic plan for fundraising and the minutes of its Development and Program Committees.
- Obtain and evaluate PAL's Board's records on Board Member individual giving.
- Discuss with PAL's Board the benefits of joining DANA.

BOARD OF DIRECTORS ROLE IN OVERSEEING PAL'S FINANCES

Observation

BoardSource, an organization that publishes materials and provides guidance on the responsibilities of nonprofit Boards, indicates in its "Ten Basic Responsibilities" for Nonprofit Boards: "Provide proper financial oversight. The Board must assist in developing the annual budget and ensuring that proper financial controls are in place."

In a memorandum from the County CAO to PAL's Board, dated March 3, 2005, the County offered several recommendations including the following: "The Board needs to win the confidence of grant funders. We understand that on occasion funders have frozen funds because of concerns with PAL's finances."

PAL's bylaws specify that an "Audit Subcommittee shall be created within the Finance Committee that shall include at least 2 of the Finance Committee members and at least one outside member not associated with PAL who has a financial/accounting background. The Audit Subcommittee shall review the financial records and provide a written report of PAL's financial activities no later than 6 months after PAL's most recent audit."

It does not appear that this Audit Subcommittee has ever been created, as our review of the Board minutes for the presentation of the June 30, 2008 and June 30, 2007 audits mentioned that the Finance Committee – not an Audit Subcommittee – had met with the auditors. There was also no indication of an outside member not associated with PAL being at this meeting. The external auditor's workpapers also mentioned that there was no formal Audit Committee.

Suggestion

Ask PAL's Board if this Audit Subcommittee was ever established and, if the answer is no, ask why not. If such Subcommittee was never established, ask PAL to consider establishing it. We particularly like the idea of someone with a strong financial/accounting background, not associated with PAL, being on this subcommittee.

UTILITIES

Observation

The line item "Telephone & Utilities", on PAL's Statements of Activities, showed a marked improvement from June 30, 2009 to June 30, 2010 ($298,463 to $208,180). Approximately 90% of this expense represents electric & gas for the Hockessin and

Garfield Park facilities. Our review of the CPA Firm's workpapers revealed the part-time bookkeeper's explanation for this was that "the large variance from fiscal year-end (FYE) 2009 to FYE 2010 was due to poor bookkeeping in 2008 and that the Delmarva bills were not being entered into the system then." This explanation caused us to question whether the marked improvement was accurate.

Since the Administration had provided us with copies of PAL's electric & gas bills for a portion of calendar year 2008, the whole calendar year 2009, and a portion of calendar year 2010, we were able to evaluate the total usage and total amount billed for Fiscal Years 2009 and 2010. (Note: We did not have June 2010's bill; therefore, we included June 2009's bill in our calculation for Fiscal Year 2010.) The results are as follows:

Hockessin

Fiscal Year	Electric Usage	Electric $	Gas Usage	Gas $	Total $
2009	497,000	$66,535	30,554	$45,760	$112,295
2010	549,600	$70,046	33,019	$43,169	$113,275

Garfield Park

Fiscal Year	Electric Usage	Electric $	Gas Usage	Gas $	Total $
2009	546,400	$64,393	28,343	$42,021	$106,414
2010	428,200	$51,570	16,269	$22,212	$73,771

The above statistics show that utilities cost has decreased at the Garfield Park facility but has actually increased (with increased usage) at the Hockessin facility. Thus, it appears that the part-time bookkeeper's explanation for the large variance in utilities expense is correct – that there were utility bills posted to PAL's accounting system in Fiscal Year 2009 that should have been posted in Fiscal Year 2008, thus inflating the number for Fiscal Year 2009. We discussed this situation with the auditors of PAL's financial statements, who confirmed that this was the case.

We obtained from Community Services certain PAL Board Minutes for calendar years 2005 though 2008 and noted the following:

- The December 2005 report from PAL's Executive Director, attached to the December 2005 minutes, indicated "I hope to follow up with the Building Committee to go over energy usage for both facilities and to implement corrective measures and policy."
- The March 2008 Board Minutes indicated "(Name removed) expressed concern about our recent electric charges especially when compared to last year's bills. He suggested that our PAL facilities be brought up to programmable rescheduling abilities and that it be monitored through his (School District name removed) facilities system. Board approved."

We do not know what steps PAL took regarding these items.

Suggestions

The County Administration should:

- Ask PAL what specific steps it has taken to reduce utility expenses, including asking PAL what became of the items from the December 2005 and March 2008 Board Meetings.
- Consider using someone from Special Services, or hiring an energy auditor, to evaluate steps that could be taken to reduce utility costs at the PAL Centers.

INCOME FROM DANCES

Observation

The workpapers for the CPA Firm that audited PAL's financial statements mentioned that the part-time bookkeeper said there is a potential risk with dance income. It is our understanding that PAL holds youth dances at the Hockessin PAL Center, and that PAL collects cash at these events.

We discussed this situation with the CPA Firm, who informed us that only one person was collecting the money at the dances and that PAL was not using a standard form to record it. Also, PAL was using cash received from the dances to pay the Disc Jockey and Police/Security in cash on the night of the dance and, thus, the amounts paid that night were not recorded as income and then later as expense. The auditors did discuss this situation with PAL and believe the control weaknesses have been corrected.

Suggestion

The County Administration should further investigate how income from these dances is handled.

CONTRACT WITH THIRD PARTY FUNDRAISER

Observation

PAL uses a third party consultant to (per the contract) "solicit funds from citizens, businesses, and foundations within the United States of America, by phone and mail, in support of Sponsor (PAL) ..." PAL's contract with the consultant specifies that the contract will "automatically renew in its entirety for each consecutive year unless the Sponsor notifies the consultant in writing of its desire to terminate by December 1 of each corresponding calendar year." It should be noted that the contract is with an organization headed by a former New Castle County police officer who is also a former PAL Board Member.

The contract provides as follows:

- "The Consultant shall receive 15% of any single contributor donation equaling $10,000 or above.
- The Consultant shall receive 33% of any single contributor donation equaling $3,000 to $9,999."
- The Consultant shall receive 55% of any single contributor donation below $3,000."

It is our understanding that these percentages are not "out of line" in comparison to other third party fundraisers (at least for the beginning of a contract).

We reviewed PAL's Board minutes from October 2009 through September 2010, looking for evidence that the contract was discussed prior to the automatic renewal of the contract for calendar year 2010. In the minutes for the 2/24/10 meeting, it was recorded that the third party fundraiser was "at 27% of goal for the fiscal year, good during time of traditionally bad contribution months." We did not see any indication in any of the Board minutes of any discussion regarding whether to continue the relationship with the third party fundraiser.

Suggestions

If the County is going to continue its relationship with PAL, and is going to be renegotiating the lease agreements, the County should ask PAL's Board and Executive Director the following questions:

- Do they assess the performance of the consultant each year and discuss whether to continue the contract? If so, what are the factors they consider in assessing performance and making the decision on the contract? If not, why?
- Have they ever tried to renegotiate the contribution percentages taken by the consultant? If so, why haven't they been successful? If not, why? An argument can definitely be made that the consultant should accept a lower percentage because the consultant is probably contacting, each year, many of the same people who have given in the past and, therefore, less effort is needed on the part of the consultant.
- Do they participate each year in establishing goals for the consultant? If so, how do they prepare for this? If not, why?
- As an alternative to the consultant, have they ever considered hiring a part-time Development Director to raise funds? If not, why?

LINE OF CREDIT WITH M & T BANK

Observation

As mentioned on page 4 of this report, PAL has a $250,000 unsecured line of credit with Wilmington Trust Company (now M & T Bank). The balance at June 30th for the last five fiscal years has been approximately $129,000. There is a requirement in the line of credit that PAL must reduce the balance to zero for a minimum of 30 consecutive days during the year, which PAL has not been able to do. Because PAL has not met this requirement each year, M & T Bank technically has the ability to "call" the entire balance. If this were to happen, PAL would not have funds to pay this balance.

Suggestion

The County Law Department should review the agreement language that contains this requirement and make a formal determination on the potential ramifications of this clause. Based on this review, the County should consider asking PAL to obtain a waiver from M & T Bank that they will not be calling the balance. We discussed this with the CPA Firm that performed the financial statement audits and they agreed it was a good idea.

HEALTH INSURANCE

Observation

PAL is paying the full cost of health insurance for its full-time employees, a budget of $54,456 for Fiscal Year 2011. Although there are only 3-4 full-time employees, we found this surprising given the state of PAL's finances. Please note that, because we did not perform our own audit of PAL, we do not know the factors that were considered by management in making the decision to pay the full cost of this insurance.

Suggestion

Ask PAL's Board and Executive Director why they made the decision, in light of PAL's financial condition, to pay the full cost of employee health care.

PREPAID INSURANCE

Observation

As of June 30, 2010, PAL's Statement of Financial Position indicated that PAL had Prepaid Insurance of approximately $23,000. Please note that, because we did not perform our own audit of PAL, we do not know the factors that were considered by management in making the decision to pay certain insurance in advance (as opposed to making a monthly payment). However, given PAL's financial condition, we do not know why PAL would be pre-paying for any of its insurance coverages.

Suggestion

Ask PAL's Board and Executive Director why they made the decision, in light of PAL's financial condition, to pre-pay insurance coverage.

CONTROL ENVIRONMENT, INCLUDING ORGANIZATION OF RECORDS

Observation

The term "control environment" is used to describe what is commonly referred to in the private sector as the "corporate culture" or the "tone at the top." When management believes that internal controls are important to achieving its goals and communicates that view to employees at all levels, internal controls are likely to function well. The key element in a favorable control environment is management's attitude, as demonstrated through its actions and examples. Management must lead by example, creating a "tone at the top" that sets the standard for the organization.

Proper organization and responsiveness by management is part of setting the tone at the top. With that, we offer this observation.

In October 2010, we requested some basic documents from PAL such as Board minutes, most recent Balance Sheet and Income Statement, etc. However, it took almost a month for the Executive Director (ED) to provide us with these and, even then, there were documents missing. During the timeframe we were waiting for the documents, we asked about them several times and had the general impression that the ED was having difficulty locating documents and/or was relying upon the one-half-day-a-week bookkeeper to find them.

In a memorandum from the County Administration to PAL's Board, dated March 3, 2005, the County offered several recommendations including the following: "The Board's Treasurer must examine the books of the organization on a regular basis. We understand the current Treasurer has never seen the books." (It should be noted that PAL now has a new Treasurer.) In May 2005, PAL's then Board Chairman responded "The Board recognizes that the Treasurer has a more specific responsibility to 'drill down' on the numbers of the organization and … our Treasurer has taken a more aggressive role in overseeing the financials of our organization, and meets every other week to review and discuss PAL's finances with PAL's Executive Director." Given the length of time it took for us to receive the basic documents we asked for, we question whether the Treasurer has taken on as active a role as outlined in PAL's response to the County. If the Treasurer has, then it makes sense that the Executive Director could have asked the Treasurer for such documents.

In PAL's Fiscal Year Form 990 filed with the IRS, the question "Does the organization have a written document retention and destruction policy?" was answered "No." This could be one of the reasons why the Executive Director took so long to provide us with the documents we requested.

Suggestions

- Have a County representative attend PAL Board meetings and obtain copies of minutes and other key documents (e.g., financial reports) distributed at the meetings.
- Follow up on the status of PAL's response to the March 2005 letter that the Treasurer would be taking a more aggressive role in overseeing the financials of the organization.
- Ask PAL's Board whether it performs an annual evaluation of the Executive Director and, if so, what performance factors they are evaluating.
- Suggest to PAL's Board and Executive Director that they prepare a written document retention policy.

NATIONAL PAL

Observation

The PAL of Delaware is a chapter of the National Police Athletic/Activities Leagues Inc. The National PAL organization has alliances with a number of corporations, governments, and sports organizations (e.g., the National Football League).

Suggestion

Ask PAL's Board and Executive Director whether they have reached out to the National organization to obtain help/ideas towards addressing their financial situation.