



STATE OF NORTH CAROLINA

INVESTIGATIVE REPORT

TRANSFORMATION CENTER OF THE CAROLINAS, INC.

CHARLOTTE, NORTH CAROLINA

MAY 2013

OFFICE OF THE STATE AUDITOR

BETH A. WOOD, CPA

STATE AUDITOR

INVESTIGATIVE REPORT

TRANSFORMATION CENTER OF THE CAROLINAS, INC.

CHARLOTTE, NORTH CAROLINA

MAY 2013

Office of the State Auditor



Beth A. Wood, CPA
State Auditor

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AUDITOR'S TRANSMITTAL

The Honorable Pat McCrory, Governor
Members of the North Carolina General Assembly
Mr. Kieran Shanahan, Secretary, North Carolina Department of Public Safety
Dr. Aldona Zofia Wos, Secretary, North Carolina Department of Health and Human Services
Ms. Sharon Allred Decker, Secretary, North Carolina Department of Commerce

Ladies and Gentlemen:

Pursuant to North Carolina General Statute §147-64.6(c)(16), we have completed an investigation of allegations pertaining to Transformation Center of the Carolinas, Inc. The results of our investigation, along with recommendations for corrective action, are contained in this report.

Copies of this report have been provided to the Governor, the Attorney General and other appropriate officials in accordance with G.S. §147-64.6 (c) (12). We appreciate the cooperation received from representatives of the North Carolina Departments of Public Safety, Health and Human Services, and Commerce.

Respectfully submitted,

A handwritten signature in cursive script that reads "Beth A. Wood".

Beth A. Wood, CPA
State Auditor

May 16, 2013

TABLE OF CONTENTS

	PAGE
INTRODUCTION	1
ORGANIZATION OVERVIEW	3
FINDINGS AND RECOMMENDATIONS.....	5
RESPONSE FROM THE NORTH CAROLINA DEPARTMENT OF PUBLIC SAFETY	9
RESPONSE FROM THE NORTH CAROLINA DEPARTMENT OF HEALTH AND HUMAN SERVICES.....	11
RESPONSE FROM THE NORTH CAROLINA DEPARTMENT OF COMMERCE	13
ORDERING INFORMATION	15

INTRODUCTION

The Office of the State Auditor received a complaint about Transformation Center of the Carolinas, Inc. (the Transformation Center), a Charlotte-based, nonprofit organization that received funding from the North Carolina Departments of Public Safety, Health and Human Services, and Commerce. Allegedly, several of the Transformation Center's contractors had not been paid after providing employment training services because the Transformation Center's Executive Director misused state funding.

To conduct our investigation of the complaint, we performed the following procedures:

- Review of federal and state statutes and the North Carolina Administrative Code
- Review of program objectives and funding information
- Examination of relevant documents and records
- Interviews with employees of the Departments of Public Safety, Health and Human Services, and Commerce, and the Mecklenburg County Manager's Office
- Interviews with the Transformation Center's vendors that provided employment training services as well as the Transformation Center's Executive Director

This report presents the results of our investigation. The investigation was conducted pursuant to North Carolina General Statute § 147-64.6 (c) (16).

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BACKGROUND AND PROGRAM OVERVIEW

Transformation Center of the Carolinas, Inc. (the Transformation Center) was organized as a nonprofit corporation in Charlotte, North Carolina in 1999. According to its Executive Director, the Transformation Center provided occupational and employability skills training to individuals that qualified for one of four state-funded programs. The training was provided by contractors and vendors selected by the Transformation Center.

Individuals who qualified for the employability skills training included ex-offenders, individuals with certain disabilities, and displaced workers. The occupational training was offered in three areas: auto technician, light industrial,¹ and forklift operator. Auto technician and light industrial training lasted six weeks, Monday through Friday, four hours per day. Forklift operator training was a two-day course. All participants in auto technician and light industrial training were also required to complete a course in employability skills training. Employability skills training included instruction in areas such as time management, balancing work and family, business communication, résumé writing, and interviewing skills. This instruction was provided as a six-week course, Monday through Friday, for four hours per day.

The Transformation Center received the following state funding from July 1, 2009 to June 30, 2012:

- \$191,651 from the Department of Public Safety for the Structured Day program
- \$112,855 from the Department of Health and Human Services, Division of Vocational Rehabilitation Services for employment training
- \$69,000 jointly funded by the Department of Public Safety and the Department of Commerce for the Offender Employment Training Initiative
- \$26,395 from the Department of Commerce for the Trade Adjustment Assistance program

The Criminal Justice Services section of Mecklenburg County administered the Structured Day program. The program was an alternative sentencing option available to offenders residing in Mecklenburg County who were sentenced to probation for Class H and Class I felonies.²

The Division of Vocational Rehabilitation Services provides counseling, training, education, transportation, job placement, and other support services. These services are provided to people with physical, psychiatric, or intellectual disabilities and to individuals who are deaf or hard of hearing or have other communicative disorders. The program's intent is to help them live independently and find and maintain a job.

The Offender Employment Training Initiative was funded by the American Reinvestment and Recovery Act and provided employment assistance for recently released offenders. The primary focus of the program was job creation through vocational and educational training

¹ Light industrial training prepares individuals for jobs that are typically found in a manufacturing or warehouse environment.

² <http://www.nccourts.org/Courts/CRS/Councils/spac/Documents/App-f12.pdf>

BACKGROUND AND PROGRAM OVERVIEW (CONCLUDED)

and employer education. Employment services included on-the-job training, job counseling, employability training, job-seeking resources, and résumé assistance.

The Trade Adjustment Assistance program provides re-employment training services and income support benefits to workers who have or may lose their jobs or suffer reduced work hours due to production being moved to a foreign country.

FINDINGS AND RECOMMENDATIONS

1. THE EXECUTIVE DIRECTOR'S DIVERSION OF STATE FUNDS FOR PERSONAL USE RESULTED IN THE NONPAYMENT OF VENDORS AND MAY HAVE VIOLATED STATE LAW.

Despite receiving funding from four state programs, Transformation Center of the Carolinas, Inc. (the Transformation Center) did not fulfill its obligations to vendors who provided training to program participants. Our interviews with vendors and our review of unpaid invoices confirmed that the Transformation Center owed four Charlotte-based vendors outstanding balances totaling \$23,785. All of these invoices were more than 18 months past due:

- \$11,250 to a vendor that provided online auto mechanics training
- \$10,000 to a vendor that provided hands-on auto mechanics training
- \$2,035 to a vendor that provided hands-on forklift training
- \$500 to another vendor that provided hands-on forklift training

The Transformation Center received state funding by contacting state agencies and requesting or applying to become a service provider. Training services were then provided to program participants through third-party vendors. The Transformation Center's Executive Director prepared and submitted invoices for these services directly to state agencies. The Executive Director then diverted state funding for personal expenditures instead of paying the third-party vendors.

Vendor representatives stated that the Transformation Center's Executive Director provided various reasons for failing to pay their invoices. For example, vendor representatives said the Executive Director claimed that she had not yet received payment from the State. However, our investigation determined that the Executive Director submitted invoices to three different state agencies and the Transformation Center received payments from those agencies for all of the invoices. The Executive Director also told vendors that the Transformation Center would pay them when its contracts with the State were renewed for the upcoming year. That explanation suggests that the Transformation Center had already expended the State's funding for purposes other than the payment of its service providers.

The Executive Director first denied, but later admitted, that the Transformation Center had not paid its vendors. However, she was unable to tell investigators how much she owed any of the four vendors. She indicated that the failure to pay the service providers was the result of "cash-flow issues." In view of that explanation, investigators reviewed the Transformation Center's financial records to determine why the third-party vendors were not paid for their services.

Our review revealed that the Executive Director received \$83,510 for "contract services" from the Transformation Center from January 2010 to June 2012.³ In addition, the

³ Transformation Center of the Carolinas, Inc. claims it had no employees. The Executive Director classified herself and others working for the non-profit organization as contractors.

FINDINGS AND RECOMMENDATIONS (CONTINUED)

Executive Director spent \$30,261 on personal items such as food, clothing, fuel, and dental work and provided \$26,753 to her church. Moreover, the Executive Director withdrew \$14,670 in cash from the Transformation Center's bank account over the same period. In total, the Transformation Center's Executive Director received \$155,194 for coordinating training programs, yet failed to pay the vendors who provided the training nearly \$24,000.

In an effort to determine how this could have occurred, investigators found that the Transformation Center did not have the oversight of an active board of directors. The Executive Director of the Transformation Center, who is listed as a board member in the articles of incorporation, could not recall the year when the board of directors last met. She speculated that it may have been in 2010. When asked for copies of board minutes and board resolutions, the Executive Director responded that they were missing. The lack of oversight by an active board of directors likely facilitated the ability of the Executive Director to pay herself rather than paying vendor invoices.

By submitting invoices to state agencies for services provided through third-party vendors, then failing to pay for those services, the Transformation Center and its Executive Director may have violated several state laws pertaining to fraud, misrepresentation, obtaining property by false pretenses,⁴ or engaging in deceptive trade practices.⁵

RECOMMENDATION

The Transformation Center should pay the \$23,785 in financial obligations to its service providers.

The North Carolina Department of Administration's Division of Purchase & Contract should place the Transformation Center on its list of vendors barred from doing business with the State for engaging in unethical and possibly illegal business conduct.

State agencies should implement a control process to ensure that nonprofit organizations have an active board of directors before they are given any state funding.

The Departments of Public Safety, Health and Human Services, Commerce, and the Mecklenburg County Manager's Office should look at any significant funding paid to the Transformation Center prior to fiscal year 2010 to ensure it was properly used.

This finding will be referred to the Mecklenburg County District Attorney's Office, the North Carolina Attorney General's Office, and the State Bureau of Investigation.

⁴ North Carolina General Statute § 14-100 – Obtaining property by false pretenses

⁵ North Carolina General Statute § 75-1.1 – Methods of competition, acts and practices regulated; legislative policy

FINDINGS AND RECOMMENDATIONS (CONTINUED)

2. THE EXECUTIVE DIRECTOR MISREPORTED HER INCOME BY IMPROPERLY CLASSIFYING HERSELF AS A CONTRACTOR AND EXCLUDING PAYMENTS FOR PERSONAL EXPENSES AND CASH WITHDRAWALS FROM GROSS INCOME.

The Executive Director of the Transformation Center improperly classified herself as a contractor of the nonprofit corporation. Corporate officers are specifically included within the definition of an employee for Social Security, Medicare, federal unemployment tax, and federal income tax withholding purposes.⁶ Therefore, the \$83,510 paid to the Executive Director between January 2010 and June 2012 should have been reported as wages on a Form W-2 rather than “contract services” on a Form 1099-Misc.

The Executive Director also underreported her income by failing to include personal expenditures⁷ that were paid by the Transformation Center. The personal expenditures included \$30,261 paid by the Transformation Center for items such as food, clothing, fuel, and dental work; \$26,753 of payments to the Executive Director’s church; and \$14,670 in cash withdrawals from the Transformation Center’s bank account. The Executive Director could not provide any documentation to show that those expenditures were ordinary and necessary⁸ to the Transformation Center’s operations. The expenditures and withdrawals, which occurred between January 2010 and June 2012, should have been included in the Executive Director’s gross personal income.

RECOMMENDATION

The Transformation Center should reclassify the amounts paid to its Executive Director as employee wages and pay all resulting federal and state employment taxes arising from this reclassification.

In addition, the Transformation Center should issue W-2s to the Executive Director which reflect her total compensation such as salary plus personal expenses paid by the corporation on her behalf.

Finally, the Executive Director should file amended personal income tax returns based upon the wages reported in these W-2s.

This finding will be referred to the Internal Revenue Service and the North Carolina Department of Revenue.

⁶ 26 USC § 3121(d)(1), § 3306(i), and § 3401(c). Also see 26 CFR 31.3121(d)-1(b).

⁷ 26 CFR 1.262-1

⁸ 26 USC § 162; Deputy v. du Pont, 308 U.S. 488, 495 (1940); Commissioner v. Heininger, 320 U.S. 467, 475 (1943); John Marshall Law School and John Marshall University v. United States, 81-2 USTC 9514 (Ct. Cl. 1981).

FINDINGS AND RECOMMENDATIONS (CONCLUDED)

3. THE TRANSFORMATION CENTER FAILED TO MAINTAIN DOCUMENTATION VERIFYING PARTICIPANT ATTENDANCE.

The Executive Director of the Transformation Center could not provide any documentation to support participant attendance for the state-funded training sessions billed to Mecklenburg County. Additionally, the Director of the Mecklenburg County Structured Day program was unable to provide a complete list of the names of individuals who participated in the program.

The Transformation Center was contracted to provide occupational training and employability skills training. According to its Executive Director, the Transformation Center sub-contracted the employability skills portion of the training to several individuals. However, the Executive Director did not maintain documentation, such as attendance records or sign-in sheets, to demonstrate that the participants actually attended the training sessions.

In addition, the Mecklenburg County Structured Day program failed to accurately track participant attendance for occupational training. Further, Mecklenburg County did not keep an accurate list of the participants. As a result, Mecklenburg County paid \$2,913 to the Transformation Center twice for one participant's auto mechanic training, once in November 2009 and again in January 2010. Also, two invoices did not identify participant names on the Structured Day program records because the names had been redacted. The Mecklenburg County Director of the Structured Day program guessed at the seven redacted participant names. The names of the seven participants provided by the Structured Day Director differed from the names listed on copies of non-redacted invoices obtained from the Transformation Center.

RECOMMENDATION

The North Carolina Department of Public Safety should recover \$2,913 for the duplicate billing from the Transformation Center.

In addition, the Department of Public Safety should consider seeking reimbursement from the Transformation Center for state funds provided for training sessions that did not maintain adequate documentation supporting participant attendance.

Mecklenburg County should maintain complete documentation which identifies program participants and adequately supports payments to vendors.



North Carolina Department of Public Safety

Prevent. Protect. Prepare.

Pat McCrory, Governor

Kieran J. Shanahan, Secretary

May 1, 2013

The Honorable Beth A. Wood
State Auditor
Office of the State Auditor
20601 Mail Service Center
Raleigh, North Carolina 27699-0601

Dear State Auditor Wood:

The purpose of this correspondence is to respond to the findings in your investigative report pertaining to Transformation Center of the Carolinas, Inc. The Department of Public Safety's responses to the findings are listed below.

Finding 1:

The funding addressed in this finding was awarded prior to the consolidation of the Department of Public Safety. The Department will ensure that its current control procedures for verifying the existence of active boards of directors are reinforced and consistently applied for all nonprofits prior to issuing awards. In addition, we will investigate the propriety of any payments to the Transformation Center made prior to fiscal year 2010.

Finding 3:

The Department of Public Safety will initiate efforts to collect the identified duplicate billing. We will also investigate the possibility of recovering funds provided for training sessions that were not supported by sufficient documentation of participant attendance.

Please let me know if you have any questions or if you need any additional information regarding this matter. Thank you for your audit recommendations and assistance.

Sincerely,

Kieran J. Shanahan
Secretary

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North Carolina Department of Health and Human Services

Pat McCrory
Governor

Aldona Z. Wos, M.D.
Ambassador (Ret.)
Secretary DHHS

May 1, 2013

The Honorable Beth A. Wood, State Auditor
Office of the State Auditor
2 South Salisbury Street
20601 Mail Service Center
Raleigh, North Carolina 27699-0601

Dear Auditor Wood:

We have reviewed your confidential draft report on the findings and recommendations that resulted from your investigation of allegations concerning the Transformation Center of the Carolinas, Inc. The following represents our response and corrective action plan to the Investigation Findings and Recommendations.

BACKGROUND AND PROGRAM OVERVIEW

The Transformation Center received the following state funding from July 1, 2009 to June 30, 2012.

- \$112,855 from the Department of Health and Human Services, Division of Vocational Rehabilitation Services for employment training.

1. THE EXECUTIVE DIRECTORS DIVERSION OF STATE FUNDS FOR PERSONAL USE RESULTED IN THE NONPAYMENT OF VENDORS AND MAY HAVE VIOLATED STATE LAW.

Individuals who qualified for the employability skills training included ex-offenders, individuals with certain disabilities, and displaced workers. The occupational training was offered in three areas: auto technician, light industrial, and forklift operator. Auto technician and light industrial training lasted six weeks, Monday through Friday, four hours per day. Forklift operator training was a two-day course. All participants in auto technician and light industrial training were also required to complete a course in employability skills training. Employability skills training included instruction in areas such as time management, balancing work and family, business communication, resume writing, and interviewing skills. This instruction was provided as a six-week course, Monday through Friday, for four hours per day.

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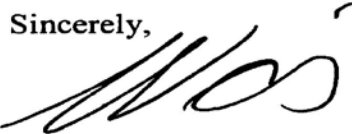
Auditor Wood
May 1, 2013
Page 2

Recommendation: Health and Human Services should look at any significant funding paid to the Transformation Center prior to fiscal year 2010 to ensure it was properly used.

DHHS Response: *The Department has reviewed your report on the findings and recommendations resulting from the investigation into Transformation of the Carolinas, Inc. The Department has begun an internal review of payments provided to the organization to ensure expenditures paid for training actually occurred and were appropriately applied; in accordance with the established contract. If discrepancies are identified, the Department will take the appropriate and immediate corrective actions.*

If you need any additional information, please contact Monica Hughes at (919) 855-3720.

Sincerely,



Aldona Wos, M.D.
Secretary

AW:mh

cc: Sherry Bradsher, Deputy Secretary
Matthew McKillip, Senior Policy Advisor
Joseph Cooper, Jr., Chief Information Officer
Elizabeth Bishop, Acting Director, Division of Vocational Rehabilitation
Pyreddy Reddy, Chief Information Security Officer
Emery E. Milliken, General Counsel
Jim Slate, Director, Budget and Analysis
Laketha M. Miller, Controller
Chet Spruill, Director, Internal Audit
Monica Hughes, Audit Resolution & Monitoring Branch Head



**North Carolina
Department of Commerce**

Pat McCrory, Governor

Sharon Allred Decker, Secretary

May 3, 2013

Beth A. Wood, CPA
North Carolina State Auditor
2 South Salisbury Street
20601 Mail Services Center
Raleigh, NC 27699.0601

Dear Ms. Wood:

I am in receipt of your draft investigative report of the Transformation Center of the Carolinas, Inc.

It is my intention that the Department of Commerce enter into performance contracts with all non-profits that receive funds through our department, beginning with the 2013-14 fiscal year. I support revisions you are currently pursuing, in statute and administrative code, to require regular audits and review of financial statements for purposes of ensuring state funds are used appropriately and that receivers of funds are held accountable for fiscal responsibility.

Thank you.

Sincerely,

A handwritten signature in cursive script, appearing to read "Sharon".

Sharon Allred Decker,
Secretary of Commerce

Thrive NC

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ORDERING INFORMATION

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This investigation required 416 hours at an approximate cost of \$29,952.