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INTERNAL CONTROL WEAKNESSES CONTRIBUTED TO THE MISMANAGEMENT AN--ETC(U)
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BY THE COMPTROLLER GENERAL

Report To The Congress OF THE UNITED STATES

Internal Control Weaknesses Contributed To The Mismanagement And Misuse Of Federal Funds At Selected Community Action Agencies.

GAO found that at 12 community action agencies over \$11 million of Federal funds were being either mismanaged or misused. For example:

- Excess cash either had been (1) used to earn (and retain) interest, (2) diverted into unrecorded bank accounts, (3) loaned to other grant programs, delegate agencies, and other governmental units, or (4) used to subsidize nongovernmental activities. In addition one case of embezzlement was noted.
- Transactions with closely related service corporations contributed to the loss of control over Federal funds.
- Funds were used to pay the same expenses twice.
- Assets purchased with Federal funds were lost, stolen, or improperly disposed of.

Some corrective action has been taken including the recovery of nearly \$9 million; however, more needs to be done.



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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON D.C. 20548

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To The President of the Senate and the
Speaker of the House of Representatives

This report discusses the major problems in controlling the use of Federal funds at selected community action agencies. It discusses the internal control weaknesses that have contributed to these problems, and points out that some corrective action has already been taken by several Federal agencies as a result of this review. The report also contains recommendations for strengthening the control over Federal funds administered by community action agencies.

This review was requested by the former chairman of the Subcommittee on Federal Spending Practices and Open Government, Senate Committee on Governmental Affairs.

Copies of this report are being sent to the Director of the Office of Management and Budget and the heads of the six departments and agencies identified in the report as the major funding sources for community action agency programs.

Milton J. Fowler

Acting Comptroller General
of the United States

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COMPTROLLER GENERAL'S
REPORT TO THE CONGRESS

INTERNAL CONTROL WEAKNESSES
CONTRIBUTED TO THE MISMANAGE-
MENT AND MISUSE OF FEDERAL
FUNDS AT SELECTED COMMUNITY
ACTION AGENCIES

D I G E S T

The Federal Government in 1979 provided an estimated \$1.5 billion to 897 community action agencies to develop and conduct programs aimed at eliminating poverty and aiding the poor. At the 12 community action agencies reviewed, GAO found that over \$11 million of such funds was being mismanaged or misused. The community action agencies reviewed may not be representative of all agencies because their selection was not made statistically. However, the problems identified are indicative of weaknesses in the internal controls used to safeguard Federal grant funds provided to these agencies.

PROBLEM AREAS IDENTIFIED

This report focuses on four problem areas:

- Excessive cash balances.
- Inadequate control over service corporations.
- Duplicate reimbursement of expenses.
- Inadequate control over fixed assets.

Excess cash

GAO reviewed several community action agencies and found that millions of dollars of excess Federal cash had been used to earn (and retain) interest income, had been diverted into unrecorded bank accounts, had been loaned to other grant programs, and had been used to subsidize non-Government activities. In addition, some excess funds were embezzled at one location. At one community action agency, \$7.5 million had been retained from expired or terminated grants; at another, employees had diverted \$1.9 million into unrecorded bank accounts, loaned over \$1 million to other programs and even to other community action agencies in other cities, and

embezzled \$120,000; and at a third, \$82,000 was used to subsidize the operation of a private enterprise which the community action agency owns. (See pp. 5-10.)

Service corporations

Some of the community action agencies GAO reviewed have used hundreds of thousands of dollars to buy services and rent property from closely related organizations called service corporations. Some of these transactions have resulted in the loss of control over Federal funds and the circumvention of restrictions on the use of grantee funds. The lack of a policy that would require an arm's length relationship between a community action agency and a closely related service corporation contributed to these problems. As a result, one service corporation was able to sell 22 buses for nearly \$85,000 and retain the proceeds even though all costs of purchasing and operating the buses were charged to Federal grants. This service corporation similarly also had purchased 33 other buses and two buildings. (See pp. 10-13.)

Duplicate reimbursement of expenses

Some community action agencies and their delegates GAO reviewed have charged nearly \$1 million of expenses to more than one Federal grant. For example, one agency received nearly \$855,000 in dual reimbursements between July 1974 and May 1977 because it was reimbursed for the same food costs under the Child Care Food program and the Title XX day care program. The grantee had not reported fund reimbursements received from one program to the other even though each program required such reporting. Over \$692,000 of this amount was refunded. (See pp. 13-14.)

Lost, stolen, and improperly disposed of assets

Several community action agencies GAO reviewed have not established property control systems to account for assets purchased with Federal funds and have not safeguarded such assets. Consequently, thousands of dollars of assets have been lost, stolen, and improperly disposed of, and neither the community action agencies nor the Federal agencies which fund them know how many assets there should be. For example, at one community action agency, GAO attempted to verify the existence of eight assets purchased in 1978

which cost over \$100 each and six assets which cost less than \$100 each. None of the 14 could be located. In addition, over \$3,000 of assets included in a certified inventory were missing and the property officer knew they were missing when the inventory was submitted to the Community Services Administration. Furthermore, over \$9,400 worth of office and photographic equipment contained in the certified inventory could not be located and over \$1,400 of assets purchased with Department of Housing and Urban Development funds were missing. (See pp. 14-17.)

WEAKNESSES CONTRIBUTING
TO THE MISMANAGEMENT AND
MISUSE OF FEDERAL FUNDS

Weaknesses in internal controls enabled the community action agencies GAO reviewed to mismanage and misuse Federal grant funds because:

- Cash was received before it was needed, and Federal grantmaking agencies did not properly monitor grantee cash balances. (See pp. 18-19.)
- The Community Services Administration, prior to September 1980, had not issued any policy instructions which specifically addressed the relationship of community action agencies and their service corporations. (See pp. 19-21.)
- Federal agencies responsible for administering similar programs have not adequately coordinated their efforts, and have not received reliable data on the amount and source of all their grantees' Federal reimbursements. (See pp. 22-23.)
- Federal agencies have not enforced their requirements that grantees establish adequate property control systems. (See pp. 23-24.)

CORRECTIVE ACTIONS BEING TAKEN

The Community Services Administration and the Departments of Health and Human Services and Agriculture have initiated some corrective actions. For example:

- Nearly \$9 million of excess cash has been recovered and grantee cash balances are being monitored.

- Safeguards have been introduced to help prevent abuse of service corporations. These safeguards include the incorporation of service corporations as nonprofit entities, the assurance that the assets acquired by these corporations remain in the low income community, the compliance with standard Federal grantee procurement and personnel practices, and the annual auditing of financial records.
- A new application and reporting system to minimize dual reimbursement has been introduced.
- The Office of Management and Budget's uniform requirements for property management have been implemented.
- Interproject loans now require justification and approval.
- Interagency agreements for financial management are being prepared to reduce dual reimbursements.
- An inspectors general joint project is being conducted to study the effects of multiple funding of Federal child care feeding programs. (See pp. 25-26.)

CONCLUSIONS

Good internal controls are the most effective deterrent to mismanagement and misuse of funds. It is apparent from the results of GAO's work that internal controls over Federal funds administered by the community action agencies GAO reviewed need strengthening. The scope of this review would not permit GAO to apply this conclusion to all community action agencies. GAO believes, however, that the corrective action already taken by several Federal agencies as a result of its work indicates that these agencies felt the problems GAO identified existed in more community action agencies than those in this review.

GAO therefore believes that in order to strengthen internal control over Federal funds administered by all community action agencies, Federal grant-making agencies must establish, revise, and/or enforce sound internal control policies and procedures particularly in the areas of cash management, program cost reimbursements, and property management. In addition, the Community

Services Administration must develop an overall policy governing the establishment of service corporations or similar organizations by community action agencies or their delegates and/or employees. While this policy should include applicable provisions of the Community Services Administration's recent procurement standard amendments, it must also cover nonprocurement contract areas of concern.

GAO also believes that the Office of Management and Budget (OMB) needs to follow up on the Community Services Administration's efforts to regulate service corporations.

RECOMMENDATIONS

The heads of Federal departments and agencies that provide funds directly or indirectly to community action agencies should:

- Enforce the provisions of OMB circulars A-102 and A-110 that deal with establishing a strong system of internal controls at the grantee level.
- Where specific weaknesses exist, develop systems for ensuring that grantees' internal controls are adequate to protect Federal funds from mismanagement and misuse. Such systems should include sanctions which can be applied against grantees who are repeatedly found to have inadequate systems.
- Develop systems to prevent grantees from claiming reimbursement for the same expense under more than one program.
- Follow current cash management policy and recover any excess funds held by grantees.
- Impose sanctions against grantees who repeatedly maintain excessively high balances of Federal cash. Such sanctions may include suspension of cash advances or the charging of interest on excess balances.
- Ensure that grantees adhere to Federal standards relating to property management by periodically receiving their property management systems.

The Director, Community Services Administration, should:

- Develop an overall policy on the establishment of service corporations or similar organizations by community action agencies or their delegates and/or employees. This should minimally (1) require that Federal approval be obtained before any Federal funds are transferred to such an organization and (2) include applicable provisions of the Community Services Administration's procurement standards, particularly those rules that promote the establishment of an arm's length relationship between a buyer and seller.
- Develop monitoring procedures for overseeing the implementation of this overall policy.
- Review service corporations established by community action agencies prior to the issuance of this overall policy to determine if an arm's length relationship exists between the two organizations; where this is not the case, act to bring this into conformity with the new policy and determine if the Government has a residual interest in any property acquired by these service corporations and establish how such interest will be protected.

The Director, Office of Management and Budget, should follow up on the Community Service Administration's efforts to regulate service corporations as part of OMB's budget review process and Financial Priorities Program.

AGENCY COMMENTS
AND GAO'S EVALUATION

GAO provided seven Federal agencies a draft of this report for their review. Comments were not received from the Community Services Administration and the Department of Labor. (See p. 28.) The comments received generally indicated concurrence with GAO's recommendations or discussed actions being taken or planned in response to the problem areas discussed in the report.

OMB agreed that there appears to have been serious weaknesses at the Community Services Administration which permitted the abuse and misuse of Federal funds at community action agencies. OMB

stated that these weaknesses need to be addressed by managers of the various Federal agencies funding these grantees.

OMB, through its circulars, stressed the need for proper accountability of Federal funds, and believed that few of the abuses cited in the report would have occurred if the standards in its Circular A-110 (which covers community action agencies) had been fully implemented. OMB stated that it is following up on agencies' implementation of the provisions of OMB grant management circulars, and is developing a policy circular for agency internal control systems.

OMB also noted that the oversight of the Community Services Administration's efforts to regulate service corporations is an issue that should be resolved by that agency. However, OMB added it will follow up on this issue with the Community Services Administration during the budget review process and as part of its Financial Priorities Program. (See pp. 28-29.)

The Department of Agriculture noted that it is trying to prevent grantees from claiming reimbursement for the same expense under more than one program. Agriculture has negotiated an agreement with the Department of Health and Human Services concerning Head Start. The issue of dual funding with the Health and Human Services Title XX program will be addressed by an amendment to Agriculture's regulations. (See pp. 29-30.)

The Department of Health and Human Services stated that as a result of discussions with the Department of Agriculture, it is developing guidance to prevent grantees from claiming reimbursement for the same expense under more than one program. Health and Human Services also stated that it has written new policies to strengthen grantee cash management practices, and that it will take necessary action, such as providing funds only after periodic receipt of expenditure reports, in cases where grantees continually maintain high cash balances. (See p. 31.)

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ABBREVIATIONS

| | |
|-----|---|
| CPA | certified public accountant |
| CSA | Community Services Administration |
| GAO | General Accounting Office |
| HHS | Department of Health and Human Services |
| HUD | Department of Housing and Urban Development |
| OMB | Office of Management and Budget |

CHAPTER 1

INTRODUCTION

The Economic Opportunity Act of 1964 as amended provides for the establishment of community action programs to encourage innovative approaches to attacking the causes of poverty and to stimulate communities to use available resources more effectively to help the poor become self-sufficient. The Community Services Administration (CSA) is responsible for administering these programs at the national level. CSA provides basic policy direction, financial assistance, training, and technical guidance to community action agencies which develop, conduct, and administer these programs locally.

The Federal Government funded 897 community action agencies during fiscal 1979. Of these, approximately 90 percent were private, nonprofit organizations governed by local boards while about 10 percent were public agencies administered by local governments.

PROGRAMS AND SERVICES PROVIDED

Community action agencies provide a variety of programs and services based on local needs and priorities. Generally, these agencies work through organizations or groups referred to as delegate agencies and operate and/or administer the following types of programs:

- Job development and employment training.
- Health and family services.
- Day care services.
- Meals for children and senior citizens.
- Headstart, tutoring, and other educational assistance.
- Housing rehabilitation and energy conservation.
- Economic development projects.

FUNDING SOURCES

Community action agencies receive funds from a variety of sources. The Federal Government, through numerous agencies--

including CSA, the Departments of Health and Human Services (HHS) ^{1/}, Labor, Housing and Urban Development (HUD), Agriculture, and Energy--provides about 80 percent of the funds. State and local governments and private organizations provide the rest.

The total amount of Federal funds provided to community action agencies is difficult to ascertain because these organizations receive such funds directly from Federal agencies as well as indirectly through State and local government agencies. However, based on grantee supplied information, we estimate that the Federal Government provided at least \$1.5 billion to the 897 community action agencies during fiscal 1979.

ACCOUNTABILITY FOR FEDERAL FUNDS

As a requisite to receiving Federal funds, the Office of Management and Budget (OMB) requires that grantees, including community action agencies, develop financial management systems which effectively account for all funds, property, and other assets. Audits and internal control systems are integral parts of a grantee's financial management system. Audits are made to assure the Federal agencies, and ultimately the Congress, that grantee financial records are reliable, that grantee operations are complying with laws and regulations, and that Federal funds are used for authorized purposes and are not subject to misuse and mismanagement. Internal controls are checks and balances over all activities (both fiscal and managerial) of an organization that are designed to prevent the misuse or mismanagement of its money or property. Good internal controls are the most effective deterrent to misuse and mismanagement of Federal funds.

OBJECTIVES, SCOPE, AND METHODOLOGY

Our review was performed at the request of the chairman of the Subcommittee on Federal Spending Practices and Open Government, Senate Committee on Governmental Affairs. We were asked to (1) investigate the allegations of misuse of Federal funds disclosed by various audits of programs operated by one specific community action agency and its subgrantees, (2) determine if action has been taken to correct the management deficiencies which permitted the misuse to occur, and (3) test other similarly funded or constituted grantee organizations elsewhere to see if comparable situations exist.

^{1/}On May 4, 1980, the Department of Health, Education, and Welfare was officially divided into the Department of Health and Human Services and the Department of Education. While most of our work was completed before the creation of the two new departments, we will use HHS throughout this report because HHS is the current cognizant agency for the former HEW programs mentioned in this report.

We reviewed 22 such organizations. Seventeen of these were selected by the subcommittee chairman, and the remaining five were selected by us nonstatistically.

For this study, we:

- Reviewed various aspects of the financial management systems of 12 community action agencies 1/ including such areas as cash management, property control, duplicate reimbursements, and establishment of service corporations. We examined financial records and reports prepared for these agencies and, on a limited basis, verified the physical existence of assets purchased by them.
- Analyzed the audit reports for the last two program years for 10 other community action agencies 2/ to see if similar financial management problems were identified.

During our review we also interviewed Federal, State, and local government officials responsible for programs operated by the community action agencies. In addition, we interviewed officials of the community action agencies and their delegates, and representatives of the certified public accounting firms and State and local government offices that audited these grantees. Our work on location at the community action agencies was performed during fiscal 1979.

We reviewed Federal laws and regulations relating to the administration and management of community action agencies and the workpapers prepared as support for the audit reports. We did not evaluate the effectiveness of the community action programs or the quality of the audits.

RELATED TESTIMONY

During the course of this review, we testified several times on our tentative findings.

On March 22, 1979, we testified before the Senate Subcommittee on Labor and Health, Education, and Welfare (Committee on Appropriations). We described instances of diverted and embezzled funds, improper loans, dual travel costs, improper payroll advances, bonuses, and unauthorized credit card charges. We also reported internal control weaknesses as well as inadequate documentation for, and accountability over, expenditures; dual and unsupported reimbursements for food costs; and other areas of program abuse.

1/See appendix VIII for a list of these 12 agencies.

2/See appendix IX for a list of these 10 agencies.

On October 19, 1979, we testified before the Senate Subcommittee on Federal Spending Practices and Open Government (Committee on Governmental Affairs). We reported excessive Federal cash in the hands of community action agencies, establishment of leasing corporations, dual reimbursement of expenses under more than one Federal program, lax control over assets purchased with Federal funds, and loaning of Federal moneys between the various programs administered by community action agencies.

In May and June 1980, we again testified on these problems--on May 6, before the House Subcommittee on Manpower and Housing (Committee on Government Operations); and on June 5, before the Senate Subcommittee on Federal Spending Practices and Open Government. This report focuses on the major problems identified during our review, their causes, and the corrective action needed.

CHAPTER 2

FUNDS GRANTED TO SELECTED COMMUNITY

ACTION AGENCIES HAVE NOT BEEN ADEQUATELY MANAGED

Since 1964 the Federal Government has provided billions of dollars to community action agencies to eliminate poverty at the local level and help the poor become more self-sufficient. We found that some of these funds, however, have not been used to meet that goal. In the 12 community action agencies reviewed, we estimate that over \$11 million of Federal funds have been mismanaged and/or misused. For example, we found that millions of dollars of excess Federal cash has been retained by community action agencies. This excess cash has been used to earn (and retain) interest income; diverted into unrecorded bank accounts; loaned to other grant programs, delegate agencies, and other governmental units; and used to subsidize nongovernmental activities of community action agencies. In addition, at one location some excess funds were embezzled.

We also found that hundreds of thousands of dollars have been used to buy services and rent property from closely related service corporations. Some of these transactions have contributed to loss of control over Federal funds and the circumvention of restrictions on the use of grant funds.

Finally, we found that nearly a million Federal dollars had been used to pay for the same expenses twice; thousands of dollars of assets have been lost, stolen, or improperly disposed of; and thousands of dollars have been misspent in a number of unrelated activities.

EXCESS CASH IS RETAINED AND MISUSED

Although Federal policy requires that grantees maintain a minimum of Federal cash on hand--usually defined by HHS as a 3-day or a 30-day supply and by CSA as a 30-day supply--we found that several community action agencies had cash balances far in excess of their immediate needs. Federal policies also require that grantees return excess Federal cash. Excessive balances have occurred because grantees received cash before they needed it and because Federal agencies did not recover unneeded funds from ongoing and expired or terminated grants. Excess cash in the hands of grantees provides an opportunity for misuse, and increases the Government's need to borrow money and thus increases its operating cost. In recent months the Treasury has been paying record interest rates on borrowed money.

Our review of the financial management systems at 12 community action agencies disclosed that 9 had excess cash on hand. In addition, a review of audit reports prepared by certified public accounting (CPA) firms for the 10 other community action agencies

showed that 7 of them also had excess cash. Examples of community action agencies having excess cash and the use made of some of these funds follow.

We found that one community action agency reported a yearend cash balance of \$1.8 million of CSA funds on January 31, 1979. However, an analysis of its quarterly Federal Cash Transaction Reports submitted to CSA for the period August 1, 1978, to January 31, 1979, showed total disbursements of \$1.1 million, or an average monthly disbursement rate of \$181,261. Thus, the agency's yearend cash on hand was 10 times its average monthly disbursement need for the last 6 months. Similarly, the agency's reports submitted to HHS on its funds for the 12 months ending January 31, 1979, showed total disbursements of \$2.3 million, or an average monthly disbursement rate of \$189,261. The agency, however, on January 31, 1979, reported to HHS yearend cash on hand of \$312,000 or \$123,000 more than its average monthly disbursement need for the last 12 months.

An analysis of the cash flow statements prepared by another community action agency showed that between July 28, 1978, and July 27, 1979, its federally supplied cash balance at the end of this period was \$2.2 million, while its average monthly disbursements during this period amounted to only \$1.5 million. Thus, the balance of Federal cash on hand was about \$700,000 above this agency's average monthly disbursement need for this 12-month period.

Although Federal policies require that grantees return excess Federal funds to the sponsoring agency, we found one community action agency had a \$7.5 million cash balance of Federal funds as of May 31, 1979, because it retained unexpended grant funds from prior program years and from expired or terminated grants. About \$2.9 million of this total was HHS Head Start grants as follows:

| <u>Program year ended</u> | <u>Leftover funds</u> |
|---------------------------|-----------------------|
| Aug. 1974 | \$ 117,800 |
| Aug. 1975 | 12,700 |
| Nov. 1976 | 985,900 |
| Nov. 1977 | 297,200 |
| Nov. 1978 | <u>1,440,700</u> |
| Total | <u>\$2,854,300</u> |

Other programs which significantly contributed to the \$7.5 million of leftover funds include:

| <u>Program</u> | <u>Funding agency</u> | <u>Program year ended</u> | <u>Cash balance as of May 31, 1979</u> |
|---|-----------------------|---------------------------|--|
| Neighborhood Youth Corps, Summer Program (note a) | Labor | June 1971 | \$ 259,000 |
| Community Action | CSA | Dec. 1972 | 126,000 |
| Community Action | CSA | Dec. 1977 | 157,000 |
| Community Development Block Grant | HUD | Sept. 1976 | 1,660,000 |
| Youth Services | Justice | Apr. 1976 | 20,000 |
| Follow Through | HHS | Aug. 1974 | <u>55,000</u> |
| Total | | | <u>\$2,277,000</u> |

a/No longer an ongoing program.

The remaining \$2.4 million of leftover funds was traced to numerous other federally supported grants.

Two other community action agencies which we visited had relatively large amounts of unexpended Federal funds in expired or terminated grants. One had \$232,000 and the other had \$201,000.

Funds diverted into unrecorded interest-bearing accounts

We found that one community action agency diverted \$1.9 million of excess Federal cash into three interest-bearing bank accounts which were not recorded on the organization's accounting records. The diversions occurred in 1973 and 1976 and were used to earn \$50,000 of interest which was neither reported nor remitted to the Federal Government as required by OMB Circular A-110. The audits performed during this period did not disclose the diversion because the auditors did not confirm with CSA the dates and amounts of fund transfers to the grantee. Such confirmation is a requirement of the CSA audit guide.

We discovered one of the unrecorded bank accounts in March 1979. It had a balance of \$76,000 including the earned interest of \$50,000. The organization's current finance director told us that he was unaware of this account, and since the account was not recorded on the organization's accounting records and only one of the two individuals who had made deposits to the account was still employed by the organization, it would have been easy

for the account to have been lost or for the fund to have been misused. On September 12, 1979, the community action agency refunded the \$76,000 to CSA.

The 1973 diversion occurred after the community action agency received \$974,000 for a CSA grant that had been canceled. However, since CSA had already sent the organization a check for that amount, rather than asking for its return, it told the organization to offset the funds against future grants. In August 1973, the agency's then finance director deposited the \$974,000 in an interest bearing bank account. Over the next 16 months, these funds were transferred in increments to the agency's regular checking account to meet normal program costs, thus accomplishing the desired offset. However, again in 1976, agency employees on six occasions deposited CSA checks in an unrecorded interest bearing account and after 9 to 31 days transferred the money to the agency's regular checking account.

The annual audits of CSA funds did not disclose these diversions because the CPA firm that performed the audits did not confirm with CSA the dates and amounts of fund transfers to the organization. Such confirmation is a requirement of the audit guide. The CPA firm stated that it confirmed the total grant award but not the individual amounts of checks because no irregularity was suspected.

Federal funds embezzled

In addition to diverting funds into interest-bearing accounts of this community action agency, the former finance director embezzled \$121,000 of idle, primarily HHS funds between February and November 1976. He did this by making checks payable to himself, depositing them in his personal savings account, and when the checks were returned, removing his name and inserting the name of the agency to make the checks appear legitimate. The embezzlement was discovered in December 1976 by a CPA firm responsible for auditing CSA funds after it received a tip from a bank official. However, HHS and CSA were not made aware of the actual embezzlement until 6 months later when we, as part of another review, brought the matter to their attention and notified the Federal Bureau of Investigation. 1/ The CPA firm contended that it did not report this problem because it involved HHS funds and the firm had been engaged to audit only CSA funds.

The former finance director repaid the Federal funds plus interest to the community action agency, pleaded guilty to three counts of embezzlement, and received a reduced jail sentence of 2 weeks, a \$1,500 fine, and a 3-year probation.

1/"Quality Testing of Audits of Grantees' Records--How It Is Done By Selected Federal Agencies and What Improvements Are Needed," FGMSD-79-38, July 19, 1979, pp. 12-13.

Excess cash used for loans

Excess Federal cash on hand has permitted community action agencies to loan funds between their projects, to delegate agencies, and to other units of local government. Such loans result in Federal funds being used for purposes other than originally authorized. For example, one agency loaned over \$1 million of its Federal funds between programs, to its delegate agencies, and to community action agencies in other cities and States since the early 1970s. ^{1/} At the time of our review, some of these loans had not been repaid. The agency's loan activities included:

- \$445,000 from a food reimbursement account, which included funding from several sources, including the Department of Agriculture. Some activities that received these funds included youth delinquency prevention programs and an energy emergency program.
- \$435,000 of CSA funds to community action agencies in other cities.
- \$180,000 of HHS and other funds to its delegate agency.

The loans which have not been repaid include \$23,000 of the \$180,000 loan to a delegate agency and \$42,000 of the food reimbursement account funds.

Loans resulted in loss of budgetary control

One community action agency lost budgetary control over Federal money by transferring funds among its various grant and non-grant bank accounts. During 1977 and 1978, such loans numbered 87 and involved about \$285,000. An audit report covering the agency's 1977 CSA funds disclosed that \$230,000 had been transferred to other projects and about \$72,000 had not been returned. Most of the \$72,000 was owed by the agency's corporate account, the account which commingled Federal and non-Federal funds. As of November 1978, this account still owed CSA \$54,000. According to the CSA regional auditor and the CPA firm, the \$54,000 was used to support non-CSA activities, including overexpended budgets in other Federal grants or expenses for non-Federal grant activities. As a result of these loans, the agency did not have sufficient funds to liquidate its obligations incurred under the CSA grant. In December 1978, CSA awarded the agency an additional \$100,000, of which \$63,000 was to be used to cover obligations and expenditures through December 1978.

^{1/}HHS has arranged with other Federal agencies for a special comprehensive audit of this agency. (See p. 25 of this report.) This audit will include a review of this loan activity. A final audit report is projected for the end of fiscal 1981.

Excess cash used to subsidize
non-Government activities

One community action agency used \$82,000 of Federal program funds in 1979 to pay operating expenses of its convalescent and nursing home. This represented unauthorized use of Federal funds to subsidize a non-Federal program. According to the agency's finance director, the home had constantly drained the agency's Federal programs for its funding. In addition, the home did not generate enough income to offset this deficit spending.

Excess cash used to earn interest

Several community action agencies also have used their excess Federal cash to earn interest. Such income should have been returned to the Federal Government in accord with OMB Circular A-110; however, we identified about \$180,000 that had been earned by four community action agencies but, at the time of our review, had not been remitted as required.

TRANSACTIONS WITH SERVICE CORPORATIONS
CONTRIBUTE TO THE LOSS OF CONTROL
OVER FEDERAL FUNDS

We identified four community action agencies which have established separately organized nonprofit corporations to provide a variety of services to the community action agency and sometimes to other local agencies. The community action agency then buys services, rents property, or otherwise does business with the nonprofit corporation as if it were a private business.

There does not appear to be anything inherently wrong with this arrangement. Some of these corporations perform valid functions related to grants such as providing bus transportation for participants in Head Start. Others, however, appear to be a means of circumventing restrictions on the use of grant funds. The close relationship of the community action agency with the service corporations contributes to problems in controlling Federal funds used in transactions with these corporations.

The following examples show how transactions with these corporations have contributed to the loss of control over Federal funds and, in some cases, the circumvention of Federal agency restrictions on the use of grant funds.

Problems created by service
corporations acquiring property

Our analysis showed that a unique relationship whereby a service corporation purchased assets and leased them to a community action agency resulted in the following:

- The service corporation retained nearly \$85,000 from the sale of 22 buses even though all costs associated with their purchase and operation were charged to Federal grants.
- The service corporation holds title to 33 other buses and two buildings even though most costs associated with these assets were charged to Federal grants.
- Interest of \$172,000 will be charged to Federal grants even though such costs are not normally chargeable to grants.

In 1973, a community action agency established a separate non-profit service corporation. The service corporation, at the time of our review, had no employees and no functions other than the writing of checks to repay loans which were used to acquire real and personal property. Both shared a common executive director, and four members of the service corporation's board of directors either served as members of the community action agency's board of directors or were involved with operating its Head Start program.

Since it was established, the service corporation has purchased and sold items of real and personal property. All assets purchased are titled to the service corporation. In 1973, it purchased 22 buses for about \$152,000. These buses were sold in 1978 for \$85,000 and the proceeds were retained by the service corporation. At approximately the same time, the service corporation purchased 33 new buses for \$472,000. The bank note for the purchase of the 33 buses was signed by the executive director of the community action agency. In addition, this service corporation has purchased two buildings--one in 1973 for \$44,000 and one in 1978 for \$25,000. On August 15, 1979, the appraised value of the two buildings was \$234,000.

Most costs associated with the purchase, operation, and maintenance of the buildings and buses have been or are being charged to Federal grants. The community action agency reimbursed the service corporation for all down payments, except one for \$5,000, and for all principal and interest payments on the loans used to acquire the buses and buildings, and charged these costs to Federal grants as lease payments. If the service corporation repays the loans as scheduled, such costs will amount to over \$860,000 including interest of \$172,000. The community action agency also paid for all renovations made to the buildings as well as all operating costs associated with the buildings and buses, and charged those costs to the Head Start grant.

The executive director of the community action agency wrote to us that the purpose of the creation, development, and continued existence of the service corporation is not and has never been for the community action agency to acquire, own, and dispose of property used in federally funded programs. Rather, the purpose behind the operations of the service corporation has always been to provide community based, dependable, and cost effective bus service

while providing jobs and job training for low income people. He added that at no time has the community action agency had the intention or desire to enter the transportation business. The executive director also stated that the proceeds of the bus sale were deposited in a minority institution to be used to defray operational and administrative overhead expenses of the service corporation. This stated purpose of the service corporation does not diminish our concern that the close relationship between the community action agency and the corporation contributes to problems in controlling Federal funds used in transactions between these two entities.

Grant funds restrictions circumvented

A CSA investigation of one community action agency showed that it used its service corporation to circumvent a restriction on the use of grant funds and to obtain interest which could later be used without CSA restrictions. As a result of transactions with the service corporation, Federal grants were charged excessive rental fees of \$27,800 and the corporation earned \$1,400 in interest income.

This community action agency established a private nonprofit leasing company to provide it vehicles and office equipment. The incorporators and original members of the leasing company's board of directors were also members of the community action agency's board, and both organizations shared a common executive director.

A CSA investigation concluded that, in order to circumvent a restriction against the community action agency purchasing cars with the Department of Commerce's Title X Alternate Care Program funds, the service corporation purchased the automobiles and leased them to the community action agency. The rental costs for the 10 vehicles for 1 year were substantially higher than their purchase prices. In addition, there was no effort to competitively obtain the vehicles. CSA estimated that the overcharge in rental fees amounted to \$27,800.

CSA's investigation also established that the community action agency loaned the service corporation \$350,000 which was used to buy a certificate of deposit. The loan was repaid within 30 days; however, the earned interest of \$1,400 was retained by the service company. The investigation concluded that the corporation "appears to have been established for the purpose of creating a method whereby grant funds could be funneled and kept for use at a later date without the restrictions imposed on CSA grant funds."

In July 1978, CSA's regional director reported that the interlocking boards of directors had been eliminated so that only one member served on both boards; that the executive director of the community action agency no longer served as the director of the leasing corporation; that the financial and property records of the leasing corporation were not maintained by the community action

agency; and the leasing company would reimburse the community action agency for the \$27,800 overcharge of rental fees.

Other problem areas identified

Other community action agencies have established service corporations which have caused or have the potential to cause similar problems for the grantmaking agencies. The following examples illustrate the use made of Federal funds by these agencies.

- One community action agency's service corporation holds title to two pieces of real estate. The community action agency denies that the Federal Government has an interest in one building even though (1) Federal program funds were used for \$42,750 of the \$47,750 downpayment, (2) all mortgage payments--principal and interest--are charged to Federal grants as lease payments, and (3) all renovation costs have been charged to Federal grants. Furthermore, the building is located within the boundaries of one of three sites under GSA consideration for the location of a new Federal office building. Thus, GSA may end up purchasing this building from the service corporation even though the Federal Government, through grant charges, has borne the bulk of the down payment, all mortgage payments, and all renovation costs associated with it.
- A delegate of another community action agency organized and controlled a corporation which used \$20,000 of CSA funds without approval as a down payment to purchase property which was then rented to the community action agency. A year later when this corporation attempted to sell the property, CSA had to file a lien against the property in order to protect its financial interest.

DUPLICATE REIMBURSEMENT OF EXPENSES

Although Federal grantees should not be reimbursed for the same expenses more than once, we and other Federal auditors found nearly \$1 million of duplicate reimbursements involving four community action agencies, their delegates, or their employees. For example:

- One community action agency had received over \$855,000 in duplicate reimbursements between July 1974 and May 1977 because it was reimbursed for the same food costs under Agriculture's Child Care Food Program and Health and Human Services' Title XX day care program. This was identified as a result of an audit by the Department of Agriculture in

1977. The auditors attributed the problem to the fact the grantee did not report the reimbursements received from one agency to the other. 1/

- A second agency received duplicate reimbursements of about \$61,000 because it charged as administrative expenses to its Emergency Energy Assistance Program the same expenses that it charged to its other Federal programs.
- A third agency charged \$1,800 of the same costs to CSA's Emergency Energy Conservation program and also to other Department of Energy and CSA programs administered by the State's Planning and Community Affairs Agency.

Other examples of the Federal Government paying more for expenses than needed include:

- A day care center that received dual reimbursements of \$38,000 during a 1-year period because salaries of employees hired under several Federal job training and work relief programs were also reimbursed under Title XX grants.
- An individual who received excess salaries of about \$10,000 for 6 months under two Federal programs. The individual served as the director of a delegate agency of a community action agency and as the director of special services at a local college. For the former position, this individual received \$21,000 annually which was charged to a CSA grant. His working hours were 9 a.m. to 5 p.m. As director of special services, a position which was funded by HHS, this individual was required to work at a local college from 8:30 a.m. to 4:30 p.m. daily. The period of duplicate reimbursement occurred between February 2 and July 31, 1979.

LOSS, THEFT, AND IMPROPER DISPOSITION OF ASSETS IS PREVALENT

Although Federal regulations require that grantees establish property control systems to account for and safeguard assets purchased with Federal funds, we found that the financial management systems at 6 of 12 community action agencies did not do so. In addition, a review of reports prepared by CPA firms for 10 other

1/Over \$692,000 of this duplicate payment was refunded by an offset against Title XX claims paid for the year ended June 30, 1977. An attempt was made to refund the rest through an offset against Title XX claims submitted for the year ended March 31, 1976. The state did not pay this claim because of a program fund shortage, but wrote off the offset because of the effort made to refund it.

agencies showed that 8 of those agencies also had inventory control weaknesses.

As a result of the property control system problems at six community action agencies many assets have been lost, stolen, or improperly disposed of. Furthermore, grantee records are incomplete and inaccurate. Consequently, neither the community action agencies nor the Federal agencies which fund them know how many assets the former are responsible for. Examples follow.

Missing assets

Safeguarding assets has been a problem at several community action agencies. For example, our review of one community action agency showed that many assets purchased with Federal funds are missing. We attempted to verify the physical existence of eight assets purchased in 1978 which cost more than \$100 each and six assets which cost less than \$100 each. None could be located. Also, we found that \$3,000 of assets included in a certified inventory provided to CSA on February 28, 1979, were missing and that the community action agency's property office knew they were missing when the inventory was submitted. The missing assets included a 1968 Ford, lawnmowers, cassette recorders, a microfiche reader, a window washer, a radio, a heater, an electric pencil sharpener, and miscellaneous photographic equipment.

At the same community action agency we also attempted to verify all items of office and photographic equipment contained in the CSA certified inventory. Most of the items, worth over \$9,400, could not be located. In addition, we found over \$1,400 of assets purchased with funds from HUD were also missing. The missing property included:

- 2 light meters,
- 1 densimeter (specialized photographic equipment),
- 2 slide screens,
- 3 cameras,
- 1 photo enlarger,
- 3 calculators,
- 11 typewriters,
- 1 check protector,
- 1 letter folding machine,
- 6 pieces of office furniture (chairs, tables, desks),

- 1 lamp,
- 3 tape recorders,
- 1 microphone,
- 1 stereo amplifier,
- 1 mini van, and
- miscellaneous tools.

Another community action agency has had problems controlling fixed assets and in February 1979 requested permission from CSA to delete over \$31,000 of fixed assets from its inventory as missing, stolen, or destroyed. In 1975, this community action agency succeeded a nonprofit organization as the community action program serving the area. Thus, some of these assets may have been lost during the transfer of responsibility.

Improper disposal of assets

One community action agency we reviewed did not maintain adequate control over its fixed assets, and consequently vehicles were disposed of improperly. For example, we noted that the agency sold nine vehicles for a total of \$64 to individuals with close ties to the agency. After we disclosed this, the agency and the individuals involved in the sale agreed that two of the vehicles would be returned to the agency and another \$699 would be paid for the other seven. A description of the vehicles involved, the original agreed-to sales prices, and the settlement prices follow:

| <u>Quantity</u> | <u>Vehicle</u> | <u>Agreed-to sales price</u> | <u>Settlement price</u> |
|-----------------|--|----------------------------------|-----------------------------|
| 5 | 1967 Scout | \$35 | \$500 |
| 1 | 1969 Chevy Carryall | 6 | 50 |
| 1 | 1959 GMC Bus | 10 | 200 |
| 1 | 1962 Ford tractor | 10 | Returned |
| 1 | International truck (with welldigger) | 3 | Returned |

This was not the only instance in which vehicles were disposed of under other than normal circumstances. For example, in June 1977, a 1968 Chevrolet panel truck which belonged to the community action agency was sold at public auction to a used car dealer for \$100 to satisfy a mechanic's lien. While attempting to obtain detailed information about this disposition we were told the following. The community action agency's director of transportation said that in 1974 he had purchased four vehicles from the agency for a total of \$12; however, he could not locate a purchase receipt. Furthermore agency officials could not find a bill of sale or any other evidence transferring ownership for the vehicles to him.

The director also told us that in the fall of 1975 he traded one of the vehicles--a 1968 Chevy panel truck--to a used car dealer for a gun. The dealer admitted trading for the truck, but stated that he gave the director an automobile engine for it. The dealer also stated that the director did not have a title for the truck, but since he only intended to use it for parts and not register it with the State, it did not matter to him if he had a title. The dealer subsequently decided to repair and sell the vehicle; thus he needed a title. To obtain one, the dealer stated that he had an auto supply firm perform about \$100 of repairs on the vehicle, and then refused to pay for them so that a mechanic's lien would be filed against the vehicle. According to the dealer, he satisfied the lien and as a result was able to apply for and obtain title to the vehicle. The used car dealer sold the truck to a third party in 1977 for \$1,000.

In order to substantiate the dealer's statements, we reviewed division of motor vehicle records and found that a mechanic's lien was filed on May 31, 1977, against this vehicle and that on June 30, 1977, it was sold at public auction to the dealer for \$100.

An August 1973 disposal of 18 vehicles as junk also appears to have been questionable because 3 of the vehicles were later resold, and as of March 1979 were still titled by the State. Furthermore, the community action agency had not obtained the required approval for disposing of 10 of the vehicles.

CHAPTER 3

WEAKNESSES CONTRIBUTING TO THE

MISMANAGEMENT AND MISUSE OF FEDERAL FUNDS

The examples of mismanagement and misuse of Federal grant funds by community action agencies identified in the previous chapter occurred mainly because of internal control weaknesses. The major weaknesses are:

- Community action agencies are permitted to receive cash before it is needed, and Federal grantmaking agencies do not properly monitor grantee cash balances.
- CSA, prior to September 1980, had not issued any policy instructions on the relationship of community action agencies and their service corporations.
- Federal agencies responsible for administering similar programs do not adequately coordinate their efforts, and do not receive reliable data on the amount and source of all their grantees' Federal reimbursements.
- Federal agencies have not enforced their requirements that grantees establish adequate property control systems.

CASH HAS BEEN WITHDRAWN BEFORE NEEDED AND BALANCES HAVE NOT BEEN MONITORED PROPERLY

Federal grantmaking agencies have permitted community action agencies to withdraw cash in excess of their immediate needs. Agencies interpret "immediate needs" to be anywhere from a 3-day to a 30-day supply of cash.

Federal policies require grantees to limit cash balances to their immediate needs and to return excess cash. Treasury's Fiscal Requirements Manual for Guidance of Departments and Agencies and Treasury Circular 1075 contain policies on cash advances under Federal assistance programs. Part 6 of the manual states that advances of Federal cash should be limited to the minimum necessary for a recipient's immediate needs. The manual also states that excess cash should be returned to the Federal granting agency and redrawn when needed.

HHS and CSA are two Federal agencies which have used a 3-day and 30-day cash supply as a guide to see whether grantees have cash balances in excess of their immediate needs. HHS has established a 3-day need limit for grantees receiving funds under the letter of credit method and a 30-day limit for grantees using the Treasury check method. CSA's policy is that grantee letter of credit withdrawals should not exceed a 30-day cash requirement; however, CSA

requires that grantees, when reporting cash balances, explain why more than a 3-day cash requirement is on hand. Most community action agencies we reviewed used the letter of credit method in obtaining their cash from the Federal Government.

Several community action agencies consistently withdrew one-twelfth of their grant funds monthly regardless of their cash needs. In addition, at one community action agency, we found that the HHS monthly line of credit would have allowed the agency to withdraw all funds authorized for a program year in 5 months.

A lack of proper Federal monitoring of grantee cash balances also helps create excess cash balances. In this regard, grant recipients are required to submit, at least quarterly, to the Federal funding agencies a report of Federal cash transactions. These reports are to be used by the Federal agencies to monitor grantee cash advances and disbursements. CSA and HHS officials in the Chicago region informed us that they have not been using these reports to monitor grantee cash balances. CSA regional officials said that they do not have the people to perform this review while HHS regional officials said they plan to start reviewing these reports. One HHS official estimated that as a result of this lax monitoring, there may be as much as \$20 million in excess or unneeded HHS grant funds in the hands of grantee agencies in the Chicago region alone.

CSA HAS ONLY RECENTLY ISSUED POLICIES ON SERVICE CORPORATIONS

Although CSA as early as 1977 acknowledged a need to establish policies and regulations that apply specifically to service corporations, it did not issue such policies or regulations until September 1980. While the recently issued policy covers future procurements, it does not address the transfer of Federal funds to service corporations other than by a procurement contract nor the need to learn if service corporations established prior to this policy have an arm's length relationship with their closely related community action agencies.

Since 1977, several memorandums prepared by CSA's Office of General Counsel have addressed the need to control the use of Federal funds applied to subsidiary business corporations, such as service corporations. For example, in a July 14, 1978, memo to the assistant director, Office of Community Action, CSA's general counsel stated that CSA should consider a comprehensive regulation that tightly controls the use of its funds to establish and pay fees to subsidiary corporations. Over a year later in a September 28, 1979, memo to us, CSA's general counsel stated "Federal grantmaking agencies have not to date concerned themselves with issues of subsidiary corporations, presumably relying on the government's audit/disallowance process as a means for discovering and controlling abuse."

Since September 1979, CSA has taken some positive action to establish regulations and policies to gain more control over the use of Federal grant funds by service corporations. These initiatives were taken in response to the regulatory and criminal problems that have surfaced through CSA inspections, lawsuits, and our various reviews.

In March 1980, CSA published proposed rules on the use of CSA funds by community action agencies for business ventures; however, a CSA official reviewing the proposal noted that they did not address many of the problems created by service corporations and suggested that they be revised to provide:

- Any corporate activity controlled by a community action agency and which provides significant business or other services to the community action agency is covered by CSA's conflict of interest regulations regarding nepotism, procurement, and employment of community action agency board and staff.
- All corporations controlled by a community action agency must make full financial reports to the community action agency board periodically and not less than once a year.
- The financial and procurement records of such corporations are to be kept available for public scrutiny.
- All accounts (regardless of source) maintained by the community action agency must be under the control of the community action agency board.
- At least once a year a comprehensive financial statement showing all revenues and expenditures for the previous year and current financial status be submitted to the community action agency board.
- No CSA funds may be used to rent or purchase property, equipment, supplies, and so forth which are owned outright by the community action agency, any delegate agency, any corporation controlled by the community action agency, or any of its delegates.
- CSA asserts an interest in property owned by a corporation controlled by a community action agency when such property is paid for by CSA grant funds for space or equipment rental.

In April 1980, CSA published its final procurement regulations, part of which revised CSA's conflict of interest policy. Before revision, purchase of services or rental of goods and space from public nonprofit organizations at cost or at general rates previously established by these organizations were exempt from the provisions of CSA's conflict of interest policy. According to CSA,

this exemption is the loophole which allowed grantees to set up private nonprofit corporations to provide goods and services or to lease property to a grantee without requesting a waiver of the conflict of interest policy.

In September 1980 CSA published an amendment to these procurement standards because of a need for Federal oversight over separate businesses established by grantees to provide business services and buy real estate, vehicles, or other major equipment. In stating the goals of the amendment CSA wrote

"CSA's goals * * * are to assure that the assets of these separate business entities remain in the community, that their hiring and procuring practices are consistent with Federal standards, that their activities are subject to public scrutiny, and that business-like financial management practices are observed."

The amendment provides in part that for any procurement contract paid for with CSA title II grant funds, if a proposed contractor does the major part of his/her business with the procuring party and/or the contracting firm was established or is controlled by a member or members of the procuring party's staff or board, CSA approval will be required. The amendment also provides that such approval will be based on, but not limited to the existence of (1) evidence that the entity is a nonprofit corporation whose income and assets would, in event of failure of the procuring party continue to be used to benefit low income individuals; (2) evidence that the hiring and procurement policies of the contracting firm include prohibitions against nepotism and conflict of interest; (3) a provision in the contract that the management, financial, and procurement records of the contracting firm must be available for inspection and examination to those parties and on the same basis as required for private nonprofit grantees; (4) an audited revenue and expenditure statement and balance sheet, both dated within the last 12 months, that have been submitted by the contracting firm; and (5) supporting documentation that the prices being charged are competitive.

The new CSA procurement standards amendment covers the majority of our concerns involving the service corporations' use of procurement contracts with CSA grantees or their delegates. However, CSA needs to establish additional policies on such issues as the transfer of Federal funds to service corporations other than by a procurement contract. Also, CSA must act to see that service corporations established prior to its September 1980 policy have maintained an arm's length relationship in business transactions with closely related community action agencies.

COORDINATION AMONG SIMILAR FEDERAL PROGRAMS
AND RELIABLE GRANTEE FUNDING DATA
HAVE NOT BEEN PROVIDED

Four community action agencies and their delegate agencies which we reviewed have claimed and received duplicate reimbursements from Federal programs for the same expenses at various times. This has occurred mainly because the Federal agencies responsible for administering similar programs have not implemented procedures that ensure effective interdepartmental coordination, and have not received reliable data on all Federal reimbursements made to their grantees.

Lack of coordination

Several different Federal programs fund similar services to the same category of grantees, and community action agencies and their delegates have received funding under these programs. For example, at least four Federal programs provide food assistance funds for preschool children. These programs are HHS's Head Start and Title XX programs and the Department of Agriculture's Child Care Food and Summer Food Service Programs. Although Federal officials administering these food assistance programs are aware of the need to coordinate their programs for efficiency, their initiatives have not resulted in any new program procedures that would facilitate interdepartmental coordination.

In 1977 HHS entered into a contract with a consultant to establish a training program to strengthen program management and the quality of the food service and nutrition component of Head Start. As a part of the training program, proper use of all funding sources was emphasized, including the Head Start grant and the Agriculture Child Care Food Program. In May 1979 the contractor made several recommendations that stressed coordination with Agriculture, at both the national and regional levels.

During our discussions with HHS and Agriculture officials in May 1979, several factors were cited which contribute to dual reimbursement among their food assistance programs for preschool children. Two of these factors were the lack of authority over another agency's programs and each agency auditing strictly its own funds. Agriculture officials advised us that it would be developing interagency agreements for financial management and a joint audit approach with Head Start and Title XX to reduce dual reimbursements.

As of May 1980, Agriculture and HHS had both prepared draft interagency agreements for the Head Start program, but had not yet drafted an agreement for Title XX. In commenting on a draft of this report, Agriculture stated that an agreement has been negotiated with HHS concerning Head Start, and the issue of dual funding with the Title XX program will be handled by an amendment to the Agriculture regulations.

While HHS and Agriculture have discussed the possibility of a joint audit approach for individual Title XX grantees, minimal efforts have been made to develop an overall policy for joint audits of Agriculture and HHS food assistance programs for preschoolers. Federal officials had cited a difference in auditing policy and regulations between Agriculture and HHS programs as the primary reason for their past inability to resolve the joint audit question.

In June 1980, a joint project to study the multiple funding of child care feeding programs was approved, and is being conducted by the Offices of Inspector General within Agriculture and HHS, in coordination with CSA and Labor. The project is expected to be completed near the end of fiscal 1981, and will attempt to determine the effects of multiple funding, make recommendations for appropriate legislative or regulatory changes, if necessary, and address the issue of improving audit coverage of entities receiving child care feeding program funds.

Lack of reliable data
on total grantee funding

No nationwide grant information system exists to account for all Federal funds to grantees. Some agencies have fairly comprehensive systems to account for their own funds but these systems do not identify the funding supplied by other agencies. Consequently, Federal agencies rely heavily on grantee supplied information to avoid duplicate reimbursements.

Federal program policies require community action agencies to report the amount and source of reimbursements they receive. This information is to be included in the remarks section of the grantee's quarterly financial status report. Program expenditures then are to be reduced by the Federal agency on the basis of the reimbursements claimed; however, accurate information is frequently not reported. For example, at one community action agency, an Agriculture auditor noted that an \$855,000 duplicate food reimbursement, involving Agriculture's Child Care Food Program and HHS's Title XX program, occurred because the grantee did not report food service reimbursements received from one agency to the other.

FEDERAL REQUIREMENTS FOR ADEQUATE
PROPERTY CONTROL SYSTEMS
HAVE NOT BEEN ENFORCED

Although Federal regulations require that grantees establish property control systems to adequately safeguard assets purchased with Federal funds, 14 community action agencies included in our review have not done so mainly because Federal grant making agencies have not enforced this requirement.

For example, between 1973 and 1978, the CPA firm auditing one community action agency repeatedly reported numerous weaknesses

in the agency's procedures for safeguarding CSA-funded fixed assets. Specific reported weaknesses included

- lost or stolen equipment not reported to CSA,
- lost or stolen equipment removed from the inventory without formal explanation,
- newly acquired assets not properly recorded,
- property records not maintained in accordance with CSA guidelines,
- property identification tags not attached to assets,
- property control cards and inventory listings not updated,
- listings of fixed assets could not be reconciled with the prior year's listing or with the records on file at CSA, and
- improper procedures used when taking a physical inventory.

In December 1978, CSA told this community action agency to comply with CSA property management regulations by February 1979; however, CSA did not verify whether such compliance was achieved. In May 1979, we found that none of the reported weaknesses had been corrected.

This lack of enforcement by Federal grantmaking agencies appears to go beyond the community action agencies we visited. CPA firms auditing 10 other community action agencies reported that eight of the grantees had inventory control weaknesses. For six of these eight the weaknesses were identified in audit reports for the last 2 years.

CHAPTER 4

CONCLUSIONS, RECOMMENDATIONS, AND

AGENCY COMMENTS AND OUR EVALUATION

The Federal agencies have initiated some corrective actions based on the concerns expressed in our earlier testimony. For example HHS reported that it:

- Is recouping \$8 million in outstanding carryover balances from Head Start grantees, and has established a specific policy to prevent the accumulation of large carryover balances. The policy provides that available obligatory authority will be reduced when the reported unobligated balance exceeds 20 percent of the amount authorized (10 percent for authorizations in excess of \$1 million).
- Initiated an effort to review the fiscal-administrative systems of all Head Start grantees and their delegate agencies over a 3-year period beginning in fiscal 1980.
- Arranged with CSA, Agriculture, Labor, and other Federal agencies for a special comprehensive audit of one of the community action agencies included in this review.

CSA reported that it:

- Is reviewing quarterly Federal Cash Transaction Reports and has instituted a monthly computerized comparison of cash drawdowns with grantee cash balances. In addition, for excessive drawdowns it will request a justification from the grantee and the return of any excess funds as well as interest earned on them. (CSA informed us that nearly \$600,000 in excess funds has been recovered from one community action agency included in our review.)
- Introduced new safeguards to prevent misuse of the service corporation arrangement. The safeguards call for the incorporation of the service corporation as a nonprofit entity, the assurance that the assets acquired by these corporations will remain in the low income community, the compliance with standard Federal grantee procurement and personnel practices, and the annual auditing of financial records.
- Is introducing a new application and reporting system to minimize dual reimbursement.
- Implemented OMB's uniform requirement for property and instituted new property monitoring procedures.
- Plans to institute controls over interproject loans by requiring that grantees request and justify the need for such

transfer and ensure that the program reporting the loan will be funded by another Federal or State agency.

- Prepared a program for following up on corrective actions taken by program officials in response to audit deficiencies.
- Requested that OMB assign it audit cognizance over community action agencies. 1/

Agriculture and HHS reported that they, to reduce dual reimbursement, have prepared an interagency agreement for financial management covering the food assistance activities of Head Start. In addition, a joint project to study the multiple funding of child care feeding programs is being conducted by the Offices of Inspector General within Agriculture and HHS, in coordination with CSA and Labor. This project will attempt to determine the effects of multiple funding, make recommendations, if necessary, for appropriate legislative or regulatory changes, and address the issue of improving audit coverage of entities receiving child care feeding program funds.

CONCLUSIONS

Good internal controls are the most effective deterrent to mismanagement and misuse of funds. It is apparent from the results of our work that internal controls over Federal funds administered by the community action agencies we reviewed need strengthening. The scope of this review would not permit us to apply this conclusion to all community action agencies. We believe, however, that the corrective action already taken by several Federal agencies as a result of our work indicates that these agencies felt the problems we identified existed in more community action agencies than those in this review. We therefore believe that in order to strengthen internal control over Federal funds administered by all community action agencies, Federal grantmaking agencies must establish, revise, and/or enforce sound internal control policies and procedures particularly in the areas of cash management, program cost reimbursements, and property management. In addition, CSA must develop an overall policy governing the establishment of service corporations or similar organizations by community action agencies or their delegates and/or employees. While this policy should include applicable provisions of CSA's recent procurement standard amendments, it must also cover nonprocurement contract areas of concern.

We also believe that the Office of Management and Budget needs to follow up on CSA's efforts to regulate service corporations.

1/On Dec. 8, 1980, OMB designated CSA the cognizant audit agency for single audits of private nonprofit community action agencies.

RECOMMENDATIONS TO THE HEADS OF
DEPARTMENTS AND AGENCIES FUNDING
COMMUNITY ACTION AGENCIES

We recommend that the heads of Federal departments and agencies that provide funds either directly or indirectly to community action agencies:

- Enforce the provisions of OMB circulars A-102 and A-110 that deal with establishing a strong system of internal controls at the grantee level. 1/
- Where specific weaknesses exist, develop a system for ensuring that grantees' internal controls are adequate to protect Federal funds from mismanagement and misuse. Such systems should include sanctions which can be applied against grantees who are repeatedly found to have inadequate systems. 1/
- Develop systems to prevent grantees from claiming reimbursement for the same expense under more than one program.
- Follow current cash management policy and recover any excess funds being held by grantees. 1/
- Impose sanctions against grantees who repeatedly maintain excessively high balances of Federal cash. Such sanctions may include suspension of cash advances or the charging of interest on excess balances. 1/
- Ensure that grantees adhere to Federal standards relating to property management by periodically reviewing their property management systems.

RECOMMENDATIONS TO THE DIRECTOR,
COMMUNITY SERVICES ADMINISTRATION

We recommend that the Director, Community Services Administration:

- Develop an overall policy governing the establishment of service corporations or similar type organizations by community action agencies or their delegates and/or employees.

1/A recent GAO report "Weak Financial Controls Make The Community Services Administration Vulnerable To Fraud and Abuse," FGMSD-80-73, Aug. 22, 1980, also discusses, in part, deficiencies of community action agencies' internal controls and Federal cash balances. That report contains recommendations to the Director of CSA, some of which parallel four of the recommendations noted above.

This should, at a minimum, (1) require Federal approval be obtained before any Federal funds are transferred to such an organization and (2) include applicable provisions of the CSA procurement standards, particularly those rules that promote the establishment of an arm's length relationship between a buyer and seller.

--Develop monitoring procedures for overseeing the implementation of this overall policy.

--Review service corporations established by community action agencies prior to this new overall policy to determine if an arm's length relationship exists between the two organizations. Where this is not the case, act to make the relationship conform to the new policy, and determine if the Government has a residual interest in any property acquired by these service corporations and establish how such interest will be protected.

RECOMMENDATION TO THE DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET

We recommend that the Director, Office of Management and Budget follow up on CSA's efforts to regulate service corporations as part of OMB's budget review process and Financial Priorities Program.

AGENCY COMMENTS AND OUR EVALUATION

We provided a draft of this report for comment to the following six Federal agencies that provide funding either directly or indirectly to community action agencies--the Community Services Administration, and the Departments of Agriculture, Energy, Health and Human Services, Housing and Urban Development, and Labor. Also, we sent the Office of Management and Budget a draft copy for its review and comment. We did not receive comments from CSA and Labor. Comments from HUD were received late and were not evaluated, but are included in their entirety as appendix VII.

The comments received generally either indicated concurrence with our recommendations, or actions being taken or planned in response to the problems discussed in the report. Where appropriate, we revised the report, including the recommendations, to clarify specific points or update information in response to the comments.

Office of Management and Budget

The Office of Management and Budget agreed (app. III) that there appears to have been serious weaknesses at CSA which permitted the abuse and misuse of Federal funds at community action agencies. OMB stated that these weaknesses need to be addressed by managers of the various Federal agencies funding these grantees.

OMB pointed out that it stresses the need for proper accountability of Federal funds through its circulars. OMB Circular A-110 covers community action agencies and requires Federal agencies to implement standards for its grantees in the areas of financial management systems, property management, procurement, and grant payment. OMB believes that few of the abuses cited in our draft report would have occurred if the standards prescribed in Circular A-110 had been fully implemented.

OMB noted that it launched the Financial Priorities Program in May 1979 to resolve a number of major financial issues, two of which involved internal controls and full implementation of the requirements in OMB circulars dealing with grant management. OMB stated that it is following up with agencies on the implementation of the requirements, and is developing a policy circular for agency internal control systems.

OMB also noted that the oversight of CSA's efforts to regulate service corporations is an issue that should be resolved by CSA with the appropriate review of its inspector general. OMB added, however, that it will follow up on this issue with CSA during the budget review process and as part of OMB's Financial Priorities Program.

Department of Agriculture

The Department of Agriculture noted (app. IV) that it is acting to prevent grantees from claiming reimbursement for the same expense under more than one program. An agreement has been negotiated with HHS concerning Head Start. It will be the responsibility of Head Start to ensure that grantees' budgets are adjusted to reflect the amount of Agriculture funds earned or anticipated to be earned during the year by the grantee. Agriculture is providing HHS with an updated list of all its Child Care Food Program institutions in states where Agriculture's regional offices administer the program, and it has suggested to State agencies to do the same. In addition, the issue of dual funding with the HHS Title XX program will be addressed by an amendment to Agriculture regulations.

Agriculture also noted other ways in which it is working with HHS to exchange and coordinate grantee funding information. For example, Agriculture intends to amend its regulations to require applicants to identify any other Federal programs in which they participate or intend to participate. This information will be used to evaluate claims for reimbursement, and to advise HHS of problems discovered. In addition, Head Start will be providing Agriculture a list of its grantees. Agriculture intends to compare the Head Start information with its own list of participating grantees to obtain reliable grantee funding data.

With regard to problems involving excess funds, Agriculture stated that its Child Care Food Program is a reimbursement program

which may provide limited advances for 1 or 2 months. In addition, Agriculture noted that the amounts of the advances and the reimbursements are monitored and adjusted as appropriate. Accordingly, grantees under this program would be unlikely to have excess funds. We agree that there may be less likelihood for excess funds under a reimbursement program with limited advances. Our review indicated that most of the excess cash problems occurred with programs that provided cash advances rather than reimbursements.

The Department of Agriculture expressed concern with the example involving loans of \$445,000 provided in part from Agriculture's Child Care Food Program reimbursements. Agriculture noted that because of the funding procedures used in its Child Care Food Program, it is unlikely that \$445,000 would be available to a grantee for loan purposes. We have clarified the report to indicate that the \$445,000 was loaned by a community action agency from its food reimbursement account which included funding from several sources including the Department of Agriculture. A special comprehensive audit of this grantee is underway and will include a review of this loan activity. (See p. 9.)

The Department of Agriculture also was concerned as to whether duplicate funding involving nearly \$1 million actually occurred in four examples we cited. Agriculture said that the funding procedures for HHS Head Start and Title XX day care programs encourage grantees to use Agriculture's Child Care Food Program reimbursements to free HHS funds previously budgeted for food service costs to actually cover other day care services. Agriculture noted that as a result of these procedures, the grantee's HHS food service budgets when added to its Agriculture food reimbursements would total more than actual food service costs, but would not be dual funding or waste of Federal funds.

We added information to the report to make clear that the largest example, involving over \$855,000, was identified as a result of a 1977 audit by the Department of Agriculture. Agriculture auditors attributed the problem to the fact that the grantee claimed reimbursements from two Federal agencies for the same food service costs and did not report the reimbursements received from one agency to the other. The majority of the duplicate payment was recovered by an offset against HHS Title XX claims (p. 14). We believe that the audit's resulting in the recovery of funds is evidence that duplicate funding did occur in this example. For two other examples, involving \$76,000 and \$2,000, we developed the data ourselves, but did not attempt to determine if the Agriculture reimbursements resulted in HHS budgeted food service costs being freed to cover other day care services. Due to Agriculture's concern that this could possibly have occurred and not resulted in dual funding, we have excluded these two examples. The fourth example was also excluded from the final report because it involved an agency that was outside the scope of our review.

Department of Health and Human Services

The Department of Health and Human Services stated (app. VI) that as a result of discussions with the Department of Agriculture, guidelines are being developed to prevent grantees from claiming reimbursement for the same expense under more than one program. HHS added that joint audits being instituted with CSA should also indicate to HHS, more definitely than in the past, those programs where corrective action is needed.

HHS also stated that it has written new policies to strengthen grantee cash management practices. In addition, HHS, in commenting on our proposal on the need and desirability of imposing sanctions against grantees who repeatedly maintain excessive balances of Federal cash, stated that prevention rather than after-the-fact solutions is the best cure. Consequently, HHS is stressing this at ongoing grantee training. HHS added, however, that it will take necessary action, such as providing funds only after periodic receipt of expenditure reports, in cases where grantees continually maintain high cash balances.

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United States Senate

COMMITTEE ON GOVERNMENTAL AFFAIRS SUBCOMMITTEE ON FEDERAL SPENDING PRACTICES AND OPEN GOVERNMENT (202) 224-0211

(PURSUANT TO S. RES. 4 AND S. RES. 71, 95TH CONGRESS)
 WASHINGTON, D.C. 20510

November 20, 1978 ,

Honorable Elmer B. Staats
 Comptroller General of the United States
 General Accounting Office
 441 G Street
 Washington, D. C.

Dear Mr. Staats:

The staff of the Subcommittee on Federal Spending Practices and Open Government has met with members of your recently announced task force on fraud and abuse and it appears that an effective and mutually beneficial liaison is developing. To afford this relationship a more formal basis, I ask that the subcommittee staff be kept up to date on the evolution, development and working of the task force through, at a minimum, monthly briefings. By the same token, your task force members should feel free to call the subcommittee staff for advice or assistance as they deem necessary.

In my letter of October 26, 1978, I expressed concern about fraud and abuse on the part of federally assisted grantees. The subcommittee has since learned of possible fraudulent transactions on the part of the Council for Economic Opportunities in Greater Cleveland (CEOGC) and certain of its subgrantees. We have also learned that GAO has performed some work at CEOGC. In this regard, I would like to request

- A review of CEOGC and its subgrantees financial affairs and compliance with federal law and regulation; and,

- A test of other similarly funded or constituted grantee organizations to determine whether comparable situations exist.

If your review shows that there are unusual and possibly fraudulent or abusive transactions, I would like your recommendations on what actions are needed to prevent such activities.

In the interest of timeliness, formal comments by the involved federal agencies, federally assisted grantees and/or subgrantees are not required. We plan additional hearings early in 1979 and will need your report and testimony at that time.

Marvin Doyal is the subcommittee staff member assigned responsibility for this matter. He can be reached at 224-0211 or 522-1094 if there are any questions.

Sincerely,


LAWTON CHILES
Chairman

LC:mdb

APPENDIX II

APPENDIX II

SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS
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United States Senate

COMMITTEE ON
 GOVERNMENTAL AFFAIRS
 SUBCOMMITTEE ON FEDERAL SPENDING PRACTICES
 AND OPEN GOVERNMENT
 (202) 224-0211
 WASHINGTON, D.C. 20510
 May 31, 1979

The Honorable Elmer B. Staats
 General Accounting Office
 441 G. Street, N.W.
 Washington, D.C. 20548

Dear Mr. Staats:

As I indicated in my correspondence to you on April 2, 1979, I wanted to see the Financial General Management Studies Division of GAO continue its present review and to take action in regard to the following agencies:

Action for Boston Community Development Corp.
 50 Tremont St.
 Boston, Massachusetts 02111

United Community Corporation
 449 Central Ave.
 Newark, N.J. 07107

Community Development Agency
 349 Broadway
 New York, N.Y. 10013

United Planning Organization
 1071 14th St. N.W.
 Washington, D.C.

Richmond Community Action Program
 1010 East Marshall St.
 Richmond, Va. 23219

Community Action Pittsburgh, Inc.
 107 6th St.
 Fulton Bldg. 9th floor
 Pittsburgh, Pa. 15222

Philadelphia Anti-Poverty Action Comm.
 1316 Arch St.
 Philadelphia, Pa. 19107

Jefferson County Committee for Economic
Opportunity
1823 Ave. E-Ensley
Birmingham, Al. 35218

Dade City Board of County Commission
395 N.W. 1st St.
Miami, Fl. 33128

Economic Opportunity Atlanta, Inc.
75 Marietta St. Bldg. N.W.
Atlanta, Ga. 30303

CAA of Memphis and Shelley County
97 North Third
Memphis, Tenn. 38103

Neighborhood Services Dept.
5031 Grandy Ave.
Detroit, Michigan 48211

Mid West New Mexico CAP
P.O. Box 266
Grants, N.W. 87020

Economic Opportunity Development of
San Antonio
410 S. Main St.
P.O. Box 9326
San Antonio, Texas 78204

Denver Opportunity, Inc.
431 Grant St.
Denver, Colorado 80203

County of San Diego Community Action
Program
348 West Market Street
San Diego, Ca. 92101

If I can be of any further assistance to you on this matter, please don't hesitate to call on me. I have designated Bob Harris of the Governmental Affairs Subcommittee on Federal Spending Practices to get in touch with your staff on this issue. With kindest regards, I am,

Sincerely,

A handwritten signature in cursive script, reading "Lawton Chiles".

LAWTON CHILES
Chairman

LC:bhs



EXECUTIVE OFFICE OF THE PRESIDENT

OFFICE OF MANAGEMENT AND BUDGET

WASHINGTON, D.C. 20503

Honorable D. L. Scantlebury
Director
U.S. General Accounting Office
Washington, D.C. 20548

JAN 29 1961

Dear Mr. Scantlebury:

This is in response to your letter asking for our comments on your draft proposed report to the Congress entitled "Mismanagement and Misuse of Federal Funds at Selected Community Action Agencies."

The report recommends that the Director, Office of Management and Budget, increase efforts to ensure that Federal grant making agencies effectively implement sound internal control systems for cash management, program cost reimbursement, and property management.* We agree that there appear to have been serious weaknesses at the Community Services Administration (CSA) which permitted the abuse and misuse of Federal funds at community action agencies. However, the weaknesses are in implementation and really need to be addressed by managers of the various Federal agencies funding the community action agencies. Through our circulars, we have stressed the need for proper accountability of Federal funds. Our Circular A-110, "Standard requirements for grants to nonprofit organizations" covers community action agencies and requires Federal agencies to implement standards for grantees in the areas of:

- ° Financial Management Systems
- ° Property Management
- ° Procurement
- ° Grant Payment

If the community action agencies had fully implemented the standards prescribed by the Circular, we believe few of the abuses cited in the draft report would have occurred.

As you may recall, in May of 1979, after consultation with the Comptroller General, OMB launched the Financial Priorities Program to resolve a number of major financial issues. Two of the priorities in that program were internal control and full implementation of our Circulars dealing with grant management. We are following up with the agencies on the implementation of the Circulars. Concerning internal control, we have established an Internal Control Task Force consisting of representatives from OMB, the General Accounting Office, and each major Federal agency to draft policies and standards for agency internal control systems. The policy circular, which will be developed by the task force, should close gaps that are presently in the system.

*GAO note: Because OMB has been taking action in this area, we have not included this proposal in our final report.

In addition, CSA has been undertaking several steps designed to solve many of the problems noted in the report through improvements in financial and managerial controls. We would cite in particular CSA's October 22, 1980, response to Chairman Jack Brooks of the House Committee on Government Operations and to Chairman Abraham A. Ribicoff of the Senate Committee on Governmental Affairs regarding the GAO report title "Weak Financial Management Controls make the Community Services Administration Vulnerable to Fraud and Abuse" (copy enclosed). That response addresses many of the concerns raised in this draft report. (See GAO Note below.)

The draft report also recommends that OMB oversee CSA's efforts to regulate service corporations. It is not clear from the report why this issue was singled out for OMB oversight. This is properly an issue that should be resolved by CSA with the appropriate review by its Inspector General. OMB should not take over responsibilities that are rightfully those of the management of CSA. However, we will follow up on this issue with CSA during budget reviews and as part of the Financial Priorities Program.

Sincerely,



Donald A. Derman
Deputy Associate Director
Health and Income Maintenance
Division

Enclosure

GAO note: Many areas discussed in the response, such as computer security, are not relevant to the issues in this report. Thus, we did not include the response with this letter. Chapter 4 of this report addresses corrective actions being initiated by various Federal agencies in response to the problems discussed in this report, and includes steps being taken by CSA.

UNITED STATES DEPARTMENT OF AGRICULTURE
FOOD AND NUTRITION SERVICE

WASHINGTON, D.C. 20250

Mr. Donald Scantlebury
Director, Accounting and Financial
Management Division
General Accounting Office
441 G St., N.W., Room 6001
Washington, D.C. 20548

JAN 29 1981

JAN 29 1981

Dear Mr. Scantlebury:

We are writing in reference to the draft of the proposed report on Mismanagement and Misuse of Federal Funds at Selected Community Action Agencies. We appreciate the opportunity to comment on this draft since we administer the Child Care Food Program (CCFP).

Our comments address both the recommendations to the heads of Federal agencies and several of the findings. We trust that these comments will be considered in the development of the final report.

P. v Recommendations

- Comply with OMB circulars which deal with establishing a strong system of internal controls at the grantee level.

FNS grantees are already required to comply with the applicable provisions of OMB Circulars A-110 and A-102. Further, the CCFP regulations require that grantees establish procedures to collect and maintain all necessary program records. Grantees' controls are monitored through the biennial audits and administrative reviews.

- Develop a system for ensuring that grantee's internal controls are adequate to protect Federal funds from mismanagement and misuse. Such systems should include sanctions which can be applied against grantees who are repeatedly found to have inadequate systems.

One purpose of the CCFP administrative review system and the biennial audits is to provide such insurance. Grantees whose internal controls are insufficient are required to correct the problem. Failure to do so could result in termination from the Program.

- Develop systems to prevent grantees from claiming reimbursement for the same expense under more than one Program.

As you pointed out, FNS is already developing systems to prevent grantees from claiming reimbursement for the same expense under more than one Program. We have already negotiated an agreement with HHS Head Start concerning this issue. It will be the responsibility

GAO note: Page references have been changed to correspond to page numbers in final report.

of Head Start to ensure that their grantees' budgets are adjusted to reflect the amount of USDA FNS funds earned or anticipated to be earned during the year by the grantee. We are providing HHS with an updated list of all CCFP institutions in States where USDA FNS Regional Offices administer the Program and we have suggested to State agencies they do the same. This list will include the funds either received or anticipated. FNS will pursue this issue differently with Title XX (Social Security Act). We will address CCFP/Title XX dual funding through an amendment to our CCFP regulations.

- Follow current cash management policy and recover any excess funds being held by grantees.

The CCFP is a reimbursement program; that is, grantees are reimbursed for the expenses of operating a food service program after the expenses are incurred. Limited advances of one or two months' expenses may be provided. The amounts of the advances and the reimbursements are monitored and adjusted, as appropriate. Therefore, it is unlikely that grantees would have any excess funds.

- Consider the need and desirability of imposing sanctions against grantees who repeatedly maintain excessively high balances of Federal cash. Such sanctions may include suspension of cash advances or the charging of interest on excess balances.

Because the CCFP funds grantees primarily through a reimbursement system, there is little likelihood that a grantee could maintain an excessively high balance of Federal funds. Also, as stated above, cash advances in the CCFP are limited and are adjusted as part of the reimbursement system. Further, sanctions are not necessary in view of the procedures for reducing high cash balances.

- Ensure that grantees adhere to Federal standards relating to property management.

All FNS grantees are required to adhere to these standards. Adherence is monitored in the CCFP through the biennial audit requirements and the administrative review system.

p. 9 Excess Cash Used for Loans

- \$445,000 of Agriculture's Child Care Food Program reimbursements, some of which was loaned to organizations which did not receive Agriculture funds including youth delinquency prevention programs and an energy emergency program.

Given the limited advances issued under the CCFP and given that the CCFP is essentially a reimbursement grant program, it is unlikely that \$445,000 of CCFP funds would be available to a grantee for loan purposes. What typically occurs is that agencies borrow funds from other sources (including other Federal grants) to meet food service program costs and then refund those sources when CCFP reimbursements are received. It could then appear that CCFP funds were loaned. We would appreciate receiving more information concerning this particular grantee so that we could review the records to determine what actually occurred.

p. 13 and 14 Duplicative Reimbursement of Expenses

- One community action agency had received over \$885,000 in duplicate reimbursements between July 1974 and May 1977 because it was reimbursed for the same food costs under Agriculture's Child Care Food Program and HEW's Title XX day care program.
- Another received over \$76,000 of excess reimbursements during the 11-month period ended August 1978 because it claimed and was reimbursed for its total costs of providing food service to children under several Federal programs including the Head Start program, the Title XX day care program, the Summer Recreation program, the Child Care Food Program and the Summer Food Programs.
- A Head Start center that had been reimbursed twice for providing breakfast to 21 children under the Head Start program and the Child Care Food Program. We estimated that this duplication could amount to \$2,000 per year.
- Two day care centers that received \$16,000 of duplicate reimbursements between July 1978 and May 1979 by claiming food service costs under both the Child Care Food Program and Title XX program.

For most child care institutions, reimbursement earned under the CCFP is not sufficient to cover the full cost of the food service. The remaining costs may legitimately be covered by other sources; it is fully appropriate that other Federal funds, where available, be used to cover the remaining food service costs.

Federal Head Start funding procedures specifically contemplate that CCFP funds should cover whatever food service costs they can, and Head Start funds should only be used for remaining costs. In addition, the Head Start procedures specifically provide for Head Start grantees to list funds for food service in their budgets, and then to use these funds for other day care services if CCFP makes it unnecessary to use these monies for food.

HHS Head Start funding procedures specifically encourage Head Start grantees to seek other Federal funds to supplement financial assistance from Head Start. When the grantee is reimbursed by another Federal agency for carrying on Program activities which were originally supported by a Head Start grant, the reimbursement is supposed to replace the previous expenditure of Head Start grant funds, and is not considered to be income to the Head Start program. The resultant Head Start balances, including carryover balances, may be retained by the grantee, and can be expended for other Head Start services after prior approval is received from the responsible Head Start granting office.

All Head Start grantees are encouraged to participate in the CCFP. If a Head Start grantee is going to participate in the CCFP, the grantee is advised not to allocate money in the food line of its budget if the grantee can anticipate the amount of the CCFP reimbursement. However, grantees who are not able to anticipate the amount of reimbursement are advised to budget Head Start grant funds for food service.

Head Start grantees who are subsequently reimbursed through CCFP are required to report such reimbursement in the "Remarks" section (Item 12) of the "Financial Status Report" citing the amount received. The Financial Status Report must be submitted quarterly. If such funds replace the Head Start grant funds originally budgeted for the food service, and result in an unobligated grant balance at the end of the report period, the grantee is also required to include that amount in item 10m of the report.

The proposed budget and an appropriate work plan should be submitted to the responsible granting office detailing how the freed-up balances of Head Start grant funds are to be used. Grantees submitting continuation applications must include, in the proposed work statement, details on how carry-over balances resulting from non-Head Start Federal reimbursements will be used. Approval of the application through issuance of a Notice of Grant Award constitutes approval to extend these carry-over balances.

This means that it is to be expected that funds listed for food service in the budgets of many Head Start grantees, when added to CCFP funds will total more than food service costs. It does not, however, mean that this constitutes dual funding or any waste of Federal funds. Quite the contrary. So long as the freed-up Head Start funds are used for proper day care expenditures in accordance with HHS procedures, the funding is operating just as it should. Indeed, without such freed-up funds being used on other day care services, the quality of Head Start services provided to low income children throughout America would deteriorate.

This does not mean that the Head Start area is without problems. The principal problem appears to be that some Head Start grantees do not report the freed-up Head Start funds in their quarterly Financial Status Report to HHS, and may not always be getting formal HHS approval before spending the funds on other day care services. This is properly an HHS reporting and accounting issue. HHS does control for this, to some degree, through a required annual audit of each Head Start grantee. Non-Head Start Federal funds, including CCFP funds, are accounted for in the annual audit reports. FNS also monitors this through its biennial audits and administrative reviews.

We believe that similar situations to the one we have described in Head Start may exist in CSA and Title XX. CSA allows grantees to shift some funds from one line item to another without prior approval. CSA also directs that where available, FNS program funds should be used first.

Title XX is a quasi block grant, and each State has somewhat different funding procedures. However, it is our understanding that in a number of States, funding procedures are prescribed that give primacy to CCFP funds in defraying food service costs. These funding procedures generally either encourage rebudgeting of freed-up Title XX funds to fund other day care services or direct that freed-up Title XX funds be returned to the State Title XX agency so they can be redistributed to other child care institutions.

A further issue is that in many States, an institution does not necessarily receive all the Title XX funds for which it was budgeted. The actual provision of Title XX funds to an institution is generally based on actual attendance at the institution. However, these same institutions generally must prepare and submit their Title XX budgets in advance, and the budgets consequently are based on projections of what the attendance is expected to be. As a result, the approved budgets essentially are used as funding estimates, but do not determine the final, actual funding levels that are provided. If attendance does not reach the projected level, funds that were budgeted are not actually provided by the State or received by the institution.

There is not enough information provided in the four "dual funding" examples cited above to determine whether any duplicate funding actually occurred. We would need to examine all the documentation in order to evaluate what actually happened. (See GAO note below.)

P. 22 and 23 Lack of Coordination

As we pointed out earlier, we have already instituted a procedure to address Head Start and CCFP funding of food service. There will be continuous liaison with the HHS Head Start agency concerning the funding being provided. Further, we are in the process of amending

GAO note: We added information to the report to indicate that the \$855,000 example involved a recovery of funds which we believe is evidence of duplicate funding. The other examples were deleted because of the reasons cited on page 30 of this report.

our regulations to require applicants to provide, when they apply, a list of all other federal programs in which they participate or plan to participate. Once implemented, this will provide us with information which can be used in the evaluation of claims for reimbursement. In addition, FNS Regional Offices advise the appropriate HHS Regional Offices of problems discovered whenever they are revealed. In these ways, we are already working with HHS to coordinate funding information.

p. 23 Lack of Reliable Data on Total Grantee Funding

The CCFP application used in States where FNS administers the Program already requires that a grantee report other Federal funds which are anticipated. As indicated above, we intend to amend the CCFP regulations to require applicants to identify any other Federal programs in which they participate or intend to participate. Head Start will be providing us with a list of their grantee. We will be able to compare this with our list of participating grantees.

We would appreciate receiving any specific information developed during your review concerning possible misuse of Child Care Food Program or Summer Food Service Program funds, so that appropriate action can be taken. We would also appreciate receiving a copy of the final report.

Sincerely,



GENE P. DICKEY
Acting Administrator



Department of Energy
Washington, D.C. 20585

JAN 29 1981

Mr. J. Dexter Peach
Energy and Minerals Division
U. S. General Accounting Office
Washington, DC 20545

Dear Mr. Peach:

We appreciate the opportunity to comment on the GAO draft report, "Mismanagement and Misuse of Federal Funds at Selected Community Action Agencies". The draft report examines issues regarding the use of good internal controls by grantees as an effective deterrent to mismanagement and misuse of Federal Funds.

Based upon the data presented in the draft GAO report and DOE's experience with grants, the conclusions and recommendations are understandable. However, we believe that additional rules or conditions will not necessarily create better grant management. We suggest greater emphasis in two areas. First, the dissemination of management information to grantees on a continuing basis. Secondly, placing greater emphasis on preaward analysis of an applicant's management experience and the adequacy of their administrative procedures. With the suggestions noted above, DOE concurs with the recommendations in the draft report. It is noted that none of the recommendations have been specifically directed to the Secretary of Energy.

We appreciate the opportunity to review and comment on this draft report.

Sincerely,

A handwritten signature in dark ink, appearing to read "P. Marshall Ryan".
P. Marshall Ryan
Controller

FEB 5 1981



DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General

Washington, D.C. 20201

28 JAN 1981

Mr. Donald L. Scantlebury
Director, Accounting and Financial
Management Division
United States General
Accounting Office
Washington, D.C. 20548

Dear Mr. Scantlebury:

The Secretary asked that I respond to your request for our comments on your draft report entitled, "Mismanagement and Misuse of Federal Funds at Selected Community Action Agencies." The enclosed comments represent the tentative position of the Department and are subject to reevaluation when the final version of this report is received.

We appreciate the opportunity to comment on this draft report before its publication.

Sincerely yours,

Bryan B. Mitchell
Bryan B. Mitchell
Acting Inspector General

Enclosure

DEPARTMENT OF HEALTH AND HUMAN SERVICES COMMENTS ON
GAO DRAFT REPORT "MISMANAGEMENT AND MISUSE OF FEDERAL FUNDS
AT SELECTED COMMUNITY ACTION AGENCIES"

GAO Recommendation - page 27

Heads of Federal departments and agencies that provide funds either directly or indirectly to community action agencies comply with OMB circulars which deal with establishing a strong system of internal controls at the grantee level.

Departmental Response

The Department fully concurs with this recommendation. Attention to the pertinent OMB circulars is being continually monitored through the annual Head Start audit, as well as through a current four-year cyclical review of each and every Head Start grantee. The review covers all aspects of the grantee's administrative and financial operation.

GAO Recommendation - page 27

Develop a system for ensuring that grantee's internal controls are adequate to protect Federal funds from mismanagement and misuse. Such systems should include sanctions which can be applied against grantees who are repeatedly found to have inadequate systems.

Departmental Response

The response to the previous recommendation also applies here.

GAO Recommendation - page 27

Develop systems to prevent grantees from claiming reimbursement for the same expense under more than one program.

Departmental Response

The Department has had extensive discussions with the U.S. Department of Agriculture on this issue, as food reimbursements to Head Start grantees have been the subject of possible "dual reimbursement". As a result of these discussions, guidelines are being developed to prevent grantees claiming reimbursement for the same expense under more than one program. In addition, the joint audits being instituted with CSA should indicate to us, more definitely than in the past, those programs where corrective action is needed.

GAO note: Page references have been changed to correspond to page numbers in final report.

DEPARTMENT OF HEALTH AND HUMAN SERVICES COMMENTS ON
GAO DRAFT REPORT "MISMANAGEMENT AND MISUSE OF FEDERAL FUNDS
AT SELECTED COMMUNITY ACTION AGENCIES"

GAO Recommendation - page 27

Follow current cash management policy and recover any excess funds being held by grantees.

Departmental Response

The Department, through the Office of Human Development Services, has written new policies directed at strengthening grantee cash management practices. In addition, our practice of promptly reprogramming/recovering excess Federal funds held by grantees continues to be on target nationally.

GAO Recommendation - page 27

Consider the need and desirability of imposing sanctions against grantees who repeatedly maintain excessively high balances of Federal cash. Such sanctions may include suspension of cash advances or the charging of interest on excess balances.

Departmental Response

The Department believes that prevention, rather than after-the-fact solutions, is the best "cure" for this problem. Accordingly, on-going grantee training stresses this issue repeatedly. However, in cases where grantees continually maintain high cash balances--and disregard our cautionary warnings on this matter--we will take necessary action, such as providing funds only after periodic receipt of expenditure reports, etc. The Department is aware of the dangers presented by excessive cash balances in the hands of grantees.

GAO Recommendation - page 27

Ensure that grantees adhere to Federal standards relating to property management.

Departmental Response

The on-site grantee financial and administrative reviews, as described earlier, clearly provide for property management controls to be examined particularly as to record-keeping involving fixed assets. The Department has to be governed, of course, by limitations set down for us by OMB regarding the extent to which we can impose record-keeping requirements on grantees in this area--particularly submission to the Department of property records.

DEPARTMENT OF HEALTH AND HUMAN SERVICES COMMENTS ON
GAO DRAFT REPORT "MISMANAGEMENT AND MISUSE OF FEDERAL FUNDS
AT SELECTED COMMUNITY ACTION AGENCIES"

Finally, the Department has taken specific measures in regard to a number of the individual grantees visited during the preparation of this report. These measures include:

- a. Instituting joint audits with CSA, in order to strengthen and enlarge the scope of audit of the Head Start grantee component.
- b. Increasing site visits to grantees, based on the General Accounting Office individual grantee reports.
- c. Requiring periodic reports from grantees, updating their progress in specific areas.
- d. Apprising the General Accounting Office periodically of progress made by individual grantees.



DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, D.C. 20410

February 27, 1981

OFFICE OF THE ASSISTANT SECRETARY
FOR COMMUNITY PLANNING AND DEVELOPMENT

IN REPLY REFER TO:

Mr. Donald L. Scantlebury
Director, Accounting and Financial
Management Division
441 G Street, N. W., Room 6001
Washington, D. C. 20548

Dear Mr. Scantlebury:

We have reviewed closely the GAO draft report entitled "Mismanagement and Misuse of Federal Funds at Selected Community Action Agencies" (December 29, 1980), and we welcome the opportunity to comment.

Community Action Agencies (CAAs) are eligible subrecipients of HUD Community Development Block Grant funds. As subrecipients, such agencies are required to comply with applicable rules and regulations of HUD and the Office of Management and Budget (OMB) for sound financial management systems.

This Office shall use the draft report as a point of departure to initiate two corrective actions:

- (1) Where there is specific knowledge of mismanagement and misuse of HUD community development funds by CAAs as indicated in the draft report, we will correct these situations by recapturing funds or by employing other appropriate measures. We have not received any specific information from the GAO relative to the study of those communities which are involved. To initiate this corrective action, we request, therefore, that the GAO provide this Office with the identity (by name, grant program year(s) reviewed, dollar amount(s) involved and rule(s) violated) of the Community Action Agency(ies) funded by HUD and found through this study to have misused or mismanaged HUD grant funds. (See GAO note below.)
- (2) HUD field offices will be instructed to reemphasize to community development funded grantees their responsibility to ensure that community development funds are utilized by subrecipients in a manner consistent with the requirements of applicable HUD and other Federal regulations as provided by the grant agreement between the grantee and the Department.

GAO note: We will give HUD this information in a separate letter.

According to the OMB, CAAs are now subject to the single audit requirement. Audit cognizance for all public CAAs resides with the Federal Agency having the greatest financial interest in the agencies. For all private non-profit CAAs, the Community Service Administration (CSA) has cognizance.

It is my strong recommendation that the final report stress the importance of distributing audit reports on each CAA by its cognizant agency to the Federal Department or Agency whose requirements appear not to have been complied with. The timely implementation of this distribution pattern will facilitate the immediate response by grant making agencies to cases of funds mismanagement and misuse by CAAs.

In response to the GAO recommendations to heads of Federal Departments and Agencies, we submit that our efforts are continually directed toward ensuring grantee and subgrantee compliance with all Federal requirements that impact on the maintenance of strong grant recipient internal control systems. Grantees are informed at the inception and throughout the life of their community development funded programs of their responsibility and that of their subgrantees to exercise practices to effect proper internal funds control. (In response to recommendation No. 1)

Second, we have a system in-place to monitor recipients' internal controls. As part of the in-place system, recipients are required to adhere to Federal audit requirements. Where appropriate, audit reports enter a HUD Audit Management System which is designed as a management tool for the identification, evaluation, processing and ultimate resolution of all audit findings. Auditing of grant recipients' property management procedures, cash balances, reimbursement claims and other aspects of their financial management systems as well as the monitoring of these same financial functions by HUD field office staff is all part of the overall system use to ensure that grant recipients have proper internal control operations. (In response to recommendation Nos. 3 and 6).

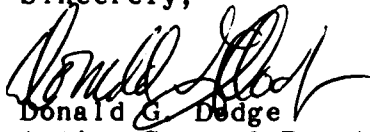
When the HUD Audit-Monitoring system surfaces grantees with inadequate internal control operations, two separate actions ensue.

- a. Grantees are offered technical assistance service from the Department. In most cases this assistance is more than sufficient to bring about the desired level of compliance to allow recipients to carry out their community development programs in accordance with applicable financial management requirements.
- b. In those cases in which a recipient fails to utilize such available assistance and demonstrates an

unwillingness to meet applicable requirements, this Office applies and will continue to apply appropriate sanctions available to it under Section 570.910-570.913 of the Community Development Block Grant Regulations. Such sanctions include the options to terminate the grant and recover any excess grant fund held by the recipient, suspension of cash advances, as well as others. (In response to recommendation Nos. 2, 4 and 5)

Our financial management procedures are designed with the objective of seeking out and correcting cases of misuse and mismanagement of HUD grant funds. We welcome this GAO study and GAO's response to the specific information we have requested which will be used in the furtherance of this objective.

Sincerely,


Donald G. Dodge
Acting General Deputy
Assistant Secretary

THE TWELVE COMMUNITY ACTION AGENCIES WHOSE FINANCIAL
MANAGEMENT SYSTEMS WERE REVIEWED BY GAO

1. Action for Boston Community Development, Inc. - Boston, Massachusetts
2. Community and Economic Development Association of Cook County - Chicago, Illinois
3. Department of Human Services - Chicago, Illinois
4. Council of Economic Opportunities in Greater Cleveland - Cleveland, Ohio
5. Neighborhood Services Department - Detroit, Michigan
6. Southeastern Tidewater Opportunity Project Organization - Norfolk, Virginia
7. Richmond Community Action Program, Inc. - Richmond, Virginia
8. Raleigh County Community Action Association, Inc. - Beckley, West Virginia
9. Central Area Motivation Program - Seattle, Washington
10. United Planning Organization - Washington, D.C.
11. Community Action Pittsburgh, Inc. - Pittsburgh, Pennsylvania
12. County of San Diego Community Action Program - San Diego, California.

THE TEN COMMUNITY ACTION AGENCIES WHOSE AUDIT REPORTS
WERE ANALYZED BY GAO

1. United Community Corporation - Newark, New Jersey
2. Community Development Agency - New York, New York
3. Philadelphia Anti-Poverty Action Commission - Philadelphia, Pennsylvania
4. Jefferson County Committee for Economic Opportunity - Birmingham, Alabama
5. Dade County Community Action Agency - Miami, Florida
6. Economic Opportunity Atlanta, Inc. - Atlanta, Georgia
7. Community Action Agency of Memphis and Shelby County - Memphis, Tennessee
8. Mid-West New Mexico Community Action Program - Grants, New Mexico
9. Economic Opportunities Development Corporation of San Antonio and Bexar County - San Antonio, Texas
10. Denver Opportunity, Inc. - Denver, Colorado

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