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STATEMENT OF

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FINANCIAL AND GENERAL MANAGEMENT STUDIES DIVISION

BEFORE THE SUBCOMMITTEE ON MANPOWER

AND HOUSING HSE01507

COMMITTEE ON GOVERNMENT OPERATIONS

HOUSE OF REPRESENTATIVES AGC00177

CONCERNING RESULTS OF AUDITS OF THE COMMUNITY SERVICES ADMINISTRATION AND SELECTED COMMUNITY ACTION AGENCIES

Madam Chairwoman and Members of the Commitee:

We are pleased to be with you today to discuss the results of two reviews which involve the Community Services Administration and selected community action agencies. With me today are Robert Raspen, Lawrence Sullivan and Stephen Backhus of the Financial and General Management Studies Division.

The first review I will discuss was performed to investigate allegations of misuse and abuse of Federal funds disclosed by audits of selected community action agencies and to determine if action had been taken to correct the management deficiencies which permitted the misuse and abuse to occur. This

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effort concentrated in four areas which we categorized as

- --excess cash on hand,
- --inadequate control over closely related service organizations,
- --dual reimbursement of grantee expenses, and
- --inadequate control over fixed assets.

In addition, we found numerous other instances of program abuse and error. Examples of these are provided as an attachment to my statement.

When the preliminary results of this first review were available, we initiated our second review as a supplementary effort. The purpose of this latter review was to determine why CSA and its grantees are vulnerable to misuse of Government funds. This study concentrated on whether CSA itself has a system of internal controls. Good internal controls are the most effective deterrent to fraud, embezzlement and related illegal acts. Internal controls are the body of checks and balances which organizations set up to spread work out in such a way that one person or function checks on what another person or function does. These checks detect errors and make fraud and related acts more difficult. Good internal control by CSA is extremely important because, as you know, the agency and its grantees annually handle about $2 billion in Federal funds. As a result of this review, we concluded that CSA has not placed enough emphasis on internal controls and that this condition influences regional offices and grantees. Therefore, we believe that many regional offices and grantees are more vulnerable to fraud, abuse, and error than they should be.

Now I would like to discuss the results of both assignments in some detail. I will start with the four problem areas identified in our first review. This review was not restricted to CSA-funded activities but rather was a comprehensive investigation of all Federal funds provided to the community action agencies we visited.

Excess Cash

We found that millions of dollars of excess Federal cash have been retained by community action agencies. Such excess cash in the hands of grantees increases the Federal Government's operating cost in the form of interest that the Treasury pays on the money it borrows. Currently, the Treasury is borrowing at a rate of interest in excess of 16-percent. In addition, this excess cash has been diverted and embezzled; has been loaned to other grant programs, delegate agencies, and other governmental units; has been used to subsidize non-governmental activities of community action agencies; and has been used to earn interest.

For example, on January 31, 1979, one community action agency reported a balance of $1.8 million of CSA funds; 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 of $181,000. Thus, this agency's cash on hand was 10 times its average monthly disbursement need.

At the same community action agency, we found that between August 1973 and October 1977, two former employees had diverted $1.8 million of CSA funds to interest-bearing accounts in three banks. None of the three appeared on the grantee's financial records. Some of these funds were held for periods of up to 6 months and earned $50,000 of interest which was not reported nor remitted to the Federal Government until our audit disclosed its existence.

In addition to diverting funds, one former employee of this community action agency also embezzled $120,000 of idle HEW funds during the period from February through November 1976, by making checks payable to himself, depositing them into his personal savings account, and when the checks were returned, changing the payee to the grantee to make them appear legitimate. The individual restored the Federal funds plus interest, pleaded guilty to three counts of embezzlement, and received a reduced jail sentence of two weeks, a $1,500 fine, and a 3-year probation.

Other examples of excess cash include:

--one grantee which had $7.5 million in leftover cash in expired or terminated grants,

--another community action agency which had an average monthly cash balance of $3.8 million between July 28, 1978, and July 27, 1979, while its average monthly disbursements during this period amounted to $1.5 million, and

--another which had $201,000 from expired grants related to alcoholism and used these funds to earn interest of $15,000.

## Service Corporations

We found that hundreds of thousands of dollars of Federal funds have been transferred to closely related, non-profit service corporations. Some of these organizations have been used to circumvent restrictions on the use of grant funds; to defederalize and funnel grant funds for later use; and to acquire buildings and other assets, some of which are being held outside the reach of the Government and some of which have been sold.

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

Since it was established, this service corporation has purchased and sold items of real and personal property. In 1973 it purchased 22 buses for $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, it purchased 33 new buses for $472,000. Prudent use of Federal funds would have dictated that the old buses should have been traded in on the new ones or at least the proceeds from their sale should have been used as a down payment for the new buses.

This service corporation has also 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. If the service corporation repays the loans as scheduled, such costs will amount to over $860,000 including $172,000 of interest, an expense not normally chargeable to Federal grants. 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.

Because of this unique relationship whereby the service corporation purchased the property and leased it to the community action agency, the Federal Government, while paying all costs of purchasing and maintaining the property, has lost all control over it. As a result, the service corporation was able to sell 22 buses for nearly $85,000 and retain the proceeds. Without Federal action, the service corporation can dispose of the remaining 33 buses and two buildings and retain the proceeds.

Other examples of closely related service corporations include:

--A leasing corporation which CSA concluded was established to circumvent a restriction prohibiting the community action agency from purchasing automobiles with grant funds. The leasing corporation purchased the automobiles and leased them to the community action agency. CSA concluded that the rental costs for 10 vehicles for one year were substantially higher than their purchase price and that the excessive rental fees charged to the community action agency amounted to $27,800.

--A service corporation whose activities are heavily supported by the community action agency, including

$85,000 of employee time, 600 feet of space and $1,000 of telephone service.

--A leasing corporation which, through lease and purchase payments, received from its community action agency twice as much as the original purchase price of three vans.

--A real estate corporation which holds two buildings. Almost all of the costs of purchasing and maintaining the buildings are charged to Federal grants.

--A service corporation which purchased a building with CSA funds and attempted to sell it to a third party. CSA had to file a lien against the property to assert and protect its interest.

Dual Reimbursement

We found that millions of dollars of Federal funds have been used to pay for the same expenses twice. This has occurred because reimbursements are claimed under more than one federally assisted program. Difficulty in tracking reimbursements to their funding source and inadequate financial reporting mechanisms make it relatively easy for this to happen. For example:

--One community action agency received over $76,000 of excess reimbursement because it claimed the total cost of providing food service to children under several Federal programs.

--Another received over $855,000 in dual reimbursement 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 program.

--Another received $61,000 of dual reimbursements because it charged as administrative expense to its Emergency Energy Assistance program the same expense that it charged to its other Federal programs.

--A day care center received dual reimbursement of $38,000 during a one-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 received excess salary of $10,000 for a 6-month period as the director of a delegate agency of a community action agency and as a director of special services at a local college. The latter postion was funded by HEW.

Fixed Assets

We found that hundreds of thousands of dollars of fixed assets purchased with Federal funds have been lost, stolen or improperly disposed of. In addition, grantee property records were incomplete and inaccurate. For example, at one community action agency we found:

--$11,000 of assets purchased with Model Cities' monies were missing,

--$3,000 of assets were included in a certified inventory sent to CSA in February 1979 even though the agency's property officer knew the items were missing. This included a 1968 automobile, lawnmowers, cassette recorders, a microfiche reader, a radio, a heater, and miscellaneous photographic equipment.

--Most items of office and photographic equipment included in the certified listing could not be located.

At another community action agency, we found that 9 vehicles had been sold 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 and an additional $699 would be paid for the other seven.

At several community action agencies, we found assets which were not recorded on their inventory records. This condition can potentially result in such items being easily lost or stolen. In total, we identified 44 vehicles which were not recorded on inventory records--37 at one agency, 5 at a second, and 2 at a third agency.

VULNERABILITY AUDIT

I would now like to discuss our second audit. This effort is a vulnerability assessment of CSA headquarters and selected regional offices and grantees. It supplements the work I just described. In making this vulnerability assessment, we were particularly interested in determining (1) whether the problems previously mentioned existed at other community action agencies and (2) whether CSA as a whole had an adequate system of internal controls at all levels of its organization that would provide adequate protection against fraud, theft and abuse of Federal funds and assets purchased with Federal funds.

Our vulnerability assessment work was conducted at CSA headquarters, four regional offices, five community action agencies, two community development corporations, and one delegate agency. We also evaluated how three other delegate agencies administered their grants. I will now briefly summarize some of the internal control weaknesses we noted during this review and relate to you what has or can happen as a result of these weaknesses. At CSA headquarters and regional offices we found that:

--Financial reports prepared by grantees are not sufficiently reviewed and as a result, some grantees have received unauthorized and excessive advances of Federal funds. For example, in reviewing grantee financial reports we observed that one grantee had 122 days of cash on hand or $409,000.

--Two basic techniques commonly used in automated payroll and grant systems to control the number and accuracy of documents being processed through the system are not used. The lack of these controls makes it easier to add, lose or alter documents during processing without detection even though all transactions are currently manually reviewed for accuracy and pass through other automated controls.

--Security of the building housing CSA's computer facility and the computer facility itself was poor at the time of our review. This lack of security increased the possibility of damage to, loss of, or unauthorized use of CSA equipment, records, or programs.

Unauthorized entry to the building was easy because of broken windows and unlocked doors. Trash was strewn throughout the building creating a fire hazard. The building has had three fires since March 1978. We have been advised that since our review and the appointment of a new data processing chief, CSA has pointed out these deficiencies to GSA, the building lessor. GSA has corrected most of the deficiencies.

Access to CSA's computer room and tape library was not properly restricted. Since our review, CSA has submitted to GSA a work order requesting the installation of a security door and cypher locks to provide added security for the computer room and tape library.

--Incomplete and outdated computer documentation for the grant system as well as the failure to require proper testing and approval for computer programs and changes makes the $700 million annual grant disbursement systems more susceptible to abuse than we think acceptable.

--Property management duties were not delegated to a sufficient number of people in order to provide necessary checks and balances. Additionally property records were inaccurate. We could not locate some furniture and equipment such as four dictating machines which also hadn't been seen by CSA property officers for some time.

At grantees, we found internal controls to be unacceptably weak despite numerous CSA publications which provide internal control guidance and repeated recommendations of independent accounting firms made during annual audits of grantee activities. Specifically:

--One grantee was not depositing employee payroll deductions for medical insurance in a self-insurance fund as it was supposed to and could not account for what had been done with these funds because of poor internal controls. Because funds were not available to pay employee health claims, the grantee used over $73,000 of CSA's funds improperly to pay for employee claims.

We learned that this grantee had no written procedures governing the methods for handling employee deductions.

--Several grantees did not properly separate payroll duties among employees. Usually, one or two persons controlled payroll additions, deletions, and calculations as well as the distribution of paychecks. At one grantee, these weaknesses resulted in persons being placed on payrolls and paid without proof that the persons were employed. In at least one instance, an employee remained on the payroll for more than 3 months after quitting.

--Purchasing and property management functions were performed by just one or two persons at many grantees. These individuals prepared purchase orders, placed orders, received goods, recorded items in inventory records, maintained inventory records, and conducted physical counts of inventories periodically to make sure nothing was lost. We found situations of post-dated purchase orders, predated and pre-written receiving reports, erroneous payments of over $13,000 to vendors, inaccurate inventory records and as much as one-third of one grantee's items missing or not listed in property records. Some of the equipment items in question were tape recorders, typewriters, dictaphones, and calculators.

--One grantee, which makes loans to community businesses failed to require, establish or use loan applications, promissory notes, repayment schedules, collateral, penalty provisions or payment due notices. As a result, this grantee has written off about 18 percent ($30,000) of its loans and established another 34 percent ($56,581) as doubtful accounts. In at least one instance the grantee has failed to collect or attempt to recoup $40,000 in delinquent loans from a company still in operation at the time of our review.

--Other grantees had internal control weaknesses in travel. The most serious, however, was one which did not require its employees to prepare travel vouchers making an audit impossible to perform. Employees would receive travel advances based on their anticipated travel and these advances were immediately expensed rather than becoming an accounts receivable owed by the employee.

--Another grantee disbursed $400,000 to a delegate agency for the purpose of training owners of small businesses and/or economically assisting community businesses. Two years and $359,000 later, the grantee learned that the delegate agency had ceased operations; that two of its employees had stolen $16,000; and that virtually none of the grant money was spent for its intended purposes. This happened because the grantee did not require the delegate agency to submit either progress or financial reports.

--And finally, this same grantee had inadequate hiring practices. Because of the failure to sufficiently define the needed qualifications for controller, this grantee, which had an $11.5 million annual budget, hired an individual with only limited experience as an accounting technician. As a result of our pointing out numerous internal control weaknesses, the controller was asked to and did resign.

These are the major internal control weaknesses we identified during our vulnerability assessment. However, many more but less serious weaknesses were also found at every location we visited and when considered in total led us to conclude that CSA is vulnerable to fraud and abuse.

We believe the primary cause of CSA's vulnerability is that CSA has not placed enough emphasis on enforcing the requirement that strong internal controls be in place throughout its organization. Officials have devoted most of their time and effort to delivering funds to grantees. This emphasis influences CSA regional officials and community action agencies who also distribute Federal funds. While we recognize the importance of establishing programs at the grantee level, we believe that CSA must strongly emphasize to Federal and grantee managers the equal importance of internal control.

The final area I would like to discuss, and which also was part of our vulnerability assessment, is the effectiveness of CSA's audit process. We found that many of the weaknesses we identified during our review were similar to or the same as weaknesses identified and reported to CSA in previous years by independent accounting firms during the annual audit of grantee operations. Yet, the problems obviously were not corrected, at least not on a permanent basis. Action must be taken to insure that grantees correct weaknesses in their internal control systems.

This concludes my statement and I will try to answer any questions you have.

 ATTACHMENT I

OTHER ABUSES AND ERRORS

--Ineligible and questionable program participants.

--The unauthorized possession of two GSA vehicles by a grantee.

--The payment of health and life insurance premium for 96 former employees for periods ranging from 1 month to 2 1/2 years after their employment ceased. For one program year such payments amounted to $36,000.

--Providing family health insurance coverage by one community action agency for 20 employees while other employees were covered under a self-only plan. This resulted in excess costs of $11,700. At another agency, similar charges for 39 individuals resulted in excess costs of $14,000.

--Charging $24,800 of unvouchered travel advances to Head Start and Title XX Program grants.

--Overpayment of $1,500 of travel costs to 4 employees attending a 1-week training course.

--Transferring $35,000 of disallowed costs from the Child Care Food program to the Head Start Program.

--Paying $16,000 of wages in excess of the authorized cost of living increase.

--Charging grants with $700 in penalties and interest for late payment of taxes.

--Improperly classifying $255,000 of employee wages as personal service contracts, resulting in a potentional tax liability of $36,000. Furthermore, required statements of earnings were not provided to 80 employees nor to IRS.

--Paying $1,500 of wages to an individual who was not an employee of the grantee. The payment was made at the direction of CSA and the individual later became a CSA employee.

--Paying nearly $14,000 for a Board of Director's training seminar, coffee and tea service, food service for meetings, and banquets.

--Charging grants with parents' entertainment costs, including nearly $1,500 for trips to an amusement park, a performance of "Hello Dolly", a dinner in Chinatown, a bowling party, and a bus ride to an ice show.

--Payroll abuses by an employee who was paid for a 40-hour week but seldom worked it and a full-time employee who also maintained a part-time job on Tuesday mornings and Friday afternoons. That employee's time cards show frequent charges to meetings, sick and annual leave for Tuesdays and Fridays.

--21 employees of one grantee failed to report their earnings when applying for welfare, and 10 of these employees have been referred to local authorities for possible fraud prosecution.

--Possible conflicts of interest including:

-employing the wife of a CSA regional administrator as the accounting manager of a grantee.

-weatherizing of homes owned by a program staff member and by three project advisory committee members.

-purchasing new buses as well as selling its old buses through an individual who was a member of the agency's Board of Directors.

--Assigning of vehicles purchased with CSA funds to the Commissioner of Human Services, Deputy Commissioner of Human Services, Director of Music and Cultural Programs, and two former employees of the Department of Human Services who were adminstrative assistants to the mayor.

--Charging suspected personal, long-distance phone calls. For example:

-a 13-minute call from Cook County to the United Nations,

-a 4-minute call on Saturday from Cook County to a blouse company in Cleveland, Ohio,

-an 11-minute call from Cook County to a physician in Wisconsin,

-3 collect calls from Puerto Rico to Chicago,

-3 calls from Chicago to England,

-5 lengthy calls from Chicago to a resident in Yellow Springs, Ohio, one lasting 3 1/2 hours, and

-a 4-minute call to Iran.

--Counting building constructed or subsidized with Federal funds as a local matching share.

--Expending 87 percent of a grantee's Head Start funds when its average daily attendance was about 50 percent of project enrollment.

--Failure of a former executive director to repay $828 in payroll advances.

--Charging a Head Start program with $890,000 of unallowable food service costs.

--Using Head Start funds to purchase $8,000 of photographic equipment, including laboratory supplies, while none of the Head Start centers had laboratory facilities.

--Purchasing $30,000 of office equipment, including a $650 couch, a $680 laminating machine, a $650 typewriter, 9 bookcases which cost $1,400, and office partitions which cost $11,000.