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STATEMENT OF MORTON E. HENIG, SENIOR ASSOCIATE DIRECTOR,  
HUMAN RESOURCES DIVISION, BEFORE THE  
SUBCOMMITTEE ON MANPOWER AND HOUSING, HOUSE COMMITTEE  
ON GOVERNMENT OPERATIONS, ON THE [ECONOMIC DEVELOPMENT  
ACTIVITIES UNDER TITLE II OF THE COMMUNITY SERVICES  
ADMINISTRATION ACT]

Madam Chairwoman and Members of the Subcommittee:

We are pleased to be here today to discuss our efforts to date regarding economic development activities carried out by certain Community Action Agencies (CAA's) under Title II of the Community Services Administration (CSA) Act of 1974.

Two of CSA's major program efforts are the Community Action Program and the Community Economic Development Program authorized by Titles II and VII, respectively, of the Economic Opportunity Act of 1964, as amended.

Under Title II CSA supports approximately 900 Community Action Agencies (CAA's); community-based agencies throughout the Nation which operate and coordinate programs designed to alleviate poverty. These CAA's are governed by a board of directors which is composed equally of representatives from the public, private, and economically disadvantaged sectors of the community. CAA's may be independent nonprofit organizations or part of a State or local government office.

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Title VII--Community Economic Development--establishes programs to provide the poor an opportunity to become self-supporting through the free enterprise system. CSA has operated the Title VII program by providing funds generally to nonprofit community development corporations (CDC's) established to alleviate unemployment and community deterioration in special target areas by investing in businesses, community development, and social service projects. Enabling legislation provides that CDC's have an appreciable impact in the community and work toward becoming self-sufficient. Under Title VII there are currently 40 CDC's in operation. CDC's have received about \$354 million from CSA since they were first authorized in 1967.

Unlike the Community Action Program which is administered by CSA's regional offices, the Community Economic Development Program is administered entirely at the headquarters level by CSA's Office of Economic Development (OED). Also, unlike the Community Action Program, the CDC program has developed a specialized body of policy and regulation governing economic development activity funded under Title VII, and is supported by extensive investments in staff expertise, technical assistance, research and training sources in the fields of investment and business.

In its August 1977 report on the need for reforms in CSA the House Committee on Government Operations expressed concern

that CSA has knowingly permitted community action agencies to establish community development corporations with their Title II funds and that such activities operate outside OED's monitoring. This results in lost control over business investment proposals by designated OED staff. Also, the Committee noted that CSA's regional staff have no special business expertise.

We are completing a review of Title II funded economic development activities. We have visited 13 economic development activities run by CAA's in three CSA regions. We interviewed officials at CSA and at State Economic Opportunity Offices. We also interviewed persons in the private sector, where complaints of unfair competition had been made. Since we have not completed our review we are not in a position to render an opinion on the effectiveness of CSA's administration of economic development activity under Title II.

At this time we would like to discuss certain issues in which the Committee staff has expressed an interest. These issues concern the extent of CSA's awareness of economic development activity carried on by CAA's, its policies regarding such activities, and the extent of CSA's expertise in administering economic development activities. As requested, we have provided the Subcommittee with case studies of some of the projects we reviewed, as examples of the type of economic development activities in which CAA's are engaged and the problems encountered by the CAA's.

CSA AWARENESS OF EXTENT OF CAA  
ECONOMIC DEVELOPMENT ACTIVITY  
UNDER TITLE II

Effective management of a program requires knowledge of and access to basic program data. ~~We found that~~ although some CAA's have been involved in economic development projects for a number of years, CSA was not fully aware of the overall extent of economic development activities and the problems encountered by CAA's with regard to their projects. CSA attempted to obtain this information through a contract with a private organization entered into in September 1977. However, the organization has been unable to obtain all of the data it requested from the CAA's and the CSA regional offices.

Many CAA's and several CSA regional offices did not provide data that was requested by the organization. For example, the organization sent questionnaires to all CAA's with telephone and written follow-up. Although all of the CAA's were requested to respond, only 278 usable responses were returned out of 871 questionnaires sent out.

The organization requested nine of the 10 CSA regional offices to provide current annual refunding request forms and the the program progress review forms for each CAA involved in economic development activities. Two of the 9 regions did not respond. Of the remaining 7 regions, 3 forwarded the requested forms for all the CAA's that were known to have economic development activities, 1 region reported that none of its CAA's were engaged

in economic development activities, and 3 regions did not provide all the requested data, including one that refused to submit the requested forms.

The information provided by one of the regions we visited was inaccurate. To comply with the organization's request the region developed a list of all projects considered to be economic development projects. We found that the list was incomplete in that activities which should have been listed as economic development activities were not reported. Activities not reported included a revolving loan fund at one CAA that had made 12 loans to small businesses totaling over \$1 million.

The organization has forwarded a draft of its report to CSA. The report states that CSA does not know, and has no effective way of finding out, about CAA economic development activity. The report includes recommendations to CSA that it design and implement an adequate monitoring system, establish a separate program account so economic development activity can be identified, and improve communication between CSA and CAA's. The organization's report also includes recommendations concerning the need for CSA to assist CAA's in their economic development activities.

CSA has recently begun to address these problems. CSA is categorizing Title II local initiative funds by major program categories including economic development. CSA plans to continue collecting similar data under its proposed Grantee Program

Management System. According to CSA, the system will record program areas selected by CAAs to address local needs, information on program participants, measures of project accomplishment, and the amount of resources devoted to the program area. In addition CSA's Seattle Regional Office is developing an automated data retrieval system which it believes will provide detailed information on the various CAA program efforts.

CSA DID NOT HAVE ANY OVERALL POLICY  
OR RULES AND REGULATIONS REGARDING  
TITLE II ECONOMIC DEVELOPMENT

CAA's have operated without an overall policy statement, regulations, or guidelines from CSA regarding economic development activities under Title II. As stated above, Title II economic development activities are carried on outside the supervision and control of OED.

The lack of an overall CSA policy on CAA economic development activity resulted in varying degrees of emphasis placed on the program by the CSA regional offices. For example, in April 1979 the San Francisco Regional Office informed its grantees that CSA looks with favor upon the use of Title II funds for economic development pursuits. In contrast, however, the organization reviewing Title II economic development efforts noted in its draft report that in early 1979 one CAA was told by its CSA regional office that it was illegal for community action agencies to engage in such activities.

Officials of the Puerto Rico community action agency, a grantee involved extensively in economic development, told us that they consider CSA's lack of policy guidance on economic development to be a major problem. (Information on the Puerto Rico community action agency was included in the case studies provided to the Subcommittee.) The officials said they need a formal policy from CSA which would include orientation, goals, and an interpretation of economic development.

In the absence of adequate guidance from CSA, the Puerto Rico agency developed its own policy. Documents prepared as background for this policy initiative stated that the lack of clear and specific guidance from CSA had forced the agency's economic development program to operate under procedures designed for traditional service-type programs; and as a result, the projects had not been able to develop within the kind of framework that would be conducive to their achieving self-sufficiency as community enterprises.

Many of the projects were funded without adequate studies of their feasibility, project managers lacked sufficient business managerial experience, and projects did not have acceptable financial management systems. Although the agency's economic development ventures had been operating for several years with over \$17 million in federal assistance, none have reached self-sufficiency and 13 have been dissolved.

Additionally, the lack of overall program guidance has resulted in some confusion as to the proper criteria for monitoring and evaluating economic development project performance. CSA regional personnel responsible for monitoring CAA activities stated that they had problems in evaluating projects since there was no criteria on whether assessments should be based on self-sufficiency or on the projects' social impact on community participants.

In Puerto Rico, community action officials believe that the agency's main goal is social service to the poor. It is their opinion that many projects cannot achieve self-sufficiency and at the same time provide effective social services. They believe that in some cases there is a direct conflict in the two goals and one must be sacrificed to achieve the other.

CSA LACKED THE NECESSARY SPECIALIZED  
EXPERTISE AND MONITORING CAPABILITY  
TO ASSIST CAA'S IN THEIR ECONOMIC  
DEVELOPMENT ACTIVITIES

X The House Committee on Government Operations' 1977 report also stated that CSA needs to take action to insure that regional offices have the specialized expertise and monitoring capability necessary to pass judgement on economic development programs. ~~We found that~~ this same need exists today.

At the three locations we visited, CSA regional office representatives who are the focal points for monitoring and evaluating CAA activities told us they have had no business training or other specialized training that would equip them to



adequately monitor, evaluate, or otherwise aid and advise CAA's with regard to economic development activities.

For example we were told by officials at the CSA New York Regional Office when discussing the economic development activities in Puerto Rico that they do not have personnel with the business expertise necessary to provide technical assistance to the CAA and the only assistance they could provide was on administrative matters.

Headquarters officials of CSA's Office of Energy Programs which funds demonstration projects with Title II funds on a one time basis advised us that they do not have the staff to monitor the projects nor are the regional offices able to monitor the projects.

For example, at one CAA, a grantee, in July 1978 requested \$200,000 to produce and install 2,035 solar water heaters over a period of five years. The target population was to be low-income residents, and the project's 19 employees were to come from the low-income population. The project was to operate as a nonprofit tax exempt organization for at least 5 years, and the units were to be sold to poor people for under \$1,000. But, immediately after the grant was awarded in October 1978, major changes took place without CSA's knowledge. It was not until almost a year later, in September 1979, that CSA asked the CAA for a more complete report on activities related to the grant.

Among the changes that took place without CSA's knowledge

were:

- The project was established as a for profit corporation instead of a nonprofit corporation.
- A decision was made to purchase the solar units instead of manufacturing them.
- The unit price was increased from less than \$1,000 to \$1,530.
- The market strategy was changed from primarily serving the poor to one of direct competition with the private sector.

While we cannot assess the project's overall long term benefits to the poor community, certain observations can be made. For example, the change from a nonprofit organization to a for profit corporation eliminated the possibility of hiring Comprehensive Employment and Training Act work experience trainees. Also, the change from a manufacturing operation to a distribution and installation operation may have reduced the number of employees that could be hired. Under the manufacturing concept the proposal called for ultimately hiring 19 employees. At the time we reviewed the project, one year after the grant had been awarded, only 4 or 5 persons were employed. Furthermore, the increase of over 50 percent in the purchase price of the project's solar water heaters could affect the number of low income families who could afford to buy them.

Finally, the change in market strategy resulted in complaints from several private businessmen of unfair competition by a Federally subsidized organization selling its product for approximately \$1,000 to \$1,500 less than comparable products sold by

non-subsidized companies.

In another example, CSA regional office officials advised us that they were not fully aware of the problems being encountered by one project which had received Title II financial assistance from one of its CAA's. (This example was included in the case studies provided to the Subcommittee.)

In this case, the CAA, with the approval of the CSA regional office, committed about \$300,000 of CSA funds to initiate the establishment of a venture capital corporation whose principal activity is to provide loans to small businesses and to socially and economically disadvantaged persons. The corporation obtained additional funding--about \$500,000 from the Small Business Administration, and \$200,000 from private sources--which brought its total capital resources to about \$1 million.

Neither the corporation's loan officers nor any of the members of its board of directors had prior loan processing or loan review experience. Since its inception, the corporation has experienced financial difficulties which the members of the board said can be attributed to poor management and lending practices. The corporation has made 12 loans totaling \$1,077,650 to 11 businesses. The corporation has written off \$697,251 as uncollectable in connection with 6 loans where the businesses have either declared bankruptcy or on which foreclosures have been initiated. After disposition of the collateral on these loans, the corporation estimates it will lose \$231,618. One

loan which was five months delinquent was repaid by another individual who purchased the business. Of the 5 loans remaining in its portfolio, only one is current. The other four are delinquent on the average of 24 months and represent \$267,820 in overdue debts out of an original loan value of \$275,000.

PROPOSED CSA CONTROLS OVER TITLE II  
ECONOMIC DEVELOPMENT ACTIVITIES

In an effort to develop program guidance CSA, in April 1979, provided a \$43,000 grant to one of the Office of Economic Development's Title VII technical assistance grantees to assist in preparing guidelines and regulations governing the use of Title II funds for economic development activities. The grantee submitted its proposed guidelines and regulations to CSA in September 1979. The regulations covered economic development planning with respect to the CAA and the community, discussed structural and administrative requirements for project implementation, and considered CSA's responsibility in program administration. The grantee also provided guidance on the organizational options for Title II economic development activities.

In an October 30, 1979, memorandum to its regional directors, CSA placed a moratorium on new proposals for economic development projects. The memorandum noted that a comprehensive policy statement on Title II economic development grants would be forthcoming within a few weeks.

On November 29, 1979, CSA informed its regional offices that it had decided not to issue a comprehensive policy statement

on the use of Title II funds for business ventures, but would develop a set of minimum requirements to be applied to these activities. According to CSA, Title II business ventures should be part of an overall strategy to reduce poverty in the community by filling an unmet need; should benefit the whole community and yield no profit to any individual; and are to be included in an approved work program.

CSA published these requirements as a proposed rule in the Federal Register on March 3, 1980. The proposed rule proposes a new appendix to the general conditions governing CSA grants by extending the applicability of CSA directives to Title II business ventures, providing for prior CSA approval of corporate documents and stock issuances, placing controls on consultant hiring, and limiting the encumbrance of assets acquired with grant funds. The proposed rule also requires that grantees proposing to use Title II funds as venture capital submit supporting materials during the application process. Such grantees must submit

- documentation that there will be no substantial negative impact on existing small businesses,
- feasibility studies and cost analyses,
- certified financial statements where funds will be invested in existing businesses,
- financial projections for two years,
- resumes of the proposed management team, and
- articles of incorporation and bylaws.

The proposed rule notes that there will be no additional funds available for Title II economic development projects and that grantees may undertake economic development activities only within the limits of their current funding levels. Because most CAA's do not have the funds necessary to undertake proper marketing and feasibility studies, CSA officials told us that the implementation of this rule will reduce CAA business development activity.

CSA has allowed a 60-day period for grantees to comment on the proposed rule before its implementation. The overall impact that this rule will have on CAA economic development activities cannot be measured at this time. However, CSA has not made specific plans to provide its regional offices with the expertise needed to adequately evaluate or advise CAA's with regard to business development activities.

~~In summary, our review has shown that~~ CSA <sup>is</sup> was not fully aware of the extent to which CAA's were engaged in economic development activities nor had it established overall policies or regulations to guide its CAA's in engaging in such activities. We found also, as the House Committee on Government Operations reported in its 1977 report, that CSA does not have the expertise to assist and advise its CAA's, nor does it have the capability to adequately monitor economic development projects which have been funded.

~~Many of the projects we looked at~~ <sup>are</sup> were funded by CAA's with-

out adequate feasibility studies or assurances that project personnel possessed the necessary business expertise. These shortcomings contributed to the expenditure of funds by CAA's to (1) start economic development projects that probably had little chance for success, and (2) continue projects that probably had no reasonable prospects of becoming successful.

In October 1979 CSA placed a moratorium on new proposals for economic development projects and began addressing some of these problems. It has begun implementing a management information system for disclosing the extent to which CAA's engage in such ventures. It is in the process of establishing guidelines, rules and procedures for controlling the activities of CAA's with regard to economic development projects. Such guidelines will require such things as feasibility studies, disclosures of the ventures' management, and other analyses before the projects could be funded.

These procedures would appear to require CAA's to approach future proposals for economic development ventures more cautiously. CSA will still have to develop the needed business expertise in its regional offices.

Madam Chairwoman, this concludes my statement. We will be happy to answer any questions you or other members of the Subcommittee may have.