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STATEMENT OF

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ACCOUNTING AND FINANCIAL MANAGEMENT DIVISION
and CHIEF ACCOUNTANT of the UNITED STATES
GENERAL ACCOUNTING OFFICE

BEFORE THE SUBCOMMITTEE ON AGING, FAMILY

AND HUMAN SERVICES

COMMITTEE ON LABOR AND HUMAN RESOURCES

UNITED STATES SENATE

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

Mister Chairman and Members of the Committee:

We are pleased to be with you today to discuss the results of two reviews involving the Community Services Administration, as well as an ongoing review of its grant accounting system. With me today are George Egan and Lawrence Sullivan of the Accounting and Financial Management Division.

We have previously testified before the House Committee on Government Operations, Subcommittee on Manpower and Housing in May 1980 concerning these reviews. We also testified before the Senate Committee on Governmental Affairs, Subcommittee on Federal Spending Practices and Open Government. On August 22,

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1980, we issued a report entitled, "Weak Financial Controls Make the Community Services Administration Vulnerable to Fraud and Abuse."

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The ~~first~~ review ~~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. We believe the problems identified are indicative of weaknesses in the internal controls used to safeguard Federal grant funds provided to these agencies. This review was not restricted to CSA funded activities but covered all Federal funds provided to these agencies. In this effort we identified four major problem areas:

—excess cash on hand,

—inadequate control over 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.

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The purpose of the second 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 the agency and its grantees annually handle about $2 billion in Federal funds.

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.

<u>Audit of Community Action Agencies</u>

<u>Excess Cash</u>

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. In addition, excess cash 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; has been used to earn interest; and at one location, excess cash has been diverted and embezzled.

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

At the same community action agency, we found that 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 (now HHS) 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.

Service Corporations

We found that hundreds of thousands of dollars have been used to buy services and rent property from closely related, non-profit organizations, called service corporations. Some of these corporations perform valid functions related to grants such as providing bus transportation for participants in the Head Start grant program. Others, however, have entered into transactions which have contributed to the loss of control over Federal funds and in some cases the circumvention of the restrictions on the use of grant funds.

One such service corporation 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. The bank note for purchase of the 33 buses was signed by the executive director of the community action agency.

In addition, 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.

<u>Dual Reimbursement</u>

We found that over a million 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.

Fixed Assets

We found that tens 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:

--Over $9,400 of office and photographic equipment contained in a certified inventory report sent to CSA in February 1979 could not be located.

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

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 amount would be paid for the other seven.

Vulnerability Audit

As I indicated earlier we issued a report to the Congress on the vulnerability of CSA to fraud, waste, and abuse in August of last year. I will 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:

--The agency made insufficient and untimely reviews of grantee cash requests and quarterly expenditure reports used in the automated cash management system. As a result, grantees continued to receive and maintain excess cash.

--Funds available for CSA's employee payroll and grants are not sufficiently protected. Also, two basic techniques commonly used in automated payroll systems -- record counts and predetermined control totals -- were not being used. The lack of such controls makes it easier to add, lose, or alter documents during processing without detection.

--Physical security at CSA's computer facility was poor at the time of our review, making both the facility and the accounting records highly vulnerable to fraud, abuse, and destruction. Also, access to the computer room and tape library was not properly restricted.

--Property management duties were not delegated to a sufficient number of people to provide the necessary checks and balances. Also, CSA's property records did not reflect the location of furniture and equipment because there was no central file of these items. Some equipment purchased with Federal funds could not be found.

At the grantees we visited, we found that internal controls were 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 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. The grantee used over $73,000 of CSA's funds improperly to pay employee claims.

--At several grantees, payroll duties were not properly separated among employees. Without any supervision, one or two persons often controlled payroll additions, deletions, and calculations as well as distribution of paychecks. At one grantee, persons had been placed on the payroll and paid without proof that they were employed. In one case, an employee remained on the payroll for over three months after quitting.

--At many grantees, purchasing and property management functions were performed by only one or two persons. They prepared purchase orders, placed orders, received goods, recorded items on inventory records, maintained inventory records, and conducted physical counts of inventories. We found postdated purchase orders, receiving reports written in advance and predated, inaccurate inventory records and many items missing from inventory.

--One grantee with an $11.5 million budget failed to sufficiently define the needed qualifications for a controller and had hired an individual with only limited experience as an accounting technician. As a result of our identification of numerous internal control weaknesses for which the controller was responsible, this official was asked to, and did resign.

--One grantee, which made 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, the grantee had written off about $30,000 (18 percent) of its loans and established another $56,581 (34 percent) as doubtful accounts.

--Other grantees had internal control weaknesses in travel. The most serious was one which did not require its employees to prepare travel vouchers. Employees received travel advances based on their anticipated travel and the advances were immediately expensed instead of becoming an accounts receivable owed by the employee.

--Another grantee disbursed $400,000 to a delegate agency for 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. The grantee had not required the delegate agency to submit either progress or financial reports.

These are the major internal control weaknesses we identified during this 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 was vulnerable to fraud and abuse. We believe that the primary cause of CSA's vulnerability is that it had not placed enough emphasis on enforcing the requirement for strong internal controls to be in place throughout its organization. Officials have concentrated more on delivering funds to grantees than they have on funds control and accountability and monitoring. This emphasis influenced CSA regional officials and community action agencies who distribuate Federal funds.

We also 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 were not corrected -- at least not permanently.

<u>Ongoing Review</u> In

We are covering CSA's grant accounting system as part of an ongoing review of advances made by the Government. We found serious weaknesses in the system--confusing financial reports, erroneous information in the automated records and the failure to follow accounting procedures--resulting in gross overstatements of assets and inaccurate monitoring of grantee cash advance balances. For example, information in the system's automated accounting records is erroneous. Direct confirmation of cash advance balances for 195 grants disclosed that the system overstated the balances by over 900 percent. The accounting system showed $100 million in undisbursed Federal cash while grantees reported they had only 10 million in Federal cash. We found that inaccurate reports on the financial status of grants--particularly cash advances outstanding--enabled grantees to hold Federal monies far in excess of the current cash needs with little fear of being questioned by agency personnel. Our confirmation of cash advances for the 195 grants disclosed that 139 grantees had between 4 and more than 90 days cash on hand even though Treasury regulations limit grantees to a 3 day supply. In three extreme cases, grantees had a year's supply of cash.

Our work has shown that the erroneous information in the accounting records was caused primarily by (1) grantees not submitting expenditure reports called for in their grant agreements in a timely manner with some reporting 7 months late, (2) CSA Personnel not promptly entering expenditure information into the automated accounting records with delays up to 30 months,

(3) CSA Personnel not using available administrative remedies, such as suspending funds to grantees to assure they complied with financial reporting requirements, and (4) inadequate accounting system reports on the status of cash advances.

This concludes my prepared statement, Mr. Chairman. We would be pleased to answer any questions you or other members of the Committee may have.