



JUN 18 1992

Memorandum

Date

From

Richard P. Kusserow
Inspector General

Subject

Use of Recipient Capability Audits by the Public Health
Service during Fiscal Year 1989 (A-04-90-04012)

To

James O. Mason, M.D., Dr. P.H.
Assistant Secretary for Health

Attached is the final report on the results of our review of the use of recipient capability audits (RCA) by the Public Health Service (PHS) agencies. The purpose of our review was to assess the use of RCAs in Fiscal Year (FY) 1989 by PHS agencies in determining whether or not to award funds to organizations that have no prior experience with governmental grants or cost-reimbursement contracts.

In FY 1989, the Office of Audit Services (OAS) performed 66 RCAs covering proposed grant awards of \$9.9 million. All requests for RCAs were from the Centers for Disease Control.

Our review revealed that 410 organizations received PHS funding for the first time in FY 1989. We identified 172 organizations which qualified for having RCAs performed by the OAS based on criteria we established from our review of various materials relating to financial evaluations and our professional judgment from past experiences with the RCA process. We were requested to perform RCAs on only 66 of the 172 organizations. Thus, the remaining 106 organizations qualified for, but were not part of any RCA request. These 106 organizations received grant awards totaling \$54,129,485.

We recommended that PHS perform a greater number of financial evaluations of organizations that are applying for grant funds and do not have prior experience in managing Federal projects. We also recommended that PHS establish uniform policies and procedures for conducting these financial evaluations. The PHS agreed with our recommendations. A copy of PHS' response is included as Appendix C to the report.

We would appreciate being advised within 60 days on the status of corrective actions taken or planned on each recommendation. If you wish to discuss our findings further, please call me or have your staff contact Daniel W. Blades, Assistant Inspector General for Public Health Service Audits, at (301) 443-3583. To facilitate identification, please refer to Common Identification Number A-04-92-04012 in all correspondence relating to this report.

Attachment

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**USE OF RECIPIENT CAPABILITY AUDITS
BY THE PUBLIC HEALTH SERVICE
DURING FISCAL YEAR 1989**



**Richard P. Kusserow
INSPECTOR GENERAL**

A-04-90-04012



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Date *[Signature]*
From Richard P. Kusserow
Inspector General

Subject Use of Recipient Capability Audits by the Public Health Service during Fiscal Year 1989 (A-04-90-04012)

To James O. Mason, M.D., Dr. P.H.
Assistant Secretary for Health

This final report provides you with the results of our review of the use of recipient capability audits (RCA) by the Public Health Service (PHS) agencies. The purpose of our review was to assess the use of RCAs in Fiscal Year (FY) 1989 by PHS agencies in determining whether or not to award funds to organizations that have no prior experience with governmental grants or cost-reimbursement contracts.

In FY 1989, the Office of Audit Services (OAS) performed 66 RCAs covering proposed grant awards of \$9.9 million. The requests for RCAs were from the Centers for Disease Control (CDC). Based on the results of the RCAs, the CDC denied funding to six organizations and instead awarded \$1,031,043 to other, more capable organizations. In addition, more stringent terms and conditions were placed on organizations as a result of the deficiencies disclosed in the RCAs.

Our review revealed that 410 organizations received PHS funding for the first time in FY 1989. We identified 172 organizations which qualified for having RCAs performed by the OAS based on criteria we established from our review of various materials relating to financial evaluations and our professional judgment from past experiences with the RCA process. First, we identified and excluded established organizations such as colleges, universities, hospitals, clinics, health centers, and State or local governments. Second, we identified and excluded organizations that had financial evaluations performed by the agencies in FY 1989. Last, we eliminated organizations that were awarded grants of less than \$100,000.

We were requested to perform RCAs on only 66 of the 172 organizations. Thus, the remaining 106 organizations qualified for, but were not part of any RCA requests. These 106 organizations received grant awards totaling \$54,129,485.

We recommended that PHS perform a greater number of financial evaluations of organizations that are applying for grant funds and do not have prior experience in managing Federal projects. We also recommended that PHS establish uniform policies and procedures for conducting these financial evaluations. The

PHS agreed with our recommendations. A copy of PHS' response is included as Appendix C to this report.

Background

The purpose of an RCA is to assess the financial management capability of organizations that have no prior experience with governmental grants or cost-reimbursement contracts. When performing an RCA, tests and other auditing procedures are conducted of an organization's accounting system and related internal controls to assess their capability to satisfactorily manage and account for Federal funds.

An RCA is performed primarily to satisfy Part 611 (Financial Evaluation of Grant Applications) of the PHS Grants Administration Manual which is used by the grants management officer (GMO). In accordance with section 611.3 (b), it is the policy of PHS that:

" . . .where a prospective grantee has had no prior governmental grants or cost-reimbursement contracts, the **GMO** must, prior to award or within a reasonable time thereafter, review or cause to be reviewed, the applicant institution's accounting system for assurance as to its adequacy and acceptability."

The **RCAs** are intended to reduce the risk of awarding funds to inexperienced or incapable organizations.

Scope

We conducted our review in accordance with generally accepted government auditing standards. Our review covered FY 1989 and was performed to determine: (1) the number of **RCAs** that were requested by PHS agencies and performed by OAS, and the results of OAS recommendations; (2) the potential universe for **RCAs** within each PHS agency; and (3) the need for PHS to perform more financial evaluations to reduce the risk of awarding funds to inexperienced or incapable organizations.

To accomplish our objectives we: (1) interviewed cognizant agency officials; (2) obtained data from each agency pertaining to their policies and procedures regarding financial management evaluations of applicants without prior experience in managing Federal projects; and (3) obtained data from the departmental payment management system (DPMS) regarding the potential universe for **RCAs**. In addition, we contacted each OAS regional office and requested RCA data.

Our review was performed from March 1990 to January 1991 at the PHS agencies in Rockville, Maryland, and the CDC in **Atlanta, Georgia.**

RESULTS OF REVIEW

Our review revealed that PHS agencies do not follow uniform policies and procedures for performing financial evaluations of applicants that have no prior experience with governmental grants or cost-reimbursement contracts. Our review also revealed that 410 organizations received PHS funding for the first time in FY 1989. We identified 172 organizations which qualified for having **RCAs** performed by OAS. We were requested to perform **RCAs** on 66 of the 172 organizations. The remaining 106 organizations qualified for, but were not part of any RCA request.

RESULTS OF RCAS REQUESTED BY PHS AGENCIES

We performed a total of 66 **RCAs** during FY 1989. The CDC requested that we conduct these **RCAs** of applicants that had applied for approximately \$9.9 million in funds authorized by Congress. These funds were made available to provide technical assistance to minority community based organizations (**CBOs**) to work with their communities to achieve a reduction of the risk of Human Immunodeficiency Virus transmission.

We found basic accounting and internal control deficiencies at most of the 66 organizations we examined. Based on the results of the **RCAs**, the CDC denied funding to six **CBOs** and instead awarded **\$1,031,043** to other, more capable organizations. In addition, more stringent terms and conditions were placed on organizations as a result of the deficiencies disclosed in the **RCAs**. The CDC classified 14 organizations as "**exceptional**", thus requiring them to comply with the rules for organizations which show evidence of poor program or business management practices. These organizations were placed under the Department's Advancement Ceiling Plan requiring the submission of monthly disbursement reports to the CDC for review.

UNIVERSE OF NEW ORGANIZATIONS FUNDED BY PHS AGENCIES

We obtained a listing from the DPMS of organizations that were awarded Federal funds for the first time in FY 1989. Our analysis of this listing identified 410 organizations that received PHS funds for the first time in FY 1989. These 410 organizations were awarded a total of 672 grants. Appendix A shows the total number of grants awarded by each agency.

The authorized amounts of the 672 grants ranged from \$1,384 to **\$16,486,000**. There were 385 grants whose authorized amounts were less than \$100,000. The total amount for the 385 grants was **\$17,791,823**. There were 287 grants whose authorized amounts were \$100,000 or more. The total amount for the 287 grants was **\$161,282,784**. The grand total for the 672 grants was **\$179,074,607**.

ORGANIZATIONS QUALIFYING FOR RCAS

We reviewed the list of 410 organizations discussed above and established criteria to eliminate organizations which, in our opinion, would not qualify for **RCAs**. This criteria was based on our review of various materials relating to financial evaluations and our professional judgment from past experiences with the RCA process.

First, we identified and excluded 46 colleges, universities, hospitals, clinics, health centers, and State or local governments. These types of organizations would most likely be established entities with accounting systems already in place.

Second, we identified and excluded 40 organizations that had financial evaluations performed by the agencies in FY 1989. We **also** obtained information from each PHS agency regarding policies and procedures adhered to when performing financial evaluations of applicants with no prior experience in managing Federal projects. Our analysis of this information revealed that the policies and procedures in performing financial evaluations vary from agency to agency. Each PHS agency has developed their own set of guidelines. The various guidelines followed by the agencies might include: requesting and evaluating data provided by the applicant; requiring independent audit reports and financial statements from the applicant; determining if the applicant has an indirect cost rate; contacting the applicant by telephone; or conducting site visits. The financial evaluations are primarily performed by the **GMO** for each agency.

Last, we eliminated 218 organizations that were awarded grants of less than \$100,000. Recognizing that we do not have sufficient resources available to perform **RCAs** on all applicants, we set a dollar limit of \$100,000. While this limit would include only 57 percent of the grants awarded, it would provide audit coverage of 90 percent of the dollars awarded.

We examined each of the 410 organizations on an individual basis. Based on the above established criteria, 106 organizations would have qualified for, but were not part of any RCA requests to the OAS in FY 1989. The total amount of awards provided to the 106 organizations was **\$54,129,485**. Appendix B shows, by agency, the total number of organizations that qualified to have **RCAs** performed in FY 1989.

Conclusions and Recommendations

Our review of the use of **RCAs** by PHS agencies revealed that, in FY 1989, over 42 percent of the organizations, with no prior experience in managing Federal projects and awarded funds by PHS, qualified for having an RCA performed by OAS. We recognize that every organization that applies for funding may not warrant an RCA by OAS and that we do not have sufficient resources available to perform a significant additional number of **RCAs**. Consequently, we recommend that PHS perform a greater number of financial evaluations.

Due to the various guidelines followed by each agency, we believe it would be beneficial to establish uniform policies and procedures for performing financial evaluations of applicants applying for PHS funds for the first time. Substantial cost avoidances and improved financial management benefits could accrue to PHS programs if guidelines are established setting forth the requirements for performing financial evaluations internally or externally.

For organizations that are applying for grant funds and do not have prior experience in managing Federal projects, we recommend that the agencies perform financial evaluations of these organizations. We also recommend that PHS establish uniform policies and procedures for conducting these financial evaluations. At a minimum, the financial evaluation process should require the applicant to provide:

- a narrative of the history and background of the organization. This narrative should include information such as how long the organization has been in existence and what type of community ties the organization has.
- a copy of the organization's certificate of incorporation and organizational chart.
- latest copies of independent audit reports, management letters, and/or financial statements.
- a list of **"other"** sources of funding.
- information regarding any outstanding loans.

In addition, the financial evaluation process should require the agency to:

- review the Health and Human Service Alert List to ensure that the organization has not been awarded Federal funds previously and mismanaged that project.
- conduct site visits if deemed necessary to clarify any questions regarding the eligibility or financial stability of the applicant.

PHS Comments

The PHS concurred with our recommendations and has agreed to reemphasize to the grants management staff the need to adhere to PHS policy for the performance of financial evaluations of grantees, especially grantees that have no prior experience with Federal grants or contracts. The PHS has also agreed to utilize, as a minimum, the procedures set forth in the "Manual for Financial Evaluations of PHS Awards" in the performance of the required financial management systems reviews.

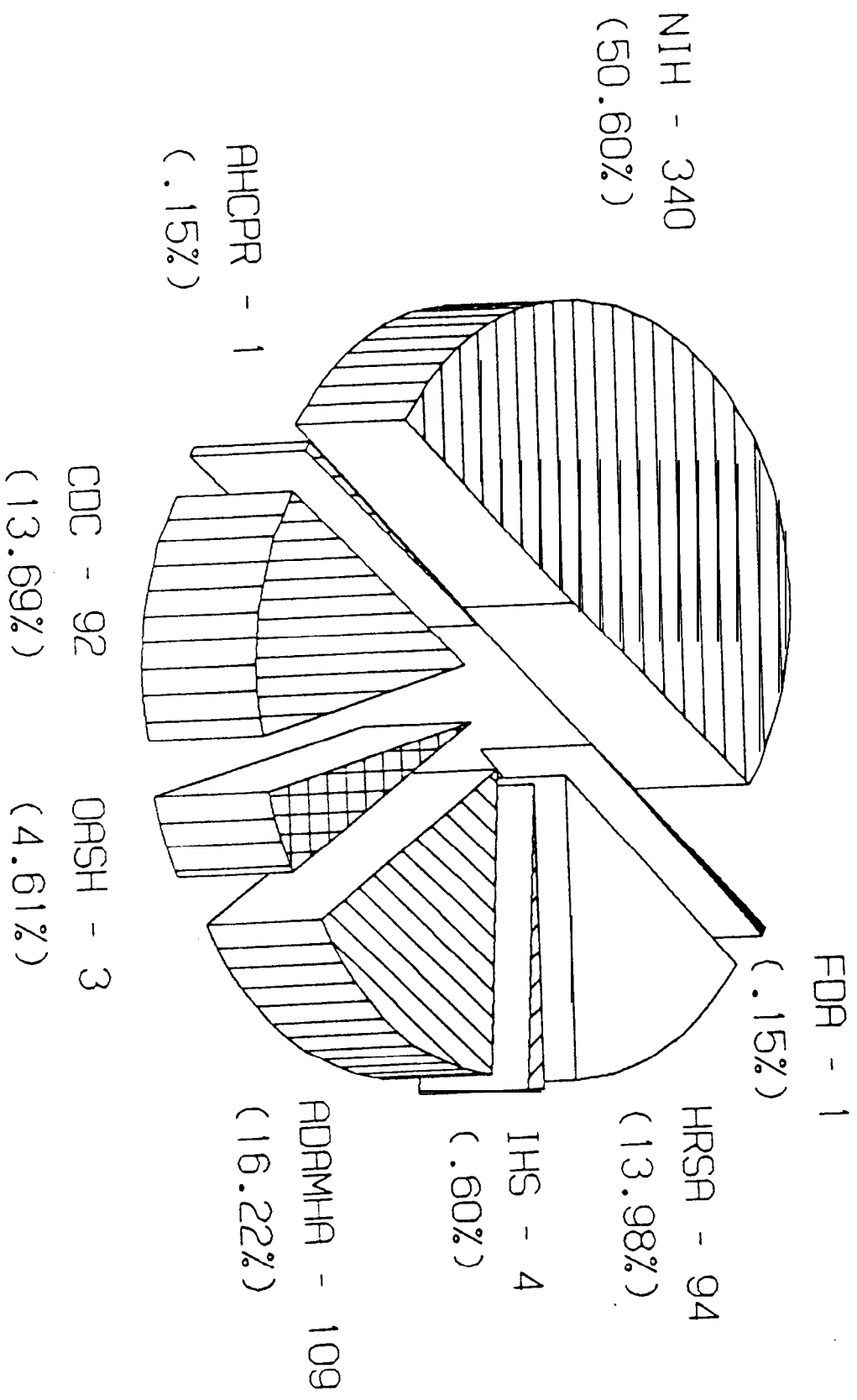
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We would appreciate being advised within 60 days on the status of corrective actions taken or planned on each recommendation. If you wish to discuss our findings further, please call me or have your staff contact Daniel W. Blades, Assistant Inspector General for Public Health Service Audits, at (301) 443-3583. To facilitate identification, please refer to Common Identification Number A-04-92-04012 in all correspondence relating to this report.

APPENDICES

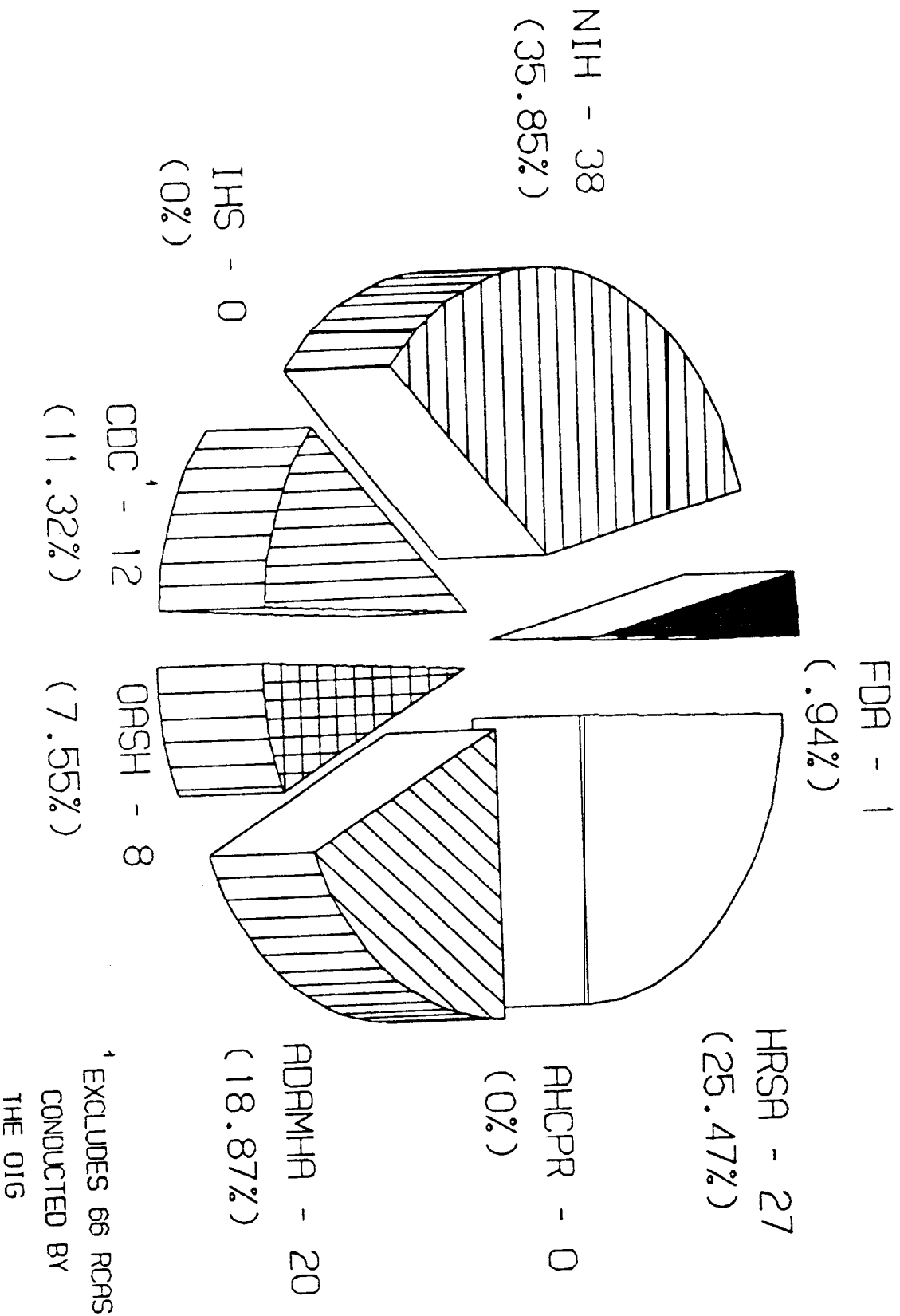
TOTAL FIRST TIME PHS GRANTS AWARDED BY AGENCY

FISCAL YEAR 1979



ORGANIZATIONS QUALIFYING FOR OIG RCAS BY AGENCY

FISCAL YEAR 1989



¹ EXCLUDES 66 RCAS CONDUCTED BY THE OIG



Memorandum

Date . **APR 24 1992**

From **Assistant Secretary for Health**

Subject **Office of Inspector General (OIG) Draft Report "Use of Recipient Capability Audits by the Public Health Service During Fiscal Year 1989"**

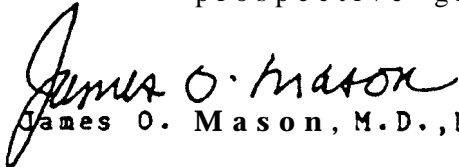
TO **Inspector General, OS**

Attached are the PHS comments on the subject **OIG** draft report.

We concur with the draft report's recommendations. We will reemphasize to our grants management staff the need to:

1. **adhere to PHS policy for the performance of financial management systems reviews of grantees, especially from grantees with no prior experience with Federal grants or contracts, and**
2. **utilize, as a minimum, the procedures set forth in the "Manual for Financial Evaluations of PHS Awards" in the performance of the financial management systems reviews required by PHS policy.**

We will also encourage them to **increase their use of your staff's capability audits of prospective grantees.**


James O. Mason, M.D., Dr.P.H.

Attachment

PUBLIC HEALTH SERVICE (PHS) COMMENTS ON THE OFFICE
OF INSPECTOR GENERAL (OIG) DRAFT REPORT "USE OF
RECIPIENT CAPABILITY AUDITS BY THE PUBLIC HEALTH SERVICE DURING
FISCAL YEAR 1989," (A-04-90-04012), JANUARY 1992

GENERAL COMMENTS

PHS agrees that it is extremely important to perform financial management evaluations prior to the issuance of an award. This is especially true when organizations with no previous experience in managing governmental grants or contracts are involved.

In the early 1970s, PHS implemented an aggressive plan for assuring that PHS grants management staff performed financial evaluations of organizations applying for grant funding.

In July 1974, PHS issued Chapter 6-500, now Part 611, of the PHS Grants Administration Manual. The Chapter required grants management officers (GMO), in the case of prospective organizations which have had no prior government grants or cost reimbursement contracts, to review or cause to be reviewed, the adequacy of the organization's accounting system. The Chapter also required GMOs to perform an analysis of the proposed grant budget costs in order to ensure that Federal funds, if awarded, were expended in a judicious manner.

Shortly thereafter, PHS initiated an aggressive training program for all regional and central office grants management staff. The training was designed to inform grants management staff of the new requirement for financial evaluations and train them on how to perform the evaluations. Since that time, training has been provided on a continuing basis to assure that personnel are familiar with the policies and evaluation procedures.

From 1975 through early 1990, staff from the Office of the Assistant Secretary for Health provided about four seminars per year on financial evaluations for grants and contracts staff. In March 1990, PHS engaged a contractor to provide at least three 3-day seminars per year on financial evaluations for grants and contracts staff. All seminar participants receive a "Student Manual" which contains the PHS policies on financial evaluations and the procedures to be used in their performance. PHS staff who participated or will participate in these training seminars from FY 1990 through FY 1992 numbered 80, 99, and 153, respectively.

In 1975, to assist grants and contracts staff in implementing these policies, PHS issued the "Manual for Financial Evaluations of PHS Awards." The Manual, revised and updated two times, provides specific guidance for the conduct of cost analyses of grant and contract proposals, reviews of financial

management systems, financial capability **surveys**, file documentation, and use of audit reports. The Manual also contains each of the minimum steps suggested in the OIG report to be used in the performance of financial evaluations.

We have provided copies of the "Student Manual" and "Manual For Financial Evaluations of PHS Awards" to OIG staff under separate cover.

In March 1977, these policies were reemphasized by the issuance of Chapter 1-03, now Part 101, of the PHS Grants Administration Manual. The Chapter clarified and more specifically defined the responsibilities of **GMOs**. These responsibilities included the performance of financial management systems reviews of grantees. Procedures for the implementation of the Chapter are also included in the manuals cited above **and addressed in the PHS training program for grants and contracts staff**.

The PHS comments on the **OIG** recommendations are as follows.

OIG RECOMMENDATION

PHS should perform a greater number of financial management evaluations of organizations that have no experience with government grants or cost-reimbursement contracts.

PHS Comments

We concur. We agree that financial management evaluations should be performed on organizations that have no experience in managing federal projects. These evaluations should be performed prior to or shortly after an award is made.

In 1989, because of other competing priorities, PHS agency grants management staff were only able to perform limited financial evaluations. However, since that time, PHS agency grants management staff have increased their efforts in this area. In addition, PHS agencies have increased their utilization of the **OIG's** recipient capability audits.

We will reemphasize to our agencies the need to ensure that financial management evaluations are performed in accordance with the policy set forth in the PHS Grants Administration Manual.

We will also encourage PHS agency staff to utilize **OIG's** expertise and obtain recipient capability audit support; especially in those situations where there is insufficient information for PHS grants management staff to perform their own financial evaluations.

OIG Recommendation

PHS should establish uniform policies and procedures for conducting financial management evaluations. The **OIG** identified specific minimum steps that should be performed.

PHS Comments

We concur. We agree that agencies conducting financial evaluations should apply uniform policies and procedures to the maximum extent possible.

We believe that the policies in the PHS Grants Administration Manual, the procedures set forth in the "Manual for Financial Evaluations of Public Health Service Awards," and the instruction given to grants staff through the PHS training **program**, are adequate for this purpose. As discussed in the general **comments** above, each of the specific steps recommended by the **OIG** is addressed within the current PHS policies and procedures.

Nevertheless, we will reemphasize to our grants management staff the importance of following these policies and procedures. We will also arrange discussions with those responsible for performing those reviews, so that all agencies will consistently and uniformly apply them.