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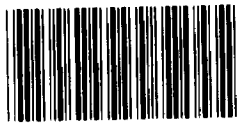
UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

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Ernst & Ernst
DLG 01256

FOR RELEASE ON DELIVERY
EXPECTED AT 9:30 A.M.
THURSDAY, MARCH 22, 1979

STATEMENT OF
DONALD L. SCANTLEBURY, DIRECTOR
FINANCIAL AND GENERAL MANAGEMENT STUDIES DIVISION
BEFORE THE SUBCOMMITTEE ON LABOR, AND
HEALTH, EDUCATION AND WELFARE
COMMITTEE ON APPROPRIATIONS
UNITED STATES SENATE
CONCERNING [RESULTS OF AUDITING AT THE COUNCIL FOR
ECONOMIC OPPORTUNITIES IN GREATER CLEVELAND]



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Mr. Chairman and Members of the Committee:

We are pleased to be here today to discuss the preliminary results of the review you requested in November 1978. You requested that we investigate the allegations of fraud and abuse disclosed by various audits of government programs operated by the Council for Economic Opportunities in Greater Cleveland and its subgrantees. You asked us to determine if action has been taken to correct the management deficiencies which permitted the fraud and abuse to occur. In addition, you asked us to test other similarly funded or constituted grantee organizations in other locations to determine whether comparable situations exist.

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Just

With me are George Egan and Robert Raspen of the Financial and General Management Studies Division and Joseph Stanziale of our Cleveland field office.

The Council for Economic Opportunities in Greater Cleveland was established as a response to the social needs and the resources offered by the Economic Opportunity Act of 1964. The Council is a community action agency through which Federal, State, and other funds are received and distributed. The Council works through many community organizations and groups referred to as subgrantees.

Federal funds are received from the Departments of Health, Education and Welfare, Agriculture, and the Community Service Administration. For fiscal year 1979, the Council's records show that they received \$6.5 million in Federal funding.

	<u>Millions</u>		<u>Percent</u>
Community Service Administration	\$3.8	or	59
Health, Education and Welfare	2.5	or	38
Agriculture	<u>.2</u>	or	<u>3</u>
Total	<u>\$6.5</u>		<u>100</u>

Community Service Administration funds are used primarily to support six Neighborhood Centers while HEW funds are for Head Start and Day Care Centers. Agriculture funding goes for food reimbursement at Head Start and Day Care Centers.

The Council and its subgrantees have at least 22 different checking accounts from which disbursements are made.

The balances in these accounts totaled \$1.4 million as of January 26, 1979.

Funds in some of these accounts have been audited by Ernst & Ernst and Peat, Marwick and Mitchell Accounting Firms. Ernst & Ernst has been auditing HEW funding and Peat, Marwick and Mitchell, CSA funding.

We used the accounting firm audit reports and workpapers to review Council activities. The auditors noted the following problems:

- unauthorized loans from the Council's checking accounts, some of which have not been repaid.
- diversion and embezzlement of Federal funds.
- dual, excessive, and questionable reimbursement of food costs.
- duplicate, excessive, and unsupported reimbursement for travel costs.
- unauthorized payroll advances and bonuses to Council and subgrantee staff.
- unauthorized credit cards charges for personal use by subgrantee staff.

While the Council stated that corrective measures have been taken to prevent a recurrence of the problems described above and to recover the funds, we found it has not corrected the entire situation and as a result, some abuse and possible

fraudulent use of Federal funds still occurs. Details of what GAO found are described in the following four areas:

- The \$120,000 Embezzlement
- Improper Loans
- Community United, Inc.
- Harvest Day Care Center

Embezzlement of \$120,000
of Federal Funds

The Finance Director of the Council pleaded guilty to diverting \$120,000 of HEW funds. The FBI report showed that the Finance Director, during the period February through November 1976, made checks payable to himself, deposited them into a personal savings account, and when the checks were returned, changed the payee's name into the Council's name to make the checks look legitimate.

The embezzlement was uncovered by Peat, Marwick and Mitchell after receiving information from a bank official. The embezzlement involved HEW funds and the accounting firm discovered it even though it was hired to audit only the Community Service Administration funds.

Once the diverted funds were discovered, the Council and Peat, Marwick and Mitchell had a number of meetings over a 7-month period before the Council took some action to improve internal controls over disbursement of funds. During this period the Council retained the Finance Director on the payroll to close the books even though Peat, Marwick and Mitchell

recommended he be suspended immediately. Neither the Council nor the accounting firm reported the diverted funds to the Federal agencies that provided the funding. In June 1977, our office reported the fund diversion to HEW and the FBI.

The FBI's investigation led to the U.S. Attorney filing charges on September 13, 1978, against the Finance Director on three counts of embezzlement totaling \$98,000 of HEW funds. On November 29, 1978, the Finance Director pleaded guilty to all three counts and returned the \$120,000 and interest that had accrued in his bank account. The U.S. Magistrate gave him a reduced jail sentence of 2 weeks, a fine of \$1,500, and a 3-year probation.

Unauthorized Loans

The Council made loans of HEW, Community Service Administration and Agriculture funds between major accounts, from May 1973 through January 1979, even though this is prohibited under existing regulations. The loans between major accounts included (1) the Council loaning money to its subgrantees and subgrantees loaning money back to the Council; (2) the Council loaning money to other major cities with apparent approval of CSA officials; and (3) one Council loan which involved the embezzlement of funds as previously discussed. While the Council's Executive Director stated all loans have been repaid we found this was not true. For example, Ernst &

Ernst reported initially in 1975 that the Council had recorded in their general ledger \$180,000 in accounts receivable made up of a number of loans by the Council to its subgrantee agencies. According to the Council's Executive Director these loans were repaid. We found from our detailed examination that \$23,000 still remained outstanding. In another example, we found the Council made numerous other loans from its Agriculture food reimbursement account. During the period 1970 through 1978 the Council made loans totaling \$445,000 of which \$387,000 have been repaid and \$52,000 still remains outstanding. Some loans were made to organizations that received no Agriculture funds. For example, loans were made to programs such as Emergency Energy, West Side Civic and Youth Delinquency Prevention.

Further, we found that the Council's general ledger and accounting records relating to loan transactions were incomplete and poorly maintained. The Council officials informed us they do not know what to do to reconcile all the loans. Ernst & Ernst called this same problem to the Executive Director's attention in December 1977. The Council has not done anything to insure a timely recording and repayment of loan transactions between major program accounts.

We believe the large number of loans made in the past indicates extra money is available in some accounts and Federal agencies are not effective in recovering excessive and unapplied funds.

Audit of Community United, Inc.

During an audit in 1976 of the Head Start Program administered by Community United, Inc., a subgrantee of the Council, Ernst & Ernst auditors found a lack of internal control, inadequate documentation, and evidence of payments that appeared to be improper and possibly fraudulent.

Ernst & Ernst reported to the HEW Audit Agency in Chicago on September 21, 1976, that their audit of Community United, Inc., had found payments that appeared to be improper and possibly fraudulent. Their routine audit uncovered evidence of the following types of activities:

1. Frequent and repeated salary advances to the Director.
2. Little internal control--Project Director has no accountability to anyone.
3. Unauthorized and frequent travel.
4. Improperly computed per diem travel allowances.
5. Excessive mileage reimbursements.
6. Improper use of gasoline credit card.
7. Questionable use of American Express Credit Card.

8. Unsupported travel cost reimbursements.
9. Unauthorized bonuses paid several employees,
including the Director.

As a result of the audit, the Council Executive Director stated that the Council took away the Community United Project Director's complete control over the agency's financial and travel transactions.

Also, the Executive Director took the following steps in taking over financial control until proper controls can be instituted at Community United, so that further practices such as described in the audit will not occur:

- Director of Community United is no longer authorized to sign checks or authorized disbursement of funds,
- cancelled all credit cards in the name of the agency,
- required all travel to have prior authorization of Community United's Board of Trustees,
- required all checks to have two signatures, one of which must be either the Chairman or Secretary of the Board,
- designated Council's Internal Auditor to review all fiscal transactions and disbursements of Community United,
- no checks may be written without prior approval of the Council's internal auditor.

On September 27, 1976, the Chicago HEW Regional Auditor notified Ernst & Ernst that since possible fraud was involved the matter was being referred to HEW's Office of Investigations.

As of September 20, 1978, the Chicago HEW investigators told us that their office had not done any work on the alleged fraud and that their office was swamped with Medicaid fraud investigations and other media publicized scandals.

GAO initially reported the potential fraud to the Chicago FBI Office in June 1977, who in turn referred the case to the Cleveland FBI Office. The Cleveland Office stated a detailed investigation was not done, but in their opinion potential fraud involving duplicate reimbursement of about \$300 travel costs existed. The FBI referred the case to the U.S. Attorney for a prosecutive opinion. On January 23, 1979, the U.S. Attorney decided not to prosecute because the case was too old and the dollar amount was insignificant. In testing Community United's 1978 disbursements, we also found many of the same weaknesses continued to exist. During fiscal year 1978, Community United Head Start and Day Care operated on a budget of over \$700,000 including about \$600,000 in HEW funds.

Harvest Day Care Center

The Harvest Day Care Center is one of eight Centers that is part of the Ministerial Day Care Association. The

Ministerial Association is a subgrantee of the Council.

The Department of Agriculture's audit report stated that the Center received excessive and duplicate reimbursements of up to \$4,700 or more in 1976 for food and related labor costs. In addition, the Council continues to reimburse the Center for parent counseling services up to \$6,000 annually without any assurances the services are actually performed.

Agriculture's investigation of the Center covering the period January 1976 through January 1977 disclosed the Center claimed unearned reimbursement under the Food and Nutrition Service's Child Care Food Program. The center failed to maintain adequate records on attendance, meals prepared and served, food purchases, and other information required by Agriculture's regulations. More specifically the Center:

- claimed reimbursement for feeding an average of 30 children during the June-August 1976 period when records showed a lower number were fed,
- claimed excessive reimbursement of \$1,116 for lunches served to children during the June-August 1976 period who were fed lunches at another public school summer program site.
- obtained dual reimbursement of \$3,673 for a dietary Aide/Cook salary from the Council under HEW funded programs for the period January 1976 through January 1977 and at the same time claimed reimbursement of

\$4,700 for similar labor costs from Agriculture
Food and Nutrition Service, and
--provided cash register tapes which did not adequately
support food purchases from November 1976 through
January 1977.

Furthermore, the Agriculture's Office of Audit found
that the Center did not qualify as a non-profit organization
under Section 501C3 of the Internal Revenue Code. As a re-
sult, the Center is not entitled to reimbursement of
costs.

This concludes our prepared testimony, Mr. Chairman,
we will be pleased to try to answer any questions.