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STATEMENT OF

DONALD L. SCANTLEBURY, DIRECTOR

FINANCIAL AND GENERAL MANAGEMENT STUDIES DIVISION

BEFORE THE SUBCOMMITTEE ON FEDERAL

SPENDING PRACTICES AND OPEN GOVERNMENT

COMMITTEE ON GOVERNMENTAL AFFAIRS SEN06609

UNITED STATES SENATE

CONCERNING RESULTS OF AUDITS AT SELECTED

COMMUNITY ACTION AGENCIES

Mr. Chairman and Members of the Committee:

We are pleased to be here today to discuss the results of the review you requested in November 1978. With me today are George Egan and Robert Raspen of the Financial and General Management Studies Division. 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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In response to the second part of your request, we performed detailed audit work at the following Community Action Agencies:

--Community and Economic Development Association of Cook County, Illinois. DLG03108

--Department of Human Services, Chicago, Illinois. DLG02078

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--Action for Boston Community Development, Boston, Massachusetts. DLG03109

--Central Area Motivation Program, Seattle, Washington. DLG03110

--Raleigh County Community Action Association, Beckley, West Virginia. and DLG03111

--Southeastern Tidewater Opportunity Project, Norfolk Virginia. DLG03112

On May 31, 1979, you provided us with a list of Community Action Agencies in which you were particularly interested. We reviewed the past audits of these agencies and performed limited field work at several locations to determine the extent of corrective actions taken. This field work was performed at:

--Neighborhood Services Department, Detroit, Michigan. DLG03113

--Richmond Community Action Program, Richmond, Virginia. DLG03114

--United Planning Organization, Washington, D.C. DLG03115

--Community Action Pittsburgh, Inc., Pittsburgh, Pennsylvania. DLG03116

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--Community Action Partnership, Department of Human Services, County of San Diego, California. DHS

On March 22, 1979, we testified before the Senate's Subcommittee on Labor, and Health, Education and Welfare, Committee on Appropriations, on the preliminary results of our review. We described instances of diverted and embezzled funds, illegal and improper loans, dual and excessive travel costs, improper payroll advances, bonuses, and unauthorized credit card charges. We also reported internal control weaknesses at the Council's subgrantees, as well as inadequate documentation for and accountability over expenditures, dual and unsupported reimbursements for food costs, and other areas of program abuse.

Today I would like to discuss the results of our audit as it relates to the second part of your request; namely, that we test similarly funded or constituted grantee organizations in other locations to determine whether comparable situations exist. In addition, we will discuss the corrective actions taken by the Council for Economic Opportunities in Greater Cleveland. Details of what we found at the other locations are categorized as DLG01255

--cash management,

--creation of leasing companies,

--dual reimbursements,

--control over fixed assets,

--interproject loans, or

--other abuses.

CASH MANAGEMENT

Several Community Action Agencies included in our review maintained cash balances in excess of their immediate needs. This situation has resulted because the agencies receive cash before they need to and because the Federal agencies do not recover unexpended funds at the end of a grant year. Excessive cash on hand may lead to fund diversions and increase the Treasury's need to borrow money. The Treasury is currently paying over 10-percent interest on the money it borrows.

For example, on January 31, 1979, the Council for Economic Opportunities in Greater Cleveland had $1.8 million of CSA funds on hand. During the 6 months between August 1, 1978, and January 31, 1979, the Council's monthly CSA expenditures averaged $181,300. Thus, the cash on hand was over 10 times greater than the Council's average monthly disbursement needs.

Other Community Action Agencies also maintain excessive cash balances. For example, an analysis of the cash flow statements of the United Planning Organization of Washington, D.C. showed that between July 28, 1978, and July 27, 1979, its average monthly cash balance amounted to $3.8 million while its average monthly disbursements amounted to only $1.5 million. Thus, cash on hand was more than 2 and 1/2 times greater than disbursement needs. Another example is Chicago's

Department of Human Resources which had $7.5 million of Federal cash on hand on May 31, 1979. Almost $2.9 of the $7.5 million represented leftover HEW Head Start funds.

HEW regional officials estimate that as much as $26 million of leftover Head Start funds may be in the hands of grantees in the Chicago region alone.

Large cash balances can lead to embezzlement and other fund diversions. In our earlier testimony we related how the Council°s former finance director embezzled $120,000 of inactive grant funds. Since that testimony we found that this individual and the former chief accountant actually diverted $1.8 million of CSA funds to unreported interest-bearing savings accounts at three banks between August 1973 and October 1977. Some of these funds were held for periods of up to 1 year, thus acquiring substantial interest.

The current finance director was not aware of the diversion of funds to the interest-bearing accounts. When informed of the existence of two such accounts, he examined Council records and reported to us the existence of a third interest-bearing account.

In a July 11, 1979, letter and in a July 25 meeting, we notified CSA regional officials about the diversions.

In addition, the CPA firms which audited HEW grants administered by the Philadelphia and Atlanta Community Action Agencies noted in their 1976 and 1977, respective reports that they too had excessive cash balance.

CREATION OF LEASING COMPANIES

Several Community Action Agencies have established corporations which acquire and lease back real and personal property to the Community Action Agency. This arrangement has resulted in Federal grants paying interest on loans used to acquire the property. In addition, the leasing companies hold title to the property and retain the proceeds from the sale of excess property. Had the Community Action Agency acquired the property in its own name, it would not have been allowed to charge interest to the Federal grants and would have had to return any excess property or the proceeds from its sale to the Federal Government. Under the leasing company arrangement, whether the Federal Government has any reversionary interest in the property is undecided. In fact, one such company has retained the $85,000 it received from the sale of excess personal property.

During the March testimony, we briefly discussed the leasing company arrangement at the Community and Economic Development Association of Cook County (CEDA) and its leasing company, the Community Action Services Inc. (CASI). Since that time we have developed the following additional information. DLG03123

CEDA established CASI as a separate nonprofit organization in 1973 and has used it as a vehicle to acquire, lease, and dispose of real and personal property. CASI had no employees and no function other than writing checks to repay the loans which were used to acquire the property. Both shared an

Executive Director, and four members of CASI's Board of Directors either served as members of CEDA's Board of Directors or were involved with operating CEDA's Head Start program.

Since it was established, CASI purchased 55 school buses and two buildings. It sold 22 of the 55 buses and retained the proceeds of nearly $85,000. CEDA reimbursed CASI for the down payments except one for $5,000, and for all principal and interest payments on loans used to acquire the buses and buildings. CEDA charged these costs to the Head Start program as lease payments. CEDA also paid for all renovations made to the buildings as well as all operating costs associated with the buildings and the buses. These costs were also charged to the Head Start grant. The remaining 33 buses and the 2 buildings are titled to CASI. The two buildings were purchased for $69,000 and have a current market value of $234,000.

Other Community Action Agencies which have established similar organizations to acquire, hold, and dispose of real and personal property include Boston, Newark, and San Antonio. In addition, we found that at least one delegate agency--the South Boston Action Council--has established a nonprofit corporation which leases a building to the Boston Community Action Agency.

DUAL REIMBURSEMENT

We testified in March that some grantees may have received dual reimbursements for the same expenditures. Our followon work has demonstrated that several federally assisted programs are so similar in nature and controls over reimbursements so lax that it is relatively easy for a grantee to claim the same expenses twice.

For example, food expenditures are reimbursable under HEW's Head Start and Title XX programs and Agriculture's Child Care Food program. In March we testified that the Department of Agriculture's Office of Audit reported that Chicago's Department of Human Services claimed food reimbursements under both HEW's Title XX program and Agriculture's Child Care Food program, thus receiving reimbursements of $747,000 in excess of actual cost. We also reported that the duplicative payments were recovered by an offset. The overpayment occurred because the city did not report the food service reimbursement received from one agency to the other even though participation in each program requires the city to do so. The Comptroller stated that the city's intent was not to withhold reimbursement information and that the City's procedure is to make an adjustment on the final billing when the grant is completed.

We are not overly concerned whether the withholding of reimbursement information in this case was intentional or the result of an incomplete transaction. What we are concerned about is the fact that expenses were reimbursed by two Federal agencies and that to prevent duplication, funding agencies must rely on the grantees to report reimbursements received under other Federal programs.

The Chicago example is not an isolated case. CEDA received over $76,000 of dual reimbursements for food service costs over a 1-year period. Furthermore, two of the three day care centers we reviewed in Virginia had received duplicative payments totaling $16,000 under Title XX and the Child Care Food program between July 1, 1978, and May 31, 1979. Moreover, the duplication is not limited to grantees, but extends to delegate agencies as well. We noted that several delegates of Chicago's Department of Human Services were claiming reimbursement under Agriculture's Child Care Food Program from the Illinois Office of Education. One of these delegates was being reimbursed by both the Department of Human Services and the Illnois Office of Education for about 20 breakfasts a day served to Headstart children. Based on Agricuture's food reimbursement rate, the Government may have been double billed $2,000 per year.

Another element of cost that is particulary susceptible to dual reimbursement is salary because many day care center employees are hired under various job training and work relief programs including the

--Comprehensive Employment and Training Act Program (CETA),

--Welfare Recipient Employment Program, and

--Work Incentive Program (WIN).

One delegate under Chicago's Title XX program had employees funded under all three of the above programs. Our review disclosed that none of the salaries charged to the Title XX program were reimbursed under these other programs. Thus duplicate reimbursements had not occurred. However, the same delegate was also running a second Title XX day care program which was funded by the Illinois Department of Children and Family Serivces. Salaries for this day care center were charged to the Title XX program under the Illinois Department of Children and Family Services and to the Federal job training programs. The duplicative charges to the Federal Government were about $38,000 for 1 year.

Another group of grants susceptible to dual billing are those relating to weatherization and energy conservation. At Seattle's Community Action Agency we noted some duplicative billing. By June 1978, this agency had received eight CSA Emergency Energy Conservation Program Grants totaling $166,000. In addition, it received $8,839 of Department of Energy weatherization funds from the State Department of Social Health Services.

A June 1978 Department of Social Health Services audit reported that the Community Action Agency had overclaimed $8,000 by inflating material costs and by claiming labor costs which were also billed to the CETA program. In addition, we found three cases in which the agency had double-billed CSA and the State Planning and Community Affairs Agency for weatherization expenses.

In all three cases, costs were charged to, and paid from the CSA weatherization grant, even though these costs were claimed and reimbursed by the State Planning and Community Affairs Agency under the Department of Energy and CSA Special

Crisis Intervention contracts. The items double-billed were

--$341 for office supplies,

--$500 for space rental, and

--$1,000 for salaries.

Another grantee charged nearly $63,000 in salary expenses to a 1978 Emergency Energy Assistance Program grant while charging the same expenses to other Federal grants.

We also noted that one individual received a $21,000 yearly salary from CSA in addition to his renumeration as a full-time employee of a college. Funding for his college job was provided by HEW's Office of Education. His working hours were listed from 9:00 a.m. to 5:00 p.m. for one job and from 8:30 a.m. to 4:30 p.m. for the other. Between February 2 and July 31, 1979, this individual received excess payments of about $10,000.

CONTROL OVER FIXED ASSETS

Safeguarding fixed assets has been a problem at several Community Action Agencies and as a result many assets that have been purchased with grant funds have been stolen, lost, or inappropriately disposed of. Furthermore, neither the Community Action Agencies nor the Federal agencies which provided the funding know how many assets the Community Action Agencies are responsible for.

The Central Area Motivation Program (CAMP) of Seattle, Washington is an example of a Community Action Agency which lost control over its fixed assets. Repeatedly between 1973 and 1978, the CPA firm which performed CAMP's audit reported weaknesses in its procedures for safeguarding fixed assets purchased with CSA funds.

Our review showed that CAMP has not corrected this weakness. For example, on February 28, 1979, CAMP submitted an inventory listing to CSA and certified it to be correct. However, the listing included $3,000 of assets that CAMP's property officer knew were missing. These missing assets included

--one 1968 Ford automobile,

--four lawnmowers,

--three cassette recorders,

--eight miscellaneous items of photographic equipment,

--one microfiche reader,

--one window washer,

--one radio,

--one heater,

--one Panasonic recorder, and

--one electric pencil sharpener

Furthermore, we found that many other assets were missing. For example, we selected for verification 8 of 10 assets purchased in 1978 which cost more than $100 and 6 of 23 assets which cost less than $100. None of the 14 could be located. We also attempted to verify all items of office and photographic equipment contained in CSA's certified inventory. Most items could not be located.

In addition, we could not locate several assets which had been purchased with Model Cities funds. The missing items cost over $11,000 and include

--eleven typewriters

--two lightmeters

--one densitmeter (which is an item of specialized photographic equipment)

--two slide screens

--three calculators

--one check protector

--one letter folding machine

--six items of office furniture (chairs, tables, desks)

--three cameras

--one photo enlarger

--three tape recorders

--one microphone

--one light

--one stereo amplifier

--one mini van, and

--miscellaneous tools, saws, drills, and staple guns.

The Community Action Agency in San Diego, has also had problems controlling fixed assets. In 1975, the County of San Diego succeeded a nonprofit organization as the Community Action Agency serving that area. In February 1979, it requested permission from CSA to delete over $31,000 of fixed assets from its inventory as missing, stolen, or destroyed.

The third Community Action Agency which has not maintained adequate control over fixed assets is the Raleigh County Community Action Association. We looked at vehicle acquisition and disposal in great detail because Association personnel could not provide us with

--an accurate inventory of vehicles on hand,

--a list of vehicles possessed and disposed of since 1964, and

--an explanation of the disposal of 22 vehicles we identified as being possessed by the Association since 1968.

Based upon our review, we determined that this Association possesses and is responsible for at least 37 vehicles. In March we testified that the Association sold 9 vehicles for a total of $64 to individuals with close ties to the Association. Subsequent to the hearings, the Association and the individuals involved in the sale agreed that two of the vehicles would be returned to the Association and another $699 would be paid for the other 7.

Our review disclosed that this was not the only instance where vehicles were disposed of under other than normal circumstances. For example, in June 1977 a 1968 Chevrolet panel truck was sold at public auction to a used car dealer for $100 to satisfy a mechanics lien. In another case, the director gave 18 vehicles to an individual in August 1973 with the accompanying explanation:

"For ***removing said vehicles from the premises***these vehicles are conveyed as junked and will not be accompanied by titles nor will titles ever be available."

We found, however, that on March 9, 1979, three of the vehicles were titled in West Virignia and that title was obtained through local constable sales--i.e., public auctions with proceeds going to the State. The total sales price was $320. These same three vehicles were later resold.

We believe that these three cases indicate that Community Action Agencies are not adequately safeguarding fixed assets which have been purchased with Federal funds. Furthermore, an analysis of the CPA reports of the other Community Action Agencies included in our review indicates that 12 agencies also need to strengthen their controls over fixed assets.

INTERPROJECT LOANS

In our earlier testimony we stated that Cleveland's Council made loans of HEW, CSA, and Agriculture funds between major accounts from May 1973 through January 1979. Our followon work indicates that this is probably a common occurrence in Community Action Agencies and in some cases, CSA has authorized these loans. However, this practice has resulted in Federal funds being expended for purposes other than those intended in grant agreements.

The Seattle Community Action Agency, is one which lost budgetary control over Federal funds by transferring funds among its various grant and non-grant bank accounts. For example, during 1977 and 1978, it made 87 cash loans, totaling about $285,000, to other projects. About $53,000 of CSA funds have not been repaid by the agencies' corporate account, which is used for non-grant activities.

Because the agency had used $53,000 of CSA funds to finance non-CSA activities, it did not have sufficient funds to liquidate obligations incurred under the CSA grant. As a result, in December 1978, CSA awarded it an additional $100,000, of which $63,000 was to be used to cover obligations of expenditures through December 1978.

The Seattle agency has not established procedures to prevent interproject loans. In fact, we found that such loans are continuing; some even with CSA approval. For example, between January 1 and May 31, 1979, the agency loaned $12,000 of CSA funds to HEW and Labor Department projects with the approval of the CSA regional chief of operations.

The Community and Economic Development Association of Cook County has also made loans. For example, in January 1977, with CSA approval, it loaned $75,000 to the Community Action Agency of Indianapolis. In addition, in June 1975, it loaned $20,000 of CSA funds to the Village of Robbins, Illinois to renovate a building to be used for grant purposes. No repayment was received until April 1978 when the Community

Action Agency paid Robbins $14,000 for Head Start program space rental which Robbins applied against the loan. The balance of $6,000 is still outstanding. The agency has also made interprogram loans of Head Start funds to its Women, Infants, and Children program.

In addition, the CPA reports of the Community Action Agencies included in our review indicate that the following agencies have also engaged in interproject loans: Newark, New York, Washington, D.C., Richmond, Pittsburgh, Birmingham, Atlanta, San Antonio, Philadelphia, and Memphis.

OTHER ABUSES AND ERRORS

Our review disclosed numerous other instances of program abuse and errors. I am prepared to discuss some of these and provide additional details if you so desire. These include the following:

--An underpayment of $23,500 for employee Federal income tax withholding and FICA taxes.

--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 $16,600 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 $225,000 of employee wages as personal service contracts, resulting in a potential 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 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 administrative 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 buildings constructed or subsidized with Federal funds as local matching share.

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

--Several assets were not recorded in the agency's accounting records, including bank accounts and parcels of real estate.

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

--Charging a Head Start program with $90,000 of unallowable food service costs.

--An unusual $3.4 million Head Start contract between the City of Detroit Neighborhood Services Department and a delegate agency under which the Department's director of child development maintained control over the program, and the delegate became a depository of money. This relationship resulted in bypassing city hiring and purchasing controls and lead to the misuse of Head Start funds. For example.

  --Department personnel possess and use vehicles purchased by the delegate agency; some use was considered personal.

  --Department personnel directed the purchase of $8,000 of photographic equipment, including laboratory supplies, while none of the Head Start centers had laboratory facilities.

  --the Director used delegate funds to purchase $30,000 of office equipment for use by the Department. The items purchased included a $650 couch, a $680 laminating machine, a $650 typewriter, 9 bookcases which cost $1,400, and office partitions which cost $11,000.

--the Director instructed the delegate to award consulting contracts totaling $42,000; a partner of one firm was a Head Start employee.

--three delegate employees actually worked for the Department.

--The Head Start program was charged $10,000, which was used by a delegate as a down payment on a building but was recorded as an advance of initial renovating and operating expenses of a new Head Start facility. The building has not been renovated nor used for Head Start program purposes. However, the Community Action Agency charges $700 monthly to the Head Start program as rental expense for this building.

CORRECTIVE MEASURES - CLEVELAND

Since the March 1979 hearings, the Council's new Executive Director has (1) refunded about $152,000 of inactive and excess funds to the Federal agencies, (2) corrected payroll abuses of employees not working the required hours, and (3) reduced the excess funds. Two Council staff members involved in apparent irregularities have resigned, and HEW, CSA, Agriculture, and Energy have initiated the first "single audit" at the Council. Furthermore, HEW is currently investigating the criminal aspects of fraud and abuse disclosed in our work.