



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



04606
COMMUNITY AND ECONOMIC
DEVELOPMENT DIVISION

B-153449

JAN 6 1978

The Honorable
The Secretary of Commerce

Dear Madam Secretary:

We have reviewed expenditures charged by the Governor's Office of the State of Connecticut to grants made by the New England Regional Commission (NERCOM) from funds provided by the Secretary of Commerce. We initiated the review as a result of questions raised by the Auditors of Public Accounts of the State of Connecticut during their audits of fiscal years 1974 and 1975 grants to the Governor's office. The Connecticut Auditors questioned whether the State Management Grant (SMG) funds and fiscal year 1975 Energy Capability Grant funds had been used to further grant objectives.

We examined SMGs and related budgets for fiscal years 1974 through 1976, selected expenditures for fiscal years 1974 and 1975 as well as selected expenditures charged to the fiscal year 1975 Energy Capability Grant. We discussed the grants and the uses made of funds with representatives of NERCOM, the Governor's office, and a former Governor's representative (the State Alternate) to NERCOM. We also discussed and examined selected working papers of the Connecticut Auditors of Public Accounts and a firm of certified public accountants NERCOM hired to make a limited audit of the fiscal years 1974 and 1975 SMGs and the fiscal year 1975 Energy Capability Grant.

SMGs were made to improve the Governor's office capabilities to plan and manage State economic development efforts. However, the grant funds were used for general expenses of the Governor's office, and State records do not show that the expenses related to grant purposes. In addition, the State program plans that NERCOM accepted were very general and did not show how the planned projects related to the grant purposes. The State budgets also did not detail how the funds were to be used.

CED-78-20
(990711)

B-153449

NERCOM did not provide specific guidance to the State on how the funds could be used and accounted for. Similarly, the Department of Commerce guidelines to all regional commissions did not identify examples of proper and improper fund use or accounting methods. We believe the Department should issue such guidance to assure better management of grant funds.

Our recommendations are presented on pages 14 and 15.

REGIONAL COMMISSIONS

NERCOM was established under title V of the Public Works and Economic Development Act of 1965 (Public Law 89-136), as amended. The act authorizes the Secretary of Commerce to designate "economic development regions" with the concurrence of participating States and solicit States within these areas to establish a multistate regional commission. A commission includes a Federal cochairman and the Governors of the member States, who elect a State cochairman. One role of Federal cochairmen, who are Federal employees appointed by the President, is to actively present to their commissions the policies and viewpoints of the Federal executive branch.

STATE MANAGEMENT GRANTS-- AUTHORITY, OBJECTIVES, AND BUDGETS

The act also authorizes the Secretary of Commerce to make Federal grants-in-aid to the commissions, which in turn may make grants-in-aid to State or local government agencies for planning, investigations, studies, demonstration projects, and training programs to further the purposes of the act. Under this authority NERCOM awards SMGs of \$150,000 annually to each of the six New England Governors. In his fiscal year 1974 review of NERCOM programs, the Federal cochairman included the following statement on the purposes of SMGs:

"Each State receives \$150,000 this Fiscal Year to provide technical assistance funds for the purpose of improving the Governor's offices' capability to plan and manage the economic development efforts of the respective States. The State determines the

B-153449

utility of the funds and files a plan with the Commission, outlining the projected use of the funds. The efforts of the State generally take the form of activities designed to increase the States' ability to plan and implement development programs more directly." (Underscoring supplied.)

The objectives of fiscal years 1974, 1975, and 1976 SMGs to Connecticut are similar, although there are some differences in wording. The grants required the State to submit a program plan describing activities to be performed, a performance schedule, a statement describing how the activities would enhance the State's capability to plan for and manage economic development, and a budget of expenditures for each activity. We could not determine whether the State submitted a program plan for the 1974 grant. Neither NERCOM nor State officials could furnish us with a copy of it. The 1975 program plan stated that the grant would be used to provide staff assistance and operate two regional offices, increasing the Governor's decisionmaking capability and improving coordination of executive branches. The plan further stated that staff assistance would make the Governor's office accessible to Connecticut citizens and enable the Governor to meet his responsibilities relating to the State's economic well-being.

The fiscal year 1976 plan stated that SMG funds would be used to

- provide staff assistance for continuing liaison between the Governor's office in Hartford and all State executive agencies;
- operate and maintain the Stamford and Norwich regional offices, which were to help provide a wide variety of State services to citizens, businessmen, and local government leaders and provide a personal touch and convenient access to Government in any areas away from the Capitol; and
- provide staff assistance to maximize services to the people of Connecticut and increase the State's ability to deliver the services and information more efficiently and effectively.

B-153449

In our opinion, the State's 1975 and 1976 program plans did not describe specific activities that would increase the State's capability to plan for and manage economic development. The planned activities were mostly of a general nature, dealing with day-to-day relationships between the Governor's office and various State and local government agencies and private citizens.

The 1975 and 1976 budgets each were:

Personnel services	\$129,000
Operation of Stamford office	10,500
Operation of Norwich office	<u>10,500</u>
	<u>\$150,000</u>

The Governor's business manager stated that the amount for personnel services included salaries for the Hartford, Stamford, and Norwich offices.

GRANT GUIDANCE AND MONITORING

Guidance on how grant funds may be used and monitoring this use needs to be improved. We could not tell from State or NERCOM records how much SMG funds were used to further specific grant objectives because expenditures were recorded by type of expense rather than program activity. According to the business manager, some personnel charged to SMG are not always performing tasks related to grant objectives. For example, an individual might work on general government matters, even though the individual's time and salary are charged exclusively to SMG. The business manager stated that records showing what an employee actually does are not maintained and that it is impossible to estimate the amount of time employees are working on grant-related or other tasks.

The business manager also stated that SMG funds are considered in establishing the Governor's office budget. Personnel requirements to be charged to the General Fund are based on the availability of SMG funding for use as salaries. Additional personnel needed after budget approval by the legislature are arbitrarily charged to SMG.

NERCOM guidance and monitoring

During our review in May 1976, (and as recently as July 1977) NERCOM had not issued written guidance to any member State on the use of SMG funds. Connecticut was using SMG funds according to a May 1974 memorandum from the State Alternate to the business manager which stated, in part, that SMG:

"* * * provided funds to the Governor's Office for the support of the Governor's programs to improve the State's capability to plan and manage for development, taking advantage of opportunities identified within the State. The funds provided under this grant are for use at the Governor's discretion according to his priorities."

Members of the NERCOM staff told us, however, that the use of SMG funds has been discussed with State officials. Further, they disagreed with the State Alternate's contention that the use of SMG funds was discretionary.

The use of SMG funds was discussed at meetings of the State Alternates in early 1974. According to minutes of the meetings, a revised agreement was proposed for fiscal year 1975 grants that would

--restrict the use of SMG funds to economic development projects instead of economic and social development projects as allowed by the fiscal year 1974 grants and

--require that \$25,000 of SMG funds be spent for professional assistance to the State Alternates. The fiscal year 1974 SMG had provided that up to 25 percent of the grant be spent for this purpose.

The minutes indicate that four Alternates objected to the new language as limiting their Governors' flexibility. One felt that the proposed language was not significantly different from the prior year, and one did not comment. The fiscal years 1975 and 1976 SMGs limited the funds to economic development but provided only that a "substantial portion" be used to assist the State Alternates.

B-153449

In September 1974, the Governor of Connecticut wrote to the Federal cochairman expressing displeasure with the 1975 SMG agreement because he felt it limited his management flexibility. In October 1974, the Connecticut State Alternate wrote to the Federal cochairman objecting to the absence of specific NERCOM guidance as to how SMG funds could be used. She further stated that all the Alternates had asked for such guidance. As of July 1977 NERCOM had not issued such guidance.

The State grant activity quarterly reports provide little assurance that SMG funds are being used for intended purposes and, in some cases, should have raised questions as to whether they were. For example, the progress report for the quarter ended December 31, 1974, stated:

"The above grant has allowed the Governor's Office to maximize its services to Connecticut taxpayers in a more efficient and effective manner.

It enables the Governor to provide staff assistance in the Capitol Office and to operate the two regional offices, in Stamford and Norwich.

On a day to day basis, one can easily see that staff coordination with State Agencies has been increased and that we are continuing to meet our goal of making State Government more accessible to the people."

In our opinion, these comments bear no direct relationship to SMG objectives of increasing the State's capability of planning and managing its economy and improving coordination among State agencies, and this should have alerted NERCOM officials to a potential problem. However, NERCOM took no decisive actions.

Department of Commerce guidance to
and oversight of NERCOM

A NERCOM official advised us that Department of Commerce oversight of regional commissions is not well defined. He stated that the regional commissions were given much flexibility and latitude in the authorizing legislation. As a result, he said NERCOM has as guidance only the act itself

B-153449

and the "Guidelines to Federal Cochairmen and Regional Commissions" issued by the Secretary on March 17, 1970.

We found nothing in the act or the Department's Guidelines specifically identifying examples of proper fund use. We also found that Department of Commerce audit coverage of NERCOM grants has been limited. A Department audit official told us that his office has not audited NERCOM recently and has not reviewed SMGs because of staffing constraints. He said that auditing NERCOM is not a high priority assignment.

FEDERAL MANAGEMENT CIRCULAR 74-4

In our opinion, accountability for SMGs as well as other grant funds could be improved by requiring regional commissions to adhere to the requirements of Federal Management Circular (FMC) 74-4 of July 18, 1974, which establishes principles for determining costs applicable to grants and contracts with State and local governments. This circular replaced Office of Management and Budget Circular A-87 of May 1968, with no substantive changes.

FMC 74-4 requires documentation of allowable costs under a grant program. In general, the grantee must demonstrate that (1) the costs conform to applicable laws, regulations (including FMC 74-4), and other governing limitations, (2) the costs are necessary and reasonable for the efficient conduct of the grant program, and (3) where a cost benefits more than one grantee activity, the costs are charged only to the extent of the benefits received.

In some cases documentation, such as timecards or log-books, will adequately support an allocated cost. In other cases, where the amount of benefits received is not readily identifiable, the costs must be pooled and equitably distributed to all benefiting activities according to Circular provisions.

In our opinion, adherence to the cost principles of FMC 74-4 would have eliminated many questions raised in our review and the State of Connecticut Auditors' reviews. Accordingly, we asked the NERCOM Legal Counsel if he considered that FMC 74-4 applied to its grants to member States. He stated that he had not considered this possibility. Subsequently, by separate letters of January 29, 1976, he requested

B-153449

guidance from the Department of Commerce General Counsel and the Office of Federal Management Policy, General Services Administration, 1/ in answering our question, since NERCOM is thought of as a Federal-State entity and FMC 74-4 applies to Federal agencies.

Subsequently, NERCOM furnished us with a copy of a September 2, 1975, Department memorandum advising all Federal cochairmen that the requirements of FMC 74-4 should be applied to regional commission grants to State and local governments. The memorandum noted that because the commissions were not Federal agencies, the circular was not automatically applicable. However, the memorandum further stated that commission technical assistance grant funds are directly traceable as Federal funds and that adopting FMC 74-4 would establish a consistent and uniform method for program management among all commissions. NERCOM officials said they did not implement FMC 74-4 because the wording of the September 2, 1975, memorandum was vague.

In a July 13, 1976, letter, the Chief, Financial Management Branch, Office of Management and Budget (OMB) advised the department that OMB's position on the applicability of FMC 74-4 to regional commissions was:

"* * * we have encouraged Commissions to use the Circular (and other related Circulars), without trying to make a legal determination as to whether they must use them. We just think it is good management practice, and brings some uniformity and consistency to the paperwork jungle that has characterized Federal assistance in the past."

In an August 2, 1976, memorandum to all Federal cochairmen, the Acting Special Assistant to the Secretary for Regional Economic Coordination cited our inquiry and quoted OMB's position. He thought the position was sensible and hoped that all commissions would view it as such and conduct

1/The Office of Federal Management Policy has since been moved to the Office of Management and Budget and redesignated the Financial Management Branch, Budget Review Division.

B-153449

their business accordingly. However, the Special Representative to the NERCOM State Cochairman subsequently advised us that NERCOM is opposed to implementing FMC 74-4 and that all regional commissions hold the same viewpoint.

We agree with the position taken by OMB and concurred in by the Acting Special Assistant. Our findings relating to the NERCOM SMGs to Connecticut show a need to establish firm guidelines for determining costs applicable to commission grants of Federal funds to State and local governments. Since FMC 74-4 is already applicable to all other Federal grants for such activities, we believe its requirements should be made applicable to commission grants also, to provide recipients with a single set of criteria for charging Federal grants.

Since the commissions do not appear to be willing to adopt FMC 74-4 requirements voluntarily, the Secretary of Commerce should, under the authority of section 701(12) of the act, require the commissions to do so. This section authorizes the Secretary to establish rules, regulations, or procedures necessary to carry out the provisions of the act.

USE OF GRANT FUNDS

The following summarizes how grant funds were used.

SMG funds

Fiscal year 1974 expenditures

According to the Connecticut Auditors' report, the following is the fiscal year 1974 SMG activity.

Balance, beginning of year	\$ 46,710.53
Revenue	<u>151,252.00</u>
	197,962.53
Expenditures	<u>189,868.81</u>
Balance, end of year	<u>\$ 8,093.72</u>

The total salaries, wages, and fringe benefits for 11 full-time and 2 part-time Hartford employees were paid from

B-153449

SMG funds. This amounted to \$100,777, or about 53 percent of the total expenditures in fiscal year 1974. Twelve employees were assigned to a clerical pool in the Governor's office and performed general office work; the others did public relations work. Two employees at the Stamford office and one at the Norwich office were also paid from SMG funds.

A similar situation exists with other types of expenditures. About \$89,000 (47 percent of total) charged to SMG was used to purchase services, material, and supplies. About \$37,307 was used for general operating expenses. Major items were: office supplies--\$20,143; postage--\$9,015; telephone and telegraph costs--\$4,596; and travel expenses--\$1,687. The business manager stated that such expenses are charged where funds are available. No attempt is made to allocate costs on the basis of benefit. Therefore, the State has no basis for showing whether these expenditures represented a proper charge to the grant.

In our review we also found that \$7,376 was charged to SMG for legal fees and expenses of the State Commission on Tax Reform. According to the 1974 Connecticut Auditors' report, this commission had a grant from NERCOM with a balance of \$326 at the end of fiscal year 1974. Although the expenses of this commission appear related to economic development, we found nothing to indicate how they related to any specific plan to increase the State's capability to plan for and manage economic development.

In their letter of July 10, 1975, to our Boston Regional Manager, the Connecticut Auditors questioned whether the following fiscal year 1974 expenditures (included in the \$89,000 above) conformed to SMG grant purposes.

B-153449

Payments to an advertising agency in connection with a series of community forums conducted by the Governor	\$15,566.42
Newspaper subscriptions	1,461.50
Net cost to Governor's office for Governor's Information Bureau lapel pins	6,860.90
Contribution to the New England Governors' Conference	8,000.00
Contribution to the National Governors' Conference	7,000.00
Payments to members of the Governor's Council of Economic Advisors for fees and travel	<u>1,822.38</u>
	<u>\$40,711.20</u>

Because of the questions raised by the Connecticut Auditors, NERCOM engaged a firm of certified public accountants to audit the State's use of the funds. The accounting firm, which had limited its review to the six transactions listed above plus two others discussed later, concluded that the six were proper charges to the 1974 SMG. The NERCOM Director of Monitoring, on the basis of the firm's findings and the opinion of the NERCOM Legal Counsel, notified the Governor on October 15, 1975, that the questioned expenditures were proper charges to SMG.

As shown, the six items are very general expenses which could be related to economic development in a broad sense. However, we found nothing to indicate how they related to any program plan or statement describing how the activities would enhance the State's capability to plan and manage economic development, as required by the grant agreement.

Fiscal year 1975
expenditures

According to the fiscal year 1975 Connecticut Auditors' report, the State received and spent fiscal year 1975 SMG funds as shown on the following page.

Balance, beginning of year	\$ 8,093.72
Grant funds received in fiscal year 1975	a/ <u>115,000.00</u>
	123,093.72
Expenditures	<u>100,763.79</u>
Balance, end of year	\$ <u>22,329.93</u>

a/The remaining \$35,000 of the fiscal year 1975 SMG was received in fiscal year 1976.

Generally, fiscal year 1975 SMG funds were used in the same manner as fiscal year 1974 funds. Expenditures for salaries and fringe benefits totaled \$65,932.01. The business manager stated that she could not identify how much of these expenditures were used for SMG purposes.

A significant portion of the remaining \$34,831.78 of expenditures appear to have been used for nongrant purposes. For example, the Connecticut Auditors in their letter to our Boston Regional Manager and the accounting firm in its report to NERCOM pointed out that \$3,520 had been used to purchase typewriters, although the grant specifically prohibited equipment purchases. State officials advised us that the State subsequently reimbursed the grant for this amount. About \$2,994 was used to pay for the Governor's proclamation for events such as "Lief Erikson Day," which appear to us to be a questionable use of SMG funds. Fees of \$1,850 related to a lawsuit on school segregation, which appear to be general governmental expenses, were also charged to the grant.

Other charges appear to be for general office expenses, some portion of which may be chargeable to the grant, although the business manager could not say how much. For example about \$14,000 was charged for typewriter rental and supplies, reproduction machine rental, postage, and subscriptions.

Use of energy capability grant funds

Professional services fees of \$4,988 were charged to the Energy Capability Grant in fiscal year 1975. This grant was to improve the State's capability to plan and manage economic

development programs involving energy problems and to allow the State to respond to energy problems. This \$4,988 related to hiring two expert witnesses to rebut testimony against the State in a lawsuit on the equalization of school districts. In their letter to our Boston Regional Manager, the Connecticut Auditors questioned charging these fees to the Energy Capability Grant. The accounting firm, in its report to NERCOM, recommended that they be charged to SMG rather than the Energy Capability Grant. In our opinion, these fees are costs of general government and it appears questionable to charge either grant. The Connecticut Auditors' report on fiscal year 1975 shows that these fees are still charged to the Energy Capability Grant.

CONCLUSIONS

Major portions of fiscal years 1974 and 1975 SMG funds were used for general expenses of the Governor's office or for expenses which can only be broadly related to the grant objectives of increasing the State's capability to plan and manage for economic development. In addition, \$3,520 was used to purchase typewriters although the fiscal year 1975 SMG specifically prohibited such purchases; however, the State subsequently reimbursed the grant for this amount. We also consider highly questionable the use of \$4,988 of the fiscal year 1975 Energy Capability Grant funds to pay expenses related to a lawsuit on the equalization of school districts.

DISCUSSIONS WITH NERCOM, STATE, AND ACCOUNTING FIRM OFFICIALS

We have discussed the contents of this letter with NERCOM's Director of Monitoring and with representatives of the Governor of Connecticut and the accounting firm.

The NERCOM Director of Monitoring initially stated that expenditures cited in this report were grant-related based on his interpretation of grant objectives. At a later date, he stated that Connecticut officials recognized the purchase of typewriters was unallowable under SMG terms.

Representatives of the Governor of Connecticut said the State had reimbursed the fiscal year 1975 SMG for the cost of the typewriters. They reemphasized that NERCOM had never provided specific guidance on the use of SMG funds and believed that the other charges were proper because NERCOM had never

taken exception to them. They indicated the State would follow whatever guidance NERCOM provides.

The accounting firm official provided no comments.

RECOMMENDATIONS

Although our review was limited to examining expenditures of fiscal years 1974 and 1975 SMGs and the 1975 Energy Capability Grant to Connecticut, we believe that the underlying causes of the problems identified may also apply to SMGs in other NERCOM member States because (1) all State Alternates sought, but apparently did not receive, NERCOM guidance on the proper use of SMG funds and (2) Department of Commerce auditors have never audited in detail any NERCOM grants.

Accordingly, the Secretary of Commerce should require NERCOM to

- insure that SMGs to all member States provide clear statements that grant funds are to be used to increase the State's capabilities to plan and manage economic development,
- require States to submit plans and budgets specifically indicating how funds will be used to meet grant objectives, and
- improve its guidance to States in the proper use of SMG funds and its monitoring of such use.

We further recommend that the Secretary (1) direct Department auditors to audit SMGs to all other NERCOM member States to determine if unallowable expenditures have been charged and (2) recover such unallowable expenditures when appropriate.

The Secretary should also direct Department auditors to review the adequacy of the guidance provided by other regional commissions to their member States on the use of grant funds and, if such guidance is found to be limited, to audit the States' use of grant funds.

Finally, to insure proper charging of costs to Federal grant funds in the future, the Secretary should require all

B-153449

regional commissions to provide that costs charged to their grants to State and local governments be in accordance with the provisions of FMC 74-4.

As you know, section 236 of the Legislative Reorganization Act of 1970 requires the head of a Federal agency to submit a written statement on actions taken on our recommendations to the House Committee on Government Operations and the Senate Committee on Governmental Affairs not later than 60 days after the date of the report and the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report.

We are sending copies of this report to the Acting Director, Office of Management and Budget; the NERCOM Federal Cochairman; the Deputy Undersecretary for Regional Affairs and the Director, Office of Audits, Department of Commerce; the Governor of Connecticut; the NERCOM State Cochairman Special Representative; the above mentioned four congressional committees; and various other congressional committees.

Sincerely yours,



Henry Eschwege
Director