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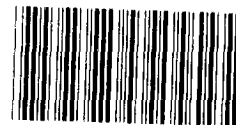
Report To The Congress

OF THE UNITED STATES

Weak Financial Controls Make The Community Services Administration Vulnerable To Fraud And Abuse

The Community Services Administration spearheads the Nation's war on poverty, but its mission is being jeopardized by poor internal controls over fiscal and managerial activities at all levels. Weak controls make the agency highly susceptible to fraudulent acts as well as nonintentional misuse of Federal money programed to assist poverty stricken members of society. GAO identified many weaknesses that have set the stage for abuses of Federal money.

This report recommends that the Community Services Administration vigorously enforce its requirement for strong internal controls at its headquarters, regional offices, and local community grant recipients.



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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548


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To the President of the Senate and the
Speaker of the House of Representatives

This report provides a risk profile of the Community Services Administration's susceptibility to fraud and other illegal acts. It describes weaknesses in fiscal and managerial internal controls which have led to or can lead to abuses and misuses of Federal funds and assets at all organizational levels of the Community Services Administration, including grantees. The report also contains recommendations to the Director, Community Services Administration outlining ways to reduce the agency's vulnerability to fraud, waste, abuse, and error.

This is the first in a series of reports we will issue on the vulnerability of selected Federal agencies and programs to fraud and abuse. The review was undertaken by our Fraud Prevention Task Force which was established to respond to growing public concern over abuses and misuses of taxpayer money.

Copies of this report are being sent to the Director, Office of Management and Budget and the Director, Community Services Administration.


Comptroller General
of the United States



D I G E S T

GAO has testified before the Congress three times on embezzlement, apparent abuse, and questionable transactions involving grantees of the Community Services Administration (CSA). This study was made to determine (1) whether CSA itself had a system of internal controls to adequately protect against fraud, theft, and abuse and (2) how grantees protect against improper use of Federal funds and the assets purchased with Federal funds. GAO found weaknesses in controls in both CSA and its grantees.

Internal controls are checks and balances that organizations set up to spread out work in such a way that a person or function checks on what another person or function does. These checks can detect errors and make fraud and related illegal acts more difficult. Each Federal agency is required by the Budget and Accounting Procedures Act of 1950 to maintain adequate systems of internal control.

CSA and its grantees annually handle about \$2 billion in Federal, State, local, and public funds. Some of this money is appropriated to other agencies but is spent by grantees whose operating expenses are provided by CSA.

BETTER INTERNAL CONTROLS NEEDED

CSA makes insufficient and untimely reviews of grantee cash requests and quarterly expenditure reports used in the automated cash management system. As a result, through the letter-of-credit system grantees continue to receive and maintain excess cash which could be used by the Government until needed by grantees. Some improvements to the cash management system have been made but do not entirely correct the problems. (See p. 8.)

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✓ Funds available for CSA's employee payroll and grants are not sufficiently protected. The computer system, which is used to process grants and employee payroll, lacks descriptive documentation. Programs and changes to them are not properly approved or independently tested. (See pp. 7 and 25.)

Two basic techniques commonly used in automated payroll systems--record counts and predetermined control totals--were not being used. CSA officials stated that present manual controls make unauthorized manipulation of data a remote possibility. However, the lack of these controls facilitates adding, losing, or altering documents during processing without detection. (See p. 12.)

CSA has no uniform method of handling cash receipts, thus making them more susceptible to loss or error. (See p. 13.) Its property records did not reflect the location of furniture or equipment because there is no central file of furniture or equipment. (See p. 14.) Some equipment purchased with Federal funds could not be found. (See p. 15.)

Physical security at CSA's computer facility was poor at the time of GAO's review, making both the facility and the accounting records highly vulnerable to fraud, abuse, and destruction. Unauthorized entry was easy through broken windows and unlocked doors. There have been three fires at the location since March 1978, and trash strewn throughout the facility creates a continual fire hazard. The General Services Administration--the building leasee--has since corrected many of these deficiencies; however, some still exist. (See p. 18.)

CSA has not submitted an acceptable accounting system design for the Comptroller General's review and approval. However, CSA officials have informed us that they are in the process of selecting a contractor to assist them in developing and implementing an approved accounting system. (See p. 16.)

GAO visited eight CSA grantees, which received almost \$17 million from CSA and more than \$29 million from other Federal, State, and local sources in fiscal 1979. These funds as well as assets bought with grant money were not only vulnerable to fraud and abuse but in some cases, had actually been misused. Grantees had not implemented good internal control systems despite (1) numerous CSA publications providing guidance on ways to establish sound internal control over functions performed and (2) repeated recommendations to improve internal controls made by independent public accounting firms.

One grantee was not depositing employee payroll deductions for medical insurance in a self-insurance fund as it was supposed to be, and it could not account for what had been done with these funds because of poor internal controls. Since funds were not available to pay employee health claims, the grantee used over \$73,000 of CSA's funds to pay for medical claims. (See p. 44.)

At several grantees, payroll duties were not properly separated among employees. Usually, one or two persons controlled payroll additions, deletions, and calculations as well as the distribution of paychecks without any supervision. At one grantee, persons had been placed on the payroll and paid without proof that they were employed. In at least one instance, an employee remained on the payroll for more than 3 months after quitting. (See p. 42.)

Purchasing and property management functions were performed by just one or two persons at many grantees. These individuals prepared purchase orders, placed orders, received goods, recorded items in inventory records, maintained inventory records, and periodically conducted physical counts of inventories to make sure nothing was lost. GAO found postdated purchase orders, receiving reports that were written in advance and predated, inaccurate inventory records, and many items missing from inventory. (See pp. 45 and 57.)

One grantee with an \$11.5 million budget had failed to sufficiently define the needed qualifications for a controller and had hired an individual with only limited experience as an accounting technician. As a result of internal control weaknesses for which she was responsible, the controller resigned. (See p. 59.)

CSA management has not taken aggressive action on audit findings at grantee organizations. Some of the same deficiencies consistently reappear on audits. GAO found deficiencies which still had not been corrected during its audit. CSA is following up at these locations. (See p. 28.)

Annual grantee audits are often not conducted in accordance with CSA requirements or Comptroller General standards for internal controls. As a result, not all areas are adequately reviewed. (See p. 32.) Grantees can still easily misuse funds, intentionally or accidentally, without being detected because auditors audit only specific segments of grantees' total funding at a time. Therefore, it is possible for grantees to charge incorrect programs or, in some instances, charge several times for the same expense and the auditors would not detect it. GAO recommended in an earlier report to the Office of Management and Budget that only one Federal agency be responsible for auditing all funds received by a grantee. OMB is currently working to make this a reality. (See p. 36.)

Until its recent fiscal 1981 budget request, CSA had not requested or provided additional auditors despite earlier statements to the Congress that it would. Consequently, audits of internal office operations and some CSA-sponsored programs have been insufficient. Many of the internal control weaknesses at grantees, headquarters, and regional offices could have been identified and corrected by CSA if its auditors had assessed the adequacy of internal controls over tasks and functions being performed at grantee and Federal levels. (See p. 39.)

The Congress is considering legislation that would give Federal agency heads greater responsibility for improving their agencies' financial systems. Basically, this legislation would require agency heads to evaluate their organization's systems of internal control and report the results annually to the Congress and to the President.

This legislation would strengthen the accountability aspects of the Accounting and Auditing Act of 1950. (See p. 60.)

CONCLUSIONS AND RECOMMENDATIONS

CSA's weak position on internal controls influences its regional offices and grantees. Many regional offices and grantees, in addition to those GAO reviewed, may be vulnerable to fraud and abuse. To improve its internal control, top management needs to take direct interest in seeing that control procedures are carried out effectively. GAO believes this is important for CSA as well as for other Federal agencies and supports the pending legislation which would accomplish this Government-wide.

At most of the locations GAO visited, internal controls can be strengthened at little or no additional cost. At the end of each chapter of this report, GAO has made specific recommendations regarding those changes.

In summary, GAO recommends that the Director of CSA should more vigorously enforce requirements for adequate systems of internal control by:

- Reemphasizing to all management levels the significance of good internal controls and the necessity for managers to make sure that their tasks and functions are adequately controlled. (See p. 17.)
- Reducing or suspending funding of grantees (in conjunction and coordination with other Federal agencies providing funding) who are repeatedly found to

have inadequate internal controls and/or withdrawn excess Federal cash. (See pp. 17, 39, and 61.)

- Implementing a timely and accurate grant monitoring system. (See p. 17.)
- Correcting the remaining computer security and system control deficiencies. (See pp. 17 and 27.)
- Enforcing the requirement that grantee audits be conducted in accordance with its established regulations, Comptroller General standards, and the "Guidelines for Financial and Compliance Audits of Federally Assisted Programs." (See p. 40.)
- Establishing minimum monitoring requirements that regional and headquarters personnel and grantees must exercise over organizations to which they provide funds. (See p. 62.)
- Documenting headquarters', regional offices', and grantees' internal controls during the audit process. (See pp. 39 and 40.)

AGENCY COMMENTS

CSA contends that this report conveys a misleading view of management, ignores pertinent facts, presents distorted statements, and is not an accurate portrayal of its concern for accounting and managerial controls. Yet, the agency generally agreed with and, in several instances, has already begun implementing GAO's recommendations.

GAO has carefully evaluated CSA's rather lengthy comments. (See app. III.) In a few instances revisions have been made, as appropriate, in the body of the report to clarify specific points or to update information provided by the agency. The report presents the current situation at CSA.

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ABBREVIATIONS

CAA	Community Action Agency
CDC	Community Development Corporation
CSA	Community Services Administration
GAO	General Accounting Office
GSA	General Services Administration
IPA	Independent Public Accounting
OMB	Office of Management and Budget

CHAPTER 1

INTRODUCTION

The General Accounting Office created a Special Task Force for the Prevention of Fraud and Abuse in response to growing public concern over abuses and misuses of taxpayer money. This report, concerning the Community Services Administration (CSA), is the first of several reports we will issue on the vulnerability of selected Federal agencies and programs to fraud and abuse.

DESCRIPTION OF VULNERABILITY ASSESSMENTS

Vulnerability assessments are designed to show the susceptibility of Government agency programs to fraud and other illegal acts by evaluating the adequacy of internal controls over activities concerned with authorizing, processing, recording, reporting, and safeguarding Federal funds and assets. Quite simply, internal controls are checks and balances over all activities of an organization (both fiscal and managerial) that are designed to prevent the misuse or abuse of its money or property.

A good system of internal control can discourage and minimize fraud, abuse, error, and waste because of two important features--the (1) separation of duties within the system and (2) procedures which govern the authorization, preparation, review, and flow of all transactions through the system. Thus, to succeed in abusing Federal programs or in defrauding an organization having sound internal controls, an individual must have the help of others.

Supervisors must play an active role in reviewing operations to ensure that controls are in place and working. They cannot rely only on auditors to detect weaknesses or abuses of control systems because they may detect problems too late. Audits normally deal with transactions that have already transpired, and then only a few of them.

Because of the importance of good financial management systems which rely heavily on good internal controls, we have issued several publications on this subject. One of the most important is our Policy and Procedures Manual for Guidance of Federal Agencies. Among the important things this manual contains are accounting principles and standards prescribed by the Comptroller General; principles and standards relating to the development, installation, and operation of that part of agencies' financial management systems concerning fiscal operations; and guidelines and principles for agencies' internal auditing efforts. Several other documents have been

issued concerning the necessity for a good financial management system. Inherent in these publications is the fact that financial management systems are only as good as the internal controls which govern actions and information affecting the systems.

Recognizing the need for strong internal controls over Government operations, the Congress enacted the Budget and Accounting Procedures Act of 1950 which, among other things, placed the responsibility for establishing and maintaining adequate systems of accounting and internal control upon the head of each executive agency. More recently, the Congress passed legislation establishing Inspectors General in 14 agencies.

COMMUNITY SERVICES ADMINISTRATION'S
PURPOSE AND PROGRAMS

CSA was created in January 1975, as the successor to the Office of Economic Opportunity. Its mission is to focus all available local, State, private, and Federal resources on the goal of enabling low-income families and individuals of all ages to obtain the skills, knowledge, motivations, and opportunities needed to become self-sufficient.

CSA activities are authorized under the Economic Opportunity Act of 1964, as amended, by the Community Services Act of 1974, and the Economic Opportunity Amendments of 1978. Presently, CSA activities fall under six legislative titles. Fiscal 1979 appropriations by title are shown below:

	<u>Title</u>	<u>Appropriation</u> (000 omitted)	<u>Percentage</u> <u>distribution</u>
I	Research and Demonstration	\$ -	- %
II	Community Action Programs (Grants)	661,500	89.1
IV	Assistance to Migrant Workers	1,000	0.1
VI	Program Administration	33,183	4.5
VII	Community Economic Develop- ment (Grants)	46,170	6.2
IX	Program Evaluation	<u>1,000</u>	<u>0.1</u>
	Total fiscal 1979 appropriation	<u>\$742,853</u>	<u>100.0%</u>

Community action programs, Title II, are administered by 878 Community Action Agencies (CAAs), funded annually by CSA, and are designed and directed primarily to meet local needs. CAAs develop their own approaches to meeting the problems of poverty in their locale. However, some poverty problems cut across local boundaries and have a national effect. CAAs also develop programs to attack these broader problems. For example, programs are developed for community food and nutrition; energy conservation and emergency assistance; senior opportunities and services; summer youth recreation and sports; rural housing and rehabilitation; and migrant workers. Funds provided to CAAs under this title are for salaries and other administrative expenses as well as for specific programs.

Most CAAs are funded through and monitored by 1 of CSA's 10 regional offices. They operate through a network of community centers and delegate agencies which are grantees funded by CAAs and which are staffed by professionals and/or neighborhood residents. Ninety percent of all CAAs are private, non-profit organizations designated by local governments.

Community economic development programs, under Title VII, are aimed at forming businesses, restoring property, and providing services to poor neighborhoods to build a stronger economic base to support the community. The programs of community economic development are carried out through 34 Community Development Corporations (CDCs) funded by CSA headquarters. CDCs invest directly in subsidiary profitmaking corporations or cooperatives to either develop new businesses or to expand existing ones. CSA gives technical assistance to these businesses through the CDCs and through supplemental grants and contracts in specialized areas.

In addition to direct funding of \$0.7 billion from CSA, the CDCs and CAAs receive funds from other Federal agencies, State and local governments, and private sources. These other funds are estimated to total \$1.3 billion. It is important to note, however, that generally the same management and internal control system is used to control all funds at a CDC and CAA.

SCOPE OF REVIEW

Work was performed at CSA headquarters; at CSA's Atlanta, Dallas, Philadelphia, and San Francisco regional offices; and at grantees in three of these regions. We visited eight grantees: five Community Action Agencies, one Delegate Agency, and two Community Development Corporations. We also reviewed grantee records on three other delegate agencies. At each location, we administered a GAO internal control questionnaire to agency officials and tested various transactions that

enabled us to determine whether internal controls were in place and working properly. The questionnaire was based on standards promulgated in our Policy and Procedures Manual for Guidance of Federal Agencies which CSA has essentially adopted as requirements its offices and grantees must follow.

Specifically, we evaluated the controls over program and administrative activities. Program activities are those which deal directly with the basic purpose of the agency; that is, awarding and managing grants. Administrative activities are those performed in support of the agency's basic mission, like processing payroll or managing property assets. Many of the activities are performed daily while others, such as verifying physical inventories, require only periodic performance. Still others are performed automatically on automatic data processing equipment. We evaluated data processing controls as well.

Generally, the grantees we selected for audit were the CAAs and CDCs receiving the most funding in the CSA regions we visited. (Exceptions were made in instances where we had recently audited the largest grantees.) In total, the 11 grantees we evaluated during this review received \$16.9 million in CSA funds during fiscal 1979. When other Federal, State, and local moneys are included, the total fiscal 1979 money received by these grantees amounted to about \$46.7 million.

RELATED GAO REPORTS AND TESTIMONY

GAO has issued several reports and testified before congressional committees a number of times on CSA and its grantees. (App. II contains a list of prior reports.) The various reports and testimony have criticized the effectiveness of grantees' and CSA's performance in monitoring, controlling, and auditing grantee activities. For example, on October 19, 1979, we testified before the Subcommittee on Federal Spending Practices and Open Government of the Senate Committee on Governmental Affairs regarding the results of an extensive study at many different Community Action Agencies. We reported a tremendous number of abuses and questionable expenditures that have occurred at grantee organizations. We have incorporated some of these examples in this report. On May 6, 1980, we testified before the Subcommittee on Manpower and Housing, House Committee on Government Operations, concerning an update of our earlier study of Community Action organizations as well as of this review.

In the following chapters, we will present our evaluation of CSA's internal controls, highlighting those that are

weak and need improvement. Recommendations are made at the end of each chapter that we believe should reduce CSA's vulnerability to fraud and abuse.

CHAPTER 2

CSA NEEDS TO IMPROVE MONITORING

AND CONTROLS AT HEADQUARTERS

AND REGIONAL OFFICES

According to the Budget and Accounting Procedures Act of 1950, the heads of executive agencies are responsible for establishing and maintaining good internal controls over their operations. However, internal controls used to safeguard CSA disbursements, receipts, and property as well as to monitor grantee activities, were generally inadequate at CSA's headquarters and some of its regional offices. They were inadequate primarily because managers concentrated most of their attention on the delivery of program funds and services to recipients and not enough attention to seeing that internal controls were working properly to safeguard the funds from fraud, abuse, and error. The following sections detail the weaknesses we identified. In appendix I, instances of internal control weaknesses are identified by location.

DISBURSEMENT CONTROLS AND MONITORING ARE INADEQUATE

Our Policy and Procedures Manual for Guidance of Federal Agencies states that the principal objectives of control over disbursements are to ensure that all disbursements are legal, proper, correct, accurately recorded, and promptly reported (7 GAO 24.1). Approximately 98 percent of CSA's annual budget is disbursed as either grants or payroll in the form of a letter-of-credit or U.S. Treasury check. The actual amounts of money disbursed are determined through a complex system of internal controls partly involving the use of automatic data processing equipment.

We found that CSA's computer system for grants lacks up-to-date and complete system documentation and that some very basic reviews of grant data entered into the computer are not made. As a result, erroneous and untimely grant data has been entered into the system causing CSA's monitoring of grantee cash balances to be ineffective. This, in turn, has allowed some grantees to receive and maintain excess Federal funds through the letter-of-credit system. In addition, CSA's computer system for payroll requires excessive manual transcriptions of personnel data before processing, and lacks some very basic controls over documents used in payroll processing. As a result, the risk of inaccurate payroll information and payments is greater than necessary.

Grant disbursements

During fiscal 1978, CSA's computer generated 1,977 letters-of-credit totaling \$456,489,502 in grants. In addition to the letters-of-credit, 11,489 checks totaling \$243,943,790 were issued to grantees. The computer system being used is not adequately documented with up-to-date flow charts and other descriptive material. It also lacks some very basic and necessary controls over data entered into the system. As a result, erroneous data can be entered into the system and make effective and timely grant monitoring very difficult.

Incomplete and outdated system documentation

Comprehensive and current computer system documentation is necessary for the efficient operation and success of any data processing system. System documentation describes the system objectives, the flow of data within the system, functions of the different processing steps and their interrelationships, instructions for entering data into the system, controls built in the system, and a schedule of output produced by the system. The documentation should include both flow charts and descriptive material.

Documentation is required to permit data entry clerks, systems analysts, programmers, operators, managers, and auditors the ability to

- understand the system's design and how it operates,
- know the input and output requirements,
- evaluate internal controls, and
- maintain continuity in operations.

We found that the grant system is not fully documented and that program documentation and data entry instructions are incomplete and outdated. As a result, the system's design, operation, requirements, and internal controls are only partly understood.

In the event of a disaster or loss of key computer programmers, the seriousness of poor documentation increases. CSA needs to update and complete the grant system documentation and maintain current documentation thereafter to assure that proper computer controls are in place and to minimize the potential loss from disaster or attempted manipulation

of grant data. In commenting on this report, CSA said it will examine the computer documentation to assure its adequacy and accuracy.

Inadequate grant monitoring

Current and accurate financial information is necessary to effectively monitor grantees' expenditures and cash balances of Federal funds. According to Department of the Treasury guidance, which is to be followed by Federal agencies and grantees, grantees receiving funds under letters-of-credit are supposed to request their grant funds in amounts necessary to meet only their immediate needs. However, CSA headquarters and most of its regional office staffs are not monitoring grantee cash balances because grantees do not submit their quarterly expenditure reports on time and because headquarters and regional office staffs do not evaluate the reasonableness of grantee cash balances on hand when they receive these reports. As a result, grantees have misused Federal cash by requesting and receiving excess cash, unbeknown to CSA.

Quarterly expenditure reports are due 15 working days after the end of each quarter to CSA headquarters or the CSA regional office serving the grantee. These reports are supposed to show grantees' expenditures by program during the quarter, Federal funds received, cash on hand, and an estimate of the number of days the cash will last. Headquarters and regional office personnel are supposed to analyze the quarterly reports and to code selected data from them for entry into the automated grant system for processing by the computer center. Printouts from the automated grant system should be used by headquarters' management to evaluate the performance of headquarters and regional office personnel responsible for managing and assisting grantees.

Quarterly reports, however, are generally not received from grantees on time, and with the exception of the Dallas region, little followup action is taken to expedite delivery of the reports. Also, expenditure reports coded by the regions are not always reviewed for accuracy before the data is forwarded for computer processing. We were told that six of the ten regions do not promptly submit expenditure data. Officials at one region said they have a 2 to 2-1/2 year backlog of expenditure reports that need to be reviewed for accuracy. Three to six months of those reports must still be coded. In other words, approximately 1 to 1-1/2 years of expenditure data has been coded without preliminary report review, and 3 to 6 months of data has not been coded at all.

Some regional office and headquarters' staff said there are two reasons that these reports are not evaluated once they are received--because of a shortage of staff and because the evaluations are considered to be of low priority. The staff also stated that the grantee's annual audit will reflect whether excessive cash was maintained during the year. In our opinion, all regional offices should follow Dallas' lead and aggressively pursue late reports, because they play an extremely important part in CSA's management and oversight of Federal funds.

Many times, a quick review of the quarterly expenditure report will reveal an excess cash situation. For example, one grantee reported that it had \$409,000, which it said amounted to 122 days of cash. CSA officials said that generally, under the letter-of-credit system, a grantee should be able to get cash between 1 and 10 days after the request, depending on the location of the grantee and the size of its bank. If, however, the grantee understates the days of cash on hand, CSA personnel can quickly evaluate the reasonableness of this by reviewing CSA's internal Grant Obligation, Advances, and Expenditures Report which reflects, among other things, the date and amount of each request as well as the frequency.

It is important to note that this review does not prove that a grantee has excess cash on hand. It may be that a large expenditure is planned. This review only serves as an indication of a potential problem that should be discussed with the grantee. CSA headquarters has instituted a pilot project which identifies grantees who have drawn down their entire year's letter-of-credit with more than 30 days left in the grant year. Grantees who have done this are requested to explain their actions. CSA officials said they hope to refine the system currently being tested so that grantee drawdowns can be monitored monthly.

Ineffective monitoring of grantees' expenditures and cash balances by CSA is not a new problem and is by no means a small one. A May 8, 1979, CSA internal audit report described a need for improved monitoring of cash balances in the possession of grantees. Specifically, the audit found that in 14 of the 20 grantee financial reports reviewed, grantees had cash on hand that exceeded an average 3-day requirement by \$10.7 million, and at least nine grantees had cash on hand in excess of a 30-day requirement. Furthermore, in October 19, 1979, testimony before the Subcommittee on Federal Spending Practices and Open Government of the Senate Committee on Governmental Affairs, we provided the following examples of excessive cash balances maintained by grantees:

--On January 31, 1979, one grantee had \$1.8 million of CSA funds on hand. During the 6 months between August 1, 1978, and January 31, 1979, the grantee's monthly CSA expenditures averaged \$181,300. Thus, the cash on hand was about 10 times greater than the grantee's average monthly disbursement needs.

--An analysis of the cash flow statements of another grantee organization showed that between July 28, 1978, and July 27, 1979, that organization's 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 2-1/2 times greater than disbursement needs.

As can be seen from the above examples, CSA needs to improve its efforts in this area by establishing a timely and accurate grant monitoring system that assures grantees do not continually maintain excess Federal cash. As noted above, initial improvements have been made. However, CSA should also require all of its headquarters and regional office staffs who are responsible for reviewing quarterly expenditure reports to make sure that grantees submit the reports on time. And expenditure reports must be coded and submitted for computer processing sooner so that information in the automated grant system is current.

Furthermore, expenditure reports should be reviewed along with existing information that reflects the number of times the grantee has withdrawn funds during the quarter to ascertain whether cash on hand is excessive. Where CSA identifies grantees with excess cash, agency officials need to decide whether funds should be returned immediately or whether the grantee, in cases where the amount is small, should use this excess before withdrawing more under its letter-of-credit. Regardless of the course of action chosen, CSA officials should monitor these grantees closely to ensure that the desired result was achieved.

Flagrant and/or frequent violators of the intent of the letter-of-credit system should be cautioned and subsequently penalized if the grantee continues to misuse the system. We believe that every effort should be made to correct the problem before a penalty is invoked; however, if efforts fail, we believe that a penalty in the form of reduced funding or suspension must be invoked.

CSA stated that several of its regional offices routinely send letters to grantees reminding them of the requirements for submitting quarterly financial reports and if the reports still are not submitted to CSA, it then issues "intent to

suspend funding" telegrams to the particular grantees. According to CSA, these steps normally are successful. However, our discussions with CSA regional officials disclosed that little such followup effort is made.

Improvements needed over payroll disbursements

Payroll processing depends heavily on automatic data processing equipment operated by CSA. The computer, for example, processed data in fiscal 1978 for 28,176 regular payroll checks totaling \$14,095,951. Overtime pay was reported to be \$168,138. Obviously, not all payroll functions can be performed by a computer--payroll documents must be prepared and reviewed manually. For example, time and attendance reports must be prepared, reviewed, and keypunched for computer use. We identified certain internal controls in the manual phase of payroll processing that need improvement. Specifically, we found that CSA needs to

- reduce the number of times personnel payroll information is transcribed for computer processing and
- improve control over documents to be used by the computer to process the payroll.

Need to reduce the number of times personnel payroll actions are transcribed for computer processing

In the payroll system, personnel pay and leave entitlement data is unnecessarily transcribed twice before it is used in computer processing. Besides being double work, this method creates unnecessary risks of intentional or accidental entry of erroneous data into the computer and increases the risk of erroneous payroll payments. Personnel department employees within each region and headquarters transcribe this data onto coding sheets, and then transmit it via a teletypewriter to the CSA computer center where it is entered into the personnel system to update the personnel master file. After the file is updated, the computer prints the personnel data on a special form that is forwarded to the payroll office. Payroll office employees then transcribe the same data onto coding sheets where it is keypunched onto cards that are used to enter the data into the automated payroll system. Each time the data is transcribed, the possibility of error exists. Therefore, the chances of erroneous payroll disbursements increase unless errors are detected when the payroll is manually reviewed.

CSA officials pointed out that to their knowledge (with the controls currently in place), no false payroll payments have ever been made by CSA. However, we believe that to further reduce the risk of error and take full advantage of the computer's capabilities, the computer could be programmed to produce a computer tape or disk containing the updated information entered in the automated personnel system. Instead of relying on payroll office employees to produce input, this tape or disk could be used to enter the data directly into payroll processing. This would (1) minimize transcription errors, (2) help prevent the intentional entry of erroneous data by payroll technicians, and (3) reduce costs associated with unnecessary document handling, keypunching, and manual verification.

CSA commented that if this proposal were implemented, the present separation of duties which exists between personnel and payroll office employees would be eliminated. This would not be the case because what CSA is calling separation of duties is, in reality, a duplication of effort--two groups of people transcribing the same information. Moreover, by currently permitting payroll technicians to enter personnel actions, time and attendance records, and permanent pay change information into the computer system, they are in fact controlling all the data which the computer needs to calculate and process a paycheck. Our proposal would eliminate the duplication of effort and prevent payroll office employees from entering personnel actions into the computer system--a proper separation of duties.

Need for improved controls over documents used in payroll processing

CSA manually verifies the completeness and accuracy of payroll data processed by its computer each pay period to make sure that no documents were altered, added, or deleted. However, because human errors are always possible, CSA needs to rely more on the computer to assist in verifying payroll data. Two basic techniques which are generally used in any automated system to help assure completeness and accuracy are record counts and predetermined control totals. CSA does not use either in its automated payroll system and as a result, documents may be added, lost, or altered during processing to the detriment of the Federal Government if CSA manual reviews do not identify the errors.

Record counts, which represent the number of documents in the group being processed, assure that all the documents are processed. These counts should be made when documents are prepared for processing and should accompany the documents

through the processing cycle. By doing this, each office receiving the documents for the next phase in processing can compare the number of documents it should have received with the actual number counted. This should identify whether documents were added or lost. Record counts could be installed and could be a real benefit. For example, timekeepers could count the number of certified time and attendance reports to be processed. This information could then be entered into the computer along with the data being processed. The computer could automatically count the records transmitted and compare the counts. If differences exist, the entire batch could be rejected and not processed until corrected or a warning message could be printed to alert a clerk that data may have been added or lost.

To help ensure that documents are not altered during processing, predetermined control totals are commonly used. Predetermined control totals are totals for a selected data field or several data fields in a group of source documents. These also could be installed and could help reduce the chance of alteration of payroll data. For example, timekeepers should calculate totals of selected fields, such as overtime hours worked or annual leave taken, for each batch of reports to be processed. These counts and totals calculated by the timekeeper should be compared with those generated by the computer. Payroll technicians should reconcile any differences with the timekeeper. Likewise, payroll technicians should calculate record counts and control totals for batches of payroll coding sheets to assure the complete and accurate processing of data. CSA officials again stated that their current system of controls is adequate because extensive manual reviews of payroll are made each pay period. We believe that record counts and predetermined control totals would provide needed and added protection against erroneous payroll disbursements.

INADEQUATE CONTROLS OVER RECEIPTS

On occasion, grantees or vendors return unused grant money, money from overcharges, or money from disallowed audit costs to CSA. During fiscal 1978, \$37.5 million was returned to CSA--mostly unused grant money. According to our Policy and Procedures Manual for Guidance of Federal Agencies (2 GAO 12.2 and 7 GAO 11.1), returned money should be controlled properly upon receipt (immediately recorded and safely kept), deposited promptly, and recorded in ledger accounts to reflect proper and current account balances. These functions should be divided among employees (i.e., no one person should perform all of the duties). However, at CSA headquarters, there is an inadequate internal control system for cash receipts mainly because there are not specific procedures governing the

handling of these receipts. Consequently, there are various and conflicting ways in which cash receipts are handled. As a result, funds due the Government may or may not be deposited to the account of the Government. Furthermore, when they are deposited, there is no assurance that it was done promptly to prevent interest loss.

Most money sent to CSA comes in the form of checks rather than cash. These checks are usually made out to CSA but sometimes they contain the name of a CSA employee as the payee. Also, checks are addressed to various offices within CSA. It is in these instances that proper internal control is most important. Because CSA does not have adequate written procedures relating to the receipts, some CSA personnel do not know what to do with checks that arrive in their office.

Cash receipts are not handled uniformly. For example, in one CSA office all cash receipts are immediately recorded in a receipt log. The checks are then forwarded to the person who prepares bank deposit slips and makes bank deposits. This person also credits the account of the organization which issued the check. In another CSA office, cash receipts are not logged in or immediately sent to the fiscal department for deposit. Officials said that cash receipts are often held as long as 2 weeks before being sent to the fiscal department for deposit. As a result, cash receipts are not recorded as received, and cash is not deposited promptly for use by the Government. The risk of losing money due CSA can be reduced by writing, publishing, distributing, and implementing specific procedures requiring that duties be segregated and that cash receipts be recorded upon receipt and promptly sent to the fiscal department and deposited. CSA officials stated that detailed procedures for use in receiving, recording, and depositing cash receipts will be updated and included as part of their accounting system design scheduled for development in late 1980.

INADEQUATE CONTROLS OVER PROPERTY

Our Policy and Procedures Manual for Guidance of Federal Agencies (2 GAO 12.5) states that agencies should manage property procured with Federal funds properly, efficiently, and effectively and that agencies should record all transactions affecting property investment in their accounts. Internal controls over property are an integral part of good management. They help ensure that property is safeguarded and used only for intended purposes.

Internal controls over property and equipment, however, were weak at CSA headquarters and two of the three regional

offices we visited--San Francisco and Atlanta. While the extent of these weaknesses varies, each location is susceptible to theft and/or misuse of Government equipment. Generally, the internal control weaknesses represent a lack of segregation of duties--too few people doing too many significant tasks. At one location, we were unable to find pieces of equipment that were recorded on property records as being in inventory.

Good property management requires that furniture and equipment be (1) promptly entered into inventory records upon receipt and promptly removed from records upon disposal, (2) given identification numbers for easy and quick identification, and (3) periodically inventoried. Property records should be adjusted as a result of physical inventories and subsequent investigations of the reasons that equipment was missing. No single person should be given responsibility for performing all these tasks. Furthermore, people with property management duties should not be responsible for purchasing the property. A lack of separation of duties can provide opportunities for theft and/or misuse of Government equipment.

At CSA headquarters and at two of the three regional offices we visited, property management responsibilities were unnecessarily vested in one or two people. At one regional office, for example, the same person responsible for purchasing and receiving equipment was also responsible for property management. Although we found no evidence of irregularities at this region, the opportunity for loss or misuse exists unnecessarily because of poor internal controls.

At CSA headquarters, we found that items of furniture are not given specific identification numbers. Property records do not reflect the location of furniture or equipment and are inaccurate and out of date. Furthermore, there is no central file or record of furniture and equipment at CSA nor is CSA's property included in the general ledger. Instead, property records are scattered throughout many different CSA offices. One person is responsible for maintaining "master" property records and for seeing that all equipment is inventoried and reconciled annually. It is conceivable, therefore, that this one person, if motivated to do so, could prevent items of equipment from being recorded in inventory and then steal the property. Detection would be almost impossible because this person takes the annual inventory and checks the count against property records.

We chose several inventory items from property records and searched at great length to find them. Most were eventually located but some were not. Four dictating machines were missing. No one at CSA knew where these pieces of equipment

were or when they were last seen. We also attempted to match specific pieces of furniture and equipment against property records. However, this test was impossible to complete because furniture is not marked with a unique identification or control number. Property records do not identify specific pieces of furniture--only quantities of the types of furniture are listed.

Overall, we believe CSA's property management system is vulnerable to abuse, and that better internal controls are needed. To reduce the possibilities of abuse, CSA needs to better segregate its property management functions and to begin identifying its furniture with control numbers or other forms of specific identification. Additionally, property records should be updated, corrected, and centralized to reflect current inventory items. All property should also be included in CSA's general ledger.

CSA officials agreed with the need to separate property management duties but stated they had been unable to assign sufficient people to fully separate all functions. However, officials said they will update property cards after a physical inventory is completed. They said recordkeeping for furniture and equipment will be improved significantly when CSA's accounting system design is completed.

LACK OF REQUIRED COMPTROLLER GENERAL APPROVAL OF CSA'S ACCOUNTING SYSTEM DESIGN

Our Policy and Procedures Manual (2 GAO 26) and the Budget and Accounting Procedures Act of 1950, require that executive agency accounting systems be approved by the Comptroller General when he deems that they are adequate and conform to the principles, standards, and related requirements he prescribes.

We found that while CSA's accounting principles and standards had been approved in April 1979, they had not submitted their accounting system design to us for review and approval by the Comptroller General. We believe this lack of an approved accounting system could contribute to some of the internal control weaknesses we found in our review. CSA officials informed us that they recently (March 1980) published an invitation for bids for a contractor to assist them in developing and implementing an approved accounting system. This action should help CSA meet the legislative requirement of obtaining approval of its accounting system.

CONCLUSIONS AND RECOMMENDATIONS

CSA headquarters and its regional offices lack some necessary internal controls over grant and payroll disbursements,

grantee monitoring, cash receipts, and property management and have not yet submitted their accounting system design for Comptroller General review and approval. In our opinion, the lack of these controls is the direct result of management not placing enough emphasis on the need for strong internal controls. Because of the lack of sound controls and an approved accounting system design, CSA is more vulnerable to fraud and abuse in these areas than is acceptable. To reduce this risk, we recommend that the Director of the Community Services Administration take the following actions:

- Emphasize to all management levels the significance of good fiscal internal controls and the need for managers to make sure that tasks and functions for which they are responsible are adequately controlled to prevent or at least reduce risks of either intentional or accidental misuse or abuse of Federal funds.
- Implement a timely and accurate grant monitoring system to prevent grantees from withdrawing and maintaining excess Federal funds.
- Reduce or suspend funding of grantees (in conjunction and coordination with other Federal agencies providing funding) who are found repeatedly to have inadequate internal controls and/or have withdrawn excess Federal cash.
- Design, implement, update, and maintain proper controls and documentation of the computer system that will further reduce the risk of erroneous payroll and grant disbursements and improve the efficiency of data processing.
- Write, distribute, and implement detailed procedures for headquarters and regional offices to use in receiving, recording, and depositing cash receipts.
- Properly separate property management functions so that no one person is responsible for receiving equipment, entering equipment in property records, maintaining property records, and conducting physical inventories.
- Improve the physical control and recordkeeping of furniture and equipment which would include establishing a general ledger control account.

CHAPTER 3

WEAKNESSES IN COMPUTER SECURITY

In chapter 2, we pointed out that CSA operates an automated grant and payroll system which plays a major part in controlling disbursements totaling over \$700 million annually. Our evaluation of the security over the building that houses the computer center as well as the computer center itself showed that both were vulnerable to such acts as unauthorized entry, unauthorized manipulation of computer programs and files, and destruction by fire. Because of the lack of contingency plans, destruction or severe damage to the facility would bring the grant and payroll processing systems to a virtual standstill.

NEED TO CONDUCT A FORMAL RISK ANALYSIS OF THE COMPUTER CENTER

Federal information processing standards recommend and the Office of Management and Budget (OMB) Circular A-71, Transmittal Memorandum No. 1, issued July 27, 1978, requires that each executive agency periodically conduct a risk analysis of the security of its computer center. Furthermore, CSA's internal audit division recommended in an October 17, 1977, report that the data processing division prepare a risk analysis for the data processing center. Although CSA stated in its February 26, 1979, response to OMB that its newly formed office of inspector general has responsibility for conducting risk analyses, at the time of our review the office had not made such analyses. In responding to our draft report, CSA officials stated that a formal risk analysis was now being made.

COMPUTER CENTER SECURITY NEEDS IMPROVEMENT TO PREVENT UNAUTHORIZED ENTRY AND FIRE

At the time of our review, the building housing CSA's computer facility, which is leased by the General Services Administration (GSA), was vulnerable to unauthorized entry and fire resulting in an inadequate level of security for CSA's accounting records and assets. Although many of the security and fire prevention deficiencies we noted have since been corrected, some still remain and need to be corrected to provide proper protection.

These conditions existed despite OMB Circular A-71, Transmittal Memorandum No. 1, which requires the head of an executive agency to assure an adequate level of security for all agency data whether processed in-house or commercially.

Weak security against unauthorized entry

During a tour of the building, we noted several security weaknesses. Lack of protection against unauthorized entry to the building stemmed, for the most part, from poor building maintenance. (See pictures on pp. 20, 21, and 23.) A glass door on the first floor was broken about 3 months before our visit and had not been replaced. The opening was covered only by a sheet of plywood loosely tied to the frame. Furthermore, a door in the alley had been left unlocked and first-floor windows, broken during a previous fire, were also covered by plywood. By pulling back the plywood, one could easily enter the building.

The ability to enter the building in an unauthorized manner, even in light of the 24-hour security guard on duty, compromises security and increases the risk of vandalism, arson, and to a lesser extent, accidental fire. CSA officials stated that GSA has repaired the glass door. However, as of May 1980 the first-floor window glass had not yet been replaced. CSA has requested GSA to make the necessary repairs.

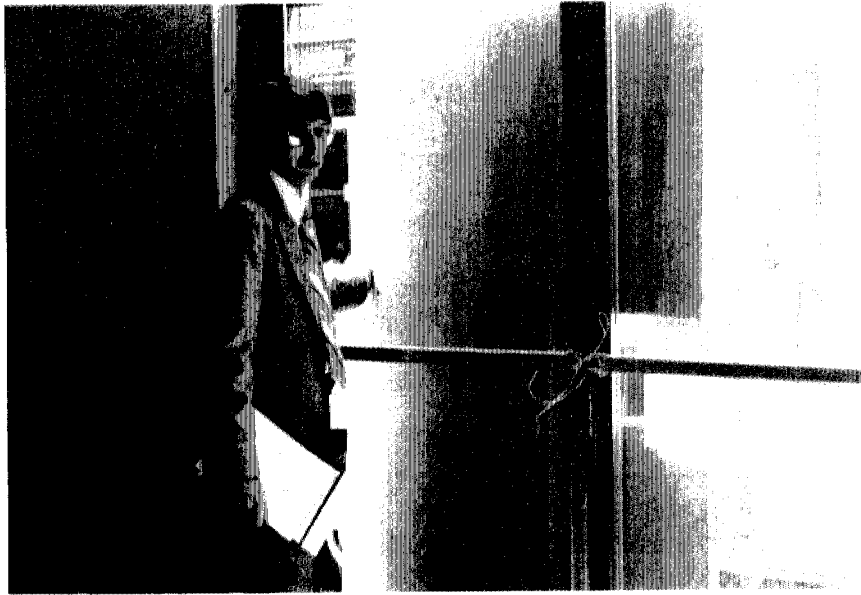
Weak security against fire

The building housing CSA's computer center was also especially vulnerable to fire at the time of our review. In fact, three fires have occurred within the building since March 1978. Two of these occurred on the first floor--one of them directly beneath CSA's computer tape library--and the third fire was in CSA's area of the building. The extent of fire damage can be seen on p. 22. As shown by the pictures on p. 21 we found trash in areas of the building occupied by former tenants. Trash poses a particular fire hazard in view of the building's prior fire record and in light of easy accessibility to the building.

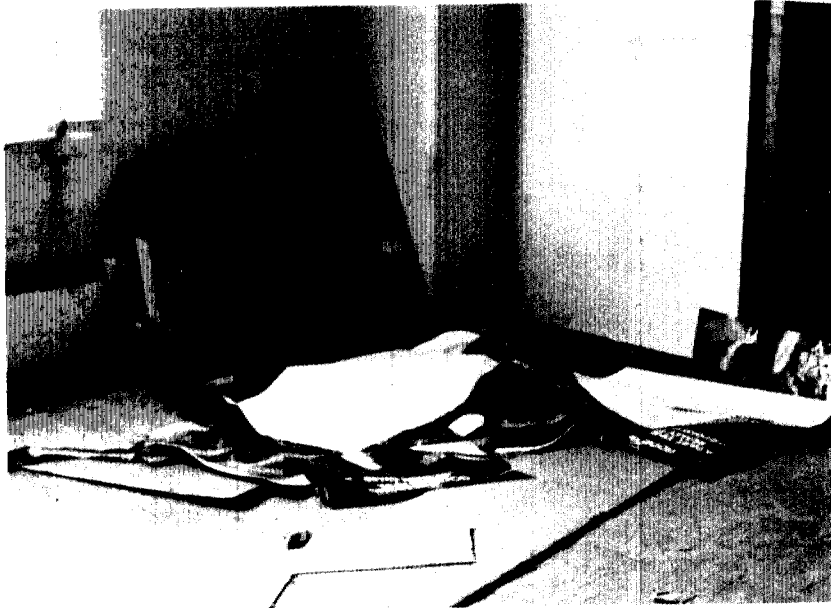
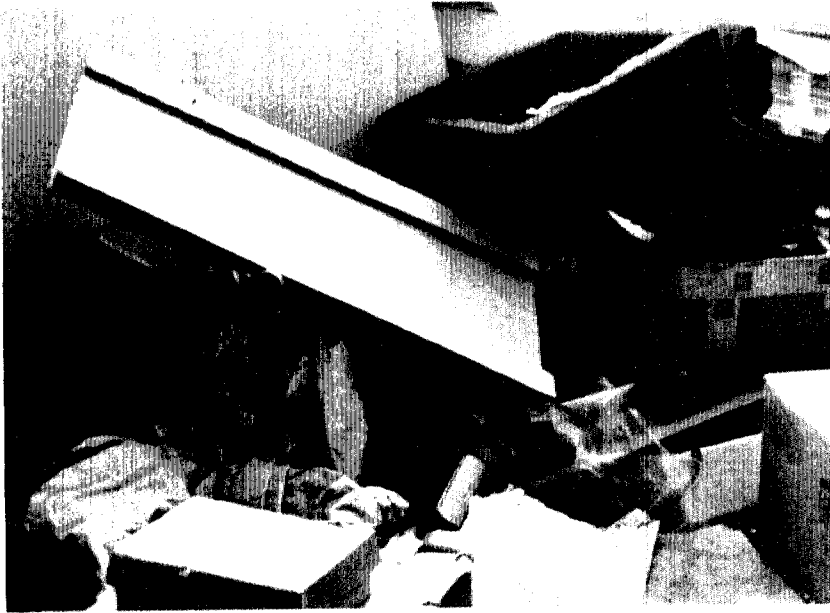
Concerning fire protection of the computer facility itself, an October 1977 CSA internal audit report pointed out that

"The security of the data processing center against fire was very weak. There were hand-fire extinguishers in the computer room and in the corridors, but there were no smoke detectors, no sprinkler system, and no fire hose in the building."

Not only did these conditions still exist at the time of our review, but we also found that the fire extinguishers in both the computer room and tape library had not been inspected since July 1976.



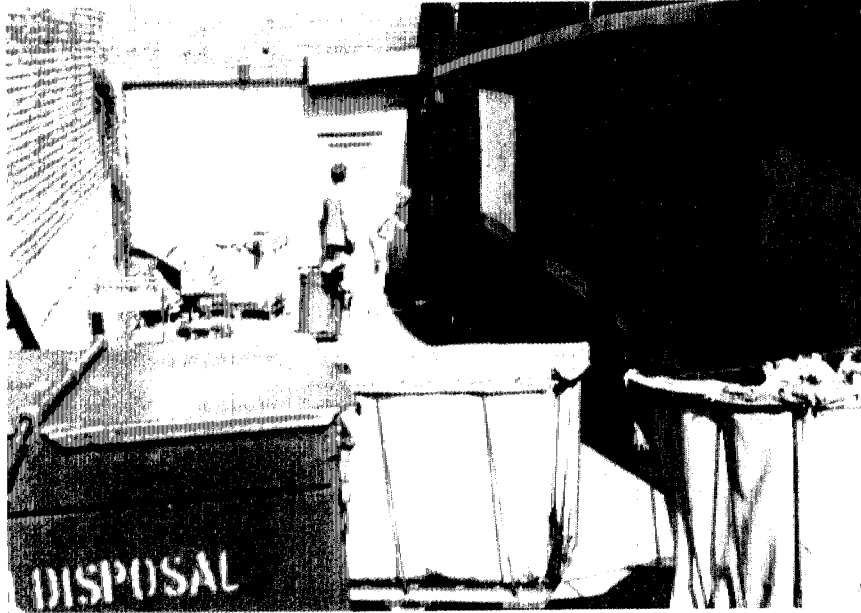
AS SHOWN, ILLEGAL ENTRY TO THE BUILDING WAS EASY BY PULLING BACK THE LOOSELY TIED PLYWOOD COVER ON A BROKEN FIRST FLOOR GLASS DOOR. SINCE OUR REVIEW THE DOOR HAS BEEN REPAIRED.



TRASH LEFT BY PREVIOUS OCCUPANTS POSES A PARTICULAR FIRE HAZARD IN VIEW OF THE BUILDING'S FIRE RECORD. SINCE OUR REVIEW THE TRASH HAS BEEN REMOVED.



ALTHOUGH THE COMPUTER TAPE LIBRARY ESCAPED DAMAGE FROM THE EXTENSIVE FIRE IN THE SPACE DIRECTLY BELOW IT, FUTURE FIRES COULD DO SERIOUS DAMAGE BECAUSE CSA LACKS EFFECTIVE FIRE PREVENTION METHODS.



THE ALLEY DOOR WAS FOUND UNLOCKED. TRASH IN THE ALLEY WOULD INHIBIT QUICK ACCESS TO THE BUILDING IN CASE OF FIRE.



BROKEN FIRST FLOOR WINDOWS ARE COVERED BY PLYWOOD, WHICH IS EASILY REMOVED FOR UNAUTHORIZED ENTRY. AS OF MAY 1980 THE WINDOW GLASS HAD NOT YET BEEN REPLACED.

Since our audit work was completed, the trash was removed and the fire extinguishers inspected, tested, and recharged. CSA has requested that GSA install smoke detectors. Also, GSA is negotiating with the current building owner to have the building extensively renovated.

COMPUTER RESOURCES SHOULD BE MORE SECURE

Access to computer equipment, computer files, and computer programs is not adequately restricted to prevent damage, loss, or unauthorized use. These deficiencies are described below.

Access to the computer room is not restricted

Computer programmers, clerks, tape librarians, and possibly even passersby may enter the computer room without restriction. No locks are used during working hours to prohibit access. As the number of persons who may enter a computer room increases, the risk of damage, loss, or improper use of equipment, files, and programs also increases. The computer room should be accessible only to those employees required to operate the equipment. CSA officials informed us that plans have been made to install cypher locks on doors to the computer room.

Entry to the tape library is not properly restricted

Access to CSA's tape library is not restricted, and tapes are not properly logged out when removed. The tape library is occasionally left unlocked and unattended and operators, programmers, and clerks may enter the library at will. In addition to unrestricted access, the removal of tapes from the library is not adequately controlled. CSA data processing standards require that data processing personnel submit tape withdrawal slips to the tape librarian. However, employees do not always submit these slips when the tapes are removed.

Unrestricted access and improper documentation of tapes removed from the library increase the risk that tapes may be removed and then lost, damaged, stolen, or used in an unauthorized manner. Access to the tape library should be restricted to the tape librarian and supervisors, and all tapes removed should be logged out to insure the proper use and accounting of computer files. CSA officials informed us that plans have been made to (1) install a cypher lock on the tape library door, (2) take a physical inventory of CSA tapes, and (3) introduce improved controls over these tapes.

Computer programs are not properly secured

CSA does not properly secure its computer programs. Grant and payroll programs are stored in the computer room and backup data to many of CSA's programs are kept in an adjacent, unlocked room in unlocked file cabinets. Consequently, computer operators have unlimited access to the programs. Computer programs should be kept in a library and issued to authorized persons only when needed. CSA is now developing procedures to properly safeguard its computer programs.

Computer programming controls need improvement

CSA needs to improve its computer programming controls to help prevent errors and fraud. The controls should include independent testing and formal approval of new systems as well as written authorization, approval, and documentation of program changes to already existing systems.

One of the basic principles of internal control is to divide the execution of critical duties and functions between two or more persons--a technique referred to as separation of duties. This principle also can and should be applied to data processing operations. For example, the computer programmer who designs and programs a system should not control its final testing. A person other than the programmer should test and give final approval to the system. An independent test and approval helps prevent manipulation of programs for unauthorized purposes. CSA did not require its payroll system to be independently tested or formally approved. Although the system was formally reviewed by a supervisor and informally approved by its intended user, the system was placed into production before it was independently reviewed in detail. As a result, the system was designed, programmed, and tested by the same individual.

CSA also does not require users to submit work orders for all program changes, and therefore does not properly control computer program changes. Program change requests should be submitted and permanently filed to

- authorize the programmer to make the change,
- document the change to clear up any initial misunderstanding that may arise when verbal requests are made, and
- provide for a history of changes for audit trail and workload purposes.

Furthermore, computer program changes are not always independently tested and approved before production processing of the change. Program changes should be independently tested and reviewed to prevent unauthorized and potentially fraudulent changes from being introduced into computer programs. This lack of control increases the possibility that errors may occur or that fraud may be perpetrated. CSA stated that it will revise its procedures for approving new computer systems, changing existing systems, and authorizing use of data processing resources.

CONTINGENCY PLANS ARE NEEDED TO INSURE CONTINUOUS OPERATIONS IF DISASTER STRIKES

At the time of our review, CSA lacked adequate contingency plans to continue operations if its computer programs or files were destroyed or if its computer equipment became inoperable. Duplicate copies of the payroll and grantee source programs ^{1/}, grantee check master file, and grantee letter-of-credit master files had not been secured in offsite storage nor in a fire resistant vault. Furthermore, no formal arrangements had been made with an alternate facility to process grantee payments and payroll in case of an emergency.

As a result of our concern, agency officials arranged to secure duplicate copies of the grantee master files offsite and in a fire resistant vault. CSA has also advised us that it has since successfully conducted a test of its grant and payroll systems at another Government agency's facility and is currently negotiating a formal backup agreement.

CONCLUSIONS AND RECOMMENDATIONS

CSA's computer facility was highly vulnerable to unauthorized entry or operation of the computer, manipulation or theft of computer programs and files, and fire. We believe the actions taken by CSA and those actions listed below will alleviate these problems and thus, reduce the vulnerability of CSA's computer operations. We recommend that the Director of CSA:

^{1/}Source programs are written by the computer programmer and are converted automatically into a form which the computer can understand. Computer programmers make modifications only to source programs. In the event that the production copy of the source program were destroyed, a facility should have a current duplicate copy of the source program so that the programmer could make future modifications.

- Complete the formal security risk analysis of the computer center as required by OMB Circular A-71.
- Ensure that the General Services Administration repairs and corrects the remaining facility deficiencies.
- Restrict access to computer equipment, programs, and files, account for files, and require tapes to be logged out.
- Carry out planned improvements in documenting, testing, and approving all computer programs and changes.
- Finalize the formal backup contingency plans to provide the capability for continuous computer operations in the event of a disaster.

CHAPTER 4

MORE EMPHASIS NECESSARY ON

INTERNAL CONTROL AUDITS AND FOLLOWUP ON FINDINGS

Internal controls over disbursements, receipts, and property as well as security over computer facilities and equipment are all very important because they affect an organization's vulnerability to fraud and abuse. There is, however, another important ingredient of an effective internal control system--internal auditing. Our Policy and Procedures Manual for Guidance of Federal Agencies (3 GAO 34), states that internal auditing is an essential tool of management with the overall objective of assisting agency management in attaining its goals by furnishing information, analyses, appraisals, and recommendations pertinent to management duties and objectives. An organization must audit its operations periodically to determine whether its internal control system is functioning properly.

Auditing is CSA's primary and most effective means of monitoring grantee activities and evaluating their internal controls. Our Policy and Procedures Manual (3 GAO 41) states that auditing the performance and records of third parties, such as grantees, is an essential aid to the administration of grant programs. The manual further states that this auditing serves as a means of ascertaining whether the terms and objectives of the grant agreement have been complied with. Each CSA grantee is audited annually by an independent public accounting (IPA) firm. The results of that audit are transmitted to CSA. CSA also employs its own auditors whose duties include evaluations of the work performed by IPA firms as well as assessments of CSA administrative activities both at headquarters and at regional offices.

We evaluated CSA's audit performance in terms of the quantity and quality of work undertaken, action taken on both IPA and administrative audit findings, and audit staffing needs vs. current staff levels. Also, we have issued several reports covering the effectiveness of the auditing of CSA's programs and have incorporated those into this report. Some of the most important are:

- "More Effective Action Is Needed On Auditors' Findings--Millions Can Be Collected Or Saved," FGMSD-79-3, October 25, 1978.
- "Grant Auditing: A Maze Of Inconsistency, Gaps, And Duplication That Needs Overhauling," FGMSD-79-37, June 15, 1979.

--"Quality Testing Of Audits Of Grantees' Records--How It Is Done By Selected Federal Agencies And What Improvements Are Needed," FGMSD-79-38, July 19, 1979.

--"Federal Civilian Audit Organizations Have Often Been Unsuccessful In Obtaining Additional Staff," FGMSD-79-43, July 27, 1979.

We found that CSA's audit performance has improved since the reports listed above were issued, but it still needs improvement in terms of (1) taking more aggressive action on audit findings concerning grantee organizations, (2) enforcing the requirement that its annual audits of grantees be conducted in accordance with CSA established regulations and Comptroller General standards, (3) conducting single audits of grantees which receive funding from several Federal agencies, and (4) fulfilling internal audit requirements.

MORE AGGRESSIVE ACTION NEEDED
ON AUDIT FINDINGS

Each of the eleven grantees we evaluated during this review had internal control weaknesses--some were widespread resulting in frequent and severe impact on the grantees' vulnerability to fraud and abuse while others were isolated. We observed, however, after conducting our own analysis of internal controls, that these same weaknesses had been identified year after year in IPA annual audits. In all instances the IPA audit reports recommended that the grantees take action to correct the deficiencies and, in some instances, recommended that CSA consider withholding or reducing grantee funding until the weaknesses were eliminated.

For example, one grantee was reported as having internal control weaknesses during its 1976 program year in the areas of travel, property, payroll deductions, and entries in accounting records. Similar weaknesses plus others were identified in the 1977 annual audit and again during the 1978 audit. In both of these years we observed that the IPA firm certified that corrective action was taken by the grantee. We noted, however, that overall the grantee received increased funding each year. Our review of this grantee's internal controls in August 1979 disclosed that, if anything, the situation had worsened. We found weaknesses in purchasing, travel, payroll deductions, property management, journal entries, cash receipts, bank reconciliations, budgeting, and personnel management--nearly all areas where internal controls should be in place. In our opinion this grantee has had ample opportunity to permanently correct its deficiencies; and therefore CSA should withhold funding until the grantee establishes adequate internal controls over money it receives and spends.

At another grantee organization, a similar situation occurred. A 1976 IPA audit report stated that, as in prior years, no written procedures, regulations, and policies existed governing the accounting for and custody of fixed assets. Further, the report noted that inventory lists were inaccurate, incomplete, and unreconciled, and items on the lists could not be located while other items on hand were not on inventory lists. The IPA firm recommended that the property management system be established with sufficient internal controls to protect the grantee from abuse. CSA wrote the grantee, instructing it to correct the deficiencies.

In 1977, similar property management weaknesses were identified. But in addition, the IPA firm noted other weaknesses including the failure to verify previous employment of new employees, the failure to sign time sheets used to pay salaries, and improper certifications of in-kind contributions. CSA requested, received, and accepted the grantee's word that corrective action had been taken.

But again in the 1978 annual audit, the IPA firm identified more of the same weaknesses. Property management deficiencies remained as did improprieties in certifying in-kind contributions. Other weaknesses found included excessive cash balances during the year, inadequate documentation to support expenditures, no written policy concerning employee conflicts of interest, and inaccurate vacation records. In July 1979, at CSA's request, the grantee responded to these findings by stating that corrective action had been or was being taken in all areas where deficiencies were noted.

We visited this grantee organization in August 1979 and found that corrective action had not been taken. In fact, even more weaknesses existed than the IPA firm identified. Specifically, we found deficiencies in payroll, purchasing, travel, imprest funds, property management, cash receipts, financial reporting, bank reconciliations, and personnel policies. As in the case of the other grantee discussed earlier, we believe that CSA has provided ample opportunity for the deficiencies to be corrected. The fact that these serious weaknesses still exist, seems to us to be reason for taking strong action against the grantee.

The above examples are only two where we believe CSA failed to take appropriate actions against grantees that were found repeatedly to have weak internal control systems. Other grantees which we visited were also able to continue their operations at similar levels of funding even though previously identified weaknesses were not corrected. Not all of the weaknesses were as severe as those found in the cases described above, but were nevertheless recurring problems which in our opinion, should have been remedied by CSA action.

In responding to the draft of this report, CSA commented that its policy is to add special grant conditions preventing the release of funds and/or to notify the grantee of its intent to suspend authority to expend grant funds unless corrective action is taken on audit findings. Apparently, CSA sometimes accepts, without verification, the grantee's assurance that it took corrective measures. It is also apparent that CSA does not always consider recurring audit findings when deciding whether to carry out the above mentioned policy.

CSA regional field representatives potentially could play a major role in verifying grantee compliance with internal control requirements when they visit grantees during the program year to check on program accomplishments and problems. However, many field representatives are not trained in fiscal matters and according to CSA, there are not enough of them to adequately monitor grantees. We discovered though, that CSA has not requested more field representatives to alleviate this shortfall.

LACK OF DOCUMENTATION TO SUPPORT REPORTED PROGRESS IN RESOLVING AUDIT FINDINGS

In our report of October 25, 1978, entitled "More Effective Action Is Needed On Auditors' Findings--Millions Can Be Collected Or Saved," FGMSD-79-3, we pointed out that as of March 31, 1977, CSA had 617 unresolved audit reports involving about \$30.3 million in questioned costs outstanding. (By November 1978, these figures rose to 1,064 unresolved reports and about \$50 million in questioned costs outstanding.) We also pointed out that CSA was prematurely closing audit reports before corrective action was completed and that periodic reports did not show the status of corrective actions. Several recommendations were made to alleviate the problem. In response to that report, the Director of OMB instructed heads of the executive branch departments and agencies to launch an immediate review of each department's or agency's system of audit followup and to comply with OMB directives.

CSA, in turn, initiated a program designed to reduce the backlog of unresolved audits and questioned costs and used the following criteria to obtain these objectives:

- Closing all fiscal 1977 or earlier audits which remained open only because of noncost deficiencies unless the findings were repeated in a current audit.
- Allowing any cost that is questioned when the total of such costs was less than \$5,000 and the audit was from fiscal 1977 or earlier.

--Allowing any cost that is questioned because of failure to meet the non-Federal share, providing that at least a 20-percent, non-Federal share could be documented.

Also, CSA targeted its efforts on the 45 grantees that accounted for 70 percent (or \$21.5 million) of the questioned costs from July 1, 1973, through March 31, 1978.

As of August 31, 1979, CSA records showed that the agency had reduced its fiscal 1978 and prior unresolved audits to 294 reports and to \$17 million in questioned costs still outstanding--a reduction of \$33 million and 770 reports from November 1978 levels. However, no documentation was available to show a breakdown of the reductions; that is, the amounts returned to CSA, the amounts in questioned costs that were allowed as legitimate expenditures, and the amounts of questioned costs that were "written-off" in accordance with the criteria above. CSA officials said they are in the process of collecting this data, but that it was not currently available. Consequently, we were not able to determine the extent of CSA's efforts to follow the above criteria before writing off questioned costs.

We noted that as a result of fiscal 1979 audits of grantees, additional questioned costs of \$21.2 million and 332 more audit reports required resolution as of August 31, 1979. Our evaluation of CSA regional office efforts to resolve recent audit findings disclosed that a low priority is given to these duties. In addition, documentation regarding action taken on these recent audit findings is inadequate. Specifically, the Atlanta and San Francisco regional offices had inaccurate records reflecting the amount of money owed CSA and recorded as a receivable, and no action had been taken on many of the audit findings. Based on our work at these regions, it was quite apparent that they had not implemented one of our earlier recommendations because they still were not adequately documenting how costs questioned by auditors were being resolved. Therefore, we were not able to evaluate the reasonableness and status of current year questioned costs.

ANNUAL GRANTEE AUDITS SHOULD BE CONDUCTED
IN ACCORDANCE WITH COMPTROLLER GENERAL
STANDARDS AND ESTABLISHED CSA REGULATIONS

On July 19, 1979, we issued a report entitled "Quality Testing of Audits of Grantees' Records--How It Is Done By Selected Federal Agencies And What Improvements Are Needed," FGMSD-79-38. In it, we reported that IPA audits were not being sufficiently reviewed by Federal agency personnel, and as a result, low quality work was not being identified. We recommended that the Director of OMB require grant making agencies to (1) require all IPA audits to be performed in

accordance with Comptroller General standards, (2) test a meaningful sample of audits against Comptroller General standards, and (3) provide for systematic and collective use of the testing results.

CSA did implement a project designed to statistically sample and review the quality of IPA audits. It concluded that only 3 of 107 audit reports and working papers reviewed from 1978 were substandard and that IPA audits were generally adequate. Similar results were reported after reviewing 136 audit reports and working papers for 1979. In response, CSA has reduced the number of quality reviews it will conduct in fiscal 1980 and plans to increase its efforts in following up on the implementation of corrective actions promised by grantees in response to audit findings of IPA firms.

Contrary to CSA, however, we believe its review of audit reports disclosed serious weaknesses and demonstrated that CSA has not sufficiently enforced the requirement that annual audits be conducted in accordance with already established CSA regulations and Comptroller General standards, which do not significantly differ. For example, CSA's analysis of 107 IPA audits conducted during fiscal 1978 identified

- 166 instances of noncompliance with CSA regulations, principally in the areas of IPAs failing to review grantees' personnel, travel, and property systems, and non-Federal share contributions;
- 29 instances of IPA auditors failing to fully complete a required internal control questionnaire which assesses the adequacy of a grantee's internal control system;
- 33 instances of grantees and IPAs not having contractual arrangements specifying work to be done;
- 20 instances of inadequate IPA testing and procedures and/or working papers not supporting opinions expressed in the audit report; and
- 19 instances of insufficient evidence to demonstrate that specific items or transactions were tested or audit work performed.

CSA concluded that the major underlying problem appeared to be that of not sufficiently documenting the audit work actually performed.

We compared our findings with IPA findings at the grantee organizations we visited (as discussed earlier in this chapter),

and found further evidence that IPA firms must be fully informed of audit requirements. It must be made clear to IPA firms that they are to conduct annual audits in accordance with CSA and Comptroller General standards--including assessments of grantees' internal control systems to provide assurance that Federal funds will be properly and legally spent. This need was recently reiterated by OMB in an October 22, 1979, revision to Circular A-102 which states that audits should be made in accordance with Comptroller General standards and the "Guidelines for Financial and Compliance Audits of Federally Assisted Programs."

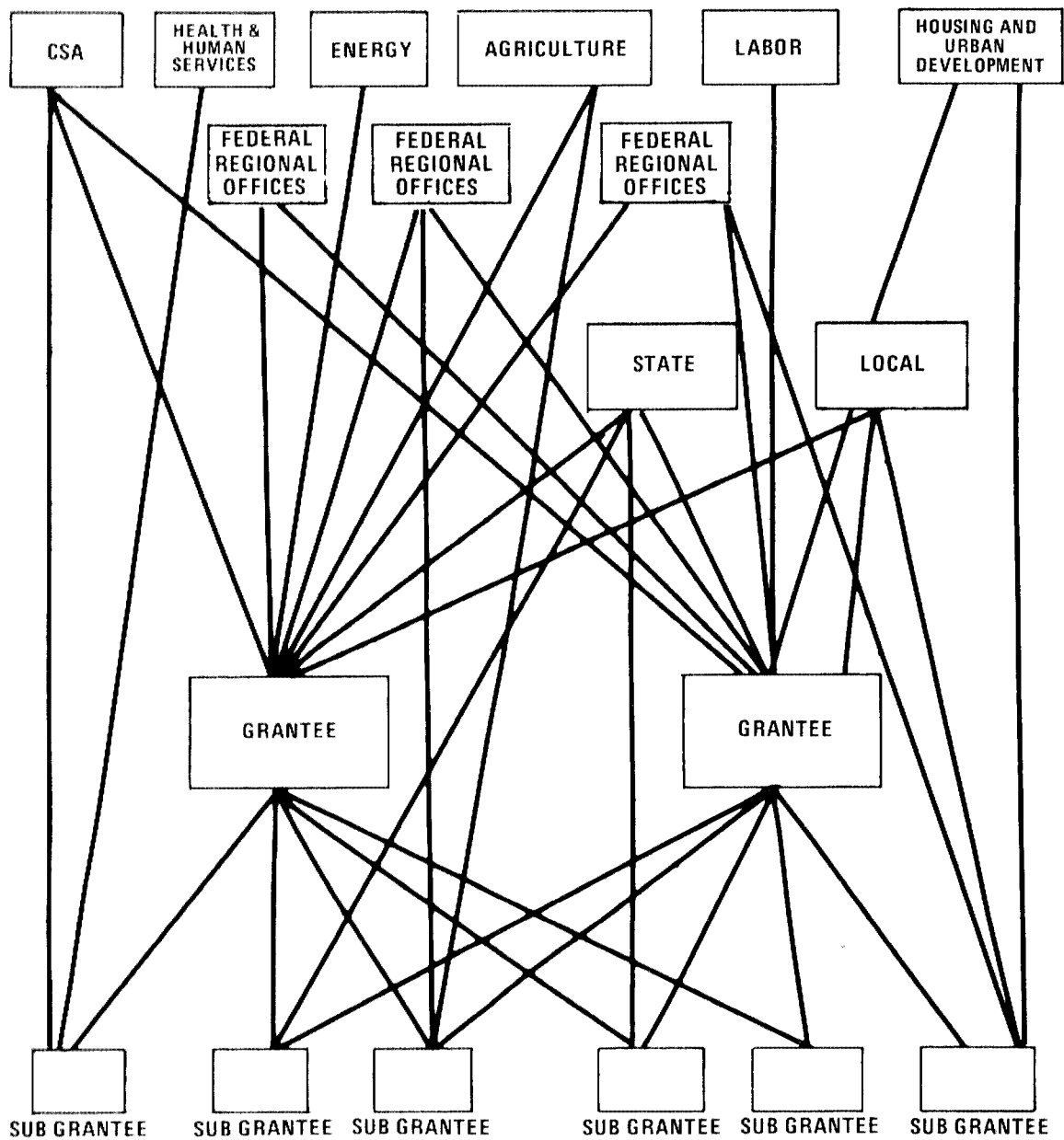
As part of these annual audits, we also believe that grantees should require IPA firms to flowchart, one time, internal controls over tasks performed to control and manage Federal funds and assets purchased with those funds. Documenting these internal controls should provide a means of identifying whether duties performed in accomplishing each major task are properly segregated and whether internal controls in place are adequate to ensure that the objective of each task is achieved. To be meaningful, such documentation must be kept up to date during the year and verified during annual audits. Documentation and verification of the internal control systems can also help expedite future audit work and provide assurance to grantees' management that the organizations are being operated in accordance with Federal regulations and generally accepted accounting principles and standards.

CSA officials agreed that IPA audits should be conducted in accordance with GAO standards and guidelines and that grantee internal controls should be documented during the audit process.

PROGRESS IN RESOLVING PROBLEMS OF MULTIPLE FUNDING AND AUDITS OF GRANTEEES

As mentioned earlier, grantees receive money from a number of different sources other than CSA, including several Federal agencies like the Departments of Health and Human Services, Housing and Urban Development, Labor, Energy, and Agriculture. In addition, grantees receive money from State and local governments as well as private contributions. As a result, the amount of money a grantee receives from CSA may only be a small portion of the total funding it obtains. The flow of funds to a grantee is pictured in a chart on the next page.

Each Federal agency established audit requirements for the funds it provides. CSA requires annual audits of its money while the Department of Labor requires that its audits



normally be conducted annually but not less than once every 2 years. However, each agency requires that audits be conducted only for the portion of money it funds and not of the grantee's total funding. In addition, these audits cover different time periods of grantee spending. Consequently, no audits give a true picture of the spending practices and internal controls of Federal grantees.

Perhaps the most serious result of this weakness is that some grantees have, in the past, been able to claim reimbursement from different funding sources for the same expenses, sometimes without auditors or the funding agencies being the wiser. We believe that a single audit covering all funds of a particular grantee may identify similar occurrences and provide a more accurate and meaningful picture of a grantee's spending practices and internal controls. This is not the first time GAO has suggested such action. Our report entitled "Grant Auditing: A Maze of Inconsistency, Gaps, and Duplication That Needs Overhauling," FGMSD-79-37, June 15, 1979, addressed this same issue.

CSA has made some arrangements with other agencies to have single audits performed at selected grantees. The number of these audits is limited but, in our opinion, represents a step in the right direction. CSA has also requested OMB to consider designating CSA as the cognizant audit agency for all private nonprofit CAAs. OMB has taken initial steps necessary for making the single audit of grantees a reality but because of the complexity of this undertaking, it will be some time before the single audit concept is fully operational.

NEED FOR IMPROVED INTERNAL AUDIT CAPABILITY

Internal auditing is a very important internal control function. Through internal auditing, agency heads assure themselves that operations are well controlled and are carried out prudently and in accordance with Federal laws and regulations. The internal audit function at CSA, however, has not been used to its fullest potential because of the lack of staff and because audit efforts have not included documentation (flowcharting) or an assessment of the adequacy of internal controls over all major tasks performed by headquarters and regional office personnel. As a result, major internal control deficiencies existed (as discussed in chs. 2 and 3), increasing the agency's vulnerability to fraud and abuse.

At the time of our review, CSA audit efforts and auditors were organized into two groups--internal and external. Internal auditors were responsible for evaluating all the administrative operations of CSA headquarters and regional

offices with a staff of three auditors, a clerk, and the chief internal auditor. In fiscal 1974, CSA had an internal audit staff of five.

External auditors were responsible for receiving, processing, and closing about 1,943 annual audits of grantees conducted by IPA firms, for conducting economy and efficiency audits of CSA programs, for performing quality assurance reviews of annual IPA audits, and for several other miscellaneous projects requested by CSA regional directors, U.S. Attorneys, CSA inspection staff, and the Congress. As of October 1979, 22 external auditors and 10 clerks were spread throughout CSA's headquarters and 10 regional offices. In fiscal 1974, CSA had an external audit staff of 25.

On October 4, 1979, the Senate confirmed CSA's first Inspector General and on October 5, 1979, she assumed her duties at CSA. The Office of Inspector General became fully operational in January 1980, with responsibilities that include those of the former external and internal audit divisions.

We obtained comprehensive lists of CSA internal audit responsibilities and compared these requirements with audits conducted since the beginning of fiscal 1977. Many audit areas have not been covered at all or were covered inadequately, including

- personnel management at headquarters and regional offices;
- support services of budgeting and computer operations at headquarters and office supply, telecommunications, printing, procurement, and travel at regional offices;
- financial services in headquarters and/or regional offices such as accounts receivable, accounts payable, voucher payments, payroll accounting, and time and attendance reporting; and
- program management of the emergency food program, summer youth program, development loan fund, and the evaluation and monitoring systems.

As a result of these shortfalls in audit coverage, CSA does not have sufficient assurance from its audit staff that proper internal controls are in place. Also, internal controls over major tasks have not been documented (flowcharted) to serve as a record of the system and to assist auditors in evaluating the acceptability of internal controls, including adequate separation of duties performed in accomplishing each

major task. Current documentation and periodic verification of its accuracy can also help expedite future audit work and assure agency management and certifying officers that the organization is operating prudently and in accordance with Federal laws and regulations.

CSA external auditing shortfalls during fiscal 1979 occurred in the following areas:

- Assistance to the internal audit division.
- Termination audits (closing out files on inactive grantees).
- Contract audits.
- Quality assurance reviews of IPA audits.
- Technical assistance of IPA firms.
- A pilot project of direct contracting with IPA firms.
- Expansion of the current audit reporting system.
- Update of audit policies and procedures.

In addition to these shortfalls, the external audit division did not perform any economy and efficiency audits or program results audits. In fiscal 1980, the external audit division plans to reduce the number of quality assurance reviews, increase its efforts in following up on audit findings at grantees, and perform about 20 economy and efficiency audits.

We have reported problems with CSA's audit staffing before. In one report, "Federal Civilian Audit Organizations Have Often Been Unsuccessful In Obtaining Additional Staff" (FGMSD-79-43, July 27, 1979), we noted that CSA's internal and external audit groups requested 8 and 27 additional auditors respectively from fiscal 1974 through 1978. However, none of the requests were approved by CSA's top management. As a result, additional audit staff was never requested of OMB or the Congress. CSA officials informed us that decreasing Government personnel ceilings precluded CSA from requesting additional auditors.

We were also told that CSA had planned to reorganize some of its divisions and increase the personnel slots available to audit groups so that more auditors could be hired. This was another reason CSA gave for not requesting more auditors in budget submissions.

The Director of CSA restated this to the Subcommittee on Manpower and Housing, House Government Operations Committee, in September 1977. In 1978, during hearings before the Senate Appropriations Subcommittee on Labor, Health, Education, and Welfare, this same message was again transmitted. We learned during this review, however, that the reorganization did not result in additional auditors; and therefore, CSA's audit staff remained essentially unchanged at the time of our review.

With the establishment of the Office of the Inspector General, CSA reprogrammed five positions from other divisions to head up the new office. For fiscal 1981, CSA requested and received authorization for 10 more inspector general positions, 7 of which are for auditors.

CONCLUSIONS AND RECOMMENDATIONS

CSA's auditing efforts have recently improved, but more must be done if the agency's vulnerability to fraud and abuse is to be minimized. Grantee organizations continue to disregard the need for strong internal controls even after audits have identified weaknesses; IPA firms often do not conduct audits in accordance with CSA regulations and Comptroller General standards; audits of grantees are sponsored by a number of different Federal agencies without sufficient coordination or coverage of total grantee funding; and internal auditing shortfalls have resulted in backlogs of important work that needs to be done. We, therefore, recommend that the Director of CSA:

- Reduce or suspend funding of grantees (in conjunction and coordination with other Federal agencies providing funding) who are repeatedly found to have inadequate internal controls and/or who have withdrawn excess Federal cash.
- Continue testing the quality of audits conducted by independent public accounting firms and insist that these firms correct any deficiencies found.
- Require each grantee to arrange with an independent public accounting firm to document (flowchart) the internal controls over major tasks it performs that affect Federal funds and other assets purchased with those funds.
- Require grantees to retain these flow charts and to update them, as necessary, to reflect the current individuals performing significant control steps.

- Enforce the requirement in OMB Circular A-102, Attachment P, that grantee audits be conducted in accordance with established CSA regulations, Comptroller General standards, and the February 1980 "Guidelines for Financial and Compliance Audits of Federally Assisted Programs."
- Place a higher priority on fulfilling internal audit requirements including the documentation (flowcharting) and assessment of internal controls over major tasks to eliminate the current backlog of audit work which exists. Additional auditors that are needed should be requested.
- Better document the amounts of questioned costs resolved regardless of whether they were ultimately allowed, disallowed, collected, or written off, to include explanations of how and why these determinations were made.
- Provide necessary fiscal training to regional field representatives to assist them in carrying out their grantee monitoring responsibilities, such as determining whether grantees have corrected internal control weaknesses found during annual audits.

CHAPTER 5

GRANTEE ORGANIZATIONS NEED BETTER

INTERNAL CONTROLS OVER OPERATIONS

Community Services Administration grantees lack adequate internal controls over their operations despite the fact that CSA has provided detailed guidance stressing the importance of internal controls and suggesting ways to establish a sound internal control system. Although following CSA guidance is not mandatory, each grantee must establish an adequate system of internal controls to provide reasonable and necessary assurances that funds are expended legally and prudently.

We found that grantees have generally disregarded CSA guidance as well as repeated recommendations to improve internal controls made by independent public accounting firms during annual audits of the grantees' activities. We believe that the grantees' disregard for the need to establish sound internal control systems is at least partly reflective of the problems and weaknesses we identified at CSA headquarters and regional offices (described in chs. 2 and 3). As a result, these grantees are vulnerable to fraud, abuse, and error in nearly every area of fiscal and managerial responsibility: disbursements, receipts, property management, and personnel evaluation.

CSA prides itself in being able to allocate about 95 percent of its annual budget directly to grantees rather than spending large amounts of money on Federal administration of its programs. This percentage does demonstrate that CSA is making a significant effort to provide maximum financial support to our nation's poor people while minimizing Federal involvement in the planning, conduct, and evaluation of local programs. While this approach has merit, we believe it has sacrificed accountability and sound financial management to a larger extent than is reasonable or allowable. In our opinion, the deficiencies which are discussed below can be corrected only by more Federal emphasis and action on grantee financial management and internal controls.

DISBURSEMENT SYSTEM NEEDS CHECKS AND BALANCES

To assure that disbursements are legal and proper, grantees need to have an adequate internal control system of checks and balances. CSA has issued various publications providing guidance to grantees in developing systems which, if implemented, would provide adequate internal control over disbursements. In addition, reports by accounting firms have

recommended ways to improve grantee internal controls. We found grantees did not follow CSA guidance or implement audit recommendations. They continue to have inadequate internal controls over disbursements in the following areas: payroll, employee benefit programs, purchasing, travel, grants, loans, and the resulting check disbursements.

Payroll

Controls over payroll were poor at seven of the eight grantees we visited. While the severity of weaknesses varied from location to location, much improvement is needed if vulnerability to fraud and abuse is to be minimized.

A good system of internal control should be based on well-defined policies and clearly stated procedures, clear assignments of responsibility and delegations of authority, proper segregation of duties, appropriate personnel qualifications, and an effective internal audit program.

The segregation of duties should, at a minimum, include division of the following tasks:

- Preparation and supervisory review of timecards reflecting the hours worked by each employee during a pay period.
- Submission of timecards to payroll personnel for comparison with personnel records and calculation of salary due, or for inclusion in a computerized pay system which will perform these tasks.
- Review and verification of paychecks issued against timecards, base pay records, and personnel records.
- Control over and verification of vacation use and leave balances.
- Control over and verification of overtime worked and paid for.
- Distribution of paychecks to employees.

We found that most of the duties described above were being performed by just one or two people, thereby allowing payroll entries, deletions, and calculations to be made without sufficient supervisory review and without adequate assurances that the tasks were performed properly and accurately. For example, one grantee that had a multimillion dollar annual payroll allowed its payroll clerks to prepare employee termination or entry documents, review timecards, calculate pay

due, and receive, sign, and distribute paychecks to employees. We tested this particular payroll cycle and found:

- Persons were being placed on the payroll and paid without all authorizing signatures or proof that the persons were employed.
- One instance where an employee remained on the payroll roster more than three months after termination of employment.
- Several instances where new employees were paid on an "exception basis" because proper employment paperwork was not processed until long after an employee began work.

The executive administrator and finance director of this grantee said that the payroll system relied heavily on the personal honesty and integrity of the payroll clerks. The executive administrator promised that steps would be taken to separate payroll duties among several employees. CSA plans to verify these corrective actions at the next annual audit of this grantee.

In another grantee's system, we noted that employee time-cards and leave slips were not reviewed by supervisory personnel prior to submission to a payroll clerk. Also, some leave slips were not furnished to payroll personnel at all, even when leave was taken. In this system the leave slips are used to form the official record of leave balances. Without controls over the preparation of leave cards and without review of timecards, there is little assurance of accurate records of leave balances or hours worked. CSA officials stated that this issue would be addressed in their annual audit of the grantee.

At the other grantees we visited, internal control weaknesses in payroll were similar--either the grantees did not properly segregate duties or they did not have supervisory reviews. Changes to the payroll could be accomplished, without supervisory review, by one or two people. Paychecks were received and distributed by the same individual(s) without review. In all cases, the grantees have either promised or taken corrective action to segregate payroll duties and require supervisory reviews.

Employee benefit programs

Most of the grantees we visited offered health insurance programs to their employees, some through a payroll deduction

plan. Some grantees also offered retirement plans to supplement the Social Security benefits for which employees have contributed. We found serious internal control weaknesses in the benefit programs at one grantee organization.

This particular grantee operates a self-insured health benefit program, but has not established accounting or administrative procedures for the operation and control of the program. As a result, accounting personnel do not know how it should be operated. This absence of operational guidance and control has resulted in erroneous accounting practices, overpayments to a company which processes health claims for the grantee, unauthorized use of Federal funds, and poor management decisions.

Theoretically, this health insurance program operates in much the same manner as Federal health insurance programs. Each participating employee contributes to the program through payroll deductions. The grantee also contributes to the program on behalf of each participating employee. A portion of the money collected is paid to a private company which processes health claims, and the remaining money is deposited in a special bank savings account from which health claims are paid. (Actually, health claims are paid from a CSA general cash account, and reimbursement to this account is made monthly from the special bank savings account.)

In testing the actual payroll deductions, health claims, payments, and accounting entries, we observed that neither the grantee records nor grantee personnel were able to account for all employee deductions. In other words, some payroll deductions were not accounted for. Secondly, we noticed that employee deductions for four separate months were not deposited in the health insurance savings account. Thirdly, some payments made to the company responsible for processing claims could not be reconciled with billings received by the grantee. Finally, we observed that the CSA general cash account had not been reimbursed from the special health insurance savings account as required. Consequently, as of May 1979, over \$73,000 of CSA funds had been used to pay medical claims without reimbursement from the health insurance savings account. Further, the savings account balance as of May 1979 was only about \$40,000--some \$33,000 short of satisfying the money owed to the CSA general cash account.

We believe the problems noted above are a direct result of the grantee's failure to develop specific procedures governing the operation and control of the insurance program. We suggested that such procedures be written. Although corrective action has been promised by the grantee's executive director, there are still questions and uncertainties about where

some of the employee deduction money has gone and how the grantee will reimburse CSA for the money it owes. We referred these matters to the CSA Inspector General and an investigation is underway.

This same grantee also operates a retirement program for employees who wish to supplement anticipated Social Security benefits. Here again, payroll deduction is used to build the retirement fund. The grantee also contributes to the plan on behalf of participating employees. To reap any benefit from the plan, an employee must acquire a vested interest by contributing for at least four years. Any employee who has no vested interest in the plan and wishes to withdraw from it will be reimbursed for his or her contribution. However, the grantee organization does not return its matching contribution to the CSA fund from which it originated. Instead, these monies are considered and treated as non-Federal matching funds. We were unable to determine how much money is involved because of poor accounting records. The grantee's executive director believes this is proper because, in his opinion, the CSA money was expended for grantee operations and thereafter lost its Federal identity and purpose.

CSA officials told us that they would have to obtain an opinion from the Administration's legal advisors before they could render a final decision on the legality and/or propriety of the grantee's actions. We believe such a determination should be made and suggest that CSA do so, not only to recover possible money owed CSA but to establish internal control over the use of Federal grant money.

Purchasing

Four of the eight grantees we visited had internal control weaknesses in the area of purchasing. As in the case of payroll and employee benefits, the weaknesses vary in degree of severity. Some weaknesses have resulted in actual abuse while others represent potential for abuse.

Internal controls over a purchasing system should provide assurance that needed goods and services are acquired at the lowest cost; goods and services paid for are actually received; and quantity, quality, and price are in accordance with the contract.

The control of purchasing should include, at a minimum, the following checks and balances:

- Preparation and supervisory review of numbered purchase requests, purchase orders, and receiving reports.

--Comparison of receiving reports with invoices and purchase orders..

--Solicitation of goods to be purchased through many different potential sources of supply.

We found that four of the grantees we visited either did not properly segregate purchasing duties among employees or did not perform certain critical purchasing steps. For example, the purchasing department at one grantee organization is responsible for preparing purchase orders, placing orders, and also preparing receiving reports upon delivery of the goods. Theoretically, someone in this department could order and take possession of goods without the knowledge of others in the organization. We tested the purchasing function at this grantee organization and found some discrepancies such as a predated receiving report. In addition, we found several instances of prerecorded quantities written on receiving reports which were different from the actual quantities received. In our opinion, these deficiencies could be eliminated if the duties were properly segregated among other employees of the organization and if employees followed written procedures already established.

At three grantee locations, we observed that purchase orders were not always approved prior to purchasing goods or services. At one location, even when these orders were submitted for approval (after the purchase), they were not thoroughly reviewed. At another location, many people have authority to initiate purchases as there is no centralized purchasing department. One organization had no written procurement procedures, although CSA officials informed us that this grantee developed written procedures after our audit work was completed.

Finally, we examined purchasing files to determine how grantees selected their sources of supply and whether price quotations were obtained to locate the best price. Two of the grantees did not always attempt to obtain price quotations even though their own internal procedures called for them. Most of the grantees had little or no written procedures dictating how suppliers were to be chosen. Consequently, purchasing departments did not consistently use the same methods in choosing the sources of supply. We saw occasional efforts to locate different sources of supply, but as a general rule no such efforts were made.

Closely related to the purchasing function is property management (assuring that goods purchased are entered into inventory), and disbursement by check (assuring that proper

documentation exists before paying for purchases). We evaluated these functions and the results are presented later in this chapter.

Travel

CSA requires grantees and delegate agencies to follow the travel policies set forth in the Federal Travel Regulations. These regulations and CSA implementing instructions specify the types of allowable expenditures and establish maximum reimbursable expenses by travelers. However, while there is no lack of criteria regarding travel allowances, there is a lack of consistent interpretation and application of these regulations by the grantees we visited. Additionally, at six of the eight grantees we visited, we found travel was so poorly managed that procedures were highly susceptible to fraud and abuse.

The most serious example of deficient internal controls over travel involves a grantee organization that does not require its employees to prepare travel orders or travel vouchers. Further, there is no internal audit of travel expenses incurred by the grantee. Travel advances are immediately expensed rather than recorded as an accounts receivable owed by the employee.

Officials of this Community Action Agency contend that their internal controls over travel are sufficient because there is very little travel. The CAA's annual travel budget in 1978 was about \$51,900 and for 1979 was projected to be \$95,500. In our opinion, these amounts are significant and are sufficient justification for internal controls. CSA officials informed us that the CAA has since developed formal travel procedures requiring travel orders and travel vouchers.

Another grantee had similar internal control weaknesses in travel. We observed that many travel requests were approved by this grantee after travel had already taken place. Some approvals were granted as much as four months after the traveler returned.

Two other grantees we visited had seemingly adequate controls over employee travel except for one group--the executive directors. Their travel was not subject to the same review and examination as that of other employees of the organization. For example, all other employees had to obtain travel authorizations from their supervisors prior to leaving on a trip. However, the executive directors approve their own travel and payment for travel expenses. Our limited test at one CAA indicates that reviews of travel are insufficient as evidenced by double payments for the same expenses.

In one instance, the executive director rented a car during his travels at a cost of \$185.36. A credit card in the name of the CAA was used to pay for the car and when the bill arrived it was paid by the CAA. However, this same expense was claimed by the executive director on his travel voucher, which he approved himself. He was reimbursed for this expense. On another occasion, the executive director was similarly reimbursed twice for the cost of a \$25 airline ticket. We brought these matters to the attention of the executive director, who stated that these claims were oversights on his part. He then reimbursed the CAA for these expenses. We also referred these matters to the CSA Inspector General and an investigation is underway.

We believe situations like the one just described demonstrate serious internal control weaknesses, regardless of the amount of money involved. However, these weaknesses are also easy to correct if responsible officials are willing to make changes. In this case, CSA officials informed us that the executive director's travel must now be approved by the grantee's board of directors.

More types of travel control weaknesses were identified at other grantee organizations. These weaknesses appear to be in the degree of review and audit given to travel claims. Our analysis of many travel vouchers which had supposedly been reviewed and approved by CAA travel clerks indicates that these reviews are superficial and that Federal Travel Regulations are not enforced, as evidenced by the following examples:

- Per diem rather than actual expenses was paid when employees traveled to high-cost geographic areas.
- Actual expenses rather than per diem were paid when employee travel was not to a designated high-cost area.
- Documentation, such as hotel receipts and itemized meal bills, was not required;
- Departure and arrival times were not shown on vouchers even when employees were reimbursed on a per diem basis.
- Use of private automobiles was allowed in lieu of common carriers without making cost comparisons.

All of the travel weaknesses highlighted in this section are, in our opinion, evidence that CAAs must pay much greater attention to employee travel. Specific corrective actions will vary depending on the particular deficiency, but generally CAAs need to implement a system of checks and balances

over travel requests, approvals, claims, and reviews--which in most cases means that people must begin performing these tasks.

Grants

Most of the Community Action Agencies we visited provide some money, in the form of grants, to other community agencies (referred to as delegate agencies) for specific programs designed to assist the underprivileged. According to CSA regulations, CAAs are responsible for the proper conduct of the financial affairs of any delegate agency that receives Federal grants and may be held liable for improper use of such grant funds. We examined the monitoring efforts of CAAs over these delegate agencies to determine whether there were sufficient internal controls and found that some CAAs do very little monitoring. As a result, delegate agencies can misuse Federal funds without CAAs or CSA knowing about it.

We found that one CAA required neither external audits nor progress reports from a delegate agency describing their expenditures. Other CAAs we visited had weak procedures for monitoring delegate agencies and so received various kinds of data from them--data which was insufficient for evaluating the success or failure of specific programs. The use of Federal money at two delegate agencies was sometimes difficult to determine from files maintained at the CAAs.

One grantee provided \$400,000 of CSA money to a delegate agency for training actual or potential owners of small businesses and/or to invest in the development or expansion of businesses in economically depressed areas. The delegate agency ceased operations in August 1978, having expended almost \$359,000 and having about \$61,000 in assets remaining. An October 1978 audit report indicated that about \$16,000 of the CSA grant money was used by two employees to pay personal loans and obtain payroll advances--none of which has been recovered because the employees could not be located. CSA officials stated that a bonding company has since reimbursed the grantee for these funds. Neither CSA nor the grantee had until recently a clear understanding of how the grant money was used because the delegate agency had provided no substantive account of its activities or accomplishments. According to CSA officials, virtually none of the \$400,000 of grant funds went directly into training or investments, which were the intended purposes of the grant. Only recently was a complete accounting of the propriety of grant expenditures made by the delegate agency because many of the accounting records were removed by former employees and had to be reconstructed.

Investigations by CSA officials revealed that the grantee did not require the delegate agency to (1) submit financial and programmatic reports of activities and obligations or (2) provide comprehensive program planning and evaluation documents assessing previous and future work. Additionally, the grantee did not have the delegate agency included in the required annual audit of grant operations. Thus, virtually no monitoring or control was exercised over this delegate agency and apparently some \$359,000 of CSA funds was misspent. CSA has told the grantee that it will examine future proposals and activities in detail to assure that the grantee is adequately fulfilling its monitoring responsibilities. We were told that the Department of Justice is considering an investigation of this matter. We were also informed that CSA's Dallas regional office is currently contacting the grantee weekly to clarify issues raised by a recent CSA audit report of the delegate agency's program.

Another delegate agency submitted reimbursement requests to the CAA for purchases it had already made. Although it was unclear to the CAA what had been purchased, they approved payment. This same delegate agency agreed to obtain \$75,000 in non-Federal contributions for 1978. As of August 1979, there was no evidence that the contributions were ever obtained. There was also no agreement or contract between the grantee and delegate agency specifying (1) the work to be accomplished with grant money or (2) the financial reporting, controls, and monitoring to be done by both parties. Nevertheless, the CAA continued to fund this delegate agency in 1978 and again in 1979. We believe the CAA should require specific and descriptive explanations of delegate agency expenses as well as evaluate the efforts of the delegate agency in obtaining non-Federal contributions.

These examples demonstrate a serious lack of internal controls over the disbursement of CAA grant moneys and a need for corrective action. Such action should take the form of closer surveillance of delegate agency activities. One possible means would be to require all delegate agencies to receive approval from the CAA prior to spending any CSA funds. Additionally, we believe that CSA needs to establish minimum requirements for CAA monitoring of delegate agencies. These should include evaluations of internal control systems and program operations as well as strict financial reporting requirements.

In responding to these suggestions, CSA stated that it already requires a written contract between grantees and delegate agencies that specifies the minimum monitoring and financial reporting which is to take place during the grant period. However, the specific contract requirements are written

by the grantee, not by CSA. CSA suggests standard language in the contracts which states, "the Delegate agrees to submit to the Grantee such reports as may be required by CSA directives or by the Grantee, including the reports listed in Attachment B according to the schedule there set out." (Underlining added by GAO.) Attachment B is written by the grantee.

Regarding monitoring, CSA's suggested standard contract language states "the Delegate further agrees that the Grantee may carry out monitoring and evaluation activities to include, at a minimum, those listed in Attachment D." This attachment is also prepared by the grantee. In our opinion, neither contract clause provides sufficient assurance that adequate monitoring of internal controls or financial reporting will be required. Moreover, as noted before, one delegate agency we visited had no written contract with the grantee for 2 years, yet it received funding each year. Severe internal control weaknesses were found at this delegate agency.

CSA also stated that it is in the process of updating a guidance manual which, among other things, will detail the responsibilities of grantees in monitoring and evaluating delegate agencies to include financial reporting, financial management, controllership, and auditing. When completed, this manual should help strengthen grantee monitoring activities.

CSA states that it has made significant progress in establishing a system for measuring and evaluating the effectiveness of grantee programs. Its Grantee Program Management System should improve CSA's oversight as well as the content of grant programs.

Loans

A good system of internal controls over loans should require that all loan requests be properly evaluated, approved, and documented prior to disbursing any funds and that all loans are properly managed once funds are expended. CSA has issued no regulations or guidance to grantees setting forth the essential and specific internal control steps that should take place when making and servicing loans. Because of this, some loans have been made without requiring loan applications, repayment schedules, or penalty provisions. These deficiencies have contributed to loan defaults and possibly a loss of revenue from interest not charged. As it stands, CSA's loan program is highly susceptible to fraud and abuse. CSA regulations and guidance for grantees are essential to minimize intentional or accidental misuse of loan funds.

CSA headquarters is responsible for planning, developing, implementing, and administering programs of financial assistance to community businesses with the objective of building a stronger economic base at the local community level. CSA program funds are granted to local Community Development Corporations (CDCs) who, in turn, use the money to invest in local businesses through equity purchases, direct loans, or loan guarantees. CSA's regulations and guidance do not address specific steps that should be taken when making a loan in order to adequately control it. They require only that CDCs periodically prepare and submit a proposed plan of action for the coming period and obtain CSA approval for some of the loans prior to any disbursement of grant money. For overall operations, however, CSA's regulations require CDCs to (1) have adequate systems of internal control, (2) have annual audits made of their operations, and (3) regularly make financial status and program progress reports to CSA concerning their activities. These general requirements, stated without further amplification, seem inadequate.

We observed the existence of very few controls at one grantee we visited. This grantee frequently did not require loan applications or write pertinent provisions into promissory notes such as payment dates, collateral, repayment priority, or penalties. According to grantee officials, it was sometimes not necessary to specify these items in loan provisions because of extensive information contained in "investment plans" prepared jointly by the grantee and the business and because of extensive verbal exchanges which took place. Additionally, this same grantee had poor or no written procedures for

- establishing payment schedules,
- notifying loan recipients of payments due or delinquent,
- periodically reconciling unpaid loan amounts with the recipient,
- collecting delinquent loans,
- transferring delinquent loans to doubtful accounts receivable, and
- writing off uncollectible loans.

Responsibility for these loan-making tasks was not clearly assigned to specific employees and the tasks were either not done or performed only sporadically. We believe that these deficiencies permitted the following situations to occur.

In 1975 and 1976, two loans were made to a business in amounts of \$10,000 (a 1-year loan) and \$30,000 (a 3-1/2-month loan). As of September 1979, no payments on either loan had been received by the grantee. We discovered that no payment notices (requests for payment) were ever sent. In addition, the grantee had not calculated accrued interest owed by the business since June 1977. This business was still operating as of September 1979, but the grantee considers repayment of the loans to be doubtful.

In total, this grantee has written off about 18 percent (\$30,000) of its investment loans and designated another 34 percent (\$56,581) as doubtful accounts. Both amounts are for principal only and do not include interest charges. We were unable to determine the extent of interest fees uncollected, because the grantee organization had not consistently or correctly computed and recorded interest amounts.

Further analysis of this grantee's operations disclosed that since at least 1976, the annual audits of the grantee have been superficial because the internal control systems were not evaluated. Only financial statements were reviewed for accuracy and adequacy by the independent auditors. Nevertheless, these audits were accepted by CSA each year as meeting their requirements. As a result, internal control weaknesses of the type we found were not identified or known to CSA or the grantee, thus leaving the grantee vulnerable to fraud and abuse. In our opinion, the audits were deficient because they did not meet either Comptroller General or CSA standards. We believe that CSA should make certain that the next annual audit of this grantee includes an evaluation of the internal control system.

This grantee's executive director, at our recommendation, agreed to require loan applications for all loans, take the necessary action to assure that promissory notes contain all pertinent provisions, improve written procedures governing the entire loan process, undertake collection efforts on the two loans we identified as delinquent, begin to regularly send payment notices, and begin computing and recording interest charges consistently and correctly.

We believe that greater attention to and control over this grantee's activities would have disclosed and perhaps even prevented the weaknesses that we identified. Therefore, we believe that CSA needs to more vigorously oversee CDCs' operations and provide specific guidance which describes loan procedures and controls. Such guidance can benefit the operations of all CDCs. We have provided CSA with the name

of this grantee so that it can take necessary followup action and correct procedures to prevent recurrence of the deficiencies. CSA officials stated that the grantee has taken corrective action which will be verified during the next annual audit. Additionally, CSA stated that it is drafting a directive to all grantees summarizing the deficiencies GAO found.

Disbursement by check

All expenditures of funds should be supported by backup documentation that includes such things as invoices, purchase orders, and receiving reports--all signed and approved by appropriate officials. Other expenditures, such as those for loans, grants, travel, and payroll, must also be supported by backup documentation. There should be strict limitations on who is permitted to sign checks. Finally, accurate records on check disbursements are necessary in order to prevent overdrafts. These necessary controls, like other internal controls, should include separation of duties thereby creating a system of checks and balances.

Of the eight grantees we visited, four had internal control weaknesses in the check disbursement function. Some of these weaknesses were serious enough to cause erroneous payments to vendors while others contributed to bad checks being written. All of the weaknesses have created a situation which could lead to improper grant expenditures as described below.

As described to us, one grantee organization established an accounts payable office which was given responsibility for receiving all expenditure documentation and writing checks for payment. The checks were forwarded to one of the organization's directors or a member of the board of directors for review and signature, and then distributed to the payee. On the surface this system appeared adequate. But in testing specific disbursements to determine whether the system was working as described, we discovered serious breakdowns. Accounts payable personnel were not comparing purchasing documentation, such as purchase orders, receiving reports, and invoices, to insure that prices and quantities agreed. As a result, the grantee organization had made overpayments to vendors. We reviewed six accounts payable transactions and, in all six cases, the quantities, prices, and/or totals on the purchase orders and receiving reports did not agree with those on the invoice or payment. These six transactions represented expenditures totaling \$4,964 and the total difference between the receiving reports and amounts paid was \$802. We brought this matter to the attention of the grantee's executive director who immediately retained an independent auditor to review the accounts payable function. As of October 1979,

the auditor had discovered approximately \$13,000 in overpayments made by the grantee, \$8,000 of which have since been recouped. According to the executive director, our recommendation that procedures be established to govern the accounts payable tasks is being adopted.

At three organizations, we observed inadequate reconciliations of checking account balances. Reconciliations are one internal control mechanism that can and should be used to monitor funds available to meet obligations as well as to "doublecheck" specific disbursements. One of the grantees had not reconciled its account since June 1978; one had not reconciled its account for April, May, or June 1979; and the third did not investigate discrepancies between the bank statement and its records. In one case, these deficiencies contributed to bank overdrafts because checks were written when there were insufficient funds in the grantee's account. Two grantees had no written procedures specifying when reconciliations should be made or how to accomplish the task. Representatives of these grantee organizations promised to correct the deficiencies by implementing procedures for bank statement reconciliations. CSA officials said that they would verify the corrective action during the next annual audits of these grantees.

CONTROLS OVER RECEIPTS ARE INADEQUATE

CSA grantees often receive money from various sources. Sometimes they are reimbursed from vendors who received overpayments for goods or services purchased by the grantees; sometimes they receive funds from private donations, CSA, and State and local governments, in cash and by check. Delegate agencies also occasionally return grant money if it is unspent at the end of a program year. Another source of funds is loan repayments which Community Development Corporations are responsible for collecting.

Funds received by CSA grantees should be properly controlled upon receipt, recorded in ledgers, securely stored, and promptly deposited in a bank. These tasks should be distributed among a number of different employees to avoid or at least minimize the risk of theft. CSA has issued guidance to grantees stressing the importance of controls over receipts and suggesting that these steps be performed.

During our visit to grantees, we observed inadequate controls over receipts at four locations. The weaknesses were essentially the same at each location:

--Checks and cash were not recorded upon receipt. Therefore if the money were lost or misplaced it would be impossible to determine whether it had ever been received.

--Receipts for cash were not prepared when money changed hands (from the person who received the money to the person who deposited the money). Therefore responsibility for any shortages could not be fixed.

--Employees who receive money sometimes did not forward the checks or cash promptly to the person responsible for making deposits. In other instances, timely deposits were not made. Also, an alternate employee was not designated to make deposits when the person who normally makes them was absent, which caused late deposits. We found one instance where a combination of the above deficiencies resulted in a check for \$43,520 not being deposited until one month after it was received by the grantee.

--Cash and check receipts were not safely secured. Rather than locking receipts in a cabinet or safe, checks and cash were simply stored in a desk drawer which was locked only at night, thereby creating an unnecessary risk of theft.

--In addition to the above weaknesses, these locations had no written procedures explaining what employees are to do in handling and protecting receipts. Lack of written procedures alone can cause the weaknesses described above.

Our view--that all of the weaknesses described above deserve corrective action--was agreed to by senior officials of the organizations. All promised to remedy the situation by writing and implementing procedures, safeguarding receipts, requiring timely deposits, issuing receipts when money changes hands, and appointing alternate employees to make the deposits. These actions, if implemented, should provide adequate control over money received by grantees and minimize the risk of loss or theft. We believe that CSA should follow up on actions taken by the grantees we visited to assure itself that they were adequate to properly control receipts. CSA officials said that these grantee actions would be verified during their next annual audits.

PERIODIC TASKS NOT ACCOMPLISHING
INTENDED MANAGEMENT OBJECTIVES

Grantees, like any other viable organizations, must perform many tasks other than receiving and disbursing money to operate effectively and efficiently. Some of the tasks which should be performed periodically include property management and personnel evaluation. These tasks help assure management that assets are protected and that the organization is operating in accordance with its directions. It is necessary that internal controls be adequate to assure management that the objective of each task is accomplished. If internal controls are inadequate, the organization becomes vulnerable to fraud and abuse.

Most of the grantees' internal controls over these tasks were inadequate despite suggestions for good internal controls contained in numerous CSA publications. As a result, we could not locate equipment which was purchased with Federal funds by grantees. Also, personnel practices at most of the grantees were so bad that they allowed an unqualified controller to be hired by one grantee and allowed most grantees to have employees working in positions which directly conflicted with their outside financial interests.

Property management

Good property management requires that nonexpendable items of equipment and supplies be (1) recorded in inventory records soon after being purchased, (2) marked with identification or control numbers, and (3) inventoried annually and physical counts reconciled with property records. These tasks should be performed by employees not associated with the purchasing or disbursing functions; ideally there should be different people involved. At all eight grantees we visited, one or more of the following property management weaknesses were identified at each location:

- Property records were maintained and physical inventories taken by procurement department personnel.
- Reconciliations of annual inventory counts to property records were not being made, allowing discrepancies to go unnoticed.
- Items of equipment were not entered onto property records when purchased or were not deleted when no longer in place.
- Some physical inventories were not taken annually.

--Property was not marked with identification or control numbers, making it difficult and sometimes impossible to determine whether property records were accurate.

The primary cause for these weaknesses is a failure to enforce existing written procedures and to emphasize the need for good control. Most grantees were already aware of the weaknesses we identified, and most of the problems have existed for a number of years.

We took physical inventories of a limited number of items at each grantee visited during this review, and found instances where poor property management has resulted in unrecorded and missing items of equipment. For example, at one grantee district office, we found about \$4,000 worth of equipment not listed in the grantee's central property records. About one-third (\$4,250) of its property was either not in the district office inventory records or missing altogether. At another district office of this grantee about 17 percent (\$1,220) of the equipment was missing. This equipment included tape recorders, typewriters, dictaphones, and calculators--attractive items for personal use or resale. This grantee had not conducted a physical inventory since June 1978.

Although it was impossible to determine whether any of the missing inventory items were a direct result of a failure to segregate duties (in other words, allowing procurement personnel to conduct physical inventories and maintain property records), it is obvious that such permissiveness invites abuse and makes grantees' property management systems highly vulnerable. Correcting these deficiencies, in our opinion, should be a high priority of the grantees we visited. CSA stated that it has instructed the grantees to correct these deficiencies and corrective action is now underway.

Personnel evaluation

Qualified and honest employees are perhaps one of the most important ingredients of an internal control system. No matter how good or bad a system of checks and balances is, the people who perform internal control functions play a major role in the effectiveness of the system and affect the organization's vulnerability to fraud and abuse. Because of the importance of people, organizations and personnel managers specifically should hire the best people available within constraints imposed, such as salary limitations in the case of Community Action Programs. Our visits to grantee organizations disclosed personnel management deficiencies which leave grantees with no assurance that prospective employees are qualified for jobs they apply and are hired for, or that employees' performances are up to acceptable levels. Personnel

weaknesses such as these increase vulnerability to fraud, abuse, and inefficiency, and therefore need to be corrected.

One of the grantees we visited during this review, which received approximately \$11.5 million in fiscal 1979 from various Federal and non-Federal sources, filled the position of controller with a person who had little educational background in accounting or finance and only very limited experience as an accounting technician. (This same grantee had serious internal control weaknesses in many fiscal areas such as disbursements by check, bank account reconciliations, payroll, employee benefit programs, travel, and cash receipts--all matters which should be the controller's responsibility.) In our opinion, this grantee organization did not sufficiently define the qualifications needed for a controller prior to hiring. As a result of our findings at this grantee organization, the controller was asked to and did resign.

Another deficiency found at seven of eight grantee organizations we visited was the failure to obtain statements from employees on their outside financial interests. Such statements can help identify potential conflicts of interest. CSA regulations do not require that grantee organizations obtain this information from their employees, but we believe it should be done and that CSA should so instruct its grantees.

The third personnel management deficiency we found was the failure of three grantees to provide adequate appraisals of employee performance or counseling. If they are to improve their work, employees must be told where and how to improve. Effective personnel management should include performance evaluations.

CORRECTIVE ACTION HAS NOT BEEN TAKEN BY
CSA ON PREVIOUS AND SIMILAR GAO FINDINGS

Many deficiencies of the same type noted in this chapter have been previously identified and highlighted in other GAO reports. (App. II contains a list of these reports.) Yet sufficient corrective actions have not been taken by CSA to prevent occurrence of similar deficiencies elsewhere. The following case typifies the situation.

On June 11, 1979, we issued a report entitled "Decisive Government Action Needed To Resolve Problems Of Community Action Programs in Los Angeles," HRD-79-91. Deficiencies we noted included the following:

- Payments were made without documentation of receipts for goods and services.

- Documents used to support payments were not canceled when paid.
- Payments were made without approval.
- Incomplete personnel and payroll data were used in preparing payrolls.
- Bank reconciliations were absent.
- Inventory records were poorly maintained.
- Physical inventories were not conducted.
- Controls over petty cash were inadequate.
- Program performance evaluations were not used in making funding decisions.
- Corrective action was not taken on the results of investigations and audits.

CSA closed this grantee in December 1978, after its own attempts to reorganize failed.

One of our recommendations was that the Director of CSA should establish guidelines and criteria for taking action, with varying degrees of severity, to reconcile conflicts between local control of funds and Federal responsibility to protect these funds. In responding to the report, CSA listed six steps it had taken to implement this recommendation. These included (1) CSA's request to OMB for audit cognizance of all funds received by grantees, (2) conducting quality reviews of IPA audit work, (3) a program to reduce the number of unresolved audits, (4) the establishment of an internal working group to strengthen controls on audits and resolution of questioned costs, (5) filing a lawsuit to assure that Federal funds are not subject to creditors' claims, and (6) reporting to program offices of repeated failure by grantees to correct deficiencies. These actions have not been fully implemented by CSA, however, so all the potential benefits have not been realized. We found many similar situations existing at other grantees year after year. In our opinion, CSA must utilize its criteria and implement its policies by taking vigorous action against grantees who repeatedly are found to have weak internal controls.

We also believe that internal controls can be made more effective by strengthening existing law. The Congress is considering legislation (referred to as the Financial Integrity Act of 1980) which would require greater accountability by

heads of Federal agencies for the effectiveness of their organizations' systems of internal financial control. This legislation would require agency heads to undertake annual evaluations of their organizations' internal control systems and report the results of such evaluations to the Congress and the President. We would participate in this process by providing guidance for conducting the examinations and by reviewing the results. We believe this legislation would contribute to the development of adequate internal control systems in CSA.

CONCLUSIONS AND RECOMMENDATIONS

Based on our analysis as well as prior audit work at CSA grantees, we believe that Federal funds at grantees and delegate agencies are highly susceptible to fraud and abuse because essential internal controls are lacking in almost every functional area. Furthermore, grantees could strengthen their internal controls at little or no additional cost. In many cases, this can be achieved by redistributing responsibilities among those in the organization who are already qualified to do the work or can be easily taught to do it. Despite CSA's requirement, guidance, and instruction to grantees on establishing sound internal controls and even in light of annual audits of grantees' activities, it appears that these grantees have not heeded the necessity for internal controls. We believe that aggressive action must be taken by CSA in their dealings with grantees if the internal control weaknesses we identified are to be corrected and CSA's vulnerability to fraud and abuse thereby reduced. One way to impress upon grantees the need for strong internal controls is for CSA to enforce its existing regulations which make this a prerequisite for funding. In other words, CSA should reduce or suspend funding of grantees until they can demonstrate to CSA a willingness to establish strong internal control systems. Not only will CSA, which is responsible for ensuring that Federal funds are spent legally and prudently, be better assured that their responsibility is being efficiently carried out, but also taxpayers can be reassured that Federal funds are going only to those recipients intended by law. Therefore, we recommend that the Director of CSA:

- More vigorously enforce the requirement that grantees have strong internal controls and, if necessary, impose strict penalties by reducing or suspending funding of grantees (in conjunction and coordination with other Federal agencies providing funding) who are found repeatedly to have inadequate internal controls.
- Follow up on the specific grantee deficiencies we noted to determine whether the actions taken and

promised by grantees to correct these deficiencies are adequate for proper control and for recovering money owed to CSA.

- Establish specific minimum monitoring requirements that grantees must exercise over delegate agencies to include evaluations of internal control systems and strict financial reporting.
- Write and publish guidance to grantees which describes the essential internal control features and tasks of loan processing and servicing.

Also, we support legislation pending before the Congress that would place greater responsibility upon the heads of Federal agencies for the soundness of their organizations' systems of internal financial control.

CHECKLIST OF INTERNAL CONTROL WEAKNESSES FOUND DURING OUR VULNERABILITY ASSESSMENT
OF CSA HEADQUARTERS, REGIONAL OFFICES, AND SELECTED GRANTEE ORGANIZATIONS

Internal control weaknesses	CSA Atlanta Region		CSA Dallas Region		CSA San Francisco Region				
	CSA headquarters	Regional Grantee office #1	Regional Grantee office #2	Regional Grantee office #3	Regional Grantee office #4	Regional Grantee office #5	Regional Grantee office #6	Regional Grantee office #7	Regional Grantee office #8
<u>DISBURSEMENTS</u>									
Grants	•	•	•	•	•	•	•	•	•
Grantee expenditures not monitored		•	•	•	•	•	•	•	•
Grantee internal controls not sufficiently evaluated before funding	•	•	•	•	•	•	•	•	•
<u>Loans</u>									
Loan applications or promissory notes not used, interest not calculated, and poor loan provisions followed									•
<u>Payroll</u>								•	
Checks not safeguarded									
Duties in processing payroll (additions/deletions/distribution) not properly segregated		•		•	•		•	•	•
Payroll, vacation and sick leave, and compensatory time not reviewed or approved by supervisors		•		•	•		•	•	•
Sufficient payroll documentation (time and attendance reports) not required					•		•		
<u>Employee Benefit Program</u>									
Written procedures for payroll deductions, bank deposits, and reconciliations not maintained				•					
Not all funds accounted for				•					
<u>Purchasing</u>									
Purchases not approved in advance									•
Duties not properly segregated (same one or two persons prepare purchase orders, place orders, and receive goods)				•			•		
Attempts to purchase through competitive means not documented									•

Internal control weaknesses	CSA Atlanta Region		CSA Dallas Region		CSA San Francisco Region				
	CSA headquarters	Regional Grantee office #1	Regional Grantee office #2	Regional Grantee office #3	Regional Grantee office #4	Regional Grantee office #5	Regional Grantee office #6	Regional Grantee office #7	Regional Grantee office #8
<u>Purchasing (cont.)</u>									
Proper documentation not required for purchases or leases (purchase orders, purchase requests, or cost comparison)	•	•						•	•
Purchase requests, purchase orders, invoices, and receiving reports not properly reviewed		•		•				•	•
No written procedures maintained								•	•
<u>Travel</u>									
Approval of travel before issuing travel advances not required		•							•
Trips or expenses incurred not sufficiently justified	•	•		•				•	•
Proper documentation (travel requests, travel orders, travel vouchers, cost comparisons) not required	•			•				•	•
Travel documentation not properly reviewed		•		•				•	•
No written procedures maintained								•	•
Not all mileage of leased automobiles accounted for or justified	•								
Leased automobile keys not adequately controlled	•								
<u>Imprest funds</u>									
Adequate or current written procedures not maintained					•				•
Proper documentation (vouchers) not required								•	
No signature required on documentation								•	•
Access to the funds not properly restricted					•				•

Internal control weaknesses	CSA Atlanta Region		CSA Dallas Region		CSA San Francisco Region			
	Regional office #1	Grantee #2	Regional office #3	Grantee #4	Regional office #5	Grantee #6	Grantee #7	Grantee #8
<u>Cash receipts</u>								
Receipts not safeguarded								•
Written procedures inadequate regarding receipt, recording, and depositing cash	•		•					•
Duties not properly segregated								•
Timely deposits not made	•		•					•
Supervisory reviews of receipts and deposits not required	•		•					
Not all cash receipts logged	•		•					•
<u>PERIODIC TASKS</u>								
<u>Property</u>								
Written procedures on conducting physical inventories and reconciling property records inadequate	•			•				•
Duties not properly segregated (same one or two persons maintain property records, conduct inventories, and reconcile records)	•	•			•	•		•
Physical inventories not conducted and records not reconciled		•		•				•
Accurate and current property records not maintained	•	•		•				•
Control numbers not assigned to items of furniture or equipment	•			•				•
Property transfers and thefts not reported to property officials		•		•				•

Internal control weaknesses	CSA Atlanta Region		CSA Dallas Region		CSA San Francisco Region				
	CSA headquarters	Regional office #1	Regional office #2	Regional office #3	Regional office #4	Regional office #5	Regional office #6	Regional office #7	Regional office #8
<u>Financial reporting</u>									
Established procedures for submitting and reviewing grant expenditure reports not followed	•			•					
<u>Confirmation of bank balance</u>									
Adequate written procedures not maintained requiring how bank statements are to be reconciled		•					•		
Bank balances not confirmed				•			•		
Bank reconciliation not reviewed		•						•	
<u>Personnel management</u>									
Previous employment and references of prospective employees not verified									•
Job descriptions not reviewed and updated								•	
Not all qualifications for positions sufficiently defined					•				
Employees not appraised									•
Outside financial interest not reported		•		•				•	•

PRIOR GAO REPORTS DEALING WITH THE
COMMUNITY SERVICES ADMINISTRATION AND OTHER
EXECUTIVE AGENCY VULNERABILITIES

"Federal Agencies Can, And Should, Do More To Combat Fraud In Government Programs," GGD-78-62, September 19, 1978.

"More Effective Action Is Needed On Auditors' Findings-- Millions Can Be Collected Or Saved," FGMSD-79-3, October 25, 1978.

"Decisive Government Action Needed To Resolve Problems Of Community Action Programs In Los Angeles," HRD-79-91, June 11, 1979.

"Quality Testing Of Audits Of Grantees' Records--How It Is Done by Selected Federal Agencies And What Improvements Are Needed," FGMSD-79-38, July 19, 1979.

"Federal Civilian Audit Organizations Have Often Been Unsuccessful In Obtaining Additional Staff," FGMSD-79-43, July 27, 1979.

"Grant Auditing: A Maze Of Inconsistency, Gaps, And Duplication That Needs Overhauling," FGMSD-79-37, June 15, 1979.

"Complications In Implementing Home Weatherization Programs For The Poor," HRD-78-149, August 2, 1978.

"Meeting Winter Heating Bills For Needy Families: How Should The Federal Program Work?" HRD-79-12, April 26, 1979.

Community WASHINGTON, D.C. 20506
Services Administration 

APR 29 1980

Mr. D. L. Scantlebury, Director
Financial and General Management
Studies Division
U. S. General Accounting Office
441 G Street, N.W.
Washington, D.C. 20548

Dear Mr. Scantlebury:

Thank you for the March 31, 1980, letter and the opportunity to review your draft report to the Congress entitled "Weaknesses in Accounting and Managerial Controls Make the Community Services Administration Vulnerable to Fraud and Abuse."

We have reviewed the document thoroughly and are gravely concerned because the draft report conveys a misleading view of CSA management, ignores pertinent facts, presents distorted statements, and is not an accurate portrayal of our concern for accounting and managerial controls. These distortions and erroneous statements are present in the March 31 letter, cover summary, and Digest as well as the body of the draft report.

The draft report fails to recognize many of the controls which were in place and working over disbursements, fails to state that no fraudulent payments were actually discovered, and in turn concludes, that because two controls which GAO considers to be basic controls were not used in initial processing steps, our whole system is inadequate.

Similarly, GAO states that fire protection, security and house-keeping practices are inadequate at our computer facility. The draft report does not make it clear that these matters are the responsibility of the General Services Administration, that a security guard is present around the clock and that the trash in question was in areas of the building occupied by previous tenants and not in CSA's area. The draft report should state clearly that the General Services Administration has the responsibility as building lessor to assure that trash and fire hazards are removed. The draft report also fails to reflect the repeated attempts by CSA to obtain corrective action by the General Services Administration.

On April 17, we met with Mr. Lawrence R. Sullivan and other members of your staff, expressed our dissatisfaction, and specifically requested that the draft report be rewritten. At the conclusion of the meeting we agreed to provide a written response stating our objections to the draft report. Mr. Sullivan agreed to take our comments into consideration and provide a revised draft report for our review.

Although our detailed comments on the draft report are enclosed, we find it important and necessary to point out bluntly our strong objection to the draft report because of its misleading and erroneous statements which falsely portray CSA's management as having a lack of concern for proper managerial controls. We firmly believe the draft report is most unfair and repeat our request that a new draft be prepared that properly and accurately reflects the concerns the Community Services Administration and its managers have for managerial controls and asset protection.



William W. Allison

Acting Director

Enclosure

GAO COMMENT: The second paragraph is not specific enough to respond to except to say that we believe the report is objective and accurately reflects the condition of CSA and its internal controls at the time of our review.

Regarding the remainder of the transmittal letter, the report has been revised on pages 6 and 12 to acknowledge the existence of CSA computer controls and manual reviews of computer-assisted disbursements. While we did not find any computer-related fraud, we did find erroneous and possibly fraudulent disbursements occurring at the grantee level. These are presented in chapters 2 and 5. We have not concluded that CSA's whole computer system is inadequate but do believe that if CSA implemented two very basic automated controls in its computer system, it would have improved protection against potential erroneous or fraudulent disbursements.

Both the draft and final reports specifically state that GSA, which leases the building that houses CSA's computers, has primary responsibility for the building's security and housekeeping. This, however, does not absolve CSA of the responsibility for bringing building deficiencies to the attention of GSA, which it did not do until our visit. The report, on page 19, now calls attention to CSA's around-the-clock security guard. The fact that trash was found in areas of the building not occupied by CSA has very little bearing on how vulnerable CSA computer operations are to fire. Fire can easily spread. More importantly this does not mean CSA should ignore it. In the report we point out that three fires have occurred since March 1978. We specifically did not agree to provide CSA with a revised draft for its review. This final report incorporates CSA's comments where appropriate.

Community Services Administration's
Response to the
General Accounting Office's
Draft Report to the Congress Entitled
"Weaknesses in Accounting and Managerial
Controls Make the Community Services Administration
Vulnerable to Fraud and Abuse"

TRANSMITTAL LETTER

In the March 31, 1980, transmittal letter the second paragraph states that the draft report has twice been discussed with CSA representatives.

CSA RESPONSE - GAO conducted an exit conference last fall with several CSA officials. Congressional hearings were scheduled for March 1980 and CSA asked that the draft report be made available prior to the hearings. Rather than provide the draft report, GAO officials agreed to a second meeting and met with CSA Inspector General personnel. The draft report was not presented, but we were again told about the audit results and the deficiencies observed. CSA did not have access to the draft report as stated in the letter; our first opportunity to see the report was when the March 31, transmittal letter was received.

GAO COMMENT: The March 31, 1980, transmittal letter does not state that CSA was given access to the draft report. It states that we discussed the draft report twice with CSA officials, which we did. In one of these discussions we permitted CSA to use a stenographer who transcribed the draft report as we read it to them.

COVER SUMMARY

1. The summary states that CSA's effect on poverty is being hampered by poor internal controls over fiscal and managerial activities at all levels of the organization.

CSA RESPONSE - This statement reflects the generally distorted theme that permeates the report. The statement implies that all CSA's internal controls are weak, inadequate or unenforced. The statement ignores most of the facts and influences the reader toward a negative picture of CSA management and its internal controls.

2. The statement continues indicating the Administration is highly susceptible to illegal acts as well as non-intentional misuses of Federal money.

CSA RESPONSE - The cover summary implies illegal acts could be perpetrated easily within the CSA program. To our knowledge the findings uncovered by the GAO audit, and CSA's record over the past several years contradict GAO's conclusion. On the contrary CSA has acted promptly and aggressively when illegal acts were found. During the April 17 meeting we cited numerous instances where CSA has taken action to close down a CAA or issued our "Intent to Suspend Telegram" (See pages 10 and 21 for further discussion of this point.)

There are numerous reviews and controls in place and operating effectively as part of our grant program. While these control and review procedures are designed to intercept and prevent intentional as well as non-intentional misuse of Federal money and other assets, our system is not (and it is doubtful if any procedure is) 100 percent perfect.

3. The last sentence of the first paragraph of the cover summary states that GAO identified many internal control weaknesses that have set the stage for potential or actual abuses of Federal money.

CSA RESPONSE - While weaknesses in internal control are cited, the draft report fails to mention the numerous controls that are in place and functioning. (See pages 7 and 8 for further elaboration of alternate and effective controls.) This sentence paints a distorted, unfair and misleading picture of CSA and fails to give recognition to the many established controls being used effectively by CSA management. The statement makes CSA guilty through inference.

4. In the second paragraph, the first sentence states a generally accepted truism that sound internal controls are the best means of preventing fraud and abuse. This truism is followed by a generalized statement that CSA should more vigorously enforce its requirement that strong internal controls be established.

CSA RESPONSE - These statements imply that CSA management is passive on enforcement of internal controls. The draft report fails to present specific courses which should be taken. Additionally, such truisms followed by negative statements implying that CSA lacks internal control procedures, taints the reader's mind and creates false impressions.

GAO COMMENT: We have revised the cover statement to say that there are poor controls over "many" fiscal and managerial activities. This change is intended to point out that not every CSA control is weak but that we found significant weaknesses. The report provides numerous examples of actual and potential abuses, especially at the grantee level. CSA officials told us there were numerous examples available that demonstrate their prompt and aggressive action in responding to illegal acts. However, they provided none of these examples to us either at the meeting they refer to or in response to our request for the information. We agree that no internal control system is 100-percent perfect, and our evaluation and recommendations take this into account. Many of the controls we found to be lacking are very basic and should be installed in any organization. As stated earlier, pages 6 and 12 of the report now recognize the existence of CSA computer and manual controls even though we found weaknesses that led us to conclude that CSA is more vulnerable to fraud, abuse, and error than is reasonable. CSA has already implemented many of our recommendations, which would not have been possible if these recommendations were too general.

DIGEST

The draft report has presented such a misleading picture about CSA's management, internal controls, computer facility, and follow-up procedures that we have requested a new draft report for our review. CSA has serious concerns with the draft report and we are equally concerned with the Digest since it reflects, in condensed form, the main points, conclusions and proposals from the report proper. Because we have commented upon each chapter, little purpose would be served by repeating these same concerns about the Digest. We are confident the Digest will be changed appropriately, but we do want to make a specific response to the Conclusions and Proposals section of the Digest.

GAO Conclusions and Proposals

GAO concludes that "The Community Services Administration's insufficient concern for internal controls influences all regional offices and grantees. Therefore, GAO believes that many regional offices and grantees in addition to those reviewed are vulnerable to fraud and abuse. To encourage concern by all managers, GAO believes the Administration's top management must take the lead by strongly emphasizing to Federal and grantee managers the equal importance of controlling tasks and functions for which managers are responsible and accountable in delivering funds and services."


CSA Response

GAO's statement that CSA has insufficient concern for internal controls is a gross injustice to our extensive efforts to establish sound control and management practices at the Headquarters, regional offices and grantee levels. The Digest's theme, repeated in the report, is not an accurate statement. CSA has numerous existing control procedures which are followed by the Agency; these control procedures were designed to ensure accountability for Federal resources. In addition, since the spring of 1977 several interrelated management improvement projects were initiated. See page 9 for a description of some of the more important projects. Our detailed comments on the report will elaborate and provide documentary support about our controls.

GAO COMMENT: The overall conclusion presented in the final report has been revised to read: "CSA's lack of enough emphasis on internal control..." and "CSA must more strongly emphasize..." It is our belief, after reviewing the documentation provided by CSA, that its management improvement projects have little to do with improving fiscal controls, especially at the grantees where we found most of the internal control weaknesses. Instead, the management improvement initiatives concentrate primarily on grantee program planning, evaluation, and information systems—worthwhile but incomplete efforts.

CHAPTER IINTRODUCTIONGeneral Comments:

Although this chapter is general in nature, provides background information, and describes the scope of GAO's review, certain sections and statements of the chapter need to be discussed. First, the introductory paragraph states this is one of several reports GAO will issue on the vulnerability of selected Federal agencies to fraud and abuse. As expressed in our cover letter, CSA is gravely concerned about the misleading picture this draft report presents. Accordingly, these deficiencies must be brought to GAO's attention so they can be addressed and corrected. We are convinced that the audit reporting demonstrated by this draft report needs to be rectified before other reviews in the fraud and abuse series get to the draft report stage. The Congress, Federal agencies, and public should be given a report that accurately and fairly presents the facts.



Second, Chapter I discusses the purpose and need for sound internal controls. We have no quarrel with the need for controls and with GAO's statement that internal controls are designed to prevent misuse or abuse of money or property. The chapter goes on to point out that to succeed in abusing programs or defrauding an organization having sound internal controls, it is necessary for an individual to enlist the assistance of others. Further, it is stressed that supervisors play important roles in reviewing operations to ensure that controls are in place and working.

Our major concern with Chapter I and the philosophy presented is that the draft report fails to acknowledge the many actions CSA management has taken to develop, install and enforce sound internal controls. The thrust of the draft report leads to the false conclusion that CSA neglects internal controls, takes no action to protect assets, and that fraud and abuse prevail throughout the agency. The draft report ignored almost all the positive steps this agency has taken, focused on isolated instances, made numerous generalizations and drew illogical conclusions.

We conclude from the information presented in the remaining chapters and Appendix I that GAO applied a more rigid standard of performance for internal controls within CSA than the performance described on page 1 of Chapter I. In its general discussion, GAO used words such as "prevent", "discourage" and "minimize fraud and abuse" when describing the results that sound internal controls might bring. Yet, GAO has held a different standard, a more rigid standard, in evaluating CSA's internal and managerial controls. The implication is, since fraud and abuse are possible within CSA's operations, that internal controls are next to non-existent. It is surprising that with the level of weakness implied by GAO, major fraud and abuses were not found during the audit.

GAO COMMENT: The guidelines and standards we used in assessing CSA's internal controls were those promulgated by the Comptroller General and published in GAO's Policies and Procedures Manual for Guidance of Federal Agencies. These guidelines do not significantly differ from the requirements already established and supposed to be in place at all levels of CSA. We have not said nor have we meant to imply that controls are next to nonexistent. However, we found many serious internal control weaknesses which led to actual abuses of Federal funds. Chapters 2 and 5 describe these findings.

CHAPTER 2CSA NEEDS TO IMPROVE MONITORING
AND CONTROLS AT HEADQUARTERS
AND REGIONAL OFFICESGeneral Comments

The draft report paints a picture of inadequate controls which infer weakness but specific examples to support the views presented were not included. Part of this results from a failure to recognize many of the controls which exist but are different from those proposed by the GAO report. Controls are present and functioning. That is why instances of fraud, abuse, or missing funds were not found.

The comment on page 6 dealing with duplicate payments was based upon instances discovered and corrected by CSA when moving from a manual to an automated grant payment system long before the GAO audit. These duplicate payments were fully recovered and no duplicate payment has been made since that time.

The comment on excessive manual transcription of personnel data into the payroll system mentioned on page 6 fails to recognize the separation of duties which is taking place. We disagree that there is a substantial risk that inaccurate payroll payments exist. In fact, many years ago our controls detected an attempt to violate the payroll system. Prompt action was taken by CSA management and the money was returned.

We believe that there is less risk under the present system than in procedures proposed by GAO. It is ironic that in discussing property, the separation of duties is strongly recommended, but when dealing with grant payments and payroll, GAO recommendations eliminate separation of duties as a control factor.

On page 7 the draft report discusses the need for improved controls over input of grant data. The report stresses the techniques of record counts and predetermined control totals and points out that documents may be added, lost, or altered during processing to the detriment of grantees or the Federal Government. Regretfully, the GAO auditors overlooked the controls and edits incorporated in the grant processing system. The system provides for an acknowledgement to the region of all records transmitted (a form of record count), messages listing errors found during the editing process, a report reflecting balanced and unbalanced grants (the unbalanced is repeated daily until corrected), and a data control procedure reflecting changes to the Organization Master File. Moreover, the basic edit concept incorporates many control features which the auditors failed to recognize or mention in the draft report.

The following are examples of controls and edits applied to grantee funding and funds advancement to the grantee:

Inter-File Edits:

- Letter of Credit (LC) and Check Issue (CK) transactions must have a corresponding transaction on the Grantee Fund File (314).
- If a valid match at transaction level is made, a further edit comparing actual obligated dollars to requested payment dollars is then made. If the requested payment is greater than the obligated dollars, the entry is rejected.
- If a grantee 314 funding has no corresponding record on the Grantee Organization File the action is accepted into the system and then maintained in an "Out of Balance" condition which would prohibit any advancement of funds.

Intra-File:

- Date verification on all files.
- Date sequence verifications to assure the proper and legal sequence of events.
- Record count and dollar totals are maintained by fiscal year for verification of file integrity in the LC, CK, and 314 files.
- All LC entries are compared to a cross reference file to assure there is no duplication of grantee records and to further assure accurate amendments to existing grantees.
- Duplication of transaction is prohibited on LC, CK, 314 and Org files.
- Obligating codes are checked for validity against a current table of acceptable codes within funding office of the agency for the 314 file.
- In all files, whenever a known code or range is available, all data fields are compared and edited to the given quantity using a specific algorithm.
- Transmission control edits such as field and message counts are used for the 314 and Org file.

- Specific data fields are required in the LC, CK, 314 and Org files and if not present a rejection of the entire record results.
- Within each 314 grant transaction a dollar summary record is transmitted for dollar control of each line item.

The following is a partial list of controls used in payroll processing:

- No payroll change is made without a signed SF-50 (Notification of Personnel Action).
- A payroll transaction will not be made without a time card.
- Time and attendance (T/A) must account for 80 hours, except for part-time employees.
- If an employee is terminated by Personnel, the employee is automatically terminated in the Payroll System.
- All time and attendance cards are sent to timekeepers with a listing of active employees. Timekeepers must return the cards and the listing to Payroll where the two are matched.
- Payroll reviews this action to insure that all leave, overtime, and compensatory time is accounted for with an officially signed supporting document. Court and military leave must also be supported with approved documentation.
- T/A's are batched and counted before going to keypunch. After punching they are computer listed and counted by batch. Payroll compares the counts.
- Payroll compares each T/A to this batch listings to detect keypunch errors.
- Manual adjustments to Payroll such as retroactive changes and lump sums are entered on a transcript and supported with official documentation. The Payroll supervisor arrives at totals which are then compared to a computer produced report.
- At the Computer Center the Payroll edit is run until it is error free. T/A rejects or errors are reviewed and corrected by the Payroll supervisor, system programmer and the Chief of Programming.
- A biweekly computer run is made comparing Personnel and Payroll indicating any discrepancy and sent to Personnel, Payroll and Finance for review.

SPECIFIC COMMENTS ON CONCLUSIONS AND PROPOSALS

GAO Proposal: Emphasize to all management levels the significance of good internal controls and of the necessity for managers to make sure that tasks and functions, for which they are responsible, are adequately controlled to prevent or reduce risks of either intentional or accidental misuse or abuse of Federal funds.

CSA Response: It is untrue that the Community Services Administration has an insufficient concern for internal controls or the tasks and functions of Federal program/project managers. For example, the following staff instructions, memoranda and procedures document the fact that the Director, Assistant and Associate Directors and the employees under their supervision have been carrying out their responsibilities in managing Federal resources and have concern for controls:

- Grant clearance memorandum of November 4, 1977 - Assistant Director, Office of Community Action. Attachment A
- OCA Staff Instruction 2610-1 establishment of OCA Project Review Board for Proposed Grants and Contracts December 6, 1977 - Assistant Director, Office of Community Action. Attachment B
- OMB Bulletin 77-9 April 19, 1977 Zero Base Budgeting - Memorandum from Associate Director for Administration (May 12, 1977) transmits Bulletin to Director/Deputy Director, Assistant Directors, Associate Directors, Regional Directors and instructs that information be given to first line supervisors. Attachment C
- Grants Management Systems Project Initial Report and Recommendation of the 6710-1 Task Force dated February 17, 1978. Attachment D
- Grantee Program Management Task Force - Initial Meeting Memorandum, April 3, 1978, with attachments Task schedule, Statement of work and Philosophy. Attachment E
- Memorandum of Agreement with the National Archives and Records Service (NARS) of the General Services Administration for NARS to assist the Community Services Administration in the determination of the resources required to design and operate improved grantee application and performance monitoring systems - January 13, 1978. Attachment F
- Report of NARS for Phase I of Grantee Information System Recommended System Concept and Implementation Requirements, May 1978; transmittal memorandum and report from the Assistant Director for Management to the Deputy Director, Assistant/Associate Directors, Regional Directors, June 27, 1978. Attachment G

- Interim Program Data Highlight for Section 221 (local initiative) funds - transmittal memorandum of November 2, 1978, with instructions and forms, from Assistant Director of Community Action to Regional Directors, revised May 1979. Specifically Section V, Grantee Eligibility (page 6, Attachment H).
- The Memorandum of Agreement between NARS and CSA and the NARS report which was a result of that agreement clearly document the concern of the CSA for grantee information and systems development for an improved grantee application and performance monitoring system. The May 1978 NARS report clearly defined the problems of the system in place in 1978. Note specifically pages 1 through 8 of the report, Attachment G.

CSA took action on the NARS report of May 1978 and executed Phase II of the Grantee Systems Development Project on July 14, 1978. The basic objective of Phase II was the design and test of an effective grantee information system and the provision of a system development document.

GAO Proposal: Strengthen internal controls over the grantee monitoring system to prevent grantees from withdrawing excess Federal funds.

CSA Response: Treasury Circulars relating to letters of credit make prevention of excessive drawdowns impossible. Over a year ago we initiated a computer comparison system to monitor letter of credit drawdowns by grantees. As grantees who are drawing down excessive amounts of funds are identified, letters are sent to those grantees asking for an explanation and the return of excess funds plus any interest earned by the grantee. In those instances where the grantee has abused the drawdown system, the program office is notified to implement appropriate sanctions.

CSA Regional Offices monitor the submission of quarterly financial reports, provide training and technical assistance to grantees, and issue letters to grantees who do not submit quarterly financial reports in a timely manner. Additionally, "telegrams of intent to suspend authority to expend grant funds" are issued when a grantee has not submitted required reports.

GAO Proposal: Reduce or suspend funding of grantees (in conjunction and coordination with other Federal agencies providing funding) who are found repeatedly to have inadequate internal controls and/or withdrawn excess Federal cash.

CSA Response: As indicated in our previous response, the program office is advised of grantees who repeatedly violate the letter of credit drawdown procedures. These grantees, together with any found to have serious internal control problems year after year, are subjected to appropriate sanctions including reduced or suspended funding. CSA has numerous examples where a grantee's funding has been suspended pending the resolution of serious internal control weaknesses. CSA also has numerous examples of notification of and coordination with other Federal agencies.

GAO Proposal: Design, implement, update, and maintain proper controls and documentation of the computer system that will reduce the risk of erroneous payroll and grant disbursements and improve the efficiency of data processing.

CSA Response: We will reexamine the controls which currently exist in the payroll and grant disbursement systems as we document our accounting system design as required for Comptroller General approval. However, as indicated previously we believe many of the controls which currently exist in the two systems are superior to those proposed by the draft report. Nevertheless, one objective of both the Financial Management and Data Processing Divisions is to review the payroll and grant disbursement systems. This examination will include the adequacy of controls, completeness of systems documentation, and effectiveness of the system design. The report would have been more helpful if specific recommendations rather than generalized proposals had been made for reducing risk and improving efficiency.

GAO Proposal: Write, distribute, and implement detailed procedures for headquarters and regional offices to use in receiving, recording, and depositing cash receipts.

CSA Response: Detailed procedures for use in receiving, recording, and depositing cash receipts will be updated as part of our accounting system design later this year. In response to a previous Treasury Circular on the same subject, a draft notice was written and distributed to our Headquarters financial personnel as an interim procedure until the accounting system design is completed. Part of the delay in handling cash receipts is caused by our centralized system of receiving, recording and depositing cash receipts at the Headquarters office. We are considering decentralizing this function so regional offices can make more timely deposits on local member banks of the Federal Reserve System. In addition, the Headquarters office of Regional Operations doesn't hold check receipts for one to two weeks as stated on page 14 of the draft report.

GAO Proposal: Properly separate property management functions so that no one person has responsibility for receiving equipment, entering equipment in property records, maintaining property records, and conducting physical inventories.

CSA Response: This area has been included in our accounting principles and standards and will be covered in more detail as we complete our accounting system design. We recognize the need for separation of functions in this area, but have been unable to assign sufficient people to fully separate certain functions. A physical inventory is in process in our Headquarters office and property cards will be updated accordingly. As indicated in a recent IG review, CSA has bought very little furniture during the past several years. Therefore, the need for an elaborate control mechanism and separation of functions is alleviated to a significant degree.

GAO Proposal: Improve the physical control and recordkeeping of furniture and equipment including establishment of a general ledger control account.

CSA Response: The recordkeeping for furniture and equipment will be improved significantly as we complete our accounting system design and our current inventory.

GAO Proposal: Take action necessary to submit an acceptable accounting system design for Comptroller General review and approval.

CSA Response: CSA had taken action toward Comptroller General approval of our accounting system design. In 1979, CSA resubmitted its accounting principles and standards and obtained Comptroller General approval. Concurrently, CSA also conducted a review of its Fiscal Control System to identify areas of needed improvement as well as actions necessary to obtain Comptroller General approval.

The tasks relating to the development and implementation of an accounting system which would meet the needs of CSA and also be approved by the Comptroller General were identified and announced in an invitation for bids in the Commerce Business Daily on March 23, 1980. We expect to select a contractor to begin providing us this assistance within the next month.

GAO COMMENT: Both the draft and final version of this chapter contain specific examples of the weaknesses we identified at CSA headquarters and regional offices, such as the lack of computer system documentation, excess grantee cash, missing property items, and the lack of record counts and predetermined control totals in computer processing. If some CSA controls did not exist, we undoubtedly would have found even more weaknesses. Neither the draft nor final reports make mention of duplicate payments. Pages 6 and 8 discuss excessive grantee cash drawdowns, not duplicate payments. What is claimed by CSA to be a separation of duties in transcribing personnel data for the payroll system is in fact a duplication of effort—the same work is being performed by two groups of people. More importantly, at present, payroll clerks have access to and enter all data in the computer necessary for calculating a paycheck. (The list of controls used in payroll processing provided by CSA are performed by payroll personnel or accomplished after the fact. See p. 25.) We are not advocating that CSA discontinue use of its present controls but instead are suggesting that it add some necessary controls that will further reduce the risks of erroneous payroll disbursements. The section of the draft report dealing with the input of grant data has been deleted in light of the many controls in place over making grants. However, we believe that if record counts and predetermined control totals were used in processing grant data to supplement existing controls, CSA would have additional protection against erroneous or fraudulent grants disbursements. Our recommendations deal primarily with the need to assure that sound fiscal internal controls are in place. CSA's response lists many actions it has taken or is implementing to improve controls, but these initiatives are predominately matters involving grantee program effectiveness rather than fiscal accountability at the grantee level where we found most of the internal control weaknesses. As such, CSA's "system" to monitor grantee letter-of-credit draw downs presently identifies only those grantees who have drawn down an entire year's grant money with more than 1 month remaining in the program year. This is not adequate. Our discussions with CSA regional officials demonstrate that, with the exception of one region, quarterly financial reports submitted by grantees are not adequately reviewed or acted upon when discrepancies are found. Despite CSA's contention of numerous examples which demonstrate that appropriate sanctions have been taken against grantees who repeatedly violate the letter-of-credit system and/or are found to have serious internal control problems year after year, few examples were provided to us. As described in chapters 2, 4, and 5 we found the opposite to be occurring. In light of CSA's efforts in March 1980 to seek contractor assistance in developing an acceptable accounting system design, we have deleted this recommendation from the final report.

CHAPTER 3WEAKNESSES IN COMPUTER SECURITYGeneral Comments

The Community Services Administration was well aware of the need for improvements in the building in which its computer center is located. CSA is a tenant in a building in which the General Services Administration has responsibility for physical security, fire protection, and housekeeping arrangements. We repeatedly called to General Services Administration's attention the same deficiencies as described in Chapter 3 of the draft report. In fact, CSA personnel provided GAO Auditors with lists of discrepancies called to General Services Administration's attention and for which we have repeatedly sought corrective action. See attachments I-1 through I-19 which record some of the repeated efforts and appeals CSA has made to the GSA Building Manager and GSA Regional offices. Furthermore, it should be pointed out that CSA occupies limited areas in the building and that most of the discrepancies noted were in areas vacated by other Federal agencies.

The fact that General Services Administration is responsible for and provides protective services for the building should be stated clearly in the draft report and the efforts CSA made to have General Services Administration correct the deficiencies included as well. Clearly acknowledging General Services Administration's responsibility throughout the Chapter is important since many of the conditions cited and described are beyond the control of CSA.

Although a formal risk analysis required by OMB Circular A-71, Transmittal No. 1 issued July 27, 1978, had not been conducted at the time of the audit, appropriate recognition of the need for protection and security measures had been taken and security procedures were in place at the computer center.

A Federal Protective Service Division guard is on duty 24 hours a day, seven days per week. Specific written instructions and duties have been prescribed. At the April 17th meeting a copy of the the security guards' responsibilities and duties was provided. The guards play an important role in fire detection by making repeated rounds of the entire building.

The draft report states that four agencies have moved to other locations because of the building's deplorable condition. We have no knowledge as to the reason the other agencies departed. GAO has not provided documentation to support the comment nor has evidence been presented to show interviews with responsible officials of the other Federal agencies that had occupied the building. GSA made the decision that the lease on the building would not be renewed and instituted forced move procedures upon the Government tenants. CSA had agreed to relocate when GSA found a suitable facility for our computer operations.

We have taken initiatives with GSA to have security and other deficiencies at the current location corrected. The broken glass door on the first floor has been repaired and the plywood removed. GSA has had the trash left by previous Government tenants removed.

One of the security features installed at the building is a card-key access mechanism. These devices were installed by one of the Government tenants that moved from the building. That agency issued and controlled the card-keys. Responsibility then passed to a second agency and only recently were the card-keys passed to CSA. The records accompanying the card-keys were incomplete and we had no way of knowing whether all keys could be accounted for or whether there were lost or stolen cards. Since assuming responsibility for the card keys, CSA has replaced the encoded key in the lock and new card keys have been issued to current occupants. This change in the lock precludes unauthorized entry by holders of the original magnetic card-keys.

The caption for the picture on page 19c, is incorrect. The CSA employee is demonstrating an authorized entry using a legitimately issued card-key. The picture and the caption should be deleted from the report.

All the photographs on pages 19a, 19b, 19d, and 19e are of areas not under CSA's control or responsibility. Furthermore, the picture at the top of 19b deals with an interior lock that is unnecessary for protection of the computer tapes. The lock on the tape library door leading to the hallway was replaced as a result of a CSA request to GSA. The picture at the top of page 19f is irrelevant. Similarly, the picture in the lower half of page 19f shows a fire extinguisher that had not been inspected. Yet, the records show that all the extinguishers were inspected and tested during the period of time covered by the audit.

We ask that all the photos be deleted from the report to help reduce the sensationalistic character of Chapter 3.

CSA has requested that the General Services Administration install smoke detectors throughout the building. Although General Services Administration has promised to take action, the smoke detectors have not been installed. GSA has at our request inspected and recharged all fire extinguishers throughout the building and updated the inspection certification.

A work order for the installation of a security door and cypher locks to provide added security for the computer room and tape library areas was submitted to GSA. We have repeatedly prodded GSA to expedite the addition of these security features, but installation has not been accomplished. (See attachment I-18).

We have made a criticality assessment of our data processing applications. The most critical have been identified and analyzed. These applications have been tested on another Government agency's computer to ascertain if that facility would be feasible for back-up purposes. The test was successful and a formalized back-up agreement is in process.

As further assurance of recoverability in the case of a major disaster, we have taken action to enforce the procedure for storing duplicate master files in vaults located in another building. The systems disk containing the necessary software to recover is compiled daily and stored at two alternate locations. Further, capability to assure continuity of operations has been verified by CSA officials that the essential elements of the most critical applications, could be accomplished manually in an emergency situation. The agency has the contingency capability to assure that the critical elements would be accomplished in the event of destruction or severe damage to the computer facility.

SPECIFIC COMMENTS ON CONCLUSIONS AND PROPOSALS

GAO Proposal: Conduct a formal security risk analysis of the computer center as required by OMB Circular A-71.

CSA Response: A risk analysis following the procedures of OMB Circular A-71, Transmittal Memorandum No. 1 and FIPS Pub. 65, Guide-line for Automatic Data Processing Risk Analysis is in progress and will document the less formal studies and analyses conducted previously which resulted in the establishment of the security and protection procedures now in place.

GAO Proposal: Request the General Services Administration to either improve building security at the current location or relocate computer operations to a facility agreeable to both agencies.

CSA Response: At the time of the GAO audit, the lease had expired and CSA was tenant under the "Holdover Lease, Quarterly Renewable" agreement between CSA and the building owner. Moreover, GSA had placed CSA in a forced move status and had proposed that CSA relocate its computer operations to the Washington Navy Yard. Although, at one time CSA reluctantly accepted the proposed site, GSA failed to renovate the facility and we

have since advised GSA that the Navy Yard was not a suitable location.

The record is clear that CSA has continually sought General Services Administration's correction of the housekeeping and other deficiencies in the building. Through our efforts, progress has been made in cleaning debris from the areas occupied by previous Government tenants, replacing the broken glass on the door and inspecting the fire extinguishers.

GSA is currently negotiating with the building owner to have all of CSA's computer operations centralized on the second floor of the present facility. It is our understanding that the building owner plans extensive renovation and the GSA will assure that deficiencies are corrected and the building brought to proper standards.

GAO Proposal: Correct security weaknesses in the computer facility by installing smoke detection and fire extinguishing equipment, restricting access to computer equipment, programs, and files, accounting for files, and requiring tapes to be logged out.

CSA Response: CSA has repeatedly called to GSA's attention the need for smoke detection equipment in the computer facility. However, detectors have not been installed to date.

A work order was submitted to the General Services Administration to construct a wall and install two cypher locks in the computer area. This modification, when completed by GSA, will isolate our computer operations and tape library areas and provide additional security measures over those already in place.

Modifications are being made to the tape library system and improved automated controls are being introduced to further improve controls over computer tapes and automated data.

GAO Proposal: Insure proper documentation, testing, and approval of all computer programs and changes.

CSA Response: Each of our systems is scheduled for review and evaluation over the coming months. Examination will be made to assure that the documentation is adequate, accurate and current. In addition, revised procedures for approving new computer systems, changing existing systems, and authorizing the use of data processing resources will be established.

GAO Proposal: Establish contingency plans which provide the capability for continuous operations in the event of a disaster.

CSA Response: We have identified our critical and sensitive systems. These systems have been tested successfully at another Government data processing facility. A suitable agreement to provide back up processing support in the event of disaster or should our computer be inoperable for prolonged periods is being negotiated.

GAO COMMENT: CSA is in fact a tenant in the building housing its computer operations, but according to OMB Circular A-71 each agency is responsible for assuring an adequate level of security no matter whether the agency data is processed in house or commercially. Thus, CSA clearly has responsibility. This point is made clearer in the final report. CSA's "repeated" calls to GSA for correcting the building deficiencies we note in the report all occurred either after or during our review, as evidenced in the documents provided by CSA. We believe that our presence, in large part, brought pressure to bear on CSA officials to notify GSA of the building deficiencies. Where broken windows and doors were found or where trash was found strewn is a moot point. These conditions made CSA's computer operations vulnerable to unauthorized access and damage by fire at the time of our review. The final report now mentions the security guard who protects CSA's computer operations. However, the guard was not very successful in preventing three fires in the building nor would this person necessarily be effective in preventing unauthorized access to the building currently available through broken windows. The draft and final reports state that three, not four agencies have moved to other locations. Nevertheless we have deleted this sentence from the report because, in our opinion, it detracts from the central theme of this chapter—weaknesses in computer security. Photographs have been removed showing the use of card keys, checking inspection dates on fire extinguishers, and a broken door lock. In our opinion the other photos clearly depict the condition of the building as we found it at the time of our review. Throughout the final version of this chapter we have acknowledged the actions taken by CSA during and since our review, such as having the fire extinguishers inspected and tested, removing the trash, repairing the broken door, installing a new card key, requesting smoke detectors and cypher locks from GSA, securing computer tapes and files, and developing computer contingency plans. Our recommendations take these actions into account.

CHAPTER IVMORE EMPHASIS NECESSARY
ON INTERNAL CONTROL
AUDITS AND FOLLOW-UP ON FINDINGSGeneral Comments

GAO states that after conducting its own review of internal controls at eight grantee locations, the same internal control weaknesses had been reported in prior years by independent public accountants.

This is convincing evidence that the objective of our quality assurance review program is being met to a considerable degree, even though CSA's audit guidelines do not now formally require that audits be done in accordance with the Comptroller General standards. CSA's audit guidelines do require that the audit be done in accordance with generally accepted auditing standards adopted by the American Institute of CPAs which also apply to audits done for governmental agencies. These have also been incorporated into the Comptroller General standards.

The analysis of our quality assurance reviews, which was done at the recommendation of GAO, was interpreted erroneously by GAO. The primary purpose of a letter to CPAs which included quality assurance results was to help improve the future audits that were to be done of grantee operations. Necessarily, our comments were made in broad terms. For example, we indicated that there were 29 cases where the internal control questionnaire required to be part of a CPA's workpapers was lacking. A more correct statement would be that an internal control questionnaire was not fully completed in 29 instances. GAO concluded that in 27 percent of the audits we reviewed (29 of 107), the CPA's had failed to review the system of internal control. This is not the case and our working papers will clearly document this. For example, there were only 2 cases where an internal control questionnaire was not included in the CPA's working papers and in both cases the CPA's work was considered substandard by CSA.

GAO states that we have documented enough instances of insufficient audit work to justify that the Comptroller General standards need to be applied. Our audit guide and generally accepted auditing standards already required the CPAs to perform the steps which we have indicated they did not perform. Therefore, one cannot conclude that these weaknesses resulted because CSA did not enforce the Comptroller General's standards.

GAO states that CSA should be conducting single audits of grantees funded from many sources.

CSA agrees that this should be done and in fact has requested the Office of Management and Budget to consider designating CSA as the cognizant audit agency for all private non-profit Community Action Agencies. We are awaiting completion of a supplement to GAO's audit guide showing the major compliance features of Federal programs which will require review by the independent public accountants at the time of their audits. When the supplement has been completed we will incorporate the "GAO Guidelines for Financial and Compliance Audits of Federally Assisted Programs" into the CSA audit system.

CSA has and continues to participate in single audits. In the last 2 years, we have engaged in over 35 single audits. In addition to cross-service audit agreements with the Department of Health, Education, and Welfare; Defense Contract Audit Agency; and Department of Energy, we have recently agreed with DHEW to pursue the possibility of auditing all Head Start and CSA funds at the same time the CSA grantee obtains its annual audit. The first step is to attempt a match of grantees having the same year end date.

We also agree that the review of internal controls be documented in some form to describe the tasks performed to control and manage Federal funds and other assets purchased with those funds. We are not sure whether an internal control flow chart for all grantees (large, small, rural, urban, etc.) would be the most practicable and/or economical format to provide the needed documentation. In some cases, a written narrative may be acceptable. In any event, the "GAO Guidelines" mentioned above recommend such documentation of internal control review and this will become a part of all grantee audits when the guidelines are introduced into the CSA audit system.

The shortage of audit staff logically impacts on both the areas covered and the degree of detail covered. However, some internal audit work has been done in each of the areas detailed in the report. Audit reviews performed during the three years since the start of FY 77 include:

In personnel management

The Reports and Statistics generated at the Headquarters and Regional Offices and the process flow of Requests for Personnel Actions in the Headquarters office.

In support services

Property Management and Accountability in five Regions and Headquarters.

Data Processing at Headquarters

Telecommunications in Headquarters

Small Purchases at Headquarters and one Region

Contract Award and Administration at Headquarters

Printing Activities in Headquarters

Travel in Headquarters

Office Supplies in Headquarters

In financial services

Apportionment, Allotment and Allowance Control at Headquarters and three Regions.

Overtime in Headquarters Office of Community Action

Cash Management at Headquarters and three Regions

In program management

The Community Food and Nutrition Program

The Rural Home Repair Program for the Poor

SPECIFIC COMMENTS ON CONCLUSIONS AND PROPOSALS

GAO Proposal: Reduce or suspend funding of grantees (in conjunction and coordinatin with other Federal agencies providing funding) who are found repeatedly to have inadequate internal controls and/or withdrawn excess Federal cash.

CSA Response: CSA's policy for grantee eligibility requires the funding office to have an Independent Public Accountant's Certificate stating the grantee has internal controls to safeguard the assets of the grantee. When audit findings report that this is not the case, CSA adds special grant conditions preventing release of funds and/or notifies the grantee of an "intent to suspend authority to expend grant funds" unless corrective action is taken.

GAO Proposal: Continue testing the quality of audits conducted by independent public accounting firms on a statistical sample basis and insist these firms correct any deficiencies found.

CSA Response: We are continuing to test the quality of audits conducted by independent public accounting firms. However, as GAO and Senator Lawton Chiles have pointed out, there is also a need to follow-up on the implementation of corrective actions taken by grantees and program officials in response to audit findings and recommendations. This we believe is of equal importance as reviewing the quality of audits and both are required by the Inspector General Act of 1973, but unless staff increases occur, we will be forced to reduce our efforts in some areas as others command increased attention.

GAO Proposal: Require grantees to arrange with an independent public accounting firm to document (flowchart) the internal controls over major tasks it performs which affect Federal funds and other assets purchased with those funds.

Require grantees to retain these flowcharts and to update them, as necessary, to reflect the current name of individuals performing significant control steps.

CSA Response: These requirements are also recommended in the GAO Guidelines For Financial and Compliance Audits of Federally Assisted Programs and will become a part of a grantee's audit at the time these Guidelines are implemented.

GAO Proposal: Enforce the requirement that grantee audits be conducted in accordance with Comptroller General standards and the "Guidelines for Financial and Compliance Audits of Federally Assisted Programs," dated February 1980 as stated in OMB Circular A-102, Attachment P.

CSA Response: We agree that CSA audit guidelines should require that grantee audits be done in accordance with the Comptroller General standards.

GAO Proposal: Place a higher priority on fulfilling internal audit requirements including the documentation (flowcharting) and assessment of internal controls over major tasks to eliminate the current backlog of audit work which exists. If additional auditors are needed, requests should be made to obtain the necessary staffing.

CSA Response: Our current authorization for FY 1981 includes 7 additional positions for the Auditing Office. Some of these positions will definitely aid in strengthening CSA's internal audit function. It should be noted that the number of positions allotted to the IG effort has been increased from 55 to 61 positions in 1980 and to 71 positions in 1981. CSA believes that although additional audit positions are necessary, there is also a need within CSA to add field representatives who can monitor the grantees current operations to prevent fraud and abuse instead of post auditing operations.

GAO COMMENT: The effectiveness of CSA's quality assurance review program is not the primary thrust of this chapter. As described in the chapter title and the body of the report itself, CSA must take more aggressive action against grantees who are repeatedly found to have weak internal control systems. While it may be CSA policy to prevent the release of funds and/or notify grantees of this intention unless corrective action on audit findings is taken, our review disclosed that this policy is apparently not always practiced by CSA. As evidence of this, in chapter 4 we present examples of repeated violators. The fact that some annual audits have disclosed serious weaknesses does demonstrate that some quality audit work has been performed. However, this does not imply nor is it sound to conclude that the objective of having quality audits is being met. We believe that CSA's own analysis of audit work demonstrates deficiencies in this regard. What CSA has characterized as an erroneous GAO interpretation concerns only one finding of CSA's own list of 9 findings resulting from its analysis. Additionally, the draft nor final GAO reports conclude that in 27 percent of the audits reviewed by CSA, the audit firm failed to review the grantee's system of internal control, as CSA contends. Nevertheless, in the final report we have inserted CSA's most current wording of the finding in question, "... that an internal control questionnaire was not fully completed in 29 instances." We have also included a reference to CSA's plans to increase its efforts in assuring that grantees take corrective action on audit findings in lieu of continuing its same level of quality assurance reviews. Finally we recognize that CSA's audit guide does not differ significantly from Comptroller General standards and as such we have changed the final report to reflect this situation. Regarding shortfalls in internal audit coverage, CSA's list of work it has performed since the start of fiscal 1977 confirms this finding. Briefly, shortfalls exist in auditing regional office procurement, travel, office supplies, and telecommunications as well as some nationally recognized programs, such as the loan development fund and the summer youth program.

CHAPTER VGRANTEE ORGANIZATIONS NEED BETTER
INTERNAL CONTROLS OVER OPERATIONSGeneral Comments

The Community Services Administration has been well aware of the need for improvement of grantee monitoring activities by its Regional Offices; specifically the field representative's role for grantee on-site reviews. CSA has initiated several projects designed to strengthen the accountability of its grantees and its field personnel (See page 9). CSA Regional Offices and Headquarters were reorganized and planning and evaluation functions were reinstalled. Significant policy and grant-making responsibilities were returned to Regional Directors. An agency planning system was instituted for the purpose of better focusing policies and resources. An Interim Program Data Highlight System was established to provide CSA with data on CAA planning capabilities and local initiative allocations. All of this took place prior to completion of the GAO audit. In addition, CSA developed and is in the process of implementing a comprehensive grantee program management system (GPMS) which sets forth standard planning, application, performance and evaluation procedures to be used by all Community Action Agencies. The new system reinstates and reemphasizes the pre-funding field visit, and places primary responsibility for grantee review and assistance on the field representative. Furthermore, it requires grantees to establish and document planning and self-evaluation processes, and provides the basic criteria for Regional Office review. Together, these changes have moved CSA, in the past two years, to a more actively supportive role in community action programming.

The Grantee Program Management System was published in the Federal Register as a Proposed Rule in August 1979; subsequent field testing of this proposed rule was completed in the fall of 1979 and detailed procedures and staff manuals for CSA personnel have been drafted for the implementation of this system. CSA expects that this system will be published as a final rule in the Federal Register this spring. It is important to note that the draft proposed rule was available to the auditors at the time of their review and yet they choose not to cite it or other management initiatives the Agency has taken since 1977.

CSA has taken follow-up action on the grantees cited in the draft report. For example, on pages 56 and 57 of Chapter 5 GAO states: "Many of the deficiencies noted in this chapter have been previously identified and highlighted in other GAO reports." ... "Yet sufficient corrective actions have not been taken by CSA. The following case typifies the situation. On June 11, 1979, GAO issued a report entitled 'Decisive Government Action Needed to Resolve Problems of Community Action Program in Los Angeles', HRD 79-91" -- then several deficiencies are noted.

The deficiencies listed in GAO's draft report failed to recognize that CSA closed this grantee in December 1978. CSA made major changes of policy both during the audit and before the GAO audit report (HRD -79-91) was issued. It is significant that the report (HRD-79-91) had to be revised several times so that GAO could recommend actions CSA had not already taken.

In this draft report GAO has mis-characterized its own recommendations from the Los Angeles report and now claims that CSA ignored them. Pages 50 and 51 of HRD-79-91 summarizes 10 recommendations made by GAO. The 2 which this GAO draft report deals with are the 7th and 9th. The 7th states that CSA develop a system for verifying self evaluations and being sure the grantee takes these into account in its funding decision. The GPMS clearly accomplishes this and GAO was provided copies of this regulation. The 9th regarded guidelines governing conflicts between Federal policy and local control. On November 6, 1979, CSA responded to the Comptroller General with a list of a half dozen steps taken to meet this recommendation. If these steps were inadequate, which we deny, an explanation is clearly due why deficiencies are again mentioned in the current draft report.

SPECIFIC COMMENTS ON CONCLUSIONS AND PROPOSALS

GAO Proposal: More vigorously enforce the requirement that grantees have strong internal controls and if necessary, impose strict penalties by reducing or suspending funding of grantees(in conjunction and coordination with other Federal agencies providing funding) who are found repeatedly to have inadequate internal controls.

CSA Response: The Community Services Administration has established procedures and a policy of immediately suspending authority of grantees to expend funds who have been found to have inadequate internal controls. Also, in contrast to the statement in Chapter II, page 9 "with the exception of one region, Dallas, little follow-up action is taken to expedite delivery of the reports" (Quarterly Financial reports), several regional offices routinely send letters to grantees reminding them of the requirements for quarterly financial reports with the following statement in the text of the letter:

Failure to comply without written waiver by CSA will require suspension procedures to be implemented as outlined in Boston Regional Instruction Br-1-6730-1, dated January 9, 1978, (or comparable instructions in other Regions) and CSA Instruction 6800-13, dated March 30, 1977.

The suspension procedure is implemented by a letter of delinquency to the grantee pointing out that the required financial reports are overdue and a warning to suspend is given. If the reports are not received within 10 days, an "Intent to Suspend" telegram is sent to the grantee. These steps normally achieve the desired corrective action. In those rare instances where proper action is not taken, the suspension is effected and the grantee is prohibited from making expenditures or obligations. This step is then followed by a hearing where the grantee's deficient performance is reviewed and unless the corrective action has been taken and the quarterly financial reports submitted, termination procedures ensue. See attachments J-1 through J-4 for examples.

The GAO proposal is well intentioned but it fails to give recognition to the vigorous follow-up and suspension program that has been a long established management practice in the Regional Offices. The following is a partial listing of the number of follow-up and management advisory notices issued to grantees in fiscal year 1979:

<u>REGION</u>	<u>NUMBER</u>
II	39
IV	236
VIII	88
X	89

Another management action, not acknowledged by the GAO auditors, is the Regional Offices' Financial Management Workshop where training is provided to grantees. This training is an overview of the whole financial structure from grant application through the annual audit. At these workshops special emphasis is given to preparation of the quarterly financial reports. Property and fiscal management will be emphasized at a workshop planned for June 1980. See attachment K for an expression of gratitude from grantees for the help and training provided at Workshops conducted in 1978. Note especially attachment K-4, dealing with the June workshop.

GAO Proposal: Establish minimum monitoring requirements that grantees must exercise over delegate agencies to include evaluations of internal control systems, strict financial reporting, and program evaluations on a recurring basis.

CSA Response: CSA Instruction 6710-1 requires a written contract between the grantee and any program delegated to another agency or organization. The standard contract form for delegation of a program account specifically requires the grantee to use the standard contract or the following; "additional material may be added which restricts the power of the delegate agency, but any contract which gives greater power to the delegate agency must be approved by OEO (CSA) prior to the signature." The grantee will, in any event, be held responsible for the successful execution of the program, and must exercise the degree of supervision and control commensurate with the responsibility." Note attachment L for specific language of the contracts. These procedures were being updated at the time of the GAO audit and a proposed rule was published in the Federal Register on August 30, 1979. Note attachment M.

CSA currently requires delegate agency financial reporting and the submission of semi-annual project progress reports. In addition CSA is in the process of updating a guidance manual entitled "Delegating and Managing Community Action Programs" to assist both CAAs and delegate agencies in working out relationships that will lead to a more effective Community Action Program. The manual outlines some basic principles of delegation, defines the responsibilities of the CAA and of the delegate and identifies processes which should help to ensure a good delegation agreement and subsequent monitoring. One chapter details responsibilities of the CAA and the delegate which includes CAA's monitoring and evaluation of the delegate. The required monitoring should take the form of reviewing significant program information and financial reporting and meeting with the key delegate decision-makers to ascertain the progress of the program.

Also provided in the guidance is a list of administrative tasks to be negotiated between the CAA and the delegate. Included under financial management are budgeting, accounting systems, controller-ship, financial reporting, auditing, etc.

Another chapter in the manual addresses the monitoring function and provides guidance to the program monitor in this process. Guidance includes an illustrative checklist of key monitoring questions in the areas of program information reporting, financial reporting, and administration.

We feel that the issuance of this manual will help to strengthen CAA monitoring of delegate agencies.

GAO Proposal: Write and publish guidance to grantees which describes the essential internal control features and tasks of loan processing and servicing.

CSA Response: In the case of the two Community Development Corporations reviewed by the GAO, corrective actions have already been taken to rectify the deficiencies and to ensure that they do not recur.

In addition to addressing those deficiencies identified by the GAO, CSA would like to point out that a complete interlocking system of accountability is already in place which ensures fiscal, managerial and administrative accountability for all funds disbursed by CSA under the aegis of the Special Impact Program.

The main features of the accountability system currently in effect are detailed in attachment N.

GAO Proposal: Follow-up on the specific grantee deficiencies we noted to determine whether the actions taken and promised by grantees to correct these deficiencies are adequate for proper control of these tasks and for recovering money owed to CSA.

CSA Response: The specific deficiencies noted for the Title II grantees (CAA's and single purpose agencies) have been addressed and in several instances were known to the grantee and the Regional office prior to the GAO audit through on-site assessments of the grantees and through their annual audit reports. These are detailed in our response for each of the grantees in attachment O.

GAO COMMENT: CSA's efforts to improve its grantee monitoring system, most notably the Grantee Program Management System, is designed to provide CSA managers and grantees with standard planning, performance, and evaluation procedures; to require grantees to establish and document planning and self-evaluation processes; and to place primary responsibility for grantee review and assistance on CSA field representatives. This awareness and action by CSA certainly appears to be worthwhile but incomplete. Our evaluation of these efforts indicates that the new system stresses and will measure program performance, not fiscal internal control compliance, which constitutes the major deficiencies we cite in the report. Only a very small segment of the new system, as published in the Federal Register in August 1979, deals with fiscal internal control, and these requirements are virtually no different than those already required by CSA. In our opinion, the deficiency that needs to be addressed and corrected by CSA is its failure to aggressively act upon recurring grantee internal control weaknesses.

Regarding CSA's actions in response to our previous recommendation that CSA establish guidelines and criteria for taking action to reconcile conflicts between local control of funds and Federal responsibility to protect these funds, we have amended the final report by listing CSA's specific steps to meet this recommendation and to describe the circumstances surrounding the closure of the grantee in question. In our opinion, CSA's actions have not been fully implemented and as such the potential benefits have not been realized. We have deleted the draft report's reference to another of our recommendations contained in a previous report because CSA's new Grantee Program Management System will incorporate grantee program evaluations into funding decisions. CSA provided examples and a listing of its regional offices' followup and management advisory notices issued to grantees who are delinquent in submitting quarterly financial reports and/or have weak internal controls. In all but one case, those examples concern regional offices we did not visit during this assignment. As such we were unable to confirm this data. This information also does not change, alter, or lessen the deficiencies we noted at other CSA regional offices and as such we believe the finding is still valid. CSA regional-office-sponsored financial workshops for grantees can potentially have a significant impact on establishing sound internal control systems at grantees. Here again, however, the problems we cite in both the draft and final reports concern the failure of CSA to act aggressively on known and repeated instances of specific grantee internal control weaknesses. CSA needs more assurance that grantees correct existing deficiencies.

Regarding grantee monitoring of delegate agencies, the currently required contract between the parties does not necessarily specify what must be performed in terms of fiscal reporting or monitoring. These contracts state that delegate agencies must submit reports required by CSA or the grantee and that the grantee may carry out monitoring and evaluation activities. Specifics in each area are up to the grantee to write into the contract. As described on page 46 of the final report, we found a delegate agency which had no contract for 2 years but continued to receive funding from the grantee. CSA has commented that it is updating a guidance manual entitled "Delegating and Managing Community Action Programs," which includes a chapter detailing the responsibilities of grantees for monitoring and evaluating delegate agency financial management. We agree with CSA that the issuance of this revised manual will help strengthen grantee monitoring of delegate agencies. CSA's interlocking system of accountability for disbursing funds under its Special Impact Program is not the issue as far as grantees controlling these funds are concerned. In other words, while CSA appears to assess grantee program performance and plans as a basis for funding, it has not provided sufficient instruction and guidance to grantees on controlling these funds once disbursed to them.

Finally, CSA has commented that several of the grantee deficiencies we found were known to the CSA regional offices prior to our audit. With this in mind, we ask why the deficiencies were not corrected. In our opinion this supports our conclusion that CSA must more aggressively enforce the requirements that strong internal controls be in place at all levels of the organizations.



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