December 4, 2003

MEMORANDUM FOR: FREDERICO JUARBE, JR
Assistant Secretary for Veterans'
Employment and Training Service

FROM: ELLIOT P. LEWIS
Assistant Inspector General
for Audit

SUBJECT: Rehabilitation Services and Veterans
Programs, Albuquerque, New Mexico
Audit Report No. 06-04-001-02-201

In June 2003, the Dallas Regional Administrator for the U.S. Department of Labor (DOL), Veterans' Employment and Training Service (VETS), requested the Office of Inspector General's (OIG) assistance regarding allegations of financial improprieties by Rehabilitation Services and Veterans Programs (RS&VP), a nonprofit agency in Albuquerque, New Mexico. RS&VP received approximately $1.7 million in VETS' grant funds to administer a homeless veterans reintegration program for the period April 1, 1998, through June 30, 2003. Currently, a $150,000 VETS' grant for the period July 1, 2003, through June 30, 2004, is RS&VP's only DOL funding.

The Regional VETS office had received allegations of financial improprieties against RS&VP from RS&VP's former Chief Executive Officer (CEO). One allegation was that RS&VP key staff had made substantial purchases on the agency's American Express cards that appeared to be for personal use. VETS provided us copies of these statements. VETS obtained these statements from RS&VP's former CEO, who had been terminated by the new President and Chairman of the Board (hereafter referred to as the President).

The VETS regional office informed us that other RS&VP funding sources -- U.S. Department of Veterans Affairs, State of New Mexico, city of Albuquerque -- had already terminated or suspended funding to RS&VP. We were told that a $150,000 VETS grant covering the period July 1, 2003, through June 30, 2004, was now RS&VP's only Federal funding source. Also, we were told that VETS has designated RS&VP a "high-risk" grantee for this grant.

After our meeting with regional VETS officials, VETS provided us with copies of RS&VP's grant agreements and expenditure reports for the period July 1, 2001, through June 30, 2003. A cursory review of these grant agreements and quarterly expenditure reports revealed that RS&VP based its expenditure reports on budgeted amounts, not actual expenditures: i.e., RS&VP charged each DOL grant 25 percent of each grant's annual budget each quarter. RS&VP's president (and former CFO) confirmed that RS&VP's expenditure reports were based on charging budgeted amounts, not actual expenditures.

Because of the allegations of financial improprieties, questionable credit card purchases, suspicious financial reports, other agencies' terminating RS&VP's funding, and VETS' concerns for the safety of DOL funds, we audited RS&VP's internal controls and financial management systems. Our objective was to determine if its internal controls and financial management systems provide reasonable assurance that costs charged to DOL grant funds are allowable, properly allocated to DOL's grants, adequately documented, and properly reported.

We determined that RS&VP does not have adequate financial management or internal control systems in place. Our audit of RS&VP's internal controls and financial management systems disclosed:

- Lack of separation of duties.

- Lack of a financial management system to provide accurate, current and complete disclosure of the financial results of each federally sponsored project or program.

- Comingling of funds without a proper financial management system to track revenue and expenses to specific grants.

- Unallowable and unreasonable costs.

- Substantial credit card charges without documentation as to necessity, reasonableness, allowability, or allocabiltiy of the charges.

- Salaried employees also paid as independent contractors.

The issues identified above, and discussed in detail in the findings section of this report, demonstrate that RS&VP does not have adequate internal control procedures or financial management systems in place to safeguard DOL funds. As a result, DOL funds were wasted and abused and are still at risk.

We recommend the Assistant Secretary for VETS disallows $1,593,700 awarded to RS&VP between April 2000 and June 2003. RS&VP's quarterly expenditure reports were based on budgeted amounts, not actual expenditures during this period. We recommend that VETS review RS&VP's method of reporting prior to April 2000 and if RS&VP used the budget method of reporting, we recommend the Assistant Secretary for VETS disallows the $178,125 granted to RS&VP during this period. We also recommend the Assistant Secretary for VETS terminates the Rehabilitation Services and Veterans Programs' (RS&VP) $150,000 grant (No. E-9-5-2-0055, modification) awarded to RS&VP for the period July 1, 2003, through June 30, 2004.

**BACKGROUND**

The RS&VP was established on November 26, 1996, as a private nonprofit agency. The agency received its Internal Revenue Code Section 501(c)(3) Federal income tax exemption status in August 1997.

The DOL VETS awarded RS&VP grants to serve urban and rural homeless veterans. The purpose of the grants was to support employment and training services for homeless veterans. Based on notice of awards that we obtained from RS&VP, the VETS awarded RS&VP over $1.7 million between April 1998 and June 2003, to operate homeless veterans reintegration programs. According to Dallas VETS officials, the VETS awarded RS&VP an additional $150,000 grant in July 2003 (for the period July 1, 2003, through June 30, 2004) but the grant was contingent on a month-to-month basis because VETS designated RS&VP as a high-risk grantee.

During the period we audited, the RS&VP also received funds from other agencies, including the U.S. Department of Veterans Affairs, State of New Mexico, city of Albuquerque, and county of Bernalillo. Some of these grantors became concerned about RS&VP's administration of their funds and either suspended funding or did not renew contracts. Because of allegations of financial improprieties, questionable credit card charges, other grantors terminating funds to RS&VP, and other related issues, the VETS requested the OIG's assistance.

**OBJECTIVE**

The OIG audited RS&VP's internal controls and financial management systems to determine if its internal controls and financial management systems were adequate to provide reasonable assurance that costs charged to DOL grant funds were allowable, properly allocated to DOL's grants, adequately documented, and properly reported. Our audit was conducted in response to the DOL VETS' concern for the safety of funds granted to RS&VP.

## SCOPE AND METHODOLOGY

We performed the following audit procedures:

- Reviewed laws, regulations, policies and procedures related to veterans programs.

- Reviewed grant documents and single audit reports.

- Interviewed RS&VP's Executive Director and President.

- Obtained and reviewed bank statements for the following three accounts:

    - operating (January 2000 through June 2003),
    - payroll (June 2000 through June 2003), and
    - campus (June 2001 through June 2003).

- Obtained and reviewed credit card statements (May 2000 through August 2002).

- Obtained and reviewed copies of payroll checks (January 2000 through June 2003).

- Reviewed a sample of RS&VP's expenses and the documents used to support these expenses.

We conducted our onsite fieldwork at RS&VP from July 29, 2003, through August 7, 2003. Additional analytical procedures were performed in our regional office through August 22, 2003.

We conducted our audit in accordance with the generally accepted government audit standards.

## FINDINGS

### 1. <u>RS&VP has inadequate separation of duties.</u>

The company does not have a system that provides for separation of duties considered necessary to ensure funds, including DOL grant funds, are safeguarded from misappropriation. For example, the Executive Director and President (wife and husband) have sole signatory authorities on checks, as well as authorizing all expenditures. This lack of separation of duties, when evaluated in connection with the other control and system weaknesses described later in this report, is considered significant. The circumstances that created this lack of separation of duties also increases its significance in relation to safeguarding of DOL grant funds. The former Chief Financial Officer (CFO) resigned his $65,000

CFO position at RS&VP in April 2003 and accepted a non-paid position as President. However, he continues to perform duties associated with the CFO position. Immediately after his selection as President, he fired the Chief Executive Officer (CEO). During the same period, RS&VP's Executive Director's salary was increased from $65,000 annually to $130,000 annually.

**2. RS&VP's internal controls and financial management systems are inadequate to administer and safeguard DOL grant funds.**

29 CFR 95.21, Standards for financial management systems states:

> (b) Recipients' financial management systems shall provide for the following:
>
> (1) Accurate, current and complete disclosure of the financial results of each federally-sponsored project or program. . . .
>
> (2) Records that identify adequately the source and application of funds for federally-sponsored activities. These records shall contain information pertaining to Federal awards, authorizations, obligations, unobligated balances, assets, outlays, income and interest.
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> . . . . . . .
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> (4) Comparison of outlays with budget amounts for each award.
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> . . . . . . .
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> (6) Written procedures for determining the reasonableness, allocability and allowability of costs in accordance with the provisions of the applicable Federal cost principles and the terms and conditions of the award.
>
> (7) Accounting records including cost accounting records that are supported by source documentation.

RS&VP's financial management system is inadequate because it does not comply with 29 CFR 95.21, cited above. Specifically, it does not provide the following:

- Accurate and complete disclosure of the financial results of each federally sponsored project or program. RS&VP received funds from several sources; however, it did not have a plan to allocate the expenses to the various sources. RS&VP charged each of its funding sources 25 percent of the funding source's annual budget each quarter regardless of expenditures; i.e., cost reports were based on percentage of budget, not actual costs.

- Records that adequately identify the source and application of funds. According to RS&VP, its financial management system allows it to generate only balance sheets and profit and loss statements for the most recent 2 years. These statements were based on budgeted amounts; therefore, the source and application of funds were not adequately identified. Since RS&VP's records were inadequate, we reconstructed the records by inputting RS&VP's bank and credit card statements into an excel spreadsheet. These statements also did not adequately identify the source and application of funds.

- Comparison of outlays with budget amounts. RS&VP's balance sheets and profit and loss statements do not compare outlays to budget amounts. The statements' line items are budget driven and not based on RS&VP's actual expenses.

- Written procedures for determining reasonableness, allocability and allowability of costs. RS&VP provided written procedures consisting of and unsigned accounting policies and procedures manual adopted December 3, 1996, and revised May 1, 1998; a personnel policies and procedures manual adopted December 3, 1996, and revised October 10, 1997, and December 7, 2002; and an intake policies and procedures manual that was not dated. These manuals did not include procedures on reasonableness, allocability and allowability of costs.

- Accounting records that are supported by source documents. We could not connect RS&VP's balance sheets and profit and loss statements directly to source documents because the statements were based on budget amounts. Also, we could not connect the statements to source documents because RS&VP had no process of allocating cost between its various programs.

RS&VP initially deposits funds from various sources in an operating account and then transfers funds back and forth among several other accounts with inadequate tracking or disclosure of the transfers.

29 CFR 95.22 (i) provides the standards governing the use of banks and other institutions as depositories of funds advanced under Federal awards as follows:

> (1) . . . DOL shall not require separate depository accounts for funds provided to a recipient or establish any eligibility requirements for depositories for funds provided to a recipient. However, **recipients must be able to account for the receipt, obligation and expenditure of funds.** [Emphasis added.]

Because of the manner in which RS&VP handled its bank accounts, it did not adequately account for the receipt, obligation and expenditure of DOL funds.

### 3. RS&VP incurred unallowable and unreasonable expenses.

RS&VP spent funds on expenses that were unallowable and unreasonable. Due to RS&VP's inadequate financial management system and lack of a plan to properly allocate specific costs to specific grants, we cannot identify specific expenses to DOL funds. Furthermore, we did not perform detail testing of transactions that would be performed in the course of a financial audit.

RS&VP maintained several bank accounts but our review of expenses was limited to the operating and payroll accounts. In addition, RS&VP either changed banks or the bank changed ownership during the grant periods. For the period September 2000 through October 2002, the new bank account did not return canceled checks with the bank statements; therefore, we did not have checks to show the payees' names. Based on RS&VP's operating account bank statements, approximately $3,600,000 was spent between January 2000 and June 2003, and approximately $3,700,000 was deposited (over $1.4 million, or 39 percent, is attributable to DOL).

Examples of unallowable or unreasonable expenses follow:

- *Loans were made to employees*.
    - Former CEO (fired by President) received two $5,000 loans; one to make a down payment on a vehicle, the other to pay Federal income taxes (his last loan was made on April 9). Evidence supports repayment of only the second loan.
    - CFO (current President of the Board) also received a $5,000 payment on April 9. Because the payment was in the same amount and on the same day as one of the loans to the former CEO (for the payment of his income taxes), we assume this $5,000 payment was also a loan. There was no other documentation as to what the payment was for. We did not find any evidence of repayment.
- *Loans were made to another program*. Over $6,500 was loaned to a Housing and Urban Development program not associated with the Homeless Veterans Reintegration Program.
- *Substantial non-salary payments were made to employees*. As stated above, the bank statements for the operating account for the period September 2000 and October 2002 did not return canceled checks for us to determine the payees. Therefore, the payments described below do not include payments for expenses for that time period. Since that period represents a substantial period of RS&VP's DOL grants, substantial non-salary payments to staff are most likely much higher than presented below. While we did not audit these expenditures for supporting

documentation, these levels of direct non-salary payments to employees appear excessive. Examples of such non-salary payments include the following:

- o The former CEO was paid over $38,800 between January 2000 and February 2003 (e.g., travel, auto, out-of-pocket expenses, etc.). These payments were in addition to his **net** salary of approximately $130,000 for the period January 2000 and May 2003. Also, these payments do not include his American Express charges of approximately $39,000 that were paid directly to American Express.

- o The Executive Director was paid over $16,500 similar to the CEO between February 2000 and May 2003. These expenses were in addition to her **net** salary of over $150,000 for the period January 2000 and June 2003. Also, these payments do not include her American Express charges of over $53,000 that were paid directly to American Express.

- o The former CFO (current President of the Board) was paid $30,600 similar to the CEO and Executive Director between January 2000 and April 2003. These payments were in addition to his **net** salary of almost $132,000 for the period January 2000 and April 2003. Also, these payments do not include his American Express charges of over $115,000 that were paid directly to American Express

- *Agency credit cards were used for personal and other questionable purchases.*

Four employees (CEO, Executive Director, CFO, and a temporary employee) charged over $218,500 to their corporate American Express cards. Over $100,000 had no receipts beyond the monthly credit card statements to support the expenses as allowable or allocable to the DOL program. Many of the charges appear personal and/or suspicious. For example:

- o The Executive Director charged over $1,500 to have her personal vehicle repaired.

- o The Executive Director charged over $6,000 for hearing aids that were for personal use and charged over $1,300 for jewelry repairs/sales.

- o The CFO charged jewelry in a single purchase that cost over $7,000.

- o The CFO charged for an airline ticket for his son who is not affiliated with RS&VP.

- The CFO charged over $3,300 for clothing in a single purchase.

- The CEO charged over $3,700 at the Hyatt Regency hotel in Albuquerque, NM, for 1 day. We do not know the purpose for the charge because of inadequate documentation.

- The CEO's credit card was used for 1 or more nights at the Hyatt Regency hotel in Albuquerque, NM, on more than 1 occasion. We question why he charged for his hotel stays with agency funds when RS&VP is located in Albuquerque.

- The CEO's and CFO's credit cards were charged for hotel stays on the same night at different hotels in different cities and for more than one room. See schedule below:

| Card Holder | Check-In | Check-Out | Charge Date | Hotel | Location |
|---|---|---|---|---|---|
| CFO | 03/21/02 | 03/22/02 | 03/21/02 | Hampton Inn | Tucumcari, NM |
| CFO | 03/21/02 | 03/22/02 | 03/21/02 | Hampton Inn | Tucumcari, NM |
| CFO | 03/21/02 | 03/22/02 | 03/21/02 | Holiday Inn | Ft. Smith, AR |
| CEO | 04/26/02 | 04/27/02 | 04/27/02 | Hyatt Regency | Albuquerque, NM |
| CEO | 04/26/02 | 04/28/02 | 04/28/02 | Hyatt Regency | Albuquerque, NM |
| CEO | Unknown | Unknown | 04/27/02 | Comfort Inn | Las Vegas, NM |

- Credit cards were used to purchase several computer games.

- Credit card purchases were made at casinos.

- Over $52,000 was spent at CompUSA between 2000 and 2002. No inventory exists to substantiate that these computers and related items were necessary or reasonable or are being used for grant purposes.

The Executive Director and her husband (Former CFO, current President of the Board) claimed to have paid their personal charges from personal funds by either repaying the operating account or directly paying the credit card bill. However, they did not provide adequate support to justify their claim.

- *Salaried employees were also paid as independent contractors*.

  - RS&VP paid $25,000 to a temporary employee between July 2000 and September 2000 as an independent contractor in addition to her salary as an employee. She **netted** approximately $73,000 in salary between August 2000 and June 2003. Her **salary** was indirectly charged to all grants through RS&VP's "budget allocation" basis of charging costs. This employee had recently started working at RS&VP when RS&VP received a $25,000 grant from the city of Albuquerque. We are not clear as to what services were required of this grant because we did not see a copy of the social service program agreement. However, according to a letter from RS&VP to the city, RS&VP prepared a presentation to Kirtland Air Force Base about what RS&VP intended to construct on land that Kirtland was going to donate or lease to RS&VP. We looked at the finished product from this $25,000 award -- a short PowerPoint presentation. The question arises as to how a temporary **employee** was selected as an **independent contractor** and paid a fee of $25,000 to prepare a short PowerPoint presentation. This individual is still working for RS&VP and considered a temporary employee, but she does not have a job description.

- RS&VP made a $6,000 payment to an employee for providing "consulting" work on a HUD development project.

Office and Management and Budget (OMB) Circular A-122, paragraph A, Basic Considerations, provides:

> 2. *Factors affecting allowability of costs*. To be allowable under an award, costs must meet the following general criteria:
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> a. Be reasonable for the performance of the award and be allocable thereto under these principles.
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> . . . . . . .
>
> g. Be adequately documented.
>
> 3. *Reasonable costs.* A cost is reasonable if, in its nature or amount, it does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the costs. The question of the reasonableness of specific costs must be scrutinized with particular care in connection with organizations or separate divisions thereof which receive the preponderance of their support from awards made by Federal agencies. In determining the reasonableness of a given cost, consideration must be given to
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> . . . . . . .
>
> b. The restraints or requirements imposed by such factors as generally accepted sound business practices, arms length bargaining, Federal and State laws and regulations, and terms and conditions of the award.
>
> c. Whether the individuals concerned acted with prudence in the circumstances, considering their responsibilities to the organization, its members, employees, and clients, the public at large, and the Federal Government. . . .

4. *Allocable costs*.

   a. A cost is allocable to a particular cost objective, such as a grant, contract, project, service, or other activity, in accordance with the relative benefits received. . . .

Although we cannot associate expenses to a particular grant, since DOL funds were deposited into a comingled bank account, it is reasonable to believe DOL funds were used to pay some of these unallowable and unreasonable expenses.

**4. <u>The RS&VP's current VETS grant is almost entirely consumed by the Executive Director's salary.</u>**

At the conclusion of our audit fieldwork, RS&VP was operating under its remaining $150,000 grant from VETS. The Executive Director's salary is $130,000 annually. The temporary employee's salary is $35,000 annually. At this rate, the grant cannot even pay their salaries. What remains to pay other expenses and to assist homeless veterans?

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RS&VP's contract requires it to follow Office of Management and Budget (OMB) Circulars A-122 (cost principles) and A-110 (financial management system requirements; codified at Title 29 Code of Federal Regulations (CFR), Part 95).

RS&VP's grant agreement states:

> VII. <u>Suspension and Termination Procedures</u>
>
> B. When a grantee has failed to comply with the terms, conditions or standards of the grant, the Grant Officer may, on reasonable notice to the grantee, suspend the grant, and withhold further payments, or prohibit the grantee from incurring additional obligations of grant funds, pending corrective action by the grantee or a decision to terminate in accordance with paragraph C below. . . .
>
> C. This grant may be terminated for cause or convenience.

29 CFR, Part 95.61(a)(1) states:

> Awards may be terminated in whole or in part . . . By grant officers, if a recipient materially fails to comply with the terms and conditions of an award.

## CONCLUSION

The RS&VP does not have adequate internal control procedures or financial management systems in place. Consequently, RS&VP is not in compliance with its grant agreement and OMB Circulars. As a result, DOL funds were wasted and abused and are still at risk. We consider all DOL funds ($1,593,700) granted to RS&VP since April 2000 as questionable.

RS&VP cannot support the charges to its various DOL grants because it does not have an accounting system that allows for grant level accounting; rather, the grantee charges all its grant programs 25 percent of each grants' costs each quarter regardless of actual expenditures. No accounting system is available to track costs by grant. Since grant budgets, not actual expenditures, are charged to all grant programs, it is impossible to determine which expenditures relate to which program.

## RECOMMENDATIONS

We recommend the Assistant Secretary for VETS take the following actions:

immediately terminate the $150,000 grant awarded to RS&VP for the period July 1, 2003, through June 30, 2004;

disallow $1,593,700 awarded to RS&VP between April 2000 and June 2003; and

review RS&VP's method of reporting prior to April 2000 and if RS&VP used the budget method of reporting, disallow the $178,125 granted to RS&VP during this period.

## SUBSEQUENT EVENTS

On September 16, 2003, the OIG received notice that the VETS had imposed a freeze on RS&VP's ability to draw down grant funds based on the OIG's preliminary discussions with regional VETS officials, but VETS could not terminate RS&VP's grant until it received the OIG's report. On October 28, 2003, VETS notified the OIG that RS&VP's administrative office had been "cleaned out" and that the President and Executive Director (husband and wife) had left town, whereabouts unknown.

cc: Lester Williams
Regional Administrator, VETS