

REPORT BY THE
AUDITOR GENERAL
OF CALIFORNIA

**THE OFFICE OF ECONOMIC OPPORTUNITY
HAS NOT CONTROLLED PUBLIC FUNDS
PROPERLY**

REPORT BY THE
OFFICE OF THE AUDITOR GENERAL
TO THE
JOINT LEGISLATIVE AUDIT COMMITTEE

P-412

THE OFFICE OF ECONOMIC OPPORTUNITY
HAS NOT CONTROLLED PUBLIC FUNDS PROPERLY

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Honorable Art Agnos, Chairman
Members, Joint Legislative
Audit Committee
State Capitol, Room 3151
Sacramento, California 95814

Dear Mr. Chairman and Members:

The Office of the Auditor General presents its report concerning the Office of Economic Opportunity's poor control over funds from the federal government's Low-Income Home Energy Assistance Program and Community Services Block Grant program. The report indicates that the Office of Economic Opportunity has had deficient fiscal management and monitoring procedures. In addition, the report identifies areas that require legislative action and contains specific information requested by the Legislature.

Respectfully submitted,


THOMAS W. HAYES
Auditor General

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SUMMARY

California's Office of Economic Opportunity (OEO) has had poor control over funds from the federal government's Low-Income Home Energy Assistance Program and Community Services Block Grant program. For fiscal year 1983-84, these funds totaled approximately \$131.6 million. Because the OEO has had deficient fiscal management and monitoring procedures, the OEO and the community agencies with which it contracts have misused public funds. The following examples illustrate this misuse of public funds:

- Public funds were used to pay for legal fees to defend an employee of the Orange County Community Development Council, Inc., against drunk driving charges;
- Public funds were used by the director of the Orange County Community Development Council, Inc., for personal expenses, such as clothing, travel, and payment of loans;
- Public funds were awarded to some community agencies that the OEO had not evaluated properly;
- Public funds were advanced to community agencies before the agencies needed the money; and
- Public funds that the OEO had awarded to the Bay Area Preparatory Program, Inc., were allegedly deposited in the bank accounts of the OEO's deputy director of administration and the director of the agency. These individuals have since been arrested and charged with grand theft and conspiracy in connection with this contract award.

Moreover, weaknesses in the OEO's fiscal management and contracting procedures have resulted in the restricting of competition between community agencies for federal funds, the delaying of financial assistance to low-income households, the underpayment of over 32,000 low-income households by approximately \$2.4 million in home energy assistance, and the overpayment of financial assistance to other low-income households. The State is liable to the federal government for any federal funds under the State's jurisdiction that are spent improperly.

Deficiencies in Fiscal and Management Controls

The weaknesses in OEO's fiscal management procedures have allowed public funds to be spent improperly at the state and local levels. We conducted limited on-site reviews at 12 community agencies that had received federal funds from the OEO and found that 5 of the 12 agencies had made either improper or questionable expenditures. In one instance, the director of the Orange County Community Development Council, Inc., who has since been replaced, used approximately \$2,900 for personal expenses and loaned \$750 to an employee involved in a drunk driving charge to help him pay for legal fees. The district attorney for Orange County is currently investigating the use of public funds by the director of this council. In another instance, the Community Housing Improvement Systems and Planning Association, Inc., used \$5,528 in program funds to pay for auditing and legal services that were unrelated to the Community Services Block Grant program. We also found that some community agencies had made questionable expenditures. The Campesinos Unidos, Inc., purchased glass doors for a food cooperative for \$1,183; the agency had not included the doors in its program budget and therefore should not have used program funds to pay for them. We were not authorized by state law to perform single audits of the total funds received and used by community agencies; we could audit only the federal grants that community agencies received through the OEO. Therefore, we

were unable to trace all expenditures made by the agencies or to identify misuse of funds in addition to that described in this report.

The OEO has also been inconsistent in its use of criteria for awarding contracts to community agencies, and it has not followed proper contracting procedures. As a result, the OEO is restricting competition for federal funds and cannot ensure that funds are spent properly. The deficiencies in the OEO's contracting procedures may have contributed to the possible misuse of federal funds by the director of the Bay Area Preparatory Program, Inc., and the OEO's deputy director of administration, who has since been replaced. Both individuals were arrested and charged with grand theft and conspiracy involving a \$75,000 contract award.

In addition, the OEO has not promptly distributed payments from the Home Energy Assistance Program. During fiscal year 1982-83, the OEO underpaid more than 32,000 households that were eligible for the Home Energy Assistance Program by approximately \$2.4 million. Once it discovered its error, the OEO took over 14 months to issue the payments due these households. Furthermore, the OEO was not prompt in applying for funds from the Low-Income Home Energy Assistance Program for fiscal year 1983-84. Therefore, the OEO was unable to provide financial assistance to low-income households during the winter of 1983, a period of high energy consumption.

Deficiencies in the OEO's fiscal management procedures have also resulted in the overpayment of financial assistance to some households. Because the OEO has not strictly adhered to its policies for ensuring that low-income households receive only the level of assistance to which they are entitled under the Energy Crisis Intervention Program, community agencies have overpaid some low-income households. We identified eight instances in which households in the Oxnard area received more than the \$300 maximum level of assistance allowed by the program.

State Statutes
Need Clarification

There is a conflict between state and federal statutes regarding the eligibility of American Indian tribes and organizations for funds from the Community Services Block Grant program. In addition, the state

statute pertaining to limitations on administrative expenditures by community action agencies and the statute that limits cash advances to community agencies may be interpreted in ways that could conflict with federal guidelines.

Corrective Action Taken or
Planned by the Governor's Office

Before the start of this audit, the Governor's Office became aware of problems at the Office of Economic Opportunity. On December 28, 1983, the Governor's chief of staff requested the Department of Finance to initiate a fiscal and program audit of the Office of Economic Opportunity. On March 6, 1984, the Director of the Office of Economic Opportunity resigned, and the Governor appointed an interim director. Since that time, the interim director has corrected some of the problems that we identify in this report and has initiated or plans to initiate corrective action to remedy some of the other problems that we identify.

As of June 22, 1984, the OEO has taken the following actions to improve its operations: submitted audit plans for fiscal years 1982-83 and 1983-84; awarded Community Services Block Grant discretionary funds on a competitive basis for fiscal year 1983-84; submitted all contracts to Department of General Services for approval; improved its administration of its energy assistance programs; reduced its revolving fund balance to within limits established by state statutes; and complied with federal requirements pertaining to the distribution of Community

Services Block Grant funds to eligible agencies. Additionally, the OEO plans to develop an audit procedures manual, train audit staff and conduct field audits, develop and implement additional contracting procedures, and establish a central contracts unit. To ensure that proper controls are in place, it is imperative not only that the OEO fully implement these actions but also that the OEO act on the recommendations we present below.

Recommendations

The Governor and the Legislature should ensure that the OEO takes the following actions to correct its deficiencies:

- The OEO should ascertain, within 90 days of the beginning of the contract period, that each community agency will use a reliable system of internal fiscal controls.
- The OEO should give each community agency an equal chance to compete for available federal funds.
- The OEO should base the timing and the amounts of its periodic payments to a community agency upon the agency's demonstrated need for funds.
- The OEO should have a reliable system for auditing and continually monitoring the community agencies with which it contracts.
- The OEO should implement a system for reviewing independent audits of all OEO program funds that are received and used by community agencies.

Further, the Legislature should authorize the Auditor General to conduct comprehensive audits of the community agencies in which we identified problems.

The Legislature should also clarify the state statutes pertaining to the Community Services Block Grant so that state and federal statutes do not conflict and so that the OEO will not interpret state statutes in ways that will conflict with federal laws and guidelines.

INTRODUCTION

The Office of Economic Opportunity (OEO), which reports to the Governor's Office, is the state agency that is responsible for developing, coordinating, and implementing two federal anti-poverty block grant programs in California: the Low-Income Home Energy Assistance Program and the Community Services Block Grant program. To receive funds from these programs, the OEO must submit an application to the federal Department of Health and Human Services. The Department of Health and Human Services requires the OEO to provide assurances that the OEO will allocate and use the federal funds in accordance with federal guidelines. In addition, the OEO is required to prepare and submit a plan to the Department of Health and Human Services describing how it will carry out the assurances.

The OEO funds three main programs under the Low-Income Home Energy Assistance Program: the Home Energy Assistance Program, the Energy Crisis Intervention Program, and the Weatherization Program. Under the Home Energy Assistance Program, the OEO provides payments of up to \$400 per year to low-income households to help defray their energy costs. The Energy Crisis Intervention Program provides emergency cash assistance to eligible households that do not have sufficient funds to establish service with a utility, to pay current or delinquent utility bills, or to prevent a utility company from terminating service. Finally, the Weatherization Program helps qualified low-income households to achieve long-term savings in energy costs by providing energy conservation measures, such as insulating attics and weatherstripping.

Under the Community Services Block Grant program, the OEO awards funds to eligible community agencies to provide services and activities that might help to eliminate the causes of poverty.* According to federal statutes, these services and activities include assisting low-income individuals to secure and retain employment and "removing obstacles and solving problems which hinder the achievement of self-sufficiency." Federal law requires that states award at least 90 percent of their funds from the Community Services Block Grant to community agencies that meet specific federal criteria. States may use no more than 5 percent of the remaining funds for administrative expenses. State law allows the OEO to allocate up to 5 percent of the grant for discretionary projects.

For fiscal year 1983-84, the OEO's budget for both the Low-Income Home Energy Assistance Program and the Community Services Block Grant program totaled approximately \$131.6 million. Of this amount, the Low-Income Home Energy Assistance Program block grant totaled approximately \$102.8 million, while the Community Services Block Grant totaled approximately \$28.8 million.

*In this report, the term "community agency" refers to a private nonprofit organization, a public agency, an American Indian tribe or organization, or a migrant and seasonal farmworker organization.

SCOPE AND METHODOLOGY

This audit focused on the OEO's administration of the Low-Income Home Energy Assistance Program and the Community Services Block Grant program. In 1983, the Auditor General conducted a federal compliance review of the Low-Income Home Energy Assistance Program and also issued a report entitled "The Office of Economic Opportunity Could Improve Its Administration of the Low-Income Home Energy Assistance Block Grant" (Report P-232, August 1983). For our current audit, which emphasized the Community Services Block Grant program, we reviewed the OEO's procedures for controlling federal funds and for awarding contracts and the statutes pertaining to the Community Services Block Grant program. We also reviewed the timing of the OEO's payments to households that were eligible for the Home Energy Assistance Program and the procedures that the OEO used to disburse Energy Crisis Intervention Program payments. Lastly, we conducted a federal compliance review of the Community Services Block Grant program.

To evaluate the OEO's management of federal funds and its compliance with federal regulations, we examined the OEO's accounting records and its procedures for monitoring disbursements. We also interviewed the former director of the OEO and officials and staff at the OEO, the Department of Finance, and the federal Department of Health and Human Services. In addition, we conducted limited reviews at 12 community agencies that had received funds from the Community Services Block Grant, from the Low-Income Home Energy Assistance Program, or from

both programs. (See Appendix A for the names and locations of the 12 community agencies that we reviewed.) The fact that some of these agencies had weaknesses in their internal fiscal controls hindered our review. For example, four of the community agencies that we visited commingled funds from the Community Services Block Grant program with funds from other sources. The funds from other sources included monies from other federal grants and from private contributions. Because we are not authorized by law to perform a single audit of all of the funds received and expended by community agencies, we could not fully determine whether the community agencies had used the Community Services Block Grant funds properly.

To evaluate the OEO's contracting procedures, we examined its administration of contracts and its compliance with standard contracting procedures. As of March 31, 1984, the OEO had awarded 250 contracts for the fiscal years 1982-83 and 1983-84 Community Services Block Grants; we reviewed 45 of these contracts. Our review included researching state contracting policies, inspecting the OEO's contract and accounting files, reviewing program records, and interviewing staff at the OEO, at the Governor's Office, at the Department of General Services, and at community agencies. However, we could conduct only a limited review of the contracts because the OEO had no central contracts file in which to keep all documentation for each contract award. Consequently, when reviewing contracts, we sometimes could not find certain documentation, such as the OEO's requests for proposal and its criteria and justification for awarding a contract.

To evaluate the OEO's disbursement of Home Energy Assistance Program payments, we reviewed program and accounting records related to this program. We also reviewed the OEO's application for Low-Income Home Energy Assistance Program grant funds for fiscal year 1983-84. Further, we interviewed staff members of the OEO and staff members of the federal Department of Health and Human Services.

To evaluate the OEO's administration of the Energy Crisis Intervention Program, we reviewed the procedures that the OEO uses to eliminate the possibility of eligible households' receiving excessive payments from the program. We reviewed the geographical areas in which 92 community agencies provided services during fiscal year 1983-84 to determine which agencies were serving the same areas. We also reviewed lists of 908 households that were receiving payments from two community agencies serving the same geographical area to determine whether the households had received excessive payments. Further, we interviewed a special assistant to the Governor, staff at the OEO, and staff at a community agency.

Finally, we reviewed the eligibility of public housing tenants for payments from the Home Energy Assistance Program, the funding formula for the Community Services Block Grant, and the timing of the OEO's application for Community Service Block Grant funds.

In March 1984, the Director of the Office of Economic Opportunity resigned, and the Governor appointed an interim director. The interim director of the OEO has taken corrective action to remedy some of the problems identified in this report.

CHAPTER I

THE OFFICE OF ECONOMIC OPPORTUNITY HAS HAD POOR CONTROL OF PUBLIC FUNDS UNDER ITS JURISDICTION

Because the Office of Economic Opportunity (OEO) has poor fiscal management procedures, public funds have been spent improperly. In addition, the OEO has not properly administered contracts related to the Community Services Block Grant program and has thus restricted competition between community agencies for federal funds. Because of its poor contracting procedures, the OEO cannot assure that the State is protected by the terms of properly completed contracts. Further, the OEO has not made home energy assistance payments promptly. As a result, low-income households did not receive needed financial assistance during the winters of 1982 and 1983. Finally, because the OEO has not strictly adhered to its own policies for eliminating excessive payments to low-income households, community agencies have overpaid some low-income households that are participating in the Energy Crisis Intervention Program.

THE OEO HAS NOT ENSURED THAT PUBLIC FUNDS ARE USED PROPERLY

The Office of Economic Opportunity has not developed adequate fiscal management procedures and has not adequately monitored the fiscal management procedures of the community agencies with which it contracts. As a result, the OEO has no assurance that community agencies are properly using the \$131.6 million from the Community Services Block Grant

program and the Low-Income Home Energy Assistance Program. Seven of the 12 community agencies that we reviewed had weaknesses in their fiscal controls, and 5 of the 12 agencies had made improper or questionable expenditures. Further, delays in the OEO's receipt and review of community agencies' final expenditure reports have prevented the OEO from collecting unspent federal funds promptly. Also, the OEO has made excessive cash advances to community agencies that contracted for Community Services Block Grant funds for fiscal years 1982-83 and 1983-84. As a result, the OEO has not complied with federal regulations, and the federal government may terminate the OEO's cash advance privileges.

Inadequate Fiscal Management and Monitoring

Because it does not adequately monitor the internal accounting controls of community agencies that have contracted for block grant funds, the OEO has little assurance that community agencies use the funds properly. Five of the 12 community agencies that we visited had used public funds improperly or had used funds in a questionable manner. For example, the director of the Orange County Community Development Council, Inc., who has since been replaced, loaned \$750 in public funds to an employee to help him pay for legal fees involving a drunk driving charge. The director also spent approximately \$2,900 in program funds for personal expenses, such as clothing, travel, and loan payments. The Orange County District Attorney is currently investigating the director's use of public funds.

To comply with the requirements of the Community Services Block Grant program and the Low-Income Home Energy Assistance Program, the OEO must monitor the community agencies' fiscal controls and accounting procedures to assure that the agencies properly disburse and account for federal funds. The OEO's monitoring procedures include preparing an annual plan for auditing the federal funds received and expended at the state and local levels, performing a preliminary audit of community agencies that are new contractors, and reviewing independent audit reports on community agencies.

Late Submission of Annual Audit Plans

To fulfill federal audit requirements, state statutes require the OEO to develop each year a plan for the OEO's annual audit of block grant funds. The OEO is to submit this plan for approval to the State Controller, the Auditor General, and the Director of Finance. According to state statutes, this audit plan is to include provisions for community agencies to "obtain independent federally mandated audits of block grant funds, preaudit conditions, and compliance indicators." State law requires that audit plans be approved and adopted no later than October 1 of each fiscal year.

Although the State Controller has several times requested the OEO to submit its audit plans for fiscal years 1982-83 and 1983-84, the OEO has not complied. In March 1983, the OEO did submit its audit plan for fiscal year 1982-83, but the State Controller rejected the plan and

requested the OEO to make changes and resubmit the plan. In April 1984, the State Controller again requested audit plans from the OEO. However, as of May 1, 1984, the OEO had neither resubmitted the fiscal year 1982-83 audit plan nor submitted its audit plan for fiscal year 1983-84.

Lack of Preliminary Audits

The OEO has not ensured that community agencies have adequate internal fiscal controls for safeguarding funds. It is OEO policy that the OEO will conduct a preliminary audit of all community agencies with which it has not previously contracted. According to the OEO's program and fiscal audits manager, the OEO should conduct these audits within 90 days of the beginning of the contract period. The purpose of these audits is to determine that community agencies have established adequate systems of internal and fiscal management controls. To perform the preliminary audits, OEO auditors visit community agencies that are new contractors and complete a standardized questionnaire that is designed to assist the auditors in determining whether an agency's system of internal control is effective and whether an agency's accounting procedures are adequate to safeguard funds.

According to the OEO's records, the OEO did not conduct preliminary audits for 57 of the 63 community agencies that were new contractors for fiscal year 1982-83. The contract awards for these 63 community agencies totaled \$4,343,705. In addition, the OEO was late in conducting the preliminary audits for fiscal year 1983-84. However, by

May 7, 1984, the OEO did complete the preliminary audits for all 7 community agencies that were new contractors. The OEO completed a total of 37 preliminary audits for new and continuing contractors during the two fiscal years.

Furthermore, the OEO has not used effective methods to conduct the preliminary audits. After the community agency answers the questions on the survey form for the preliminary audit, the OEO auditor must be satisfied by observation and/or test that the agency is actually practicing the procedures that the agency has described. We reviewed 8 of the 37 preliminary audits that the OEO had completed during fiscal years 1982-83 and 1983-84. For these 8 preliminary audits, the OEO auditors indicated that they had conducted tests for only 3 preliminary audits to determine that the community agency actually used the procedures described by the agency on the survey form; furthermore, we could find little evidence that the auditors had actually performed the testing for those 3 preliminary audits. Moreover, the OEO does not give its auditors written guidelines to ensure that all preliminary audits meet uniform standards.

Delays in Reviewing
and Following Up on
Independent Audit Reports

In addition to performing inadequate preliminary audits, the OEO has not been prompt in reviewing independent audit reports or in following up on deficiencies noted in those reports. The OEO requires a

qualified state or local government auditor or an independent certified public accountant to conduct audits of community agencies after their contracts have expired and to submit the audit reports to the OEO. The purpose of the audit is to provide the OEO with reasonable assurance that community agencies have spent program funds in accordance with program requirements and that internal control and fiscal management systems have safeguarded program funds. The OEO audit staff review the independent audit reports to identify any questionable or disallowed costs and any weaknesses in the community agencies' accounting controls.

However, the OEO has not been prompt in reviewing the audit reports submitted by community agencies for the Low-Income Home Energy Assistance Program and the Community Services Block Grant program. The OEO's records show that, as of May 1, 1984, the OEO had received 697 (61.4 percent) of the 1,136 audit reports that were due. The OEO's records also indicate that the OEO's audit staff had reviewed only 88 (13 percent) of the 697 audit reports, thereby leaving a backlog of 609 audit reports that the OEO had not reviewed. Furthermore, we estimate that at least 146 additional audit reports will be due to the OEO before December 31, 1984.

The need for the OEO to review independent audit reports is evidenced by the results of the few reviews that the OEO has conducted. For example, the OEO requested one community agency to remit \$5,200 because of disallowed costs that the independent audit reports had identified. In another case, the independent certified public accountant

recommended that the community agency refund over \$23,000 to the OEO because households that the community agency had funded did not meet income eligibility requirements.

We also identified weaknesses in the system that the OEO uses to determine which independent audit reports that it will review first. According to the OEO's program and fiscal audits manager, the OEO gives priority to the independent audit reports on those community agencies that the OEO has previously identified as having problems with their management of funds. However, the OEO reviews all other independent audit reports in alphabetical order. The OEO's system for determining which independent audit reports have the highest priority does not take into account the fact that community agencies have award amounts that range from \$500 to over \$1 million. Thus, the OEO does not give priority to those contracts with the potential for the largest recovery of misspent funds.

Inadequate Monitoring of Community Agencies

The OEO has not identified inadequacies in the fiscal management of the community agencies with which it contracts because it has not carried out its audit responsibilities and has not periodically reviewed these agencies. We reviewed 12 community agencies that had received block grant funds from the OEO to determine whether the agencies had adequate internal fiscal controls and whether they were spending block grant funds in accordance with the objectives of the federal

programs. The following table shows the community agencies we visited that had fiscal control weaknesses or had made improper or questionable expenditures.

TABLE 1
INADEQUATE FISCAL MANAGEMENT PROCEDURES
AT AGENCIES IN OUR SAMPLE

<u>Agency</u>	<u>Fiscal Control Weaknesses</u>	<u>Improper Expenditures</u>	<u>Questionable Expenditures</u>
California Hispanic Commission on Alcohol & Drug Abuse, Inc.	X		
Campeños Unidos, Inc.	X		X
Center for Employment Training	X		X
Community Housing Improvement Systems and Planning Association, Inc.		X	X
Kern County Economic Opportunity Corporation	X	X	X
National Hispanic University	X		
Orange County Community Development Council, Inc.	X	X	X
Project Go, Inc.	X		

As the table above shows, seven community agencies that we reviewed had weaknesses in fiscal controls. For example, the Kern County Economic Opportunity Corporation had not recorded bank deposits totaling \$22,600 in its accounting records. Also, this agency had recorded \$2,909 in its cash receipts ledger; however, the agency's bank statements did not reflect this amount. Further, we found that three community agencies had used funds improperly and that five community agencies had used funds in a questionable manner. The Community Housing Improvement Systems and Planning Association, Inc., for example, spent program funds improperly when it used \$5,528 in Community Services Block Grant funds to pay for auditing and legal services that were unrelated to the Community Services Block Grant program. Campesinos Unidos, Inc., made a questionable expenditure when it purchased glass doors for \$1,183 for a food cooperative; the agency's program budget did not authorize the purchase of these items.

Weaknesses in the internal fiscal controls at the community agencies in our sample prevented us from fully ascertaining whether the agencies were using program funds properly. For example, some community agencies we visited commingled the OEO's program funds with funds from other sources. Therefore, without performing a single audit of all funds used by an agency, we could not fully determine whether the OEO's program funds had been used properly.

Causes of Inadequate Fiscal Management and Monitoring

There are several reasons why the OEO has not monitored community agencies to identify weaknesses in their internal fiscal controls and to ascertain whether the agencies can safeguard program funds. One reason is that the OEO's management did not give high priority to monitoring community agencies. Additionally, the OEO has lacked sufficient staff to conduct preliminary audits and to review independent audit reports. Although the OEO's audit unit was authorized six audit positions, only three of the positions were filled as of March 1984. Further, the OEO has not adequately trained its staff to conduct preliminary audits and to review independent audit reports, and it has not developed adequate policies and procedures for conducting audits and for reviewing audit reports.

Delays in the Receipt and Review of Final Expenditure Reports

Community agencies that contract with the OEO for federal funds have been slow to submit their final expenditure reports to the OEO, and the OEO has not reviewed all of the final expenditure reports that the OEO has received from community agencies. Final expenditure reports reconcile total expenditures of a community agency with the total cash received by that agency. The community agency is to return any unexpended funds to the OEO.

For fiscal year 1982-83, the OEO required community agencies in the Community Services Block Grant program to submit final expenditure reports within 30 days after the contracts expired. Most of the final expenditure reports were due to the OEO by the end of January 1984; however, the OEO had received 81 (56 percent) of the 144 required expenditure reports as of April 15, 1984. Of those 81 reports, which represent contracts totaling \$13,622,505, only 4 reports (5 percent) were submitted within the required time limit. Of the 21 community agencies that reported that they owed reimbursements to the OEO for unspent funds, 14 agencies submitted payments to the OEO or requested a carry-over of the unexpended funds to the 1983-84 contract year. The remaining 7 community agencies did not indicate whether they would repay the OEO or request a carry-over of funds. According to their final expenditure reports, these 7 community agencies owe the OEO more than \$100,000.

Not only have community agencies been late in submitting final expenditure reports, but the OEO has not reviewed all of the final expenditure reports that it has received from community agencies. According to OEO policy, the OEO is to review the agencies' final expenditure reports to check for arithmetic accuracy and to determine if the agencies made expenditures only for items in their program budgets. However, the OEO's records indicate that the OEO reviewed only 3 of the 81 final expenditure reports that it had received. The OEO was unable to review all final expenditure reports because it did not allocate sufficient accounting staff to complete the task.

Because of delays in the OEO's receipt and review of final expenditure reports, the OEO cannot promptly collect unspent federal funds or recover federal funds that agencies have spent improperly. Under federal law, the State is liable for federal funds that are used improperly and may be requested to return such funds to the federal government.

Excessive Cash Advances to Community Agencies

The OEO has not followed federal regulations that limit cash advances to community agencies that have contracted for federal funds to the minimum amounts that the agencies need to meet their immediate cash requirements. As a result, the federal government may terminate the OEO's cash advance privileges. Moreover, the OEO has not complied with its own guidelines or with the state statutes that limit the amount of money that the OEO can advance to a community agency.

To determine whether the OEO's cash management practices complied with federal regulations, we reviewed a sample of 69 of the OEO's 250 contracts with community agencies that were receiving Community Services Block Grant funds for fiscal years 1982-83 and 1983-84. We found that the OEO made excessive cash advances for 21 of the contracts. For each of 13 contracts in which the community agency received periodic advances equal to 25 percent of the total contract award, the OEO's accounting records indicate that the OEO made cash advances without having sufficient records of the community agency's expenditures to

substantiate the agency's need for additional funds. For 7 of the 13 contracts, the OEO provided cash advances totaling 98 percent or more of the contract amount before the OEO's accounting staff had recorded the community agencies' expenditures. Even for those community agencies for which the OEO had recorded expenditures, the OEO's accounting records show that cash advances to a community agency exceeded the agency's recorded expenditures by at least 50 percent of the contract amount.

The OEO's ability to determine a community agency's need for additional funds has been limited because the OEO has not recorded in its accounting records all of the expenditures reported by the agencies. As of March 1984, the OEO had not yet recorded approximately 700 monthly expenditure reports in its accounting records. Some reports dealt with expenditures made as far back as February 1983.

Because the OEO had not recorded in its accounting records all of the expenditures of community agencies, we obtained from the OEO the agencies' monthly expenditure reports for our sample of contracts for fiscal years 1982-83 and 1983-84, and we assessed the community agencies' monthly cash balances to determine the agencies' need for the cash advances. While most community agencies needed periodic advances by the OEO, 5 of the 13 agencies that received advances of 25 percent of their award had monthly cash balances that exceeded 25 percent of the contract amount for two or more consecutive months. One agency had cash balances averaging \$105,119 (40 percent of its total contract) for four consecutive months; however, the agency reported to the OEO average

monthly expenditures of only \$26,256 during this period. Another agency had cash balances averaging \$74,057 (46 percent of its total contract) for four consecutive months, while it reported average monthly expenditures of just \$11,837 during the same period.

The excessive cash balances at community agencies occurred because the OEO did not consistently follow the terms of the community agencies' contracts or the state guidelines that require the OEO to pay cash advances just once a quarter. For example, the OEO paid one community agency two advances in two consecutive months. The OEO also paid three cash advances to another community agency in three consecutive months.

Because the OEO has not complied with federal regulations requiring that cash advances be limited to the minimum amounts needed by community agencies and that advances be timed to meet the agencies' immediate cash requirements, the federal government may terminate the OEO's cash advance privileges. The State would then have to finance the \$28.8 million Community Services Block Grant program with its own working capital, and the federal government would only make payments to reimburse the State for actual cash disbursements.

In May of 1983, the OEO established guidelines, approved by the Department of Finance, that limited cash advances to 25 percent of a community agency's contract amount except in certain cases. For contracts of less than one year that did not exceed \$50,000, the OEO

could make advances of between 25 and 50 percent of the contract amount. The OEO could also make advances of up to 90 percent of the contract amount for contracts not exceeding \$10,000. For all advances exceeding 25 percent, however, the OEO was to provide the Department of Finance with a monthly report that included justification for such advances.

However, the OEO did not always follow its own guidelines for limiting the amount of money that it could advance to a community agency. For eight community agencies, the OEO provided single advances of 50 to 98 percent of the contract amounts during fiscal years 1982-83 and 1983-84. The OEO made most of these advances, which ranged from \$22,400 to \$302,596, at the beginning of the contract period. The OEO made the single advances to three of the eight community agencies after the OEO's guidelines became effective. Although the guidelines required the OEO to notify the Department of Finance about the three advances, the OEO did not inform the Department of Finance that the OEO made advances exceeding the limits stated in the guidelines.

The OEO also did not comply with state statutes that became effective in October 1983. These statutes, which pertain to the Community Services Block Grant, require the OEO to make quarterly advance payments to community agencies in an amount equal to 25 percent of the agencies' annual operating expenses. However, five of the eight community agencies to which the OEO gave single advances of 50 to 98 percent received their advances after these statutes became effective. In addition, one of the five agencies received \$302,596 (90 percent of

its total contract amount) during the first month of a three-month contract even though the agency had not demonstrated a need for such a large advance. According to OEO's accounting records, the agency had spent only \$180,000 of the advance by the termination date of the contract.

In March 1984, the interim director of the OEO discussed with staff from the Department of Finance and with the OEO's legal counsel the state statutes pertaining to cash advances. Based on the information that he obtained, the interim director of the OEO concluded that, because the state statutes require the OEO to make quarterly advances of 25 percent to community agencies, he does not have the authority to further limit cash advance payments to community agencies even if the agencies' monthly expenditure reports do not demonstrate a need for the funds. The Legislative Counsel disagrees, however. In the Legislative Counsel's opinion, "The State Office of Economic Opportunity, after making an initial advance payment to a recipient of CSBGP [Community Services Block Grant program] funds, may condition further quarterly advance payments upon receipt of periodic financial reports demonstrating the grantee's actual cash flow needs, if that action is both necessary and appropriate for the effective administration of the provisions of state law governing the Community Services Block Grant program."

One reason that the OEO has made excessive advance payments is that community agencies have not submitted their monthly expenditure reports promptly; therefore, the OEO has not been able to use the

expenditure reports to determine the amount of money that community agencies need. In addition, the OEO has had insufficient staff to record the expenditures once the community agencies do submit their monthly expenditure reports. As a result, the OEO has acquired a backlog of expenditure reports and has not recorded the agencies' expenditures in the OEO's accounting records. The OEO's management also failed to inform staff in its accounting unit, which processes cash advances to community agencies, about the limitations on cash advances included in the OEO's May 1983 guidelines. The accounting staff did not learn of these limitations until March 1984.

Furthermore, the OEO made excessive cash advances to community agencies because its management did not coordinate the activities of the units responsible for administering the Community Services Block Grant program. The OEO's program unit for the Community Services Block Grant, which determines whether community agencies that contract for this grant fulfill the terms of their contracts, was to review the monthly expenditure report from each community agency to ascertain that the agency made its expenditures in accordance with its program budget. The program unit was to tell the accounting unit whether the OEO should make a cash advance to the community agency. According to the manager of the accounting unit, the program unit did not always notify the accounting unit that cash advances were necessary; therefore, the accounting unit automatically made cash advances to community agencies that had contracted for the Community Services Block Grant. The accounting unit did not obtain prior approval from the program unit for the advances. In

addition, the accounting unit did not accurately determine when quarterly advances should be made, and it was sometimes late in paying community agencies. Thus, community agencies would sometimes receive advances for two quarters of the contract year in two consecutive months; the agencies would then retain cash balances that exceeded their immediate cash requirements.

THE OEO HAS NOT FOLLOWED PROPER CONTRACTING PROCEDURES

The OEO has not developed adequate contracting policies or procedures to ensure that the OEO properly administers its contracts with community agencies. In addition, the OEO has not consistently used its criteria for awarding contracts and has not followed standard contracting procedures. As a result of improper contracting procedures, the OEO is restricting competition for block grant funds and is not ensuring that public funds are spent properly. These conditions may have contributed to the possible misuse of federal funds by a director of a community agency and the OEO's deputy director of administration, who has since been replaced. Both individuals were arrested and charged with grand theft and conspiracy involving a contract award for \$75,000.

Inconsistent Use of Criteria for Selecting Contractors

The OEO did not consistently use the criteria that it had established for awarding funds from the fiscal year 1982-83 supplemental Community Services Block Grant to community agencies. Even though the

OEO's management decided to evaluate all of the proposals for the supplemental grant that community agencies submitted, the OEO evaluated only 158 of the 350 proposals that it received from community agencies. The OEO indicated that it reviewed only the proposals from community agencies that met certain federal criteria; however, we found that the OEO did evaluate proposals from agencies that did not meet the federal criteria. Furthermore, the OEO awarded funds to community agencies that had not even submitted proposals.

During fiscal year 1982-83, the State received a supplemental \$2.9 million Community Services Block Grant award to help create new employment opportunities in order to expand "humanitarian assistance" to both the unemployed and the disadvantaged. According to federal guidelines, the OEO was to award at least 90 percent of the \$2.9 million to community agencies that met specific federal criteria for direct funding through the State. The OEO used the supplemental grant to award 45 contracts to community agencies.

In awarding funds from the supplemental Community Services Block Grant, the OEO did not follow its own policies for reviewing proposals and awarding contracts; the OEO thus restricted the competition between community agencies for federal funding. The OEO required community agencies interested in receiving federal funds to submit a contract proposal that met the criteria specified in the OEO's request for proposal. The OEO established an awards committee composed of program analysts who would review and evaluate the contract proposals.

According to OEO policy, the awards committee was to evaluate all of the proposals that the OEO received. However, according to the OEO, the awards committee did not review all of the proposals that the OEO had received because some community agencies that had submitted proposals did not meet the federal requirements that specify which kinds of entities can receive funds from 90 percent of the State's grant. We found, however, that the OEO did review proposals from community agencies that did not meet the federal criteria. Furthermore, the OEO was able to provide \$964,476 to 25 agencies that were not eligible for direct funding from the 90 percent portion of the State's grant. This amount was 33.5 percent of the entire \$2.9 million supplemental Community Services Block Grant award. The OEO funded the 25 community agencies by awarding 9 contracts to agencies that were eligible for direct funding and then asking these agencies to subcontract with the 25 agencies that were not eligible for direct funding through the State.

The former director of the OEO and a special assistant to the Governor used their own judgment to select the community agencies not eligible for direct funding that would receive funding through subcontracts with eligible agencies. In this way, the OEO complied technically with federal requirements yet still funded community agencies that were not eligible for 90 percent of the State's grant.

The OEO also provided \$95,304 to five community agencies that had not even submitted proposals for funds from the supplemental Community Services Block Grant. Three of the five community agencies were among those that the OEO had determined were ineligible to receive direct funding.

The special assistant to the Governor who approved most of the contracts for the supplemental Community Services Block Grant agreed that the OEO did not use its procedures for awarding contracts consistently. He stated that he did not believe that the proposals submitted by community agencies addressed the "humanitarian assistance" criterion specified in the federal guidelines for the supplemental Community Services Block Grant award. In addition, he stated that the community agencies recommended by the OEO for contract awards would not serve certain geographical locations or ethnic groups. Therefore, using their own judgment, the special assistant to the Governor and the former director of the OEO selected additional community agencies for contract awards. The special assistant to the Governor and the former director of the OEO chose these community agencies for specific geographical locations, ethnic groups to be served, and types of services to be provided.

Although the request for proposal that the OEO sent to potential contractors did mention the humanitarian purposes of the grant, the request for proposal did not specifically state the types of services that the OEO would fund or the geographical locations and ethnic groups

that the OEO would give special consideration. Proper contracting procedures require that, once an agency decides to award program funds on a competitive basis, an agency should be consistent in its use of criteria to award the funds. A request for proposal by the OEO should clearly define the criteria that the OEO will use to evaluate proposals. Also, to ensure adequate competition for funds, the OEO should advertise its request for proposal. Once it receives proposals, the OEO should award contracts to community agencies based on the criteria specified in the request for proposal. Furthermore, the OEO should document its reasons for any deviations from the criteria.

In addition to being inconsistent in selecting community agencies for funds from the fiscal year 1982-83 supplemental Community Services Block Grant, the OEO did not use contracting procedures consistently when awarding contracts for the fiscal year 1983-84 Community Services Block Grant. The OEO planned to award \$1,467,320, which was the 5 percent discretionary portion of the grant, on a competitive basis; however, the former director and the special assistant to the Governor used their own judgment to award four contracts amounting to \$140,746 before the OEO's competitive selection process began. The special assistant stated that he selected one of the community agencies for a contract award and that the former director selected the other three community agencies. On May 25, 1984, the interim director of the OEO reclassified the four contract awards as "administrative contracts" instead of "discretionary contracts" because of the type of activities to be performed under the contracts. Under the interim director, the OEO

did use a competitive process to select 24 community agencies to receive awards from the 5 percent discretionary portion of the fiscal year 1983-84 Community Services Block Grant; the OEO awarded contracts to these community agencies in May 1984.

A further example of the OEO's inconsistent use of contracting procedures pertains to the cancellation of one contract. In October 1983, the OEO delivered an award letter to Projects to Assist Employment, Inc., but then rescinded the contract award in November. According to the special assistant to the Governor, the OEO rescinded this contract because the special assistant did not feel that the agency's proposed study met the federal guidelines for the supplemental Community Services Block Grant that pertain to providing jobs, training, or "humanitarian assistance." However, rather than citing this reason for rescinding the contract, the former director of the OEO advised the agency that the OEO could not execute the contract because of insufficient funds.

As a result of its inconsistencies in selecting community agencies for contract awards, the OEO has not given all qualified agencies that have requested public funds an equal opportunity to receive those funds. In addition, the OEO cannot assure that the most qualified agencies have received contract awards.

Inadequate Contracting Procedures

The OEO has not obtained the required approval from the Department of General Services (department) for contract awards, has not controlled funds awarded to community agencies, and has not amended contracts properly. As a result, the OEO cannot be certain that the State is legally protected by the terms of a properly completed contract or that federal funds are being spent properly.

The OEO has been inconsistent in submitting contracts to the department for approval. Section 10295(b) of the Public Contract Code states that "all contracts entered into by any state agency for...services, whether or not the services involve the furnishing or use of equipment, materials or supplies or are performed by an independent contractor...are void unless and until approved by the Department of General Services." The department states that the OEO's contracts are subject to the department's review. In 1982, the OEO and the department entered into an agreement by which the department would review and approve a master contract that the OEO would use as a standard form for all contracts for federal funding. However, according to staff at the department's Office of Legal Services, the department terminated this agreement on January 3, 1983, partly because the department had identified problems with some of the OEO's contracts. These problems included the OEO's failure to date contract amendments and its submission of contracts to the department for approval after the OEO had already signed and sent them to the community agencies. From January 1983 until

March 1984, the OEO did not submit any contracts to the department for approval. During March 1984, the interim director of the OEO required the OEO's staff to submit all new contracts to the department for approval before the OEO awarded the contracts.

In addition to being inconsistent in obtaining the required approval for contracts, the OEO has not used proper contracting procedures in administering contracts with community agencies. For example, the OEO does not have a central contracts file that holds all documentation supporting a contract award. Standard documents that should be in a contract file, such as contract amendments and the community agencies' proposals for funding, are not centrally located. Also, there is no central control over the funds awarded to community agencies. Both the OEO's program unit and the OEO's accounting unit have been involved in controlling funds for the federal grant programs. For example, the program unit amended one contract to reduce the total grant award to a community agency from \$160,000 to \$120,000. However, the program unit did not notify the accounting unit that the program unit had amended the contract. The accounting unit issues the federal funds to community agencies. Consequently, the accounting unit paid the community agency \$156,000, which was \$36,000 more than the amended contract award.

We also identified 11 contract awards that the OEO had amended improperly by using correction fluid to "white-out" terms on the contract documents and by failing to sign and date the contract amendments. For example, on two contract documents the OEO increased the amounts of the

contract awards by a total of \$30,000. In other instances, the OEO changed the names of the specific fund sources for the contracts.

Because the OEO has not obtained required approvals for contracts and because it has not administered contracts properly, the OEO cannot ensure that federal funds are spent properly and that the State is legally protected by the terms of contract documents that have been properly completed. These deficiencies in the OEO's contracting procedures may have contributed to the possible misuse of federal funds by the director of a community agency, the Bay Area Preparatory Program, Inc., and the OEO's deputy director of administration, who has since been replaced. The OEO advanced \$67,500 to the Bay Area Preparatory Program, Inc. The OEO, after reviewing the activities related to the advance, requested that the Department of Justice conduct an investigation. The Department of Justice investigated the case and subsequently arrested the director of the Bay Area Preparatory Program, Inc., and the OEO's deputy director of administration. The Department of Justice then referred the case to the Sacramento County District Attorney for prosecution. The Sacramento County District Attorney alleges that \$66,000 of the advance to the Bay Area Preparatory Program, Inc., was deposited into the personal and business accounts of the director of the agency and the OEO's deputy director of administration. Both individuals have been charged with grand theft and conspiracy involving a \$75,000 contract award.

Noncompliance With Affirmative
Action Requirements

The OEO has not enforced federal affirmative action requirements. The OEO requires that each community agency comply with federal civil rights requirements that pertain to nondiscrimination and affirmative action. We reviewed the OEO's procedures for assuring compliance with federal affirmative action requirements by community agencies and found that the OEO had identified 22 community agencies that had not submitted required data showing that they are meeting federal requirements for affirmative action. The OEO sent letters to the 22 community agencies in July 1983 reminding the agencies of federal requirements, and the OEO contacted 18 of the agencies a second time. However, the OEO has not received any affirmative action data from the community agencies, and the OEO has taken no additional action to enforce compliance by these agencies. Because the OEO has not ensured that all community agencies with which it contracts have met affirmative action requirements, the federal government may restrict its future funding of OEO programs.

THE OEO'S PAYMENTS TO
HOME ENERGY ASSISTANCE
RECIPIENTS HAVE BEEN LATE

During fiscal year 1982-83, the OEO underpaid over 32,000 low-income households that were eligible for the Home Energy Assistance Program. The OEO did not pay approximately \$2.4 million due to these households until more than 14 months later. In addition, the OEO delayed

in applying for the fiscal year 1983-84 Low-Income Home Energy Assistance Program block grant. Therefore, the OEO was unable to provide needed financial assistance to low-income households during the winters of 1982 and 1983.

During December 1982 and January 1983, the OEO underpaid over 32,000 Home Energy Assistance Program recipients by approximately \$2.4 million. The underpayments occurred because of errors in the computer program that the OEO used to calculate the amount of money it should pay households that were eligible for the program. According to OEO officials, the OEO corrected the error immediately and issued subsequent payments correctly. However, the OEO did not issue the \$2.4 million due the more than 32,000 low-income households until April 1984, more than 14 months after the underpayments occurred.

According to the former manager of the OEO's administrative services division, the OEO could have paid the \$2.4 million that it owed recipients in February 1983. However, he also indicated that the OEO's management decided that the OEO would not make the payments and that the OEO would instead use the available funds for the Energy Crisis Intervention Program. Not until September 1983 did the OEO's management begin to discuss issuing the payments to the households that the OEO had underpaid. Then, in February 1984, the OEO's management decided to issue the payments. However, due to incorrect and changed addresses for more than 5,000 recipients, the OEO could not issue payments to recipients until April 1984.

In addition to underpaying Home Energy Assistance Program recipients, the OEO delayed in applying to the federal Department of Health and Human Services for the Low-Income Home Energy Assistance Program block grant for fiscal year 1983-84. As a result of the delayed application and the lack of staff in OEO's data processing unit, federal funds were not available for Home Energy Assistance Program payments to low-income households in California during the winter of 1983, a period of high energy use.

The federal Department of Health and Human Services allows states to submit applications for the Low-Income Home Energy Assistance Program block grant on September 1. Since this program is designed to assist low-income persons in paying their home energy costs, it is important that the OEO apply, receive, and distribute these block grant funds before periods of high energy consumption.

The OEO's application for the Low-Income Home Energy Assistance Program block grant was not submitted until December 29, 1983. As a result, California did not receive the initial funds for its grant award, which totaled \$102.8 million, until January 4, 1984, even though block grant funds were available to states on October 24, 1983. According to the federal Department of Health and Human Services grant administrator for Region IX, California was the next to last state to submit its application for the fiscal year 1983-84 Low-Income Home Energy Assistance Program.

The late receipt of federal funds has impaired the operation of the Home Energy Assistance Program. According to the OEO's annual plan for administering the Low-Income Home Energy Assistance Program, the OEO could have made the first payments to Home Energy Assistance Program participants on November 14, 1983. Yet the OEO did not make its first payments until March 2, 1984. Thus, low-income households received their assistance payments after the winter months, a period of high energy consumption.

The OEO's deputy director of programs stated that there were several reasons for the OEO's late submission of its application for the Low-Income Home Energy Assistance Program block grant. The deputy director stated that she had assumed her current position in September 1983, that she was unaware of any due date for the submission of the application, and that other program matters had priority. She also stated that the OEO was late in distributing Home Energy Assistance Program payments because of staffing shortages in the OEO's data processing unit.

THE OEO HAS NOT EFFECTIVELY
CONTROLLED ENERGY CRISIS
INTERVENTION PROGRAM PAYMENTS

The OEO has not ensured that low-income households receive only the amount of financial assistance to which they are entitled under the Energy Crisis Intervention Program. In October of 1983, the OEO adopted a policy that should have addressed this problem; however, the OEO has

not correctly implemented this policy throughout the State. As a result, some low-income households that are eligible for the program have received payments that exceed the maximum level of assistance allowed by the program.

During October 1983, the OEO assigned zip code numbers to each community agency that contracted for the Energy Crisis Intervention Program so that the OEO could establish the geographical areas that each agency would serve. The purpose of this policy was to eliminate each possibility of eligible households' obtaining assistance from more than one community agency and thus receiving more than the \$300 maximum level of annual assistance. However, we reviewed the OEO's assignment of zip code numbers to community agencies for fiscal year 1983-84 and found that 47 of the State's zip code areas are each served by two different community agencies. We submitted this information to the manager of the OEO's Energy Crisis Intervention Program to determine whether assigning the same geographical area to two different community agencies was appropriate. She stated that specific geographic circumstances justify the assigning of two agencies to each of 16 zip code areas. For example, the OEO may assign two agencies to one zip code area if the zip code applies to two counties. However, for the remaining 31 of 47 zip codes, geographic circumstances did not justify the OEO's assignment of the same area to two contractors.

In one instance, the OEO awarded a contract to the Mexican American Opportunity Foundation to serve the Oxnard area even though Candelaria American Indian Council was already serving that area. In examining payments made by these two community agencies, we identified eight households that received more than the \$300 maximum amount of assistance allowed by the Energy Crisis Intervention Program. The total overpayment to the eight households amounted to approximately \$900. In this instance, a special assistant to the Governor requested members of the OEO's staff to award the second contract for the same area to the Mexican American Opportunity Foundation. The special assistant to the Governor stated that the OEO awarded the second contract to address the needs of the Hispanic community in the Oxnard area by having a Hispanic organization serve the area. However, we found no evidence of any complaints that Candelaria American Indian Council had failed to serve the Hispanic community.

In January 1984, the OEO eliminated the overlap in geographical areas for 12 of the 31 zip code areas that were being served by two community agencies. Also, as a result of our audit, the OEO has taken similar corrective action for the other 19 zip code areas.

CONCLUSION

The OEO's fiscal management procedures do not ensure that community agencies are properly using federal funds from the Community Services Block Grant and the Low-Income Home Energy Assistance Program. The OEO has not monitored community agencies adequately and has not developed effective cash management procedures. We found weaknesses in internal control, instances of improper expenditures, or instances of questionable expenditures at 8 of the 12 community agencies we reviewed.

The OEO also has not properly administered contracts with community agencies for the Community Services Block Grant program. The OEO has inconsistently used criteria for awarding contracts and has not followed proper contracting procedures. The OEO is therefore restricting competition for federal funds and is unable to ensure that federal funds are spent properly. Deficiencies in the OEO's contracting procedures may have contributed to the possible misuse of federal funds by the OEO's former deputy director of administration and a director of a community agency. In addition, the OEO has not enforced federal laws that require community agencies that contract with the OEO to submit to the OEO data about their fulfillment of affirmative action requirements.

Further, the OEO was late in distributing payments to households eligible for the Home Energy Assistance Program. The OEO took over 14 months to provide Home Energy Assistance Program payments to more than 32,000 households that the OEO had underpaid by approximately \$2.4 million in fiscal year 1982-83. In addition, the OEO delayed in applying for the fiscal year 1983-84 Low-Income Home Energy Assistance Program block grant. The OEO was therefore unable to provide needed financial assistance to low-income households during the winters of 1982 and 1983.

Finally, the OEO has not adhered to its own policy for ensuring that low-income households receive only the amount of financial assistance for which they are eligible under the Energy Crisis Intervention Program. As a result, some households are receiving excessive payments from community agencies that distribute the federal funds.

RECOMMENDATIONS

The Governor and the Legislature should ensure that the OEO corrects the weaknesses in its fiscal and administrative controls.

To ensure that federal funds are properly used at the local level, the OEO needs to improve its fiscal management and monitoring procedures by taking the following actions:

- Submit its annual audit plan to the State Controller, the Auditor General, and the Director of Finance so that the plan can be approved and adopted by October 1 of each year.

- Develop procedures for the OEO's audit staff to follow when conducting preliminary audits. These procedures should ensure that the auditors conduct proper testing and that they keep adequate documentation to support their work.

- Promptly conduct preliminary audits of each community agency with which the OEO has not previously contracted to determine that the agency has a reliable system of internal and fiscal management controls. The OEO should conduct the preliminary audit within 90 days of the beginning of each contract.

- Review reports from independent auditors and follow up promptly on the problems identified in those reports. The OEO should give priority to reports on community agencies for which independent auditors and the OEO have previously identified problems and to those reports on community agencies that have received large contract awards.

- Periodically conduct audits of community agencies to ensure that agencies have adequate internal fiscal controls and that they use federal funds properly.
- Add provisions to its contracts with community agencies that will allow the State to conduct comprehensive audits of community agencies.
- Promptly recover any federal funds that community agencies have spent improperly.
- Train audit staff in the proper procedures for carrying out preliminary audits, for reviewing independent audit reports, and for conducting periodic audits of community agencies.

To correct deficiencies in its disbursement of and accounting for federal funds, the OEO should take the following steps:

- Establish and implement procedures to ensure that community agencies complete monthly and final expenditure reports accurately and that the agencies submit these reports to the OEO on time. Once it receives the community agencies' reports, the OEO should review the reports and promptly record the reported expenditures in the OEO's accounting records. If agencies report unspent

funds on their final expenditure reports, the OEO should promptly collect these funds.

- Establish policies for limiting cash advances to community agencies. The OEO should make any advances after an initial cash advance contingent upon the community agency's submitting expenditure reports to the OEO demonstrating the agency's need for the additional funds.

To correct the deficiencies in its contracting procedures and thus to ensure that the State administers federal funds properly, the OEO should take the following actions:

- Develop a comprehensive manual of contracting procedures. The manual should contain all state laws and guidelines pertaining to the administration of contracts and all standard contracting procedures. Once it has completed the contracting manual, the OEO should train its staff to implement the contracting procedures.
- Continue to submit contracts to the Department of General Services for approval in order to comply with state requirements.

- Establish a central contracts file to keep all documentation relating to a contract award. The documentation should include a copy of the community agency's proposal, the OEO's justification for the contract award, and all amendments related to the contract.

- Designate a unit within the OEO that will be responsible for controlling contract funds. This unit should approve all changes made to the terms of a contract.

- Establish criteria for awarding federal grant funds to community agencies and base every award on the established criteria. Further, the OEO should place in the contract file all justifications and documentation for any exceptions to the criteria.

- Strictly enforce its requirement that community agencies submit affirmative action data to ensure that the agencies are complying with federal affirmative action requirements.

To prevent delays in payments to households eligible for the Home Energy Assistance Program, the OEO should establish a schedule for ensuring that it obtains and disburses federal funds as soon as these funds become available. Furthermore,

the OEO's management should supervise the payment process to ensure that low-income households receive all of the benefits to which they are entitled.

To ensure that eligible households do not receive more than the maximum amount of assistance allowed by the Energy Crisis Intervention Program, the OEO should adhere to its policy of assigning each zip code area to a single community agency. If the OEO does make exceptions to this policy, the OEO should establish controls to prevent eligible households from receiving financial assistance from more than one community agency.

To assure the Legislature that community agencies use federal funds in compliance with the objectives of the Low-Income Home Energy Assistance Program and the Community Services Block Grant program, the Legislature should authorize the Auditor General to conduct comprehensive audits of the community agencies in which we identified problems.

To allow the Legislature to better monitor the activities of the OEO, the OEO should give the Auditor General, within 30 days after this report is issued, plans for implementing the recommendations contained in this report. The plans should include the OEO's goals and the names of persons who will be responsible for implementing changes. Further, the OEO should

establish schedules for completing its reviews of final expenditure reports and independent audit reports. The OEO should also provide the Auditor General with reports on its progress in implementing corrective action 60 days, 6 months, and one year after the issuance of this report.

CHAPTER II

STATE STATUTES PERTAINING TO THE COMMUNITY SERVICES BLOCK GRANT PROGRAM NEED CLARIFICATION

Several areas in state statutes that pertain to the Community Services Block Grant program need clarification by the Legislature. Although state statutes require that American Indian programs receive Community Services Block Grant funding through the State, some American Indian programs are not eligible under federal law for funding from 90 percent of the State's grant. To ensure that the state statutes comply with federal guidelines, the Legislature also needs to clarify the state statutes pertaining to limitations on administrative expenditures by community action agencies and pertaining to the amount of cash that the OEO can advance to community agencies.*

STATE FUNDING FOR AMERICAN INDIAN PROGRAMS

The state statute governing the distribution of Community Services Block Grant funds conflicts with federal law. Section 12730 of the California Government Code states that American Indian tribes and organizations are eligible to receive funds from the 90 percent portion of the Community Services Block Grant that the State must allocate to

*According to the California Government Code, a community action agency is "a private nonprofit organization or a public agency which is designated by a political subdivision to serve as that community's antipoverty agency."

agencies that meet certain federal requirements. Under federal law, however, an American Indian tribe or organization is not eligible for this 90 percent portion unless it meets specific federal criteria, such as being a community action agency.

For fiscal year 1982-83, the OEO awarded \$381,706 (1.3 percent) of the State's Community Services Block Grant to 44 agencies representing American Indian tribes and organizations. The OEO's funding of these 44 agencies contributed to the State's noncompliance with the federal requirement that states award at least 90 percent of Community Services Block Grant funds to agencies that are eligible for direct funding through the State. The OEO awarded only 87.1 percent of California's fiscal year 1982-83 Community Services Block Grant to community agencies that met the federal criteria for direct funding through the State.

For fiscal year 1983-84, the OEO again planned to follow both the state statute and the 1983-84 State Budget Bill in funding American Indian programs. However, the federal Department of Health and Human Services notified the OEO that its plan for funding American Indian tribes and organizations may be in violation of Section 673(1) of Public Law 97-35, which lists the entities that are eligible for funding through the State. The OEO then requested and received a State Attorney General Opinion, which confirmed the conflict between federal and state laws and found the state law invalid. The opinion also noted that, if the OEO does not comply with federal law, "adverse financial consequences most likely would befall OEO" in that the federal government might withhold funds.

To avoid federal sanctions, the OEO requested and received authorization from the Department of Finance for the OEO to redirect funds from the fiscal year 1983-84 Community Services Block Grant that the OEO had allocated for American Indian tribes and organizations to community agencies that the federal government considers eligible for the funds. The OEO will then direct agencies that are eligible for the funds to subcontract with the American Indian tribes and organizations.

LIMITATIONS ON
ADMINISTRATIVE EXPENDITURES

State statutes related to the Community Services Block Grant program allow a community action agency to spend up to 12 percent of its total operating funds for administrative purposes. Officials at the OEO interpret "total operating funds" to mean an agency's entire budget for all of the programs that it operates. According to the officials' interpretation, a community action agency could use 100 percent of its Community Services Block Grant funds for administrative purposes. Although there are no specific federal guidelines to limit community agencies' administrative costs, the Federal Register states that the congressional intent for this block grant program is for states to "devote a very high percentage of their block grant funds to direct payments or services."

CASH ADVANCE PROVISIONS

Section 12781(c) of the California Government Code requires the OEO to issue quarterly advance payments to each community agency in an amount equal to 25 percent of the agency's annual operating expenses. The OEO interprets "annual operating expenses" to mean a community agency's total grant award. However, if the OEO were to interpret "annual operating expenses" to mean an agency's entire budget for all of the programs that it operates, as the OEO does the terms "total operating funds," a community agency could receive its entire grant award with its first advance payment from the OEO. For example, if a community agency's annual operating expenses for all of the programs that it operates is \$2 million, and if its grant award is \$500,000 (25 percent), the community agency could receive its entire grant award with its first advance payment. This interpretation of the state statute could conflict with federal guidelines stating that community agencies are to receive advances only after the agencies have demonstrated a need for funds.

CONCLUSION

There is a conflict between state and federal statutes regarding the eligibility of American Indian tribes and organizations for funds from the Community Services Block Grant program. In addition, the OEO might interpret state statutes in a manner that conflicts with federal guidelines pertaining to the administrative expenditures of community action agencies and to advance payments to community agencies.

RECOMMENDATIONS

To ensure that state statutes do not conflict with federal requirements that pertain to the Community Services Block Grant program, the Legislature should amend the state statutes related to American Indian programs in order to clarify that these programs are not eligible under federal law for funding from 90 percent of the State's grant unless the programs meet specific federal criteria. The Legislature should also amend state statutes to further limit the amount of money from a grant award that a community agency can use for administrative expenses. Finally, the Legislature should amend state statutes to require that the timing and the amount of cash advances to a community agency be contingent upon the agency's demonstrating a need for funds.

OTHER INFORMATION REQUESTED BY THE LEGISLATURE

The Legislature asked us to provide information regarding the eligibility of public housing tenants for Home Energy Assistance Program payments. The Legislature also requested information on the funding formula for the Community Services Block Grant and on the timing of the OEO's application for Community Services Block Grant funds.

THE ELIGIBILITY OF PUBLIC HOUSING TENANTS FOR HOME ENERGY ASSISTANCE PROGRAM PAYMENTS

Before May 1, 1984, it was the OEO's policy not to pay Home Energy Assistance Program benefits to residents of public housing until these residents provided documentation that they had actually paid for their utility costs. For example, when public housing tenants, such as those living in residences managed by the San Francisco Housing Authority, applied for payments from the Home Energy Assistance Program, the OEO automatically issued letters of denial. The OEO required public housing tenants who wished to receive payments to submit to the OEO documentation of their "vulnerability" to high energy costs. The OEO based this requirement on its interpretation of federal law. However, the only criteria for participating in the Home Energy Assistance Program that state and federal laws specifically mention are the criteria concerning the income of applicants' households. The OEO's criterion concerning "vulnerability" to energy costs prolonged the time that public housing tenants had to wait for benefits and may thus have caused them to suffer financial hardships.

The OEO has recently reexamined its policy concerning public housing tenants' requests for Home Energy Assistance Program payments. For fiscal year 1982-83, the OEO's data for the Home Energy Assistance Program indicate that 80 percent of the public housing tenants to whom the OEO sent letters of denial eventually received program payments. Consequently, the interim director of the OEO has decided that, as of May 1, 1984, the OEO will eliminate the review of Home Energy Assistance Program applications that automatically denies benefits to residents of public housing.

THE FUNDING FORMULA FOR THE
COMMUNITY SERVICES BLOCK GRANT

The OEO is following the formula for distributing Community Services Block Grant funds that is specified in state statutes. Amendments to the Government Code enacted during fiscal year 1982-83 require the OEO to disburse Community Services Block Grant funds in a manner that reflects the geographical distribution of low-income households in California as documented by the most recent census data. The amendments also require the OEO to implement this adjustment fully by the beginning of fiscal year 1985. Our review indicates that, for fiscal year 1983-84, the OEO's allocation of Community Services Block Grant funds complies with state law. However, as a result of this new allocation method, there will be a greater amount of program funds going to southern California counties, where most of the State's low-income population is located. For example, during fiscal year 1983-84, when the OEO implemented 25 percent of the adjustment, the community action agency

for Orange County received \$790,029, which was an increase of \$96,918 (14 percent) over its Community Services Block Grant award for fiscal year 1982-83. In contrast, for fiscal year 1983-84, the community action agency for San Francisco County received \$1,657,323, which was a decrease of \$327,763 (16 percent) from its award for fiscal year 1982-83.

THE TIMING OF THE OEO'S
APPLICATION FOR COMMUNITY
SERVICES BLOCK GRANT FUNDS

To apply for Community Services Block Grant funds, California must submit annually to the secretary of the federal Department of Health and Human Services a state plan for administering the federal funds. The OEO prepares the state plan, and the Legislature reviews the plan and submits it to the Governor for final approval. The Governor then submits the plan to the Department of Health and Human Services for acceptance.

In May 1983, the OEO began preparing its fiscal year 1983-84 state plan for the Community Services Block Grant program by requesting local community agencies that were eligible for the program to submit plans detailing their proposed use of grant funds. The Senate held a public hearing on the OEO's state plan on August 16, 1983; the Assembly held a public hearing on October 18, 1983. The OEO submitted the state plan to the Governor's Office on September 14, 1983, where the approval process was delayed.

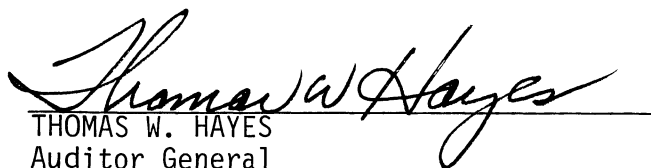
According to a special assistant to the Governor, the cause for the delay in the Governor's approval of the state plan was that the Governor's Office wanted to wait until after the Assembly held its hearing on the plan. However, the special assistant further stated that, after the Assembly hearing, the plan was misplaced in the Governor's Office. This mishap delayed the submission of the plan to the federal Department of Health and Human Services until December 15, 1983, approximately two months after the Assembly hearing.

Our review of OEO's records, interviews with a sample of community agencies that receive Community Services Block Grant funds, and an interview with a representative of the Cal-Neva Community Action Association indicate that the late submission of the state plan did not affect community agencies adversely. Most community agencies begin their programs in January of each year, and the OEO did make initial payments to agencies in January 1984.

However, to make the January payment to community agencies promptly, the OEO had to receive approval from the Department of Finance to increase substantially its revolving fund account to over \$6 million. Although the Department of Finance approved this increase to the revolving fund through February 1, 1984, the OEO did not reduce the revolving fund balance to \$219,900 until April 1984. A balance of \$219,900 is within the limits allowed by state statute.

We conducted this review under the authority vested in the Auditor General by Section 10500 et seq. of the California Government Code and according to generally accepted governmental auditing standards. We limited our review to those areas specified in the audit scope section of this report.

Respectfully submitted,


THOMAS W. HAYES
Auditor General

Date: June 25, 1984

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GEORGE DEUKMEJIAN
GOVERNOR

State of California

GOVERNOR'S OFFICE

OFFICE OF ECONOMIC OPPORTUNITY

1600 NINTH STREET, ROOM 340

SACRAMENTO 95814

(916) 322-2940

June 22, 1984

Mr. Thomas W. Hayes, Auditor General
660 J Street, Suite 300
Sacramento, CA 95814

Dear Mr. Hayes:

We appreciate this opportunity to comment upon the Auditor General's Report P-412 of the State Office of Economic Opportunity (SOEO).

It is our view that your report:

1. Confirms our previously reported conclusion that SOEO in the past has been an organization with serious managerial deficiencies and lacking the most basic managerial programs and procedures.
2. Validates the findings of the April 3, 1984 internal status report by SOEO, including those findings contained in the Department of Finance audit undertaken by the Administration beginning in late 1983 (See Attachment 1).
3. Only identifies those corrective actions which have been completed to date. It fails to identify or acknowledge planned remedial actions and does not make any reference to significant changes in procedures that are underway and not yet fully implemented. These were outlined in our April 3, 1984 status report, as referenced above.
4. Contains recommendations for improving SOEO management policies and procedures with which we concur. In fact, numerous procedural and policy changes are underway that, when completed, will satisfy each of these recommendations.
5. Inescapably and unfortunately leaves the reader with a picture of SOEO operations in the past, rather than reflecting the current state of SOEO operations.
6. Should, in fairness, point out the impetus for reform of SOEO operations originated with the Deukmejian Administration.

Please permit me to expand upon these points.

BACKGROUND

SOEO has for more than a decade suffered from controversy surrounding the administration of its programs and has not been previously required to remedy its shortcomings. As these persistent management problems, along with the failure of both SOEO and its subcontractors to adhere to commonly accepted fiscal management and accounting practices came to the attention of the new Administration, actions were immediately undertaken to correct the deficiencies.

The years of 1982-83 and 1983-84 represented major change in the roles and responsibilities of SOEO. With the enactment of the federal government's block grant program and subsequent acceptance by California of the Community Services Block Grant (CSBG) program, SOEO had to assume responsibilities which in the past were maintained by the federal government. The role of SOEO was changed from one of an advisory and coordinative agency to one responsible for assuring that all block grant funds were contracted and expended consistent with federal and state law. The fulfillment of the role has also been hampered by conflicting federal and state statutes. The addition of CSBG program responsibilities to those already existing for the administration of the Low-Income Home Energy Assistance Program (LIHEAP) created further problems for SOEO, contributing to administrative weaknesses and inappropriate behavior.

In September of 1983, Steve Merksamer, Governor Deukmejian's Chief of Staff, responded to a lack of progress in SOEO's administration by initiating a series of steps for remedial action. Numerous consultations and discussions were held with the former director of SOEO from September through November. These meetings focused on the continued and recurring management programs. As a result of a final meeting in late December of 1983, Mr. Merksamer requested the Department of Finance (DOF) to conduct a systematic and thorough review of SOEO's fiscal and program management. The summary findings by the DOF released to the public indicated "an organization with serious managerial deficiencies," lacking "the most basic managerial programs and procedures." The former director resigned on March 6, 1984.

Immediately the Administration assigned the Assistant Director of Finance to assume the duties and responsibilities of the directorship.

Additionally, he was requested to assemble a team of experienced and knowledgeable professional staff to continue the DOF audit, initiate corrective action and to administer the office. The Interim Director was instructed to take all necessary steps required for making SOEO an organization in state government that would meet the "highest managerial standards."

In March of 1984, the Auditor General also initiated an audit of SOEO's activities, focusing on specific issues. However, the Auditor General temporarily withdrew his audit team in order to permit the Administration to complete the DOF audit and to undertake whatever corrective action was necessary to respond to identified deficiencies.

On April 3, 1984, the Governor and the Auditor General received a status report (see Attachment 1) from SOEO identifying the DOF audit findings and documenting the corrective actions which had already been taken, as well as those which were planned over the next several months. At that time, in order to verify the findings of the DOF audit and the corrective actions of SOEO, the Auditor General reestablished his audit.

The concurrent DOF and Auditor General audits were conducted in a spirit of full cooperation and sharing of information and findings, including those obtained through SOEO staff. Corrective actions instituted by SOEO were shared with the staff of the Auditor General prior to implementation. This cooperative and positive working relationship is not clearly reflected in this report.

Essentially the Auditor General's report validates the findings of the April 3, 1984 status report by SOEO, including those findings contained in the DOF audit. The report only identifies those corrective actions which have been taken to date. It does not identify the planned remedial actions nor those that have yet to be fully implemented and are currently in progress as proposed in the April 3, 1984 status report.

CORRECTIVE ACTIONS

Absence of these "planned" and "in progress" corrective actions could lead the reader of this report to erroneous conclusions regarding the existing condition of SOEO. It is appropriate to cite in summary form the overall accomplishments of the Office and to identify the "planned" and "in progress" corrective actions:

o Audits

A complete audit of SOEO's internal accounting records was conducted by the special team of the DOF auditors. Required corrective actions were recommended and are being implemented. The accounting records of SOEO are now complete and consistent with the Uniform State Accounting System. The annual audit plans for 82-83 and 83-84 have been submitted and the audit procedure manual is currently being developed and should be finalized in August 1984. A fully staffed Audits Unit is now operationally in the midst of training and is expected to begin field audits in September 1984.

- o Awarding of discretionary funds

SOEO has developed and adopted a policy and procedure for awarding CSBG discretionary funds. Goals, objectives, and criteria for evaluation methodology are clearly stated in this system. The Request-for-Proposal (RFP) and the selection process fully adhere to these mandates. For Fiscal Year 1983-84 CSBG discretionary funding, 24 projects were selected out of 141 received, and over \$1 million in these monies have been provided and awarded, effective May 1984.

- o Cash advance requirements

SOEO established a procedure to ensure that the CSBG contractors have adequate cash advances for program operation. This procedure is based on the prescriptions of Government Code Section 12781(c) which requires that SOEO issue to a CSBG grantee a quarterly advance payment equal to 25% of the grantee's annual operating expenses.

Based on the advice of SOEO legal counsel, no authority exists to specifically condition cash advances on either "need" or "performance." If an agency fails to perform in a manner consistent with the administrative and fiscal requirements of AB 3X, that agency can be suspended or terminated.

In legal opinion 9550, the Legislative Counsel's Office cited an alternative interpretation of the law that would allow SOEO under certain circumstances to condition cash advances on the criterion of cash flow need. This opinion was referred to the Attorney General's Office for confirmation. When the Attorney General's response is received, SOEO will adhere to the precepts contained in this legal finding and will modify its procedure if necessary. (See related memorandum of June 18, 1984, Attachment 2.)

- o Contracting procedures

Uniform contract awarding procedures and guidelines have been adopted and are currently being implemented, including the establishment of a central contract control unit. The unit maintains a complete central file, as well as coordinates the processing of all contracts. Furthermore, a comprehensive manual on contract procedures is currently being developed to reflect information provided by the Legal Office of the Department of General Services, Attorney General's Office, and other departments.

SOEO identified uniform contract policies and procedures as a primary objective. Since April 1984, a standardized comprehensive contract, approved by the Department of General Services, has been used in all contracting for CSBG and

Department of Energy programs. All executed contracts are subject to the approval of the Department of General Services.

o Legislative Recommendations

SOEO has identified a number of conflicting areas based on the discrepancy between federal and state laws. SOEO joins with the Auditor General's Office in recommending these issues for legislative attention. The Administration and the SOEO are ready to work with the Legislature for corrective and/or clarifying actions.

It is the view of SOEO that there are no "factual" errors in the Auditor General's report. However, some of the conclusions and resulting recommendations are based on assumptions which may not be based on facts. To illustrate this assertion, page 48, line 5, of the report suggests a hypothetical situation and then concludes that "this interpretation could conflict with Federal Guidelines". Similarly, on page 31, paragraph 3, line 5, there is a suggestion that the deficiencies in SOEO's contracting procedures contributed to the possible misuse of federal funds by the Director of the Bay Area Preparatory Program Inc., and the former SOEO Deputy Director of Administration. These assumptions are not and could not be substantiated.

CONCLUDING REMARKS

In identifying managerial and program deficiencies in SOEO and its contractors, one should not ignore the valuable and necessary services which are provided to the people of the state through the programs administered by SOEO and its contractors.

SOEO wishes to acknowledge the professionalism and competence exhibited by the Auditor General's staff in the conduct of this audit. The purpose of this response of the SOEO is to provide the reader with an opportunity to appreciate the work underway and to assure that SOEO carries out its responsibilities in full accordance with the law and the higher professional standards.

SOEO has already taken the initial steps to transform itself from an organization of controversy and deficiency to one striving for excellence in its performance. This major change is reflected in the findings of the audit report and the responses to it. The road ahead should lead to an organization capable of responding to the needs of the people of California in an efficient and effective manner.

Sincerely,


CHON GUTIERREZ
Interim Director

Attachments (2)

Memorandum

To : Steve A. Merksamer, Chief of Staff
Governor's Office

Date : April 3, 1984

Subject: Progress Report

From : OFFICE OF ECONOMIC OPPORTUNITY
1600 NINTH STREET, ROOM 340
SACRAMENTO, CA 95814
(916) 322-2940

At your direction, I met today for 2 hours with the State Auditor General and members of his staff and provided him with the preliminary conclusions of our review of the State Office of Economic Opportunity.

I shared with him the detailed steps we have undertaken to ensure that the State Office of Economic Opportunity is operating in a manner which is consistent with state and federal laws, as well as the various procedures required in the State Administrative Manual.

Also, as you requested, I assured him of our full and continuing cooperation in any further audit activities undertaken by the Auditor General.

Our review of the State Office of Economic Opportunity began approximately December 10, 1983, when you asked me, through the Department of Finance, to ensure that the State Office of Economic Opportunity's operations -- in particular, its fiscal and budgetary activities -- receive special attention from Finance budget staff.

Our conclusions, to date, are based upon the fiscal and program management audit you subsequently ordered December 28, 1983, to be undertaken by the Department of Finance. It began formally on January 4, 1984. Our conclusions are further based upon additional knowledge gained and evaluated since I assumed responsibility for the State Office of Economic Opportunity as its Interim Director on March 6, 1984.

I have enjoyed the cooperation of many State Office of Economic Opportunity employees as well as the work of individuals on temporary assignment from other state agencies, and retired annuitants who have graciously accepted limited-term appointments and have shared with us their many years of experience in state service. Aside from myself, eight individuals have augmented State Office of Economic Opportunity staff for various periods of time. Collectively, these individuals have 137 years of state experience, primarily in the areas of fiscal and accounting activities.

Our review of the State Office of Economic Opportunity revealed an organization with serious managerial deficiencies. For years, it has lacked the most basic managerial practices and procedures.

Its problems have been both minor and major: Paperwork was often lost or set aside and never located; new employees were given no direction to familiarize themselves with such basic matters as their respective job duties, responsibilities, and office policies; important decisions, such as the development of mandated reports, were postponed or never undertaken at all. (For example, grants required by both federal and state law have yet to be made to Indian groups because of a conflict in federal and state law. While the conflict has been clearly understood, management has failed to determine a resolution for the problem.)

In short, the State Office of Economic Opportunity has suffered from a historical lack of managerial discipline and a failure to be held accountable for its shortcomings. The consequences of poor management have created dissension among employees, and ultimately, suspicion, distrust and the inevitable rumors that subsequently emerge.

My highest priority, set by you, has been to bring the State Office of Economic Opportunity up to the same high managerial standards that exist in other state agencies. I can report today that a comprehensive set of new procedures has been implemented, are being implemented, or will be ordered implemented as soon as practical on a specific timetable.

These include specific management procedures that include tighter fiscal and budgetary controls, plans and regular reports, personnel practices, internal organization and office procedures, and tighter contract awarding procedures.

One aspect of our management audit and review has involved pursuing a variety of allegations regarding past practices in the State Office of Economic Opportunity. These inquiries have been raised through anonymous or privileged communications from those individuals currently and formerly associated with the State Office of Economic Opportunity, as well as legislators and members of the news media.

The most serious allegations relate to the process of awarding 1983 federal Jobs Bill Supplemental monies and Discretionary grants, which constitute approximately \$4 million of the \$32 million in Community Services Block Grant monies administered by the State Office of Economic Opportunity.

Department of Finance auditors have reviewed the procedures following both the awarding and/or termination of every State Office of Economic Opportunity Discretionary grant and the majority of Jobs Bill grants in the past six months.

It is correct to conclude that the director of the State Office of Economic Opportunity often exercised the very broad discretion he has under law in the awarding of discretionary grants, and established State Office of Economic Opportunity procedures were not always followed. However, the auditors have not discovered, to date, any evidence that the director or others violated state or federal law in the awarding of discretionary grants.

Nor, I would add, has any evidence been discovered that any employee of the State Office of Economic Opportunity (in the past 14 months) has misappropriated State Office of Economic Opportunity funds for personal gain.

Likewise, we have been unable to substantiate allegations of preferential treatment of employees by supervisors who allegedly demanded and received sexual favors.

As you know, at our initiative I met yesterday with senior members of the Attorney General's staff to share with them our audit efforts, particularly as they relate to allegations of unlawful behavior. I will report back to you on their assessment and recommendations of how we might further proceed.

Despite the many allegations and unfavorable publicity surrounding the State Office of Economic Opportunity, I believe the staff of the State Office of Economic Opportunity are generally good, competent employees. Many of these employees have worked long hours in assisting me in my new role in preparing this report.

While the State Office of Economic Opportunity has suffered from many problems, I am personally convinced this organization -- properly staffed and managed -- can and will respond to your challenge to make the State Office of Economic Opportunity an efficient organization with the highest standards. With new management procedures in practice, the State Office of Economic Opportunity will leave behind those operational problems and inefficiencies which have plagued it for so many years, and proceed on a road of new self-esteem and pride, knowing its employees are delivering critical services to those in great need in the State of California.

We now have in place a structured framework for an open decision-making process within the State Office of Economic Opportunity. It should lead to improved performance accountability. It is critical that the State Office of Economic Opportunity use this framework to secure professionalism and integrity in future operations. Again, I am convinced that such a management strategy will greatly improve the administration, public perception and credibility of the State Office of Economic Opportunity.

Original signed by;
Chon Gutierrez

CHON GUTIERREZ
Interim Director


*Editorial Note: After this letter was written, information was discovered which appears to conflict with this statement.

Memorandum

To : Chon Gutierrez
Interim Director

Date : June 18, 1984

Subject: CSBG Contract Advance
Payment Policy

Tom Topuzes 
Legal Counsel

From : OFFICE OF ECONOMIC OPPORTUNITY
1600 NINTH STREET, ROOM 340
SACRAMENTO, CA 95814
(916) 322-2940

You requested a brief summary of the CSBG contract advance payment policy. On October 1, 1982, the Office of Economic Opportunity (OEO) assumed the administration of the Community Service Block Grant (CSBG) program. The Department of Finance (DOF) authorized the OEO to make quarterly advance payments to CSBG contractors in a memo dated December 7, 1982.

The DOF approved a comprehensive CSBG advance payment plan on May 4, 1983. The plan authorized the OEO to make quarterly advance payments not to exceed 25% of the grants annual budget. The plan contained two exceptions to this advance authority. First, an advance between 25% and 50% could be made on contracts with a term of less than one year and a grant amount of \$50,000 or less. Second, an advance up to 90% could be made on contracts with a grant amount of \$10,000 or less.

During the first week of January 1984, the DOF authorized the OEO to increase CSBG cash advance payments to 50% in recognition of cash flow problems experienced by local agencies. This authority was subsequently revoked and the previous 25% advance limit was reinstated effective January 20, 1984. The OEO then began a review of the advance payment procedure.

In March 1984 you requested that Legal Services, the CSBG program unit, the DOF audit staff assigned to the OEO, and the interim chief deputy director review the advance payment policy. It was determined that Government Code section 12781(c) requires the OEO to issue to a CSBG grantee a quarterly advance payment equal to 25% of the grantee's annual operating expenses.

The Legislative Counsel issued opinion #9550, dated May 18, 1984, which provides that after making an initial advance payment, the OEO may condition further quarterly payments upon receipt of periodic financial reports demonstrating the grantee's actual cash flow needs. I have requested an opinion from the Attorney General's Office seeking clarification of OEO's role and authority regarding CSBG cash advance payments.

TT:nc

cc Jim Phillips
Peter Ladany
Theresa Speake

APPENDIX A

COMMUNITY AGENCIES REVIEWED

We reviewed the 12 community agencies listed below as part of our audit of the Office of Economic Opportunity. These agencies contract with the Office of Economic Opportunity for federal funds.

<u>Agency</u>	<u>City</u>
California Hispanic Commission on Alcohol and Drug Abuse, Inc.	Sacramento
California Human Development Corporation	Windsor
Campeños Unidos, Inc.	Brawley
Center for Employment Training	San Jose
Community Housing Improvement Systems & Planning Association, Inc.	Salinas
Golden State Business League, Inc.	Oakland
Kern County Economic Opportunity Corporation	Bakersfield
The National Hispanic University	Oakland
Orange County Community Development Council, Inc.	Santa Ana
Project Go, Inc.	Roseville
Proteus Training & Employment, Inc.	Visalia
United Community Efforts, Inc.	Los Angeles

cc: Members of the Legislature
Office of the Governor
Office of the Lieutenant Governor
State Controller
Legislative Analyst
Assembly Office of Research
Senate Office of Research
Assembly Majority/Minority Consultants
Senate Majority/Minority Consultants
Capitol Press Corps