California State Auditor

BUREAU OF STATE AUDITS

Kern County Economic Opportunity Corporation:

Poor Communication, Certain Lax Controls, and Deficiencies in Board Practices Hinder Effectiveness and Could Jeopardize Program Funding

June 2000
99136

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June 22, 2000 99136

The Governor of California
President pro Tempore of the Senate
Speaker of the Assembly
State Capitol
Sacramento, California 95814

Dear Governor and Legislative Leaders:

As requested by the Joint Legislative Audit Committee, the Bureau of State Audits presents its audit report concerning our review of the Kern County Economic Opportunity Corporation (KCEOC).

This report concludes that the controversy over compensatory time off (CTO) practices and policies resulted from poor communication between the KCEOC board of directors (board) and some members of management. Although both parties are at fault, management is particularly to blame because it missed numerous opportunities to inform the board about the CTO. In addition, we observed certain weaknesses in internal controls including mismanagement of health center billings, questionable costs charged to grants, poor inventory practices, inappropriate loans between grants, and other less serious, but troubling weaknesses. The board has also suffered from vacancies and absences, and has violated open meeting laws and its bylaws. These problems and weaknesses hinder KCEOC's mission of providing services to the low-income, disadvantaged, and elderly residents of Kern County.

Respectfully submitted,

Mary P Noble

MARY P. NOBLE
Acting State Auditor

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SUMMARY

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The Kern County Economic Opportunity Corporation (KCEOC) experienced a serious disagreement between its board of directors (board) and some members of management over compensatory time off (CTO) practices and policies. It also has significant deficiencies in certain controls over operations. Specifically, our review revealed the following:

- ☑ ***Poor communication between the board and some members of management, including the former executive director, led to the dispute over $581,000 in payments and leave taken for CTO.***
- ☑ ***Certain weak controls have allowed $90,000 in questionable costs, the potential write-off of $642,000 in health center billings, and inappropriate loans between grants to cover deficits.***
- ☑ ***Vacancies and poor attendance at meetings have plagued the board, thus limiting its effectiveness. Also, the board has violated open meeting laws and its own bylaws.***

RESULTS IN BRIEF

Lax internal controls in certain areas at the Kern County Economic Opportunity Corporation (KCEOC) may jeopardize its continued receipt of program funds, cause financial difficulties, and hinder its mission of helping Kern County's low-income population. Weaknesses in KCEOC's operations include poor communication between the agency and its oversight board of directors (board), some fiscal and administrative problems with grants, and deficiencies in board practices. The poor communication led to a serious disagreement between KCEOC's board and some members of management. Certain lax controls also have allowed KCEOC to incur questionable costs, inappropriately lend funds between programs, and mismanage billings at its health center. Monitoring of KCEOC operations by the board and some managers is limited, resulting in an overreliance on the director of finance and on reviews by external entities. In addition, the board does not always have effective participation by its members, adequate compliance with its bylaws and open meeting laws, and training in specific areas to enable board members to provide more effective oversight.

KCEOC is a nonprofit community action agency that administers numerous health, education, and child development programs to Kern County's low-income, elderly, and disadvantaged residents. It is governed by a 15-member volunteer board with representatives from the county's public, private, and low-income sectors. Individual staff prepare or present information to the board; however, KCEOC's executive director is the principal link between the board and agency staff and is responsible for the agency's day-to-day operations and for the quality of information given to the board.

The board and some members of management, including the former executive director, have disagreed on the policy for compensating management staff for overtime. In late 1998, the board became concerned that management staff were receiving compensatory time off (CTO) for overtime worked and, further, that they could choose to receive cash payouts in lieu of CTO, practices that the board should have been aware of, although it indicated it was not. Certain members of management stated that the practices were long-standing and believed that the board had approved the practices. This issue has disrupted the leadership of KCEOC and has resulted in a legal dispute with a former employee. In addition, because the board believes that it did not authorize the practice of paying for CTO for management staff, the federal government could disallow the $581,000 spent for payments and leave time.

The controversy over CTO arose because of poor communication between the board and some members of management, including the former executive director. Most of the blame for this poor communication rests with these members of management, who had numerous opportunities to clearly inform the board about compensation practices and policy but failed to do so. The board must share the blame, however, primarily because its members failed to communicate effectively among themselves. Former board presidents were aware of payments for CTO, but there is no evidence they told current board members of the practice.

Administrative weaknesses, including poor oversight over grant requirements, have resulted in questionable expenditures and practices. For example, we found almost $90,000 in unallowable costs, primarily for professional fees related to the dispute over CTO, that were paid with grant funds that were restricted in use and not available to cover these costs. These grant funds were originally used to subsidize KCEOC's health center and then transferred to cover the unallowable costs. Another problem is that mismanagement of billings at the health center has resulted in a backlog that its records show total $642,000 that are old and possibly uncollectible. Because the billings are old and the records are in poor condition, KCEOC has limited confidence in the accuracy of this amount and does not know how much is related to unbilled amounts, denied billings, or errors. Thus, KCEOC is researching if it can pursue collection of these accounts. Although the board was concerned about the health center's finances, neither management nor KCEOC's independent auditor disclosed the billing problem to the board. These uncollected claims have aggravated KCEOC's cash-flow problems—problems that have led to frequent improper uses of restricted funds as short-term loans to other grants.

We observed many minor weaknesses in internal controls that were not individually significant but, taken together, create an environment that unnecessarily exposes assets to risk of loss or misuse. These other weaknesses include breakdowns in the approval of expenditures, security lapses, and weaknesses in personnel practices.

Monitoring of KCEOC operations by some members of its management is limited, resulting in an undue reliance on the director of finance. The board also has relied on outside reviews to identify problems; however, these reviews are not meant to provide comprehensive information about the agency's programs and may not cover all areas of concern to the board. In a future audit, we intend to follow up on the issue of comprehensive grant management reviews and grant oversight of nonprofits throughout the State. Based on that audit, we will, if necessary, suggest changes to management practices and existing laws to improve oversight.

The board does not always comply with KCEOC bylaws and open meeting laws. For example, it often has vacant seats and it has been slow to fill them because it relied too heavily on the former executive director to recruit new members. In addition, some members have neglected to attend meetings consistently, but until recently, the board has not taken steps to remove and replace them. These vacancies and absences have limited the board's effectiveness in providing oversight. The board has also violated open meeting laws. According to the board president, the board believed that it did not need to comply with these laws based on the advice of a former attorney and the former executive director. Further, until a few months ago, the board was violating its bylaws because it was not keeping minutes for closed meetings. Additionally, the board has not received training in subjects that could improve the quality of its oversight, such as allowable costs, financial statement review, and open meeting laws. Finally, a new bylaw change that allows officers to act on the board's behalf between meetings exposes the agency to the risk that the officers could act inappropriately. The board president indicated that the change was intended to allow the officers to be more involved with the agency and was approved by their attorney.

RECOMMENDATIONS

To improve the relationship between the KCEOC board and management, both parties, particularly management, must communicate more openly. Management, in particular the executive director, should ensure full disclosure of crucial issues.

Both parties should clarify their understanding of issues so they know each other's position. Finally, the board should systematically identify key issues it wants to know about and require management to provide regular and detailed reports on those issues.

To ensure that it follows federal and state grant requirements, KCEOC should improve its internal controls over expenditures and approvals, cash management practices, and security of assets, including food donated to its food bank. Further, KCEOC should contact federal and state grant agencies to determine whether it will have to repay the $581,000 spent for CTO and the $90,000 spent for professional fees and to repay bonuses. Additionally, KCEOC needs ways to avoid future billing problems at the health center.

The board and management should provide better oversight of the agency and its programs and reduce their reliance on the director of finance and outside reviews. Management should regularly receive more informative financial reports. To provide a fresh perspective on operations and internal controls, the board should ensure that KCEOC periodically change its independent auditor. In addition, KCEOC should provide better training to its management and board members to enable them to provide more effective control, oversight, and management of the agency and its programs.

Finally, to improve its effectiveness as an oversight body, the board should actively recruit new members to minimize vacancies and should take steps to eliminate the absenteeism that has plagued the board. The board also should ensure that it complies with open meeting laws and its bylaws by providing proper public notice and keeping minutes for all meetings. To minimize risk, the board should clearly define the actions that officers may take between meetings.

AGENCY COMMENTS

The Kern County Economic Opportunity Corporation generally agrees with our findings and plans to, or has begun to take steps to, implement our recommendations. ■

INTRODUCTION

BACKGROUND

The Kern County Economic Opportunity Corporation (KCEOC) was established in 1965 after passage of the federal Economic Opportunity Act of 1964. As a non-profit community action agency, it administers numerous health, education, and child development programs to eligible residents of Kern County. It receives funding from federal, state, local, and private sources. Its 1999 operating budget was $43.7 million.

KCEOC is governed by a 15-member volunteer board of directors (board) with representatives from the county's public, private, and low-income sectors. Its executive director is responsible for the agency's day-to-day operations and is the principal link between the board and agency staff. Some of the federal and state agencies that provide grants to fund KCEOC's programs also monitor, in varying degrees, its activities to ensure they are in compliance with grant requirements.

KCEOC'S PROGRAMS ARE DIVERSE

As a community action agency, KCEOC provides services to low-income, elderly, and disadvantaged residents. Such services are provided through a variety of programs, including:

- Head Start, a federally funded preschool program for low-income children. Children attending Head Start participate in a variety of educational and social activities. In addition, they receive free medical and dental care. Head Start also provides referrals to disability, mental health, and employment services, as well as social services. In 1999, KCEOC's Head Start funding was $17.2 million.

- State Child Development Programs, which provide child care and development programs for eligible children. Program goals include increasing the quality and number of child care spaces in the county. The funding in 1999 was $3.8 million.

- The Food Bank, which apportions U.S. Department of Agriculture surplus commodities and emergency food to the needy through monthly distributions and through deliveries to homebound seniors and the disabled. The funding in 1999 was $1.1 million.

- The Family Health Center, which provides health services to the low-income community, offering obstetrical, gynecological, and pediatric care; family practice and internal medicine; free immunizations; disabilities prevention; and comprehensive prenatal services. It receives funding through reimbursements from state and federal medical assistance programs, such as Medicare and Medi-Cal, private insurers, and payments from some of its patients. Funding in 1999 was $1.2 million.

- The Low-Income Home Energy Assistance Program, which offers weatherization for the dwellings of low-income families; assistance with energy payments for electricity, natural gas, home heating oil, propane, or wood; and repair or replacement of home furnaces. Its funding in 1999 was $619,000.

- The Community Services Block Grant (CSBG), a federally funded program intended to help alleviate the causes of poverty. The CSBG agreement allows KCEOC to use this funding for program administration and for costs of the Family Health Center. Funding in 1999 was $791,000.

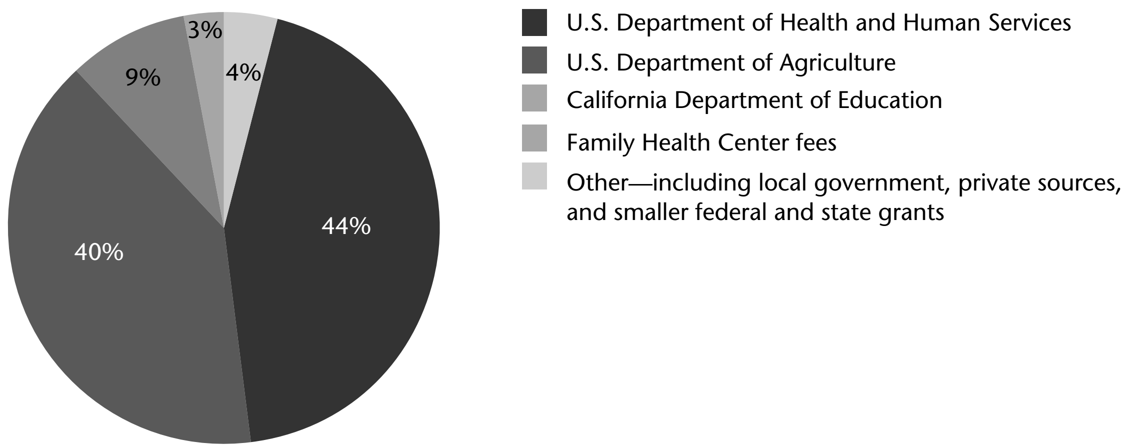
- Other programs accounted for nearly $19 million of KCEOC's $43.7 million budget. The largest of these programs was the Special Supplemental Nutrition Program for Women, Infant, and Children (WIC). WIC vouchers for food purchases comprised $14.5 million. Smaller federal, local, and private grant programs accounted for the remainder.

Figure 1 depicts KCEOC's funding sources in 1999.

In addition to these sources of funding, KCEOC recently was awarded a grant for the Migrant Alternative Payment program, a federally funded pilot program providing child care services for migrant farm worker families in a six-county area. The program pays all or part of child care costs to providers chosen by parents. The grant began in November 1999 and has total funding of $8.2 million over a 20-month period.

FIGURE 1

KCEOC Sources of Funds for 1999



Source: Information compiled by the KCEOC director of finance.

KCEOC Has Grown Rapidly

During the 1990s, KCEOC grew significantly under the direction of a new executive director, expanding its services and increasing its revenues. According to KCEOC, its budget grew from $24.9 million in 1995 to $43.7 million in 1999 due to new grants and increases in funding for existing grants. KCEOC has indicated that its programs report serving more than 150,000 low-income, elderly, and disadvantaged residents, some of whom may be served by multiple programs. It provides services at 60 offices, employs about 600 staff, and operates a fleet of 34 school buses, trucks, and cars.

The executive director who oversaw much of this growth resigned in September 1999 following public controversy over compensation he received, in addition to his salary, for working more than 40 hours a week. The circumstances of his departure resulted in the request for our audit.

SCOPE AND METHODOLOGY

The Joint Legislative Audit Committee (JLAC) asked the Bureau of State Audits to perform a comprehensive audit of executive compensation practices at KCEOC to determine whether the State's investment and interests in KCEOC's programs were protected. In particular, JLAC asked us to review the methods KCEOC used to monitor compensatory time off, salary increases, and administrative costs, and to determine the extent to which KCEOC board members are informed about these practices. Further, we were asked to determine whether KCEOC's policies, procedures, and internal controls ensure compliance with state and federal funding requirements and whether such practices are consistent with those of similar nonprofit organizations.

To gain a general understanding of KCEOC's policies and procedures, we interviewed board members, management, agency staff, and outside parties, including staff at federal and state oversight agencies. We also reviewed laws and regulations relevant to nonprofit agencies. We reviewed a sample of KCEOC's grant agreements to understand the services it provides. Finally, we reviewed single audit reports and minutes from open board meetings.

To gain an understanding of KCEOC's compensation to executives, we interviewed executives, managers, board members, and the former executive director. The board already had engaged a CPA firm to review its compensation to executives and its personnel policies and practices, so we reviewed the CPA's work to determine the reliability of the information reported and the reasonableness of the conclusions reached. We performed additional testing as needed to verify the accuracy of this work. We also examined other forms of compensation to executives, including travel reimbursements, business meals, and car allowances, for evidence of compensation abuse.

To determine if controls over state and federal funds were sufficient to ensure that those funds were used as intended, we reviewed KCEOC's annual single audit report and the supporting documents for the fiscal year ended 1998-99. Based on this review, we decided to perform additional testing of controls over federal and state grants. To assess controls over cash management and expenditures, we sampled cash draws and expenditure transactions from specific grants. In addition, we reviewed federal and state oversight reports available from KCEOC to better understand the extent of federal and state monitoring over grant funding. As needed, we called federal or state oversight agencies to further clarify monitoring procedures. To assess KCEOC's monitoring of compliance with grant requirements, we interviewed staff to learn the practices they employed and reviewed the tools used for this monitoring. We visited other KCEOC sites, including the Food Bank, Family

Health Center, and the WIC main office, to investigate their control practices.

In addition, JLAC asked us to assess whether our observations at KCEOC had ramifications for state policies governing nonprofit organizations that receive state and federal dollars. We include some observations in this report, but we intend to follow up on the issue of comprehensive grant management reviews and grant oversight of nonprofits in a future audit. Based on that audit, we will, if necessary, suggest changes to management practices and existing laws to improve oversight.

Finally, we reviewed certain board actions and practices, met with its members, and reviewed its bylaws. We also determined the extent of board vacancies and absences, and assessed their impact on the board's oversight. To determine if the board followed open meeting laws, we reviewed board minutes and met with board members, staff, and the interim executive director. ■

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CHAPTER 1

Poor Communication Led to the Dispute Over Compensatory Time Off

CHAPTER SUMMARY

The dispute between Kern County Economic Opportunity Corporation's (KCEOC) management and board over compensatory time off (CTO)—that is, time off allowed or paid to management staff for overtime hours worked—stems from poor communication. In late 1998, current members of KCEOC's board of directors (board) raised concerns that management staff were receiving payments for CTO, and that this practice was against the agency's policies. Some members of management, including the former executive director, insisted these payments were a long-standing practice and had received board approval. Since 1993, management's payments and leave taken for CTO in violation of agency policy amounted to $581,000.

Poor communication about CTO is a symptom of the less-than-effective relationship between the board and management. All parties bear responsibility for this problem, but most blame seems to rest with some members of management. Knowing the board relied upon them for accurate and complete information, the former executive director and some members of management still missed numerous opportunities to furnish the board with specific information and initiate open discussion of this important issue. Historically, the board is also at fault for the dispute. Three former board presidents knew of and approved cash payments for CTO, yet newer members apparently were not told about them. The board could have questioned the practices much sooner if it had overseen KCEOC policies and operations more thoroughly, and if former presidents properly informed incoming members of these practices.

Now the controversy over this issue has disrupted the KCEOC leadership and could threaten grant funding. The executive director resigned in September 1999 after several board meetings to discuss the issue. Since October 1999, KCEOC also has been embroiled in a legal dispute with a former executive who is demanding payment of her CTO balance. Because the board believes that it did not authorize the CTO payments to management, grant agencies could force KCEOC to repay funding that went toward this purpose.

DISAGREEMENT AROSE OVER THE ACCEPTED POLICY FOR CTO

Although cash payouts of CTO to managers began in 1993, current board members indicated they were unaware of this practice until late 1998; however, management believed the board was aware of the practice earlier.

The KCEOC board and certain members of management, including the former executive director, did not agree upon either what the policy for CTO payments to management had been or the extent to which the board knew of the payments. Because cashing in CTO was a long-standing practice, management contended the board was fully aware of it and had even approved it for incorporation into the employee manual in 1997. Management employees were allowed to accrue and use CTO since at least 1991, and possibly earlier, while cashing in CTO began in 1993. However, current board members, some of whom have served up to eight years, indicated they were not aware of this practice until late 1998, when the board's former vice president learned that all employees, including managers, were paid on an hourly basis for additional hours worked.

Exempt employees, such as executive, administrative, professional, and certain other types of employees, typically do not receive an hourly wage and instead receive a flat salary. In addition, exempt employees usually do not accrue or receive pay for overtime, regardless of the time spent completing their duties. Under specific conditions, the law requires that nonexempt employees, who are usually lower-level staff receiving an hourly wage, must receive paid overtime. There is no similar provision for exempt employees; instead, the decision whether to pay overtime rests with the employer. As of April 2000, just 32 of the agency's approximately 600 employees were exempt.

In August 1999, after investigating the CTO payments to managers, the board directed the then executive director to halt the accrual or cashing out of CTO for the seven executive-level staff, including himself. Because it was awaiting results of a study on the adequacy of compensation for KCEOC employees, the board did not immediately act to stop CTO payments for the remaining 25 management employees. The initial results of this study, which were available in December 1999, showed that some management employees were paid less than those in comparable positions in similar agencies. In December 1999, the board discontinued accruals and payouts for eight other management employees. Shortly afterward, several of these employees who were working significant additional hours received pay increases to bring their salaries more in line with the results of the salary study. In April 2000, the final group of 17 management employees was reclassified to exempt status to prevent them from accruing any more CTO.

The CPA Firm's Findings

- Between 1993 and August 1999, management received $581,000 in CTO benefits. Of this amount, $542,000 was given in pay and the remainder as time off from work.
- Management staff received $104,000 for unused vacation time between 1993 and 1999.
- Executive staff accrued, but has not been paid, $38,000 in CTO.
- CTO payments to management violated agency policy.
- CTO was not approved in advance by the employees' supervisors.
- Little conclusive evidence exists that the current board knew of the payments.

According to the board president, the board did not know whether it received accurate or complete information from KCEOC management, so it hired a local CPA firm in October 1999 to analyze KCEOC's CTO policies and practices. The firm concluded that the accrual and payout of CTO to management violated KCEOC policy. It calculated that CTO payments and leave taken cost the agency $581,000 since 1993. The CPA firm also discovered that employees were receiving cash payments for their vacation time, another violation of agency policy.

We found that the facts and conclusions the CPA firm reported, described in the text box, were generally accurate and reliable. In particular, we agree that the CTO was paid in violation of agency policy since 1993 because, among other reasons, there was no evidence of pre-approvals. However, we do not fully agree with the CPA firm's belief that there is little conclusive evidence that the board was aware of the CTO payments. We believe that at least one current board member had been provided sufficient information to have known about the payments.

CTO DISAGREEMENT HAS HINDERED AGENCY OPERATIONS

The disagreement between management and the board has hurt KCEOC's operations and its mission of serving the low-income community of Kern County. The disagreement has disrupted the agency's leadership and precipitated the executive director's resignation in September 1999. In June 2000, the board appointed a permanent director. The agency is also in a legal dispute with a former executive because the board refused to cash out her accrued CTO when she resigned in October 1999. Finally, because the board believes it did not authorize cash payouts for CTO, the payments violate grant requirements. As a result, granting agencies could request reimbursement for the CTO payments already made.

A Former Executive Sued Over CTO

A legal dispute with a former executive employee presents another drain on KCEOC's time and resources. This executive accrued approximately $7,000 in CTO before she resigned in October 1999. The board refused to pay this balance because it felt she was instrumental in modifying the employee manual to allow CTO payments to management and she failed to inform the board of the change. It further maintained that, as an exempt employee, the executive was not entitled to CTO. The executive took her case to the state labor commissioner and, in December 1999, won a settlement against the agency for the CTO accrued. However, the labor commissioner did not award her penalties or legal fees. The labor commissioner ruled against KCEOC because a section in the employee manual allowed CTO payments; the executive employee reasonably believed she was entitled to the funds because she received other payments for CTO; and the board did not terminate the cash payout policy until August 1999, by which time the employee already had accrued significant CTO.

__The KCEOC board filed a countersuit against the former personnel officer, alleging among other items, fraud and deceit, and negligence in performing her duties.__

The board filed a countersuit against the executive in December 1999. According to the current board president, the outcome of this legal dispute will determine if KCEOC will pay three other employees for their CTO balances, which amount to $31,000. The former executive director received his accrued CTO in periodic cash payouts or as time off, so he had no balance when he resigned from the agency.

The countersuit has yet to go to trial. This suit alleges that the executive breached her fiduciary duty as personnel officer because she did not inform the board that the payouts to management staff, including her, violated KCEOC policy. The suit further accuses the executive of hampering the board's investigation of the payouts, of fraud and deceit, and of negligence in performing her duties. As discussed further in Chapter 2, the board is incurring attorney fees for this legal dispute that cannot be paid from KCEOC's federal and state grants. The board must find a source of unrestricted funds—funds available for general use—to pay the fees.

Granting Agencies May Disallow Unauthorized CTO Payments

KCEOC may need to repay granting agencies the $581,000 of CTO because federal regulations do not allow payment for unauthorized costs. In this case, the current board contends that it did not authorize management's CTO payments. Federal regulations do not allow reimbursement for employee compensation costs that do not conform to the grantee's established policies. Therefore, we believe federal agencies overseeing KCEOC's grants could determine that these costs violated KCEOC policies and require repayment from funds available for general use. Lacking any significant source of unrestricted funds it could use for this purpose, KCEOC would have difficulty repaying these funds, in which case the granting agencies could reduce funding or impose other sanctions.

GOOD COMMUNICATION AND ROLE CLARIFICATION ARE CRUCIAL

The board must have confidence that the executive director and staff fully disclose accurate information, while management must trust that the board will act fairly and responsibly.

A good relationship, open communication, and well-defined roles for the board and management are critical for the proper management of any nonprofit organization. The training manual for KCEOC's board incorporates guidance from the National Association of Community Action Agencies on the board's role and relationship with management. The agency is more likely to meet its goals when the relationship works appropriately. The board must be able to trust that management gives it accurate and complete information to enable it to properly govern the agency, while management must be able to trust that the board will act fairly and responsibly in setting policies for the agency.

The board's role is to define the organization's purpose and mission; set goals and select strategies for meeting them; manage the relationship between the organization and its constituents (program clients, funding agencies, and the community); and monitor the executive director and overall operations to ensure the organization meets its mission and goals. The board has an added fiduciary responsibility for ensuring the organization's financial well-being. The KCEOC bylaws state the board is responsible for determining the overall plans and priorities of the agency as well as for evaluating progress against the performance. In this role, the board holds formal meetings to discuss issues and reach decisions on the appropriate courses of action.

The KCEOC board is composed of volunteers who have limited time to oversee the agency's operations; therefore, the board relies upon the executive director and agency staff to provide accurate and full disclosure of their activities to enable it to make informed decisions. As the board's agent, the executive director bears the ultimate responsibility for keeping the board fully aware of all crucial policies and practices and for ensuring that staff implement the board's policies. The executive director and agency management also should establish appropriate internal controls to ensure that day-to-day operations are in accordance with the board's policies and federal, state, and local grant requirements.

When the relationship between the board and management breaks down, problems can remain unidentified and unresolved and decisions can be made without appropriate information. As the following sections detail, such was the case with the executive compensation practices at KCEOC.

MANAGEMENT DID NOT GIVE THE BOARD ESSENTIAL INFORMATION ABOUT CTO

The board relied upon KCEOC management to fully disclose all compensation matters, but some members of management, including the former executive director, failed to do so. Apparently, management assumed that the board was already aware of these issues. Management had numerous opportunities to clearly communicate CTO policies and practices before the board began asking explicit questions. These opportunities included discussions of salary studies, changes to the employee manual, and sharing of certain payroll records. Once the board began requesting information, management was not always forthright in its responses. Although individual managers or staff were responsible for preparing or presenting information to the board, the former executive director had ultimate responsibility for ensuring the accuracy and completeness of the information.

Various members of management had numerous opportunities to explicitly disclose the CTO payouts to the board, but failed to do so.

CTO Payments Were Not Disclosed During Discussions of Salary Adjustments

Some of the key interactions in which some members of management failed to notify the board about the CTO payments were discussions of salary adjustments from 1995 to 1998. Periodically, the board evaluated the former executive director's performance, and it increased his salary almost every year. In some instances, it made decisions based on information from management. The board believed the total compensation for the former executive director and other managers was lower than it actually was because management failed to disclose the payments received for CTO in addition to their salaries.

Management told the board that the former executive director's compensation was $86,091; however, including CTO payments it totaled $112,891.

In September 1995, for example, management, including the former executive director, told the board that the former executive director was earning $86,091 annually. His salary, weighted against the salaries for comparable positions at 12 other agencies, ranked in eighth place. To bring his compensation in line with pay at other agencies, the board increased the former executive director's salary to $94,702. However, the board was not told this was only his base salary; the former executive director had received additional payments of $26,800 for CTO from January through August 1995, making him the second-highest paid officer at the 12 agencies before the pay increase. Management also did not disclose that the director took more than 270 hours of CTO as leave between January and August 1995.

Another opportunity for discussing CTO presented itself in late December 1998, when the board was considering salary increases for six executives. Again, management failed to disclose any payments for CTO. At that time, management stated that the director of finance was earning $76,024 annually and proposed a salary increase of $998. However, management failed to disclose that the director of finance had received more than $36,400 in CTO during 1998. Another three of the six executives received $5,900 to $13,000 for CTO in addition to their salaries. The board awarded these six executives raises of $998 to $12,834. The CTO each received varied from year to year depending on the individual's workload, need to work additional hours, and desire to cash out the accrued balances. As an illustration, between 1994 and 1999, one executive earned $6,200 to $55,700 extra each year.

Management's failure to disclose CTO payments hindered the board's ability to make informed decisions about executive salaries.

The failure to disclose CTO payments prevented the board from making informed decisions about these executives' salaries. Had the board known this information, it could have made several choices about the compensation of these individuals. For example, it could have decided to continue CTO payments for management, but not granted pay increases. This course of action would have allowed CTO to compensate management for the additional hours worked. Another option would have been to discontinue CTO while increasing management salaries. This option would have treated them as exempt employees—that is, they would have received higher pay to compensate them for working in a job that likely required them to work more than 40 hours a week. The board also could have used this information as a basis for adjusting duties if it believed the workload for a particular position was excessive. For instance, had the board determined that the director of finance was working excessive hours, it might have authorized more accounting staff to relieve her workload. The crucial factor in all these options, however, would have been the board's explicit knowledge of CTO payments to management.

When Formalizing CTO Practices, Management Did Not Explicitly Inform the Board

In July 1997, management proposed changes to the employee manual, including a change to align policies on CTO with KCEOC's actual practices over the previous several years. In presenting the proposed changes to the board, the former personnel director did not explicitly call this particular modification to the board's attention, even though it was a significant departure from the prior policy. Table 1 compares how KCEOC's policies and practices have differed since 1993, including the changes in policy that occurred in 1997.

The former personnel director briefed the board on five proposed policy changes in 1997 but did not raise the issue of CTO for discussion. Instead, she presented the following issues as key changes to the manual: conflict-of-interest policy; payouts or rollovers of unused sick leave (which was questioned by the board and denied approval at this meeting); update to employee standards of conduct; update to the sexual harassment policy; and approval date of the manual by an oversight committee. None of these issues would have had such a significant financial effect on KCEOC as the cash payouts for CTO. The former personnel director informed the CPA firm that later reviewed CTO practices that she did not highlight this section as a major

TABLE 1

Compensatory Time Off Policy and Practice Have Differed

Year	Policy	Practice
1992	• CTO allowed for exempt employees. • Definitions of exempt and nonexempt employees included. Examples given of exempt employees include the executive director, personnel officer, program managers, and the director of finance. • Accrual of up to 40 hours, at straight time, for use as time off by year-end. • Cash payments allowed only if the employee leaves the agency. • Additional hours worked must be approved in advance by the employee's supervisor.	• CTO accrued at straight time with no limit. • Cash payments allowed only if employee leaves agency.
1993	• Policy is unchanged.	• Accrual is increased to time-and-a-half to comply with a "ruling on federal guidelines." Current staff cannot locate this ruling. • Most employees fail to obtain advance approval for CTO worked.
1994	• Policy is unchanged.	• Cash payments begin at time and a half.
1997	• Cash payments of CTO for eligible employees allowed, with approval of executive director. • Time-and-a-half for accrual and payout. • "Eligible" employee terminology introduced, but no definition provided. • 40-hour limit on accrual of CTO eliminated. • Definition of exempt and nonexempt is unchanged.	• Practice is unchanged.
1999	• Policy discontinued; management employees formally reclassified to exempt status.	• Practice is discontinued.

change because she considered it routine. However, had she explicitly discussed the change, the board might have changed the policy or discontinued the practice altogether.

In the 1997 changes, management revised the CTO policy to apply to "eligible" employees instead of to exempt employees, but did not define which positions were considered eligible. The lack of specificity renders this change ambiguous at best. Further confusing the issue is a contradictory section, retained in the revised manual, that describes exempt employees as those classified by the agency as exempt from the overtime provisions of the Fair Labor Standards Act. This section further elaborates that exempt employees' salaries are based on a job to be accomplished, not on a 40-hour workweek. It named the executive director, personnel officer, program managers, and the director of finance as exempt employees. Although these executives do not qualify for overtime as exempt employees, without a specific definition of "eligible" employees, the manual is unclear whether they are considered to be eligible employees. Thus, the language in the employee manual is vague and contributes to the confusion over the accepted CTO policy.

Language in the employee manual is ambiguous and contributes to the confusion over the CTO policy.

Management Did Not Share Certain Payroll Records With the Board

Despite keeping detailed records of employees' CTO balances, management did not periodically share these records with the board, nor did it require board approval of each CTO payment. Thus, except in a few cases, the board did not give its approval for these payments. Accounting staff prepare records of CTO for each two-week pay period to monitor the balances. Providing these records to the board would have been an excellent method of keeping members informed of the effort management puts into running KCEOC. Additionally, KCEOC did not treat CTO payments as exceptions to employees' normal pay, which would require separate board approval. Instead, staff added the payments to the employees' biweekly paychecks, which are not subject to the board's direct review.

KCEOC uses a private company to compute its payroll and prepare paychecks. All other payments for goods and services are subject to board review and require a board member's signature. If management had chosen to treat the CTO payments as exceptions to the payroll process and write the employees a separate check, the board could have reviewed these separate payments as they occurred and might have identified and resolved its concerns earlier. In the past, the board actually has approved cash payments for CTO in certain circumstances. Since 1993, several management employees cashed out their CTO with board approval when they left employment. Documentation attached to these payments indicated that the employees were nonexempt; that is, they were paid at an hourly rate and were eligible for CTO according to the employee manual. Also, by 1997, the revised employee policy allowed cash payments for CTO to "eligible" employees; however, this is the provision that management did not explicitly discuss with the board. Although the board should have known who its managers were and questioned whether these employees were classified accurately as nonexempt and the payments appropriate, it did not.

Despite keeping detailed records of CTO earned and paid, management did not share these records with the board.

Board Minutes Lack Mention of CTO

The absence of any discussion of CTO in board meetings from 1991 until early 1999, or any mention of CTO in documents that were shown to the board, is further indication that the board was unaware of this issue and that management did not bring it up for board consideration. The CPA firm that reviewed CTO policies and practices examined minutes from January 1991 until early 1999 for full board meetings, executive committee meetings, and all subcommittee meetings; however, it found no evidence that the board explicitly discussed or voted on the practice. We believe that, if it were aware of the practice, the board probably would have discussed it at some of these meetings. The board also held closed meetings during this time, but it only recently began keeping minutes for these closed sessions. Thus, there were no minutes from closed sessions available for review. Nevertheless, it seems highly unlikely that the board would have discussed this matter in the closed sessions if members never made mention of it in any other meeting. The board's executive committee apparently discussed the issue by late 1998 when it asked management to prepare an analysis of CTO practices. A discussion of this analysis was on the meeting agenda in April 1999.

Our review of documents, files, and other information that the board was provided, except for the former executive director's time sheets, did not reveal any evidence that the board had explicit knowledge of CTO practices. Considering the public's sensitivity over the issue of employee compensation at nonprofits, it would have been prudent for management to document board approval even if it were convinced that the board was fully aware of the practice. By doing so, management would have assurance that its oversight board was taking responsibility for CTO payments.

Management Was Not Initially Forthright When the Board Requested Information About CTO

The analysis management initially gave the board in April 1999 masked the dollar amounts paid for CTO.

After the board requested information on CTO paid, certain members of management did not initially supply all the information the board wanted or needed. Management presented an analysis of CTO for 1998 to the board's executive committee on April 20, 1999. Rather than simply provide the amount of CTO paid to 13 executives and managers, this analysis presented the amount paid as a percentage, thus masking amounts that had been paid. The director of finance prepared this analysis using hours as the basis for the percentage. However, the analysis did not include an explanation for the basis of calculating the compensatory time percentage. Such an analysis is confusing at best and can be quite misleading because there exist several different ways to calculate percentages and with different results. The CTO percentage could have been presented as hours worked either at straight time or at time-and-a-half during the year. Alternatively, the CTO percentage could have been calculated as CTO hours cashed in for pay during the year. Table 2 uses facts about the former executive director's CTO activity during 1998 to illustrate some of the varying percentages that can result by using different calculations and compares these percentages with the one presented to the board.

As Table 2 shows, the director of finance's calculation is lower than any of the three calculations that we believe are more appropriate to use. The director of finance based the calculation on the number of extra hours worked during the year (564 hours), less the CTO hours taken off as leave (106 hours), compared with the standard number of work hours in a year (2,080 hours). According to the director of finance, the former executive director instructed her to use this method and she did not personally receive instructions from any board member about how to prepare this calculation. Several flaws exist with this approach that will make the percentage lower. One flaw is that many of the extra hours worked are earned at time-and-a-half; thus, the amount of CTO earned during the year will be much greater. Specifically, the former executive director worked 564 extra hours during 1998, but accrued more than 776 hours of CTO. Another problem with the calculation is with the reduction of CTO hours taken off as leave. The

106 hours of CTO leave taken represented a benefit to the former executive director because he was not required to work during that time. Reducing the accrual by CTO leave taken understates how much the former executive director claimed and will make it seem that CTO accrued is less than it actually was. Finally, this calculation focused on hours earned during the year and not the hours cashed in for pay. During 1998, the former executive director cashed in 772 CTO hours for pay.

TABLE 2

Comparisons Can Show Many Different Percentages of Compensatory Time Off

Assumptions for Calculating the Compensatory Time Off Percentage	Resulting Percentage
The director of finance's method	22%
CTO hours worked at straight time divided by standard work hours in a year	27%
CTO hours worked at time-and-a-half divided by standard work hours in a year	37%
CTO hours cashed in for pay during 1998 divided by standard work hours in a year	37%

Source: Workpapers of the CPA firm that reviewed KCEOC's CTO practices. The following facts were used relating to the former executive director's CTO during 1998:

- He worked 564 extra hours, which translated to 776.5 CTO hours. (Because not all hours were earned at time-and-a-half, the 776.5 hours is not equal to one-and-a-half times 564 hours.)
- He cashed in 772.75 hours of CTO for additional pay and took off another 106 CTO hours as leave.
- The standard work hours in a year are 2,080.

To avoid any ambiguity, management should have given the board dollar amounts. The study was also incomplete as it only included information for a single year, 1998, and not for all years that management received CTO. Although the board requested information for only 1998, a more complete analysis and better response would have shown the amounts since 1993 when payouts began. The analysis did include an explanation of why some managers earned a high percentage of CTO, as well as the percentage of the CTO earned during evenings or weekends. However, the explanations for the CTO for several managers appeared to merely reiterate the normal duties of their positions. For example, the justification for the former executive director's additional pay appears to be a list of expected duties for this position.

After receiving only the CTO percentages at the April 1999 meeting, the board requested specific amounts paid for CTO. On June 21, 1999, management presented to the board's executive committee information on CTO paid to 12 managers for 1994 through 1998. Also included was the percentage of CTO paid each year compared with each manager's salary. However, the percentages given for 1998—the only year covered in both analyses—differed from those in the April analysis. The April analysis asserted that CTO for the former executive director equaled 22 percent of his base salary, while CTO for the director of finance came to 40 percent of her base salary. Without explanation, the June analysis revised these percentages to 26 percent and 32 percent, respectively. When board members asked why the percentages changed, management responded only that the information had been updated; it did not explain that the previous information was incorrect. Given the lack of clarity and consistency in the data that KCEOC management reported, the board would be justified in having less faith in management's information.

Justification for the Former Executive Director's CTO

"Compensatory time off hours are incurred to direct the overall diversified activities of the organization which has undergone tremendous growth and has an operating budget of 43.7 million dollars and approximately 700 employees in addition to developing new programs and identifying opportunities for expansion of KCEOC services at meetings which are generally held before and after normal business hours and on weekends."

Source: "Compensatory Time Off Analysis for 1998" provided to the board's executive committee in April 1999.

SOME BLAME RESTS WITH THE BOARD

Although we believe that certain members of management, including the former executive director, are more at fault, the board must share responsibility for poor communication about paid CTO. In its oversight role, the board is responsible for KCEOC's operations. Even though the board relies extensively upon the executive director and staff for information, it must review and question information received. For example, one board president's inattentiveness when signing time sheets may have led management to believe that it had approval for the practice. Additionally, former board presidents who acknowledged they were aware of the practice did not ensure that current board members also knew of it.

The Former Board President Signed the Former Executive Director's Time Sheets Detailing CTO Earned and Paid

As the former executive director's supervisor, the board president should have known that he had been paid for CTO.

The president of the board from January 1997 to January 2000 claims she was unaware of CTO payments to the former executive director, even though she reviewed and signed time sheets detailing this information. As the former executive director's supervisor, she was responsible for reviewing, approving, and signing his time sheets and should have known about his CTO payments. She stated that she reviewed the time sheets to examine the propriety of the time he charged to programs, but she never saw key indicators that he was accruing or receiving paid CTO. The time sheets detailed the hours that the former executive director worked each day and the time that he allocated to various grants. In addition, many of the time sheets show notations by accounting staff of overtime worked and requests to cash out CTO.

For example, the time sheet for the two weeks ending on March 8, 1998, shows that the former executive director earned 40.5 hours of overtime and included a calculation that he was to be paid $24,500 for cashing in 497.9 CTO and vacation hours. Although the board president reviewed many of the former executive director's time sheets at once, these notations should have been apparent. We believe it is likely this information was on the time sheets when she reviewed them because the payments already had been made. If she had a problem with these payments, she could have raised the issue with the full board and management. On the other hand, if she lacked a full understanding of what her review entailed, she should not have signed the documents.

The Board Does Not Establish Reporting Priorities and Relies Too Much on Management

The board has not systematically identified all areas of KCEOC's operations that are of greatest concern. According to its president, the board has identified issues of primary importance during committee meetings and discussions with management. These issues include but are not limited to the financial status of the health center; enrollment for Head Start, including enrollment of disabled children; status of the homes purchased for remodel and sale; and issues identified from the federal review of the Head Start program. He further stated that these issues are discussed at regularly held committee meetings and at full board meetings, if appropriate. Management is supposed to give detailed updates on these issues on a regular basis. However, the approach he describes focuses on reacting to problems rather than systematically determining which issues are of greatest risk to the board.

When considering policy changes, new grants, or other items requiring board approval, a board subcommittee typically will review the issue, then the full board will vote on it. Reliance upon management and staff to bring key changes to its attention may require less time from the board, but it also may expose the board to an incomplete view of an issue. Such was the case when management changed the employee manual to formalize the CTO practices. If the board had decided that it needed to know of all changes affecting employee compensation and had communicated this decision to management, management may have been compelled to inform it of the formal policy change.

Former Board Presidents Were Aware of CTO Practices

Three former board presidents did not ensure that current members knew of the CTO payments.

Poor communication also exists among board members. Former board presidents acknowledged that they knew of management's CTO payments but did not ensure that this information was passed on to current board members. After the issue arose and the board began considering which actions to take, the three former presidents who served between 1990 and 1996 stated that they knew of payments to the former executive director.

One president recalled that the board's executive committee discussed and voted on the use of CTO in lieu of a stronger benefits package for the former executive director. However, the CPA firm reviewing KCEOC's compensation practices found no evidence of a discussion or vote. Another president who was aware of the practice told the CPA firm that she did not recall bringing the issue before the full board or the board's executive committee; the CPA firm's review of board minutes appears to confirm her statement. Even though the presidents knew of this issue, despite its potential sensitivity, and despite the fact the payments violated KCEOC policy during some of their time in office, they did not require management to formalize the practice of accruing and paying CTO to management staff. Such an action could have ensured that all board members were aware of the CTO payouts and could knowledgeably vote on the policy.

Although we found no documentation that the current board knew of the cash payouts, some or all of the current board members could have known of them anyway. The lack of written evidence from open meetings does not necessarily mean that the board did not notice the practice. The board only recently began complying with the requirement of state open meeting laws to keep minutes of closed sessions. Thus, we cannot clearly conclude whether the board discussed the practice in these closed meetings, although it appears unlikely given other evidence.

KCEOC'S INDEPENDENT AUDITOR DID NOT DISCLOSE MANAGEMENT'S NONCOMPLIANCE WITH THE FORMAL CTO POLICY

For several years, the independent auditor who performed the annual single audit for KCEOC did not disclose to the board that the CTO payments to management violated agency policy. Thus, an important source of information about KCEOC's internal controls failed to provide information that the board could have legitimately expected to receive. Under federal regulations and generally accepted auditing standards, the independent auditor is to disclose material instances of noncompliance with laws and regulations. Deciding which instances of noncompliance require disclosure is a matter of auditor judgment. The same audit firm had conducted these audits since the 1980s and should have been very familiar with KCEOC's fiscal and personnel practices. Moreover, for the fiscal year ended February 28, 1999, the auditor analyzed the reasonableness of the liability for CTO owed to employees when auditing KCEOC's financial statements. Nevertheless, between 1993 and 1998, when management accrued and received paid CTO in violation of agency policy, the auditor did not disclose the noncompliance. Federal regulations do not allow payment of personnel costs that violate an agency's own policies, so we believe the cash payouts would have warranted reporting to the KCEOC board.

In our opinion, the CTO payouts warranted reporting to the board because they were in violation of the KCEOC's policy.

The auditor did not disclose executive compensation as a potential issue of noncompliance until the controversy arose in 1999. In its single audit report for the fiscal year ended February 28, 1999, which was delivered to the board in December 1999, the audit firm said the "Board of Directors differ (sic) with management in its interpretation of established policy pertaining to payment of overtime, leave time and compensatory time" and characterized the condition as a "material weakness." When we met with the auditor, he indicated he was aware of the practice earlier but did not believe it to be a problem because other nonprofits also pay CTO to management staff. However, the auditor conceded that the practice was uncommon. The auditor did not explain why he failed to report management's noncompliance with its own policies between 1993 and 1998.

RECOMMENDATIONS

To improve the communication and relationship between the board and management:

- The board should clearly request information from management so it receives the information needed to make informed decisions and to oversee the agency properly.

- The board should identify key issues it wishes to be kept apprised of through regular briefings and reports from management.

- Management, in particular the executive director, should keep the board fully informed by being forthright and disclosing all relevant information on crucial topics.

- When questions arise, the board and management should clarify their understanding of the issue so both sides know each other's position.

- The board should ensure that it documents its actions and communicates its knowledge to future members.

Additionally, KCEOC should contact federal granting agencies to discuss the amounts of CTO paid in violation of agency policy, the circumstances of these payments, and whether the federal agencies actually will disallow these costs. If so, KCEOC should work with the federal agencies to negotiate the terms of repayment. ■

CHAPTER 2

KCEOC's Poor Control Environment Has Allowed Imprudent Practices

CHAPTER SUMMARY

The Kern County Economic Opportunity Corporation (KCEOC) has lax controls in certain areas that have allowed charges to federal programs for inappropriate expenditures and questionable practices that place its assets at risk. As a result, it has less money to devote to the needs of Kern County's low-income, elderly, and disadvantaged residents and may be jeopardizing the receipt of future grants.

KCEOC has charged almost $90,000 in unallowable or questionable expenditures to federal grants. The granting agencies may require repayment of this money, but KCEOC has little cash available to cover these costs. At the Family Health Center (health center), mismanagement of billings has resulted in a large backlog of uncollected amounts totaling $642,000—equal to nearly a year's revenue. KCEOC has limited confidence in the accuracy of this amount and does not know how much is related to unbilled amounts, denied billings, or errors. Thus, KCEOC is researching if it can pursue collection of these accounts. Despite the concern of KCEOC's board of directors (board) with the health center's finances, neither management nor the agency's auditor informed the board of the billing problems. These uncollected amounts exacerbate KCEOC's cash-flow difficulties and require the health center to obtain subsidies from the Community Services Block Grant (CSBG). KCEOC also has made inappropriate temporary loans from grants with positive cash balances to those with deficits. Further, inadequate controls over inventory at the Kern County Food Bank (food bank) may expose it to theft or loss.

KCEOC also has other control problems that, although not individually significant, collectively weaken the controls needed to protect KCEOC's assets. These weaknesses include breakdowns in the approval of expenditures, questionable costs, security lapses, and weaknesses in personnel practices.

Control problems exist within KCEOC operations in part because monitoring by some members of management and the board is limited. These members of management place too much of the responsibility for monitoring and controlling costs on KCEOC's director of finance. Additionally, the board relies on reviews performed by outside parties, such as the annual single audit, to reveal problems. These reviews are not meant to provide comprehensive information about how well the agency's programs operate and may not cover all areas of interest to the board. Neither the board nor some managers have the information or training needed to effectively manage and oversee grants appropriate to their levels of responsibility.

SERVICES TO THE POOR ARE JEOPARDIZED

Control weaknesses are long-standing and have spread through its operations.

KCEOC's efforts to serve the county's low-income, elderly, and disadvantaged population have been undermined by certain lax controls that have resulted in it diverting resources to subsidize mismanaged program billings and certain professional expenses. An adequate system of controls would safeguard assets and financial resources by establishing rules of conduct for basic business transactions, assigning responsibility to particular staff for designated tasks, and ensuring that vital decision-making and administrative powers are not concentrated with a single individual, who is then in a position to abuse them. It also would ensure that the entity operates effectively and efficiently in meeting its goals. Lapses in important controls at KCEOC have been long-standing and have pervaded its operations, as the sections that follow demonstrate.

KCEOC MADE UNALLOWABLE CHARGES TO FEDERAL PROGRAMS

KCEOC used almost $90,000 of what it believed to be health center funds to pay costs that granting agencies have disallowed for not meeting the requirements of the federal grants. Of the $90,000, the board required payment of $60,000 for the review of agency compensatory time off practices and related litigation fees that we discussed in Chapter 1. For the remaining $30,000 in improper charges, KCEOC used CSBG funds to repay Head Start in 1997 for disallowed bonuses it granted to Head Start employees. Head Start reviewed KCEOC's operations in May 1990 and determined that during the fiscal year ended February 28, 1989, KCEOC spent $30,000 to pay each Head Start employee a $500 bonus. KCEOC's personnel policies did not provide for bonuses and program officials did not approve them in advance, so Head Start disallowed these charges and ordered KCEOC to repay the $30,000. KCEOC repaid the money in June 1997.

KCEOC transferred funds from the health center to pay costs of the bonuses, as well as the costs for the review of agency compensatory time off practices and related litigation fees. Health center profits are not restricted to particular uses, so they can be used to pay costs not allowable under federal regulations. However, the health center routinely operates at a deficit, so it receives substantial subsidies from CSBG to meet expenses. Therefore, health center funds used to make the repayment actually would have been CSBG funds. Transferring funds from CSBG to the health center does not make those funds unrestricted; the funds still must be used for purposes allowable under CSBG. KCEOC has reported that, since 1993, CSBG has provided approximately $1.1 million to the health center. According to KCEOC's internal records, for the fiscal year ended February 28, 1999, the health center operated with a deficit of $264,000 before CSBG subsidies. Unless the health center generates sufficient cash to operate without CSBG subsidies, KCEOC should use the health center's unobligated funds only for purposes that comply with CSBG funding restrictions.

KCEOC has little in unrestricted funds to repay the $90,000 of disallowed costs.

Because of these restrictions, KCEOC may possibly have to repay these funds to CSBG. The state monitor for CSBG already has disallowed the legal expenses and costs for the CPA firm's review of executive compensation. Since November 1999, the board has twice requested permission to charge to CSBG its costs related to the executive compensation issue. However, the state monitor for CSBG disallowed those costs because KCEOC did not comply with its own regulations requiring competitive bidding for contracts when it hired both the CPA and legal firms, and legal expenses do not alleviate poverty in the community as required for CSBG expenditures. Likewise, we believe the disallowed Head Start bonuses should not have been repaid with CSBG funds because federal regulations, delineated in the Office of Management and Budget's (OMB) Circular A-122, *Cost Principles for Non-Profit Organizations,* prohibit transfer of disallowed costs from one federal program to another. For the above cases, KCEOC may be required to repay all the disallowed charges with unrestricted funds—that is, cash available for general use. However, it has little unrestricted cash to cover these costs.

KCEOC used health center funds to pay these disallowed costs because it considered those funds to be available for general uses. According to the board president, KCEOC felt this action was appropriate because it included documentation of the transaction in records provided to its independent auditor, who did not challenge the action. Nevertheless, because KCEOC did not closely follow prescribed cost principles and procedures, both the cost of the compensation review and the cost of the bonuses paid to Head Start employees totaling $90,000 were questioned and disallowed. An understanding of the flow of funds between KCEOC programs and stronger oversight of expenditures by the agency's management and board may have prevented these inappropriate activities.

MISMANAGED BILLINGS AT THE FAMILY HEALTH CENTER DRAIN CSBG FUNDS

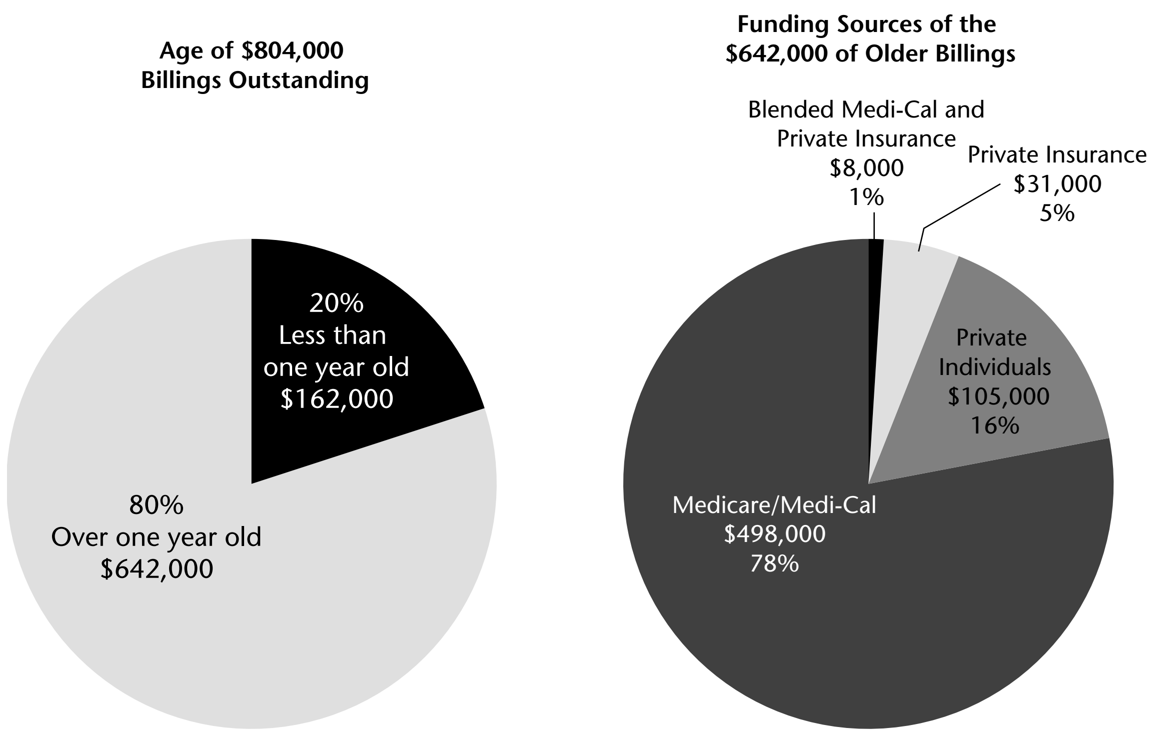
KCEOC has turned to CSBG to subsidize its health center operations partly because of mismanaged medical billings. As of December 31, 1999, the health center had not collected $804,000 that its accounting records show is due from private sources and state and federal medical assistance programs, primarily Medi-Cal and Medicare. Its records indicate that about $642,000, nearly 80 percent of these uncollected amounts, have been owed for more than a year. However, KCEOC has limited confidence in the accuracy of this amount because the balance due is composed of amounts that have not been billed, were denied payment and returned to the health center for correction and resubmission, or are in error. KCEOC does not know how much relates to each category. Figure 2 summarizes the health center's accounting records showing the proportion of older amounts to newer amounts as well as the breakdown of funding sources.

CSBG Subsidizes the Family Health Center

The health center's failure to resolve these unbilled amounts, denied billings, and errors has contributed to KCEOC's cash-flow problems and may decrease the health center's ability to recoup any amounts owed. Funds due from those billings are not available for the health center's needs, so CSBG funds must subsidize the center's operations and are unavailable for other purposes benefiting the poor of Kern County.

FIGURE 2

State and Federal Programs Make Up Most of the Health Center's Older Billings

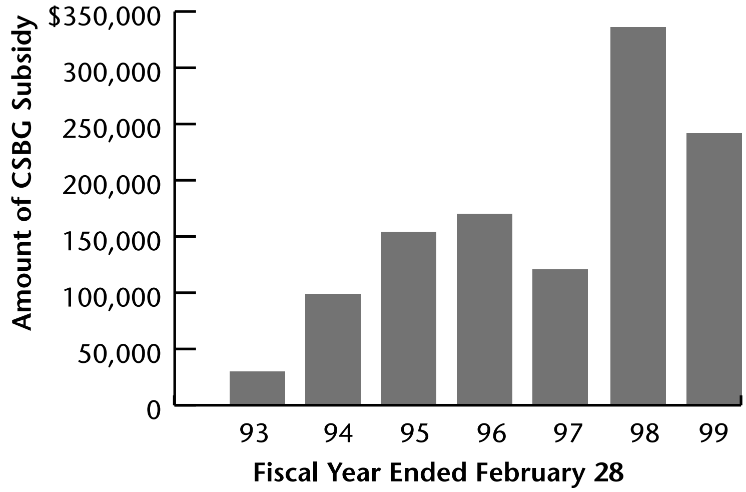


Source: Family Health Center accounting records as of April 2000 for transactions prior to December 31, 1999, and discussions with the health center manager.

The $642,000 backlog represents nearly a year's income for the health center. Internal KCEOC documents report the health center's revenues totaled $707,000 for the fiscal year ended February 28, 1999. Without considering CSBG subsidies, the backlog is nearly equal to the health center's deficit for the last three years combined. Figure 3 indicates the CSBG subsidy to cover these health center deficits over the past seven years.

FIGURE 3

CSBG Has Provided A Significant Subsidy to the Family Health Center



Source: Based on KCEOC's internal documents showing the Family Health Center subsidies from CSBG.

KCEOC's preliminary financial results for the fiscal year ended February 29, 2000, show that the health center will have a surplus of approximately $263,000; however, neither we nor the agency's independent auditor have reviewed this amount.

Health center management recognizes that it has a significant backlog, which it asserts resulted from various causes. A major factor is high turnover in billing staff. Instead of adding staff to tackle the backlog, however, health center management focused on catching up with its current billings, which it reported accomplishing in April 2000. Neglecting to address the old billings further delays their resolution.

Good management practices and federal guidelines in the OMB's Circular A-110, *Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals, and Other Non-Profit Organizations,* require KCEOC to have effective control over and accountability for all assets. We believe this includes a system of controls adequate to ensure collection of amounts owed to KCEOC. The health center should promptly bill for services, periodically examine the amounts owed, monitor late or overdue payments, set policy to ensure that services provided are billed appropriately, and maintain adequate financial records. Prompt billing for services is particularly important because Medi-Cal, one of the health center's largest funding sources, will pay the full amount of claims if received within 6 months and a lesser amount if received within 12 months. Medi-Cal also will accept appeals for payment of claims older than a year. Further, good management practices require that the health center have sufficient staff to perform these basic bookkeeping procedures.

Reasons the Health Center Manager Cited for the Large Balance of Accounts Receivable

- High turnover of billing staff and health center managers.
- Use of untrained temporary billing staff.
- Failure to write off known uncollectable accounts.
- Lack of follow-up on claims that were initially denied payment.
- Failure to mail billing statements to patients.
- Lack of monthly reports needed to analyze billings.

KCEOC Has Not Decided if It Will Write Off the Backlog

Despite the size of the backlog, KCEOC did not originally plan to negotiate with funding programs or insurers to collect even partial payment. The health center manager supported writing off these amounts because some payers require billings to be submitted within a year, low-income or uninsured patients were never billed and may be difficult to find, and some of the accounting records are inaccurate.

When the manager proposed writing off the billings, we expressed our concerns to KCEOC. The agency decided to investigate its records to determine if it could bill insurers or others to obtain at least partial payment of funds. For example, the health center's accounting records show that Medi-Cal owes the health center nearly $475,000 in charges incurred before December 1998. Based upon the experience of another agency we audited, we believe it is possible that the health center still may collect a significant portion of this amount. The other agency reported that it negotiated payment of 75 percent of Medi-Cal charges even though more than a year had passed between service and billing. As of June 2000, KCEOC continues to research the quality of the billing records and plans to contact Medi-Cal to determine whether it can pursue collection of the amounts.

Financial Reports Have Failed to Disclose the Health Center's Billing Problems

Although the charges owed to the health center were significant to its financial standing, KCEOC's monthly internal financial reports have not disclosed the amount of money owed. Without this disclosure, these financial statements do not provide sufficient information for management to effectively monitor the health center's financial standing and its effect on the financial

Even though the board requested additional information to more closely monitor the health center's finances, it was not informed of the billing problems.

position of KCEOC as a whole. Moreover, the board was not informed of the billing backlog. The director of finance stated that she knew as early as 1993 that the health center's records were inaccurate. She further indicated that improving their accuracy has been an ongoing project since 1996, but it remains incomplete due to management changes and the health center's focus on catching up on patient billings. The director of finance stated, however, that she told a board subcommittee that the accounts receivable accrual on the financial statements was an estimate based on the health center's cash collections for several months after the year end because the accounts receivable records were inaccurate and could not be used as a basis for determining the accounts receivable accrual. She does not recall formally informing the board in writing about problems with the accounts receivable. Her failure to notify the board about the billing backlog is especially grievous because the board had requested a monthly detailed revenue and expenditure statement so it could monitor the health center's finances more closely. In addition, the independent auditor's reports on the health center did not disclose the billing problems.

KCEOC INAPPROPRIATELY BORROWED FROM SOME PROGRAMS TO COVER TEMPORARY SHORTFALLS IN OTHERS

KCEOC did not ensure a steady flow of funds to each of its programs resulting in it borrowing from programs with positive cash balances to meet demands of programs with temporary deficits. When we reviewed program cash balances from January 1998 through December 1999, we found that some programs ran deficits each month, with the total monthly deficits ranging from $82,000 to $492,000. KCEOC's history of programs with cash deficits during the last two years demonstrates the agency's need to improve its overall cash management.

KCEOC considers CSBG funds, health center funds, and the general fund, which primarily encompasses employee benefit funds, to be available for other programs. Although KCEOC does not identify the source grant for the funds it uses, our review of program cash balances found eight occasions during 1998 when KCEOC appears to have used funds from other grants for programs with deficit cash balances. Most likely the funds came from the federal Head Start program, the Special

Supplemental Nutrition Program for Women, Infants, and Children, or the California Department of Education's child development programs.

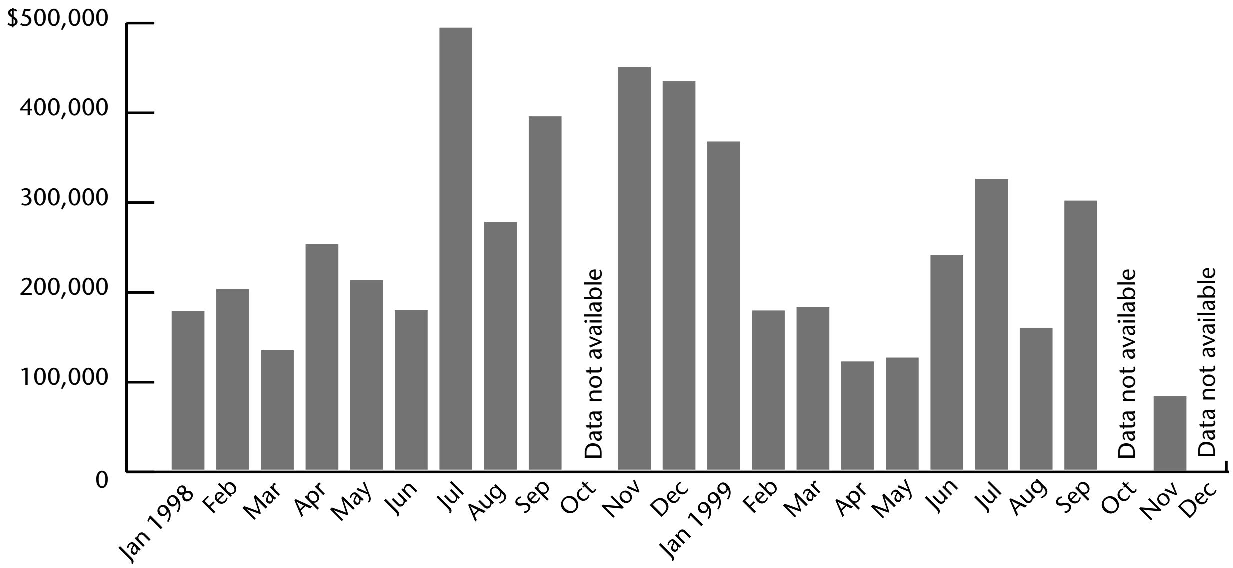
For example, KCEOC had programs with deficits totaling $448,000 on November 30, 1998. After using $407,000 from CSBG and its general fund, including its employee benefit funds, it still had a deficit of $41,000. To cover this remaining deficit, KCEOC probably borrowed from either the federal Head Start program or the California Department of Education's child development programs, which had cash balances exceeding $41,000. However, under federal regulations and grant requirements, KCEOC may not use these funds for short-term loans to other programs. By using restricted state or federal cash balances of programs that are limited to specific uses, KCEOC violates its grant agreements and is risking sanctions by granting agencies. The Code of Federal Regulations specifies that recipients such as KCEOC must ensure that program funds are used solely for authorized purposes.

Additionally, KCEOC's assessment that all general fund dollars are available for general use appears to be incorrect. The general fund cash balance consists primarily of restricted employee benefit funds, federal or state cash that is being held to cover the agency's future costs of employees' earned but unused vacation time, and according to federal regulations should not be used for short-term loans. KCEOC's records indicate that the $407,000 of available cash in the example above included $214,000 from the employee benefit funds. During 1998 and 1999, we noted that KCEOC augmented programs experiencing cash deficits on 13 occasions with employee benefit funds from the general fund ranging from $15,000 to $214,000. Further, the health center does not always have cash available for short-term loans since KCEOC reports it has operated at a deficit during each of the last seven years. Because the CSBG grant terms are very flexible, our interpretation of federal regulations is that it is the KCEOC's only federal or state grant with a significant source of cash available for short-term loans to other programs.

KCEOC programs sometimes have deficits because the agency's cash management practices do not adequately anticipate program cash needs and draw down grant money to meet those needs, program by program. Figure 4 shows the total cash deficits of those programs as presented in KCEOC's monthly financial statements during 1998 and 1999.

FIGURE 4

Monthly Deficit Cash Balances in KCEOC Programs



Source: KCEOC monthly financial statements.

Better anticipation of its upcoming program expenditures would allow KCEOC to predict its future cash needs more accurately, to expedite its payment processes, to manage its program expenditures more effectively, and to reduce the need to borrow funds or delay payments. For KCEOC's management to more accurately project its upcoming cash needs, each program manager should have monthly reports showing cash receipts and disbursements to help identify each program's cash needs and position.

POOR INVENTORY PRACTICES AT THE FOOD BANK PLACE DONATIONS AT RISK

Another example of poor control over resources is the inadequate inventory practices at the KCEOC food bank. Management at the food bank has not established effective inventory practices to keep track of donated foods and to ensure efficient use of food bank resources. The food bank receives donations of funds and food from several sources, including the federal government, the United Way, other food banks and agencies, churches, and private parties. Loose inventory controls at the food bank unnecessarily subject these donations to the risk of theft or loss and may discourage future donations.

Food bank staff do not adequately track food received or distributed.

To meet the needs of eligible residents, KCEOC must maintain an adequate, timely inventory of the food supply at the food bank. The OMB's Circular A-110, *Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals, and Other Non-Profit Organizations,* requires KCEOC to have a system of control adequate to keep track of grant resources. Good management practices also require that KCEOC efficiently use its resources. However, we found several indicators of poor controls at the food bank, which we discuss in the following sections.

Inventory Records Are Inadequate

Food bank management stated that it does not always update inventory records promptly to track food distributed or received. Although the food bank receives and distributes food daily, management updates inventory records monthly at most. According to the food bank's manager, staff and volunteers conducted a thorough physical inventory each month of all food items until the summer of 1999, when the food bank received a large amount of food to assist people affected by a severe freeze. Since then, according to the manager, the food bank has been able to conduct thorough inventories only once every three months because of its increased workload and volume of food.

The food bank does not have consistent, accurate counts of available food because records are not updated promptly and compared with the amount of food on hand. Thus, management cannot easily identify when theft or loss occurs. Further, it cannot adequately manage food stores to ensure that food is used before it goes bad or is available when needed.

We also noted during our visits to the food bank that some volunteers consume or set aside donated foods while working at the food bank. The manager stated that volunteers are allowed to take food if they complete a recipient form demonstrating eligibility and obtain approval from a food bank employee. When the manager attempted to show us documentation proving that the food had been removed from inventory and was an approved distribution to eligible recipients, he was unable to locate it and conceded that the procedure was not

The food bank could neither demonstrate whether its warehouse volunteers were eligible to receive donated food nor identify how much food volunteers had received.

being followed. This failure to follow the procedure meant the manager could neither establish whether the volunteers were eligible to receive food nor keep adequate records of food used. Further, allowing volunteers to identify and remove desirable goods before they are provided to other beneficiaries gives the appearance of favoritism. It also may jeopardize the receipt of future food donations from private sources, which may not wish their products to be consumed by the volunteers rather than by program recipients whose eligibility is documented.

Valuable Items Are Not Adequately Safeguarded

The food bank does not always secure or segregate valuable items to reduce the risk of theft. For example, expensive items such as baby formula were left out in the warehouse rather than being secured in a restricted area, leaving them more vulnerable to theft. In our opinion, the food bank could use different inventory procedures for high-value items such as baby formula than for fresh produce. Baby formula, an expensive product vulnerable to theft and possible resale, could be kept in a secured area and counted more frequently than produce. On the other hand, items such as onions or tomatoes spoil quickly and may not need to be controlled so strictly.

The Warehouse Is Disorganized and Unsafe

Finally, we observed that the warehouse was disorganized and contained safety hazards. Many food items are stored on large pallets and stacked in rows that are several pallets high and several pallets deep. In addition, some pallets are buried in deep rows. This arrangement makes it very difficult to determine what food is stored and limits the staff's ability to reach the food. Thus, food items could sit unused for long periods and possibly become stale or rot.

Warehouse staff also has stacked the pallets unsafely. In some rows, the upper pallets are leaning against the pallets in adjacent rows. This unsafe stacking creates the danger that rows could tip over, possibly resulting in injuries to warehouse staff and damage to the food. In addition, some rows are stacked higher than the light fixtures and connecting wires. Moving the upper pallets in these rows could damage the lighting or injure warehouse staff.

MANY MINOR CONTROL WEAKNESSES CONTRIBUTE TO THE LAX OVERALL CONTROL ENVIRONMENT

Other problems exist that, although not individually significant, collectively weaken the controls needed to protect assets and ensure compliance with appropriate policies. These weaknesses include a failure to establish and update formal accounting policies, a lack of appropriate approvals for some expenditures, security lapses, weaknesses in personnel practices, and costs that are questionable under federal guidelines, as shown in Table 3. KCEOC's process for approving expenditures is informal and is not consistently enforced. For instance, the former board president did not review the former executive director's time sheets until months after the pay period, long after the payroll was distributed. An example of a questionable cost is the former executive director's use of program funds to pay for meals he justified as business meetings. His expense reports show that these meals were variously attended by board members, KCEOC management and staff, and oversight agency staff, including employees of the California Department of Education and the federal Head Start program. However, federal regulations for business meals generally do not allow these meals to be charged to federal programs, and we believe these charges may not be allowable. These control weaknesses and others, shown with potential consequences in Table 3 on page 42, exist because KCEOC does not have policies covering some areas and does not enforce some of the policies it does have.

The former executive director may have inappropriately used program funds to pay for meals he justified as business meetings.

TOO MUCH RESPONSIBILITY AND AUTHORITY REST WITH THE DIRECTOR OF FINANCE

KCEOC has allowed too much responsibility to accrue to the director of finance position. The director of finance ensures that expenditures are within budget limits, provides guidance to management and board members on topics such as appropriate controls, is the primary monitor of certain programs' expenses, prepares financial statements, and approves transactions for payment. These duties, particularly the primary monitoring of certain programs' expenditures, focus an inappropriate level of authority on one position. In addition, these duties probably contribute to the excess number of extra hours worked by the director of finance.

TABLE 3

Many Minor Weaknesses Degrade Controls

Control Weakness	Actual or Potential Effects
Improper approvals of expenditures*	
• Nine checks totaling $22,500 were not co-signed by board members.	• Board members do not have the opportunity to provide oversight.
• Thirteen expenditures were approved by the secretary for the executive director.	• Directors of programs charged have more difficulty monitoring expenditures or grant activities.
• Five expenditures were not approved by the executive responsible for the grant.	• Same as previous bullet.
• An executive signed two checks for expenditures for her program.	• The executive was able to approve the expenditure and sign the check. A second director did not evaluate the appropriate nature of the transaction.
• Two executives co-signed seven checks to themselves.	• Questionable expenses may be charged to grants.
Questionable costs*	
• The former executive director used grant funds to pay for questionable meal costs.	• Grant funds could be used for inappropriate costs, and are not available for other, allowable purposes.
Inadequate security over assets	
• Blank checks and blank purchase orders are not secured.	• Unauthorized persons could write checks or place purchase orders.
• Unapproved use of two agency vehicles.	• Personal use of vehicles could occur.
• Although drugs are kept in a locked closet, they are not inventoried at the health center.	• Health center would not be able to tell whether drugs are stolen, and could not assign responsibility for potential theft.
Poor payroll practices	
• In one department, the same person submits time sheets and receives checks to distribute.	• The individual could submit a time sheet for a fictitious employee, receive the paycheck, and fraudulently cash the check.
• Board supervision of the executive director's time sheets was not timely.	• The board cannot effectively monitor the executive director's time.
Insufficient documentation of procedures	
• The accounting manual is out of date. Some procedures are communicated verbally and others may be based on historical practice.	• Accounting practices may vary among staff, and new accounting staff may not have adequate information to complete work appropriately.

* Based on our review of reimbursements to executives for the propriety of expenditures, and a review of 52 other transactions during 1999.

The current director of finance has been with the KCEOC since 1993. She oversees 15 accounting positions. Most accounting staff perform technical duties, handling routine aspects of accounting transactions. Included in these positions are a controller and an accounting manager, who are supposed to provide professional level back-up to the director of finance. However, no one has been completing the duties of the accounting manager since March 1999, and the controller position was created in September 1999, but was not filled until February 2000. As a result, the director of finance has taken on additional responsibilities and continues to work significant amounts of overtime. Although KCEOC recently hired a new controller, we expect that many responsibilities will remain with the director of finance until the new controller becomes fully familiar with agency operations.

Because too much responsibility rests with the director of finance, KCEOC could suffer serious problems if she left or had an extended absence.

Too much reliance on the director of finance could result in serious problems. KCEOC has not updated its accounting manual to formalize KCEOC's procedures and policies and to impart the director of finance's knowledge of KCEOC's operations to other staff. If the director of finance were to leave or require an extensive absence, KCEOC could have trouble processing payments, preparing financial statements, and effectively monitoring expenditures.

Some Members of Management Rely Heavily on the Director of Finance

Because they lack important financial reports about their programs or adequate training in program monitoring, some program managers rely too much on the director of finance. Some program managers indicated they believed they have enough financial data to monitor their grants, but others indicated that they lack the necessary fiscal data to monitor their programs and emphasized that they rely on the director of finance for additional information to tell them if their grants have fiscal problems.

Although they may receive a variety of financial documents about their programs, members of management do not always receive important financial reports that disclose their programs' line-item budgets, related expenditures and commitments, or program cash balances. If these reports were regularly available, program managers would have the tools to compare the amount of program funds spent to the budget, to help prevent program deficits, and to better plan future expenditures and program activities.

In addition, KCEOC has not provided the training its program managers need to properly monitor their programs, which increases management's reliance on the director of finance. In a May 1999 memo to three executives issued in response to concerns raised by the director of finance, the former executive director stated that some programs may need to be monitored more closely. The memo stated that program managers should receive training in how to use budgets and financial statements to better monitor their programs. However, no training was ever held. The director of finance indicated that she was unable to provide the training due to personnel vacancies, increased accounting workload, and additional work related to the executive compensation issue. Training of this nature may enable program managers to better monitor grant finances, making them less reliant on the director of finance for this type of monitoring, and thus possibly reducing the director of finance's workload.

THE BOARD RELIES HEAVILY ON AUDITS AND REVIEWS, WHICH MAY BE LIMITED IN SCOPE

Because recent external audits and reviews had not identified problems, the board believed KCEOC had good internal controls.

KCEOC's board places heavy reliance on external reviews to perform oversight of agency operations. The board is responsible for governing the agency, providing guidance regarding program direction and overall focus, and providing oversight to ensure that its guidance is carried out. However, three of the board members we met with, including the board's current president and vice president, indicated that the board depends very heavily on financial and compliance audits and reviews performed by oversight agencies. One board member stated that the board believed the agency had a good system of controls because external reviews, including the financial and compliance audit, did not identify problems. Although the board members we spoke with are correct in believing that these reviews are supposed to ensure that funds are being spent in accordance with regulations and to identify significant control problems, the scope of these reviews may not cover all areas of concern to the board. Further, KCEOC has not regularly changed the audit firm it uses for its annual single audit to ensure a fresh look at KCEOC's operations. In addition, the board has not always ensured that management follows up on problems identified during external reviews.

The Same Firm Has Performed the Annual Financial and Compliance Audit Since the 1980s

KCEOC is subject to an annual financial and compliance audit, known as a single audit, performed by an independent CPA. This audit is intended to determine whether KCEOC's financial statements are materially correct as well as whether KCEOC is complying with federal and state requirements, laws, and regulations. The single audit also examines KCEOC's internal controls, but auditors have been required to focus attention only on the agency's large or risky programs, and thus some grants are not subject to close scrutiny. Further, although single audits should disclose material noncompliance with laws and regulations, they might not disclose noncompliance that is less material but still of importance to KCEOC.

Until the CTO issue became public, KCEOC's independent auditor had not criticized controls for several years.

KCEOC has used the same audit firm since the 1980s. However, such a long-standing relationship is not ideal. Changing auditors periodically would provide a fresh perspective on KCEOC's control systems. Until the recent dispute arose regarding compensatory time off, KCEOC's annual single audit had not reported issues criticizing the agency's management in several years. An auditor familiar with an organization may not question or report a control problem because the auditor may not consider the problem to have the same level of risk as one less familiar with the agency. According to the board's current vice president, KCEOC continued to use the same audit firm because it had a good reputation and because management recommended that KCEOC continue to use it. However, KCEOC is working on changing to a different auditor and expects to select a new firm by mid-July 2000.

Other Third-Party Reviews Are Generally Not Designed to Be Comprehensive

Like the single audit, external reviews of grants by federal or state agencies may not cover all areas of concern to the board or all KCEOC programs and practices. Most of KCEOC's external reviews focus on specific grants. For each grant covered, the reviews assess specific aspects of KCEOC's operations and grant management based on criteria important to the reviewing agency. Thus, while KCEOC may be subjected to several audits or reviews in any given year, certain practices or programs will not be scrutinized, and for those that are, the reviews are not always comprehensive.

Several grants, including Head Start, have thorough external reviews, while most others are monitored in less detail.

A few grants, such as WIC and Head Start, are subject to program and financial review, but others have not yet been reviewed and some do not appear to be specifically examined by federal, state, or local oversight agencies. Further, as shown in Table 4, review detail varies, and not all reviews are annual. For example, we classified the level of detail in the review as "low" for several grants the California Department of Education gives KCEOC. A KCEOC executive told us that these grants are on a three-year monitoring plan that calls for annual reviews of KCEOC's single audit report and a program review at the KCEOC offices every third year. So far, KCEOC has received only the single audit review. The California Department of Education has not provided us with evidence of any additional work performed. Among the grants that do not appear to be specifically reviewed by any oversight agency is a grant for supportive housing from the federal Department of Housing and Urban Development to KCEOC for $631,000 over a three-year period. The Appendix has more details regarding information KCEOC has on the reviews that funding sources perform.

KCEOC Has Not Always Followed Up on Issues That Third Parties Raise

KCEOC's board and management have not always ensured that the agency promptly and appropriately resolves the findings of third-party reviewers. According to federal guidelines in the OMB's Circular A-133, *Audits of State and Local Governments, and Non-Profit Organizations*, KCEOC is responsible for following up on problems and for taking corrective action.

KCEOC's board and management have not acted to ensure that some of the weaknesses identified in two of the reviews we examined were corrected as planned. Its 1997 Head Start review concluded that KCEOC "lacks a willingness to impose a system of internal controls, checks and balances in making certain expenditures," that financial regulations were not always followed, and that "decision-making processes were circumvented." The review identified problems in KCEOC's fiscal administration of the program, such as a lack of policy documentation and the failure to repay unapproved bonuses that Head Start disallowed in 1990. In response, KCEOC acted to resolve some of the weaknesses. However, although KCEOC

TABLE 4

The Extent of External Monitoring of KCEOC Grants Varies Greatly

Grant Reviewed	Amount of Grant in 1999	Level of Monitoring
Head Start	$17,190,000	High
Special Supplemental Nutrition Program for Women, Infants, and Children	16,109,000	High
Child and Adult Care Food Program	718,000	High
Emergency Food and Shelter Program	186,000	Medium
Emergency Food Assistance Program	116,000	Medium
Various U.S. Department of Energy and Health and Human Services grants for community services, energy assistance, and home weatherization	2,439,000	Medium to Low
State Child Development	3,849,000	Low
Supportive Housing Program	236,000	None
All Others	1,662,000	None

Source: Based on our review of KCEOC's file of reviews, discussions with reviewing agency staff, and information compiled by the KCEOC director of finance.

promised to update its accounting manual, it has not done so. Further, KCEOC asserted that it had repaid the bonuses from unrestricted funds, in accordance with Head Start's instructions, but as we discussed earlier in this chapter, it inappropriately used federal CSBG funds transferred to the health center to make this repayment.

In another instance, a 1997 report by the State's Department of Community Services and Development (CSD) noted that 3 of KCEOC's 21 board positions were vacant. Two of those board vacancies were designated for representatives of low-income persons and existed for more than the 90 days allowed by KCEOC bylaws. In October 1997, CSD recommended that

KCEOC immediately fill its empty board seats. More than five months later, in April 1998, KCEOC responded that it would fill its board seats within 90 days. Instead of doing so by July as it had promised, it modified its bylaws in November 1998, decreasing the size of its board from 21 to 15 members and removing a provision requiring it to fill board vacancies representing low-income residents within 90 days. According to the board president, the decision to decrease the size of the board was based on a survey of the practices of other nonprofit organizations.

By not taking prompt or appropriate action on issues raised by external reviews, KCEOC does not receive the full benefit from the reviews.

Because KCEOC management has not taken all the corrective actions it promised, it has not derived the anticipated benefits from the reviews identifying needed improvements to its internal control, efficiency, or effectiveness. Further, KCEOC's management has exposed itself to the risk that Head Start or CSBG may impose sanctions on the agency.

RECOMMENDATIONS

To ensure that it uses grant funds only for allowable purposes, KCEOC should improve internal controls by:

- Providing training to program managers and the board appropriate to their levels in the provisions contained in the OMB's Circular A-122, *Cost Principles for Non-Profit Organizations*, and in the requirements of KCEOC's grant agreements.
- Requiring KCEOC's program managers and accounting staff to review program expenditures carefully for compliance with grant requirements and to question any that are potentially unallowable.
- Getting permission in advance from granting agencies when it is unsure whether proposed charges to grants are allowable.

Further, for the questionable costs we noted, KCEOC should work with the appropriate federal agency to determine whether the costs are unallowable and how it can repay them, if necessary.

To address the large billing backlog at the health center, we recommend that KCEOC:

- Negotiate with state and federal funding programs and insurers to recoup at least part of the long-standing amount they owe to KCEOC.

- Direct staff efforts to ensure that unpaid charges are billed, rebilled, or modified to allow prompt payment. Health center management should work with funding programs and insurers that owe balances to determine the cause for late or denied bills.

KCEOC should ensure health center staff promptly bill for services and follow-up on late or overdue payments. We also recommend that KCEOC monitor the health center billing department's workload to determine whether additional staff members are needed or whether staffing problems are creating backlogs.

To ensure accurate reporting and to allow proper disclosure of billings, KCEOC should periodically disclose and report to the full board the total amount of the billings outstanding, along with an estimate of the amount that is collectible.

To prevent inappropriate loans between grant funds and to better manage its cash, KCEOC should:

- Institute cash management procedures that allow it to anticipate the cash needs of each program and to draw down grant funds accordingly.

- Provide program managers with adequate information regarding program revenues, expenditures, cash balances, and cash flows to allow them to determine cash needs.

- Limit cash expenditures by restricted programs to their existing cash balances.

- Discontinue lending grant funds to other grants to cover deficits.

To strengthen inventory controls at the food bank, we recommend that KCEOC:

- More regularly and promptly reconcile the physical inventory to the inventory records and take prompt action to correct errors.

- Maintain adequate records of inventory received and distributed, including identification of those staff who certify quantities received and distributed.

To adequately protect assets and ensure that food is used only for allowable purposes, the food bank should implement appropriate levels of control over goods and should protect them from theft. Particular care should be taken to segregate and protect valuable items or items that are susceptible to misuse. In addition, when volunteers work at the warehouse, the food bank should ensure that volunteers' use of food is properly authorized. Finally, KCEOC should take steps to better organize the food stored in the warehouse and eliminate safety hazards.

To address the minor control weaknesses we noted, KCEOC should implement controls to ensure that:

- Expenditures are approved properly and are for allowable costs.

- Assets are secured adequately.

- The duties of receiving and approving time sheets, and distributing paychecks, are segregated.

- Approval of all time sheets occurs in a timely manner.

- Standard procedures are documented sufficiently.

To improve the quality of monitoring and reduce reliance on the director of finance:

- Managers and board members should receive training in fiscal monitoring appropriate for their levels.

- Managers should receive monthly line-item budget-to-actual and cash-activity statements.

- Managers and the board should act promptly to ensure that problems are remedied.

- The board should consider creating an internal auditor position to follow up on problems noted in external reviews and to work to improve and maintain the control environment of the organization. To preserve the internal auditor's independence, this position should report directly to the board.

To ensure that its annual single audit adds value and provides a fresh perspective on agency operations, KCEOC should change auditors regularly, every three to five years. ■

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CHAPTER 3

Better Board Participation, Compliance With Open Meeting Laws, and Training Are Needed

CHAPTER SUMMARY

Frequent vacancies on the Kern County Economic Opportunity Corporation's (KCEOC) board of directors (board), low attendance of members at board meetings, and noncompliance with its bylaws and open meeting laws that apply to local agencies have contributed to the board's uncertain oversight of KCEOC activities. As a result, some board members may not have kept themselves and the public current with the business of KCEOC, thereby limiting their ability to make informed decisions and undermining the board's leadership role. These problems persisted because the board has failed to follow its own policies to act promptly to fill vacant seats and, until recently, to address absenteeism among board members. In addition, the board president indicated that the board relied on faulty advice from a former KCEOC attorney and the former executive director when it did not comply with open meeting laws because the members incorrectly believed the laws did not apply to KCEOC meetings.

The board also has not received adequate training on federal regulations related to the allowability of costs, use of financial statements, and compliance with open meeting laws. The lack of training may have contributed to the board's failure to identify problems or issues as they surfaced. Finally, a recent bylaw change that allows board officers to act on the board's behalf between meetings exposes the board to the risk that the officers could act inappropriately, because it does not define the actions they can take. The board president indicated that the change was intended to allow the officers to be more involved with the agency and was approved by their attorney.

THE BOARD REGULARLY HAS VACANCIES

The KCEOC board has experienced problems with filling vacant seats in two of the three required membership categories. Vacancies consistently occurred from March 1994 to January 2000 in positions designated for representatives of the county's low-income and private sectors. Persistent vacancies hinder the board's ability to adequately represent these categories and provide effective oversight of the agency, and may jeopardize the agency's funding. The board usually maintained the required representation in the third category, which is designated for public officials. As shown in Figure 5, on occasion, the low-income and private sectors each had only two of their required seven or five members. In light of historical difficulties in filling all seats and results of a survey of other nonprofits, the board eventually reduced required membership for each category.

By allowing vacancies to remain for a long period, KCEOC violates its bylaws and runs the risk of sanctions from the federal Community Services Block Grant (CSBG). As a condition for receiving CSBG funds, federal law requires KCEOC to have a tripartite board consisting of representation from the public officials, low-income, and private sector categories. Furthermore, the board's current bylaws specifically require one-third of the board members to represent public officials, one-third to represent low-income residents, and one-third to represent the private sector. Special rules apply to the seating of members in each category. In 1996 and 1997, the State's Department of Community Services and Development reported that KCEOC had vacancies on its board and recommended that it immediately fill them. Although KCEOC did fill all low-income seats for approximately a year ending in September 1999, KCEOC continues to have vacancies on its board.

The Selection of Board Members Varies by Category

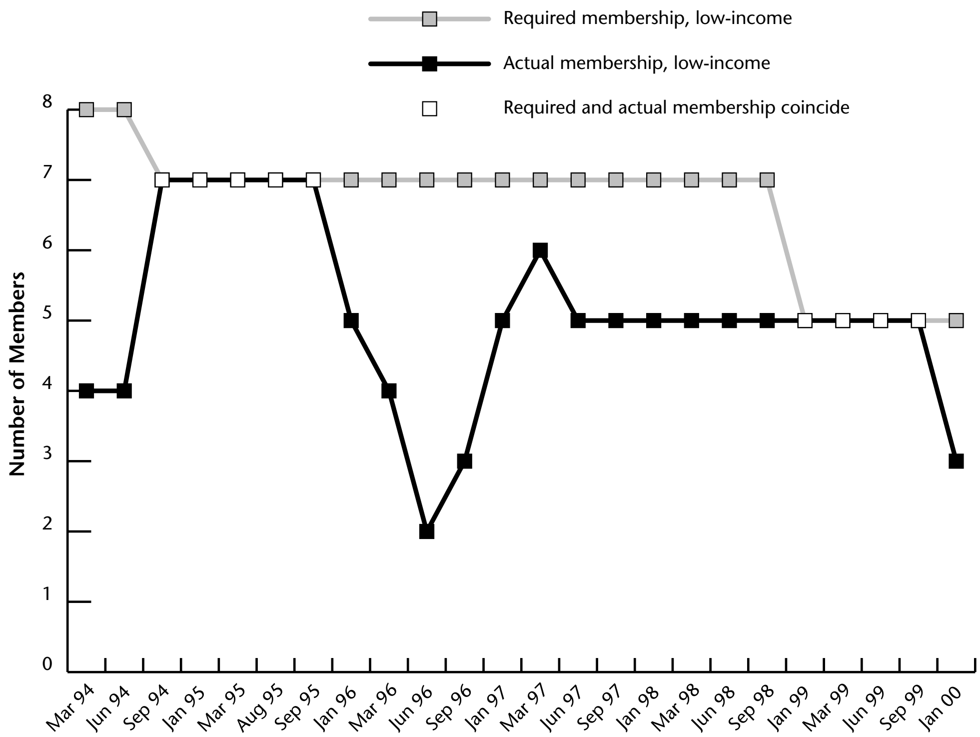
- Public Officials (five seats)—appointed by KCEOC board. Terms are concurrent with the public official's tenure in office. Currently, the seats are filled by a county supervisor and representatives from a California State senator, the Bakersfield mayor, and two U.S. congressional representatives.
- Low-Income Representatives (five seats)—four seats are elected by voters to represent four areas in the county. The fifth is filled by KCEOC's Head Start Policy Counsel chairperson. Representatives serve a five-year term.
- Private Sector (five seats)—nominated by their organizations and approved by existing board. Representatives serve a five-year term.

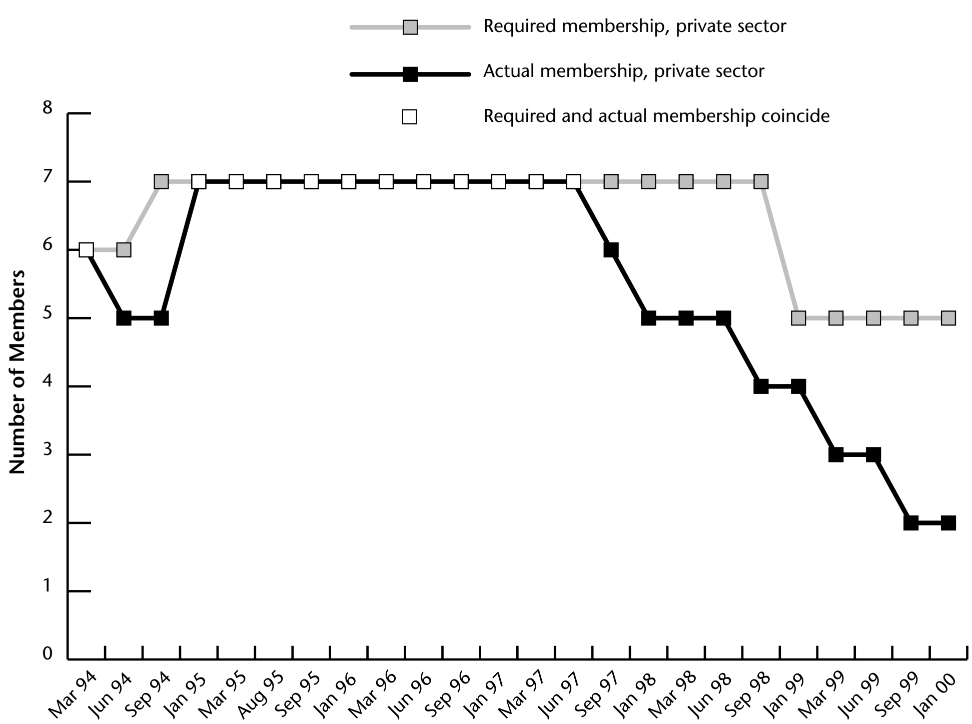
Source: KCEOC Bylaws, January 2000. The number of seats has varied in the past.

The current board president attributes past vacancies to a lack of candidates interested in serving and difficulty getting individuals representing low-income and private sector categories. In addition, while it was taking steps to reduce board membership from 21 to 15 seats, the board maintained some vacancies to avoid

FIGURE 5

Low-Income and Private Sector Seats are Rarely Fully Staffed





Source: Monthly board packets.

displacement of members. Moreover, to fill past vacant seats for these two categories, the board relied on the former executive director to bring forward nominations for board membership.

The board is taking several steps to address current vacancies. To fill low-income vacancies, the current board president indicated that the board has begun the election petition process, advertised for the openings, and contacted local groups that may have contacts with low-income people who may be interested in serving on the board. To fill the private sector vacancies, the board has advertised for the openings and has developed a process to evaluate individuals interested for private sector membership. The board president also stated that the board is evaluating several candidates.

BOARD MEETINGS HAVE LOW ATTENDANCE

In addition to its problems filling vacancies, the board has difficulty with the attendance of its existing members. The lack of participation weakens the board's oversight of KCEOC. Some decisions have been postponed because of a lack of quorum at committee meetings. The board's leadership role is undermined when board members do not regularly attend meetings or make timely decisions, and thus may not keep themselves current with the business of KCEOC. To be an effective governing body, the board must enforce its absence policy and gain the full contribution of all members.

Despite an average absence rate of 30 percent, until recently the board has not removed a member for excessive absences.

Since 1994, board meetings have had an average absence rate of 30 percent. Some representatives from all three categories—public, private, and low-income—have had high absentee rates. Some have missed three or more consecutive meetings in a 12-month period. According to the former board president, the board attempted to improve attendance. Members were sent written notifications of meetings, received calls to confirm that they would attend, and were requested to give advance notice if they could not come to a meeting. However, the board has not adequately enforced its absence policy and until recently has never removed a member for excessive absences. Attendance has generally been left to the members' discretion. In some cases, members choose to skip full board meetings because they attend committee meetings.

Several factors contribute to low attendance at board meetings. Board members are unpaid volunteers filling a demanding role. The board's work can be particularly demanding when members must make difficult decisions in a contentious environment. Equally important, however, is the board's failure to enforce its absence policy and remove members for poor attendance. When members know they will not suffer any consequences for their absences, even the most committed have less incentive to attend.

KCEOC's bylaws state that three excused or unexcused absences from consecutive meetings or five absences during any 12-month period can result in removal. According to the Management Assistance Program for Nonprofits (MAP), a non-profit agency that provides consulting and other services to other nonprofits, attendance is problematic if a member does not notify the board for two consecutive absences, is absent for three consecutive meetings, or misses one-third of all board meetings in a 12-month period. To resolve the board attendance problem, MAP suggests that the board president promptly contact absent members to discuss their attendance. The president then should share their responses at the next meeting, and the board should decide what action to take.

THE BOARD HAS NOT CONSISTENTLY NOTIFIED THE PUBLIC OF ITS MEETINGS

The board held six meetings during August, September, and October 1999 without proper notice to the public.

The board violated open meeting laws that apply to local agencies when it held six meetings during August, September, and October 1999 without proper notice to the general public. These meetings were held to discuss the board's planned actions on CTO payments, but the public had no opportunity to offer views on this key issue because the board failed to notify the public of the meetings. The board also faces possible reversal of its decisions during these meetings because actions taken in meetings held in violation of the laws can be rendered null and void. Moreover, KCEOC risks sanctions from the California Department of Education, because it must comply with open meeting laws as a condition of receiving grants from that department.

The public received no notice of five of the meetings scheduled during this period; the notice for the remaining meeting was posted just that morning—still in violation of the law—and failed to properly disclose the agenda. The board also neglected to keep minutes for five of these meetings—a violation of a bylaw requirement. The executive director's secretary, whom the board designated to take minutes of public meetings, stated that the board held other meetings around this time that also were not properly noticed and recorded. However, she could not recall the dates of the meetings. Table 5 summarizes the violations of open meeting laws or the KCEOC bylaws in the meetings that we know about.

TABLE 5

Six Meetings Violating Open Meeting Laws or Agency Bylaws

Date	Type of Meeting	Proper Notice Given?	Minutes Kept?
August 5, 1999	Executive Committee	No	No
September 12, 1999	Special full board	No	No
September 15, 1999	Special full board	No*	Yes
September 22, 1999	Executive Committee	No	No
October 14, 1999	Executive Committee	No	No
October 29, 1999	Executive Committee	No	No

* Notice was posted on the morning of the meeting in violation of the law requiring 24-hour advance posting for special meetings.

Open meeting laws exist to ensure that the agencies conduct business in a public forum. Agencies must take these actions:

- Post an agenda containing a brief general description of each item of business to be transacted or discussed at the meeting.

- Provide notice to the public at least 72 hours before regular meetings and 24 hours before special meetings.

According to the current board president, the board did not comply with these laws and the KCEOC bylaws specifically for the six meetings addressed above due to its desire to act quickly and resolve the executive compensation issue. Additionally, there was some confusion over applicability of these laws to certain meetings. The current board president indicated that, prior to January 1999, the board believed its committee meetings were not subject to open meeting laws based on incorrect advice from KCEOC's former attorney and the former executive director. The question of applicability to the laws surfaced again shortly before January 1999. At that time, the board changed its bylaws to acknowledge that KCEOC must follow open meeting laws. Although the actual bylaw change indicated that only the board's special meetings were subject to open meeting laws, the current president understood that the full board meetings were always subject to the laws, but based on advice received, was unaware that committee meetings needed to comply with them. In October 1999, after consultation between KCEOC staff and the State, the interim executive director told the board that all meetings, not just full board meetings, must follow open meeting laws.

The Board Only Recently Began to Keep Minutes of Closed Meetings

The board did not keep minutes for closed meetings until November 1999 in violation of its bylaws. Without minutes for closed meetings, there is no evidence of all board discussions and decisions. Agency bylaws require minutes for all board meetings, including closed sessions.

In November 1999, the board informally assigned responsibility to its former president for keeping the minutes. She kept notes for the November meeting and recorded the December meeting on audiotape. The current board president stated he kept the closed session minutes for January, February, and March 2000 meetings. Even though KCEOC's bylaws require that the board shall keep minutes for each meeting, the board has yet to formalize this process and document specifically who keeps the minutes and where the minutes should be stored.

ADEQUATE TRAINING COULD ENHANCE BOARD OVERSIGHT

Some board members lack training on specific areas that are crucial to providing effective oversight to KCEOC.

Although a few board members received some training during 1997 and 1998, most have not had adequate training in crucial areas. According to its current president, the board has not considered providing group or ongoing training on the following problem areas we noted throughout this report: federal regulations on allowability of costs, financial statement review and interpretation, and open meeting laws that apply to local agencies. The board's training manual provides information on the board's responsibilities but was last updated in October 1991 and is limited in scope. Moreover, the manual lacks information regarding the areas mentioned above.

Lack of training may have resulted in the board's inappropriate reliance on others to assess KCEOC's operations. For instance, when evaluating the agency's finances, the board relied on external auditors' reports to disclose problem areas. Although those reports are supposed to identify major problems or issues, they may not identify concerns with all areas of interest to the board. Similarly, insufficient training may have contributed to the board's failure to comply with open meeting laws. Once it learned that it had to comply with these laws, the board would have been better served if it had promptly sought appropriate training to correct any misunderstandings of the laws.

Proper training is a key factor contributing to the effectiveness of any governing body. The board president and the executive director should help design training that conveys knowledge board members need to effectively carry out their role. MAP suggests that board members be offered training shortly after joining the board and each year thereafter. It recommends training topics such as overview of the organization, orientation to the board manual, roles and responsibilities of the governing board, an overview of board structure and board operations, and review of the agency's strategic plan. Providing training in critical areas such as those discussed above could improve the board's oversight.

ALLOWING OFFICERS TO ACT ON THE BOARD'S BEHALF WITHOUT SPECIFIC LIMITATIONS ON THEIR AUTHORITY IS RISKY

Changes in the bylaws are not sufficiently clear about actions officers can take between board meetings.

A bylaw change in January 2000 that allows officers to act on behalf of the board exposes KCEOC to the risk that the officers may act inappropriately. The bylaw revision is broadly written and states that between meetings of the board, the officers "may act on behalf of the full board to ensure continuity of agency business." It further elaborates that the officers must report any actions to the full board at the next regular board meeting for consideration and ratification. According to the board president, the board acted on the advice of an attorney and its intent was to make the board officers more involved with the agency and to remove some of the power from the executive director position. When officers meet informally between board meetings, their meetings are not subject to open meeting laws because they do not have continuing subject matter jurisdiction and are not fixed by the agency's bylaws. The meetings require no public notice or record of discussion, so there is little to hold the board officers accountable for their actions.

Although open meeting laws do not prohibit this arrangement, they do state that the officers' actions must be limited to an advisory role. Thus, the full board must approve the actions later. However, the KCEOC bylaws do not clarify what actions the officers can take or under which conditions they may act. Additionally, the bylaws do not clarify whether officers can act individually or if they must act in consultation with each other. Previously, KCEOC bylaws established a standing committee of the four board officers and up to two other board members. The bylaws allowed the committee to act on behalf of the full board between meetings and required it to report its actions at the full board's monthly meetings. The standing committee meetings were also subject to open meeting laws. Thus, the old process provided a mechanism to have the officers' actions conducted in a public forum. The recent bylaw change eliminated that openness.

RECOMMENDATIONS

To ensure that it provides effective oversight, the board should:

- Continue with its plans to recruit new members to fill vacancies as they occur. The board should publicly advertise openings and seek other avenues to generate interest, such as contacting the groups that KCEOC serves. If the board is unable to fill the vacant seats, it should consider reducing the number of seats.

- Follow its attendance policy and take steps to remove any member who violates that policy. Initially, the board should counsel a member that has excessive absences. If this approach fails to improve attendance, the board should remove the member and immediately search for a more committed replacement.

- Update its training manual to include topics on federal regulations on allowability of costs, financial statement use, and open meeting laws requirements, and require current board members to attend periodic training on these topics. KCEOC and the board also should provide orientation training to new members to explain the board's role in governing and overseeing KCEOC.

In addition, the board should adhere to the requirements of opening meeting laws and its bylaws when conducting meetings, regardless of the circumstances, to provide for public awareness of its activities. It should give sufficient advance notice of meetings and formalize the process for keeping minutes of all closed sessions.

To minimize the risk of any actions officers take between full board meetings, the board should explicitly define the circumstances under which officers may act on behalf of the full board.

We conducted this review under the authority vested in the California State Auditor by Section 8543 et seq. of the California Government Code and according to generally accepted government auditing standards. We limited our review to those areas specified in the audit scope section of this report.

Respectfully submitted,

Mary P Noble

MARY P. NOBLE
Acting State Auditor

Date: June 22, 2000

Staff: Lois Benson, CPA, Audit Principal
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APPENDIX

Additional Information About External Monitoring of KCEOC's Operations

The Kern County Economic Opportunity Corporation (KCEOC) receives funding from federal, state, local, and private sources. Many of these funding sources monitor the KCEOC's use of these funds for compliance with grant requirements. In Chapter 2, we provided a table of these monitoring efforts. Table 6 provides additional information about the content and frequency of the reviews conducted by the funding sources based on our review of KCEOC's file of reviews and discussions with review agency staff. The reviewers may conduct a desk review of documents or reports, such as the single audit report or program expenditure reports, at their own location, perform an on-site review of program operations and procedures at the recipient's location, or both.

TABLE 6

Grant Reviewed	Amount of Grant in 1999	Reviewing Agency	On-Site or Desk Review	Review Frequency	Level of Monitoring and Items Examined by the Reviewing Agency
Head Start	$17,190,000	U.S. Department of Health and Human Services	On-site	Every three years	**High**—Examines and reviews case files, policies and procedures, and accounting documents.
Special Supplemental Nutrition Program for Women, Infants, and Children	16,109,000	State Department of Health Services	Both	On-site review every two years and desk review annually	**High:** Reviews internal controls related to security and reviews certifications in areas including administration, nutrition assessment, outreach, and integration and referrals. In addition, grantor reviews the annual single audit report.
		State Controller's Office	On-site	Every three years	Examines internal controls and reviews contracts, invoices, warrants, documents, and other records for allowability of expenditures.
Child and Adult Care Food Program	718,000	California Department of Education	On-site	Every three years	**High**—Reviews eligibility, meal count records, meal content, sanitation, fiscal accountability, and other related areas.
Emergency Food and Shelter Program	186,000	Local Federal Emergency Management Agency Board	On-site	Twice per year	**Medium:** Reviews the disbursement process and practices, and verifies that funds are spent appropriately.
			Desk review	Every three years	Reviews expenditures for propriety.
Emergency Food Assistance Program	116,000	Emergency Food and Shelter National Board California Department of Social Services	On-site	At least once every four years, last performed in 1998	**Medium**—Reviews eligibility, civil rights, food ordering, storage, inventory, distribution sites, and reporting and record keeping.

Grant Reviewed	Amount of Grant in 1999	Reviewing Agency	On-Site or Desk Review	Review Frequency	Level of Monitoring and Items Examined by the Reviewing Agency
Various U.S. Department of Energy and Health and Human Services grants for community services, energy assistance, and home weatherization	$2,439,000	State Department of Community Services and Development	Both	Annually	**Medium to Low**—Examined the agency's expenditure activity reports for the last review. During the on-site visits, performs a preliminary review including some of the following areas: affirmative action, financial management, intake, purchasing, personnel, and the board of directors. In addition, the grantor reviews the annual single audit report.
State Child Development	3,849,000	California Department of Education	Desk review	Annually	**Low**—Reviews the annual single audit report.
Supportive Housing Program	236,000	U.S. Department of Housing and Urban Development	None	None	None
All others	1,662,000	Various	None	None	None

Source: Based on our review of KCEOC's file of reviews, discussions with reviewing agency staff, and information compiled by the KCEOC director of finance.

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Agency's comments provided as text only.

Kern County Economic Opportunity Corporation
300 19th Street
Bakersfield, CA 93301-4906

Mary P. Noble*
Acting State Auditor
Bureau of State Audits
555 Capitol Mall, Suite 300
Sacramento, CA 95814

Re: KCEOC Response to Bureau of State Audits Report

Dear Ms. Noble:

This correspondence provides the response and corrective action of KCEOC Board of Directors and staff to the issues identified in the June 2000 Bureau of State Audits Report.

I. Poor communications led to the dispute over compensatory time off.

Audit findings revealed that: 1) The current Board and management disagreed on the accepted policy for CTO; 2) The disagreement over CTO has hindered the agency's operations; 3) Good communication and role clarification between the Board and management are necessary; 4) Management did not give the Board crucial information about CTO; 5) Some blame for poor communication rests with the Board; and 6) KCEOC's independent auditor did not disclose management's noncompliance with the formal CTO policy.

KCEOC fully concurs with the recommendations by the State Auditors. Specifically, we note that:

1) The employee policy manual is being revised to eliminate all CTO and to clarify the designation of exempt and non-exempt employees.

2) The Board will take the necessary steps to be more specific regarding requests for information from staff, including the use of a Request for Information Form developed by Head Start and being considered for use by the Head Start Parent Policy Council.

3) A committee will be created comprised of Board members and agency staff to review Board reporting requirements, outlining specific reports needed to effectively manage the agency.

4) The Board will develop a systematic approach to identify areas of concern, and Board committees will work with staff to obtain needed information on those issues on a regular basis.

5) The Agency's Deputy Director will be responsible for updating and expanding the Board Training manual, which identifies and categorizes Board activities, actions, policy changes, and other pertinent data. This manual will be reissued to all Board members annually,

*California State Auditor's comment appears on page 75.

rather than being given to members only as they join the Board. Additionally, the Executive Director and a Board officer will jointly conduct orientation of all new Board members.

6) All Board and committee meeting minutes are being properly recorded and maintained. The agency will monitor these procedures to ensure continued compliance for all meetings, including executive sessions.

II. KCEOC's poor control environment has allowed imprudent practices.

Audit findings revealed that 1) Inadequate control over resources jeopardizes services to the poor; 2) KCEOC made unallowable charges to federal programs.

1 While KCEOC does not wish to minimize the findings in this report, in all fairness to the agency, it should be noted that the review included KCEOC child care and WIC programs which account for nearly $35 million of KCEOC's $43 million dollars in grants and contracts reviewed by state auditors, or over 80% of the agency. No substantial deficiencies were reported in these programs. The Board and management realize that satisfactory controls of ALL programs are required to be maintained at all times to ensure proper expenditure of contract and grant funds. We will move forward with recommendations suggested to ensure an environment of accurate reporting, periodic reviews, and monitored controls of program and budgets.

Agency staff and some Board members have attended training in the past for grant funded programs provided by Howard Gesbeck of Williams, Young & Associates, LLC on OMB's Fiscal and Administrative Requirements, including Head Start Administrative Requirements and OMB Circular A-122. In cooperation with the Board, KCEOC staff will offer similar training to Board members and identified managers, including staff who develop, monitor and/or administer grant funds. Staff, at the Board's direction, will identify ongoing training programs for Board members and identified managers that will refresh and reinforce learning. A staff person will be identified that will be responsible to ensure training plans are being implemented and documentation of training is maintained.

As is detailed in a following section of this response, KCEOC will complete the update of its comprehensive accounting policies and procedures manual to include identifying the roles and responsibilities of program and accounting personnel for ensuring that expenditures are in compliance with grant requirements, the required documentation to support the allowability of expenditures, and the procedures to be taken to request clarification from funding sources as to the allowability of certain proposed expenditures.

For the questionable costs noted by the State Auditors, we will work with the appropriate federal agency to resolve the matter. KCEOC has taken the necessary steps to ensure that funding agencies are contacted, in advance, regarding questionable costs which may be anticipated.

Audit findings revealed that 3) Mismanaged billings at the FHC drain CSBG funds.

KCEOC has made a conscious decision to maintain and support the Family Health Center (FHC). It has been our commitment to the community to provide much needed basic health services and counseling at little or no cost using available state, federal, and private programs such as medi-cal, medicare, blue cross, EAPC and others. As is well documented in reports from other Kern County medical clinics there are a variety of obstacles that inhibit profitability for medical facilities, especially those like the FHC that serve the poor, the homeless, the unemployed and otherwise needy of Kern County. KCEOC is not without fault in timely addressing the management and operation concerns of the facility. However, great strides have been made in returning the FHC to a self-sustaining operation. To meet the ever-increasing demands and needs of the community, continued improvements, innovations, management controls, and added services will be incorporated into the clinic. For the fiscal year ended February 29, 2000 no CSBG funds were required for the operation of the clinic.

KCEOC agrees with the recommendations outlined by the State Auditors. KCEOC will contact state and federal funding programs for approval to submit claims older than one year for payment. FHC staff has already begun the review process by reviewing billing records in order to verify that the outstanding claims are accurate and unpaid. Records being reviewed are billing balances reports, patient payment receipts, aging reports, as well as other related documents. The billing staff will confirm the validity of the outstanding claims before submitting the claim for payment. Charges denied for payment by the state or federal agencies will be written off only after approval from the Board.

Since April 2000, patient charges have been posted on a daily basis and a schedule has been established for follow up of outstanding claims. Patient statements for self-pay patients are mailed on a monthly basis requesting payment for services rendered.

Detailed procedures for receiving and posting of receipts is in place at the health center to include the immediate logging, posting and deposit of all payments received.

The FHC has stabilized the billing department by hiring a billing supervisor, as well as staffing the two billing clerk and two billing receptionist positions. Workloads and staffing of these billing positions will be monitored on a monthly basis to insure timely and accurate posting, billing, and verification of payment for claims to the clinic. Full and current reports regarding accounts receivable will be included in monthly reports to the Board.

In seeking additional assistance for the operation of the FHC, KCEOC applied for and was recently awarded a TIDES Foundation grant, in the amount of $ 35,000, which will be used to upgrade existing computer systems in improving the overall clinic operation.

Audit findings revealed that 4) KCEOC inappropriately borrowed from some programs to cover temporary shortfalls in others.

KCEOC will review and strengthen its cash management procedures to better anticipate the cash needs of its various programs. The Board's Budget and Finance Committee will closely monitor the status of cash balances for each program.

Audit findings revealed that 5) Poor inventory practices at the food bank place donations at risk of theft or loss.

The Food Bank has recently implemented new inventory procedures, increasing the state required monthly inventories to biweekly inventories for unit and pallet counts. Two additional staff have been added to the Food Bank staff bringing the full-time paid staff to 6 individuals. The additional clerical and warehouse support staff will aid in storing and accounting for food inventories, and storage and transfer of food inventories for the various programs. KCEOC management is currently reviewing recommendations to secure additional and/or temporary staff to assist in annual inventories. Food Bank personnel will be included in planned training for program monitoring, including inventory control and follow-up. Food Bank staff is currently reviewing storage procedures and strategies to ensure that valuable food items are properly secured to minimize loss and misuse. Monitoring and documentation of volunteer consumption and distribution of food items will be reviewed with all staff and volunteers to ensure compliance with policy.

Audit findings revealed that 6) Many minor control weaknesses contribute to the lax overall control environment.

KCEOC concurs with the State Auditors recommendation to strengthen internal controls over the appropriate approval of expenditures, safeguarding of certain assets, segregation of certain payroll processing duties, timely approval of the Executive Directors time sheets, and the documentation of accounting procedures.

KCEOC is in the process of reviewing and revising its Employee Policy Manual and developing an Accounting Policies and Procedures Manual. These manuals will document the roles and responsibilities of agency personnel to further strengthen its overall internal control environment. The agency is taking steps to address improvements to the accounting system, telecommunications systems, purchasing standards and procedures (including contract services and leasing arrangements), and office automation utilizing current and innovative computer technology.

Audit findings reveal that 7) Too much responsibility and authority rest with the Director of Finance.

The Board and management acknowledge the strain and extent of responsibilities that have been placed on the Director of Finance. Turnover of accounting personnel and medical leave for a key accounting position have impacted and hindered plans for improving the quality of fiscal monitoring of programs, such as providing managers with internal fiscal training and additional detailed monthly financial reports. In recognition of management's over-reliance on the Director of Finance, and the need to improve fiscal monitoring of programs, the decision to add a controller position was made in September 1999. This position was filled in early 2000. Also, there are plans to add professional staffing to the accounting department to strengthen the fiscal control environment.

Audit findings reveal that 8) The Agency should change auditors regularly every 3 to 5 years.

KCEOC agrees that requesting proposals for audit services regularly every three to five years is a good practice. In May 2000, KCEOC issued a request for proposal for audit services to over thirty accounting firms and included the request on its web page.

Agency policies are being reviewed and evaluated to create a regular cycle for rotation of audit firms. Contracts with future audit firms will be closely scrutinized to clearly state the Boards expectations for audits, reportable conditions, and the firms independence in their reviews and findings.

III. Better Board participation, compliance with open meeting laws, and training are needed.

Audit findings revealed that 1) The Board regularly has vacancies; 2) Board meetings have low attendance; 3) The Board has not consistently notified the public of its meetings; 4) Adequate training could enhance Board oversight; 5) Allowing officers to act on the Boards behalf without specific limitations on their authority unnecessarily creates risk.

The composition, involvement, and participation of the all-volunteer Board of Directors for KCEOC are of great concern. As has been well documented by other non-profit organizations, the ability to attract and retain committed volunteers to serve on boards is difficult. Individuals must be willing to devote year-round time and energy to familiarize themselves with the many complex issues, programs and financial reports of managing an organization. KCEOC concurs with the recommendations set forth by the State Auditors.

KCEOC recently completed an extensive recruitment effort, which has resulted in selection of two new Board members (one low-income representative and one private sector representative) that will be introduced and seated on the Board at the next scheduled Board of Directors meeting on June 28, 2000. The recruitment effort included: announcements in the Bakersfield Californian and other local community newspapers; press releases sent to 230 individuals, agencies, organizations and companies throughout Kern County; letters sent to over 170 entities including local collaboratives, city council and Board of Supervisors members, local government agencies, non-profit organizations, agency partners, and corporations; announcement in the KCEOC Newsletter; and inclusion in KCEOC Web Pages. KCEOC will continue its recruitment efforts to fill its remaining vacancies on the Board. KCEOC will also look for ways to accelerate the recruitment/election process when a Board vacancy occurs.

The Board of Directors has begun actively enforcing its attendance policy. At the May 31, 2000 Board meeting, a member of the Board was removed due to excessive absences not in compliance with the policy.

The Board and management will be working to update the Board Training Manual to ensure that specific topics are addressed including federal regulations on allowability of costs, financial statement use, and open meeting law (Brown Act) requirements. In addition, KCEOC is in the process of reviewing a list of potential consultants who will be hired to provide Board member training and assist in updating board manuals. Board member training on the above mentioned items will be conducted on a regular basis. A training calendar will be developed for Board training throughout the year, which will include a new Board member orientation to be held quarterly or as needed. On Saturday, July 1, 2000, several Board members (including both of the new members) and one management staff will attend Board member training conducted by the State of California, Community Services and Development (CSD) Department. The topic “Boards of Directors: How Do We View Our Roles and Responsibilities?”, includes information on planning, finance, human resources, community relations, and organizational operations.

The Board revised its bylaws to establish more accountability in the management of the agency, on the advice of legal counsel, to address actions that may be required between scheduled full Board meetings. The by-laws were adopted after review by legal counsel and much Board discussion. KCEOC will follow-up on the suggestion by the auditors to explicitly define the circumstances under which Board officers may act on behalf of the full Board and make clear that the full Board must approve their actions at a later time.

Summary

The Board and staff of KCEOC wish to thank the state audit team for the professionalism that they displayed throughout this process and for the respect they gave to each of us. We appreciate the perspective provided by this audit and we are determined to strengthen the organization by addressing the issues brought forth in the report.

The agency looks forward to returning our focus to our mission of providing quality services to those in need in Kern County.

Sincerely,

(Signed by: Fred Plane)

Fred Plane
Board President

(Signed by: Bob Patterson)

Bob Patterson
Interim Executive Director

FP/BP/map

COMMENTS

California State Auditor's Comment on the Response From the Kern County Economic Opportunity Corporation

To provide clarity and perspective, we are commenting on the Kern County Economic Opportunity Corporation's (KCEOC) response to our audit report. The number below corresponds to the number we placed in the response.

1 While we agree that we did not identify specific programmatic weaknesses with the Head Start and Special Supplemental Nutrition Program for Women, Infants, and Children (WIC) grants, we observed other control weaknesses that affect both grants. These weaknesses include using Community Services Block Grant funds to repay bonuses that KCEOC paid with Head Start funds; inappropriate lending of grant cash, including Head Start and WIC funds, to programs with cash deficits; and not always resolving issues identified in grant agency reviews. In addition, many of the minor control weaknesses did affect, or have the potential to affect, both grants. Because these weaknesses degrade the overall control environment, KCEOC's characterization of the Head Start and WIC grants as having no substantial deficiencies is not entirely accurate.

cc: Members of the Legislature
Office of the Lieutenant Governor
Milton Marks Commission on California State
Government Organization and Economy
Department of Finance
Attorney General
State Controller
State Treasurer
Legislative Analyst
Senate Office of Research
California Research Bureau
Capitol Press