KERN COUNTY ECONOMIC OPPORTUNITY CORPORATION

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

REPORT NUMBER 99136, JUNE 2000

Audit Highlights . . .

The Kern County Economic Opportunity Corporation had poor communication, internal control weaknesses, and problems with board practices. Specifically, we found that:

- ☑ *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.*
- ☑ *Vacancies and poor attendance plague the board, limiting its effectiveness. The board also violated open-meeting laws and its own bylaws.*

At the Legislature's request, we reviewed the management-compensation practices of the Kern County Economic Opportunity Corporation (KCEOC), a nonprofit community action agency that administers various programs for low-income, elderly, and disadvantaged residents. The review sought to determine the reasons behind the board and management dispute over $581,000 of payments and leave taken for compensatory time off (CTO) for management employees. In addition, we reviewed internal controls and board practices to determine whether the KCEOC was managing its operations effectively. We found the following:

Finding #1: Poor communication led to the dispute over CTO.

The KCEOC board and certain members of management disagreed on the past policy for CTO payments to management and the extent to which the board knew of the payments. We found that on numerous occasions some members of KCEOC management, including the former executive director, failed to fully disclose these payments and other compensation practices to the board even though they knew the board relied upon them for accurate and complete information. The board shared responsibility for the miscommunication because it did not adequately review and question information received. Further, the KCEOC's independent auditor knew of the payments, but failed to disclose them to the board. The disagreement disrupted KCEOC's operations and resulted in the executive director's resignation. Another problem facing KCEOC is that federal and state agencies providing some of its funding could require repayment of the CTO payments and leave taken, which totaled $581,000, because they violated agency policy.

To improve the communication and relationship between the board and management, we recommended that the board make clear requests for information, identify the key issues for its review, and document its actions and decisions for future members. Management, in particular the executive director, should keep the board fully informed by being forthright and disclosing all relevant information on crucial topics. In addition, the board and management should clarify their understanding of any issue so both sides know each other's position. KCEOC should also contact funding agencies to determine if they will require repayment of the CTO paid and work out a repayment plan if necessary.

KCEOC Action: Corrective action taken.

KCEOC reports that it has taken several steps that it believes have resulted in an excellent relationship and meaningful communication between the board and management staff. These steps include revising board reports to contain complete and detailed information about management's activities; developing a process for formally documenting board requests for information; establishing set times for board subcommittee meetings and requiring all primary KCEOC staff to attend; and participating in joint board and management planning sessions, training courses, and seminars. KCEOC has also developed a new board training manual and in August 2000 adopted a new employee manual to clarify management compensation practices. In regards to the $581,000 of CTO paid to management employees, the agencies funding KCEOC have determined that the payments will not be disallowed.

Finding #2: KCEOC spent grant funds for unallowable costs.

KCEOC improperly spent $90,000 of grant funds to pay costs that granting agencies have disallowed for not meeting the requirements of the federal grants. The costs include $60,000 of accountant and attorney fees related to the CTO issue and $30,000 to repay disallowed bonuses it had previously granted to Head Start employees. Granting agencies could require KCEOC to repay these costs.

We recommended that KCEOC contact granting agencies to discuss the allowability of these costs and, if needed, work out a repayment plan. Further, we recommended that KCEOC train board and management on federal cost principles and grant requirements, require staff to carefully review proposed expenditures for adherence to these guidelines, and obtain permission in advance for questionable charges.

KCEOC Action: Corrective action taken.

KCEOC indicates it has received approval for the $60,000 of accountant and attorney fees, but is still negotiating with the California Department of Community Services and Development for the previously disallowed bonuses of $30,000 paid to Head Start employees. To ensure that staff critically evaluates expenditures in the future, KCEOC has conducted internal training courses and sent several board members and management staff to seminars on program management and fiscal controls. KCEOC reports that it is now contacting granting agencies before making any questionable expenditures.

Finding #3: Mismanagement of the KCEOC health center's billings may result in a loss of $642,000.

Mismanagement at the health center resulted in a backlog of approximately $642,000 in billings that were old and possibly uncollectable. In addition, even though the board was concerned about the health center's finances, neither management nor KCEOC's independent auditor disclosed the billing problems to the board. These uncollected billings aggravated KCEOC's cash-flow problems because it had to provide subsidies totaling $1.1 million to the health center since 1993.

To address the backlog and prevent future problems, we recommended that KCEOC contact private and governmental insurers to recoup at least part of the old billings, promptly bill for services and follow up on overdue payments, and, if needed, add staff to alleviate the billing workload. We also recommended that the board receive regular reports on billings along with an estimate of how much is collectible.

KCEOC Action: Corrective action taken.

KCEOC reports that it has hired a new health center manager with extensive experience in health care management and that billings are now current. It also contacted insurers to determine if they will honor billings that are over one year old, but its requests were denied and it will write off these billings. In March 2001 KCEOC implemented a new clinic computer system to allow better management of accounts receivable. Finally, clinic staff received training to ensure accurate billing for services.

Finding #4: KCEOC made inappropriate loans between grants to cover temporary cash deficits.

Because KCEOC did not manage its cash to ensure a steady flow of funds to each program, it inappropriately lent funds from grant programs with positive cash balances to meet the demands of others with temporary deficits. 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. In addition, KCEOC regularly lent grant funds held in reserve to other grants with temporary cash deficits. By lending restricted cash balances, KCEOC was violating its grant agreements and risking sanctions by granting agencies.

We recommended that KCEOC discontinue lending funds between grants, develop procedures to better anticipate the cash needs of programs, limit cash expenditures of grants to their existing cash balances, and provide program managers with the financial information needed to better manage their cash needs.

KCEOC Action: Corrective action taken.

KCEOC reports that the practice of lending grant funds to cover other grant deficits has been discontinued and that the board now receives more detailed information on cash balances to identify problem areas. In addition, accounting staff have trained managers how to more effectively monitor program expenditures, budgets, and cash needs.

Finding #5: Other control weaknesses, including lack of an effective inventory system at the food bank, place assets at risk.

The food bank lacked an effective inventory system to keep track of donated foods and to properly manage donated food. Further, some food bank volunteers inappropriately consumed or set aside donated foods and the food bank did not always secure or segregate valuable items to reduce the risk of theft. Minor control weaknesses that were not individually significant, but collectively weaken internal controls, included 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 were questionable under federal guidelines.

We recommended that KCEOC take steps to strengthen inventory controls at the food bank and implement controls to address the other weaknesses that we found.

KCEOC Action: Partial corrective action taken.

To address our concerns at the food bank, KCEOC indicates that it implemented a new inventory system, fenced a portion of the warehouse to secure valuable food items, hired additional staff to assist in organizing and managing inventory, and hired a safety specialist to address safety issues at all KCEOC facilities, including the food bank. In addition, KCEOC established a committee to study ways to improve inventory control and to develop policies to govern staff and volunteers. In regards to the other minor control issues we noted, KCEOC is preparing administrative and accounting manuals, asking its independent auditor to review its compliance with grant requirements, and training staff on timesheet procedures and internal controls.

Finding #6: KCEOC has weak internal oversight of its operations.

We found that internal oversight of KCEOC's operations was weak for several reasons. Because program managers lacked fiscal training and reports for their grants, too much responsibility for fiscal monitoring rested with KCEOC's director of finance. In addition, the KCEOC board placed too much reliance on external reviews to perform oversight of agency operations. These reviews are supposed to ensure that funds are being spent according to regulations and to identify significant control problems. However, these reviews are not comprehensive and KCEOC had not regularly changed the audit firm it used for its annual single audit to ensure a fresh look at KCEOC's operations. Finally, the board had not always ensured that management followed up on problems identified during external reviews.

To address the overreliance on the director of finance, we recommended that KCEOC provide fiscal training to managers and board members and provide managers with more informative financial reports about their programs. In addition, we recommended that the board consider creating an internal auditor position that would report to the board to follow up on problems noted in external reviews and work to improve and maintain the control environment of the organization. Finally, KCEOC should change auditors regularly to ensure that the annual single audit adds value and provides a fresh perspective on agency operations.

KCEOC Action: Partial corrective action taken.

To improve internal oversight of operations, KCEOC hired a new independent auditor and indicates it will seek a new firm every three to five years, provided training to the board and KCEOC staff, and is in the process of preparing administrative and accounting manuals. KCEOC explored the feasibility of hiring an internal auditor, but decided against doing so at this time because it believes its other actions to improve controls will be sufficient.

Finding #7: Persistent absences and vacancies hinder the board's oversight.

The KCEOC board had persistent problems with member absences and vacancies. Since 1994 board meetings had an average absence rate of 30 percent, which may be a result of the failure to adequately enforce its absence policy. Vacancies consistently occurred in positions designated for representatives of the county's low-income and private sectors. The absences hindered the board's ability to provide effective oversight, while the persistent vacancies could jeopardize the agency's funding because the board must have adequate representation on its board as a condition of receiving certain grant funds.

To address the absences, we recommended that the board counsel members with excessive absences and remove any members that continue to violate the absence policy. Because the board had recently begun to actively recruit new members, we recommended that it continue with these efforts, and if unsuccessful, consider reducing the number of seats.

KCEOC Action: Corrective action taken.

As of June 2001, KCEOC reports that all board positions were filled and that the board had an attendance rate of 90 percent in 2001. Board staff have also participated in fiscal and administrative reviews and training specifically designed for community action agencies.

Finding #8: Board practices need improvement.

Certain board practices needed improvement to ensure that it complied with laws, minimized the risk that officers act inappropriately, and provided more effective oversight. Specifically, 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. The board also neglected to keep minutes for five of these meetings—a violation of a bylaw requirement. KCEOC also exposed itself to the risk that the officers may act inappropriately when it changed the bylaws in January 2000 to allow officers to act on the board's behalf. Although the new bylaws require officers to report their actions for consideration and ratification at the next regular board meeting, they do not specify the circumstances under which officers can take these actions. Finally, board members have received little training on how to conduct proper oversight of the agency.

We recommended that the board comply with open-meeting laws and its bylaws by giving advance notice of meetings and keeping minutes of all closed sessions. In addition, the board should explicitly define the circumstances under which officers may act on the board's behalf between meetings. Finally, the board should provide appropriate training to its members to allow them to carry out their responsibilities.

KCEOC Action: Corrective action taken.

The board reports it has reviewed and studied open-meeting laws and is strictly adhering to those laws. In addition, the board has adopted procedures for documenting the minutes of closed board sessions. To address our concern about board officers' actions between meetings, KCEOC has reestablished an executive committee, comprised of officers and up to two other members, to deal with issues when the full board cannot meet. To improve oversight, board members have participated in various seminars and training sessions.