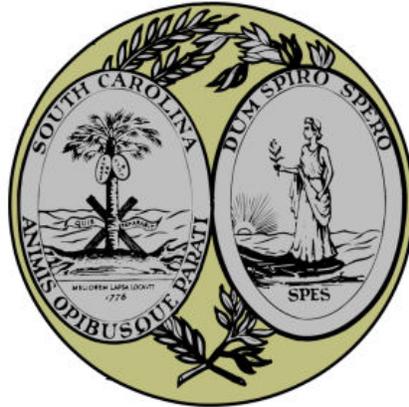


Office of the Inspector General

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Review of Execution & Monitoring of Grants at the Piedmont Community Action, Inc.

I. Executive Summary

The State Inspector General (SIG) initiated its investigation based on credible complaints from concerned stakeholders of mismanagement at Piedmont Community Action, Inc. (PCA), as well as a 2013 U.S. Department of Health and Human Services (US-DHHS) review of PCA's Head Start program with findings of non-compliance and disallowed costs. PCA is a non-profit organization under contract with the South Carolina Office of Economic Opportunity (OEO) to perform services under federal grants awarded and administered by the OEO. OEO joined the SIG's investigation by conducting a special monitoring of the federal grants it awarded to PCA for the period 2010-2012.

OEO conducted both a fiscal monitoring of PCA and performance monitoring of two of the four grants it administers representing 34% of OEO grants, which were the Weatherization Assistance Program (WAP) and the American Recovery and Reinvestment Assistance Act of 2009 – Weatherization Assistance Program (WAP-ARRA). The monitoring resulted in findings of substantial non-compliance. PCA's other two grants, the Low-Income Home Energy Assistance Program (LIHEAP) and the Community Services Block Grant (CSBG) representing 66% of OEO administered grants, had recently been monitored with determinations of relatively minor non-compliance.

OEO's fiscal monitoring focused on the accounting and control of expenditures in order to verify that grant funds have been expended in accordance with the agreement and all applicable laws, rules, and regulations. OEO's findings included a lack of internal control over materials and equipment; insufficient communications or understanding of procedures between operational and fiscal areas; insufficient records; discrepancies between client and fiscal records; and a weak financial control environment (see Appendix A).

OEO's performance monitoring of the weatherization programs centered on reviewing 67 weatherization projects (10% sample), which illustrated both performance and fiscal shortcomings. Virtually all of the 67 project files failed to contain sufficient documentation as required by state grant contracts to support weatherization grant expenses, particularly a required final inspection report after completion of a project. The lack of documentation gave OEO little choice but to *preliminarily* disallow corresponding project costs in the sample projects under review. The 67 weatherization projects had a total grant expense of \$464,498, of which \$325,217 (70%) was *preliminarily* disallowed, primarily for lack of documentation as well as, but to a lesser extent, substandard work performed. Obviously, this large \$325,217 disallowed cost on a 10% sample could be extrapolated over the entire weatherization projects during the audit period resulting in estimated losses in the millions.

PCA was allowed to address both the missing project file documents and non-performance identified during physical inspections. Two months later, OEO conducted a second review of additional documentation provided by PCA along with re-inspecting some of the projects. PCA's project files dramatically improved. As a result, although OEO has not finalized its disallowed cost number, this \$325,217 *preliminary* disallowed cost figure representing 70% of the grant expenses on these 67 projects will be substantially reduced. The current estimated disallowed costs range from 13% to possibly as low as 7% with PCA making modest repairs on several of the projects. The remaining issues included: a lack of documentation on one project; ineligible costs on four projects; inflated subcontractor hours on five projects; and additional work needed on three projects.

Even with a disallowed costs as low as 7%, it is still indicative of operational deficiencies inasmuch as, in the SIG's opinion, OEO applied a very lenient standard in calculating disallowed labor costs. From a mitigating perspective, the federal stimulus WAP-ARRA funds caused PCA to increase its annual weatherization projects from 35 to 223 annually (600% increase), which certainly played a role in its weatherization programs' fiscal and performance shortcomings.

OEO's audit was tested by the SIG and further validated by an independent audit by the federal U.S. Department of Energy in late August 2014 where 12 additional projects were independently examined from the period of 2009 -2013. The results included five (41%) projects had excessive labor charges; two projects (16%) did not have a final inspection potentially leading to disallowing all costs; and concerns about complete file documentation. The report stated, "Given that the State was required to monitor each subgrantee at least once a year, it is alarming that these anomalies were not identified and addressed before now."

PCA's overall financial control environment was determined to be weak impacting the reliability of the system to support grants. Issues included numerous funds from prior years remaining active with unresolved balances; an unusually large number of reclassification entries due to posting errors; and inconsistencies in posting transactions to various locations. Reclassifications result in the loss of the identity of the original transaction and require additional audit steps to verify the composition of an account. Internal PCA reports in 2013 and 2014 from its consultant and external auditor echoed similar concerns.

Basic oversight steps are required for the State to successfully administer a grant. In the case of OEO, there were adequate grant expectations, performance monitoring procedures, and on-site performance reviews, but it did not conduct a mandated triennial fiscal audit during the audit period. Performance monitoring mechanisms were numerous to include annual federal A-133 audits; OEO desk audits; monthly/quarterly/annual PCA fiscal and performance reports; OEO oversight interaction with PCA throughout the year; and even annual on-site performance reviews. Additionally, all these controls generated reports to the leadership of PCA and OEO that everything was operating properly. Yet, the extreme contrast between OEO's monitoring results during the period of 2010-12 and the 2014 OEO special review indicated a monitoring failure, either by a lack of rigor in prior monitoring or flawed methodology. OEO's monitoring shortcomings do not obviate management liability on the part of PCA's leadership for not paying attention to their operations, but, in the real world, serious failures occur based on multiple points of failure.

To OEO's credit, its staff recognized its shortcomings and no attempts were made to minimize the situation, as has been seen by the SIG with other state agencies. Even more impressive, OEO also proactively exercised its fiduciary duty by self-initiating reviews at 13 other non-profits receiving OEO grants similar to PCA. PCA is one of 14 Community Action Agencies (CCA), which collectively provide services to address the needs of the state's low-income, vulnerable, and indigent population. OEO distributes \$50 million annually in federal grants to these 14 agencies.

The direction for improvement to most organizational problems is application of fundamental management practices. First, upgrade PCA's financial management system and its record retrieval system to be able to meet OEO grant requirements to document grant expenses in the normal course of business without extraordinary forensic audit efforts. Second, if PCA re-starts its weatherization program, it needs rigorous procedures to contain costs with consistent quality; adequate internal operating controls to support executive management's oversight of the program; and a strong first line supervisor to manage the many day-to-day moving components involved with weatherization projects.

Lastly, OEO should re-examine its monitoring process to emphasize robust on-site reviews, with emphasis on assessing subgrantees' financial management capabilities to accurately manage grants. After OEO develops a baseline to assess non-compliance risk among its 14 CAAs, it should move to a risk based monitoring methodology to save oversight resources, both personnel and paper, and apply monitoring/audit resources based on risk.

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APPENDICES

- A. OEO’s Fiscal Monitoring Report of PCA for Period 2010-2012, dated 8/15/2014
(link: http://oig.sc.gov/Documents/OEO_Fiscal_Monitoring_Rpt_of_PCA.pdf)
- B. US-Department of Energy cover letter, dated 11/24/2014, and August 2014
Onsite Monitoring Report of PCA
(link: http://oig.sc.gov/Documents/US_DOE_Monitoring_Rpt_of_PCA.pdf)

II. Background

A. Objectives

The SIG initiated its investigation based on the results of a 2013 US-DHHS review of Head Start programs at PCA, as well as credible complaints from concerned stakeholders of mismanagement at PCA. PCA is a non-profit organization receiving federal grants administered by the OEO. A US-DHHS review determined there was non-compliance in the areas of record keeping; indirect cost allocations; and regulations related to Head Start. In addition, US-DHHS disallowed costs totaling \$135,722 of which \$109,294 were unallowable indirect cost allocations, and \$26,428 were specific unallowable expenditures determined to be unrelated to Head Start. OEO joined the SIG investigation by initiating a special monitoring of PCA in January, 2014, which involved both fiscal and performance monitoring of the grants it awarded to PCA during 2010-2012.

Given the range of alleged mismanagement concerns, the SIG's scope included:

- Review state-administered federal grants awarded to PCA to determine if compliant with grant requirements, as well as review for potential fraud, waste, and abuse;
- Review OEO's oversight of grant performance by PCA;
- Review PCA's financial control environment supporting the management of its grants administered by OEO; and
- Based on the PCA investigative results, assess risks in the other 13 Community Action Agencies (CAAs) within the state receiving grants administered by OEO.

Reviews by the SIG are conducted in accordance with professional standards set forth by the Association of Inspector General, often referred to as the "Green Book."

B. Piedmont Community Action, Inc.

PCA evolved from the Spartanburg Economic Opportunity Commission, incorporated on February 25, 1966, as part of the War on Poverty. Today, PCA is promoted as the largest independent, private non-profit in Spartanburg and Cherokee counties assisting more than 50,000 low-income individuals and families annually.

PCA's 2012 income totaled \$11,610,933, which was comprised of \$5,592,306 (48%) in direct federal grants for Head Start programs; \$3,745,583 (32%) in OEO administered grants; \$444,812 (6%) in other federal grants; \$1,421,282 (13%) in fair market value of free rent donated by local government and charities; and \$406,950 (1%) of other income comprised of non-federal grants, contributions, fees and interest income.

PCA is one of 14 non-profits, known as Community Action Agencies (CAAs), which collectively provide services to address the needs of the state's low-income, vulnerable, and indigent population. OEO distributes approximately \$50 million annually in federal grants to these 14 agencies.

C. Overview – PCA’s State Administered Grants

During the period under review, the four grants awarded to PCA by OEO were as follows:

- Low-Income Home Energy Assistance Program (LIHEAP) provides home energy assistance to help eligible low-income households meet their home heating and/or cooling needs. LIHEAP is a block grant to South Carolina funded by the US-DHHS.
- Community Services Block Grant (CSBG) provides an array of funding for local community initiatives, including assistance for program-eligible households in areas such as education, employment, financial emergencies, housing, nutrition and health care. CSBG is a block grant to South Carolina funded by the US-DHHS.
- Weatherization Assistance Program (WAP) provides home weatherization assistance to improve the quality of life for low-income families, particularly for the elderly, people with disabilities and children by improving the energy efficiency of their homes while ensuring their health and safety. WAP is a formula grant to South Carolina funded by the U.S. Department of Energy (US-DOE).
- American Recovery and Reinvestment Assistance Act of 2009 – Weatherization Assistance Program (WAP-ARRA) also provided home weatherization with marginally different requirements. WAP-ARRA funds are designed to stimulate the economy and job creation. These funds are formula-based grants to South Carolina funded through the US-DOE.

LIHEAP and CSBG are “direct” client assistance programs where funds are dispersed to qualifying low-income families in need of financial support or assistance. WAP and WAP-ARRA are homeowner energy-saving programs in which the PCA subcontracted the weatherization work to outside contractors during most of the period under review.

OEO ADMINISTERED GRANTS TO PCA 2010-2012

<u>Year</u>	<u>LIHEAP</u>	<u>CSBG</u>	<u>WAP</u>	<u>WAP-ARRA</u>	<u>Total</u>
2010	\$ 2,627,936	\$ 686,648	\$ 565,034	\$3,669,306*	\$ 7,548,924
2011	2,702,260	668,370	576,869	*	3,947,499
2012	<u>2,774,773</u>	<u>683,305</u>	<u>440,277</u>	<u>*</u>	<u>3,898,355</u>
Totals	\$ 8,104,969	\$2,038,323	\$1,582,180	\$3,669,306	\$15,394,778
%	53%	13%	10%	24%	100%

*The WAP-ARRA grant covered the three year period where the others were annual awards.

III. OEO’s Special Monitoring of PCA

Grant monitoring falls into two types of reviews; fiscal and performance. Fiscal monitoring focuses on the accounting and control of expenditures in order to verify that funds have been expended in accordance with the agreement and all applicable laws, rules, and regulations. Performance monitoring focuses on the delivery of services in compliance with the grant agreement and all applicable laws, rules and regulations.

A. OEO Fiscal Monitoring Results

OEO's fiscal monitoring of its four grants at PCA determined there were no specific operational issues in LIHEAP and CSBG, which represented 66% of OEO administered grants. However, the two weatherization grants, representing the remaining 34%, had substantial non-compliance resulting in five "findings", one "area of concern", and two "special areas of interest" [See Appendix A]. The findings included the lack of internal controls over materials and equipment; insufficient communications or understanding of procedures between operational and fiscal areas; insufficient records maintenance; discrepancies between fiscal records and client records; and insufficient client file documentation.

Two findings associated with the WAP and WAP-ARRA grants noted incomplete client files and discrepancies between fiscal records and records found in the client files. A sample of 25 client files were reviewed for documentation compliance and 23 files were found to be non-compliant. Also, OEO was unable to perform their standard audit procedure of tracing expense documentation from client files to the fiscal files and vice versa, to obtain assurance the weatherization services were paid and accounted for accurately. In addition to the lack of documentation in the client files, shortcomings in PCA's accounting processes and practices contributed to OEO's inability to trace the expenses.

Interestingly, the LIHEAP and CSBG grants, which had no specific operational "areas of concern and/or findings," had the benefit of a longer, more stable history, along with a much simpler operational process. On the other hand, WAP-ARRA was a new grant that required PCA to scale up its weatherization operations by over 600% (from an average of 35 projects to 223 projects annually), and it was a more complicated operational process utilizing subcontractors to perform the work for most of the grant period.

PCA's financial control environment failed the weatherization programs. When PCA's financial management disbursed funds without a clear documented audit trail to a project, it exposed PCA to being unable to validate a grant expense claimed to a project. Additionally, financial management should have realized a fundamental grant fiscal control is PCA's ability to maintain records of expended funds. Given the poor state of PCA's client files, it is hard to understand how PCA's financial management did not identify this deficiency, which exposed PCA to the potential liability of these expenses being disallowed. Certainly, the operational managers contributed to poor documentation in files, but the poor fiscal control environment failed to note the many "red flags" exposing PCA to this liability.

OEO's findings were mirrored by PCA's external audit report for the fiscal year ended December 31, 2013. The auditor issued a "qualified" opinion on compliance for the Weatherization programs and identified a material weakness in internal control over financial reporting, which resulted from PCA's finance staff being unable to complete significant adjustments in order to prepare year-end financial statements. The report also included two findings of non-compliance with weatherization file documentation based on the auditor's review of weatherization client files, which were initially missing required documentation that PCA subsequently provided.

Following the presentation of OEO's fiscal monitoring results, PCA's finance staff undertook an effort to collect and prepare supplemental documentation to assist OEO in a second attempt to trace client expense documentation to fiscal records. OEO, in conjunction with the SIG spent most of a day successfully tracing a portion of the sampled records and concluded the results were satisfactory, but PCA's accounting procedures required improvement to provide a clear audit trail to support grant expenses.

B. OEO Performance Monitoring Results

OEO's performance review focused entirely on the two weatherization grants. CSBG and LIHEAP had recently been monitored with no significant findings. OEO performed a comprehensive review of 67 weatherization projects (a 10% sample of completed projects), which included a review of each client file and a physical inspection of each project, as directed by the US Department of Energy. OEO selected projects to be monitored from monthly or recap reports PCA provided to OEO. Difficulty occurred in scheduling physical inspections with homeowners, which required more than the 10% sample to be selected in order to achieve the required 67 physical inspections.

At the time of the review, virtually all of the client files were found to be incomplete and missing required documentation, most notably either a final inspection by PCA staff or an independent post weatherization inspection – essentially, there was often no final inspection to document the work had been satisfactorily completed. The OEO physical inspections revealed moderate to significant issues with approximately one third of the 67 projects involving: substandard or incomplete work performed; the work was unsuccessful in reducing the client's energy usage; overbilling by subcontractors; unallowable expenditures; and remaining safety hazards. Eight of the clients were vocal in expressing dissatisfaction with the work performed.

The 67 project expenses totaled \$464,498, of which OEO initially disallowed weatherization costs totaling \$325,217 (70%); the majority of the disallowed costs being related to the lack of adequate documentation to support contractual grant expenses. After a two month period, PCA produced almost all of the missing documentation and addressed some of the remaining safety hazards. OEO and PCA then undertook a comprehensive review of the newly produced documentation and OEO re-inspected some of the projects. The second review reduced the number of projects with remaining documentation or performance issues to 13 projects, or 19% of the sample of 67. The remaining issues included: a lack of documentation on one project; ineligible costs on four projects; inflated subcontractor hours on five projects; and additional work needed on three projects.

Although OEO has not finalized its disallowed cost number, it is safe to say this \$325,217 preliminary disallowed cost figure representing 70% of the grant expenses on these 67 projects has been substantially reduced. The current estimated disallowed costs range from 13% to possibly as low as 7% with PCA making modest repairs on several of the projects.

OEO's audit was tested by the SIG and further validated by an independent audit by the federal U.S. Department of Energy in late August 2014 where 12 additional projects were examined during the period of 2009 -2013 [see Appendix B]. The results included five (41%) projects had excessive labor charges; two projects did not have a final inspection potentially leading to disallowing all costs; and concerns about complete file documentation. The report stated, "Given that the State was required to monitor each subgrantee at least once a year, it is alarming that these anomalies were not identified and addressed before now."

C. Allegations of Fraud, Waste, and Abuse

The SIG had numerous allegations of fraud involving both the weatherization programs and general PCA operations. None of the allegations reviewed involving PCA employees were substantiated.

Within the weatherization program, several incidents were identified of nominal nature. Several homeowners' made allegations of theft by PCA weatherization subcontractors while on homeowner's property. In one case, a subcontractor's employee was criminally charged. Another incident involved a homeowner's four window air conditioners being removed during weatherization and furnace replacement, but then these air conditioners disappeared from the job site. A third incident pertained to a subcontractor returning unused weatherization material to the local commercial supplier with an allegation of receiving a personal benefit, possibly a \$900 gift

card. PCA staff was notified and corrective actions were taken by the supplier to credit PCA's account, but no criminal charges were pursued.

The risk of waste was high based on PCA's inadequate oversight of the weatherization programs, particularly supervision of its contractors. There was a lack of documentation to indicate either PCA obtained a bid or even an agreed upon labor price from subcontractors prior to awarding jobs, nor was there any documentation of normal change orders requested by subcontractors based on unforeseen circumstances during a job. As a result, there was no documented basis for PCA to assess the accuracy or reasonableness of a subcontractor's final invoice bill. Further, OEO's Fiscal Guidance and Procedural Manual (page 28) states that competitive bids are required to be obtained where estimated costs equal or exceed \$5,000. The Manual further notes specifically that "Weatherization program subcontractor agreements and contracts are required to follow the procurement guidelines and require OEO approval each program year." Violations of this regulation occurred in 12 of the 67 projects sampled. The common pattern observed by OEO in the 67 sample projects was suspicious high labor costs compared to work performed. A 2010 OEO on-site review noted an issue where PCA's average cost per dwelling was \$9,284 compared to the estimated average cost per dwelling of \$6,500 per the State Weatherization Plan.

Equally concerning, there was little to no indication PCA staff conducted appropriate oversight at the completion of weatherization projects. Although independent, third party inspections reports were eventually provided, there is no documentation of PCA staff evaluating the reports and approving the subcontractors' work before payments were made. In addition, 24 of the 67 final independent inspections noted some recommended work had not been done, yet there was no demonstrated effort to follow up on these post inspection notations.

PCA also deployed a strategy to purchase and deliver project materials to each project site in an effort to better control materials used on projects and to save the 15% markup allowed on materials if acquired by a subcontractor. This may have proved inefficient due to the volume of projects undertaken under the ARRA funding (223/year) as compared to the typical number of projects handled under the regular weatherization grant (35/year). The joint "tracing" effort by OEO, SIG and PCA's Finance staff revealed a further practice of purchasing materials to be warehoused and subsequently charged to weatherization projects. Periodic purchases averaging \$5,000 were observed throughout the grant periods. However, these purchases were never recorded as inventory in PCA's accounting records and there was no audit trail to document their usage and provide a proper accounting.

There is still a pending issue of the purchase of over \$32,000.00 of weatherization materials on 9/28/2012 from ARRA funds, two days before the ARRA grant period ended. This issue may be mitigated by the US DOE fortuitously extending the ARRA Weatherization grant period on 12/22/2012, thus creating the opportunity of allowing PCA to utilize the inventory it purchased at the end of the original grant period if it can document use on ARRA projects during this extension period.

All of these management weaknesses inhibited cost containment and consistent quality weatherization. It should be noted there was a clear pattern of improved costs and quality when it decided to discontinue using subcontractors in 2012 and establish an on-board staff to execute the weatherization mission internally.

IV. Assessment of PCA's Financial Control Environment

During the course of the OEO special review, there was a pattern of fiscal non-compliance by PCA determined by the weatherization grant reviews. As a result, PCA's overall financial control environment's capability was reviewed to assess its ability to support OEO grants.

A. Reliability of Accounting Records

The review of the audited financial statements and the accounting records of PCA did not result in a determination of any impropriety or wrongdoing. However, it was determined the accounting records are of questionable reliability. The poor condition of the accounting records appears to be the result of a lack of experience/knowledge of the accounting staff and possibly a lack of sufficient staff, and is illustrated by the following:

- The presence of numerous funds covering prior years' grants remaining open and active with unresolved balances; erroneous postings of current year transactions to prior year funds; unnecessarily voluminous accounting records; and the absence of the proper finalization and close-out of grant funds.
- The presence of numerous reclassifications of original entries noted to have been entered to the wrong fund, department, or account, including reclassifications of reclassifications. Such numerous reclassifications result in a loss of the identity (description) of the original transactions within the general ledger and obscure the audit trail.
- Inconsistency in posting transactions to various departments within funds and inconsistency in posting transactions to various line items.
- A failure to utilize features of the accounting software that would have enabled "project basis reporting" of expenses which, among other benefits, would have facilitated OEO's audit step of tracing weatherization project transactions between client files and the general ledger.
- The intermingling of the accounting records of three separate organizations with PCA's accounting records. The full ledgers of three separate non-profit organizations – related parties to PCA – are included within PCA's general ledger adding unnecessarily to the length and complexity of PCA's general ledger. Further, this intermingling was a factor in US-HHS' disallowance of indirect costs charged to the Head Start and Early Head Start programs.
- The fact that PCA's external auditor prepares routine end-of-year adjustments and corrections to the accounting records indicates PCA's accounting staff lacks either the knowledge, experience or time to do so. Such entries include routine expense accruals, annual leave accruals, recording depreciation, corrections to various incorrect postings, and, at the 2012 year-end, an unsuccessful attempt to balance the numerous "Due to" accounts to the "Due from" accounts. The PCA Finance Manager stated she did not understand the due to/from accounts and they were handled by the auditor.
- PCA's 2013 external audit report included a finding of a material weakness in the internal control over the preparation of financial statements related to the inability of PCA's accounting staff to prepare financial statements in accordance with generally accepted accounting practices.

PCA appropriately practices "fund accounting" where separate, self-balancing sets of accounts are created to record and report the grant transactions for each grant period (typically a year). At the end of the grant period, it is expected that grant funds will be fully expended, and if not, any remaining balances will be promptly resolved. In either case, after grant closeout, the fund should not reflect any accumulated balance, either positive or negative, and can be made inactive without any effect on the organization's other funds. At the 2012 year-end, PCA's general ledger included 41 due to/from accounts representing unresolved balances among various funds that totaled \$3.8 million of the \$8.5 million reported as total assets. This is indicative of years of not properly maintaining the accounting system. This practice was inconsistent with that of another community action agency where funds were promptly made inactive at year-end following a concerted effort to clear any balances.

Following the 2013 US-DHHS review of Head Start, PCA engaged a consultant to respond to DHHS' findings. The consultant had been utilized over a number of years to prepare for Head Start monitoring and, at one time, to train a former finance manager. The consultant's report noted instances of accounting errors in indirect cost allocations and recommended that PCA contract with a third party to recalculate its indirect cost rates for 2009-2012, and appeal the \$109,294 in indirect cost disallowance based on the recalculated rates. Some errors, if corrected, would have been to PCA's benefit. The consultant sustained the majority of the remaining disallowed costs and attributed the findings also to accounting errors. The consultant stated in summary, "During the visit, there was clear evidence expenses are being allocated incorrectly which had a negative financial impact to the agency. There was also evidence transactions are being made without supporting documentation. There was no evidence of an effective review and monitoring of financial transactions. The financial record keeping, reporting and accountability for federal funds have been compromised. The agency must immediately implement corrective actions to regain the credibility of agency recordkeeping and accountability of public funds."

US-DHHS, following PCA's appeal, sustained the disallowance of the \$26,428 in specific costs, and remanded the decision of its disallowance of overstated indirect costs pending a recalculation of PCA's indirect cost rates for 2009-2012. In its appeal decision, US-DHHS stated that information PCA provided in the determination of its original indirect cost rate was "materially incomplete".

US-DHHS, OEO, PCA's own consultant, and PCA's external auditor raised questions on the reliability of PCA's accounting records. Based on the issues raised and the SIG's review, it's questionable whether the PCA financial and record systems adequately support the grant expenditures without improvement to permit routine grant audits to test compliance in the ordinary course of business without extraordinary audit measures, to include retrieving supporting documentation records in client files.

B. Risk to PCA's Financial Condition

HUD Retirement Homes: PCA's audited financial statements reported "related parties" to PCA consisting of three separate, non-profit entities operating apartment facilities under the National Housing Act and regulated by the U.S. Department of Housing and Urban Development (HUD). The Notes to the Financial Statements explained that PCA manages each of the three properties and charges management fees, which collectively total approximately \$66,000 annually. Based on the latest available annual federal information returns, six PCA Board members also serve on each of the entities' boards, which were created during the period from 1999 to 2002.

Of concern is a debt owed to PCA by the entities totaling \$308,197 at December, 2013, which exceeded PCA's unrestricted net assets (i.e., working capital) of \$257,503. No significant progress has been made in collecting this debt over the last several years. Less than \$100 of the debt was collected during 2013. Prior financial reports showed the debt began to accumulate after 2005 and occurred from PCA paying expenses of the related parties, and not from unpaid management fees. HUD regulations require each entity to submit annual budgets and request rent increases if needed. HUD staff advised that, if the budget supports a rent increase, it will be approved, but noted the only approved rent increase in their records was effective April 26, 2013. PCA finance staff advised that HUD has not approved the reimbursements because the properties have not had any residual earnings, and this was confirmed by HUD staff. PCA has essentially loaned its working capital to these three separate entities and may be relying on temporarily restricted funds to meet its day-to-day financing needs. PCA's temporarily restricted funds consist almost exclusively of federal and state administered grant funds. PCA's ability to repay any disallowed costs may be impacted.

Federal Affordable Housing Program: The SIG found various documentation showing PCA's partial ownership in a number of separate entities in the business of developing low income rental properties under the Federal Affordable Housing Program. The entities are in the form of LLCs or limited partnerships, and PCA appears as having a minute percentage of ownership, although one document reflected a 40% ownership by PCA.

PCA's involvement with these entities appears appropriate and within its mission. Of concern is the apparent lack of awareness by PCA's management and its Board of the existence of these relationships, along with any unknown financial impacts to PCA. Indicative of the lack of awareness is the Executive Director's statement that he only became aware of one of these entities after being served papers in a lawsuit by a tenant. Also of concern is the absence of any recognition of these entities in PCA's financial reports.

Subsequent to SIG's investigation, PCA's latest external audit report for fiscal year ended December 31, 2013, now reflect \$1,850,000 in notes receivable and an offsetting \$1,850,000 in notes payable related to the limited partnerships. The notes to the financial statements provide further explanation to these arrangements. PCA obtained loans from the Federal Home Loan Bank (FHLB) and the City of Greer for the development of affordable rental housing and entered into limited partnerships with the developers of each property. The limited partnerships provided PCA with promissory notes offsetting its loan obligations. PCA serves as the general partner and is also the primary obligor on the FHLB and City of Greer loans. The loans are essentially grants where no obligation for repayment remains after retention periods, typically of 15 to 20 years, during which the use of the project must remain for elderly and low income individuals and families. A change in the viability or use of the projects could impact PCA.

The SIG concluded the debt owed to PCA by its related parties and its limited partnerships have a potential downside impact upon its financial condition and it appears that impact will continue for some time. PCA is a contracted party to OEO and OEO should be cognizant of PCA's financial condition and any potential impacts its financial condition may have on their relationship.

V. Review of OEO's Grant Monitoring at PCA

After awarding grants, OEO is required to provide oversight of subgrantees, through grant monitoring. Grant monitoring is conducted by OEO program managers utilizing a variety of tools to include, but not limited to:

- Day-to-day interaction with the 14 CAAs throughout the year by answering questions, providing guidance, and general interaction with the CAAs.
- Reviewing and analyzing monthly and final Financial Status Reports and other periodic reports.
- Conducting classes and training sessions at meetings and conferences.
- Conducting annual desk audits, which include reviewing the final grant annual reports, audited financial statements, and the A-133 audits. Resolving any issues raised in the financial audit or A-133 auditor's testing, which specifically deals with compliance with laws, regulations, contracts and grant agreements.
- Conduct on-site performance monitoring annually. Annual monitoring efforts of LIHEAP and CSBG performance are comprehensive and include assessments of all activities under the two programs and determinations of compliance specific to each program and general compliance. WAP and WAP-ARRA monitoring includes reviews and assessments of client files, quality assessments through client interviews, and technical inspections of weatherization efforts for a sample of clients served.
- Conducting a fiscal monitoring at least every three years (triennial).

OEO had adequate grant expectations, fiscal and performance monitoring procedures, on-site performance reviews, but the mandated triennial fiscal monitoring was not conducted during the period of 2010-2012. Additionally, all of these controls generated annual reports to the leadership of PCA and OEO that everything was operating properly. Given this, the question remains, how was the substantial non-compliance and mismanagement of WAP and WAP-ARRA grants not detected earlier?

Four weatherization monitoring visits were conducted by OEO during the 2010 and 2011. Thirty-six client weatherization projects were reviewed during these four visits with relatively insignificant findings. OEO was required by the US DOE, the federal grantor, to review 5% of the completed projects. By reviewing 36 projects during 2010 and 2011, OEO more than met the federal monitoring requirement of 15. However, OEO did not perform any monitoring visits in 2012, but relied on a federally-contracted monitoring by a third party, which involved a review of an additional 29 projects in May, 2012. The methodology involved in this monitoring could be questioned in that the list of client files to be reviewed were provided in advance to PCA; and 19 of the 29 projects were apartments in one complex, completed by the same contractor, to the same specifications, at the same time. The extreme contrast between monitoring results for 2010-12 and the 2014 OEO special review indicates a lack of rigor in prior monitoring or flawed methodology.

Of equal importance in this performance monitoring failure, OEO did not conduct on-site fiscal monitoring. The missed triennial fiscal monitoring was another lost opportunity because it likely would have uncovered documentation issues in the client files and the accounting records, as well as shortcomings in PCA's overall financial management. OEO's monitoring shortcomings do not obviate mismanagement liability on the part of PCA managers and leadership for not paying attention to their operations, but, in the real world, serious failures occur based on multiple points of failure as was the case here.

Outside of on-site monitoring, all the other grant oversight mechanisms generally provide only a high level assurance of grant performance. The best evidence of grant performance is on-site testing, if done correctly. Reviewing the lengthy paper processes between OEO and PCA providing high level assurance can, in the SIG's opinion, numb a grantor and grantee into a false sense of confidence turning the on-site review into just one more "check the box" exercise. It is not. An on-site monitoring with a robust methodology, to include not allowing a subgrantee prior knowledge of which files will be sampled, is a cost/efficient control when compared to the somewhat other voluminous paper assurance mechanisms. Further, this basic grant monitoring technique, if done early in a grant, provides a firm basis for a risk based monitoring program to most efficiently use finite grant monitoring resources.

To OEO's credit, its staff recognized its shortcomings and no attempts were made to minimize the situation, as has been seen by the SIG with other state agencies. Even more impressive, OEO also proactively exercised its fiduciary duty to self-initiate reviews at the other 13 CAAs. OEO contracted with an independent auditing firm to conduct risk assessments at the other 13 CAAs. To date, twelve reviews have been completed. All CAA reviews will be completed by the end of the 2014 calendar year.

VI. Conclusion

The direction for improvement to most organizational problems is application of fundamental management practices. First, PCA should upgrade its financial management system and record retrieval system to be able to meet OEO grant requirements to document grant expenses in the normal course of business without extraordinary forensic audit efforts. Second, if PCA re-starts its weatherization program, it needs rigorous procedures to contain costs with consistent quality; adequate internal operating controls to support executive management's oversight of the program; and a strong first line supervisor to manage the many day-to-day moving parts involved with weatherization projects.

Lastly, OEO should re-examine its monitoring process to emphasize robust on-site reviews, with emphasis on assessing subgrantees' financial management capabilities to accurately manage grants. After OEO develops a baseline to assess non-compliance risk among its 14 CAAs, it should move to a risk based monitoring methodology to save oversight resources, both personnel and paper, and apply monitoring/audit resources based on risk.

Virtually every state agency accomplishes its mission through third parties by use of contracts or grants. An important outcome of the SIG's report is to increase awareness of the importance of grant monitoring to prevent problems like PCA and OEO are currently experiencing.

VII. Findings and Recommendations

Finding #1: OEO had substantial oversight mechanisms, yet those mechanisms failed to identify a weak financial control system, along with systemic deficiencies in PCA's execution of two weatherization grants.

Recommendation #1a: OEO should re-examine its oversight of all 14 CAAs with an emphasis on increasing robust on-site testing of both fiscal and program performance, which provides more cost/effective assurance than high level assurance efforts performed at a distance, and provides a basis for a long-term risk based grant oversight.

Recommendation #1b: OEO should consider requiring minimum sample sizes for transaction testing and client file reviews during A-133 audits.

Finding #2: PCA had a weak financial control system and mismanaged the execution of its weatherization grants.

Recommendation #2a: PCA should develop a strong financial control system and assure that competent management is in place to execute all grants in a sound business-like manner in full compliance with its contract obligations to OEO.

Recommendation #2b: OEO should conduct special recurring on-site fiscal and performance monitoring until PCA has developed a strong financial control system, as well as adequate operational controls and supervision in its weatherization programs to comply with grant requirements.

Finding #3: PCA has potential financial risks pertaining to its loans to the HUD regulated properties and its relationships with a number of separate entities involved in the business of developing and operating rental properties under the Federal Affordable Housing Program.

Recommendation #3: OEO should closely monitor PCA's overall financial health in future grant awards.