

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**NORWALK ECONOMIC OPPORTUNITY
NOW, INC., DID NOT ALWAYS
CHARGE ALLOWABLE COSTS TO THE
COMMUNITY SERVICES BLOCK GRANT
AND THE COMMUNITY SERVICES
BLOCK GRANT – RECOVERY
ACT PROGRAMS**

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Assistant Inspector General**

**April 2013
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Office of Inspector General

<https://oig.hhs.gov>

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OFFICE OF AUDIT SERVICES FINDINGS AND OPINIONS

The designation of financial or management practices as questionable, a recommendation for the disallowance of costs incurred or claimed, and any other conclusions and recommendations in this report represent the findings and opinions of OAS. Authorized officials of the HHS operating divisions will make final determination on these matters.

EXECUTIVE SUMMARY

BACKGROUND

The Community Opportunities, Accountability, and Training and Educational Services Act of 1998 (COATES Act), P.L. 105-285 authorized the Community Services Block Grant (CSBG) program to provide funds to States and local communities to alleviate poverty. Within the U.S. Department of Health and Human Services, the Administration for Children and Families (ACF), Office of Community Services, administers the CSBG program. The CSBG program funds a State-administered network of more than 1,000 local Community Action Agencies (CAA) that create, coordinate, and deliver programs and services to low-income Americans. The CAAs provide services and activities addressing employment, education, housing, nutrition, emergency services, and the better use of available income. The CSBG program awarded \$689 million in fiscal year (FY) 2010, \$668 million in FY 2011, and \$667 million in FY 2012.

The American Recovery and Reinvestment Act of 2009, P.L. No. 111-5 (Recovery Act), enacted February 17, 2009, provided \$1 billion for the CSBG program. ACF distributed Recovery Act CSBG funds to States and local communities using an existing statutory formula. These funds were provided to States and local communities (working through a network of CAAs and other neighborhood-based organizations) to help reduce poverty, revitalize low-income communities, and empower low-income families and individuals in rural and urban areas to become fully self-sufficient.

Section 676(a) of the CSBG Act requires each State to designate a State agency as the lead agency for carrying out the State's CSBG activities. The State of Connecticut designated its Department of Social Services (State agency) as the lead agency for carrying out State activities for the CSBG program, pursuant to section 17b-2 of the Connecticut General Statutes. The State agency is responsible for approving CAA Recovery Act grant applications and for monitoring CAAs' compliance with program requirements.

Norwalk Economic Opportunity Now, Inc. (NEON), is a not-for-profit CAA that provides social programs and services to economically vulnerable populations in and around Norwalk, Connecticut. For the period October 1, 2009, through September 31, 2012, the State agency awarded to, and claimed on behalf of, NEON \$722,336 in CSBG funds. The State agency awarded to, and claimed on behalf of, NEON an additional \$357,651 in CSBG Recovery Act funds from July 1, 2009, through September 30, 2010.

OBJECTIVE

Our objective was to determine the allowability—under the terms of the grants and applicable Federal requirements—of selected CSBG and CSBG Recovery Act costs that the State agency claimed on behalf of NEON.

SUMMARY OF FINDINGS

Of the \$513,779 in CSBG and CSBG Recovery Act costs that the State agency claimed on behalf of NEON and that we reviewed, \$199,174 was allowable under the terms of the grant and applicable Federal regulations. However, the State agency claimed \$314,605 (or 61 percent of reviewed expenditures) in unallowable costs on behalf of NEON. These costs included:

- \$144,319 for costs with inadequate documentation or that were not reasonable for the performance of the program;
- \$93,415 in indirect expenses charged to the grants based on an unallowable methodology;
- \$57,040 in operating costs that were not reasonable and renovation costs without a Federal waiver that did not meet program objectives;
- \$14,327 in prohibited lobbying, fundraising, and donations; and
- \$5,504 in missing equipment.

These deficiencies occurred because NEON's policies and procedures did not ensure that it complied with all Federal grant requirements. Additionally, NEON did not have adequate controls in place for maintaining adequate documentation, ensuring program objectives were met, preventing personal purchases, and safeguarding equipment to ensure that it charged only allowable costs to its CSBG and CSBG Recovery Act grants.

RECOMMENDATIONS

We recommend that the State agency:

- return to the Federal Government unallowable costs, totaling \$314,605, that it claimed on behalf of NEON and
- ensure that NEON establishes and implements policies, procedures, and related internal controls to:
 - comply with all Federal grant requirements,
 - ensure that it charges only allowable costs to the CSBG program, and
 - ensure that it follows generally accepted, sound business practices.

NORWALK ECONOMIC OPPORTUNITY NOW COMMENTS AND OFFICE OF INSPECTOR GENERAL RESPONSE

In written comments on our draft report, NEON did not fully concur with our first recommendation and provided details of the corrective actions it has taken in response to our

second recommendation. Regarding our first recommendation that the State agency return to the Federal Government unallowable costs totaling \$314,605, NEON stated that it “is not reasonable to hold the State (or NEON) solely responsible for the actions of specific, identifiable individuals who are directly responsible for wrongdoing”

States must repay the Federal Government amounts found not to have been expended in accordance with the CSBG program requirements, or ACF may offset such amounts against future CSBG grants (COATES Act § 678D(a)(3)). We, therefore, maintain that our first recommendation is correct.

STATE AGENCY COMMENTS

In written comments on our draft report, the State agency concurred with our findings and outlined corrective actions to (1) return funds to the Federal Government and (2) establish and implement policies and procedures to reduce the risk of noncompliance with Federal grant requirements.

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INTRODUCTION

BACKGROUND

Community Services Block Grant Program

The Community Opportunities, Accountability, and Training and Educational Services Act of 1998 (COATES Act), P.L. 105-285, authorized the Community Services Block Grant (CSBG) program to provide funds to States and local communities to alleviate poverty. Within the U.S. Department of Health and Human Services, the Administration for Children and Families (ACF), Office of Community Services, administers the CSBG program. The CSBG program funds a State-administered network of more than 1,000 local Community Action Agencies (CAA) that create, coordinate, and deliver programs and services to low-income Americans. The CAAs provide services and activities addressing employment, education, housing, nutrition, emergency services, and the better use of available income. The CSBG program awarded \$689 million in fiscal year (FY) 2010, \$668 million in FY 2011, and \$667 million in FY 2012.

The American Recovery and Reinvestment Act of 2009, P.L. No. 111-5 (Recovery Act), enacted February 17, 2009, provided \$1 billion for the CSBG program. ACF distributed Recovery Act CSBG funds to States and local communities using an existing statutory formula. These funds were provided to States and local communities (working through a network of CAAs and other neighborhood-based organizations) to help reduce poverty, revitalize low-income communities, and empower low-income families and individuals in rural and urban areas to become fully self-sufficient.

Connecticut Department of Social Services

Section 676(a) of the CSBG Act requires each State to designate a State agency as the lead agency for carrying out the State's CSBG activities. The State of Connecticut designated its Department of Social Services (State agency) as the lead agency for carrying out State activities for the CSBG program, pursuant to section 17b-2 of the Connecticut General Statutes. The State agency is responsible for approving CAA Recovery Act grant applications and for monitoring CAAs' compliance with program requirements. The State agency received approximately \$8 million annually in CSBG Act funds and an additional \$12 million in CSBG Recovery Act funds for the State's CSBG program.

Norwalk Economic Opportunity Now, Inc.

Norwalk Economic Opportunity Now, Inc. (NEON), is a not-for-profit CAA that provides social programs and services to economically vulnerable populations in and around Norwalk, Connecticut. NEON's main programs are employment services and job training, early childhood development and day care, housing, food vouchers, and energy cost assistance. NEON is funded primarily through Federal, State, and local government grants.

For the period October 1, 2009, through September 31, 2012, the State agency awarded to, and claimed on behalf of, NEON \$722,336 in CSBG funds. The State agency awarded to, and

claimed on behalf of, NEON an additional \$357,651 in CSBG Recovery Act funds from July 1, 2009, through September 30, 2010.

In a prior report on NEON's Federal Head Start program,¹ we found that NEON charged (1) unallowable indirect expenses to Federal Head Start grants without obtaining an approved indirect cost rate and (2) unallowable expenses to its Recovery Act Head Start quality improvement grant. We recommended that NEON refund to the Federal government \$406,434. After we issued that report, NEON's CEO resigned. We refer to him in this report as the "former CEO."

OBJECTIVE, SCOPE, AND METHODOLOGY

Objective

Our objective was to determine the allowability—under the terms of the grants and applicable Federal requirements—of selected CSBG and CSBG Recovery Act costs that the State agency claimed on behalf of NEON.

Scope

We reviewed \$513,779 that the State agency claimed on behalf of NEON under its CSBG and CSBG Recovery Act agreements for the period July 1, 2009, through March 30, 2012.² This review is part of a series of audits that the Office of Inspector General is conducting to oversee funds provided by the Recovery Act. We reviewed only the internal controls that related to our objective.

We performed fieldwork at NEON's main office in Norwalk, Connecticut, from September 2011 through May 2012.

Methodology

To accomplish our objective, we:

- reviewed applicable Federal laws, regulations, and guidance;
- reviewed the Federal Excluded Parties List System to confirm that NEON was not excluded from receiving Federal funds;
- interviewed NEON's senior management and program, human resources, and financial staff about NEON's policies and procedures related to our audit objective;

¹ We issued our report entitled *Results of Limited Scope Review at Norwalk Economic Opportunity Now, Inc.*, in January 2012 (CIN A-01-11-02505). It is available online at <https://oig.hhs.gov>.

² We reviewed CSBG funds for the period October 1, 2009, through March 31, 2012, and CSBG Recovery Act funds for the period July 1, 2009, through September 30, 2010.

- reviewed the terms and conditions of the CSBG and CSBG Recovery Act agreements between NEON and the State agency;
- reviewed the State agency’s fiscal and program report that it used to monitor NEON;
- reviewed NEON’s articles of incorporation, bylaws, organizational chart, and minutes of the board of directors’ meetings;
- reviewed NEON’s financial policies and procedures, chart of accounts, and financial reports;
- reviewed and analyzed NEON’s annual Office of Management and Budget (OMB) Circular A-133³ audit reports for FYs 2007 through 2010;
- judgmentally selected CSBG transactions totaling \$289,263 (\$4,295 in personnel and \$284,969 in nonpersonnel costs) and CSBG Recovery Act transactions totaling \$224,516 (nonpersonnel costs) on the basis of risk factors such as whether the transactions were:
 - of high dollar value;
 - for items usually considered unallowable (e.g., construction, personal items, donations, etc.); or
 - identified as high risk during our prior audit of NEON’s Head Start program;⁴
- conducted a physical inventory of selected computers and other equipment; and
- discussed our findings with NEON and State agency officials.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

FINDINGS AND RECOMMENDATIONS

Of the \$513,779 in CSBG and CSBG Recovery Act costs that the State agency claimed on behalf of NEON and that we reviewed, \$199,174 was allowable under the terms of the grant and applicable Federal regulations. However, the State agency claimed \$314,605 (or 61 percent of reviewed expenditures) in unallowable costs on behalf of NEON. These costs included:

³ Per OMB Circular A-133, §_200(a), non-Federal entities “that expend \$300,000 (\$500,000 for fiscal years ending after December 31, 2003) or more in a year in Federal awards shall have a single or program-specific audit conducted for that year”

⁴ See report No. A-01-11-02505 cited above.

- \$144,319 for costs with inadequate documentation or that were not reasonable for performance of the program;
- \$93,415 in indirect expenses charged to the grants based on an unallowable methodology;
- \$57,040 in operating costs that were not reasonable and renovation costs without a Federal waiver that did not meet program objectives;
- \$14,327 in prohibited lobbying, fundraising, and donations; and
- \$5,504 in missing equipment.

NEON's policies and procedures did not ensure that it complied with all Federal grant requirements. Additionally, NEON did not have adequate controls in place to ensure that it charged only allowable costs to its CSBG and CSBG Recovery Act grants.

UNALLOWABLE COSTS

Federal Requirements

Section 678D(a)(1)(B) of the CSBG Act requires that States receiving CSBG funds ensure that recipients of those funds, such as CAAs, follow the cost and accounting standards of the Office of Management and Budget (OMB). CAAs are subject to the requirements of 45 CFR part 74, which covers grants awarded to nonprofit organizations. The regulations at 45 CFR § 74.27(a) state that the allowability of costs incurred by nonprofit organizations must be determined in accordance with 2 CFR part 230 (OMB Circular A-122), *Cost Principles for Non-Profit Organizations*.

Federal cost principles (2 CFR § 230, App. A, § A.2) state that for costs to be allowable under an award, costs must be reasonable for the performance of the award and adequately documented, among other requirements. Further, grantees are required to maintain accounting records that are supported by source documentation (45 CFR § 74.21(b)(7)).

Federal cost principles (2 CFR § 230, App. A, § A.4.b) state that any cost allocable to a particular award or other cost objective may not be shifted to other Federal awards to overcome funding deficiencies or to avoid restrictions imposed by law or by the terms of the award.

Federal cost principles (2 CFR § 230, App. B, § 11) state that compensation for the use of a grantee's buildings may be made through use allowance or depreciation. Use allowances or depreciation shall be based on the acquisition cost of the building excluding (1) the cost of land and (2) any portion of the cost of buildings paid or donated by the Federal Government. The annual use allowance cannot exceed 2 percent of the building's acquisition cost.

Federal cost principles (2 CFR § 230, App. B, 8.h) prohibit the portion of the cost of organization-furnished automobiles that relates to personal use by employees from being charged to a grant award.

Federal cost principles (2 CFR § 230, App. B, 19) prohibit the costs of goods or services for personal use from being charged to a grant award.

Costs Inadequately Documented or Not Reasonable for Program Performance

NEON charged to its CSBG and CSBG Recovery Act grants a total of \$144,319 for costs that were not adequately documented or not reasonable for program performance. Specifically, NEON charged:

- \$71,030 for costs without supporting documentation and that were improperly transferred from other programs to the CSBG and CSBG Recovery Act grants,
- \$46,463 for the use of space in a building that NEON owns that was not based on depreciation or use allowance;
- \$10,763 for credit card charges made by the former CEO that were either inadequately documented or not reasonable for the performance of the program;
- \$3,175 for gift cards with documentation that the director of community services said he recreated; and
- \$12,888 for other costs with insufficient documentation.

Costs Transferred From Other Programs Without Supporting Documentation

NEON charged to its CSBG and CSBG Recovery Act grants a total of \$71,030 for expenses that it transferred from other programs and accounts. NEON could not provide supporting documentation for those expenses. NEON charged costs to its programs on the basis of the amount that it had budgeted; it did not always base those charges on actual expenses. NEON financial staff told us that the director of finance and planning services, who has since resigned, said that if a program exceeded its budget, financial staff should transfer the excess costs to another account or another program. The transferred amounts were not related to specific costs and could not be readily traced back to an original invoice or expense. For example, NEON made 28 transfers of various amounts totaling \$43,782 from other programs to the CSBG grants with only the note “CSB” recorded in the accounting system. NEON could not provide documentation or other evidence to link the transferred amounts with allowable costs associated with CSBG programs.

Use Costs Not Based on Depreciation or Use Allowance

NEON charged \$46,463 for space for the CSBG programs’ use of NEON’s facilities based on an estimate by the former director of finance and planning services. However, NEON did not provide documentation showing how the charges were calculated or supporting that the estimate was based on depreciation or use allowance. As a result, NEON charged its CSBG grants \$46,463 for space that it could not support.

CEO Credit Card Charges Inadequately Documented or Not Reasonable

NEON charged its CSBG and CSBG Recovery Act grants \$10,763 for credit card purchases made by its former CEO that were either not supported or did not meet the program's objectives. NEON's board of directors issued its former CEO credit cards that were to be used exclusively for business travel and other expenses related to his duties. In reviewing the former CEO's credit card purchases, we found the following:

- NEON's former CEO charged \$4,983 for items that did not meet the program's objectives. For example, the former CEO charged \$733 for personal travel following a business conference, \$624 for three briefcases, \$364 in purchases from Apple iTunes, and \$142 for two Cross pens.
- NEON's former CEO charged \$1,973 for costs such as fuel, car washes, and Sirius XM radio that were related to his company vehicle. The former CEO's contract included a company vehicle that was used for both business and personal use. However, he did not maintain mileage logs documenting his business and personal use, despite recommendations to do so from State and NEON's auditors.
- NEON's former CEO made 27 credit card transactions totaling \$2,478 that did not have adequate documentation to assess their allowability. Many of these purchases were made at stores that sell both business and personal items, such as restaurants (10 transactions), large retail stores (5 transactions), and supermarkets (2 transactions).
- NEON's former CEO made 47 credit card transactions totaling \$1,329 that had no supporting documentation. Many of these purchases were made at stores that sell both business and personal items, such as Apple iTunes (18 transactions) and Amazon.com (12 transactions).

Unallowable Gift Cards

NEON charged its CSBG Recovery Act grant \$3,175 for 127 unallowable gift cards from Wal-Mart, Barnes & Noble, and Borders. NEON intended to distribute the gift cards to fathers who attended events that encouraged them to take a more active role in their children's lives. As supporting documentation, NEON's former director of community services provided us with attendance sheets of gift card recipients. However, when we reviewed and compared the attendance sheets, we noted that some attendance sheets were duplicates, included staff members as recipients,⁵ and included additional signatures that had been added after these events had taken place. The former director said that he had "recreated" some attendance sheets by photocopying attendance sheets for Head Start events, changing some of the dates and adding information indicating that the event recipients had received gift cards. Our analysis further showed that information on the attendance sheets did not match the information on the finance department's gift card logs.

⁵ The attendance sheets provided by NEON's former director of community services indicated that the gift cards were provided to staff members. However, the staff members told us that they did not receive gift cards as incentives for attending fatherhood events.

Other Costs With Insufficient Documentation

NEON charged its CSBG and CSBG Recovery Act grants \$12,888 for costs that had insufficient documentation to assess the allowability of the transactions. For example, because of the way that NEON's former director of finance and planning services instructed financial staff to enter expenses, NEON's accounting system sometimes summarized costs that were charged to NEON's CSBG and CSBG Recovery Act grants on the same day into a single charge. NEON's financial staff could not identify or provide supporting documentation for the individual expenses that made up the summarized costs, which totaled \$9,527.

INDIRECT EXPENSES WITHOUT AN INDIRECT COST RATE

Federal Requirements

Federal regulations define direct costs as those that can be identified specifically with a particular award, project, or service of an organization (2 CFR § 230, App. A, B.1) and indirect costs as those that have been incurred for common or joint objectives and cannot be identified readily with a particular final cost objective (2 CFR § 230, App. A, C.1).

The allowable methodologies that nonprofit organizations can use to allocate indirect expenses to Federal grants are outlined in Federal regulations found at 2 CFR § 230, App. A, D.

HHS will not reimburse indirect costs unless the recipient has an indirect cost rate covering the applicable activities and period (HHS Grants Policy Statement, page I-23). Indirect cost rates are negotiated by HHS's Division of Cost Allocation or another Federal agency with the authority to negotiate indirect cost rates. However, an organization is not required to establish an indirect cost rate (1) if the organization's total operations consist of a single grant-supported project or (2) if the organization properly and consistently treats all costs as direct costs to projects and accounts for them as such. This includes being able to identify and segregate costs on the basis of a project that assigns costs commensurate with the benefits provided to individual projects or programs.

Unallowable Indirect Costs

NEON charged \$93,415 in indirect costs to its CSBG grants using an internally developed methodology. NEON pooled its indirect expenses, which included unallowable expenses, such as salary for NEON's director of development who raised funds for the organization, and allocated the expenses to its programs based on each program's percentage of NEON's total salaries. NEON's methodology for allocating indirect costs did not properly and consistently treat all costs as direct costs to projects and accounts for them as such. Additionally, if a program's indirect expenses exceeded its budget, NEON would reallocate the indirect expenses to other programs.

OPERATING COSTS AND RENOVATIONS THAT DID NOT MEET PROGRAM OBJECTIVES

NEON charged \$57,040 to its CSBG and CSBG Recovery Act grants for costs that were not allowable under Federal requirements. These costs included:

- \$28,924 for thrift store operating costs that were not reasonable and
- \$28,116 for thrift store renovations that were not preapproved.

Unallowable Thrift Store Operating Costs

Federal Requirements

Federal requirements for nonprofit grant recipients specify that for a cost to be allowable under a grant award, it must be reasonable for the performance of the award and conform to any limitations set by the award (2 CFR § 230, App. A, § A.2). Further, 2 CFR § 230, App. A, § A.3, defines a reasonable cost as one that does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the cost.

In determining the reasonableness of a cost, consideration is given to (1) whether the cost is ordinary and necessary for the performance of the award; (2) the restraints or requirements imposed by such factors as generally accepted sound business practices, arms-length bargaining, Federal and State laws and regulations, and terms and conditions of the award; and (3) whether the individuals concerned acted with prudence in the circumstances (2 CFR § 230, App. A, § A.3).

Compensation for the use of a grantee's buildings may be made through use allowance or depreciation (2 CFR § 230, App. B, § 11). Use allowances or depreciation are based on the acquisition cost of the building excluding (1) the cost of land and (2) any portion of the cost of buildings paid or donated by the Federal Government. The annual use allowance cannot exceed 2 percent of the building's acquisition cost.

Program income shall be retained by the recipient and shall be (1) added to program funds and used to further program objectives or (2) deducted from the total allowable program costs in determining the net allowable costs on which the Federal share of costs is based (45 CFR § 74.24(b)). Program income is the gross income earned by the recipient that is directly generated by a supported activity or earned as a result of the award. Program income includes, but is not limited to, the use or rental of real or personal property acquired under federally funded projects (45 CFR § 74.2).

Operating Costs Did Not Meet Program Objectives

In its CSBG Recovery Act project proposal, NEON stated that it would use grant funds to establish a nonprofit thrift store at property that it owns at 24 Havilland Street, which would

create at least five retail jobs in the store and provide a job training site for NEON clients with little-to-no work history.

NEON did not meet its program objectives of operating a thrift store, creating retail jobs, and training clients as it described in its project plan. Specifically, we found that:

- NEON could not obtain the appropriate permits from the City of Norwalk to operate a thrift store because 24 Havilland Street is located in an area where retail businesses are prohibited by city regulations;
- NEON did not use the second floor of 24 Havilland Street as a job training site; instead, it converted the space into a two-bedroom apartment that was rented at below fair-market value to the former CEO's ex-wife for \$600 per month (including utilities, parking, telephone, cable, and Internet access);
- none of NEON's clients received retail job experience at the thrift store, according to NEON staff;
- NEON hired only one employee to operate the thrift store, the former CEO's ex-wife, who lived outside of NEON's service area at the time that she was hired;
- the thrift store was closed during six out of seven unannounced visits that we made during business hours;⁶
- total retail sales from the thrift store were \$848 from June 2011 through April 2012 (an average of \$84.80 per month for the 10-month period);
- NEON charged, to its CSBG Recovery Act grant, rent for use of the thrift store that was not based on depreciation or use allowance but was based on an estimate by NEON's former director of finance and planning services; and
- NEON charged, to its CSBG Recovery Act grant, utilities at 24 Havilland Street, which included utilities for the second-floor apartment.

NEON charged \$28,924 to its CSBG and CSBG Recovery Act grants for the operating expenses of its Havilland Street thrift store. Although these costs were consistent with NEON's CSBG Recovery Act grant application, these expenses were not reasonable and did not meet program objectives and, therefore, were unallowable. The unallowable operating expenses included: \$16,000 that NEON charged to the grants as "rent" for the use of NEON's Havilland Street facility; \$9,095 paid to the former CEO's ex-wife for contract and payroll expenses to set up and manage the thrift store; \$2,439 for display racks, equipment, and supplies to operate the store; and \$1,390 for utilities.

⁶ The thrift store was closed when we conducted unannounced visits on August 16, 17, and 18 and September 13, 2011. It was also closed during unannounced visits on May 9 and 11, 2012. The thrift store was open during an unannounced visit on May 10, 2012.

In addition, NEON did not report the program income generated through the apartment rent or thrift store sales and either (1) use the program income to further CSBG and CSBG Recovery Act program objectives or (2) deduct the program income from the total allowable CSBG and CSBG Recovery Act program costs to determine the net allowable costs on which the Federal share of costs should have been based.

Havilland Street Thrift Store Renovations Not Preapproved

Federal Requirements

CAAs are prohibited from using CSBG funds to purchase, construct, or permanently improve (other than low-cost residential weatherization or other energy-related home repairs) any facility without obtaining a Federal waiver (CSBG Act, § 678F(a)).

Renovations Without Federal Waiver

Neither NEON nor the State agency obtained a Federal waiver prior to using the CSBG Recovery Act grant funds to permanently improve the facility. NEON charged \$28,116 to the CSBG Recovery Act grant for 33 invoices related to unallowable renovations at its 24 Havilland Street facility. NEON's management said that it was unaware that NEON was required to obtain a Federal waiver before using CSBG Recovery Act funds for renovations. However, NEON certified in its CSBG Recovery Act Risk Assessment, dated October 9, 2009, that it would not use CSBG Recovery Act funds for the permanent improvement (other than low-cost residential weatherization or other energy-related home repairs) of any of its facilities. Renovation costs included:

- \$4,647 to purchase and install hardwood flooring;
- \$4,000 to remove carpeting, cabinets, bathroom fixtures, and provide a clean shell prior to renovations;
- \$3,522 to remove old wiring and install new wiring and a fire alarm system; and
- \$1,373 to purchase and install an outdoor fence.

PROHIBITED LOBBYING, FUNDRAISING, AND DONATION COSTS

Federal Requirements

Federal cost principles (2 CFR § 230, App. B) prohibit the following costs from being charged to a grant award:

- lobbying costs used to influence the introduction, enactment, or modification of Federal or State legislation through communication with any member or employee of the congress or State legislature or with any government official or employee in connection with a decision to sign or veto legislation;

- fundraising costs, including financial campaigns, endowment drives, solicitation of gifts and bequests, and similar expenses incurred solely to raise capital or obtain contributions; and
- contributions or donations, including cash, property, and services, made by the organization, regardless of the recipient.

Lobbying, Fundraising, and Donations Prohibited

NEON charged \$14,327 in costs to its CSBG and CSBG Recovery Act grants that were unallowable according to Federal regulations. Of these costs, \$9,490 (66.2 percent) were credit card charges made by NEON's former CEO. Specifically, NEON charged:

- \$8,100 for contributions and travel related to prohibited lobbying activities (\$5,834 from the former CEO's credit card),
- \$3,411 for fundraising costs using the former CEO's credit card, and
- \$2,816 for donations (\$245 from the former CEO's credit card) to organizations such as State and local NAACP and community agencies.

MISSING EQUIPMENT

Federal Requirements

Federal requirements state that grantees' financial management systems shall provide effective control over and accountability for all funds, property, and other assets, and grantees shall adequately safeguard all such assets and assure that they are used solely for authorized purposes (45 CFR § 74.21(b)(3)). Grantees' equipment records for equipment acquired with Federal funds must include a description of the equipment, the manufacturer's serial number or other identification number, the source of the funds used to acquire the equipment (including the award number), the acquisition date and cost, and the location and condition of the equipment (45 CFR § 74.34(f)(1)). Additionally, the grantee shall (1) take a physical inventory of equipment and reconcile the results with the equipment records at least once every 2 years (45 CFR § 74.34(f)(3)) and (2) investigate and fully document any loss, damage, or theft of equipment (45 CFR § 74.34(f)(4)).

Missing Equipment

NEON did not maintain adequate equipment records or take physical inventories at least every 2 years as required until after we had identified inventory problems in our prior audit report. We performed a physical inventory of 61 items of computers and other equipment totaling \$68,635 that NEON charged to its CSBG and CSBG Recovery Act grants. Of the 61 items that we selected, we were able to locate 56 items. However, we were unable to locate five items totaling

\$5,504, including two iPads, one 17-inch MacBook Pro laptop, and one iPod Touch, which were purchased by the former CEO using his credit card, and one HP Pavilion computer.

UNALLOWABLE COSTS LIMITED THE RESOURCES AVAILABLE TO MEET PROGRAM OBJECTIVES

These deficiencies occurred because NEON's policies and procedures did not ensure that it complied with all Federal grant requirements. Additionally, NEON did not have adequate controls in place for maintaining adequate documentation, ensuring program objectives were met, preventing personal purchases, and safeguarding equipment to ensure that it charged only allowable costs to its CSBG and CSBG Recovery Act grants and that it followed generally accepted sound business practices. Because NEON charged \$314,605 in unallowable costs to the grants, these funds were not available for program use. These funds could have been used to meet the program objectives of reducing poverty, revitalizing low-income communities, and empowering individuals to become fully self-sufficient.

RECOMMENDATIONS

We recommend that the State agency:

- return to the Federal Government unallowable costs, totaling \$314,605, that it claimed on behalf of NEON; and
- ensure that NEON establishes and implements policies, procedures, and related internal controls to:
 - comply with all Federal grant requirements,
 - ensure that it charges only allowable costs to the CSBG program, and
 - ensure that it follows generally accepted, sound business practices.

NORWALK ECONOMIC OPPORTUNITY NOW COMMENTS AND OFFICE OF INSPECTOR GENERAL RESPONSE

In written comments on our draft report, NEON did not fully concur with our first recommendation and provided details of the corrective actions it has taken in response to our second recommendation. Regarding our first recommendation that the State agency return to the Federal Government unallowable costs totaling \$314,605, NEON stated that it "is not reasonable to hold the State (or NEON) solely responsible for the actions of specific, identifiable individuals who are directly responsible for wrongdoing"

States must repay the Federal Government amounts found not to have been expended in accordance with the CSBG program requirements, or ACF may offset such amounts against future CSBG grants (COATES Act § 678D(a)(3)). We, therefore, maintain that our first recommendation is correct. NEON's comments are included in their entirety as Appendix A.

STATE AGENCY COMMENTS

In written comments on our draft report, the State agency concurred with our findings and outlined corrective actions to (1) return funds to the Federal Government and (2) establish and implement policies and procedures to reduce the risk of noncompliance with Federal grant requirements. The State agency's comments are included in their entirety as Appendix B.

APPENDIXES

**N.E.O.N.****Norwalk Economic Opportunity Now, Inc.**

98 SOUTH MAIN STREET, NORWALK, CT 06854-3126

January 28, 2013

Mr. Michael J, Armstrong
Regional Inspector General for Audit Services
Office of the Inspector General

USDHHS, OIG draft report: Norwalk Economic Opportunity Now, Inc Did Not Always Charge Allowable Costs to the Community Services Block Grant and the Community Service Block Grant – Recovery Act Programs

NEON, Inc.'s Comments on Draft Findings and Recommendations

Dear Mr. Armstrong:

On behalf of Norwalk Economic Opportunity Now, Inc., (NEON) in regard to your letter dated January 11, 2013, to Mr. Greg Burnett, Chairman of the Board of NEON, we have the following response to that letter.

In order that you properly consider our views on the validity of the facts and reasonableness of the recommendations in the report and, on behalf of NEON, I would like to provide the following written comments:

The Former President/CEO resigned from NEON in 2012. In cooperation with the Connecticut Department of Social Services, NEON appointed a new Interim President/CEO and sought outside technical assistance to cure the problems. NEON used "accounting" methodologies that had been in place for years. With no formal business or accounting training, the former CFO was ill-equipped to implement commonly accepted accounting practices nor to tackle the complex cost accounting required in the management of CSBG, Head Start and multiple other state and local funding sources each run according to specific, sometimes conflicting policies, and across different fiscal years and funding cycles.

We are concerned that the initial summary does not acknowledge the extent to which NEON worked with the OIG to help uncover information and to provide documentation. These efforts were undertaken by NEON staff in order to apportion individual responsibility where appropriate, and otherwise to facilitate needed change from past practices. NEON is moving forward. We have worked to overcome long-term mismanagement and to achieve future excellence.

Although covered in the full report, the initial summary does not fully describe the action of NEON's former Executive Management (CEO, Deputy Director, CFO) and the Community Service Program Director with responsibility for the Twenty-Four Havilland

Boutique. Many of the problems are directly attributed to senior management no longer associated with NEON.

Indeed, NEON's entire Board was not always fully informed of actions by the former Executive Management and were therefore, not able to perform the appropriate oversight. We feel it is important to acknowledge that by the time your office had completed its audit, all persons who had been implicated in the direct violation of federal procedures and incompetent management practices cited in the report had been separated from NEON employment.

In recognition of problems identified by OIG and State directed audits, NEON took immediate action to remediate alleged issues identified and to proactively uncover potential weaknesses in NEON's other internal controls. Before the OIG on-site investigation was completed, NEON had already started working to achieve full compliance with all grant requirements.

- NEON Managers are now becoming familiar with program rules, responsibilities, reporting requirements, budgets and expectations for programs under their supervision (CSBG, Head Start and multiple unrelated state and federal programs);
- NEON purchased and has begun to implement project, inventory and purchasing systems. Staff training will help integrate these systems and procedures into daily practice and improve program accountability.
- NEON engaged a new audit firm (CohnReznick) to conduct required and recommended audits (see 2011 single state and federal audits released 1/126/13). NEON contracted with this firm to perform a forensic audit covering the time period addressed in your offices audit.
- As a result of these actions programmatic and accounting inaccuracies identified in the report, cannot easily occur again.

NEON is working diligently to insure that charges to CSBG program are only those that are allowable:

- In August, NEON hired an appropriately credentialed CFO.
- The agency developed and presented new budget formats for its multiple cost centers enabling future detail and insuring accountability at the program level, and across the entire agency.
- NEON has retained its former accounting firm (Hope and Hernandez) to advise our agency in three key areas:
 - Development of an appropriate agency wide cost allocation plan and the supporting processes, procedures and training that will insure consistency and on-going accuracy.
 - Development/negotiation of an acceptable federal indirect cost rate, and
 - The appropriate re-structure, staffing and training of NEON's finance department and process-related programmatic staff.

In closing, NEON understands and takes seriously the issues identified and resulting recommendations. Our agency regrets that these deficiencies represent missed opportunities to meet program objectives that reduce poverty, revitalize the community and empower people to become self-sufficient. In recent months our agency has separated staff that were not moving the agency in the right direction. We have worked closely with those providing technical assistance in Head Start and CSBG areas to review, adjust, republish and train on the practices and procedures that will help to insure good service delivery and in time, regain the confidence of State, Federal, municipal and private funders.

NEON is committed to demonstrating its ability to right the wrongs done to this agency's reputation and the confidence of its clients and funders by its former Executive leadership. Please be assured that NEON has retained counsel to further the process of recouping funds that were misdirected by persons formerly in authority. We will use any civil and/or criminal vehicles that are available in this circumstance to recoup misspent, fraudulently utilized or poorly accounted funds.

We look forward to continued close collaboration with the State of Connecticut and its technical assistance contractors as we seek to indemnify our agency against the potentially devastating impact of having to repay funds to the State CSBG Agency.

Thank you again for the opportunity to comment on the draft report. I have appended for your review an outline of the actions NEON, Inc has taken to rectify problems identified in each section of the draft OIG CSSBG/ARRA Report.

Respectfully,



Patricia Wilson Pheanious, JD, MSW
NEON Inc., Interim President/CEO

Outline of the actions NEON, Inc has taken to address the issue raised in each section of the draft OIG CSSBG/ARRA Report:

Unallowable Costs/Inadequate Documentation /Prohibited Fundraising:

- Costs are now being charged as direct expenses until an indirect cost rate is developed and approved.
- NEON has developed accurate square footage so that reasonable costs can be accounted for and recouped when allowable by grant terms.
- Cost allocation plan being developed under the direction of an accounting firm experienced in non-profit cost accounting (Hope and Hernandez).
- Credit cards have been cancelled and are no longer available to staff or CEO. The agency retains one card kept in the Finance Department safe under the sole authority of the comptroller.
- Expenditures are not reimbursed to anyone without proper documentation, and supporting original receipts.
- Gift cards policy and procedure has been developed to insure that cards, when used are properly accounted for: Strict controls are now in place. The serial number of the card is noted; the purpose for which the gift card is disseminated, and each recipient must sign for receipt of the card. Cards are strictly recorded and disseminated as required from the finance office.
- The CEO's car was returned at the end of the lease. No new cars will be rented by the agency. If the agency decides in the future to supply a car for a President/CEO, the appropriate controls will be in place to insure that it is used for business use only. Regular business travel logs must be kept for any person to receive travel reimbursement from NEON. No personal use will be allowed or personal-use miles reimbursed
- Expenses that may be classified as "fundraising" are no longer being improperly changed to state or federal sources, which do not permit these expenses.

Operating Costs and Renovations that Did Not Meet Program Objectives: Havilland Street Thrift Store:

- The former President/CEO vetoed plans that were in place to run the Havilland Street Boutique in accordance with the design developed to secure ARRA and certain private funds. The hiring of the former President/CEO's ex-wife against staff objection and zoning problems that should have been identified and resolved early on, contributed to problems cited in the report and resulting in a failure to realize jobs or revenue.
- Since that time we are diligently working to return the facility to its original purpose. We have served clients on a regular basis. The store is now opened Tuesday through Friday.
- Zoning rules preventing sales have not changed, however the Norwalk Mayor granted an emergency request to operate in the aftermath of Hurricane Sandy.

We do not accept any money at the site. Artificial currency “NEON Bucks” are used providing clients with a mechanism to “purchase” clothing and accessories (for men, women and children) from the store. The store is staffed by volunteers and staff associated with our workforce initiatives. We are working with a locally owned business (Her Game Two) to help clients learn to accessorize and to hold future fashion events. (Refer to News Items)

- NEON budgets now have a cost center for building renovation and repair.
- Maintenance staff has been instructed to undertake no renovations without securing the appropriate building certificates. The program management now routinely approves building renovation requests and checks them against the terms of grant funds proposed to insure that renovations can be documented to improve service delivery and are allowable under the terms of the grant.
- All purchasing is being centralized. A system of purchase orders is being implemented. A centralized area has been identified and staffed to insure that purchases are received, inventoried and specifically assigned to the appropriate cost center in accordance with grantee requirements.

Missing Equipment:

- Software has been installed to assist in effective inventory management: inventory will now include a description of the equipment, the manufacturer's serial number or other identifying number, the grant source of the equipment (including award number) the acquisition date and cost and the location and condition of the equipment.
- A physical inventory of all equipment was undertaken and reconciled. Such inventories are now regularly scheduled once every other year. Agency procedures will require investigation and documentation of any loss, damage or theft of equipment.
- Certain missing Agency property (cell phones, computers, I-pads, etc.) has been recouped from former employees; civil/criminal means will be used to pursue unreturned property.
- Purchases that are directly attributable to the Agency's former President/CEO, and which have not been returned to the agency have been recouped from sick and vacation time dollars otherwise due to the former President/CEO when he resigned.
- NEON has employed counsel to explore legal means to recoup unaccounted for property. In addition, any information uncovered in the forensic audit will be reviewed by our Counsel and if appropriate, referred to the State's Attorney General for review and possible prosecution.

CONCURRENCE or NON-CONCURRENCE WITH DRAFT REPORT RECOMMENDATIONS

Recommendation #1 (regarding the return of disallowed funding): **NEON does not fully concur with Recommendations #1**

NEON continues to serve thousands of clients at a time when its services are critical to the struggle of very vulnerable people. NEON is fighting to overcome the effects of long-term mismanagement. With the completion of its merger with CTE on September 29, 2012, NEON now serves all of lower Fairfield County. Programming and fundraising are beginning to thrive. All existing Board members have agreed to resign as soon as a new Board is in place.

NEON has restructured its management team and expects to seat a new Board of President/CEOs at the end of February. A training and development plan for the new Board and management is under development focusing on governance responsibilities, and effective cost management of agency programs.

NEON will continue to work with state officials to utilize technical assistance from Connecticut, regional and national sources for technical assistance (Community (e.g. Connecticut Association for Community Action, New England Institute for Quality Community Action, CAPLAW, Brown Buckley and Tucker).

It is not reasonable to hold the State (or NEON) solely responsible for the actions of specific, identifiable individuals who are directly responsible for wrongdoing. NEON's critical role in the low-income community is being crippled by more than \$700,000 (Head Start and CSBG) in recommended disallowances due directly to the negligence and ineffective oversight of its former executives.

Recommendation #2: (regarding NEON's policies, procedures and related internal controls):

We have taken immediate, significant action to address each of the concerns raised by OIG audits (Head Start and CSBG/ARRA).

NEON management will continue to work to implement and document important changes in agency operations and accountability. We welcome the DSS continued guidance and assistance as we move to recover dollars that were misdirected, inappropriately accounted for or not used in the best interest of the vulnerable people our staff works so hard to serve.

APPENDIX B: STATE AGENCY COMMENTS

Page 1 of 3



STATE OF CONNECTICUT
DEPARTMENT OF SOCIAL SERVICES
OFFICE OF THE COMMISSIONER

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Commissioner

March 15, 2013

Michael J. Armstrong
Regional Inspector General for Audit Services
U.S. Department of Health and Human Services
Government Center – Room 2425
John F. Kennedy Building
Boston, MA 02203

Re: OIG Audit performed on Norwalk Economic Opportunity Now, Inc.
Report Number A-01-11-02510

Dear Mr. Armstrong,

The State of Connecticut Department of Social Services (DSS) has reviewed the draft report issued by the Department of Health and Human Services (DHHS) Office of Inspector General (OIG) Audit Number A-01-11-02510. The audit objective was to determine the allowability under the terms of the grants and applicable Federal requirements of selected Community Services Block Grants (CSBG) and CSBG Recovery Act costs that the State Department of Social Services claimed on behalf of Norwalk Economic Opportunity Now, Inc. (NEON). Provided below is our written comments for each recommendation.

OIG Recommendation:

We recommend that the State agency return to the Federal Government unallowable costs, totaling \$314,605 that it claimed on behalf of NEON.

State of Connecticut Department of Social Services comments:

The state concurs with the recommendation in that all unallowable expenditures incurred under the CSBG should be returned to the Federal government. The department will require NEON to reimburse any unallowable costs charged to the CSBG and CSBG-ARRA programs. Repayment discussions have already begun. The Department of Social Services legal counsel will review whether any legal action may be warranted based on the findings in the OIG audit report.

Mr. Michael J. Armstrong
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OIG Recommendation:

We recommend that the State agency ensure that NEON establishes and implements policies, procedures, and related internal controls to:

- comply with all Federal grant requirements,
- ensure that it charges only allowable costs to the CSBG program, and
- ensure that it follows generally accepted, sound business practices.

State of Connecticut Department of Social Services comments:

The state concurs with the recommendation that procedures need to be established and implemented. The department has reviewed NEON's response to the audit concerning NEON's new procedures that have been developed. The department believes that these new procedures will reduce the risk of noncompliance with Federal grant requirements.

The department contracted with a consultant in calendar 2012 to assist all community action agencies in establishing adequate internal controls. As part of this contract, the consultant is reviewing practices of community action agencies and making recommendations for improvement.

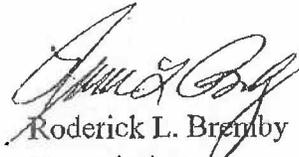
To further ensure adequate controls are in place for all Connecticut's community action agencies, the department has taken additional steps to ensure that the goals of federal and state grants provided to community action agencies are met, as well as ensuring that the agencies are complying with applicable federal and state requirement as follows:

- The Department is in the process of developing a new unit, the Office of Community Services, that will be dedicated to working closely with community, state, and federal partners to administer programs designed to ameliorate the causes and characteristics of poverty or otherwise assist persons in need. The goal of this move is to devote focused expertise to these important programs.
- A new role within the Office of Quality Assurance-Audit Division is being developed to improve the Department's oversight and monitoring of DSS-funded contractors including community action agencies. The Audit Division, in coordination with the various program divisions, will be responsible for fiscal and compliance monitoring of the agencies to ensure that Federal and State awards are expended in compliance with laws, regulations, and the provisions of contracts or grant agreements and that performance goals are achieved. In addition, this monitoring will also include the review of internal controls of the financial management and accounting systems and recommend improvements, as needed, to account for program funds in accordance with state, federal or other program requirements.

Mr. Michael J. Armstrong
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The Department of Social Services appreciates the opportunity to provide comments in response to the OIG audit findings. The department looks forward to improving its effectiveness as a partner in the administration of CSBG funds on behalf of the individuals and families in the State of Connecticut receiving critical services provided by the state's network of community action agencies.

Sincerely,



Roderick L. Bremby
Commissioner

- c: Claudette Beaulieu, Deputy Commissioner
- Astread Ferron-Poole, Chief of Staff
- John McCormick, Director of Quality Assurance
- Frank LaRosa, Director of Internal Audits