# Office of the State Inspector General

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## Fraudulent Activity at a Non-Profit Organization Involving State Funds & Lessons Learned to Improve Statewide Contract and Grant Monitoring

Case #2012-237 I

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## I. Executive Summary

The State Inspector General (SIG) initiated its investigation based on a credible complaint of wrongdoing at the South Carolina Autism Society, Inc. (Society) pertaining to fraud, misuse, or diversion of state funds. The Society is a South Carolina chartered, non-profit organization that receives a substantial amount of its funding from various state agencies. The allegations consisted of a fraud committed by a former bookkeeper and false grant expense reports submitted by the Society and reimbursed by multiple South Carolina state agencies.

The former bookkeeper admitted to stealing $5,771.02 by improperly using the Society's business credit card for personal benefit. The former bookkeeper also confirmed submitting false grant reimbursement requests to two state agencies at the direction of the Society's president.

In fiscal year (FY) 2012, $978,000 (86%) of the Society's total revenue of $1,141,000 was funded by state agencies, with the balance of funding from donations and other non-state grants (14%). During fiscal years 2010, 2011, and 2012, the Society had five revenue streams from three state agencies totaling $2,998,193. The two grant funding streams from two different agencies totaled $512,017, which contained $188,819 (36%) in false reimbursement expense requests when compared to Society's books and records. The Society had a $1,067,500 revenue stream through legislative provisos for the Parent School Partnership Program administered through a state agency, which contained $273,241 (25%) in unaccounted for funds unsupported by the Society's books and records. These three funding streams' unaccounted for funds totaled $462,060.

Based on a cash flow analysis of the Society for the three FYs under review, the unaccounted for funds likely were expensed through other Society expense accounts. In the best possible light, the unaccounted for funds were diverted to other Society functions to support its autism mission. For example, the two other revenue streams from the state had expenses exceeding revenue by $385,392, likely due to the Society maintaining these operations despite decreasing state funding for these functions.

Given the collusion between the Society president and its bookkeeper in making up accounting numbers and records, a systemically weak accounting system, and many unusual and unexplainable transactions, the risk of unaccounted for funds being expensed through the Society's accounting system and then converted to personal benefit was high. The SIG also noted an unusually high salary ($110,000) for the president and what appeared to be excessive purchases of technology equipment. Given the requirement for grants, as well as basic organizational accountability, the SIG takes the position the Society should reimburse the state $188,819 in unaccounted for grant funds or obtain documentation from the Society's forensic accountant attempting to mitigate these unaccounted for funds with additional actual expense documentation. Inasmuch as the legislative provisos were devoid of any specific measurable objectives and accountability mechanisms, resolving the Society's liability to the state for the $273,241 in unaccounted for proviso funds is less clear. This provides the clear lesson that the lack of clarity in mission, objectives, and accountability metrics not only increases the likelihood of poor performance, but also creates obstacles, in terms of time and money, in unwinding a problem situation.

This investigation has a lesson for every agency in state government. Virtually every agency accomplishes its mission through third parties using contracts or grants, which require contract monitoring skills to effectively manage, as well as provide basic accountability to taxpayers. Ample organizational research identifies contract/grant monitoring as a high risk area for waste in government. Contract/grant monitoring is simply defined as having a plan, and then working the plan. The monitoring plan provides reasonable assurance the state is getting the results set forth in the contract or grant. The plan can be simple or complex depending on the complexity of the contract/grant, its value, and the risk of poor performance. Contract/grant monitoring prevents poor performance, but also serves as a deterrent to more egregious conduct, such as fraud and diversion of funds.

The review of the contract and grant monitoring plans for the five Society revenue streams from the State identified the good, the adequate, less than adequate, and the bad. One agency's contract service coordination function had no issues or unaccounted for funds, and it was not a coincidence this agency had a robust contract monitoring plan. The two agencies with grants both suffered unaccounted for funds. However, the agency with an adequate grant monitoring process had substantially lower unaccounted for funds (25%) than the agency with a less than adequate grant monitoring process (60%). The largest dollar figure in unaccounted for funds pertained to the provisos ($273,241), which had a broad, general mission without measurable objectives and no monitoring plan and a complete absence of any form of oversight and accountability to the taxpayers.

Review of the State Budget Control Board (BCB) guidelines determined the state does not have any central guidance or standards for agency contract or grant monitoring. A cursory review of grants from state agencies determined those grants provided from federal funds tended to have mandated federal grant monitoring protocols, while state funded grants' monitoring mechanisms varied greatly. Absence of a central standard leads to varying levels of quality among agencies in their respective programs, often following a traditional "bell curve." This investigation should stimulate every agency to examine its contract and grant monitoring programs, policies, procedures, and training to add both effectiveness to operations, as well as accountability to taxpayers.

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## II. Background

### A. Objectives

The State Inspector General (SIG) initiated its investigation based on a credible complaint of wrongdoing at the South Carolina Autism Society, Inc. (Society) pertaining to fraud, misuse, or diversion of state funds. The Society is a South Carolina chartered, non-profit organization that receives a substantial amount of its funding from various state agencies. The allegations consisted of a fraud committed by a former bookkeeper and false grant expense reports submitted by the Society and reimbursed by multiple South Carolina state government agencies. The SIG used this investigation secondarily to evaluate the involved state agencies' contract and grant monitoring programs for lessons learned to benefit those agencies and state government as a whole.

### B. South Carolina Autism Society, Inc.

The Society was founded by parents of children with autism seeking information and support in raising their children. The Society currently has approximately 30 employees located around the state and offers several programs including family support, advocacy, information, referral, and service coordination. The Society assists children in achieving their maximum potential and provides mentors who collaborate both with parents and school personnel in the development of individual education plans.

The Society receives most of its funding from state agencies. In FY 2012, $978,000 (86%) of its total revenue of $1,141,000 was provided by state agencies. The balance of funding came from donations and other non-state grants (14%). During FYs 2010, 2011, and 2012, the Society had five revenue streams from three state agencies as follows:

- Department of Disabilities and Special Needs (DDSN) - Society provided service coordination (45% of total state funds provided);
- DDSN - Society provided information and referral services (2%);
- Developmental Disabilities Council (DDC) - Grant funded projects (11%);
- Department of Education (DOE) - Grant funded projects (6%); and
- DOE via legislative proviso – Parent School Partnership Program (36%).

## III. Allegations

### A. Credit Card Fraud

The initial interview of the Society president confirmed the former bookkeeper had used the Society's credit card to pay personal expenses. The president stated he discovered the misuse in September, 2012, approached the bookkeeper, and then terminated her employment. He also stated she reimbursed the Society approximately $3,000 for her personal charges. When questioned about the time period of the credit card misuse, the president initially stated it took place over several months just prior to its discovery. Later in the interview he stated the time period may have been longer, but all had occurred in calendar year 2012. He offered to provide a copy of the accounting used to determine the reimbursement amount.

The former bookkeeper was interviewed and she admitted having used the credit card for personal purchases. She stressed the activity took place only during 2012 and she had paid back all personal charges.

The following week the president provided a new accounting of the credit card misuse which covered all of calendar years 2011 and 2012 and totaled $5,771.02. The president stated he had contacted the former bookkeeper and she had agreed to repay the additional amount. The president voluntarily allowed the SIG access to the Society's books and records to fully assess the allegation, corroborate the admissions, and determine its impact on state funds managed by the Society.

The Society's credit card statements for the past four years were analyzed. The SIG determined the president's revised accounting ($5,771.02) agreed approximately with the SIG's analysis for calendar years 2011 and 2012, which was repaid by the former bookkeeper. However, the SIG found obvious personal charges by the bookkeeper as far back as 2009. In a subsequent interview the former bookkeeper admitted personal use prior to 2011 and claimed that she had also reimbursed that amount. However, due to the untimely death of the president, the extent of any repayment prior to the 2011 – 2012 time period could not be conclusively determined.

In reviewing the accounting transactions associated with the former bookkeeper's personal charges and the reimbursement of those charges, it appeared that none of the transactions were recorded as grant expenses or charged to programs funded by the state. The charges and the reimbursements of those charges were booked to general office expenses.

## B. False Expense Reporting to the State

The former bookkeeper was questioned concerning false grant reimbursement requests being made to state agencies. She confirmed that did occur and stated she was following orders of the president, *"he would tell me what to put on the forms."* She acknowledged that she knew the false reimbursement requests were wrong, but believed that she would lose her job if she questioned the president. She further stated that she needed a job with great flexibility in order to care for her severely autistic son.

The SIG with the assistance of the Society's staff could not locate within the Society's record system copies of the grant reimbursement requests and expense reports for the grants active from 2009 through 2012. The agencies providing grant funds, the DDC and DOE, were contacted and copies of the reports were obtained along with copies of supporting documentation of expenses where documentation was required to be provided. A contractual requirement of accepting the grants mandated that the Society's accounting system segregate the expenses of each grant. The SIG found that the accounting system did segregate some of the grant expenses, but the Society's personnel inadequately operated this system, to include the failure to maintain supporting documentation outside of the accounting system. The SIG compared the grant expenses per the accounting system to the reports of expenses submitted to the state agencies. To enable an accurate comparison, the SIG investigator included facility and equipment overhead costs allowed under the grants but not segregated in the accounting system, and adjusted the expenses in the accounting system from a calendar year basis to a fiscal year basis to coincide with the grant reporting periods. After these adjustments, substantial differences were found with the expense reports showing more expenses than the adjusted accounting system data reflected.

It quickly became clear grant reimbursement expenses had a systemic pattern of not agreeing with the Society's accounting system. The SIG also found the accounting records to be poorly organized with many key documents missing. The collusion between the Society president and its former bookkeeper further increased the risk of fraud, misuse, or diversion of state funds, so the SIG increased its scope to review all five state revenue streams into the Society for the most recently completed FYs of 2010, 2011, and 2012. Troubling too were reports the President reluctantly fired the former bookkeeper only due to her fraud being known by fellow employees, and subsequent to her dismissal, the president shredded a large volume of documents, which was an unusual activity for him.

The table below compares state funds provided in each of the five state revenue streams with expenses from the accounting system as follows:

SUMMARY-State Funding Provided Compared to Society Records
For FYs 2010, 2011, and 2012

| | Funding Agency | State Funding Provided* | Expenses per Autism Society Records | Differences |
|---|---|---|---|---|
| Grant Funded Projects | DDC* | $ 338,362 | $ 254,052 | $ 84,310 |
| Grant Funded Projects | DOE | 173,655 | 69,146 | 104,509 |
| Parent School Partnership (by Proviso) | DOE | 1,067,500 | 794,259 | 273,241 |
| Subtotal | | 1,579,517 | 1,117,457 | 462,060 |
| | | | | |
| Service Coordination Function | DDSN | 1,363,768 | 1,630,397 | (266,629) |
| Information & Referral Services | DDSN | 54,908 | 173,671 | (118,763) |
| | | | | |
| TOTALS | | 2,998,193 | 2,921,525 | 76,668 |

*NOTE: The "State Funding Provided" amount shown for the DDC grants ($338,362) is the total reported grant expenses and includes both the state portions and the matching Autism Society portions of the grants. The DOE grants did not require an Autism match.

Throughout this investigation, the SIG observed significant disparity among the various state agencies in oversight of the state funds provided to this outside organization. This expected function in every agency is called either contract monitoring or grant monitoring, depending on the mechanism the agency used to provide the third party funds to execute a task.

The four grants provided by DOE included total reported expenses of $173,655 (all state portion, no match) compared to total expenses from the accounting system of $69,146, which results in a difference of $104,509 representing 60% unaccounted for funds. DOE did require performance reports. However, reimbursements did not require underlying source documents; just an expense description and an amount. The DOE did not have a systematic, risk based audit plan for grants.

The reported $338,362 total expenses for the ten grants provided by the DDC (comprised of both the state portions and the Society's matching portions) was compared to the total expenses from the accounting data of $254,052, which resulted in a difference of $84,310 representing 25% unaccounted for funds. The DDC required documentation, both financial and performance. Expense reports had to be accompanied by documentation to be reimbursed, and performance was evaluated by a committee. The DDC did not have a systematic, risk based audit plan for grants.

The Parent School Partnership Program funding ($1,067,500) administered by DOE from the legislative provisos did not provide any specific requirements for the services to be performed, other than to state the name of the service program, nor did it require any state agency oversight or subsequent reporting by the Society on its expenses or accomplishments. $273,241 of these proviso funds were not accounted for representing 25% of total funding.

The service coordination function ($1,363,768) appeared to be well managed by DDSN in that the Society first had to qualify as a contract provider. DDSN then makes the eligibility determinations for the service recipients, and the case is referred to the Society. The Society is required to document all services provided in a DDSN operated Internet-based system, and DDSN contracts with a third party to evaluate the Society's performance. There were no funds (0%) unaccounted for in this program.

The DDSN Informational and Referral Service grant ($54,908) did not require any performance reporting or expense accounting. Funds were provided for a general purpose without further grant monitoring. There were no funds (0%) unaccounted for in this program.

The DDC grants, DOE grants, and the DOE administered legislative provisos had a total of $462,060 in unaccounted for funds. Where did these funds go? The SIG conducted a cash flow analysis of the Society for FYs 2010-2012, and determined expenses nearly equaled revenues which gives the appearance the unaccounted for funds were likely expensed through other Society expense accounts. In the best possible light, the unaccounted for funds were diverted to other Society functions to support its autism mission. For example, both DDSN functions' expenses exceeded their revenue by $385,392. DDSN had been cutting its reimbursement rates over the recent past, but the Society maintained its full operational footprint resulting in deficit spending in the program, likely supported from those programs with the unaccounted for funds.

Given the collusion between the Society president and its former bookkeeper in making up accounting numbers and records, a systemically weak accounting system, and many unusual and unexplained transactions, the risk of unaccounted for funds being expensed through the Society's accounting system and then converted to personal benefit was high. The SIG also noted an unusually high salary ($110,000) for the president and what appeared to be excessive purchases of technology equipment.

The SIG found the accounting records to be poorly organized with many key documents missing. Given the strict accounting system and expense documentation requirement for grants, as well as basic organizational accountability, the SIG takes the position the Society should reimburse the state $188,819 in unaccounted for grant funds or obtain documentation from the Society's forensic accountant attempting to mitigate the unaccounted for funds with additional actual expense documentation. Inasmuch as the legislative provisos were devoid of any specific measurable objectives and accountability mechanisms, resolving the Society's liability to the state for the $273,241 in unaccounted for proviso funds is less clear. This provides the clear lesson that the lack of clarity in mission, objectives, and accountability metrics not only increases the likelihood of poor performance, but also creates obstacles, in terms of time and money and unwinding a problem situation.

## IV. Conclusion

The results of this investigation provide a lesson for every agency in state government. Virtually every agency accomplishes its mission through third parties by the use of contracts or grants, which require agency monitoring skills to effectively manage, as well as provide basic accountability to taxpayers. Ample organizational research identifies contract/grant monitoring as a high risk area for waste in government. Contract/grant monitoring is simply defined as having a plan, and then working the plan. The monitoring plan provides reasonable assurance the state is getting the results set forth in the contract or grant. The plan can be simple or complex depending on the complexity of the contract/grant, its value, and the risk of poor performance. Contract/grant monitoring prevents poor performance, but also serves as a deterrent to more egregious conduct, such as fraud and diversion of funds.

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Review of the State Budget and Control Board guidelines determined the state does not have central guidance or standards for agency contract or grant monitoring. A cursory review of grants from state agencies determined those grants supported with federal funds tended to have mandated federal grant monitoring protocols, while state funded grants' monitoring mechanisms varied greatly. Absence of a central standard leads to varying levels of quality among agencies in their respective programs, often following a traditional "bell curve." This investigation should stimulate every agency to examine its contract and grant monitoring programs, policies, procedures, and training to add both effectiveness to operations, as well as accountability to taxpayers.

## V. <u>Findings & Recommendations</u>

**<u>Finding #1</u>:** The Society's former bookkeeper stole $5771.02, proven through admissions and records, by improperly using the Society's business credit card for personal benefit.

**<u>Recommendation #1</u>:** The SIG will coordinate presenting the facts and circumstances to the State Solicitor's Office for a potential prosecution.

**<u>Finding #2</u>:** The Society submitted false grant expense reimbursements reports to DOE and DDC, which resulted in $188,819 in reimbursement requests exceeding the Society's actual expenses according to its accounting records.

**<u>Recommendation #2a</u>:** DOE and DDC should engage the Society to collect all unauthorized reimbursements or obtain documentation from the Society's forensic accountant attempting to mitigate the total unaccounted for funds with additional actual expense documentation.

**<u>Recommendation #2b</u>:** DOE should consider enhancing its grant procedures through obtaining, or at least testing, underlying documentation to support grant expenses.

**<u>Recommendation #2c</u>:** DOE and DDC should develop a risk based audit methodology for grants, or at a minimum test the adequacy of the grantees' accounting system and personnel to accurately segregate grant expenses, particularly overhead cost allocations, which appears to be the highest risk factor and indicator of the a successful grant execution.

**<u>Recommendation #2d</u>:** All state agencies should review their respective contract and grant monitoring programs, policies, procedures, and training so that every contract and grant has an intentional plan, based on complexity, value, and risk, to provide reasonable assurance of successful execution and accountability to the taxpayers.

**<u>Finding #3</u>:** DOE administered legislative proviso funding without adequate monitoring controls to provide reasonable assurance of appropriate use of funds and accountability to taxpayers.

**<u>Recommendation #3a</u>:** All state agencies should be reminded each has an affirmative responsibility to monitor any funding, to include legislative provisos, to third parties to provide reasonable assurance funds are used consistent with legislative intent and accountability to the taxpayers.

**Recommendation #3b:** Provide this report to the State Legislative House and Senate Finance Committees for situational awareness.