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The Honorable Adlai E. Stevenson, III
United States Senate

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Dear Senator Stevenson:

Your letter of January 31, 1973, requested us to audit the financial records of the Ascending Citizen's Development Company (ACDC)--the economic development contractor of the Model Cities Program in East St. Louis, Illinois--and its related corporations and the Model Cities Program in East St. Louis to determine whether the program's resources had been mismanaged, mishandled, or misappropriated. The Department of Housing and Urban Development (HUD) administers the program at the national level.

As agreed with your office on February 1, 1973, we began our work by reviewing the activities of ACDC and its related corporations, the results of which are discussed in this report. We plan to report to you at a later date on our review of the Model Cities Program in East St. Louis.

We are unable to comment on the propriety of ACDC's financial activities because of inadequate documentation and our inability to obtain pertinent records and documents which we requested relative to ACDC's operations. We were not provided enough information to complete our review and render an opinion on ACDC's handling of Federal funds.

We did note, however, that \$100,000 in Model Cities funds advanced to ACDC for the Ascending Citizen's Investment Company (ACIC)--an ACDC corporation--to establish a loan program under the Small Business Administration's (SBA) Minority Enterprise Small Business Investment Program (MESBIC) were not used for that purpose. We could not verify the purposes for which these funds were expended because of the lack of pertinent records.

On September 13, 1973, we discussed this matter with city officials and officials of the City Demonstration Agency (CDA) of East St. Louis which is responsible for the administration of the Model Cities Program.

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City officials said they had authorized an audit of ACDC in January 1973 but had not pursued this action pending the results of our review. CDA officials added that they had contacted HUD officials in Chicago to determine a course of action on the use of the \$100,000 in Model Cities funds but had not received a response.

We also brought this matter to the attention of officials in HUD's Chicago Area Office on September 19, 1973. By letter dated October 30, 1973, the Area Office Director requested the CDA to explain the circumstances surrounding the grant and CDA's position or action to be taken. The Director recommended that should ACDC be unable to provide satisfactory evidence that the \$100,000 was legally used, CDA should have ACDC audited.

Detailed information on activities of ACDC and its related corporations follows.

BACKGROUND

ACDC was incorporated in Illinois as a nonprofit organization on April 25, 1969. It was established as the economic development arm of the East St. Louis Model Cities Program. ACDC personnel were instrumental in establishing the following corporations to aid it in assisting the community's economic development.

- The East St. Louis Ascending Citizen's Development Company (East St. Louis ACDC) was established on August 8, 1969, as a nonprofit corporation to obtain SBA loans. These loans were to be used to purchase or construct facilities which would be leased or sold to businesses.
- Ascending Citizen's Investment Company was established on July 29, 1971, to qualify as a MESBIC. SBA licenses, regulates, and, in part, finances MESBICs and provides loans for small business enterprises of minority groups.
- The Inner-City Business Management Research Computer Corporation was established in January 1971 to provide computerized management services to generate sufficient revenue to pay personnel and overhead costs of the other four corporations.
- The Regional Business Economic Development Council was established on September 27, 1972, as a nonprofit corporation to provide planning, coordination, and direction to the other four corporations.

FEDERAL FUNDING

ACDC and its corporations were awarded about \$761,500 in Federal funds from HUD under the Model Cities Program, from SBA through its loan and grant programs, and from the Department of Labor under its Concentrated Employment Program. In addition, the Economic Development Administration (EDA) of the Department of Commerce as of November 27, 1973, was reviewing an application for \$2,240,000 in Federal funds submitted by the Regional Business Economic Development Council on July 13, 1973.

HUD

CDA provided ACDC \$412,323 of Model Cities funds under two contracts covering October 1970 through September 1972. ACDC was to use these funds on projects to stimulate the development of small businesses, through such means as providing technical assistance, counseling, and venture capital. CDA also provided East St. Louis ACDC with \$50,000 under a contract covering October 1969 through July 1970 for providing financial and technical assistance to minority businesses.

SBA

In June 1972 SBA awarded a \$75,000 grant to ACDC to expand its small business development activities during July 1972 through June 1973. In November 1972 SBA approved a \$76,500 loan to East St. Louis ACDC to purchase a building to be leased to a minority businessman. Although ACIC was licensed by SBA in January 1973 as a MESBIC, no loans were made under the MESBIC program, and ACIC did not receive any funds from SBA. In October 1973, SBA withdrew ACIC's license because it failed to comply with certain legal requirements. (See p. 6).

Department of Labor

The Inner-City Business Management Research Computer Corporation contracted with the Illinois Bureau of Employment Security to provide typist, data controller, and keypunch training under the Department of Labor's Concentrated Employment Program. Two contracts, for September 1970 through May 1972, were awarded to the corporation with Federal funds amounting to \$147,680.

EDA

The Regional Business Economic Development Council applied to EDA on July 13, 1973, for a grant to develop an industrial park in the East St. Louis area. The application stated the project would cost about \$3.2 million--\$2,240,000 from EDA and \$960,000 from local sources. On

October 24, 1973, an EDA official in Chicago said EDA headquarters had not approved the application and had returned it to his office for resolution of certain legal and certification matters. On November 27, 1973, an EDA regional official said the application would not be approved until certain problems dealing with the ownership of the water system for the industrial park were resolved.

We informed EDA officials of the accounting deficiencies we had noted. They said that, in accordance with EDA's normal operating procedures, if the grant to the Regional Business Economic Development Council is approved, they will require the establishment of an adequate recordkeeping system to facilitate audits and to insure proper expenditure of Federal funds.

PRIOR REVIEWS OF ACDC OPERATIONS

Two certified public accounting (CPA) firms and SBA had reviewed ACDC operations.

A CPA audit report dated July 15, 1972, covering October 1, 1970, to September 30, 1971, stated:

"No provision has been made in the accounts for possible losses on client loans and certificates of deposit assigned as collateral for clients' indebtedness to third parties. We could not determine a reasonable amount for reserves from the information available, because the response to our request for positive confirmation of client loans was inadequate to support an opinion on their accuracy.

"Because of the significance of the matters referred to in the preceding paragraph, we are unable to express an opinion on the accompanying financial statements of Ascending Citizen's Development Company taken as a whole."

In August 1972, CDA requested an audit of ACDC which covered October 1, 1971, to September 5, 1972, because numerous errors and insufficient documentation existed throughout all cost control reports that ACDC provided to CDA. On August 31, 1972, CDA officials advised ACDC that they would not provide any additional Federal funds to ACDC until CDA reporting requirements were met.

The CPA report, dated September 8, 1972, presented the following information:

"In our opinion, the Project's system of internal control is inadequate to administer the program because of the following material weaknesses* * *. Costs charged to capital acquisitions are questioned because repayments of loans charged to this account totalling approximately \$9,400.00 were not deposited to the credit of this project but were directed elsewhere. In addition, a transfer of \$110,000.00 has been made from the project to another bank account under the control of the Project. At the time this transfer was made, it was reported as a cost of the Project. This is in violation of generally accepted accounting principles. * * * Payroll taxes have not been remitted to the appropriate governmental agencies on a timely and accurate basis. The Project commingles funds in violation of Model City Administrative directives.

"Subject to the above exceptions, we are unable to express an opinion as to the fairness of the financial position of the Small Business Development Association, Project 97-56-559, as of September 5, 1972, or the results of its operations or the eligibility of its cost for the period October 1, 1971, through September 5, 1972."

On May 18, 1973, as agreed with your office, we met with SBA officials and advised them that preliminary information obtained at ACDC showed that \$100,000 of Model Cities funds had been used to meet SBA's capitalization requirements of \$150,000 for obtaining a MESBIC license. In August 1971, ACIC applied to SBA for a MESBIC license. In a letter dated January 10, 1972, an East St. Louis bank advised the Associate Administrator for Investment, SBA, that \$150,000 in unencumbered funds were on deposit in ACIC's MESBIC bank account. We advised SBA officials, however, that only \$45,000 of the total reported capitalization was in the MESBIC bank account in March 1973. SBA officials said the \$150,000 should have been on hand when the license was issued and advised us that they would review this matter. SBA's audit report^{1/} dated August 1973 contained the following information.

"At the time of licensing, January 31, 1973, the company did not have the minimum (\$150,000.00) required paid-in-capital and paid-in-surplus.

^{1/} SBA furnished us a copy of the audit report with an understanding that the information in it would be used for Government purposes only and the disclosure of that information may be prohibited by the United States Code (18 U.S.C. 1905).

"On January 31, 1973, the licensee had on deposit in its name \$45,000.00 * * * which was encumbered to the extent of \$40,000.00. As of June 15, 1973, the bank balance and encumbrance remained unchanged.

"* * *Therefore, the unencumbered \$5,000.00 on deposit * * * is the most that the licensee had on January 31, 1973, and since that date."

On the basis of its August 1973 investigation, SBA, in a letter dated October 9, 1973, requested ACIC to surrender its MESBIC license. SBA also instructed ACIC to take immediate steps to dissolve the corporation and furnish them with evidence of such dissolution within 60 days. On October 26, 1973, an SBA official advised us that SBA received ACIC's MESBIC license on October 25, 1973.

LACK OF ADEQUATE DOCUMENTATION

ACDC provided us with (1) bank statements and canceled checks for designated Model Cities bank accounts through July 1972, (2) a general ledger-type document covering the first action year, (3) files containing loan applications and approvals, and (4) various information relating to ACDC corporate purposes and functions. While reviewing and analyzing this data, we made several requests for and provided ACDC officials with a listing of the following data which was essential to complete our review but which was not made available.

- General ledger, cash receipts register, cash disbursement register, and journal vouchers, as required by the contracts with the CDA, for the second and third years of the Model Cities Program.
- A listing of current officers, directors, and employees for each company or corporation; financial statements; and annual reports.
- Bank statements and canceled checks for several bank accounts to which funds were transferred and a listing of all other bank accounts and the primary purpose of each.

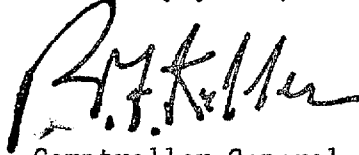
On September 21, 1973, after several additional attempts to get this information, we discussed with the Executive Director of ACDC the results of our work. We again advised him that the data furnished to us was not sufficient to enable us to evaluate ACDC's handling of Federal funds. He stated that he would provide us with written comments on these matters; however, as of December 18, 1973, we had not received them.

To expedite the issuance of this report, your office requested that we not give HUD, the city of East St. Louis, or ACDC officials an opportunity to formally review and comment on the matters discussed in this report. However, we have discussed these matters with officials of these organizations and included their comments where appropriate.

As previously indicated, we brought the use of Model Cities funds advanced to ACDC to establish a MESBIC loan program to the attention of HUD's Chicago Area Office, which is inquiring into the matter. Therefore, we plan no further action at this time.

As agreed with your office, we are sending copies of this report to Congressman Melvin Price, the Secretary of Housing and Urban Development, and the Secretary of Commerce; however, we do not plan to distribute this report further unless you agree or publicly announce its contents.

Sincerely yours,



Comptroller General

Deputy of the United States