

August 12, 2002

Ms. Marsha Johnson Evans
President and Chief Executive Officer
American Red Cross
430 Seventeenth Street, NW
Washington, D.C., 20006

Dear Ms. Evans:

I write to express concern about several issues raised in the American National Red Cross' (Red Cross) response dated June 14, 2002, to my letter dated May 7, 2002. As Ranking Member of the Senate Committee on Finance (Committee), I initially wrote to Harold Decker, Red Cross Interim Chief Executive Officer, to better understand Red Cross' strategy and procedure to deliver disaster relief, particularly 9-11 monetary relief, judiciously and with due speed to qualified recipients. I also sought information about your organization's transparency in terms of its financial reporting requirements for its national headquarters (National), 1,007 chapters, and four Regional Offices that oversee chapter compliance.

The Red Cross' written response and its senior officials' statements made during a recent meeting with me conveyed an image of financial accountability at all organization levels. However, information that I have received from independent sources reveals significant problems for the Red Cross in that: (1) several important chapters have a history of financial mismanagement; (2) the Red Cross knew of these problems before and after 9-11; and (3) the Red Cross failed to implement reforms that would guarantee that the chapters account for their finances. Unless and until the Red Cross guarantees chapter accountability, it will continue to experience financial irregularities that may lessen its credibility with the donating public.

The documents that I will reference in this letter highlight problems at the chapter level on a systemic basis. The time frame referenced in these documents begins April 3, 2001, to September 27, 2001. They are:

A letter written by former Red Cross President and Chief Executive Officer, Dr. Bernadine Healy, to the Audit Committee Chairman dated April 3, 2001, that discusses the need for institutional reform to ensure greater chapter accountability in the wake of New Jersey chapter officials embezzling \$1 million.

An August 2001 internal document prepared at Dr. Healy's request, entitled "Emerging Trends in the FY 2001 Operations of Chapters," that summarizes findings based on 80 chapter audits and reveals serious financial problems.

A confidential memorandum by Dr. Healy to the Red Cross' General Counsel dated April 16, 2001, that chastises the Red Cross' Executive Committee for turning the other cheek to chapter mismanagement and misuse of funds.

A memorandum by the Red Cross' outside auditor, KPMG, to Dr. Healy dated September 27, 2001, that reports the results of its "surprise" audit of 27 Red Cross chapters to include findings that chapters mishandled donations received in response to the 9-11 terrorist attacks.

Although I generally prefer to paraphrase documents in written correspondence, those that I reference herein merit reproduction.

First, Dr. Healy's letter to the Audit Committee Chairman references the embezzlement of \$1 million by Hudson County, New Jersey, chapter officials. She states that information about this crime "demonstrates that many of the controls presumed by you and senior management to be in place are not there." In discussing this chapter, which National re-charted during the period of embezzlement, Dr. Healy raises the need for institutional reform:

"Compensation information from chapters is voluntarily reported to headquarters. Headquarters does not have direct access to a complete record of this information. Therefore, we cannot assure the accuracy of the form 990 (annual Return of Organization Exempt From Income Tax) provided to the Internal Revenue Service. Furthermore, based on a recent meeting of the compensation subcommittee, we are not adequately addressing our exposure under the Taxpayer Bill of Rights legislation as we do not always know the compensation levels of our chapter employees or how it compares to the market.

We do not routinely monitor government grant compliance nor do we sign off on institutional assurances for chapter submission for Federal money.

The external auditor engaged by the Corporation (KPMG) has not been overseeing the process of auditing chapters, the Headquarters review of the chapter external audit reports, or the periodic chapter audits done by our own internal audit team. Moreover, the KPMG reviews of our form 990 filings are inadequate. This appears to be a major business and legal risk, and would impact many of KPMG's certifications. On this issue, chapter boards engage external auditors at the local level and Headquarters does not have assurance that these audits are performed adequately. Most 'reporting' is voluntary.

Other issues that have been festering and are widely known include the lack of accountability of chapters for annual performance; a reluctance of Headquarters to exercise hiring and firing authority over chapter executives; and a tendency of Headquarters to relegate its authority to an advisory role as it relates to chapters. We have limited organization-wide systems to ensure compliance."
(Emphasis added.)

The August 2001 internal document prepared at Dr. Healy's request, entitled "Emerging Trends in the FY 2001 Operations of Chapters," details findings based on 80 audits at Red Cross chapters nationwide to reveal serious financial mismanagement. These trends range from inadequately overseeing accountings to inaccurately informing the public about financial and service delivery operations (each classified in the document as a "Critical Issue"). For example:

"National disaster contributions are not remitted to national headquarters or are not remitted timely (classified as a 'Critical Issue')."

"Bank reconciliations are not completed, or not completed timely, reviewed, or tested by someone with no cash-related responsibilities and/or signed and dated by the reviewer (classified as a 'Major Issue')."

"Endowment moneys are not appropriately maintained (e.g., maintained locally) (classified as a 'Critical Issue')."

"Investments (e.g., stocks, corporate bonds, and collateralized mortgage obligations) are not in compliance with corporate policy (classified as a 'Critical Issue')."

"Financial reports to the board are not prepared or reviewed regularly and/or do not contain adequate information (e.g., comparison to the budget, a balance sheet, or year-to-date figures) and/or are not accurate (classified as a 'Critical Issue')."

Although I request information and documents from the Red Cross at the end of this letter, here I ask that you explain what steps the Red Cross has taken or intends to take to remedy each of these problems. If none, explain why not.

Presently, Red Cross does not require all chapters to report financial information to National. Red Cross states in response to my May 2002 letter, Question #27, "To ensure accountability, more than 70 percent of the total assets and revenues of our chapters are reviewed by national headquarters." 1(See also Red Cross response to Question #29.) Please explain why the Red Cross does not require all chapters to report financial information to National. Also, identify the approximate 30% of chapter revenue and assets that National does not review, and state their monetary value. Further, state whether and how this Red Cross review policy guarantees that chapters safeguard and account for all funds; minimizes theft or fraud particularly relating to those assets and revenues that are not reviewed; and guarantees that all government filings are complete and accurate.

Next, Dr. Healy's confidential memorandum to Red Cross' General Counsel regarding the April 2001 Executive Committee Meeting chastises the Committee's apparent indifference to the \$1 million embezzlement. Dr. Healy writes:

"I am concerned that the discussions by the Executive Committee did not reflect an appropriate sense of outrage regarding the offenses committed by the Hudson County Chapter Executive against the community he was to be serving or against the American Red Cross. I believe there was little if any sense of urgency regarding evaluating other chapters where there may be problems, nor enthusiasm or support of management for designing more effective control mechanisms and compliance systems. To the contrary, there were statements that the Board had dealt with this in the past by firing a few executives and boards and the situation was not unusual as isolated events and we

should not overreact... The statement that touching the chapters was like touching the 'third rail,' was a Board warning to management about addressing system-wide issues, but less clear was their support for such actions.

It would seem to me that we need to get solid Board support behind the corrective action plan we have laid out or it will be ineffective and unenforceable. Moreover, without strong Board support, increased management oversight by National will only become a source of strife and division within an organizational culture that is already divided." (Emphasis added.)

Further, I was surprised by findings relating to a "surprise" audit of 27 Red Cross chapters that KPMG performed on September 18, 2001. In a memorandum to Dr. Healy and other high-ranking Red Cross officials including its Chief Financial Operator, Jack Campbell, KPMG identified problems at the chapters relating to how they processed and allocated donations received since 9-11. KPMG's findings range from chapters mishandling "9-11" donations by keeping the money instead of transmitting the funds to the Liberty Disaster Relief Fund (Liberty Fund), to failing to follow national accounting procedures. For example:

Alexandria, Virginia, "Chapter has not counted lockbox donations since 9/11, but assumes that most will be coded as local funds."

Bergen Crossroads, NJ, "Due to this chapter's location, almost all funds were designated [World Trade Center]. For non-designated funds, coded as local."

Los Angeles, California, "Chapter has no accurate accounting for funds received after 9/11, at least \$500,000 in total."

Montgomery County, MD, "Amount collected prior to 9/11 unknown due to backlog in accounting reconciliations (recent transition in accounting department)."

Pine Tree, ME, "Cash/checks unlocked at all times."

Savannah, GA, "Chapter could not provide information regarding cash/checks collected."

Taken as a whole, these documents reveal a history of serious financial mismanagement by Red Cross chapters that I find troubling. However, I am more concerned that Red Cross senior management appears to take an attitude that bad news from local chapters is all best swept under the rug. The Red Cross' indifference to these major accountability problems was verbalized by Mr. Campbell during a CBS Evening News interview broadcast on July 30, 2002:

CBS News Correspondent Sharyl Attkisson: "Weren't you troubled by the results of the audits?"

Campbell: "Actually, we were not troubled by the results of the audits at all. There was no recognition of any kind of problem."

Please explain this response in detail, particularly Mr. Campbell's apparent lack of concern that hundreds of thousands of dollars were at risk of not going to the 9-11 victims' fund or, worse, of loss or theft. Also, explain why these infractions occurred despite Red Cross' prior knowledge of accounting irregularities at the chapter level. Did any infraction that KPMG identified occur at a chapter with a prior financial problem known by Red Cross? If so, identify that chapter and explain Red Cross' failure to take remedial measures. Moreover, identify any remedial measure taken in response to KPMG's September 27 findings. Further, please produce all documents relating to these findings as well as any remedial measure.

Importantly, KPMG's findings call into question several Red Cross statements that all of the funds received in response to the 9-11 attacks were deposited in the Liberty Fund,² and that the Red Cross had and would continue to use the Liberty Fund for the 9-11 victims.³ These findings also cast serious doubt that, "The Red Cross has instituted unprecedented financial procedures and controls to ensure the highest level of accountability and accuracy in its accounting for contributions to and disbursements from the Liberty Disaster Relief Fund." (Red Cross response to Question #4.) Please explain these apparent inconsistencies.

In summary, the information that I received independent of the Red Cross leads me to conclude that the rosy picture the Red Cross sought to present does not match the reality presented in these documents. To get to the bottom of whether Red Cross has secured all 9-11 donations in the Liberty Fund for the exclusive use of the victims and holds its chapters accountable, please provide detailed responses to the following questions:

I have received information that at least one chapter has not yet turned over all donations meant for the Liberty Fund. Identify that chapter and any others that have not turned over these donations, explain why not, and identify any penalty imposed against that chapter.

For the past three years, identify any chapter that failed to provide any required financial information to any Red Cross governing body (i.e., National) in full or on time.

Red Cross' answer to Question #29 is unclear as to whether there are guidelines for uniform record keeping and financial reporting by the regions and chapters ("In regard to uniform record keeping and reporting, chapters use standard charts of accounts for accounting purposes.") Please clarify this response including what is meant by "standard charts of accounts."

For the past three years, identify any investigation involving allegations of mismanagement or fraud by any Red Cross officer, director, employee or volunteer. Also, state the status of the investigation and whether any settlement or penalty resulted, and identify the settlement amount or penalty.

For the past three years, identify all Red Cross officials who have left their positions under circumstances involving allegations of mismanagement or fraud.

State whether any internal disciplinary proceeding was conducted or whether any lawsuit or charge was filed against the individual and the status of that action. Also, state whether he or she was allowed to retain benefits or transfer to another chapter and, if so, explain why.

Identify and explain the circumstances for the "five involuntarily decharters" referenced in your response to Question #24.

It is my understanding that the Red Cross has a strong policy that the chapters should be financially self-sufficient. The CBS Evening News reported on July 31, 2002, that the Red Cross has allowed chapters to receive money from the National Disaster Fund more than 3,000 times last year. Please list all income to and expenditures from the National Disaster Fund from Fiscal Year 2000 to the present. This list should include but not be limited to all chapter "Form 903" requests as well as chapter accruals and advances. The list should also disclose the purpose of each Form 903 request (i.e., the precise reason why the chapter requested the funds). Also, describe the method by which the Red Cross approves or denies each 903 request as well as the procedures in place to ensure, after it approves the request, that the chapters properly use the "903" funds.

Information that I have received indicates that, contrary to the Red Cross' response to Question #26, the organization may receive more than 5% of its funds from federal, state, and local government sources and that in many chapters this amount frequently exceeds 30-40%. Please clarify your response and identify all chapters at which government funds (federal, state, and/or local) comprise more than 10% of the chapter budget.

Please produce the following documents for the past three-year time frame:

Minutes of the Board of Governors and Executive, Audit, and Finance Committees;

Copies of management letters and audit reports of chapters performed by the internal or external auditor; and

Copies of all reviews or summaries of locally-performed chapter audits by the internal and external auditor.

Has the Red Cross considered strengthening accountability to the Congress and the Executive by adding independent compensation and audit committees as well as active board members who are independent of the chapters?

Thank you for your cooperation. Given the timeliness of this information, I appreciate your providing me with the Red Cross' complete responses by September 6, 2002. Afterwards, I would like to arrange a meeting with John D. Campbell, Red Cross Chief Financial Officer and Senior Vice President, and my Committee staff to discuss proposals for greater chapter accountability.

Again, I thank you for your time and courtesy in responding to these questions. I recognize that I have requested a significant

amount of material, but I know from our meetings that you acknowledge Congress is responsible for conducting oversight of the Red Cross. If you have any questions, please do not hesitate to contact Dean Zerbe or Faith Cristol of my Committee staff at (202)224-5315.

Giving to a charity isn't a frivolous act. People think hard about how much they can afford and where their money will do the most good. Charities should treat them accordingly. I am sure that you will agree that, accountability is critical to any charity's continued operation since it instills public confidence that taxpayer dollars are used wisely. I hope that we can continue to work together to help the Red Cross prioritize accountability to maximize financial relief to those in need.

Sincerely,

Charles E. Grassley
Ranking Member

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