



**APPALACHIAN
REGIONAL
COMMISSION**

*A Proud Past,
A New Vision*

Office of Inspector General

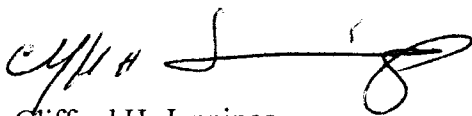
July 12, 2005

Memorandum for: The Federal Co-Chair
ARC Executive Director

Subject: OIG Report 05-17
Review of Revolving Loan Fund (RLF) Grant for the
Georgia Department of Community Affairs

Attached are copies of the subject report dealing with the RLF grant to the Georgia Department of Community Affairs. The Georgia Department of Community Affairs received its initial RLF Grant in 1988. As of December 31, 2004, the Georgia Department of Community Affairs had received \$1,437,176 in ARC grant funds and has 13 loans outstanding, with an unpaid balance totaling approximately \$1.3 million.

The report contains two recommendations. The responses by the grantee and ARC are considered responsive to the recommendations. One response requires follow-up to ensure grantee compliance and the report will remain open until documentation is received documenting compliance.


Clifford H. Jennings
Inspector General

Attachment

cc: Director for Program Operations
Director for Finance and Administration

**APPALACHIAN REGIONAL COMMISSION
OFFICE OF INSPECTOR GENERAL
AUDIT OF REVOLVING LOAN FUND
Georgia Department of Community Affairs**

**Report No. 05-17
June 2005**

**Prepared by
Leon Snead & Company, P.C.**



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June 29, 2005

Inspector General
Appalachian Regional Commission
1666 Connecticut Avenue, N.W.
Washington, DC 20009

Leon Snead & Company, P.C. has completed an audit of the Georgia Department of Community Affairs (DCA) Revolving Loan Fund (RLF). The audit was performed at the request of the Appalachian Regional Commission (ARC), Office of the Inspector General (OIG), to assist in its oversight of ARC operations.

The primary objective of the audit was to ensure that the DCA operated the ARC RLF in accordance with the grant agreement, and its RLF operating plan. The audit covered the period October 1, 2003 through April 29, 2005. Audit work at the grantee's office was completed on April 29, 2005.

The audit determined that DCA: (1) operated the RLF in compliance with ARC regulations and guidelines, the grant agreement, and operating plan; and (2) implemented sufficient internal control policies and procedures to assure semiannual reports to ARC were completed accurately and timely. However, we determined that management actions were needed to ensure: (1) the RLF Operating Plan fully complies with ARC requirements, and includes accurate, up-to-date information; and (2) the ARC grant funding level is maintained at an appropriate level. These areas are discussed in the Findings and Recommendations section of this report.

A draft report was provided to ARC and RLF officials on May 12, 2005. The ARC Director of Finance and Administration concurred with our audit finding, and stated that corrective actions have been taken or planned to address the report recommendations.

Sincerely,

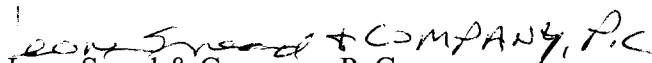

Leon Snead & Company, P. C.

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Introduction

Leon Snead & Company, P.C. has completed an audit of the Revolving Loan Fund (RLF) grant awarded by the Appalachian Regional Commission (ARC) to the Georgia Department of Community Affairs (DCA). The audit was performed at the request of ARC's Office of the Inspector General (OIG) to assist it in carrying out its oversight of ARC grant activities.

The Georgia Department of Community Affairs (DCA) was established in 1977 to serve as an advocate for local governments. Today, DCA is responsible for numerous state and federal grant programs. It also serves as the state's head agency for housing finance and development; promulgates building codes; provides comprehensive planning, technical and research assistance to local governments; and is the lead agency for the state's solid waste reduction efforts.

DCA's mission is to create opportunities to improve the quality of life for Georgia citizens by fostering partnerships within State government, local governments, and the private sector. It is governed by a sixteen member Board of Directors appointed by the Governor. Each of Georgia's eleven congressional districts must be represented by one member and other members are appointed at-large. Day-to-day management is provided by the DCA Commissioner who is appointed by the Board of Community Affairs.

DCA uses ARC loan funds to allow local development authorities to make below market rate loans on a matching basis to qualified businesses. These funds are available for use in 37 northern Georgia counties. DCA received its ARC grant in 1988. As of December 31, 2004, DCA had received \$1,437,176 of ARC funds, and had 13 outstanding loans with unpaid balances totaling approximately \$1.3 million.

A RLF is a business development revolving loan fund that is used by eligible grantees to make loans to create and/or save jobs. As borrowers repay loans, the money is returned to the RLF to make other loans. RLF loans are not intended to match or replace the capacity of lending institutions, rather, RLF's fill gaps in local lending, and provide capital which otherwise would not be available for economic development.

The grantee is required to administer the RLF in accordance with its grant agreement and operating plan. The operating plan, developed by the grantee as part of the grant agreement, defines specific objectives and operating procedures, including standards and selection criteria for loans in the portfolio. ARC does not review and approve individual loans made by the RLF. Instead, ARC monitors RLF activities for conformance with applicable laws, RLF Guidelines, operating plans, and other conditions of the grant agreement.

Objectives, Scope, and Methodology

The audit objectives were to determine if: (1) the grantee complied with applicable laws, OMB Circulars, ARC Guidelines, its grant agreement and operating plan, (2) the grantee's internal control policies and procedures were adequate to assure that RLF transactions are properly recorded, and accurately and timely reported to ARC on its semiannual reports, (3) administrative costs reported on semiannual reports were allowable, supported and reasonable,

and (4) appropriate actions have been taken to resolve or correct deficiencies identified in prior audits and reviews. The audit covered Department's activities during the period October 1, 2003 to April 29, 2005. Audit fieldwork was completed at the DCA office on April 29, 2005.

We reviewed grantee policies and operating procedures to gain an understanding of the grantee's system of administrative and accounting controls. In addition, we assessed the accounting and administrative controls established by DCA to assure RLF operations adhered to applicable ARC Guidelines, OMB regulations, and DCA's grant agreement and operating plan. The audit included tests of DCA's subsidiary and detailed loan records to assure the financial information submitted to ARC was supported. We verified that loans made by the grantee complied with ARC Guidelines and the RLF operating plan. We performed tests of selected administrative costs claimed by DCA to validate that the costs were allowable, reasonable and supported. We also reviewed ARC internal reviews to ensure that corrective actions were taken on any weaknesses identified in the reports.

The audit was performed in accordance with *Government Auditing Standards*, and included appropriate tests necessary to achieve the audit objectives.

Summary of Audit

The audit determined that the DCA: (1) operated the RLF in compliance with ARC regulations and guidelines, the grant agreement, and operating plan; and (2) implemented sufficient internal control policies and procedures to assure semiannual reports to ARC were completed accurately and timely. However, we determined that management actions were needed to ensure: (1) the RLF Operating Plan fully complies with ARC requirements, and includes accurate, up-to-date information; and (2) the ARC grant funding level is maintained at an appropriate level. These areas are discussed in the Findings and Recommendations section of this report.

FINDINGS AND RECOMMENDATIONS

1. RLF Operating Plan

DCA's current RLF Operating Plan did not include a certification or statement of assurance that the RLF will be managed and operated in accordance with ARC requirements. Also, the Plan Operating should be updated to replace information that has become inaccurate over time with current information. Consequently, the Operating Plan did not fully comply with ARC requirements.

ARC RLF Guidelines, Section III.C requires that RLF Operating Plans include an affirmation that the grantee understands and agrees to operate the RLF in accordance with the ARC policies contained in the Guidelines. ARC relies on this affirmation as a basis for releasing grant funds.

DCA's current RLF Operating Plan consisted of two documents, one entitled "ARC Business Development Revolving Loan Fund Plan" and another entitled "Loan Policies." Both documents were dated August 1991. We reviewed the two documents to determine whether they included the requirements specified in the ARC RLF Guidelines. We determined that neither the Loan Fund Plan nor the Loan Policies included assurances or certifications that the RLF will be operated in accordance with ARC policies and procedures.

During our review of the RLF Operating Plan, we also determined that the Plan included some inaccurate, out-of-date information. These inaccuracies were as follows.

-- The Loan Fund Plan identified the Loan Review Committee members, and included information on their commercial loan experience. This information, however, was out-of-date. Only four of the Committee members identified in the Loan Fund Plan were currently members of the Committee.

-- The Loan Policies, Section 6-2 stated that eligible projects were "only projects which are within downtown boundaries or projects outside of downtown boundaries that do not compete with downtown revitalization efforts." This statement was inaccurate. The ARC grant applies to projects for 37 northern Georgia counties.

We discussed these matters with DCA management officials. They agreed that the current Operating Plan did not include the required affirmation, and the information on Loan Review Committee members and eligible projects was out-of-date. They indicated that the Operating Plan would be revised accordingly.

Recommendation

ARC should ensure that DCA's RLF Operating Plan includes: (1) assurances that the RLF will be managed and operated in accordance with the ARC RLF Guidelines; and (2) accurate, up-to-date information on Loan Review Committee members and eligible projects.

Management Response

The Director of Finance and Administration responded that DCA has provided ARC: (1) a signed affirmation that the RLF will be operated in accordance with the ARC RLF Guidelines; and (2) a new RLF Operating Plan that includes a current list of the Loan Review Committee members and their commercial loan experience. The Director further stated that DCA's RLF Operating Plan has been revised to reflect the current lending environment.

Auditor's Comments

ARC's comments are responsive to the finding and recommendations.

2. Grant Funding Level

The ARC grant funding level exceeded DCA's current needs. Consequently, unneeded funds should be deobligated and made available for other ARC projects.

ARC RLF Guidelines, Section VI.D.3 and D.4 states that:

A grantee holding unloaned RLF cash in excess of 25% of the outstanding loan principal or in excess of \$200,000, as reported in the grantee's semiannual financial report, is deemed to be holding excess cash. If after six months, the grantee is still holding excess cash, the excess must be returned to ARC. Also, any grant funds returned to ARC will remain available for reuse by the grantee for 18 months. If the grantee has not reused these funds within 18 months, the funds will be deobligated with the State's concurrence.

Our review of the grant funding level revealed that as of January 2005, ARC Headquarters was holding approximately \$822,000 of DCA loan funds. As shown below, DCA had returned these funds to ARC at various times during the life of the grant, and ARC had been holding some of the funds for several years.

<u>Amount Refunded</u>	<u>Date Returned</u>	<u>Months Held by ARC</u>
\$ 8,877	March 6, 1997	94
4,154	March 3, 1998	82
80,983	February 17, 2000	59
136,806	August 28, 2000	53
75,278	March 6, 2001	46
128,699	June 12, 2002	30
178,594	March 28, 2003	21
143,860	August 25, 2003	17
<u>64,955</u>	March 30, 2004	9
\$828,206		

We also determined that DCA returned an additional \$9,410 to ARC on March 24, 2005, and as of December 31, 2004, DCA had excess cash on-hand totaling approximately \$83,000. ARC authorized DCA to hold the \$83,000 through June 30, 2005 in order to close addition loans. However, if these funds are not required for additional loans or administrative expenses, DCA must make another refund to ARC by August 1, 2005. We also noted that during the last five years, DCA only closed six loans, and no loans were closed during the period of September 7, 2002 through December 2, 2004, i.e. a period of more than two years.

On November 5, 2004, the ARC RLF Manager requested DCA to deobligate \$434,799 of the \$828,206 being held at ARC Headquarters. The ARC RLF Manager stated that ARC has held these funds for many months beyond the 18-month holding period for deobligation. The ARC RLF Manager further stated that, after these funds are deobligated, they would be returned to the Georgia ARC allocation for use in funding other State projects.

As of April 29, 2005, DCA had not responded to ARC's request to deobligate the \$434,799 of excess funds. DCA management officials informed us that a detailed review of this matter had not yet been conducted. They stated, however, that the need to deobligate excess grant funds would be evaluated, and DCA would inform ARC Headquarters of the results of this assessment.

Recommendation

ARC should ensure DCA thoroughly review the current grant funding level to determine the amount of funds needed for RLF loans. All funds in excess of current and anticipated future needs should be deobligated immediately.

Management Response

The Director of Finance and Administration responded that, as of June 16, 2005, DCA had \$533,204 of pending loans, and this amount will exhaust all loanable cash on-hand. The Director further stated that DCA plans to drawdown some of the excess cash currently being held at ARC Headquarters. DCA is also reviewing the current grant funding level, and if this review indicates that the fund is overcapitalized, actions will be taken to deobligate an appropriate amount of funds.

Auditor's Comments

The comments received from ARC are responsive to the finding and recommendation.

APPENDIX A
MANAGEMENT RESPONSE



**APPALACHIAN
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June 20, 2005

Leon Snead, President
Leon Snead & Company, P.C.
416 Hungerford Drive, Suite 400
Rockville, Maryland 20850

Subject: Management Response to ARC Inspector General Audit of the ARC Funded Revolving Loan Fund at the Georgia Department of Community Affairs performed by Leon Snead & Company, P.C.

Dear Mr. Snead:

Thank you for your thorough examination of the Georgia Department of Community Affairs (GDCA) ARC RLF grant contract GA-10091. The assistance provided by this examination will enhance ARC's oversight over the grantee's activities. The following is provided as comment on the draft report.

RLF Operating Plan

The Georgia Department of Community Affairs has provided ARC the affirmation required by paragraph III.C.2., ARC BDRLF Guidelines signed by the GDCA Commissioner.

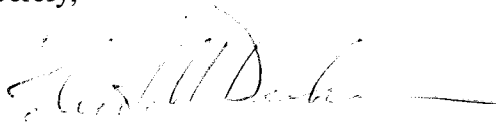
The Georgia Department of Community Affairs has provided ARC with a new operating plan for the Georgia ARC RLF. Appendix A to that plan contains a current list of Loan Review Committee members and their commercial loan experience. Paragraph III.C.1.d., ARC RLF Guidelines is complied with.

The Georgia Department of Community Affairs has rewritten part II section 6-2b. of their operating plan to reflect the current lending environment.

Grant Funding Level

In a letter to the ARC Executive Director, dated June 16, 2005, the GDCA Commissioner has stated that GDCA has \$533,204 in loans pending. This will exhaust all loanable ARC RLF cash on hand at GDCA as reported by the GDCA Finance office. The Commissioner reports that GDCA will draw down some of the \$831,617 currently held at ARC as excess to GDCA lending requirements. The Commissioner further reports that GDCA is reviewing the current grant funding level and target lending levels. If the review indicates the overcapitalization of ARC RLF funds GDCA will move to deobligate an amount yet to be determined. Finally the GDCA Commissioner states that it is their goal to resolve the issue by September 30, 2005.

Sincerely,

A handwritten signature in dark ink, appearing to read "Robert M. Decker", with a long horizontal flourish extending to the right.

Robert M. Decker, Director
Finance and Administration