

**AUDIT OF THE ARC REVOLVING LOAN FUND
OPERATED BY
Mountain Association for Community Economic Development
Berea, Kentucky**

ARC Grant Numbers: KY-11801-94-I-302

November 17, 1994 through April 30, 2005

CAUTION: Certain information contained herein is subject to disclosure restrictions under the Freedom of Information Act, 5 U.S.C. 522 (b) (4). Distribution of this report should be limited to Appalachian Regional Commission and other pertinent parties.

Report Number: 06-18

Date: May 24, 2006

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November 17, 1994 through April 30, 2005

Prepared By:

**Tichenor & Associates, LLP
Certified Public Accountants
304 Middletown Park Place, Suite C
Louisville, Kentucky 40243**

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TICHENOR & ASSOCIATES, LLP

CERTIFIED PUBLIC ACCOUNTANTS and MANAGEMENT CONSULTANTS

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To: Appalachian Regional Commission (ARC)
Office of Inspector General (OIG)

Report For: Federal Co-Chair: Anne B. Pope
ARC Executive Director: Thomas M. Hunter
OIG Report Number: 06-18

Independent Auditor's Report

We have audited the ARC RLF grant Schedule of Fund Balance of the Mountain Association for Community Economic Development as of April 30, 2005, and the related Statement of Source and Application of Funds for the period of November 17, 1994 through April 30, 2005. These financial statements are the responsibility of the Mountain Association for Community Economic Development. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. We also used the ARC, OIG Audit Guide of ARC Revolving Loan Funds (RLF) as a guide. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe our audit provides a reasonable basis for our opinion.

In our opinion, the accompanying ARC RLF grant financial statements present fairly in all material respects the financial position of the Mountain Association for Community Economic Development's fiduciary activities as of April 30, 2005 and the source and application of funds resulting from fiduciary activities for the period of November 17, 1994 through April 30, 2005 in conformity with accounting principles generally accepted in the United States of America.

In accordance with Government Auditing Standards, we have also issued our report dated December 1, 2005 on our consideration of the Mountain Association for Community Economic Development's internal control over ARC RLF grant financial reporting and on our tests of compliance with certain provisions of laws and regulations, included herein. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be read in conjunction with this report in considering the results of our audit.

Tichenor & Associates, LLP

Tichenor & Associates, LLP
Louisville, Kentucky
December 1, 2005

Mountain Association for Community Economic Development

SCHEDULE OF FUND BALANCE

(As of April 30, 2005)

Cash in Bank	\$ 119,195
Loans Outstanding	<u>169,877</u>
Other Investments	<u> </u>
Due from Other Accounts	<u> </u>
Other Assets	<u> </u>
Less: Current Liabilities	<u> </u>
Fund Balance	<u>\$ 289,072</u>

The accompanying auditor's report should be read with these financial statements.

Mountain Association for Community Economic Development

**STATEMENT OF SOURCE AND APPLICATION OF FUNDS
(For The Period of November 17, 1994 through April 30, 2005)**

Source of Funds	
ARC Grant	\$ 447,000
Loan Interest Income	<u>136,827</u>
Fees Charged	<u>11,179</u>
Other Income	<u>12,099</u>
 Total Funds Available	 <u>\$ 607,105</u>

Application of Funds	
Cash in Bank	\$ 119,195
Loans Balances Written Off	<u>57,918</u>
Loans Outstanding	<u>169,877</u>
Grant Funds Returned to ARC	<u>185,000</u>
Administrative Expenses	<u>75,115</u>
 Total Funds Applied	 <u>\$ 607,105</u>

The accompanying auditor's report should be read with these financial statements.

TICHENOR & ASSOCIATES, LLP

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Report on Compliance and on Internal Control Over Financial Reporting Based on an Audit of the Financial Statements Performed in Accordance with Government Auditing Standards

We have audited the ARC RLF grant financial statements of the Mountain Association for Community Economic Development as of and for the period of November 17, 1994 through April 30, 2005, and have issued our report thereon dated December 1, 2005. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

COMPLIANCE

As part of obtaining reasonable assurance about whether the Mountain Association for Community Economic Development ARC RLF grant financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance that are required to be reported under Government Auditing Standards which are described in the accompanying Schedule of Findings.

INTERNAL CONTROL OVER FINANCIAL REPORTING

In planning and performing our audit, we considered the Mountain Association for Community Economic Development's internal control over financial reporting for the ARC RLF grant in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted a certain matter involving the internal control over financial reporting and its operation that we consider to be a reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Mountain Association for Community Economic Development's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. The reportable condition is described in the accompanying Schedule of Findings.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are considered to be material weaknesses. However, we do not believe the reportable condition described above is a material weakness.

This report is intended solely for the information and use of the ARC; however, the final report is a matter of public record and its distribution is not limited.

Tichenor & Associates, LLP

Tichenor & Associates, LLP

Louisville, Kentucky

December 1, 2005

EXECUTIVE SUMMARY

ARC makes grants to grantees. The grantee uses the grant funds to make loans to achieve economic benefits for a designated project area. As the loans are repaid, the principal funds and interest in excess of expenses are returned to the RLF to make other loans. The program's primary goal is private sector job creation and capital formation.

ARC requires that RLF projects be administered in accordance with the grantee's RLF plan. This plan defines specific objectives and operating procedures, including standards and selection criteria for loans. ARC does not normally approve or review individual RLF loans. Instead, ARC monitors RLF project grantee objectives for conformance with guidelines, the RLF plan and other grant agreement conditions.

The grantee is required to submit financial and progress reports to ARC.

Purpose:

The purpose of the audit was to determine if (a) the administration by Mountain Association for Community Economic Development (MACED) for its ARC Revolving Loan Fund Program was managed in accordance with the ARC approved grant and did not violate any restrictions imposed by the terms and conditions of the grant; (b) the accounting, reporting and internal control systems provided for disclosure of pertinent financial and operation information applicable to the revolving loan program; and (c) that the objectives of the grant are being met.

Background:

ARC awarded Grant Number KY-11801-94-I-302 to Mountain Association for Community Economic Development. Total original funding for the grant was \$262,000. ARC did not require that the grants be matched with any grantee cash, contributed services, or in-kind contributions.

Scope:

Tichenor & Associates, LLP, under contract to the Appalachian Regional Commission (ARC), Office of Inspector General (OIG), performed a financial, compliance and internal control audit in accordance with Government Auditing Standards and ARC, OIG Audit Guide of ARC Revolving Loan Funds (RLF) of ARC grant funds administered by Mountain Association for Community Economic Development for the period of November 17, 1994 through period May 1, 2003 through April 30, 2005.

Status:

As of April 30, 2005, MACED had six ARC-RLF loans outstanding, with an unpaid balance of \$169,877.

EXECUTIVE SUMMARY

Audit Results:

The audit resulted in the following:

a. Compliance

1. The loan file for Nu-Legend Boats did not include documentation that showed key person life insurance was in place as required by ARC DBRLF Guidelines (see para. V.B.4).
2. The loan to Cartersville Slaughterhouse & Processing, Inc. is recorded on the semi-annual report for the amount of \$41,970.87. The loan file shows that the loan was actually for \$45,000.00.
3. Three payments were made on the Cartersville Slaughterhouse & Processing, Inc. loan after it had been written off. These payments totaled \$4,284.33 and were not properly accounted for on the semi-annual report that was submitted to ARC.
4. Two working capital loans were made that exceeded the maximum three-year term specified in the approved operating plan. The loan to Custom Officials Wear LLC (DBA Ump Attire) was for 4 years, and the loan to Teague Metal & Truss, Inc. was for 5.5 years.
5. Administrative expense charged to the ARC program during the period of May 1, 2004 through April 30, 2005 exceeds program income by \$2,155.91.

b. Internal Control

1. The Grantee has one person who performs three key duties related to the payroll function. This person maintains time and attendance records, prepares the paychecks and distributes the paychecks. Proper internal controls dictate that the person responsible for maintaining time and attendance records be separated from the person who prepares and distributes the paychecks. This lack of control leaves a possibility of data manipulation.

Refer to the Schedule of Findings for more details on each audit finding.

EXECUTIVE SUMMARY

Auditee's Response:

In response to our draft report, the Grantee officials provided the following response to the compliance findings.

a. Compliance

1. The loan file for Nu-Legend Boats did not include documentation of key person life insurance because MACED staff and the Loan Committee of the Board of Directors determined that key person life insurance was not required.
2. The loan was originally for \$45,000 and was purchased by MACED from a subsidiary organization for \$41,970.87. Hence, the loan's beginning balance at the time acquired by MACED was correctly reported to ARC.
3. The semi-annual report was revised and resubmitted to ARC with the recovered \$4,284.33 properly accounted for in the RLF loan fund balance.
4. ARC's grant manager in Washington, D.C., Mr. Dorwaldt, authorized an exception to ARC guidelines and MACED's RLF operating plan in approving two working capital loans exceeding the maximum three-year term.
5. When the \$4,284.33 was properly accounted for as detailed in audit finding three above, the net effect was expenses exceeding program income by \$2,155.91 for the period of May 1, 2004 through April 30, 2005.

b. Internal Control

- a. The Grantee stated that it has always had adequate segregation of time, attendance and payroll duties and provided a brief description of the process.

A copy of the Grantee's complete response to the draft report is included in the report as Exhibit – Auditee's Response.

Auditor's Conclusion:

Based on the Grantee's response to the draft report we are providing the following conclusion for each finding.

a. Compliance

1. In the future proper documentation must be maintained in the loan file to support the waiver of key person life insurance requirement.

EXECUTIVE SUMMARY

2. In the future complete documentation must be maintained in the loan file to support the loan purchased amount.
3. The Grantee agreed to the finding and stated that they are currently following ARC RLF guidelines.
4. The Grantee stated they received ARC authorization and MACED's RLF operating plan for these two working capital loans exceeding the maximum three-year term, but did not provide any support in their response to the draft report. In the future the Grantee must obtain prior written documentation from ARC and MACED's officials and document same in the loan file.
5. The Grantee agreed to the finding, but did not indicate if an adjustment had been made to the accounting records and ARC reports for the \$2,155.91 of administrative expenses charged to the ARC RLF program.

b. Internal Control

1. The internal control finding related to the payroll function was based on Grantee response to the internal control questionnaire used in assessing controls and Grantee interviews at the time the audit fieldwork was completed. The controls described by the Grantee in its response to the draft report appear to be adequate related to the payroll function.

We believe that by implementing all of the report recommendations, the Grantee will (a) be in compliance with the requirements and responsibilities of its ARC approved grant; and (b) strengthen its systems of internal controls providing for disclosure of pertinent financial and operational information applicable to the revolving loan program. We further believe that the Grantee is meeting the objectives of its grant.

Mountain Association for Community Economic Development

SCHEDULE OF FINDINGS

SUMMARY OF AUDIT RESULTS

1. The auditor's report expresses an unqualified opinion on the ARC RLF grant financial statements of the Mountain Association for Community Economic Development (MACED) for the period of November 17, 1994 through April 30, 2005.
2. Five (5) instances of noncompliance were disclosed during the audit.
3. One (1) reportable condition was disclosed during the audit.

FINDINGS AND RECOMMENDATIONS

NONCOMPLIANCES

1. Per ARC BDRLF Guidelines (para. V.B.4), RLF loans to closely held corporations, partnerships, or proprietorships whose continuing success is dependent on certain individuals, will be required to provide and assign to the RLF, life insurance on those key people.

The current loan file for Nu-Legend Boats shows no evidence that the adequate key person life insurance was properly obtained as a condition of lending.

MACED management did not ensure proper adherence to ARC RLF and operating plan guidelines that the loan files contain evidence of the appropriate key person life insurance.

We recommend that the borrower, Nu-Legend Boats, be required to obtain key person life insurance and that the policy be provided to MACED management to be included in the loan file in accordance with ARC RLF and operating plan guidelines.

In response to our draft report, the Grantee stated that the loan file for Nu-Legend Boats did not include documentation of key person life insurance because MACED staff and the Loan Committee of the Board of Directors determined that key person life insurance was not required. (See Exhibit – Auditee's Response.)

2. Per ARC RLF Guidelines, grantee accounting records must be maintained so that the information traces to the Semi-Annual Financial Reports.

Per review of loan activity, the loan amount made to Cartersville Slaughterhouse & Processing, Inc. is recorded on the Semi-Annual Report as \$41,970.87. The loan file documentation shows that the loan was actually made in the amount of \$45,000.

Per MACED management, the difference in the loan amount reported of \$3,029.13 is due to the implementation of a new accounting system and the incorrect beginning balance included for Cartersville Slaughterhouse & Processing, Inc.

We recommend that MACED make the appropriate adjustments to their accounting records and to the Semi-Annual Financial Reports.

In response to our draft report, the Grantee stated that the loan was originally for \$45,000 and was purchased by MACED from a subsidiary organization for \$41,970.87. Hence, the loan's beginning balance at the time acquired by MACED was correctly reported to ARC. (See Exhibit – Auditee's Response.)

3. The MACED management is required to report current and correct information pertaining to the ARC RLF grant financial statements for the period of November 17, 1994 through April 30, 2005.

Three payments totaling \$4,284.33 were made on the Cartersville Slaughterhouse & Processing, Inc. loan after it had already been written off. These payments were not properly accounted for on the Semi-Annual Financial Report that was submitted to ARC for the period ending April 30, 2005.

Payments made on the previously written off loan were not properly accounted for on the Semi-Annual Financial Report because subsequent loan principal repayments were reported as bad debt expense, which resulted in the write off amount on the Financial Report to be overstated by \$4,284.33.

We recommend that MACED make the appropriate revisions to the Semi-Annual Financial Report, and accordingly decrease loan balances written off by \$4,284.33.

In response to our draft report, the Grantee stated that the semi-annual report was revised and resubmitted to ARC with the recovered \$4,284.33 properly accounted for in the RLF loan fund balance. (See Exhibit – Auditee's Response.)

4. Per ARC BDRLF Guidelines (para. IV.B.1.d) and the approved operating plan, working capital loans are not to exceed a term of three years.

Two working capital loans were made that exceeded the maximum three-year term as specified in ARC RLF Guidelines and the approved operating plan. The working capital loan to Custom Officials Wear, LLC was made on a 4-year term, and the working capital loan to Teague Metal & Truss, Inc. was made on a 5.5-year term.

MACED management did not properly adhere to ARC RLF grant agreement guidelines and the approved operating plan to ensure that loans made for the purpose of working capital do not exceed a three-year term.

We recommend that the MACED comply with ARC RLF Guidelines and the approved operating plan and ensure proper adherence by limiting loans made for the purpose of working capital to a term of three years or less.

In response to our draft report, the Grantee stated that ARC's grant manager in Washington, D.C., Mr. Dorwaldt, authorized an exception to ARC guidelines and MACED's RLF operating plan in approving two working capital loans exceeding the maximum three-year term. (See Exhibit – Auditee's Response.)

5. Per ARC BDRLF Guidelines (para. VI.B.2) and the approved operating plan, administrative costs charged may not exceed program income for the period.

Our analysis of the Semi-Annual Financial Report submitted for the period May 1, 2004 through April 30, 2005 revealed that administrative costs exceeded program income by \$2,155.91.

MACED management did not properly follow the guidelines set forth by the approved operating plan and ARC by ensuring that administrative expenses applicable to the current period did not exceed program income for that same period.

We recommend that MACED reduce administrative costs charged on the Semi-Annual Financial Report for the period ending April 30, 2005 by \$2,155.91 to equal program income for the period.

In response to our draft report, the Grantee stated that when the \$4,284.33 was properly accounted for as detailed in audit finding three above, the net effect was expenses exceeding program income by \$2,155.91 for the period of May 1, 2004 through April 30, 2005. (See Exhibit – Auditee's Response.)

REPORTABLE CONDITIONS

1. Proper internal control procedures require a segregation of duties when it comes to the payroll function. The person who is responsible for maintaining time and attendance records should be different from the person who prepares and distributes the payroll checks.

Presently, only one person is performing all three of these 3 key payroll functions (maintaining time and attendance records, preparing and distributing the payroll checks).

MACED management stated that they only have 15 employees and that this lack of manpower is the reason for the lack of segregation of duties.

The detection of keying errors or data manipulation is significantly reduced by this lack of segregation of duties.

We recommend that the duties of maintaining time and attendance records and preparing and distributing the payroll checks be assigned to more than one person, or establish compensating controls necessary to provide assurance that the payroll is prepared and distributed properly.

In response to our draft report, the Grantee stated that the Grantee stated that is has always had adequate segregation of time, attendance and payroll duties and provided a brief description of the process. (See Exhibit – Auditee’s Response.)

AUDITOR’S CONCLUSION

Based on the Grantee’s response to the draft report, we are providing the following conclusion for each finding.

a. Compliance

1. In the future proper documentation must be maintained in the loan file to support the waiver of key person life insurance requirement.
2. In the future complete documentation must be maintained in the loan file to support the loan purchased amount.
3. The Grantee agreed to the finding and stated that they are currently following ARC RLF guidelines.
4. The Grantee stated they received ARC authorization and MACED’s RLF operating plan for these two working capital loans exceeding the maximum three-year term, but did not provide any support in their response to the draft report. In the future the Grantee must obtain prior written documentation from ARC and MACED’s officials and document same in the loan file.
5. The Grantee agreed to the finding, but did not indicate if an adjustment had been made to the accounting records and ARC reports for the \$2,155.91 of administrative expenses charged to the ARC RLF program.

b. Internal Control

1. The internal control finding related to the payroll function was based on Grantee response to the internal control questionnaire used in assessing controls and Grantee interviews at the time the audit fieldwork was completed. The controls described by the Grantee in its response to the draft report appear to be adequate related to the payroll function.


We believe that by implementing all of the report recommendations, the Grantee will (a) be in compliance with the requirements and responsibilities of its ARC approved grant; and (b) strengthen its systems of internal controls providing for disclosure of pertinent

financial and operational information applicable to the revolving loan program. We further believe that the Grantee is meeting the objectives of its grant.

EXHIBIT

Auditee's Response

 Reply  Reply to all  Forward    X   Close  Help

 Attachments can contain viruses that may harm your computer. Attachments may not display correctly.


From: Valen Poff [Vpoff@MACED.org]

Sent: Mon 3/27/2006 1:59 PM

To: William R. Tichenor

Cc: Jonathan Harrison; Carol Lamm

Subject: KY-11801-94-I-302 MACED ARC RLF audit response

Attachments:  MACED - Auditee's response to the ARC RLF audit 2006 - final version.doc(45KB)

[View As Web Page](#)

Dear Sir or Madam:

Please find attached Mountain Association for Community Economic Development's response to your audit of our ARC RLF. Should you require further information please contact me at your convenience at 859/986/2373, x. 208.

Sincerely,

Valen Poff

Valen Spears Poff

(859) 986-2373, x. 208

vpoff@maced.org

Mountain Association for Community Economic Development, Inc. (MACED)
Auditee's Response
Page one of two

a. Compliance

1. Compliance result on Nu-Legend's key person life insurance. The loan file for Nu-Legend Boats did not include documentation of key person life insurance because MACED staff and the Loan Committee of the Board of Directors determined that key person life insurance was not required. Key person life insurance was not required because ARC Guideline V.B. 4 states "RLF loans to closely held corporations, partnerships, or proprietorships dependent for their continuing success on certain individuals ordinarily will be required to provide and assign to the RLF, life insurance on these key persons."

The Nu-Legend's term sheet presented by MACED staff to the Loan Committee explicitly noted an exception to MACED's general practice of requiring key person life insurance. Staff did not believe that the continuing success of the corporation was dependent upon certain individuals; hence, key man life insurance was unnecessary. However, the term sheet did note that property and business insurance were required.

The RLF form for Reporting Loans Disbursed/Requesting a Release of Grant Funds specifically noted that key person life insurance was not required but property and business insurance were required. The RLF form for Reporting Loans Disbursed/Requesting a Release of Grant Funds was approved by ARC's Washington, DC, grant manager, Mr. Dorwaldt.

2. Compliance result on Cartersville beginning loan balance. The loan to Cartersville Slaughterhouse & Processing, Inc. is recorded on the semi-annual report for the correct beginning balance amount of \$41,970.87. The loan was originally for \$45,000 and was purchased by MACED from a subsidiary organization for \$41,970.87. Hence, the loan's beginning balance at the time acquired by MACED was correctly reported to ARC.

3. Compliance result on Cartersville recovered bad debt. The methodology for accounting for the recovery of previously written off RLF loan balances was originally in compliance with ARC RLF guidelines; however, the method was restructured for a brief time. After the initial restructuring it was determined that the new method was not in compliance with ARC RLF guidelines. At that time, the treatment was changed back to reflect the requirements of the ARC RLF guidelines. The semi-annual report was revised and resubmitted to ARC with the recovered \$4,284.33 properly accounted for in the RLF loan fund balance.

Mountain Association for Community Economic Development, Inc. (MACED)
Auditee's Response
Page two of two

4. Compliance result for two working capital loans length of terms. ARC's grant manager in Washington, DC, Mr. Dorwaldt, authorized an exception to ARC guidelines and MACED's RLF operating plan in approving two working capital loans exceeding the maximum three-year term specified in the approved guidelines and operating plan.

The RLF form for Reporting Loans Disbursed/Requesting a Release of Grant Funds for both working capital loans specifically noted the length of terms and was approved by ARC's grant manager, Mr. Dorwaldt, in Washington, DC.

5. Compliance result on excess administrative expenses. The methodology for accounting for the recovery of previously written off loan balances noted above in audit result three was changed to reflect the requirements of the ARC RLF guidelines. When the recovered \$4,284.33 was properly accounted for as detailed in audit result three above, the net effect was expenses exceeding program income by \$2,155.91 for the period of May 1, 2004 through April 30, 2005.

b. Internal Control

1. Internal Control result timesheet and attendance segregation of duties. The Grantee has always had adequate segregation of time, attendance and payroll duties. MACED has multiple employees performing the payroll function and maintaining time and attendance records, preparing the paychecks and distributing the paychecks. Supervisors authorize the time and attendance records of supervisees. The senior associate for finance prepares the paychecks. Two non-finance employees sign the paychecks. The finance clerk distributes the paychecks.