APPALACHIAN REGIONAL COMMISSION
A Proud Past, A New Vision

Office of the Inspector General

March 20, 2003

MEMORANDUM FOR The Federal Co-Chairman
ARC Executive Director

SUBJECT: OIG Report 03-08—ARC Grant KY-6302, Review of Kentucky Department for Local Government

Attached is a copy of the subject report dealing with the Review of Kentucky Department for Local Government in Frankfort, Kentucky. There are four open recommendations—three in the body of the report and one based on the Section C (Other Matters) issue discussed below. The grantee has promised to resolve the findings in the near future. We recommend that the project coordinator verify and concur with promised actions. Further, the report recommends that no further funds be disbursed without submission of required progress reports. Please notify my office when actions have been taken and necessary corrections are made to bring the grantee into compliance.

In Section C, the auditor reports an apparent excessive amount of idle funds, most of which are in an interest bearing account. I recommend the Program Operations Division analyze this situation and make a determination as to the appropriateness and placement of this balance. I would appreciate notification of any decision that is made.

Please contact me if you have any questions.

Clifford H. Jennings
Inspector General

Attachment

cc: Director, Program Operations

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MEMORANDUM REPORT ON REVIEW OF KENTUCKY DEPARTMENT FOR LOCAL GOVERNMENT FRANKFORT, KENTUCKY

KENTUCKY APPALACHIAN HOUSING PROGRAM

ARC Grant Number: KY- 6302

July 1, 2000 through June 30, 2002

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

FROM: Tichenor & Associates, LLP
Louisville, Kentucky

REPORT FOR: The Federal Co-Chairman
ARC Executive Director
OIG Report Number: 03-08

SUBJECT: Memorandum Review Report on the Kentucky Department for Local Government, Kentucky Appalachian Housing Program, ARC Grant Number: KY-6302.

PURPOSE: The purpose of our review was to determine if (a) the total funds claimed for advance by the Kentucky Department for Local Government for its Kentucky Appalachian Housing Program were expended in accordance with the ARC approved grant budget 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 operating information; and (c) that the objectives of the grant were met.

BACKGROUND: ARC awarded Grant Number KY-6302 to the Kentucky Department for Local Government in July of 1978. The initial grant period was for one year, but the grant itself is perpetual in nature. We discussed the scope of this audit with the Inspector General and decided that we would review the years ended June 30, 2001 and June 30, 2002. Each year the grant is recapitalized based on applications submitted by the Grantee. Total grant funding for the years ended June 30, 2001 and June 30, 2002 was $1,450,000.

Neither the ARC nor the Grantee could produce a copy of the original application; however, we did obtain a copy of the 1978 Grant Agreement. No matching requirements were indicated in the 1978 agreement and we found none in any amendments since that time. The Grantee advised us that the ARC would never provide funding in excess of 50% of the total project costs for any project under KY-6302. For the years ended June 30, 2001 and June 30, 2002, the ARC has made advance payments totaling $1,450,000.

The purpose of grant KY-6302 is to provide Section 207 funding and stimulate the construction and rehabilitation of housing for low- to moderate-income families and individuals throughout Appalachian Kentucky. The major goal of this project is to provide support for the Kentucky Appalachian Housing Program, which is being overseen by the Kentucky Housing Corporation.

The ARC funds are being used to revitalize existing structures, prepare land for new construction, and constructing new residential structures throughout the Appalachian Region of Kentucky.

SCOPE: We performed a program review of the grant as described in the Purpose above. Our review was based on information made available to us and on the application of certain agreed-upon procedures previously discussed with the ARC, OIG. Specifically, we determined if the tasks described above are being performed, if the accountability over ARC funds is sufficient as required by applicable Office of Management and Budget (OMB) Circulars, and if the Kentucky Department for Local Government is in compliance with applicable governing regulations (OMB Circulars). In addition, we discussed the program objectives and performance with the Kentucky Department for Local Government and Kentucky Housing Corporation personnel. Our results and recommendations are based on those procedures. These review procedures were performed in accordance with applicable Government Auditing Standards generally accepted in the United States of America.

RESULTS: The following results are based on our review performed at the Kentucky Housing Corporation in Frankfort, Kentucky from February 24, 2003 through February 26, 2003.

A. Incurred Costs

The Kentucky Department for Local Government claimed total program costs of $1,450,000 for the period July 1, 2000 through June 30, 2002 of which they claimed direct reimbursable cost of $104, 675 and matching costs of $1,241,970. It should be noted that all ARC funds are only expended as needed. Funds not disbursed are carried forward to subsequent periods. See Section **C., Other Matters,** for reporting of funds on hand. We reviewed the direct and matching costs claimed for the years ending June 30, 2001 and June 30, 2002 and determined that, in general the funds are being expended as reported and are being used to prepare for construction, remodel existing structures, and construct new structures throughout the Appalachian Region of Kentucky.

B. Internal Controls

1. Progress Reports Not Prepared Adequately Or In A Timely Manner

The Kentucky Department for Local Government does not prepare progress reports that are adequate in detail or timely. Progress reports are being prepared and submitted on an annual basis and only present financial information about projects that have been completed or are still in progress.

The Grant Agreement that we obtained is dated July 1, 1978 and requires progress reports to be submitted semi-annually. Since that agreement appears to be fifteen years old, we chose to base this finding on more recent experiences and the Inspector General's concerns regarding adequate reporting. Our experience is that progress reports should be submitted at least every 120 days and should specifically detail the status of the project. Part II of the Appalachian Regional Commission Grant Agreement: General Provisions, paragraph (1) Progress Reports states,

> "Grantee shall prepare and submit to the ARC Project Coordinator, progress reports indicating the work accomplished under the agreement to date, any problems encounter and ameliorative actions taken, and a forecast of work for the next report period."

In addition, we obtained a Grant Agreement between the Kentucky Department for Local Government (DLG) and the Kentucky Housing Corporation (KHC), which specifically required the KHC to submit quarterly progress reports to both the DLG and to the ARC.

RECOMMENDATION

We recommend that the Kentucky Department for Local Government prepare progress reports that provide detailed insight into the progress of the projects and submit those reports to the ARC for review every 120 days. We further recommend that the ARC not disburse any additional funds to the Grantee until such progress reports are forthcoming.

GRANTEE'S RESPONSE

In response to our draft report, the Kentucky Housing Corporation (KHC) responded by stating that in 2003 the KHC will become the Grantee and begin receiving funds for the Kentucky Appalachian Housing Program directly from the Appalachian Regional Commission (ARC). When the KHC becomes the Grantee, it will review the contract and agreements and will comply with all written reporting requirements.

2. The Grantee's Reconciliation Process Does Not Include Reviewing Endorsements

During our review, we determined that the Grantee's reconciling process does not require the review of endorsements on cancelled checks. We advised the Grantee that this lack of internal controls was not in compliance with the guidelines set forth by Office of

Management and Budget (OMB) Circular A-102, Appendix D, §___20, Subsection (a), Item (2), which states in part:

> (a) ...Fiscal control and accounting procedures of the State, as well as its subgrantees and cost-type contractors, must be sufficient to-
>
> > (2) Permit the tracing of funds to a level of expenditures adequate to establish that such funds have not been used in violation of the restrictions and prohibitions of applicable statutes.

Subsection (b), Item (3) goes on to add:

> > (3) Internal Control. Effective control and accountability must be maintained for all grant and subgrant cash, real and personal property, and other assets. Grantees and subgrantees must adequately safeguard all such property and must assure that it is used solely for authorized purposes.

<u>RECOMMENDATION</u>

We recommend that the Grantee's delegate, the KHC, inspect endorsements to avoid any malfeasance of assets.

<u>GRANTEE'S RESPONSE</u>

In response to our draft report, the KHC stated that reviewing the endorsements on every check issued was not a practical procedure to employ due to the volume of checks issued. However, it stated, there are two controls in place to prevent any malfeasance. First, documentation supporting the reimbursement requests is reviewed and compared to the request and appropriate approvals are noted. Second, missing checks reported by the intended recipient are investigated. If they have cleared the bank, the endorsement is reviewed and if a theft has occurred appropriate steps are taken to recoup the funds. In addition, the KHC stated that during its annual internal audits endorsements are tested.

3. <u>The Grantee Does Not Check Invoice Extensions And Does Not Compare Invoices With Purchase Orders As To Unit Prices And Quantities</u>

We noted that the Grantee's Accounting Department does not check invoice extensions and does not compare invoices with purchase orders as to unit prices and quantities. We advised the Grantee that this lack of internal controls was not in compliance with the guidelines set forth by Office of Management and Budget (OMB) Circular A-102, Appendix D, §___20, Subsection (a), Item (2), which states in part:

> (b) ...Fiscal control and accounting procedures of the State, as well as its subgrantees and cost-type contractors, must be sufficient to-

> (2) Permit the tracing of funds to a level of expenditures adequate to establish that such funds have not been used in violation of the restrictions and prohibitions of applicable statutes.

Subsection (b), Item (3) goes on to add:

> (3) Internal Control. Effective control and accountability must be maintained for all grant and subgrant cash, real and personal property, and other assets. Grantees and subgrantees must adequately safeguard all such property and must assure that it is used solely for authorized purposes.

RECOMMENDATION

We recommend that the KHC's Accounting Department begin performing these functions in order to better safeguard the assets of KY-6302.

GRANTEE'S RESPONSE

In response to our draft report, the KHC stated that it only serves as the applicant for federal funds. Actual services are subgranted to nonprofit organizations and local governmental units throughout Appalachian Kentucky. The agreements between the KHC and the Subgrantees require the Subgrantees to maintain financial records that support all costs claimed. KHC Field Services Staff verify costs and approve draw requests before their submission. KHC monitors each project through its close out process to ensure that all costs can be tracked and verified.

C. Other Matters

We deemed it relevant to report, not as a negative finding, but as a fact that at June 30, 2002 the Grantee had funds available for disbursement totaling $968,968. Of those funds, $750,000 was deposited in an interest bearing account while the remaining $218,968, which includes interest earned, was used to obtain investments on behalf of the program. Though there were investments, we were assured that the instruments could be liquidated quickly in order to make disbursements to the subgrantees.

We were advised that since the inception of the grant, 1978, the ARC had disbursed the total amount of funds applied for by the Grantee. For example, the Grantee applied for $500,000 in 2001 and the ARC disbursed the entire amount to them at one time. The Grantee; however, disburses funds on a reimbursement basis and as a result has a balance of funds on hand at the end of each of its fiscal years.

Upon our initial review, it appeared that the Grantee had drawn down funds in excess of its current and immediate needs. However, given the nature of KY-6302's objectives it is feasible for the Grantee to retain funds and carry them forward to subsequent periods when they will actually be used. It is also feasible for the interest earned on the bank account and the investments to be rolled back into the program. This practice appears to be conducive to a smooth flow of funds under KY-6302.

We advised the Grantee that we would report this as a fact, but that the final disposition would reside with the Appalachian Regional Commision.

RECOMMENDATION

We have no recommendation at this time.

GRANTEE'S RESPONSE

The KHC agreed with our statement and had no response.

D. Program Results

The ARC grant funds are being used to revitalize existing residential structures, prepare property for construction of residential structures, and actually constructing residential structures for low- to moderate-income families and individuals throughout the Appalachian Region of Kentucky.

Tichenor & Associates, LLP

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