



September 8, 2004


Memorandum for: The Federal Co-Chair
ARC Executive Director

Subject: OIG Report 04-13
Review of Distressed Revolving Loan Fund (DRLF) Grants for the
Buckeye Hills-Hocking Valley Regional Development District

Attached are copies of the subject report dealing with the DRLF grants to the Buckeye Hills-Hocking Valley Regional Development District (BH-HVRDD). BH-HVRDD received its initial RLF grant in 2000. As of May 25, 2004, BH-HVRDD has received \$120,000 in ARC RLF grants, and has four loans outstanding, with unpaid balances totaling approximately \$69,925.

The report contains two recommendations. The responses by the grantee and ARC are considered responsive to the recommendation. They have agreed to take the necessary steps outlined in the recommendations.

This report is considered closed. However, ARC staff should verify that the promised actions have indeed taken place. Please contact me if you have any questions on this issue.


Clifford H. Jennings
Inspector General

Attachment

cc: Director for Program Operations
Director for Finance and Administration



**LEON SNEAD
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& Management Consultants*

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MEMORANDUM

DATE: September 3, 2004

TO: Clifford Jennings, Inspector General
Appalachian Regional Commission
Office of Inspector General
1666 Connecticut Avenue, N.W. Room 215
Washington, DC 20009-1068

FROM: 
Leon Snead, President

SUBJECT: Final Audit Reports

Leon Snead & Company is submitting to ARC and Grantee Officials five copies of the audit reports for the following assignments.

Buckeye Hills – Hocking Valley Regional District
Buckeye Hills – Hocking Valley Regional District (Distressed)
Southern Tier Enterprise Development Organization
Regional Economic Development and Energy Corporation

Enclosure

**APPALACHIAN REGIONAL COMMISSION
OFFICE OF INSPECTOR GENERAL**

AUDIT OF DISTRESSED REVOLVING LOAN FUND

**Buckeye Hills-Hocking Valley
Regional Development District**

**Report No. 04-13
September 2004**

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



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September 1, 2004

Appalachian Regional Commission
Office of the Inspector General
1666 Connecticut Avenue, N.W.
Washington, D.C. 20009

Leon Snead & Company, P.C. has completed an audit of the Buckeye Hills-Hocking Valley Regional Development District (BH-HVRDD) Revolving Loan Fund (RLF). The audit was performed at the request of the Appalachian Regional Commission's (ARC), Office of the Inspector General (OIG) to assist in carrying out its oversight of ARC activities.

The audit objectives were to determine if: (1) the grantee complied with the requirements of applicable laws, OMB Circulars, ARC Guidelines and its grant agreement and operating plan (2) the grantee's internal control policies and procedures were adequate to assure that RLF transactions were properly recorded, and accurately and timely reported to the ARC on its semiannual reports, (3) administrative costs reported on the 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 determined that, overall, the BH-HVRDD: (1) operated the RLF in compliance with ARC regulations and guidelines, the grant agreement, and operating plan; and (2) implemented sufficient internal controls to assure semiannual reports to ARC were completed in a timely manner; However, we noted that BH-HVRDD needed to strengthen its follow-up to ensure key borrower financial information, used for loan servicing, is obtained as required by the borrower's loan agreement.

A draft report was provided to ARC and RLF officials for comment on June 22, 2004. The Executive Director, ARC agreed with the findings and recommendations. The comments of the Executive Director are included in their entirety in Appendix A.

Leon Snead & Company appreciates the cooperation and assistance received from ARC and BH-HVRDD personnel during the audit.

Sincerely,

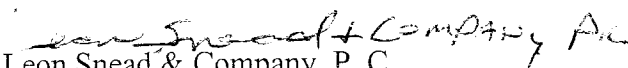

Leon Snead & Company, P. C.

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Introduction

Leon Snead & Company, P.C. has completed an audit of Distressed Revolving Loan Fund (DRLF) grant awarded by the Appalachian Regional Commission (ARC) to Buckeye Hills-Hocking Valley Regional Development District (BH-HVRDD). The audit was performed at the request of ARC Office of the Inspector General (OIG) to assist it in carrying out its oversight of ARC grant activities.

BH-HVRDD is a state certified Regional Planning and Development Organization representing local governments in eight counties. BH-HVRDD was designated as a Local Development District (LDD) for ARC in 1969. BH-HVRDD assists local officials in preparing plans and projects to improve living conditions, reverse trend of out migration of people, and to spur economic development. BH-HVRDD's organizational structure is governed by the General Policy Council. The Council is made up of 51 people from throughout the region, two-thirds of whom serve by reason of elected public office. The remaining one-third represent various interests such as business, industry and labor, agriculture, education, health, low-income families, minorities, the elderly and others. The General Policy Council officers are elected annually and the Council meets semiannually.

BH-HVRDD received its initial DRLF grant in 2000. As of May 25, 2004, BH-HVRDD had received \$120,000 in ARC grant funds and had 4 loans outstanding, with unpaid balances totaling approximately \$69,925.

A DRLF is a business development revolving loan fund that is used by eligible grantees to make loans to create and/or save jobs. As loans are repaid by the borrowers, the money is returned to the DRLF to make other loans. DRLF loans are not intended to match or replace the capacity of lending institutions, rather, DRLF's fill gaps in local lending, and provide capital which otherwise would not be available for economic development. The primary goals of BH-HVRDD's DRLF were to: (1) increase the birth and expansion of businesses and industries in the distressed Appalachian counties of Athens, Meigs, Morgan and Monroe and (2) encourage increased employment opportunities, with the focus on the low/moderate income work force in the geographic area of BH-HVRDD.

The grantee is required to administer the DRLF 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 DRLF. Instead, ARC monitors DRLF activities for conformance with the ARC code, DRLF Guidelines, operating plan, and other conditions of the grant agreement.

Objectives, Scope, and Methodology

The audit objectives were to determine if: (1) the grantee complied with the requirements of 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 DRLF transactions were properly recorded, and accurately and timely reported to the ARC on its semiannual reports, (3) administrative costs reported on the 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 BH-HVRDD activities during the period October 1, 2002 to March 31, 2004. Audit fieldwork was completed at BH-HVRDD on May 25, 2004.

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

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

Summary of Audit

The audit determined that, overall, BH-HVRDD: (1) generally operated the DRLF in compliance with ARC 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. ARC's latest internal reviews of BH-HVRDD's operations did not disclose any deficiencies in operations.

While we found that administrative costs charged to ARC DRLF appeared reasonable, BH-HVRDD's unwritten policy for allocating administrative costs did not result in a reasonable and supportable allocation among the loan programs. BH-HVRDD's policy was to allocate administrative costs equally without regard to the size of the program or the program activity. In addition, we noted that BH-HVRDD needed to ensure that the make up of the RLF Committee complied with ARC Guidelines.

FINDINGS AND RECOMMENDATIONS

1. Administrative Cost Allocation Procedures

BH-HVRDD needs to modify and document its policies on the allocation of salary costs to the ARC DRLF. While we found that administrative costs charged to ARC DRLF appeared reasonable, BH-HVRDD's unwritten policy for allocating administrative costs equally among BH-HVRDD's four loan programs without regard to the size of the loan program did not result in a reasonable and supportable allocation of administrative costs to ARC DRLF programs. .

ARC guidelines require grantees to establish internal controls over Federal programs to ensure they are managing the DRLF in accordance with provisions of the grant. ARC guidelines require grantees to keep complete records to document those administrative costs charged to the program. In addition, OMB Circulars contain specific requirements concerning documentation needed to support administrative costs charged to a program.

Review of administrative costs charged to the ARC DRLF program showed that all direct costs charged to the program were fully supported. However, for those costs related to the salary and other expenses charged to the ARC DRLF, no written documentation was available to support the allocation of these costs. Although an unwritten policy existed regarding the process followed to allocate these costs, this policy was not equitably distributed among the loan programs. The policy was to allocate administrative costs equally among its four loan programs despite the size of the program. For example, the administrative costs claimed by BH-HVRDD for the period July 2002 through March 2003 was allocated at \$2,319 for each of the four loan programs. The ARC loan program covered 24 active loans with an outstanding balance of \$964,332, whereas the ARC Distressed Loan Program covered 5 loans with an outstanding balance of \$101,632.

BH-HVRDD's payroll and other systems did not track time charges by program; therefore, we were unable to determine if the administrative costs charged to ARC DRLF were supported by time sheets. However, based upon review of the various loan activity and outstanding loan balances, and discussions with BH-HVRDD officials, the administrative charges to ARC DRLF did not appear to be materially out of line with the administrative requirements of the overall loan program.

Recommendation

ARC should require BH-HVRDD to:

Document the procedures for allocating salary costs to the ARC DRLF. Perform periodic studies of actual time charges as well as other administrative costs claimed to support the allocation of administrative costs to the program.

Management Response

The ARC Executive Director concurred with the finding and recommendation. BH-HVRDD responded that; (1) the RLF Program Manager prepares a bi-weekly timesheet and a monthly travel sheet which are used to invoice the RLF program for salary and travel expenses; (2) BH-HVRDD will spread the ROLF Program Manager's salary, travel and other administrative costs not directly related to a specific loan fund on a percentage basis based upon the accounts receivable in each loan fund; and (3) administrative costs that can be directly tied to one of the found RLFs will continue to be charged directly to that loan fund.

Auditor's Comments

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

2. Regional Loan Review Committee Membership

The BH-HVRDD Regional Loan Review Committee (RLRC) membership does not comply with ARC Guidelines or the RLF Plan submitted by the grantee. ARC and BH-HVRDD guidelines state that the RLRC should be composed of representatives from the participating communities and which will have at least 60 percent of its membership made up of individuals with commercial lending experience. However, BH-HVRDD revised its Revolving Loan Fund Program Procedures and Loan Administration Manual in February 2004 to alter the make up of the RLRC.

The guidance calls for BH-HVRDD to choose the members for the distressed loan committee from the current members for the RLRC. Also, each distressed county should have representation on the committee. There are currently 3 members, an economic development director, a banker, and a businessman, down from the five members on the committee for 2002 and 2003. There are currently no members representing 3 of the 4 identified distressed counties.

BH-HVRDD personnel indicated that the membership makeup was changed because of the inability to obtain sufficient participation from the banking and business sectors. BH-HVRDD personnel also indicated that the ARC did not approve new provisions, such as the make up of RLRC, in the Administrative Manual. In addition, BH-HVRDD did not seek a waiver from ARC regarding the composition of the RLRC.

Recommendation

ARC should require the BH-HVRDD to:

Comply with ARC Guidelines regarding the composition of the RLRC, or seek approval for a variance in the requirement.

Management Response

The ARC Executive Director concurred with the finding and recommendation. The Executive Director responded that BH-HVRDD restructured its Distressed County RLRC with the publication of a new Procedures and Loan Administration Manual and will now use one committee for all loans programs. The Executive Director also stated that BH-HVRDD has furnished ARC a list of RLRC members for 2004/2005 that complies with ARC DRLF requirements.

Auditor's Comments

The comments received for the grantee and ARC are considered responsive to the finding and recommendation.

APPENDIX A
MANAGEMENT RESPONSE



August 25, 2004

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 Distressed County Revolving Loan Fund at the Buckeye Hills-Hocking Valley Regional Development District performed By Leon Snead & Company, P.C.

Dear Mr. Snead:

Thank you for your thorough examination of the Buckeye Hills-Hocking Valley Regional Development District (BH-HVRDD) Distressed County ARC RLF grant. The assistance provided by this examination will aid BH-HVRDD in justifying the costs of the lending program charged against program income from ARC RLF lending activities. Please correct the typographical error (DRFL) in the third paragraph of the draft report introduction.

Administrative Cost Allocation Procedures.

ARC agrees with the finding and recommendation regarding Administrative Cost Allocation Procedures. BH-HVRDD was asked to respond to the audit recommendation for the Distressed County RLF Grant. Their response follows:

The BH-HVRDD RLF Program Manager fills out a bi-weekly timesheet and this timesheet is used to invoice the RLF program for administrative salary expenses. The RLF Program Manager also fills out monthly travel sheet to document travel expenditures for the RLF program.

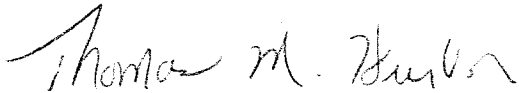
BH-HVRDD has historically spread the salary, travel and administrative costs equally among all programs, unless the costs could be directly tied to a specific loan fund. In the future, BH-HVRDD will spread the RLF Program Manager salary, travel, and any other administrative costs not directly related to a specific loan fund on a percentage basis, based upon the accounts receivable in each fund (ARC, ARC-Distressed County, EDA and USDA-RBCS IRP).

Administrative costs that can be directly tied to one of the four (4) RLFs such as loan closing fees from the BH-HVRDD attorney, will continue to be directly charged to that loan fund.

Regional Loan Review Committee (RLRC) Membership.

ARC was furnished a roster of the Distressed County Regional Loan Review Committee membership in May 2002 that complied with ARC RLF Guidelines. BH-HVRDD has restructured their Distressed County RLRC with the publication of a new Procedures and Loan Administration Manual and will now use one committee for all of their RLF programs. BH-HVRDD has been reminded of the requirements of ARC BDRLF Guidelines for loan review committee membership. In response BH-HVRDD has furnished ARC with a list of Regional Loan Review Committee members for 2004/2005 that complies with ARC BDRLF Guideline requirements. More than 50% of the members represent the private sector of their community as opposed to government and a majority have had commercial loan experience. Evidence of the member's commercial loan experience accompanied the list.

Sincerely,

A handwritten signature in cursive script that reads "Thomas M. Hunter". The signature is written in dark ink and is positioned above the typed name.

Thomas M. Hunter
Executive Director