



September 28, 2004

Memorandum for:     The Federal Co-Chair  
                                  ARC Executive Director

Subject:                 OIG Report 04-17  
                                  Review of Revolving Loan Fund (RLF) Grant for the  
                                  Washington County Council on Economic Development

Attached are copies of the subject report dealing with the RLF grant to the Washington County Council on Economic Development. The Washington County Council on Economic Development received RLF grant PA-13686-00-I-302 for \$100,000.00 effective June 15, 2000.

The report contains five 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

**AUDIT OF THE ARC REVOLVING LOAN FUND  
OPERATED BY  
Washington County Council on Economic Development  
Washington, Pennsylvania**

**ARC Grant Number: PA-13686-00-I-302**

**June 15, 2000 through April 30, 2004**

**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: 04-17**

**Date: September 27, 2004**

**AUDIT OF THE ARC REVOLVING LOAN FUND  
OPERATED BY  
Washington County Council on Economic Development  
Washington, Pennsylvania**

**ARC Grant Number: PA-13686-00-I-302**

**June 15, 2000 through April 30, 2004**

**Prepared By:**

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

## TABLE OF CONTENTS

<u>Title</u>	<u>Page</u>
Independent Auditor's Report	1
Schedule of Fund Balance	2
Statement of Source and Application of Funds	3
Report on Compliance and on Internal Control Over Financial Reporting Based on an Audit of the Financial Statements Performed in Accordance with <u>Government Auditing Standards</u>	4
Executive Summary	6
Purpose	6
Background	6
Scope	6
Audit Results	7
Recommendations	7
Auditee's Response	8
Auditor's Conclusion	8
Schedule of Findings	9
Exhibit – Auditee's Response	12

# 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 04-17

## Independent Auditor's Report

We have audited the ARC RLF grant Schedule of Fund Balance of the Washington County Council on Economic Development as of April 30, 2004, and the related Statement of Source and Application of Funds for the period of June 15, 2000 through April 30, 2004. These financial statements are the responsibility of the Washington County Council on 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 Washington County Council on Economic Development's fiduciary activities as of April 30, 2004 and the source and application of funds resulting from fiduciary activities for the period of June 15, 2000 through April 30, 2004 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 August 25, 2004, on our consideration of the Washington County Council on 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  
Louisville, Kentucky  
August 25, 2004

**Washington County Council on Economic Development**

**SCHEDULE OF FUND BALANCE**

**(As of April 30, 2004)**

Cash in Bank	\$ 1,534.96
Loans Outstanding	<u>117,609.90</u>
Other Investments	<u>                    </u>
Due from Other Accounts	<u>                    </u>
Other Assets	<u>                    </u>
Less: Current Liabilities	<u>                    </u>
Fund Balance	<u>\$ 119,144.86</u>

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

**Washington County Council on Economic Development**

**STATEMENT OF SOURCE AND APPLICATION OF FUNDS  
(For the Period of June 15, 2000 through April 30, 2004)**

Source of Funds	
ARC Grant	<u>\$ 100,000.00</u>
Loan Interest Income	<u>18,860.66</u>
Fees Charged	<u>                    </u>
Other Income	<u>284.20</u>
Total Funds Available	<u>\$ 119,144.86</u>

Application of Funds	
Cash in Bank	<u>\$ 1,534.96</u>
Loans Outstanding	<u>117,609.90</u>
Loan Losses	<u>                    </u>
Administrative Expenses	<u>                    </u>
Total Funds Applied	<u>\$ 119,144.86</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 Washington County Council on Economic Development as of and for the period of June 15, 2000 through April 30, 2004, and have issued our report thereon dated August 25, 2004. 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 Washington County Council on Economic Development's 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 Washington County Council on 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 certain matters involving the internal control over financial reporting and its operation that we consider to be 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 Washington County Council on Economic Development's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are 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 believe none of the reportable conditions 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  
Louisville, Kentucky  
August 25, 2004

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## EXECUTIVE SUMMARY

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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 the Washington County Council on Economic Development 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 PA-13686-00-I-302, effective June 15, 2000. Total grant funding was for \$100,000. ARC did not require that the grant 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 Washington County Council on Economic Development for the period of June 15, 2000 through April 30, 2004.

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## EXECUTIVE SUMMARY

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### **Audit Results:**

During the audit we noted the following:

#### 1. Compliance

- 1.1. Loan commitment letters do not include the requirement of job impact (created/saved) as a condition of loan approval.
- 1.2. Loan agreements do not include the requirement of job impact (saved/created) as a condition of lending.
- 1.3. Loan agreements do not include language that permits immediate recovery of principal or an increase in interest rate to commercial levels if the loan is not used for said purpose or it becomes apparent that the number of jobs saved or created will not meet operating plan criteria, in accordance with ARC RLF Guidelines.

#### 2. Internal Control

- 2.1. Cash receipts are not deposited daily.
- 2.2. Persons in key financial positions are currently not required to take annual vacations.

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

### **Recommendations:**

We recommend that the Washington County Council on Economic Development take the following actions:

#### 1. Compliance:

- 1.1. We recommend that commitment letters be updated to include the job impact requirement as a condition of loan approval.
- 1.2. We recommend that loan agreements be updated to include the job impact requirement as a condition of lending.
- 1.3. We recommend that the loan agreements be updated to include, in a legally enforceable manner, a statement that loan assistance will be withdrawn if loan funds are not used for purposes stated in the application or if it becomes apparent that claimed accomplishments or goals of jobs created or saved have not, or will not, be met.

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## EXECUTIVE SUMMARY

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### 2. Internal Control

- 2.1. We recommend that all cash receipts be deposited on a daily basis.
- 2.2. We recommend that persons in key financial positions be required to take annual vacations.

#### **Auditee's Response:**

In response to our draft report, Washington County Council on Economic Development officials agreed to each of the report's recommendations.

A copy of the Washington County Council on Economic Development's complete response to the draft report is included in this report as Exhibit - Auditee's Response.

#### **Auditor's Conclusion:**

We believe that by implementing the above recommendations, the Washington County Council on Economic Development 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 Washington County Council on Economic Development is meeting the objectives of its grant.

## **Washington County Council on Economic Development**

### **SCHEDULE OF FINDINGS**

#### **SUMMARY OF AUDIT RESULTS**

1. The auditors report expresses an unqualified opinion on the ARC RLF grant financial statements of the Washington County Council on Economic Development for the period of June 15, 2000 through April 30, 2004.
2. Three (3) instances of noncompliance were disclosed during the audit.
3. Two (2) reportable conditions were disclosed during the audit.

#### **FINDINGS AND RECOMMENDATIONS**

##### **NONCOMPLIANCES**

1. ARC RLF Guidelines require that the job impact (created/saved) requirement be included as a condition of loan approval.

Loan commitment letters do not currently include the requirement of job impact (created/saved) as a condition of loan approval.

Because the job impact (created/saved) requirement is included in the loan application, the grantee did not realize it was necessary to include the requirement in the commitment letters.

Failure to include job impact as a requirement of loan approval in the commitment letter could result in loan funds being distributed contrary to ARC RLF objectives. Failure to comply could further result in not having a legal basis to demand repayment in the event that jobs are not created or saved with ARC loan funds.

We recommend that commitment letters be updated to include the job impact requirement as a condition of loan approval.

In response to our draft report, the grantee stated that henceforth loan commitment letters would include the job impact requirement as a condition of loan approval. (See Exhibit – Auditee’s Response.)

2. ARC RLF Guidelines require that the job impact (created/saved) requirement be included as a condition of lending.

Loan agreements do not currently include the requirement of job impact (saved/created) as a condition of lending.

Because the job impact (created/saved) requirement is included in the Loan Application, the grantee did not realize it was necessary to include the requirement in the Loan Agreements.

Failure to include job impact as a condition of lending in the loan agreement could result in loan funds being distributed contrary to ARC RLF objectives. Failure to comply could further result in not having a legal basis to demand repayment in the event that jobs are not created or saved with ARC loan funds.

We recommend that loan agreements be updated to include the job impact requirement as a condition of lending.

In response to our draft report, the grantee stated that henceforth loan agreements would include the job impact requirement as a condition of lending. (See Exhibit – Auditee’s Response.)

3. ARC RLF Guidelines require that loan agreements include language that permits the immediate recovery of the loan principal, or an increase in interest rate to commercial levels, if (1) a loan is not used for the purpose represented in the loan application, or if (2) it becomes apparent that the number of jobs created or saved in the project will not meet the grantee’s RLF Operating Plan criteria.

Loan agreements do not currently include language that permits immediate recovery of principal or an increase in interest rate to commercial levels if the loan is not used for said purpose or it becomes apparent that the number of jobs saved or created will not meet operating plan criteria, in accordance with ARC RLF Guidelines.

The Grantee was not aware of the requirement to include such language in loan agreements.

Failure to include language that permits the immediate recovery of loan principal in the loan agreement could result in not having a legal basis to withdraw loan assistance if a loan is not used for the purpose stated in the application or if it becomes apparent that the borrower will not meet its claimed goals of jobs that will be created or saved.

We recommend that the loan agreements be updated to include, in a legally enforceable manner, a statement that loan assistance will be withdrawn if loan funds are not used for purposes stated in the application or if it becomes apparent that claimed accomplishments or goals of jobs created or saved have not, or will not, be met.

In response to our draft report, the grantee stated that henceforth loan agreements will be revised to permit either the immediate recovery of principal or an increase in the interest rate on the loan of one percent (1%) over the original loan rate if the loan is not used for

purposes stated in the application or if it becomes apparent that the number of jobs saved or created will not meet operative plan criteria. The grantee further stated that it would exercise sole discretion in enforcing these measures, taking into consideration market fluctuations and/or the economic situation which would occur if the measures were enforced. (See Exhibit – Auditee’s Response.)

## **REPORTABLE CONDITIONS**

1. Proper internal control procedures require that cash receipts be deposited daily.

Because of the limited number of cash of receipts, the grantee makes deposits on a weekly basis.

Failure to deposit cash receipts on a daily basis could lead to the loss or theft of funds while on the premises.

We recommend that all cash receipts be deposited on a daily basis.

In response to our draft report, the grantee stated that they will begin depositing cash receipts on the day received if received before 2:30 PM. Any cash receipts received after that time will be locked in a secure, fireproof area and deposited the next business day. (See Exhibit – Auditee’s Response.)

2. Proper internal control procedures require that all persons in key financial positions be required to take annual vacations.

Persons in key financial positions are currently not required to take annual vacations.

The detection of misappropriation of funds is made more difficult by not requiring that persons in key financial positions take annual vacations.

We recommend that persons in key financial positions be required to take annual vacations.

In response to our draft report, the grantee stated that henceforth all persons in key financial positions will be required to take annual vacations. (See Exhibit – Auditee’s Response.)

## **AUDITOR’S CONCLUSION**

We believe that by implementing the above recommendations, the Washington County Council on Economic Development 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 Washington County Council on Economic Development is meeting the objectives of its grant.

**EXHIBIT**  
**Auditee's Response**





WASHINGTON COUNTY COUNCIL  
ON ECONOMIC DEVELOPMENT

September 03, 2004

Mr. Jack Somerville, CPA; Supervisor  
Tichenor & Associates, LLP  
304 Middletown Park Place, Suite C  
Louisville, Kentucky 40243

Re: Draft Audit Report

Dear Mr. Somerville,

Included below are the comments of the Washington County Council on Economic Development in regards to the *Draft Audit Report – Audit of ARC Revolving Loan Fund for the 12 months ending April 30, 2004* received by the Council on September 1, 2004. The Council's response has been divided, as in the manner of the report, into sections discussing compliance and internal control.

1. Compliance

- 1.1. Loan commitment letters shall henceforth include the requirement of job impact as it is stated on the application and will speak to the consequences of goals for jobs created/saved not being met.
- 1.2. Loan agreements shall be revised to include a job impact requirement in concordance with that on the application.
- 1.3. Loan agreements shall be revised to permit either an immediate recovery of principal or an increase in the interest rate for the loan of one per cent (1%) over WCCED's original loan rate (at the time of borrowing) if the loan is not used for the agreed purposes or it becomes apparent that the number of jobs saved or created will not meet operative plan criteria.

1.3.1. **Note: It will be at the sole discretion of WCCED when making a credit decision to enforce these measures. Such a decision will take into consideration market fluctuations and/or the economic situations which would occur if the measures were enforced at any given time.**

2. Internal Control

- 2.1. It shall be WCCED's internal procedure to deposit cash receipts on the day received if they are received before 2:30 PM (Eastern Time). Any cash receipts received after that time will be locked in a secure, fireproof area and deposited the following business day.
- 2.2. It shall be WCCED's internal procedure that persons in key financial positions will be required to take annual vacations.

WCCED expects that these modifications will adequately fulfill the requirements of our compliance with the regulations involving disbursement of these funds. If you have any questions, please feel free to contact my office at (724) 225-8223.

Sincerely,

Malcolm L. Morgan  
Executive Director, WCCED