



October 12, 2004

Memorandum for: The Federal Co-Chair
 ARC Executive Director

Subject: OIG Report 05-02
 Review of Revolving Loan Fund (RLF) Grant for the
 County of Chautauqua Industrial Development Agency

Attached are copies of the subject report dealing with the RLF grant to the County of Chautauqua Industrial Development Agency (CCIDA). CCIDA received its initial RLF Grant in 1997. As of December 31, 2003, CCIDA had received \$964,572 in ARC grant funds and had 18 loans outstanding, with an unpaid balance totaling approximately \$729,000.

The report contains two recommendations. The responses by the grantee and ARC are considered responsive to the recommendations. 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.

A handwritten signature in black ink, appearing to read "Clifford H. Jennings", with a long, sweeping flourish extending to the right.

Clifford H. Jennings
Inspector General

Attachment

cc: Director for Program Operations
 Director for Finance and Administration



**LEON SNEAD
& COMPANY, P.C.**

*Certified Public Accountants
& Management Consultants*

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MEMORANDUM

DATE: October 1, 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*
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.

1. Southern Tier Central Regional Planning and Development
2. County of Chautauqua Industrial Development Agency

Enclosure

**APPALACHIAN REGIONAL COMMISSION
OFFICE OF INSPECTOR GENERAL
AUDIT OF REVOLVING LOAN FUND
County of Chautauqua
Industrial Development Agency**

**Report No. 05-02
October 2004**

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



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October 1, 2004

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

Leon Snead & Company, P.C. has completed an audit of the County of Chautauqua Industrial Development Agency (CCIDA), 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 CCIDA operated the ARC RLF in accordance with the grant agreement, and its RLF operating plan. The audit covered the period October 1, 2002 through March 31, 2004. Audit work at the grantee's office was completed on July 23, 2004.

The audit determined that CCIDA: (1) generally 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 in a timely manner. However, we determined that CCIDA needed to strength its procedures and controls to ensure: (1) the RLF Operating Plan fully complies with ARC requirements; and (2) key person life insurance for RLF loans is obtained when required. These areas are discussed in the Findings and Recommendations section of this report.

A draft report was provided to ARC and RLF officials for comment on August 2, 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 CCIDA personnel during the audit.

Sincerely,

Leon Snead & Company, P.C.
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 County of Chautauqua Industrial Development Agency (CCIDA). 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.

CCIDA was established as a public benefit corporation under Title 1, Article 18A of the General Municipal Law of the State of New York on March 22, 1972. The Agency manages and operates the Chautauqua Revolving Loan Fund to foster and maintain economic growth in Chautauqua, Cattaraugus and Allegany counties. The goals of the loan fund are to: (1) increase job opportunities; (2) increase per capita income; and (3) diversify and stabilize the general economic base.

CCIDA received its initial RLF grant in 1977. As of December 31, 2003, CCIDA had received \$964,572 in ARC grants funds, and had 18 loans outstanding, with unpaid balances totaling approximately \$729,000.

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 plan, 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 were 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 CCIDA activities during the period October 1, 2002 to March 31, 2004. Audit fieldwork was completed at CCIDA on July 23, 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 CCIDA to assure RLF operations adhered to applicable ARC Guidelines, OMB regulations, and CCIDA's grant agreement and operating plan. The audit included tests of CCIDA'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 CCIDA to validate that the costs were allowable, reasonable and supported. We also reviewed CCIDA's most recent single audits, 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 with *Government Auditing Standards*, and included appropriate tests necessary to achieve the audit objectives.

Summary of Audit

The audit determined that CCIDA: (1) generally operated the RLF 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. However, we determined that CCIDA needed to strength its procedures and controls to ensure: (1) the RLF Operating Plan fully complies with ARC requirements; and (2) key person life insurance for RLF loans is obtained when required. These areas are discussed in the Findings and Recommendations section of this report.

FINDINGS AND RECOMMENDATIONS

1. RLF Operating Plan

The current CCIDA 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. The Operating Plan also did not identify the members of the Loan Review Committee. Consequently, the Operating Plan did not fully comply with ARC regulations.

ARC RLF Guidelines, Section III.C.2 requires that 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 loan funds. Section III.C.1d of the Guidelines also requires that Operating Plans identify the members of the Loan Review Committee.

We reviewed CCIDA's current RLF Operating Plan to determine whether it included the requirements specified in the ARC RLF Guidelines. We determined that the Operating Plan did not: (1) include assurances or certifications that the RLF will be managed and operated in accordance with ARC policies and procedures; and (2) identify the members of the Loan Review Committee. We discussed these matters with CCIDA officials. They agreed that the current Operating Plan did not include these requirements, and it should be revised accordingly.

Recommendations

ARC should require CCIDA to revise its RLF Operating Plan to: (1) include assurances that the RLF will be managed and operated in accordance with the ARC RLF Guidelines; and (2) identify the members of the Loan Review Committee.

Management Response

The ARC Executive Director concurred with the finding and recommendation. CCIDA has revised its operating plan to include the required signed assurance of compliance with ARC guidelines and a current list of loan committee members is included in the revised operating plan.

Auditor's Comments

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

2. Key Person Life Insurance

CCIDA did not always obtain documentation verifying that borrowers had acquired key person life insurance. As a result, loan file documentation did not fully comply with ARC requirements, and ARC was exposed to potential losses.

For loans made to closely held corporations, partnerships, or proprietorships that are dependent on certain individuals for their continued success, ARC RLF Guidelines, Section V.B.4 states that these key persons will ordinarily be required to provide and assign life insurance policies to the grantee.

CCIDA approved a loan for Jo-Lyn Enterprises, Incorporated during April 1999. The loan was for purchasing machinery and equipment, and making building renovations. As a condition for the loan, the borrower was required to provide and assign a \$75,000 life insurance policy to CCIDA. The loan closed on July 29, 1999.

We reviewed the files for this loan during July 2004. We found that the borrower had a life insurance policy, and had filed a request with the insurance company to assign the policy to CCIDA. The loan files, however, did not contain an "Assignment of Life Insurance Policy as Collateral" or other documentation showing that the policy had actually been assigned to CCIDA. We discussed this matter with CCIDA officials. They agreed that documentation verifying that the life insurance policy had been assigned to CCIDA was needed. They indicated that appropriate actions would be taken to acquire the necessary documentation.

Recommendation

ARC should ensure CCIDA acquires and maintains appropriate documentation verifying that borrowers have obtained life insurance and assigned the policies to CCIDA whenever required.

Management Response

The ARC Executive Director agreed with the finding and recommendation. CCIDA responded that a \$75,000 life insurance policy has been obtained and documentation provided by CCIDA to ARC shows that the insurance has been assigned to CCIDA. In addition, CCIDA now uses a checklist to ensure that all proper documents are obtained before each loan is closed.

Auditor's Comments

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

**APPENDIX A
MANAGEMENT RESPONSE**



September 21, 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 Revolving Loan Fund at the County of Chautauqua Industrial Development Agency performed by Leon Snead & Company, P.C.

Dear Mr. Snead:

Thank you for your thorough examination of the County of Chautauqua Industrial Development Agency (CCIDA) ARC RLF grant. The assistance provided by this examination will aid CCIDA in keeping their RLF Operating Plan fully compliant with ARC RLF Guidelines and reemphasize the need to obtain the assignment of the life insurance policy that they required but did not obtain at the loan closing in 1999.

Please correct the typographical error on the first line (RLF instead of RFL) of the third paragraph on page 1 of the draft report. The second sentence of the third paragraph needs to be modified as CCIDA has received \$845,000 in ARC RLF grants. CCIDA returned \$119,572 of that amount in 1999 do to slow lending. This amount was returned to them as lending improved in late 1999-2001 thus the total amount of RLF loan funds currently paid to CCIDA is 964,572.

RLF Operating Plan

ARC agrees with the finding that the CCIDA RLF Operating Plan did not include an affirmation that the ARC funded RLF would be operated in accordance with ARC RLF polices contained in the BDRLF Guidelines. ARC agrees that the CCIDA Operating Plan did not include a current list of the members of the Loan Review Committee.

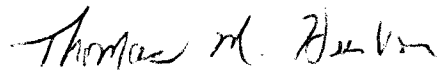
CCIDA has revised its operating plan, called the "Chautauqua Revolving Loan Fund" and included the required signed assurance, signed by the Administrative Director who is also the Grantee's Project Director, as required by ARC BDRLF Guidelines, paragraph III.C.2. A current list of the members of the Loan Review Committee was included with the revised operating plan.

Key Person Life Insurance

ARC agrees with the finding that the Jo-Lyn Enterprises loan file did not contain evidence of an assignment of life insurance as collateral required by CCIDA as a condition of lending. This condition was previously identified by ARC staff in 2002 as a result of a reoccurring visit to assess the quality of loan documentation.

CCIDA has responded that a \$75,000 life insurance policy has been assigned to the CCIDA and the paper work received. The document furnished ARC is a fax of a fax and appears to show that coverage began in 1999 when the loan closed. The document furnished shows that insurance has been assigned to CCIDA. ARC considers this sufficient to close this item. CCIDA reports that a checklist is now used to ensure that all proper documents are obtained for each loan closed.

Sincerely,

A handwritten signature in cursive script that reads "Thomas M. Hunter".

Thomas M. Hunter
Executive Director