




Memorandum for: Clifford Jennings, Inspector General
Appalachian Regional Commission

From: William Grant, RLF Program Manager 

Subject: OIG Report 05-06
Review of Revolving Loan Fund (RLF) Operated by the
Southwestern Pennsylvania Corporation (SPC)
Pittsburgh, Pennsylvania

Date: January 16, 2007

The report on the Revolving Loan Fund (RLF) Operated by the Southwestern Pennsylvania Corporation has been received and reviewed. The report included three compliance and two internal control recommendations. Four of the recommendations were kept open and outstanding. SPC agreed to change its cash deposit procedures in its original response to the audit. The following is a response to each recommendation:

SPC has delivered written responses to ARC dated April 11, 2005 and November 7, 2005 that addresses each of the recommendations below. These responses are submitted as part of the ARC response and are attached.

Compliance

Finding 1: K & K Gourmet Foods loan file does not contain an inter-creditor agreement with National City Bank as specified in the loan commitment letter.

National City Bank has refused to sign the inter-credit agreement and to settle this issue SPC has agreed to a second position on the collateral as approved in the original loan review committee decision. This acceptance is evidenced in a letter to ARC dated November 7, 2005.

Finding 2: Write off of three loans totaling \$356,767 to borrowers in bankruptcy.

At its January 31, 2005 Board of Directors meeting SPC approved the write off of the three loans to Fayco Plastics, Inc, Custom Woodworks, Inc, and Briary Enterprise, Inc. Subsequent SPC ARC RLF semi-annual reports have these amounts written off.

Finding 3: Discrepancy of \$5,330 in accounting for ARC/RLF funds.

In its letter of April 11, 2005 SPC notified ARC that these funds were deposited into the cash account for the RLF.

Internal Control

Finding 2: Separation of duties for maintaining time and attendance and preparing checks

In its letter of April 11, 2005 SPC states that "We have redistributed these duties and responsibilities and the payroll clerk no longer maintains the time and attendance records.



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Chairman

Bracken Burns
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James R. Hassinger
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Chuck DiPietro
Vice-President

Vincent M. Massaro
Secretary-Treasurer

April 11, 2005

Mr. Robert Decker
Director of Finance
Appalachian Regional Commission
1666 Connecticut Ave, NW, Suite 700
Washington, DC 20009-1068

Re: ARC Audit Letter dated December 15, 2004
ARC/RLF

Directors:

Tom Balya

Georgia Berner

Charles A. Camp

Steve Craig

Susan Golomb

Charles L. Gregory

William E. Hunt

James L. Kennedy

Dan Onorato

James V. Scahill

Bernie Smith

Vincent Vicites

Dear Mr. Decker:

Please accept our apology for not responding timely to this audit letter. We take seriously the findings mentioned and have taken action to correct them.

Our response to the audit findings are as follows:

1. ARC comment on the OIG finding of non-compliance relating to a loan to K & K Gourmet Meats, Inc. inter-creditor agreement between National City Bank and business owner.
Response: Staff is continuing to work to resolve this issue.
2. Write off of three loans: Fayco Plastics, Inc; Custom Woodworks, Inc; and Briary Enterprise, Inc.
Response: The SPC Board of Directors at its January 31, 2005 meeting adopted resolution #7-05 authorizing the write-off of these three loans as presented. A copy of said resolution is attached.
3. Discrepancy of \$5,330 in accounting for ARC/RLF funds.
Response: Authorization has been given to fund the cash account to replace shortage. Funds were deposited to the cash account.
4. Reportable condition #2. The duties of maintaining the time and attendance records and preparing paychecks being performed by the same person.
Response: We have redistributed these duties and responsibilities and the payroll clerk no longer maintains the time and attendance records.



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November 7, 2005

Officers:

Dave Coder
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Vice-Chairman

James R. Hassinger
President / CEO

Chuck DiPietro
Vice-President

Vincent M. Massaro
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James L. Kennedy

Dan Onorato

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Bernie Smith

Vincent Vicites

Robert Decker
Director Finance & Administration
1666 Connecticut Avenue
NW Suite 700
Washington DC 20009-1068

Dear Mr. Decker,

This letter is in response to your e-mail dated November 2, 2005 regarding the ARC IG audit 05-06 and the outstanding issue of an unsigned inter-creditor agreement with National City Bank for the 2002 loan to K & K Gourmet Meats, Inc.

SPC board affirmed it would accept a second position per our board action on the loan committee recommendation by resolution dated April 29, 2002 and on the ARC RLF form for Reporting Loans Disbursed/Requesting a Release of Grant Funds submitted prior to closing the loan.

We hereby affirm that we have attempted to secure a second position in compliance with the audit request instead of the first position we currently hold; National City Bank has been non responsive to our request to reduce our position in their favor.

While it has been our expressed intent to the bank that we accept a second position subordination of the loan with respect to the ARC funds, the ARC funds do remain secured by recorded lien regardless. We will accede to a second position if the bank signs the agreement as requested. This letter is intended to resolve this matter to the acceptance of the Inspector General. Please advise me if you need us to provide anything further.

Sincerely,

James R. Hassinger
President and CEO



September 30, 2004

MEMORANDUM FOR: FEDERAL CO-CHAIR
ARC EXECUTIVE DIRECTOR
SUBJECT: OIG Report 04-18 - ARC Grant AL-13495
Auburn University at Montgomery
Alabama Mentoring Entrepreneurial Network

Attached is a copy of the subject report dealing with the Auburn University at Montgomery in Montgomery, Alabama. There is one recommendation and \$128,133 in questioned costs.

The questioned costs are the result of the grantee's inclusion of ineligible participants into the program; unauthorized changes in the scope of work; unauthorized use of ARC funds; and internal control issues.

The grantee stated that they have revised their policies and procedures. Follow-up and oversight by ARC should result in the resolution of many of the issues raised in the report. This report will remain open pending receipt of your management response.

Please contact me if you have any questions on this issue.

Handwritten signature of Clifford H. Jennings

Clifford H. Jennings
Inspector General

Attachment

cc: Director, Program Operations Division
Alabama State Alternate
Alabama State ARC Program Manager

Handwritten number 239

**AUDIT OF THE ARC REVOLVING LOAN FUND
OPERATED BY
Southwestern Pennsylvania Corporation
Pittsburgh, Pennsylvania**

ARC Grant Number: PA-7752B-93-I-302-1117

October 1, 1992 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: 05-06

Date: November 12, 2004

**AUDIT OF THE ARC REVOLVING LOAN FUND
OPERATED BY
Southwestern Pennsylvania Corporation
Pittsburgh, Pennsylvania**

ARC Grant Number: PA-7752B-93-I-302-1117

October 1, 1992 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: 05-06

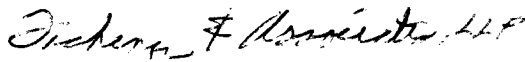
Independent Auditor's Report

We have audited the ARC RLF grant Schedule of Fund Balance of the Southwestern Pennsylvania Corporation as of April 30, 2004, and the related Statement of Source and Application of Funds for the period of October 1, 1992 through April 30, 2004. These financial statements are the responsibility of the Southwestern Pennsylvania Corporation. 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 Southwestern Pennsylvania Corporation's fiduciary activities as of April 30, 2004 and the source and application of funds resulting from fiduciary activities for the period of October 1, 1992 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 5, 2004 on our consideration of the Southwestern Pennsylvania Corporation'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 5, 2004

Southwestern Pennsylvania Corporation

**SCHEDULE OF FUND BALANCE
(As of April 30, 2004)**

Cash in Bank	<u>\$ 316,473</u>
Loans Outstanding	<u>1,498,853</u>
Other Investments	<u> </u>
Due from Other Accounts	<u> </u>
Other Assets	<u> </u>
Less: Current Liabilities	<u> </u>
Fund Balance	<u><u>\$1,815,326</u></u>

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

Southwestern Pennsylvania Corporation

**STATEMENT OF SOURCE AND APPLICATION OF FUNDS
(For the Period of October 1, 1992 through April 30, 2004)**

Source of Funds	
ARC Grant	\$ 806,955
Program Income Transferred	
from PA Department of Commerce	380,496
Loan Interest Income	477,477
Fees Charged	57,704
Other Income	98,024
Total Funds Available	<u>\$1,820,656</u>
Application of Funds	
Cash in Bank	\$ 316,473
Loans Outstanding	1,498,853
Administrative Expenses	0
Unreconciled Difference	5,330
Total Funds Applied	<u>\$1,820,656</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 Southwestern Pennsylvania Corporation as of and for the period of October 1, 1992 through April 30, 2004, and have issued our report thereon dated August 5, 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 Southwestern Pennsylvania Corporation'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 Southwestern Pennsylvania Corporation'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 Southwestern Pennsylvania Corporation'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

Tichenor & Associates, LLP

Louisville, Kentucky

August 5, 2004

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 Southwestern Pennsylvania Corporation 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-7752B-93-I-302-1117 to Southwestern Pennsylvania Corporation, effective October 1, 1992. Total grant funding was for \$806,955. 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 Southwestern Pennsylvania Corporation for the period of October 1, 1992 through April 30, 2004.

As of April 30, 2004, Southwestern Pennsylvania Corporation had twenty (20) ARC RLF loans outstanding, with an unpaid balance of \$1,498,853.

EXECUTIVE SUMMARY

Audit Results:

The audit resulted in the following:

1. Compliance

- 1.1. The loan file for K & K Gourmet Meats does not contain an inter-creditor agreement with National City Bank as specified in the loan commitment letter.
- 1.2. Briary Enterprises, Inc., Custom Woodworks, Inc., and Fayco Plastics, Inc. have all filed for Chapter 7 bankruptcy. Loan balances of \$96,588, \$188,333, and \$71,846, respectively, have not been written-off and remain on the grantee's financial reports as delinquent.
- 1.3. A discrepancy of \$5,330 was noted in the Statement of Source and Application of Funds, as of April 30, 2004.

2. Internal Control

- 2.1. Cash receipts are not deposited daily.
- 2.2. The duties of maintaining the time and attendance records and preparing paychecks are performed by the same person.

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

Recommendations:

We recommend that the ARC require that Southwestern Pennsylvania Corporation take the following actions:

1. Compliance

- 1.1. We recommend that a signed inter-creditor agreement be obtained.
- 1.2. We recommend that these loans be written-off.
- 1.3. Unless the discrepancy can be reconciled and properly documented, we recommend that the \$5,330 be returned to the RLF capital base.

EXECUTIVE SUMMARY

2. Internal Control

- 2.1. We recommend that all cash receipts be deposited on a daily basis.
- 2.2. We recommend that the duties of maintaining time and attendance records and preparing paychecks be segregated.

Auditee's Response:

1. Compliance

- 1.1. The Grantee stated that they will continue with the process of obtaining a signed inter-creditor agreement, and will add this to the loan file.
- 1.2. The Grantee stated that their Loan Review Committee had not yet authorized the write-off of these loans. As such, the loans will continue to be carried on the books as receivables.
- 1.3. The Grantee stated that they will continue to reconcile the account and correct for the discrepancy.

2. Internal Control

- 2.1. The Grantee stated that they will change their procedures and begin depositing cash on a daily basis.
- 2.2. The Grantee stated that they have in place sufficient payroll processing internal controls to minimize the possibility of misappropriation of funds. However, the Grantee also stated that they will review their payroll processing internal controls and, if found to be insufficient; will take to steps to correct.

Auditor's Conclusion:

We continue to recommend that the ARC require that the loans to Briary Enterprises, Inc., Custom Woodworks, Inc., and Fayco Plastics, Inc. be written-off, as we believe that it is unlikely that Southwestern Pennsylvania Corporation will collect any significant amounts.

We also believe that by implementing the other recommendations noted above, the Southwestern Pennsylvania Corporation 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 Southwestern Pennsylvania Corporation is meeting the objectives of its grant.

Southwestern Pennsylvania Corporation

SCHEDULE OF FINDINGS

SUMMARY OF AUDIT RESULTS

1. The auditors report expresses an unqualified opinion on the ARC RLF grant financial statements of the Southwestern Pennsylvania Corporation for the period of October 1, 1992 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. The loan file for K & K Gourmet Meats, Inc. does not contain an inter-creditor agreement with National City Bank. Both the Grantee and the bank have a collateral position in machinery owned by the borrower.

The Grantee stated that the bank has indicated that they refuse to sign the inter-creditor agreement.

ARC Guidelines (V.B.1) states that “when the purpose of a loan is for working capital a Grantee will normally obtain such collateral as liens on inventories, accounts receivable, fixed assets and/or other available assets of the borrower.” In this case, an inter-creditor agreement is warranted to indicate the amount each creditor receives in the event of default or bankruptcy.

In the event that the borrower defaults on the loan or files for bankruptcy, the lack of an inter-creditor agreement could cause a reduction in the RLF capital base and the amount of funds available to loan.

We recommend that the Grantee resolve this issue with National City Bank and obtain a signed inter-creditor agreement.

In response to our draft report, the Grantee stated that they will continue to proceed with getting this document signed and when signed, will place this document in the loan file.

2. Briary Enterprises, Inc., Custom Woodworks, Inc., and Fayco Plastics, Inc. have all filed for Chapter 7 bankruptcy. The loan balances of \$96,588, \$188,333, and \$71,846,

respectively, have not been written-off, but remain on the Grantee's financial reports as delinquent.

The Grantee stated that its Loan Review Committee had decided not to write-off these loans.

Generally accepted accounting principles require that uncollectible accounts be written-off and not included in fund balances.

If the loans remain on the Grantee's records as delinquent, loan pool dollars are overstated by the amounts that will not likely be recovered. In addition, the remaining balances of the loans are still included in the fund balance. An overstated fund balance could result in excess cash being held.

We recommend that the ARC require that these loans be written-off, as we believe it is unlikely that Southwestern Pennsylvania Corporation will collect any significant amounts.

In response to our draft report, the Grantee stated that their Loan Review Committee had not yet authorized the write-off of these loans, and as such, they will continue to carry them on the books as loan receivables.

3. A discrepancy of \$5,330 was noted in the Statement of Sources and Application of Funds, as of April 30, 2004. The Grantee's records showed "Total Funds Available" to be \$1,820,656 and "Total Funds Applied" to be \$1,815,326 for the difference of \$5,330.

The Grantee stated that this difference is due to mis-postings over the years.

ARC Guidelines (VI.F.6) requires that grantees maintain accurate financial records of RLF activities.

Failure to maintain accurate records could result in funds being expended for purposes contrary to ARC objectives and/or a reduction in the RLF capital base and the amount of funds available to loan.

We recommend that the ARC require that the Grantee return the \$5,330 to the RLF capital base, unless the discrepancy can be reconciled and properly documented.

In response to our draft report, the Grantee stated that they will continue to reconcile the account and correct for the difference.

REPORTABLE CONDITIONS

1. Cash receipts are not deposited daily.

The Grantee stated that cash receipts are deposited at least weekly.

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

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 change their cash receipts depositing procedures to reflect daily depositing of funds.

2. The duties of maintaining the time and attendance records and preparing paychecks are performed by the same person.

Proper internal control procedures require that the duties of maintaining time and attendance records and preparing paychecks be segregated.

Failure to segregate these duties could lead to the misappropriation of funds.

We recommend that the duties of maintaining time and attendance records and preparing paychecks be segregated.

In response to our draft report, the Grantee stated that they have in place sufficient payroll processing internal controls that minimize the possibility of any misappropriation of funds. The Grantee further stated the its Finance Director will review the payroll processing internal controls and verify that they are sufficient in guarding against any misappropriation of funds; if found to be insufficient, then steps will be taken to correct.

AUDITOR'S CONCLUSION

We continue to recommend that the ARC require that the loans to Briary Enterprises, Inc., Custom Woodworks, Inc., and Fayco Plastics, Inc. be written-off, as we believe that it is unlikely that Southwestern Pennsylvania Corporation will collect any significant amounts.

We also believe that by implementing the other recommendations noted above, the Southwestern Pennsylvania Corporation 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 Southwestern Pennsylvania Corporation is meeting the objectives of its grant.