



December 8, 2004


Memorandum for:     The Federal Co-Chair  
                                  ARC Executive Director

Subject:                OIG Report 05-09  
                                  Review of Revolving Loan Fund (RLF) Grant for the  
                                  Northeastern Pennsylvania Alliance

Attached are copies of the subject report dealing with the RLF grant to the Northeastern Pennsylvania Alliance. The Northeastern Pennsylvania Alliance received its initial RLF Grant in 1992. As of April 30, 2004, the Southwestern Pennsylvania Corporation had received \$833,333 in ARC grant funds and has 24 loans outstanding, with an unpaid balance totaling \$747,210.

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

This report is considered closed. However, ARC staff should verify that the promised actions have indeed taken place. Of special importance is getting formal documentation to support there telephonic assurance to the auditors on the internal control finding. 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

**TICHENOR & ASSOCIATES, LLP**  
CERTIFIED PUBLIC ACCOUNTANTS and MANAGEMENT CONSULTANTS

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November 30, 2004

Mr. Clifford H. Jennings, Inspector General  
Appalachian Regional Commission  
1666 Connecticut Avenue, NW, Suite 215  
Washington, DC 20235


RE: Final Audit Report on of the following:

1. Northeastern Pennsylvania Alliance – Grant No. PA-8291A-92-C1-302-0827 and PA-7752D-93-I-302-1117
2. Northwest Pennsylvania Regional Planning and Development Commission – Grant No. PA-8285-81-I-302-0723 and PA-7752F-93-I-302-1117

Dear Mr. Jennings:

Enclosed please find five copies of each of our final audit reports on the above listed Grantees. Report numbers have been included. It has been our pleasure working with you and your staff on this project. If we can be of further assistance, please call (502) 245-0775.

Sincerely,

  
William R. Tichenor  
Tichenor & Associates, LLP

Enclosures

WRT/jps

**AUDIT OF THE ARC REVOLVING LOAN FUND  
OPERATED BY  
Northeastern Pennsylvania Alliance  
Pittston, Pennsylvania**

**ARC Grant Numbers: PA-8291A-92-C1-302-0827  
PA-7752D-93-I-302-1117**

**September 18, 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: 05-09**

**Date: November 30, 2004**

**AUDIT OF THE ARC REVOLVING LOAN FUND  
OPERATED BY  
Northeastern Pennsylvania Alliance  
Pittston, Pennsylvania**

**ARC Grant Numbers: PA-8291A-92-C1-302-0827  
PA-7752D-93-I-302-1117**

**September 18, 1992 through April 30, 2004**

**Prepared By:**

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

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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: 05-09


## Independent Auditor's Report

We have audited the ARC RLF grant Schedule of Fund Balance of the Northeastern Pennsylvania Alliance as of April 30, 2004, and the related Statement of Source and Application of Funds for the period of September 18, 1992 through April 30, 2004. These financial statements are the responsibility of the Northeastern Pennsylvania Alliance. 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 Northeastern Pennsylvania Alliance's fiduciary activities as of April 30, 2004 and the source and application of funds resulting from fiduciary activities for the period of September 18, 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 July 16, 2004 on our consideration of the Northeastern Pennsylvania Alliance'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  
July 16, 2004

**Northeastern Pennsylvania Alliance**

**SCHEDULE OF FUND BALANCE**

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

Cash in Bank	<u>\$ 356,830</u>
Loans Outstanding	<u>747,210</u>
Other Investments	<u>                    </u>
Due from Other Accounts	<u>                    </u>
Other Assets	<u>                    </u>
Less: Current Liabilities	<u>                    </u>
Fund Balance	<u>\$1,104,040</u>

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

**Northeastern Pennsylvania Alliance**

**STATEMENT OF SOURCE AND APPLICATION OF FUNDS  
(For The Period of September 18, 1992 through April 30, 2004)**

Source of Funds	
ARC Grant	<u>\$ 833,333</u>
Program Income Transferred	
From PA Department of Commerce	<u>155,054</u>
Loan Interest Income	<u>309,939</u>
Fees Charged	<u>29,005</u>
Other Income	<u>85,650</u>
 Total Funds Available	 <u><u>\$1,412,981</u></u>
 Application of Funds	
Cash in Bank	<u>\$ 356,830</u>
Loans Outstanding	<u>747,210</u>
Grant Funds Returned	<u>36,040</u>
Match for EDA Fund	<u>95,402</u>
Loan Losses	<u>83,533</u>
Administrative Expenses	<u>93,966</u>
 Total Funds Applied	 <u><u>\$1,412,981</u></u>

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



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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 Northeastern Pennsylvania Alliance as of and for the period of September 18, 1992 through April 30, 2004, and have issued our report thereon dated July 16, 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 Northeastern Pennsylvania Alliance 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 an instance of noncompliance that is required to be reported under Government Auditing Standards which is described in the accompanying Schedule of Findings.

### **INTERNAL CONTROL OVER FINANCIAL REPORTING**

In planning and performing our audit, we considered the Northeastern Pennsylvania Alliance'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 a certain matter involving the internal control over financial reporting and its operation that we consider to be a reportable condition. 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 Northeastern Pennsylvania Alliance's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. One reportable condition is 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 do not believe the reportable condition 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

July 16, 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 Northeastern Pennsylvania Alliance 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 Numbers PA-8291A-92-C1-302-0827 and PA-7752D-93-I-302-1117 to Northeastern Pennsylvania Alliance, effective September 18, 1992 and October 1, 1992, respectively. Total funding for the two grants was \$833,333. ARC did not require that the grants 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 Northeastern Pennsylvania Alliance for the period of September 18, 1992 through April 30, 2004.

As of April 30, 2004, Northeastern Pennsylvania Alliance had twenty-four (24) ARC RLF loans outstanding, with an unpaid balance of \$747,210.

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## EXECUTIVE SUMMARY

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### **Audit Results:**

The audit resulted in the following:

a. Compliance

1. The Grantee's RLF Operating Plan does not indicate whether or not administrative expenditures are to be charged to the ARC RLF program.

b. Internal Control

1. 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 Northeastern Pennsylvania Alliance take the following actions:

a. Compliance

1. We recommend that the RLF Operating Plan be updated to indicate that administrative expenditures may be offset against program income accumulated from ARC RLF lending activities.

b. Internal Control

1. We recommend that persons in key financial positions be required to take annual vacations of at least one week.

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

In response to our draft report, Northeastern Pennsylvania Alliance officials updated the RLF Operating Plan to allow administrative expenditures to be charged against program income accumulated from ARC RLF lending activities. The ARC OIG approved this change.

Northeastern Pennsylvania Alliance did not formally respond to our internal control finding, but did indicate, via telephone conversation, its willingness to implement to our recommendation.

A copy of Northeastern Pennsylvania Alliance's complete response to the draft report is included in this report as Exhibit – Auditee's Response.

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## EXECUTIVE SUMMARY

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

We believe that by implementing the above recommendations, the Northeastern Pennsylvania Alliance 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 operating information applicable to the revolving loan program. We further believe that the Northeastern Pennsylvania Alliance is meeting the objectives of its grant.

## **Northeastern Pennsylvania Alliance**

### **SCHEDULE OF FINDINGS**

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

1. The auditors report expresses an unqualified opinion on the ARC RLF grant financial statements of the Northeastern Pennsylvania Alliance for the period of September 18, 1992 through April 30, 2004.
2. One (1) instance of noncompliance was disclosed during the audit.
3. One (1) reportable condition was disclosed during the audit.

#### **FINDINGS AND RECOMMENDATIONS**

##### **NONCOMPLIANCES**

1. ARC RLF Guidelines require that a statement identifying the planned source of funds for financing the administrative expenditures of operating the RLF must be incorporated into the RLF Operating Plan.

The current RLF Operating Plan does not indicate whether or not administrative expenditures are to be charged to the ARC RLF program. However, the Grantee stated that they did seek and receive approval from ARC to charge administrative expenses to the ARC RLF program, which does reduce the loan pool dollars. The Grantee further stated that they did not realize that this procedure needed to be outlined in the RLF Operating Plan.

The fact that the RLF Operating Plan does not state that administrative expenditures are or are not to be charged to the ARC RLF program, when in fact administrative expenditures are being charged, is not consistent with ARC guidelines and with the semi annual report.

We recommend that the Grantee update the RLF Operating Plan to indicate that administrative expenditures will be offset against program income accumulated from ARC RLF loan activities.

In response to our draft report, the Grantee updated the RLF Operating Plan to allow administrative expenditures to be charged against program income accumulated from ARC RLF loan activities and ARC approved this change. (See Exhibit – Auditee’s Response.)

## **REPORTABLE CONDITIONS**

1. Proper internal control procedures suggest that all employees in key financial positions be required to take annual vacations.

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

Presently, employees in key financial positions are not required to take annual vacations.

We recommend that employees in key financial positions be required to take annual vacations of at least one week.

The Grantee did not formally respond to this finding, but did indicate, via telephone conversation, its willingness to implement our recommendation.

## **AUDITOR'S CONCLUSION**

We believe that by implementing the above recommendations, the Northeastern Pennsylvania Alliance 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 Northeastern Pennsylvania Alliance is meeting the objectives of its grant.

**EXHIBIT**

**Auditee's Response**



Northeastern Pennsylvania Alliance

**NEPA**



October 29, 2004

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

RE: Northeastern Pennsylvania Alliance  
Draft Audit/ARC Revolving Loan  
Fund Program

Dear Mr. Somerville:

Reference is herein made to the Draft Audit Report of the Appalachian Regional Commission (ARC) Revolving Loan Fund Program (RLF) operated by the Northeastern Pennsylvania Alliance (ARC Grant Numbers: PA-8291A-92-C1-302-0827 and PA-7752D-93-1-302-117) prepared by Tichenor & Associates, LLP for the period September 18, 1992 through April 30, 2004.

The Audit resulted in the identification of one compliance issue that the Northeastern Pennsylvania Alliance RLF Operating Plan does not indicate whether or not administrative expenditures are to be charged to the ARC RLF Program.

Prior to the completion of the Draft Audit Report, the Northeastern Pennsylvania Alliance amended its ARC RLF Administrative Plan to allow administrative expenditures to be charged against program income accumulated from ARC RLF activities.

This amended Administrative Plan was submitted to ARC on August 25, 2004 and approved on September 15, 2004. Paragraph 11 of the amended ARL RLF Administrative Plan is attached to this correspondence for your review.

NEPA appreciates the opportunity to comment on the Draft Audit Report. Please contact me with any questions or comments that you may have.

Sincerely,

A handwritten signature in black ink, appearing to read "Cameron Moore", written over a horizontal line.

Cameron Moore  
President & CEO

CM/db

- F. One borrower will not have more than 20% of the total ARC RLF capitalization based upon their outstanding loan balances through multiple loans.
- G. A borrower is eligible for RLF financing only when credit is not otherwise available on terms and conditions that would permit accomplishment of the borrower's project. RLF participation in a project will not displace local commercial lending. NEPA is responsible for determining that a borrower meets this requirement and for maintaining documentation in the loan file describing, in each case, the basis for the determination. A borrower eligibility determination will be supported by either:
- a. A loan commitment letter from the commercial lender participating in the project.
  - b. A commercial lender letter declining participation.
  - c. A memorandum documenting discussions with commercial lenders about the limits of their participation in a borrower's project.

## **11. ADMINISTRATIVE COSTS**

NEPA intends to utilize grant funds and program fees (commitment fee) to cover necessary administrative costs of the RLF, as much as possible. However, at times it may become necessary to utilize program income to cover administrative costs (direct, indirect, as well as legal costs). In these situations, NEPA would have the ability to utilize program income generated by the ARC RLF to cover these expenses.

NEPA will keep complete records to document these administrative costs including direct, in-direct costs as well as legal expenses relating to loan collection activities.