



August 4, 2005

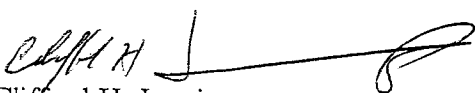
Memorandum for: The Federal Co-Chair
ARC Executive Director

Subject: OIG Report 05-18
Review of Revolving Loan Fund (RLF) Grants for the
Mid-Ohio Valley Regional Planning and Development Council

Attached are copies of the subject report dealing with the RLF grants to the Mid-Ohio Valley Regional Planning and Development Council (the Council). The Council received its initial RLF grant in 1998. As of March 31, 2005, the Council had received \$1,215,000 in ARC RLF grants, and has 17 loans outstanding, with unpaid balances totaling approximately \$1.1 million.

The report contains four 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.


Clifford H. Jennings
Inspector General

Attachment

cc: Director for Program Operations
Director for Finance and Administration

**APPALACHIAN REGIONAL COMMISSION
OFFICE OF INSPECTOR GENERAL
AUDIT OF REVOLVING LOAN FUND
Mid-Ohio Valley Regional Planning and
Development Council
Parkersburg, West Virginia**

**Report No. 05-18
July 2005**

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



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

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& Management Consultants*

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July 26, 2005

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 Mid-Ohio Valley Regional Planning and Development Council (the Council) 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 Council operated the ARC RLF in accordance with the grant agreement, and its RLF operating plan. The audit covered the period October 1, 2003 through April 15, 2005. Audit work at the grantee's office was completed on April 15, 2005.

The audit determined that the Council: (1) operated the RLF in general 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 accurately and timely. However, we determined that the Council needed to strengthen its procedures and controls to ensure: (1) its RLF Operating Plan fully complies with ARC requirements; (2) loan agreements include all required provisions; (3) the ARC loan participation rate does not exceed 80 percent; and (4) loan file documentation is maintained in accordance with ARC regulations. These areas are discussed in the Findings and Recommendations section of this report.

A draft report was provided to ARC and RFL officials on May 19, 2005. The ARC Director of Finance and Administration provided documentation in a letter dated June 28, 2005 addressing our audit recommendations. These comments are included in their entirety in Appendix A.

Leon Snead & Company appreciates the cooperation and assistance received from the Council personnel and the ARC RLF Manager 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 Mid-Ohio Valley Regional Planning and Development Council (the Council). 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.

The Council was established in 1971 as a political subdivision of the State of West Virginia under Chapter 8, Article 25 of the Code of West Virginia. Its mission is to promote regional planning and economic development relating to the ARC program in Calhoun, Jackson, Ritchie, Roane and Wirt Counties in the State of West Virginia.

The Council is governed by a Board of Directors which is composed, on an ex officio basis, of the Presidents of the County Commissions, or a representative thereof, from the five counties identified above; the Mayors, or a representative thereof, of each of the municipalities within the Council's designated counties; and a member of the Development Authority Board of each of the counties.

The Council received its ARC grant on September 28, 1998. As of March 31, 2005, the Council had received \$1,215,000 of ARC funds, and had 18 outstanding loans with unpaid balances totaling approximately \$1.1 million.

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

Council activities during the period October 1, 2003 to April 15, 2005. Audit fieldwork was completed at the Center on April 15, 2005.

We reviewed grantee policies and operating procedures to gain an understanding of the grantee's system of administrative and accounting controls. In addition, we assessed the accounting and administrative controls established by the Council to assure RLF operations adhered to applicable ARC Guidelines, OMB regulations, and the Council's grant agreement and operating plan. The audit included tests of the Council'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 the Council to validate that the costs were allowable, reasonable and supported. We also reviewed the Council'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 the Council: (1) operated the RLF in general 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 accurately and timely. However, determined that the Council needed to strength its procedures and controls to ensure: (1) its RLF Operating Plan fully complies with ARC requirements; (2) loan agreements include all required provisions; (3) the ARC loan participation rate does not exceed 80 percent; and (4) loan file documentation is maintained in accordance with ARC regulations. These areas are discussed in the Findings and Recommendations section of this report.

FINDINGS AND RECOMMENDATIONS

1. RLF Operating Plan

The Council's current RLF Operating Plan did not include required information relating to four areas and contained inaccuracies. Consequently, the Operating Plan did not fully comply with ARC requirements.

ARC RLF Guidelines, Section III.C require that RLF Operating Plans must include, among others: (1) the proportion of the grantee's RLF lending capacity that one borrower may have outstanding (unpaid) through multiple loans; (2) the definition of a delinquent loan, and the actions the grantee plans to take to deal with a delinquency; (3) a statement identifying the planned source of funds for financing the administrative expenditures of operating the RLF; and (4) the names of the Loan Review Committee members, and a brief statement of each member's commercial loan experience.

We reviewed the Council'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 include: (1) the proportion of lending capacity one borrower may have unpaid through multiple loans; (2) a definition of a delinquent loan, and the planned actions to deal with a delinquency; (3) the planned source of funds for financing administrative expenditures; and (4) statements explaining the Loan Review Committee members' commercial lending experience.

During our review of the RLF Operating Plan, we also determined that the Plan included some inaccurate statements. These inaccuracies were as follows.

- the Plan stated that ARC RLF participation levels in Tyler, Pleasants, Jackson and Wood Counties will not exceed 50 percent of the total project costs. This statement should not have been included in the Plan because Tyler, Pleasants and Wood Counties were not included in the ARC grant. Furthermore, the loan participation level for Jackson County should be between 50 percent and 80 percent.
- the Plan also stated that a borrower's equity contribution must be at least 10 percent; however, ARC approved a minimum borrower equity level of 5 percent on November 18, 2004.

We discussed these matters with Council officials. They agreed that the current Operating Plan did not include all of the elements specified in the ARC RLF Guidelines, as discussed above, and it should be revised accordingly. They also stated that the inaccuracies we identified in the Operating Plan were corrected after we informed the Council of these matters. They provided us with a corrected Operating Plan.

Recommendation

ARC should ensure the Council revises its RLF Operating Plan to include each of the elements specified in ARC RLF Guidelines.

Management Response

The ARC Director of Finance and Administration responded that the Council provided ARC a revised “Targeted Revolving Loan Fund Operating Plan.” The revised Plan included the elements required by the ARC RFL Guidelines. The revised Plan also appropriately addressed loan participation levels in eligible counties, and stated that the required borrower equity participation is 5% of the total project cost.

Auditor’s Comments

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

2. Loan Agreements

The Council's loan agreement did not include provisions for immediate recovery of the loan principal under certain conditions. As a result, the loan agreement did not comply with ARC requirements.

ARC RLF Guidelines, Section V.A.7 requires that loan agreements must include language that permits the immediate recovery of the loan principal, or an increase in the 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 jobs saved in the project will not meet the Grantee's RLF Operating Plan criteria.

Our review of the Council's current loan agreement revealed that it did not include provisions for the immediate recovery of the loan principal if the funds are not used for the purpose stated in the loan application, or if the number of jobs created or saved do not meet the RLF Operating Plan criteria. We discussed this matter with Council officials. They agreed that the Operating Plan did not include provisions for the immediate recovery of the loan principal. They stated that the Operating Plan would be revised to ensure it complies with ARC regulations.

Recommendation

ARC should ensure the Council's loan agreement includes provisions for the immediate recovery of the loan principal if the funds are not used for the purpose specified in the loan application, or if the number of jobs created or saved do not meet the RLF Operating Plan criteria.

Management Response

The Council has provided ARC a draft RFL loan agreement. This agreement includes provisions for the immediate recovery of the loan principal or an increase in the interest rate to commercial levels if: (1) funds are not used for the purpose specified in the loan application; or (2) the number of jobs created or saved in the project will not meet the requirements stated in the RLF Operating Plan.

Auditor's Comments

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

3. Loan Participation Rate

The ARC loan participation rate for a loan made to North Fork Logging, Incorporated was 91%. This participation rate exceeded the maximum allowable rate of 80%.

ARC RLF Guidelines, Section IV.D states that the grantee's RLF Operating Plan designates the maximum percentage of costs of any loan project that may be financed from ARC RLF sources. The Guidelines further state that loans are limited to 50% of project costs, except for distressed counties, which may borrow up to 80% of the total project cost. The Council's current RLF Operating stated that the ARC loan participation rate will range from 50% to 80%.

The Council closed a loan with North Fork Logging, Incorporated on March 9, 2005. The loan was for the acquisition of an existing logging operation. The total project cost was \$165,000 which included a \$150,000 ARC loan and borrower equity of \$15,000. Consequently, the ARC loan participation rate was 91% (i.e. \$150,000 divided \$165,000).

We discussed this matter with Council officials. They agreed that the ARC loan participation rate for the North Fork Logging loan exceeded the maximum allowable rate. They stated that the loan would be restructured to ensure it complies with ARC requirements. They indicated that the ARC loan amount would be reduced to \$135,000, and other appropriate adjustments would be made ensure compliance with the ARC loan participation rate.

Recommendation

ARC should ensure the Council takes appropriate actions to reduce the ARC loan participation rate to 80% or less for the North Fork Logging, Incorporated loan.

Management Response

The Council has reduced the loan participation rate for the North Fork Logging project to 80%.

Auditor's Comments

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

4. Loan File Documentation

The Council's loan files did not include all required documents, and the loan information the Council provided to ARC for certain loans was inaccurate. Consequently, the Council did not fully comply with ARC requirements.

ARC RLF Guidelines, Section IV.3 states:

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 must not displace local commercial lenders. The Grantee 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 must be supported by either: (a) a loan commitment letter from the commercial lender participating in the project; (b) a commercial lender letter declining participation; or (c) a memorandum documenting discussions with commercial lenders about the limits of their participation in a borrower's project.

ARC RLF Guidelines, Appendix A, "Reporting Loans Disbursed/Requesting a Release of Grants Funds", must be used to report each loan closed to ARC. Appendix A also requires that certain documents be maintained in the loan files, including a credit report or credit verification.

We performed a detailed review of five loans and the associated loan files. Our review identified the following loan file documentation deficiencies.

1. four of the loan files (Boyles & Hildreth Consulting Engineers, Incorporated; North Fork Logging, Incorporated; Life-Tite Medal Products, LLC; and Hayhurst Equipment, Incorporated) did not contain sufficient documentation of the borrowers' eligibility determinations.
2. one loan (Boyles & Hildreth Consulting Engineers, Incorporated) file did not include documentation that a credit check or credit verification was performed.
3. for two loans (Life-Tite Medal Products, LLC and Morkop, Incorporated) the information provided to ARC in the Report of Loans Disbursed/Request for Release of Grant Funds did not accurately reflect the actual terms and conditions of the loans.

We discussed these matters with Council officials. They agreed that additional documentation on borrower eligibility determinations was needed, and the loan file for Broyles & Hildreth should have included documentation that a credit verification was performed. They also informed us that a revised RFL Report of Loans Disbursed/Request for Release of Grants Funds for Morkop, Incorporated was provided to ARC after we informed the Council of this matter. A revised report on the Life-Tite Medal Products loan will also be provided to ARC.

Recommendation

ARC should ensure the Council: (1) maintains adequate loan file documentation on borrower eligibility determinations and credit checks or credit verifications; and (2) accurate and complete Reports of Loans Disbursed/Requests for Release of Grant Funds are provided to ARC.

Management Response

The ARC Director of Finance and Administration stated that the Council has provided ARC with sufficient documentation of eligibility determinations for the loans made to North Fork Logging, Incorporated; Life-Tite Metal Products, LLC; and Hayhurst Equipment, Incorporated. The Director also stated that the Council has provided ARC sufficient credit information on the loan made to Broyles & Hildreth Consulting Engineers, Incorporated.

Auditor's Comments

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



**APPALACHIAN
REGIONAL
COMMISSION**

*A Proud Past,
A New Vision*

June 28, 2005

Leon Snead, President
Leon Snead & Company, P.C.
416 Hungerford Drive, Suite 400
Rockville, Maryland 20850

Subject: Management Response to an ARC Inspector General Audit of the ARC Funded Revolving Loan Fund at the Mid-Ohio Valley Regional Council performed by Leon Snead & Company, P.C.

Dear Mr. Snead:

Thank you for your thorough examination of the Mid-Ohio Valley Regional Council (MOVRC) ARC RLF grant contract WV-13206. The assistance provided by this examination will enhance ARC's oversight over the grantee's activities. The following is provided as comment on the draft report.

RLF Operating Plan

The Mid-Ohio Valley Regional Council has provided ARC with a revised Targeted Revolving Loan Fund Operating Plan. The revised plan includes: (1) in paragraph 11.f. the statement that applicants are limited to a maximum loan amount of \$150,000 through multiple loans; (2) in paragraph 12.i. the definition of a delinquent loan and the planned actions to deal with the delinquency; (3) in paragraphs 12.c., 12.f. and 12.h. the definition of the planned source of funds for financing administrative expenditures, and (4) in paragraph 12.l. a general explanation of the loan review committee members commercial lending experience. MOVRC has provided a more detailed description of member's commercial lending experience as Appendix A to the Targeted RLF Operating Plan that complies with ARC RLF Guidelines.

ARC can find no reference in the Targeted Revolving Loan Fund RLF Operating Plan to the West Virginia counties of Tyler, Pleasants and Wood. The ARC Grant made to MOVRC did not include those counties in its scope. Jackson county is currently categorized as a transitional county for the purposes of the ARC financial program under the authority provided by Section 14526a., Title 40 U.S.C. The maximum loan participation allowed is 50% of a project. (see Section 14507g.1., Title 40 U.S.C.)

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Mississippi
New York

North Carolina
Ohio

Pennsylvania
South Carolina

Tennessee
Virginia

West Virginia

MOVRC's revised Targeted RLF Operating Plan states that the required borrower equity participation shall be 5% of the total project cost.

Loan Agreements

MOVRC has provided ARC with a draft ARC/RLF Loan Agreement which in paragraph 6 provides that 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 jobs saved in the project will not meet the requirements stated in the Lender's ARC RLF Operating Plan the Lender reserves the right to seek immediate recovery of the loan principal or to increase the interest rate to commercial levels. This satisfies the wording desired by the Audit however it is a statement of future action that requires follow up to confirm its effectiveness.

Loan Participation Rate

MOVRC has taken action to reduce the ARC RLF participation in the North Fork Logging loan project to the maximum allowable of 80% of the project.

Loan File Documentation

1. The loan to Boyles & Hildreth, Consulting Engineers, was approved as an exception to ARC RLF Guidelines, paragraph IV.A.3. as authorized in paragraph V.A.2. and documented in the RLF Form. MOVRC has provided additional documentation for the North Fork Logging, Inc. loan that satisfies the requirement of ARC BDRLF Guidelines, paragraph IV.A.3.a. MOVRC has provided additional documentation for the LIFE-TITE Products, LLC loan that satisfies the requirement of ARC BDRLF Guidelines, paragraph IV.A.3.c. MOVRC has provided additional documentation for the Hayhurst Equipment, Inc. loan that satisfies the requirement of ARC BDRLF Guidelines, paragraph IV.A.3.c. This item is considered closed.

2. MOVRC has responded with sufficient credit information on Boyles & Hildreth, Consulting Engineers to comply with the good lending practice of assessing a borrower's ability to repay the debt. A memo evidencing the credit evaluation should be in the loan file. This will require future follow-up.

3. MOVRC has provided ARC with the RLF form evidencing the loan project for LIFE-TITE Metal, LLC that MOVRC attests is an accurate as to actual terms and conditions of the loan. As presented the loan project is in accord with ARC BDRLF criteria. On April 14, 2005 ARC received a revised RLF Form on the MORKOP, Inc. loan project along with an explanation of the changes from the original. As presented in the revised RLF Form this loan is also in accord with ARC BDRLF criteria. ARC considers this item closed.

Sincerely,

A handwritten signature in black ink, appearing to read "Robert M. Decker", with a long horizontal flourish extending to the right.

Robert M. Decker, Director
Finance and Administration