APPALACHIAN REGIONAL COMMISSION
A Proud Past, A New Vision

March 16, 2006

Memorandum for: The Federal Co-Chair
ARC Executive Director

Subject: OIG Report 06-04
Review of Revolving Loan Fund (RLF)
Operated by the North Central Pennsylvania
Regional Planning & Development Commission
Ridgway, Pennsylvania

Attached is the subject report dealing with the RLF grant to the North Central Pennsylvania Regional Planning & Development Commission. As of April 30, 2004, the North Central Pennsylvania Regional Planning & Development Commission RLF grant had a balance of $2,007,181. The North Central Pennsylvania Regional Planning & Development Commission received its initial RLF grant in 1983. Combined with a subsequent grant in 1992, total funding for the two grants was $1,090,810. As of April 30, 2004, the North Central Pennsylvania Regional Planning & Development Commission had 37 loans outstanding, with an unpaid balance totaling approximately $1,623,166.

The report contains six instances of noncompliance and one reportable condition. The report includes four recommendations. This report will be kept open until the recommendations have been implemented.

Clifford H. Jennings
Inspector General

Attachment

cc: Director for Program Operations
Director for Finance and Administration
Mary Moran

1666 CONNECTICUT AVENUE, NW WASHINGTON, DC 20009-1068 (202) 884-7675 FAX (202) 884-7696

Alabama Georgia Kentucky Maryland Mississippi New York North Carolina Ohio Pennsylvania South Carolina Tennessee Virginia West Virginia

AUDIT OF THE ARC REVOLVING LOAN FUND
OPERATED BY
North Central Pennsylvania Regional Planning & Development Commission
Ridgway, Pennsylvania

ARC Grant Numbers: PA-8844-83-Y1-302-0815
PA-7752G-93-I-302-1117

July 1, 1983 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: 06-04

Date: March 9, 2006

AUDIT OF THE ARC REVOLVING LOAN FUND
OPERATED BY
North Central Pennsylvania Regional Planning & Development Commission
Ridgway, Pennsylvania

ARC Grant Numbers: PA-8844-83-Y1-302-0815
PA-7752G-93-I-302-1117

July 1, 1983 through April 30, 2004

Prepared By:

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

TABLE OF CONTENTS

TICHENOR & ASSOCIATES, LLP

CERTIFIED PUBLIC ACCOUNTANTS and MANAGEMENT CONSULTANTS

304 MIDDLETOWN PARK PLACE, SUITE C
LOUISVILLE, KY 40243

BUSINESS: (502) 245-0775
FAX: (502) 245-0725
E-MAIL: TICHENORKY@AOL.COM

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: 06-04

Independent Auditor's Report

We have audited the ARC-RLF grant Schedule of Fund Balance of the North Central Pennsylvania Regional Planning & Development Commission as of April 30, 2004, and the related Statement of Source and Application of Funds for the period July 1, 1983 through April 30, 2004. These financial statements are the responsibility of the North Central Pennsylvania Regional Planning & Development Commission. 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 North Central Pennsylvania Regional Planning & Development Commission fiduciary activities as of April 30, 2004 and the source and application of funds resulting from fiduciary activities for the period July 1, 1983 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 June 25, 2004 on our consideration of the North Central Pennsylvania Regional Planning & Development Commission'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

Tichenor & Associates, LLP
Louisville, Kentucky
June 25, 2004

Columbus, OH Detroit, MI Frankfort, KY Alexandria, VA

North Central Pennsylvania Regional Planning & Development Commission

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

Cash in Bank	$ 384,015
Loans Outstanding	1,623,166
Other Investments	
Due from Other Accounts	
Other Assets	
Less: Current Liabilities	
Fund Balance	$2,007,181

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

North Central Pennsylvania Regional Planning & Development Commission

STATEMENT OF SOURCE AND APPLICATION OF FUNDS
(For the Period July 1, 1983 – April 30, 2004)

Source of Funds	
ARC Grant	$1,090,810
Program Income Transferred	
from PA Department of Commerce	345,999
from Housing Revolving Loan Fund	120,739
Loan Interest Income	631,616
Fees Charged	40,708
Other Income	45,114
Total Funds Available	$2,274,986
Application of Funds	
Cash in Bank	$ 384,015
Loans Outstanding	1,623,166
Loan Losses	71,963
Administrative Expenses	96,710
Unreconciled Difference	99,132
Total Funds Applied	$2,274,986

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

TICHENOR & ASSOCIATES, LLP

CERTIFIED PUBLIC ACCOUNTANTS and MANAGEMENT CONSULTANTS

304 MIDDLETOWN PARK PLACE, SUITE C
LOUISVILLE, KY 40243

BUSINESS: (502) 245-0775
FAX: (502) 245-0725
E-MAIL: TICHENORKY@AOL.COM

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 North Central Pennsylvania Regional Planning & Development Commission as of and for the period July 1, 1983 through April 30, 2004, and have issued our report thereon dated June 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 North Central Pennsylvania Regional Planning & Development Commission 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 North Central Pennsylvania Regional Planning & Development Commission'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 North Central Pennsylvania Regional Planning & Development Commission's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. The 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
June 25, 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 North Central Pennsylvania Regional Planning & Development Commission 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-8844-83-Y1-302-0815 and PA-7752G-93-I-302-1117 to North Central Pennsylvania Regional Planning & Development Commission, effective July 1, 1983 and October 1, 1992, respectively. Total funding for the two grants was $1,090,810. 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 North Central Pennsylvania Regional Planning & Development Commission for the period July 1, 1983 through April 30, 2004.

As of April 30, 2004, North Central Pennsylvania Regional Planning & Development Commission had thirty-seven (37) ARC-RLF loans outstanding, with an unpaid balance of $1,623,166.

EXECUTIVE SUMMARY

Audit Results:

The audit resulted in the following findings: (please refer to the Schedule of Findings, beginning on page 11, for more details on each audit finding)

1. Compliance

   1.1. Grantee wrote off three loans during the audit period. In each case, a dollar settlement was obtained or the collateral was sold. In each case, the proceeds were applied incorrectly; first to fees, then interest, and lastly to principal. According to ARC Guidelines (VI.B.2.), recovered proceeds should first be applied to principal. $18,180 of principal was incorrectly applied to fees and interest.

   1.2. The assignment of life insurance documentation for International Cartridge Corporation and PC Systems has not been obtained. This is a requirement for all guarantors of a loan application.

   1.3. The operating plan indicates that administrative expenses are not to be charged to the ARC-RLF program. However, administrative expenses are being charged thus reducing the loan pool dollars. Grantee does have approval from the ARC; however it is not reflected in the operating plan.

   1.4. There was an entry made for consulting fees of $24,500 that was made in error. It should have been charged to the SEA loan fund program, not the ARC-RLF program. This amount should be removed, thus adding back $24,500 to the loan pool.

   1.5. Grantee has excess cash of $184,015 greater than the $200,000 ceiling allowed.

   1.6. A discrepancy of $99,132 was noted in the Statement of Source and Application of Funds, as of April 30, 2004.

2. Internal Control

   2.1. Employees in key financial positions are not required to take mandatory vacations. The grantee policy is that the vacation time accrued must be used during the fiscal year or it is lost, however, it is not mandatory to take it.

EXECUTIVE SUMMARY

Recommendations:

We recommend that the ARC require that North Central Pennsylvania Regional Planning & Development Commission take the following actions: (please refer to the Schedule of Findings, beginning on page 11, for more details on each audit finding)

1. Compliance

   1.1. We recommend that the proceeds from a settlement of a delinquent loan, or the sale of collateralized assets due to a delinquent loan, be applied first to outstanding principal, then to available program income.

   1.2. We recommend that the assignment of adequate life insurance on key individuals be procured prior to releasing any loan funds.

   1.3. We recommend that the Operating Plan be updated to indicate that administrative expenditures will be offset against program income realized during the same business year.

   1.4. We accept the grantee's response (see Auditee's Response, Item 1.4.) and therefore make no recommendation.

   1.5. We accept the grantee's response (see Auditee's Response, Item 1.5.) and therefore make no recommendation.

   1.6. Unless the discrepancy of can be reconciled and properly documented, we recommend that the $99,132 be returned to the RLF capital base.

2. Internal Control

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

Auditee's Response: (Please refer to the Schedule of Findings, beginning on page 11, for more details on each audit finding)

1. Compliance

   1.1. The grantee stated that their interpretation of ARC Guidelines does not specify the RLF as principal only or program income and principal. The grantee further stated that the principal of the RLF has been more than adequately protected by their administration of the program.

1.2. The grantee stated that key-man life insurance is not considered primary collateral to secure a loan and that the principal would be protected by the security interest in the assets of the business, the reaffirmation of debt by the remaining owners, or the personal guaranty of the owners in the form of claims against the estate of the deceased shareholder.

1.3. The grantee stated that their operating plan is in the process of being revised concerning the issue of program income being used for administrative purposes.

1.4. The grantee stated that the mis-posting of $24,500 for employee training was an entry error, and the $24,500 was mis-posted to the loan program's administrative budget, not the general ledger.

1.5. The grantee stated that as of April 30, 2004, four (4) loan commitments, totaling $258,914, had been made that were pending closing.

1.6. The grantee stated that they had found three discrepancies: (1) administrative expenses had been understated by $16,774; (2) they could find no record of ever receiving $43,132 turned-back from the PA Department of Commerce; and (3) there was a discrepancy of $12,895 between the ARC reported loan balances and the actual loan balances assumed from the PA Department of Commerce turn-back.

2. Internal Control

2.1. The grantee stated that they do not have a mandatory leave policy but one based on accrual of time in days worked.

A copy of North Central Pennsylvania Regional Planning & Development Commission's complete response to our draft report is included in the report as Exhibit – Auditee's Response.

Auditor's Conclusion:

Because of the grantee's fiduciary responsibility to protect the RLF grant principal, we continue to recommend that the ARC require that the grantee apply the proceeds from a settlement of a delinquent loan, or the sale of collateralized assets due to a delinquent loan, first to the outstanding principal, then to available program income.

In accordance with ARC Guidelines (V.B.4.) and the grantee's RLF operating plan, when the continuing success of a closely held corporation, partnership, or proprietorship is dependent upon certain individuals, we continue to recommend that the ARC require that the grantee procure adequate assignment of life insurance on key individuals prior to releasing any loan funds.

Because the discrepancy of $99,132 has not been adequately reconciled, we continue to recommend that this amount be returned to the RLF capital base.

We also believe that by implementing the other recommendations noted above, North Central Pennsylvania Regional Planning & Development Commission will (a) be in compliance with the requirements and responsibilities of its ARC approved grant; and (b) strengthen its systems if internal controls providing for disclosure of pertinent financial and operational information applicable to the revolving loan program. We further believe that North Central Pennsylvania Regional Planning & Development Commission is meeting the objectives of its grant.

North Central Pennsylvania Regional Planning & Development Commission

SCHEDULE OF FINDINGS

SUMMARY OF AUDIT RESULTS

1. The auditors report expresses an unqualified opinion on the ARC-RLF grant financial statements of the North Central Pennsylvania Regional Planning & Development Commission for the period July 1, 1983 through April 30, 2004.

2. Six (6) instances of noncompliance were disclosed during the audit.

3. One (1) reportable condition was disclosed during the audit.

FINDINGS AND RECOMMENDATIONS

NONCOMPLIANCES

1. When a borrower defaults on a loan, the grantee will either accept a settlement payment or sell collateralized assets to apply to the outstanding principal balance. According to ARC Guidelines (VI.A.2.), all repayments from a settlement or sale, collection or liquidation of loan collateral must be applied to outstanding principal first. Any proceeds from a settlement or sale of collateral assets above the original unpaid principal amount of the loan are treated as program income.

   The grantee does not return all proceeds received from settlements or sale of collateral assets to the RLF program. In three instances, proceeds from a settlement and/or from the sale of collateral assets were applied first to service/late fees charged, then to interest earned and lastly to the outstanding principal.

	Dollar amount improperly applied to interest and fees
Altfather Manufacturing Company	$ 5,141
Robert/Bryce Containers, Inc.	1,856
True-Die & Tool, Inc.	11,183
Total principal improperly applied to interest and fees	$18,180

   Both the loan committee and the grantee's attorney have approved this process. This application of funds procedure is also outlined in the collateral note and loan agreement with the borrower.

The current application of funds due to the settlement of a delinquent loan or the sale of collateralized assets due to a delinquent loan does not protect the RLF loan fund balance. When proceeds are applied to program income first, this increases the amount to which administrative expenses may be reimbursed. If applied properly, the amount of principal dollars available for re-loaning would increase by $18,180.

We recommend that the ARC require that the grantee apply the proceeds from a settlement of a delinquent loan, or the sale of collateralized assets due to a delinquent loan, first to the outstanding principal, then to available program income. This ensures that the principal of the ARC-RLF program is protected as much as possible and that the loan pool is maximized.

In response to our draft report, the grantee stated that their interpretation of ARC Guidelines does not specify the RLF as principal only or program income and principal. The grantee further stated that the principal of the RLF program has been more than adequately protected by their administration of the program. (See Exhibit – Auditee's Response.)

2. According to ARC Guidelines (V.B.4.) and the grantee's RLF Operating Plan, loans to closely held corporations, partnerships or proprietorships dependent for their continuing success on certain individuals ordinarily will be required to provide and assign to the RLF, life insurance on these key persons.

During the loan file review of the International Cartridge Corporation and PC Systems it was determined that the assignment of life insurance on all key persons had not been received.

The grantee stated that for International Cartridge Corporation, they simply have not received a response from the borrower. For PC Systems, the grantee stated that there was a discrepancy regarding how many entities could be named as an assignee of life insurance. The borrower's primary bank already had an assignment of the owners' life insurance, therefore, leaving the grantee unprotected. It was being discussed if there could be a split in the total beneficiary dollars between the two lending parties.

Without the assignment of life insurance on key persons, as required by ARC Guidelines (V.B.4.) and the grantee's RLF Operating Plan, the grantee exposes the ARC-RLF program to the loss of principal. If the borrower would happen to cease operations due to the death of a key person, thus defaulting on the loan, the grantee would have no recourse and the loan would have to be written off.

When the continuing success of a closely held corporation, partnership, or proprietorship is dependent upon certain individuals, then those individuals should be sufficiently insured to ensure that all lending parties would be adequately protected. We recommend that the ARC require that the grantee procure adequate assignment of life insurance on key individuals prior to releasing any loan funds.

In response to our draft report, the grantee stated that key-man life insurance is not considered primary collateral to secure a loan and that the principal would be protected by the security interest in the assets of the business, the reaffirmation of debt by the remaining owners, or the personal guaranty of the owners in the form of claims against the estate of the deceased shareholder. (See Exhibit – Auditee's Response.)

3. According to ARC Guidelines (III.C.1.c.), 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 indicates that administrative expenditures are not to be charged to the ARC-RLF program. However, administrative expenses are being charged, reducing the loan pool dollars. The grantee does have approval from the ARC; however it is not reflected in the operating plan.

   The grantee stated that they had received written approval from the ARC and relied on the ARC operating guidelines to cover this action. The grantee further stated that they assumed that no other action need be taken.

   The fact that the RLF Operating Plan states that administrative expenditures are not to be charged to the ARC-RLF program, when in fact administrative expenditures are being charged, is not consistent with ARC guidelines.

   We recommend that the ARC require that the grantee update its RLF Operating Plan. The Operating Plan should indicate that administrative expenditures will be offset against program income realized from ARC-RLF loan activities during the same business year, as permitted by ARC Guidelines (VI.B.2.).

   In response to our draft report, the grantee stated that their operating plan is in the process of being revised concerning the issue of program income being used for administrative purposes. (See Exhibit – Auditee's Response.)

4. Per OMB Circular 87, only those expenditures that relate directly or indirectly to the ARC-RLF program can be used to offset program income.

   An expenditure item of $24,500 for consulting fees was mis-posted to the ARC-RLF general ledger. The expense relates to general training that was held for all employees of the grantee. A portion of the cost was funded through the Self Employment Assistance program, which is where the entry should have been made.

   The grantee stated that the cause of this error was a mis-posting to the ARC-RLF general ledger, versus the SEA general ledger, by the accounting staff.

   The effect of this posting error is that program income is understated by $24,500, thus the amount of dollars available for loan activities is understated.

In response to our draft report, the grantee stated that the mis-posting of $24,500 for employee training was an entry error, and the $24,500 was mis-posted to the loan program's administrative budget, not the general ledger. (See Exhibit – Auditee's Response.)

Because this entry has been corrected, we accept the grantee's response and make no recommendation.

5. According to ARC Guidelines (VI.D.3.), a grantee holding unloaned RLF cash in excess of 25% of the outstanding loan principal or in excess of $200,000, as reported by the grantee in its semi-annual financial report is deemed to be holding excess unloaned cash. If the next semi-annual financial report shows that the excess cash, previously identified, is still being held, grantees must return the excess to the ARC.

   As of the end of the current audit period of April 30, 2004, the excess cash on hand is $184,015 greater than the $200,000 ceiling allowed. At this time, no firm loan commitments have been made.

   The grantee stated that the cause of the excess cash is that repayments of loan principal and interest exceed outstanding loan commitments at the end of the audit period of April 30, 2004.

   The purpose of the ARC-RLF program is to make available loan dollars that will create or save jobs. If excess dollars are being held by grantees, they are not being used as intended by the ARC. These dollars could be used by other regions in the ARC or by other governmental programs.

   In response to our draft report, the grantee stated that as of April 30, 2004, four (4) loan commitments, totaling $258,914, had been made that were pending closing. (See Exhibit – Auditee's Response.)

   The four (4) loans referred to above were closed within ninety (90) days of the audit period ending April 30, 2004. We accept the grantee's response and therefore make no recommendation.

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

   A discrepancy of $99,132 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 $2,274,986 and "Total Funds Applied" to be $2,175,854 for the difference of $99,132.

   The grantee stated that interest and principal payments, unpaid principal balances, and the amount and number of loans disbursed had all been reviewed and no errors of this size were found. The grantee further stated that the only other place an error could have occurred is with the original grant amount and/or the turn-back from the PA Department of Commerce.

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 $99,132 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 had found three discrepancies (See Exhibit -- Auditee's Response):

- The grantee stated that administrative expenses had been understated by $16,774. After reviewing supporting documentation provided by the grantee, we accept the grantee's response and have adjusted administrative expenses from $79,936 to $96,710. This adjustment is reflected throughout this report.

- The grantee stated that they could find no record of ever receiving the turn-back of $43,132 from the PA Department of Commerce. Because ARC reports indicate that the grantee is accountable for these funds, we have declined to make this adjustment to our report.

- The grantee stated that there was a discrepancy of $12,895 between the ARC reported loan balances and the actual loan balances assumed by the grantee in the PA Department of Commerce turn-back. Because ARC reports indicate that the grantee is accountable for the funds, we have declined to make this adjustment to our report. Furthermore, because the loans in question are no longer outstanding, any initial discrepancy would be reflected in either principal repayments or loan losses with the net result having no effect on the $99,132 discrepancy.

The grantee further stated that after taking into account their above adjustments, actual cash in bank is still $56,000 below their reported amount.

Because we have already included the grantee's $16,774 adjustment to administrative expenses and we believe that the discrepancy of $12,895 in assumed loan balances would have no net impact on the $99,132 discrepancy between "Total Funds Available" and "Total Funds Applied", the following items remain to be reconciled:

- Grantee's stated $56,000 shortfall in cash in bank

- $43,132 in turn-back funds from the PA Department of Commerce

REPORTABLE CONDITIONS

1. Proper internal control procedures require 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.

   In response to our draft report, the grantee stated that they do not have a mandatory leave policy but one based on accrual of time in days worked.

AUDITOR'S CONCLUSION

Because of the grantee's fiduciary responsibility to protect the RLF grant principal, we continue to recommend that the ARC require that the grantee apply the proceeds from a settlement of a delinquent loan, or the sale of collateralized assets due to a delinquent loan, first to the outstanding principal, then to available program income.

In accordance with ARC Guidelines (V.B.4.) and the grantee's RLF operating plan, when the continuing success of a closely held corporation, partnership, or proprietorship is dependent upon certain individuals, we continue to recommend that the ARC require that the grantee procure adequate assignment of life insurance on key individuals prior to releasing any loan funds.

Because the discrepancy of $99,132 has not been adequately reconciled, we continue to recommend that this amount be returned to the RLF capital base.

We also believe that by implementing the other recommendations noted above, North Central Pennsylvania Regional Planning & Development Commission will (a) be in compliance with the requirements and responsibilities of its ARC approved grant; and (b) strengthen its systems if internal controls providing for disclosure of pertinent financial and operational information applicable to the revolving loan program. We further believe that North Central Pennsylvania Regional Planning & Development Commission is meeting the objectives of its grant.

EXHIBIT

Auditee's Response

North Central Pennsylvania Regional Planning and Development Commission

A Pennsylvania Local Development District "LDD"

651 Montmorenci Road Ridgway, PA 15853

Phone (814) 773-3162 Fax (814) 772-7045 e-mail - ncprpdc@ncentral.com www.ncentral.com/~ncprpdc

November 17, 2004

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

Dear Mr. Somerville:

Re: ARC Draft Audit Report – NCPRPDC

We at North Central have reviewed the "Draft Audit Report" as related to our ARC Revolving Loan Funds and appreciate the opportunity to submit written responses.

Joe Baudo and staff must be commended for completing a thorough and exhausting audit of North Central's active and mature loan program. Since the commencement of the loan program on July 1, 1983 to our current operating year, the results as announced in your draft reflect that North Central does operate a revolving loan fund that benefits the business community of our region. These past twenty-one (21) years, North Central has diligently administered a loan fund that addresses industrial growth needs; establishes partnerships with private lenders; and, perhaps most important, sustains a framework of integrity. The audit by your firm substantiates this operating threshold we established in 1983 and continue to practice.

The comments attached are inclusive of Ronald W. Kuleck, Executive Director; Patricia Brennen, Loan Director; and me, Donald J. Masisak, Deputy Director. After reviewing the attached comments, should you have any questions, please call one of the names referenced at (814) 773-3162.

Sincerely,

Donald J. Masisak
Deputy Director

DJM/mf
Enc.

North Central Pennsylvania Regional Planning and Development Commission

A Pennsylvania Local Development District "LDD"

651 Montmorenci Road Ridgway, PA 15853

Phone (814) 773-3162 Fax (814) 772-7045 e-mail - ncprpdc@ncentral.com www.ncentral.com/~ncprpdc

COMMENTS ON DRAFT AUDIT REPORT TICHENOR & ASSOCIATES, LLP NORTH CENTRAL ARC/RLF

(1) ARC GUIDELINES

Paragraphs VI.A.1 and VI.A.2 instruct that principal and repayment must be used for lending and this has been the case. Paragraph VI.B.2 explains the allowable use of program income to cover necessary administrative cost and we feel this is the case with the three (3) companies referenced.

Our interpretation of the guidelines does not specify the RLF as principal only or program income and principal. All proceeds are to go to the fund for relending because all principal, interest and fees are available for relending, not principal payments only. The application of payments is done so in accordance with the Notes. The language in the Notes used to close the loans was written in accordance with the guidelines and standard practices for RLFs. The amount of $18,180 was returned to the fund as program income where it will become available for relending as do principal repayments.

Since all payments are returned to the fund in accordance with the guidelines, differentiating between principal and program income is unrelated since all monies recovered and all payments received are available for relending. Program income is only available for use on a limited basis for administration or the cost of collections and only in accordance with the guidelines and only in the fiscal year in which the income is earned. North Central's commitment to protect the principal is evidenced by the base amount of the ARC/RLF which was $1,090,810 with recaptured interest, principal and fees and other RLF commitments, and the RLF pool has doubled to $2,159,080. Total program income to be used for administrative purposes, including the cost of collecting on defaulted loans, is $79,936, or 4% of the total fund. The 18,180 in question is 2% of the $1,068,270 in program income and grant funds added to the program since its inception. The principal of the RLF has been more than adequately protected by our administration of the program.

(2) INSURANCE

Relative to the noted lacking of key man life insurance assignments for two (2) firms, the shareholder of PC Systems in question does have life insurance in place. This insurance was assigned to North Central but then could not be acknowledged by the insurer, so a new policy was issued that could not be assigned and acknowledged by the insurer. Since the principal of the loan made to PC Systems is protected by the collateral held as security for the loan, a lapse in key-man life insurance coverage does not expose the outstanding principal of the loan to default or write-off.

Furthermore, the shareholder of International Cartridge Corporation has life insurance in place, with North Central listed as a contingent beneficiary; however, the home office acknowledgement of this policy for insurer has not been received. The statement that the coverage is not in place is therefore not correct nor is the assumption that the death of this particular shareholder would put the outstanding principal balance of this loan in jeopardy of recovery. Should this shareholder die, this would constitute a change in ownership covered by the terms of commitment.

The key-man life insurance is responsible for only a percentage of the outstanding debt, based on the number and percentage of owners, and is not considered primary collateral to secure the loan. The principal would be protected by the security interest in the assets of the business, the reaffirmation of debt by the remaining owners, or the personal guaranty of the owners in the form of claims against the estate of the deceased shareholder. To assume that a lapse in the key-man life insurance coverage automatically exposes the principal balance of the fund to default or charge-off situations is an erroneous and rudimentary assessment of the situation. It is for these reasons that this finding is not legitimate and should not be included in the final audit.

(3) OPERATING PLAN

The stated criteria for use of program income does not reference the operating plan. The operating plan used by North Central is in the process of being revised relative to the issue of program income being used for administrative purposes. The administrative costs for the RLF have historically been charged to the Enterprise Development Program administrative budget. As the costs of RLF administration, particularly costs associated with debt collection increased, an administrative budget for the loan programs was designed. This budget was presented to ARC for approval as RLF program income funds were represented in this budget at a percentage commensurate with the project activity and prior to the institution of the administrative budget. This percentage was calculated at 30% of the total loan program administrative budget.

All items charged to the administrative budget have been made in accordance with the items VI.B.2.2 and 3. Because of program income for administrative purposes is permitted in the guidelines and because the guidelines do not specify a procedure for access or approval, the audit report has mixed the guidelines on two separate issues (operating plan contents and program income) to create a finding. To carry this finding forward, it is our recommendation that ARC place "Updating Operating Plans" as an agenda item at the annual conference.

(4) ENTRY FOR CONSULTING FEE

The statements made concerning the mis-posting of $24,500 for employee training to the ARC general ledger, thus reducing program income by this amount, as indicated, is an entry error. The amount of $24,500 was mis-posted to the loan program's administrative budget, not the general ledger. The loan program administrative annual budget included 31%, or $36,042.42, in ARC/RLF program income. As of April 30,2004, only $12,014.16 in the RLF program income had been used. The line item for training was not employee training but technical assistance training for RLF-approved applicants.

The entire amount of $24,500.00 could not have been charged to the ARC program income since ARC program income does not constitute the entire budget, but only 31% thereof. The $24,500.00 was to be charged to the Self-Employment Assistance Program which is a technical assistance training program for small business owners, not an RLF. Since technical assistance is an appropriate administrative budget line item, posting the $24,500 to the loan administrative budget would not have been an audit finding and would not have decreased the ARC/RLF program income by any more than the original budgeted amount of $36,042.42 stated at the beginning of the fiscal year. This finding should be completely removed from the audit report since it is not part of the ARC/RLF.

(5) EXCESS CASH

The statement made in this finding concerning excess cash in the amount of $184,015 with no firm loan commitments does not reflect pending loan commitments. As of April 30, 2004, four loan commitments had been made that were pending closing. These commitments include Penn Pallet, Inc. of St. Marys, Elk County, which is expanding to a second location in Clearfield County with an equipment loan in the amount of $58,914.00; Continuous Metal Technology, Inc. of Ridgway, Elk County, for an additional powder metal compaction press in the amount of $50,000.00; TQA Fabricating, Inc., an industrial HVAC supplier and designer, located in Clearfield County, for a working capital loan in the amount of $50,000.00; and DuBrook, Inc. of DuBois, Clearfield County, was approved for concrete production on-site construction equipment in the amount of $100,000.00.

The loan to Penn Pallet, Inc. was closed on July 1, 2004, the loan to Continuous Metal Technology, Inc. was closed on July 1, 2004, the loan to TQA Fabricating, Inc. was closed on June 1, 2004. Thus, $258,914.00 in loans was closed with 90 of the reporting period of May 31, 2004 in accordance with the ARC guidelines. The excess cash figure of April 30, 2004 in the amount of $184,015, or $384,015 fund balance, was reduced within 60 days to $125,101.00, which is less than the $200,000.00 fund balance limit. Therefore, the finding of excess cash in the amount of $184,015 results from a cyclical application process and the need to allow the fund balance to increase to a level that will accommodate the number of applications received on an annual basis. Since the fund balance is committed within the 90-day timeframe of the semi-annual reporting period, the excess cash reference does not apply.

B(1) MANDATORY VACATION

We are assuming the key financial person in the case of the North Central RLF would be Patricia Brennen, Loan Program Director. North Central does not have a mandatory leave policy but one based on accrual of time in days worked. From this, Pat accrues three (3) weeks annual leave or vacation time per year and historically for the past decade has used two (2) weeks each summer to vacation on the "Outer Banks" with her family. Time sheets and leave sheets will reflect this is the case.

Memorandum

To: North Central Pennsylvania Regional Planning & Development Commission audit report

From: Tichenor & Associates, LLP audit personnel

The following two pages were sent to us in response to inquiries about the discrepancy between the grantee's source and application of funds – see Noncompliance Item 1.6.

Please note that where applicable supporting documentation was also provided.

The following comments should also be noted:

1. The tables at the top of the following page show preliminary and revised Statements of Source and Application of Funds, labeled January 4, 2006 and January 13, 2006, respectively. These are simplified reports with some line-items combined and/or labeled differently from Statement of Source and Application of Funds shown on page 3 of this report.

2. The following items were the basis of our calculations in the Auditee's Response to Noncompliance Item 1.6.:

	January 4, 2006	Change	January 13, 2006
ARC Grant	$ 543,132.36	$(43,132.36)	$ 500,000.00
Assumed balances	585,903.18	(12,895.12)	573,008.06
Total ARC Grant	$1,129,035.54	$(56,027.48)	$1,073,008.06
Administrative	$ 79,935.97	$ 16,773.82	$ 96,709.79

3. The preliminary (January 4, 2006) Difference of $115,906 less the increase in Administrative Expenses of $16,774 equals the Unreconciled Difference of $99,132 in the audit report.

4. The revised (January 13, 2006) Difference of $43,105 plus the decrease in Total ARC Grant of $56,027 equals the Unreconciled Difference of $99,132 in the audit report.

5. The handwriting on the attached Schedule B-1 is the grantee's, and shows the shortage in cash in bank of $56,000, after making the above adjustments.

January 4, 2006		January 13, 2006	
ARC Grant	$1,129,035.54	ARC Grant	$500,000.00
		Assumed balances	$573,008.06
Loan interest income	$ 631,616.35	Loan Interest income	$631,616.35
Fees Charged	85,821.73	Fees Charged	$ 85,821.73
Other Income	$ 428,513.03	Other Income	$428,513.03
Total	$2,274,986.65	Total	$ 2,218,959.17

Application of Funds

Cash in Bank	$ 384,015.43	Cash in Bank	$ 384,015.43
Loans Outstanding	$1,623,165.83	Loans Outstanding	$1,623,165.83
Loan Losses	$ 71,962.58	Loan Losses	$ 71,962.58
Administrative	$ 79,935.97	Administrative	$ 96,709.79
Total	$2,159,079.81	Total	$2,175,853.63
Difference	$115,906.84	Difference	$43,105.54

The difference of $43,105.54 may be an overstatement of the fees on the report. The interest and principal payments as well as the amount and number of loans disbursed have all been reviewed and no errors of this size were found. The only discrepancies found were administrative expenses and the grant and principal assumption amounts. I am open to any suggestions. Also, I have revised the ARC semi-annual report for 4/30/04 with the above referenced changes so that you can see what the changes do to the report. The cash in bank is off by $56,000.71 This will be sent to you as well.
Pat Brennen

Statement of Funds Available from the Inception of the Fund thru *4/30/2004 - Revised-1-13-06*

Name of Grantee North Central PA Regional Planning & Development Commission

Receipts

Grant Funds Received from ARC:	$	500,000.00
Loan Balance Transferred from PCLF 10/1/92:		573,008.06
Loan Principal Repayments:		4,579,987.77
Interest on Loans:		631,616.35
Loan Fees:		35,390.03
Investment Interest:		45,113.77
Late Payment Fees/Interest:		5,317.93
Other: Merge Housing Revolving Loan Fund 9/30/96:		428,513.08
Total Receipts Available for Disbursement:	$	6,798,946.99

Disbursements and Set Asides

Loan Balances Assumed from PCLF 10/1/92:	$	573,008.06
Loans Disbursed by Grantee:	$	5,689,213.00
RLF Administrative Costs:	$	96,709.79
Grant Funds Returned to ARC:		
Program Income Set Asides:		
Other: (Explain)		
Total Disbursed and Set Aside:	$	6,358,930.85
Funds Available for Loans:	$	440,016.14

- $384015.43
$56,000.71

Loans Committed

End of Period Loan Commitments:	$	381,750.00
Net Loanable Funds Available to the Grantee:	$	58,266.14

Loan Summary

Total Loans Disbursed and Balances Assumed:	$	6,275,116.18
Less Loan Principal Repayments:	$	4,579,987.77
Unpaid Principal Balance:	$	1,695,128.41
Less Loan Balances Written Off:	$	71,962.58 *
Grantee Adjustments: (Explain)		
Reported Balance of Loans Outstanding:	$	1,623,165.83 *

* Must agree with total of column 6 on Schedule B-2.

* Additional loan balances charged off: Robert Bryce Containers-$25,792.16; Altfather Manufacturing-$10,730.55; Tru-Die & Tool-$9,927.49

The RLF Financial Reports are submitted as prescribed by ARC Business Development RLF Guidelines. The information contained in these Schedules is accurate and complete to the best of my knowledge.

Signature: ______________________________

Patricia Brennen, Loan Program Director

RLF Manager (or other responsible official designated by the grantee)