APPALACHIAN REGIONAL COMMISSION
A Proud Past, A New Vision

Office of Inspector General

March 16, 2006

Memorandum for: The Federal Co-Chair
ARC Executive Director

Subject: OIG Report 06-07
Review of Revolving Loan Fund (RLF)
Operated by the East Alabama Regional Planning
and Development Commission
Anniston, Alabama

Attached is the subject report dealing with the RLF grant to the East Alabama Regional Planning and Development Commission. Currently, the East Alabama Regional Planning and Development Commission RLF grant has a balance of $ 288,804. The East Alabama Regional Planning and Development Commission received its initial RLF grant in 1995 with a grant of $ 250,000. As of August 31, 2005, the East Alabama Regional Planning and Development Commission had 7 loans outstanding, with an unpaid balance totaling approximately $ 249,000.

The report includes two recommendations. The auditee responses to the recommendations are considered responsive and the report will be closed. Implementation of the recommendations should be verified at the next possible opportunity.

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

AUDIT OF THE ARC REVOLVING LOAN FUND OPERATED BY EAST ALABAMA REGIONAL PLANNING AND DEVELOPMENT COMMISSION ANNISTON, ALABAMA

ARC GRANT NUMBER: (AL-12117-95-I-302-0515)

September 11, 1995 through August 31, 2005

ARC OIG Report Number: 06-07
Date: March 7, 2006

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.

ALLMOND & COMPANY
Certified Public Accountants
8181 Professional Place, Suite 250
Landover, Maryland 20785
(301) 918-8200

TABLE OF CONTENTS

A/C

ALLMOND & COMPANY

CERTIFIED PUBLIC ACCOUNTANTS

8181 PROFESSIONAL PLACE, SUITE 250
LANDOVER, MARYLAND 20785

(301) 918-8200
FACSIMILE (301) 918-8201

MARVIN C. ALLMOND, CPA

Appalachian Regional Commission
Office of Inspector General

INDEPENDENT AUDITOR'S REPORT

We have audited the Appalachian Regional Commission (ARC) Revolving Loan Fund (RLF) grant Schedule of Fund Balance of East Alabama Regional Planning & Development Commission as of August 31, 2005, and the related Statement of Source and Application of Funds for the period of September 11, 1995, through August 31, 2005. These financial statements are the responsibility of East Alabama 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 Office of Inspector General (OIG) Audit Guide of ARC Revolving Loan Funds 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 East Alabama Regional Planning & Development Commission's fiduciary activities as of August 31, 2005 and the source and application of funds resulting from fiduciary activities for the period of September 11, 1995 through August 31, 2005 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 December 2, 2005 on our consideration of East Alabama 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.

Allmond & Company

Allmond & Company
Landover, Maryland
December 2, 2005

EAST ALABAMA REGIONAL PLANNING & DEVELOPMENT COMMISSION
SCHEDULE OF FUND BALANCE

AS OF AUGUST 31, 2005

Cash in Bank	$ 16,260
Loans Outstanding	249,000
Fund Balance	$265,260

EAST ALABAMA REGIONAL PLANNING & DEVELOPMENT COMMISSION
STATEMENT OF SOURCE AND APPLICATION OF FUNDS

For the period September 11, 1995 through August 31, 2005

SOURCE OF FUNDS	
ARC Grant	$250,000
Loan Principal Repayments	340,516
Loan Interest Income	96,179
Investment Interest Income	4,951
Fees Charged	16,682
Total Funds Available	$708,328

APPLICATION OF FUNDS	
Cash in Bank	$ 16,260
Loans Disbursed by Grantee	635,763
Grant Funds Returned to ARC	23,544
Administrative Costs	34,092
Unreconciled Difference	(1,331)
Total Funds Applied	$708,328

A/C

ALLMOND & COMPANY

CERTIFIED PUBLIC ACCOUNTANTS

8181 PROFESSIONAL PLACE, SUITE 250
LANDOVER, MARYLAND 20785

(301) 918-8200
FACSIMILE (301) 918-8201

MARVIN C. ALLMOND, CPA

Appalachian Regional Commission
Office of Inspector General

REPORT ON COMPLIANCE AND ON INTERNAL CONTROLS OVER FINANCIAL REPORTING BASED ON AN AUDIT OF THE FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

We have audited the Appalachian Regional Commission (ARC) Revolving Loan Fund (RLF) grant financial statements of East Alabama Regional Planning & Development Commission as of and for the period of September 11, 1995 through August 31, 2005, and have issued our report thereon dated December 2, 2005. 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 a part of obtaining reasonable assurance about whether East Alabama Regional Planning & Development Commission's ARC RLF grant financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under Government Auditing Standards.

INTERNAL CONTROL OVER FINANCIAL REPORTING

In planning and performing our audit, we considered East Alabama Regional Planning & Development Commission's (EARPDC) 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 controls over financial reporting. However, we noted a certain matter involving internal controls 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 controls over financial reporting that, in our judgment, could adversely affect EARPDC's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. Two reportable conditions were identified during the audit and are described in the accompanying Summary Report.

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 controls over financial reporting would not necessarily disclose all reportable conditions that are considered to be material weaknesses. However, we believe that the reportable conditions described above are not 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.

Allmond & Company

Allmond & Company
Landover, Maryland
December 2, 2005

SUMMARY REPORT

INTRODUCTION

The Appalachian Regional Commission (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 Revolving Loan Fund (RLF) to make other loans. The program's primary goal is private sector job creation and capital formation, specifically in the Appalachian region.

ARC requires that RLF projects be administered in accordance with the grantee's RLF plan. This plan explicitly defines the specific objectives and operating procedures, including the standards and selection criteria that are used to grant funds through the RLF for loans. ARC does not approve or review the RLF loans on an individual basis. ARC monitors the 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 the ARC on a bi-yearly basis.

OBJECTIVES OF THE AUDIT

The objectives of the audit were (1) to determine whether East Alabama Regional Planning & Development Commission (EARPDC) is administering its ARC RLF in accordance with the ARC approved grant and did not violate any restrictions imposed by the terms and conditions of the RLF grant, (2) to determine whether the accounting, reporting and internal control structure of the EARPDC provides for the disclosure of pertinent financial and operation information applicable to the revolving loan program, and (3) to determine whether the objectives of the grant are being met.

BACKGROUND

In September 1995, ARC granted the EARPDC $250,000 in accordance with Grant Number AL-12117-95-I-302-0517. The EARPDC has been an active lender through the RLF program since 1997. Currently, the EARPDC RLF grant with ARC has a balance of $288,804. Since the inception of the original grant to EARPDC, the grant program has expanded to create assistance loans for capital investments for the creation and/or retention of jobs in a ten-county area of east Alabama.

SCOPE OF AUDIT

Allmond & Company, a certified public accounting firm, was contracted by the ARC's Office of Inspector General (OIG) to perform a financial, compliance, and internal control audit in accordance with Government Auditing Standards and ARC, OIG Audit Guide for Revolving Loan Funds of the ARC grants administered by the EARPDC for the period September 11, 1995 through August 31, 2005.

As of August 31, 2005, EARPDC had 7 ARC RLF loans outstanding, with an unpaid balance of $249,000.

AUDIT RESULTS

As a result of the audit performed, we concluded that (1) EARPDC was administering its ARC RLF in accordance with the ARC approved grant and nothing came to our attention that they were violating restrictions imposed by the terms and conditions of the RLF grant, (2) EARPDC 's accounting, reporting, and internal control structure provided for the disclosure of pertinent financial and operation information applicable to the revolving loan program, and (3) EARPDC was meeting the objectives of the grant program. We found no material weaknesses and two reportable conditions.

REPORTABLE WEAKNESS IN INTERNAL CONTROL

Finding 1: Procedures for Collection Activities were Ineffective

EARPDC's procedures for collection of loan payment were ineffective. Our review of collection practices for loan payments disclosed that one loan had been written off since program inception and two of the seven active loans were in serious delinquency status. (one was over 1095 days late and the other was 122 days late). Our examination of EARPDC loan records revealed that the same action was used for both delinquent cases - one system-generated delinquency letter was mailed to the borrower every month. No other efforts of collections were documented. Our review of the loan file maintained for the loan written-off revealed that the same system-generated delinquency letter was mailed to the borrower every month until receipt of the bankruptcy notice. As a result, adequate monitoring and collection procedures were not in place prior to the filing of bankruptcy.

The Standards for Internal Controls in Federal Government issued by the Government Accountability Office (GAO) states that control activities are the policies, procedures, techniques, and mechanisms that enforce management's directives. They help ensure that actions are taken to address risks. Control activities are an integral part of an entity's planning, implementing, reviewing, and accountability for stewardship of government resources and achieving effective results.

Recommendation:

We recommend that EARPDC develop and implement policies and procedures that would reduce to writing standard monitoring and collection activities. The policies and procedures should include at a minimum the following:

1. Delinquency letters with different language depending on the length of the delinquency.

2. Specific actions that should be taken when a borrower reaches the default stage (90 days late).
3. Documented guidance on specific recovery procedures that should be taken to mitigate loss and when, and at what step these actions should be taken.

These procedures should be followed for all loans subject to collection.

Auditee's Response:

The Grantee concurred with the recommendation to develop and implement policies and procedures that govern collection activities; however, the grantee contends that no other actions were taken against the current delinquent borrowers because of the following:

1. They both were still in business and maintaining jobs in the region, and
2. The collateral position of the Grantee was inferior to the commercial lenders who also were delaying calling the loan.
3. The grantee also said that calling the loan would force the borrower to file bankruptcy.

Auditor's Conclusion:

We believe that the implementation of documented policies and procedures governing loan processing, collateral strategies and collection actions would reduce the risk of loss. We also believe that a documented structured range of collection and recovery activities would help mitigate the amount of loss.

Finding 2: Unreconciled Difference in Sources and Applications of Funds

EARPDC was unable to explain an unreconciled difference in sources and applications of funds of $1,331. Our review of EARPDC's records revealed that it often mixed funds from the various RLFs when disbursing loans with reimbursement records on "due to" and "due from" being kept outside of its Grants Management System. Also, a review of the ARC bank records indicated that the first three ARC RLF loans were disbursed from the local fund account prior to the opening of an ARC RLF fund account (at least one disbursement was made prior to receipt of ARC funds). Also, in another case, EARPDC made a disbursement from the ARC RLF for the entire split project amount (EDA and ARC) that caused the account to be in a deficit position prior to being reimbursed by the EDA RLF. We also observed that disbursements from the ARC RLF account that appear to be administrative costs do not adequately reconcile to the reported amount of administrative costs at end of report period. We believe that, where the mixing and mingling of revolving fund activities from different sources occur, periodic reconciliations should be performed to clearly identify all sources and uses of funds in accordance with ARC guidelines.

ARC Business Development Revolving Loan Fund Guidelines, revised October 1999, states in part that all program income must be reported and complete records (e.g., time cards, logs, invoices, vouchers) must be kept to document reported administrative costs.

The Standards for Internal Controls in Federal Government issued by GAO states that control activities occur at all levels and functions of an entity and they include among other things the creation and maintenance of records which provide evidence of execution of entity activities as well as appropriate documentation.

Failure to maintain accurate records could result in funds being expended for purposes contrary to ARC objectives.

Recommendations:

We recommend that EARPDC management and employees adhere to the RLF Guidelines, which states that grantees must report all program income and keep complete records to document administrative costs. Also, specific policies and procedures should be developed and implemented to ensure that all "due to" and "due from" are properly reconciled. These procedures should ensure that the mingling of the various RLF funds do not cause loss of program income due to investment interest and additional costs due to penalties/service fees.

Auditee's Response:

EARPDC officials concur with the finding. They add that loans are made from more than one RLF fund on occasion because of availability of funds and the need to fully fund approved loan requests. It is recognized that EARPDC must carefully account for all sources and uses of funds and appropriately allocate expenditures and revenues.

EARPDC will adhere to ARC guidelines and will develop written policies and procedures to provide guidance on tracking of program income and costs so appropriate allocation may be made to the applicable RLF funds, when loans are drawn from and repaid to more than one RLF fund.

Auditor's Conclusion:

We believe that EARPDC adherence to ARC guidelines and its development of documented policies and procedures for mingling of RLF funds would ensure that all sources and uses of ARC RLF funds will be properly accounted for and no improper expenditures will occur.

APPENDIX

AUDITEE'S COMMENTS

To: Mr. Marvin Allmond

From : East Alabama Regional Planning and Development Commission

Date: March 1, 2006

Re: Comments to Draft Audit Report regarding the Appalachian Regional Commission Revolving Loan Fund program

Finding 1: Procedures for Collection Activities were Ineffective

Recommendation:

We recommend that EARPDC develop and implement policies and procedures that would reduce to writing standard monitoring and collection activities. The policies and procedures should include at a minimum the following:

1. Delinquency letters with different language depending on the length of the delinquency.
2. Specific actions that should be taken when a borrower reaches the default stage (90 days late).
3. Documented guidance on specific recovery procedures that should be taken to mitigate loss and when, and at what step these actions should be taken.

These procedures should be followed for all loans subject to collection.

Auditee's Response:

The Grantee concurred with the recommendation to develop and implement policies and procedures that govern collection activities; however, the grantee contends that no other actions were taken against the current delinquent borrowers because of the following:

1. They both were still in business and maintaining jobs in the region, and
2. The collateral position of the Grantee was inferior to the commercial lenders who also were delaying calling the loan.
3. The grantee also said that calling the loan would force the borrower to file bankruptcy.

Auditee's Comments on Draft Report Finding No 1: Standard collection procedures will documented in writing and implemented.

Finding 2: Unreconciled Difference in Sources and Applications of Funds

Recommendations:

We recommend that EARPDC management and employees adhere to the RLF Guidelines, which states that grantees must report all program income and keep complete records to document administrative costs. Also, specific policies and procedures should be developed and implemented to ensure that all "due to" and "due from" are properly reconciled. These procedures should ensure that the mingling of the various RLF funds do not cause loss of program income due to investment interest and additional costs due to penalties/service fees.

Auditee's Response:

Auditor's Conclusion:

We believe that EARPDC adherence to ARC guidelines and its development of documented policies and procedures for mingling of RLF funds would ensure that all sources and uses of ARC RLF funds will be properly accounted for and no improper expenditures will occur.

Auditee's Comments on Draft Report Finding No 2:

Loans are made from more than one RLF fund on occasion because of availability of funds and the need to fully fund approved loan requests. It is recognized that EARPDC must carefully account for all sources and uses of funds and appropriately allocate expenditures and revenues.

EARPDC will adhere to ARC guidelines and will develop written policies and procedures to provide guidance on tracking of program income and costs so appropriate allocation may be made to the applicable RLF funds, when loans are drawn from and repaid to more than one RLF fund.