



March 16, 2006

Memorandum for: The Federal Co-Chair
 ARC Executive Director

Subject: OIG Report 06-08
 Review of Revolving Loan Fund (RLF)
 Operated by the North-Central Alabama Regional
 Council of Governments
 Decatur, Alabama

Attached is the subject report dealing with the RLF grant to the North-Central Alabama Regional Council of Governments. The North-Central Alabama Regional Council of Governments received its initial RLF grant in 1998 with a grant of \$500,000. An additional \$200,000 was granted in September 2004. As of August 31, 2005, the North-Central Alabama Regional Council of Governments had 4 loans outstanding, with an unpaid balance totaling approximately \$194,644.

The report includes three recommendations. The auditee responses to the recommendations are considered responsive for two of the recommendations. The report will remain open until the remaining recommendation is satisfied.

A handwritten signature in black ink, appearing to read 'Clifford H. Jennings', with a long, sweeping horizontal stroke extending to the right.

Clifford H. Jennings
Inspector General

Attachment

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



**AUDIT OF THE ARC REVOLVING LOAN
FUND OPERATED BY
NORTH-CENTRAL ALABAMA REGIONAL
COUNCIL OF GOVERNMENTS
DECATUR, ALABAMA**

ARC GRANT NUMBER: (AL-14893-04)

November 2004 through August 31, 2005

**ARC OIG Report Number: 06-08
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
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MARVIN C. ALLMOND, CPA

Appalachian Regional Commission
Office of Inspector General

INDEPENDENT AUDITOR'S REPORT

We have audited the ARC RLF grant schedule of Fund Balance of the North Central Alabama Regional Council of Governments as of August 31, 2005, and the related Statement of Source and Application of Funds for the period of November 1, 2004 through August 31, 2005. These financial statements are the responsibility of the North Central Alabama Regional Council of Governments. 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 the North Central Alabama Regional Council of Governments' fiduciary activities as of August 31, 2005 and the source and application of funds resulting from fiduciary activities for the period of November 1, 2004 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 9, 2005 on our consideration of the North Central Alabama Regional Council of Governments' 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 9, 2005

**NORTH CENTRAL ALABAMA REGIONAL COUNCIL OF GOVERNMENTS
STATEMENT OF FUND BALANCE**

AS OF AUGUST 31, 2005

Cash in Bank	\$ 8,396
Loans Outstanding	<u>194,644</u>
Fund Balance	<u>\$204,040</u>

**NORTH CENTRAL ALABAMA REGIONAL COUNCIL OF GOVERNMENTS
STATEMENT OF SOURCE AND APPLICATION OF FUNDS**

For the period November 1, 2004 through August 31, 2005

SOURCE OF FUNDS

ARC Grant	\$200,000
Loan Principal Repayments	5,356
Loan Interest Income	3,837
Fees Charged	2,147
Investment Income	<u>556</u>
 Total Funds Available	 <u>\$211,896</u>

APPLICATION OF FUNDS

Cash in Bank	\$ 8,396
Loans Disbursed by Grantee	200,000
Administrative Costs	3,770
Unreconciled Difference	<u>(270)</u>
 Total Funds Applied	 <u>\$211,896</u>



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 North Central Alabama Regional Council of Governments as of and for the period of November 1, 2004 through August 31, 2005, and have issued our report thereon dated December 9, 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 the North Central Alabama Regional Council of Governments' 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 Summary Report.

INTERNAL CONTROL OVER FINANCIAL REPORTING

In planning and performing our audit, we considered the North Central Alabama Regional Council of Governments' internal control over financial reporting for the ARC RLF grant in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving internal

control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the North Central Alabama Regional Council of Governments' ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying 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 none of the reportable conditions described above is a material weakness.

This report is intended solely for the information and use of the ARC; however, the final report is a matter of public record and its distribution is not limited.

Allmond & Company

Allmond & Company
Landover, Maryland
December 9, 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 North Central Alabama Regional Council of Governments' (NARCOG) 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 NARCOG 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

The NARCOG has been an active lender through its RLF program since 1998. The NARCOG RLF was established in 1998 with initial capitalization of \$500,000. Since 1998 the loan fund has expanded to \$2,145,620. It has closed on 30 loans leveraging over \$22,000,000 and creating 483 jobs. In 2004, the RLF did not have sufficient funds for pending projects in Lawrence, Morgan and Cullman Counties. In September 2004, ARC granted NARCOG \$200,000 in accordance with grant number AL-14893. The ARC RLF disbursed its first loan in November 2004 and has since disbursed three other loans utilizing all \$200,000 of the ARC-RLF grant.

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 NARCOG for the period November 1, 2004 through August 31, 2005.

As of August 31, 2005 the NARCOG had four (4) ARC RLF loans outstanding, with an unpaid balance of \$194,644.24.

AUDIT RESULTS

As a result of the audit performed, we concluded that (1) NARCOG 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) NARCOG accounting, reporting, and internal control structure provided for the disclosure of pertinent financial and operation information applicable to the revolving loan program, and (3) NARCOG was meeting the objectives of the grant program. We found no material weaknesses and three reportable conditions.

REPORTABLE WEAKNESS IN INTERNAL CONTROL

Finding 1: NARCOG did not Report All Loan Processing Fees

NARCOG did not include all loan processing fees in reported program income. NARCOG reported ARC RLF loan processing fees and late fees of \$1,147 as of August 31, 2005. Our review of loan documents and files revealed that an additional \$1,000 in loan processing fees should have been included in program income.

Business Development Revolving Loan Fund Grants ARC RLF Guidelines under Sub-Section VI RLF Administration (B) 1 *Program Income* Report states that program income earned as a result lending authorized by the grant agreement must be reported to ARC. The section also states that program income includes loan interest, fees for processing loan applications, loan closing fees, periodic servicing fees, penalties and interest caused by borrowers' late payments.

Recommendation:

We recommend that the NARCOG develop and implement policies and procedures that would ensure that all ARC RLF program income is accurately captured and included in its semi-annual progress reports.

Auditee's Response:

The Executive Director stated that the NARCOG concurs with the finding and would make necessary remedial actions to fix deficiencies.

Auditor’s Conclusion:

We believe that, with the implementation of the recommendation, NARCOG will be in compliance with the requirements and responsibilities of its ARC approved grant, and its internal control structure will be strengthened.

Finding 2: Basis for Allocating Administrative Costs is Questioned

NARCOG allocated administrative costs to ARC RLF on a basis that had no relationship to usage or benefit received. Our examination disclosed that administrative costs reported to ARC were based on a percentage of calculated program income and was not traceable to any recorded ARC RLF specific identifiable costs or any allocation methodology of indirect costs to the ARC RLF based on incurred cost pool expense. As a result, administrative costs were allocated on an “ability to bear” methodology. The allocation method known as “the ability to bear” is not an acceptable method of allocation. This method results in the funds driving the usage rather than the usage driving the funds.

Business Development Revolving Loan Fund Grants ARC RLF Guidelines under Part 2 of sub-section VI.B. permit program income incurred in a business year to be used to offset administrative costs incurred in the same year. However, subsection VI. B. 3 states in part that Grantees must keep complete records (e.g., time cards, logs, invoices, vouchers) to document those administrative costs. Administrative costs include direct costs that are specifically identifiable to an RLF cost and indirect costs that are incurred for a common objective.

Recommendations:

We recommend that the NARCOG develop and implement policies and procedures that would ensure that all ARC RLF administrative costs are allocated on a basis consistent with usage or benefit received. Also, we recommend that policies and procedures be developed and implemented that would ensure that sufficient documentation is maintained to support any offsetting administrative costs.

Auditee’s Response:

NARCOG’s responsible official stated that NARCOG’s indirect cost methodology is based on direct salaries charged to each project. Indirect costs are those having a common purpose of benefiting or supporting all agencies programs which tracks and allocates all indirect cost to the appropriate program. A computer system tracks and allocates all indirect costs to the appropriate program. The allocation cannot be manually changed and all charges are traceable to corresponding records.

Auditor’s Conclusion:

NARCOG’s semi-annual reporting periods ends on a date other than its year-end. During our fieldwork, the responsible official represented to us that the amount reported semi-annually was 10 percent of revenues generated during that period. NARCOG officials may adjust at fiscal year-end to report externally based on the indirect cost methodology. However, the semi-annual reports to ARC are external reports that ARC Headquarter officials relied upon and, as such, should reflect the use of the same indirect cost allocation methodology. We believe that with the implementation of the recommendation, NARCOG will be in compliance with the requirements and responsibilities of its ARC approved grant, and its internal control structure will be strengthened.

Finding 3: Unreconciled Difference in Sources and Applications of Funds

NARCOG was unable to explain an unreconciled difference in sources and applications of funds of \$270. We believe the difference may relate to the ARC RLF loan processing fees and administrative costs not being tracked separately from other RLF funds. The process of segregating these items may result in an overage or underage that was never allocated.

Recommendation:

We recommend that the NARCOG identify the unreconciled difference and adjust future reporting to ARC to reflect all sources and applications of funds.

Auditee’s Response:

The Executive Director stated that the NARCOG concurs with the finding and would make necessary remedial actions to fix deficiencies. The Statement of Source and Application of Funds included in the draft report does not total properly. The reconciled difference should be \$1,000 instead of \$730.

Auditor’s Conclusion:

We agree that the statement in the draft report did not total properly. However, we recomputed the unreconciled difference to be \$270. We confirmed the true cash balance based on NARCOG’s records to be \$8,396, not \$8,126. We believe that, with the implementation of the recommendation, NARCOG will be in compliance with the requirements and responsibilities of its ARC approved grant, and its internal control structure will be strengthened.

North-central Alabama Regional Council of Governments
P.O. Box C
Decatur, AL 35601
256-355-4515

February 22, 2006

Allmond & Company
Landover, Maryland

RE: Response to ARC RLF Audit

Finding 1: NARCOG did not Report All Loan Processing Fees

Response:

The \$1000.00 not posted were legal fees which were paid to the attorney at closing. These funds did not pass through our bank account but have been posted to the books.

Finding 2: Basis for Allocating Administrative Costs is Questioned

NARCOG indirect cost methodology is based on direct salaries charged to each project. Indirect costs are those costs having a common purpose of benefiting or supporting all agencies programs activities and can not be readily assigned directly. We have a computer system which tracts and allocates all indirect cost to the appropriate program. The allocation cannot be manually changed and all charges are traceable to corresponding records.

Attached is a letter from our agency wide auditor who examined NARCOG's Indirect Cost Allocation Plan and verified that it meets Standard Governmental Auditing Standards.

Our RLF Loan officer records her time to prepare the loans to the RLF Administration fund. As discussed, ARC funds were the only loan funds available during the time frame audited, therefore her charges would be for the ARC RLF Administration. She now distinguishes on her weekly time sheet which RLF fund she is working on. It is possible to set up a separate accounting fund for the ARC RLF administration. However, this not practical.

Finding 3: Unrecognized Difference in Sources and Applications of Funds

The Statement of Source and Application of Funds included in this report does not total properly. The reconciled difference should be \$1000.00 instead of \$730.00. When revenue and expenses are adjusted, cash has to be adjusted accordingly. Below is the reconciled balance.

NARCOG Books 8/31/05

REVENUE		Audit Adjustments	Balance
Federal Grant	\$200,000.00		200,000.00
Interest Earned	556.19		556.19
Loan Principal Repaid	5,355.76		355.76
Loan Interest Earned	3,837.65		3,837.65
Loan Penalty	146.62		146.62
Loan Origination Fee		+ 2,000	2,000.00
Revenue	\$ 209,896.16		211,896.00
EXPENSES			
Loan Principal	200,000.00		200,000.00
RLF Administration	1,500.00	-2,270	3,770.00
Expenses	201,500.00		203,770.00
Cash in Bank	8,396.16	-270.00	8,126

**NORTH CENTRAL ALABAMA REGIONAL COUNCIL OF GOVERNMENTS
STATEMENT OF SOURCE AND APPLICATION OF FUNDS**

For the period November 1, 2004 through August 31, 2005

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ARC Grant	\$200,000
Loan Principal Repayments	5,356
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Investment Income	<u>556</u>
 Total Funds Available	 <u>\$211,896</u>

APPLICATION OF FUNDS

Cash in Bank	\$ 8,396
Loans Disbursed by Grantee	200,000
Administrative Costs	3,770
Unreconciled Difference	<u>730</u>
 Total Funds Applied	 <u>\$211,896</u>

