

**AUDIT OF THE ARC REVOLVING LOAN FUND
OPERATED BY
Southern Kentucky Economic Development Corporation
Somerset, Kentucky**

**ARC Grant Numbers: KY-13126
July 1, 1998 through September 30, 2005**

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Report Number: 06-19

Date: May 24, 2006

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Prepared By:

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

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To: Appalachian Regional Commission (ARC)
Office of Inspector General (OIG)

Report For: Federal Co-Chair: Anne B. Pope
ARC Executive Director: Thomas M. Hunter
OIG Report Number: 06-19


Independent Auditor's Report

We have audited the ARC RLF grant Schedule of Fund Balance of the Southern Kentucky Economic Development Corporation as of September 30, 2005, and the related Statement of Source and Application of Funds for the period of July 1, 1998 through September 30, 2005. These financial statements are the responsibility of the Southern Kentucky Economic Development Corporation. 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 Southern Kentucky Economic Development Corporation's fiduciary activities as of September 30, 2005 and the source and application of funds resulting from fiduciary activities for the period of July 1, 1998 through September 30, 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 November 23, 2005 on our consideration of the Southern Kentucky Economic Development Corporation's internal control over ARC RLF grant financial reporting and on our tests of compliance with certain provisions of laws and regulations, included herein. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be read in conjunction with this report in considering the results of our audit.


Tichenor & Associates, LLP
Louisville, Kentucky
November 23, 2005

Southern Kentucky Economic Development Corporation

**SCHEDULE OF FUND BALANCE
(As of September 30, 2005)**

Cash in Bank	<u>\$ 4,825</u>
Loans Outstanding	<u>175,000</u>
Other Investments	<u> </u>
Due from Other Accounts	<u> </u>
Other Assets	<u>578</u>
Less: Current Liabilities	<u>374</u>
Fund Balance	<u><u>\$180,029</u></u>

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

Southern Kentucky Economic Development Corporation

**STATEMENT OF SOURCE AND APPLICATION OF FUNDS
(For The Period of July 1, 1998 through Audit September 30, 2005)**

Source of Funds	
ARC Grant	<u>\$306,150</u>
Loan Interest Income	<u>29,250</u>
Fees Charged	<u>3,220</u>
Other Income	<u>4,202</u>
 Total Funds Available	 <u><u>\$342,822</u></u>

Application of Funds	
Cash in Bank	<u>\$ 5,029</u>
Loans Outstanding	<u>175,000</u>
Grant Funds Returned	<u>156,150</u>
Match for EDA Fund	<u>0</u>
Loan Losses	<u>0</u>
Administrative Expenses	<u>6,643</u>
 Total Funds Applied	 <u><u>\$342,822</u></u>

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

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Report on Compliance and on Internal Control Over Financial Reporting Based on an Audit of the Financial Statements Performed in Accordance with Government Auditing Standards

We have audited the ARC RLF grant financial statements of the Southern Kentucky Economic Development Corporation as of and for the period of July 1, 1998 through September 30, 2005, and have issued our report thereon dated November 23, 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 part of obtaining reasonable assurance about whether the Southern Kentucky Economic Development Corporation 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 the Southern Kentucky Economic Development Corporation'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 Southern Kentucky Economic Development Corporation'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

November 23, 2005

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 Southern Kentucky Economic Development Corporation 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 Number KY-13126 to Southern Kentucky Economic Development Corporation. Total funding for the original grant was for \$150,000. The ARC grant is to provide units of local government and industrial authorities in twenty-four (24) ARC counties with financing for the construction of industrial buildings.

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 Southern Kentucky Economic Development Corporation for the period of July 1, 1998 through September 30, 2005.

Status:

As of September 30, 2005, Southern Kentucky Economic Development Corporation had one ARC RLF loan outstanding with an unpaid balance of \$175,000.

EXECUTIVE SUMMARY

Audit Results:

The audit resulted in the following:

a. Compliance

No compliance issues noted.

b. Internal Control

The Grantee has one person who performs three key duties related to the payroll function. This person maintains time and attendance records, prepares the paychecks and distributes the paychecks. Proper internal controls dictate that the person responsible for maintaining time and attendance records be separated from the person who prepares and distributes the paychecks. This lack of control leaves a possibility of data manipulation.

Refer to the Schedule of Findings for more details on the audit finding.

Recommendations:

We recommend that the Southern Kentucky Economic Development Corporation take the following actions:

a. Compliance

No compliance issues noted.

b. Internal Control

We recommend that the duties of maintaining time and attendance records, preparing and distributing the payroll checks be assigned to more than one person or establish compensating controls necessary to provide assurance that the payroll is prepared and distributed properly.

Auditee's Response:

Southern Kentucky Economic Development Corporation did not provide a written response to our draft report.

EXECUTIVE SUMMARY

Auditor's Conclusion:

Our recommendation remains unchanged.

Southern Kentucky Economic Development Corporation

SCHEDULE OF FINDINGS

SUMMARY OF AUDIT RESULTS

1. The auditors report expresses an unqualified opinion on the ARC RLF grant financial statements of the Southern Kentucky Economic Development Corporation for the period of July 1, 1998 through September 30, 2005.
2. No instances of noncompliance were disclosed during the audit.
3. One (1) reportable condition was disclosed during the audit.

FINDINGS AND RECOMMENDATIONS

NONCOMPLIANCES

No issues of noncompliance notes.

REPORTABLE CONDITIONS

1. Proper internal control procedures require a segregation of duties when it comes to the payroll function. The person who is responsible for maintaining time and attendance records should be different from the person who prepares and distributes the payroll checks.

Presently, only one person is performing all three of these 3 key payroll functions (maintaining time and attendance records, preparing and distributing the payroll checks).

The Southern Kentucky Economic Development Corporation only has 7 employees. This lack of manpower is the reason for the lack of segregation of duties.

The detection of keying errors or data manipulation is significantly reduced by this lack of segregation of duties.

We recommend that the duties of maintaining time and attendance records, preparing and distributing the payroll checks be assigned to more than one person or establish compensating controls necessary to provide assurance that the payroll is prepared and distributed properly.

The grantee did not provide a written response to our draft report.

AUDITOR'S CONCLUSION

Since the grantee did not respond to our draft report, we continue to recommend that the duties of maintaining time and attendance records, preparing and distributing the payroll checks be assigned to more than one person or establish compensating controls necessary to provide assurance that the payroll is prepared and distributed properly.