U.S. DEPARTMENT OF COMMERCE
Office of Inspector General

ECONOMIC DEVELOPMENT ADMINISTRATION

The EDC Fund, Inc.
Revolving Loan Fund
EDA Grant No. 01-39-01829

Audit Report No. ATL-17285-6-0001/January 2006

PUBLIC RELEASE

Office of Audits, Atlanta Regional Office

TABLE OF CONTENTS

UNITED STATES DEPARTMENT OF COMMERCE
Office of Inspector General
Office of Audits
ATLANTA REGIONAL OFFICE
401 W. Peachtree St., N.W., Suite 2742
Atlanta, Georgia 30328
(404) 730-2788 FAX
(404) 730-2780

JAN 1 1 2006

MEMORANDUM FOR: Paul M. Raetsch
Regional Director
Philadelphia Regional Office
Economic Development Administration

Kathleen M. McKevitt

FROM: Kathleen M. McKevitt
Regional Inspector General
for Audits

SUBJECT: Final Audit Report No. ATL-17285-6-0001
Auditee: The EDC Fund, Inc.
EDA Grant No. 01-39-01829

We are attaching a copy of the subject audit report for your action in accordance with DAO 213-5, "Audit Resolution and Follow-up." The original report has been sent to the auditee/recipient, who has thirty (30) days from the date of the transmittal to submit comments and supporting documentation to you. We have also attached a copy of our transmittal letter. Requests from the public for copies of this report under the Freedom of Information Act must be referred to:

Office of Inspector General
Office of Compliance and Administration
Publication Unit
U.S. Department of Commerce
14th & Constitution Ave., N.W. - Room 7099C
Washington, DC 20230

Under DAO 213-5, you have sixty (60) calendar days from the date of this memorandum to reach a decision on the actions you propose to take on each audit finding and recommendation and to submit an Audit Resolution Proposal to this office. The format for the proposal is Exhibit 8 of the DAO. As applicable, your written proposal must include the rationale and/or legal basis for reinstating any questioned cost in the report and should reference any supporting documentation relied on. Your comments should also address the funds to be put to better use cited in the audit report. Under the DAO, the Office of the Inspector General must concur with your proposal before it may be issued as a final determination and implemented. The DAO prescribes procedures for handling any disagreements this office may have with the Audit Resolution Proposal. Also, please copy us when the audit determination letter is sent to the auditee.

Any inquiry regarding this report should be directed to Jerry McMahan at (404) 730-2065. All correspondence should refer to the audit report number given above.

Attachments

cc: Sandy Baruah, Acting Assistant Secretary for Economic Development
Mary Pleffner, Acting Deputy Assistant Secretary and Chief Operating Officer, EDA
Deborah Caution, Audit Liaison, EDA

EXECUTIVE SUMMARY

In September 1978, the Economic Development Administration (EDA) awarded a $720,000 long-term economic deterioration assistance grant to the Economic Development Council of Southwest Vermont Incorporated, a local development district in Manchester, Vermont. The grant required no matching share.

The grant established a revolving loan fund (RLF) to redress an actual or threatened economic dislocation or other adjustment problem for the areas of Bennington and Rutland Counties in the State of Vermont. In July 1999, EDA amended the award and transferred the assets and responsibility for administration of the RLF to the EDC Fund, Inc., a non-profit corporation in Rutland, Vermont.

We conducted a financial and compliance audit of the RLF during December 2004. The audit covered the three-year period from January 1, 2002, to December 31, 2004. Our objectives were to determine (1) the financial status of the RLF, (2) the propriety of administrative costs charged to the RLF, and (3) the EDC's compliance with applicable federal laws and regulations, grant terms and conditions and the RLF plan.

Our audit found that the EDC had not complied with certain terms and conditions of the grant. We determined that the EDC (1) had $94,013 in excess cash; (2) made a $10,000 line of credit RLF loan to its executive director; (3) entered related party transactions without written contracts, required disclosures or prior approvals through written determinations; (4) failed to always obtain formal loan applications; (5) had RLF loan files without the required supporting documentation for private leveraging, credit reports, and jobs created or retained; (6) failed to submit most semiannual reports and others were not timely, complete and accurate; (7) failed to submit RLF plan certifications, and income and expense statements; and, (8) had not obtained single audits required by OMB Circular A-133.

In their response to the draft report, grantee officials: (1) stated that they made additional loans of $75,000 and have an additional $75,000 in loans pending but did not submit any supporting documentation; (2) stated that the line of credit loan to the executive director would not be renewed; (3) submitted missing written contracts for the related party agreements; (4) submitted formal loan applications for 3 of 9 loans that could not be located at the time of our fieldwork; (5) stated that they are working to obtain better leveraging and that jobs to be created or retained will be documented in future loan applications; (6) stated that they are working to improve timely submission of semiannual reports; (7) stated that they have no funds for a new RLF plan update or certification, and that the annual audit report takes the place of the income and expense report; and (8) stated that they have used the same audit source since the grant was first issued.

We recommend that EDA's Philadelphia Regional Director require that the EDC:

1. Deposit the excess funds, $94,013 as of December 31, 2004, into a separate interest bearing account and remit the interest monthly to the U.S. Treasury; use the excess funds within six months to make direct loans or loan guarantees in accordance with RLF program objectives; and, remit any unused excess funds remaining in the account after six months to the U.S. Treasury. In determining excess funds, EDA should

require EDC to write off the uncollectable portion of the $128,437 in reserve for loan losses.

2. Provide written support that the RLF line of credit loan to the executive director has not been renewed and bank records showing the loan has been repaid in full.

3. Obtain EDA approval of all related party contracts. If EDA does not approve, we recommend that the Regional Director require EDC to repay the RLF for expenses charged under the related party agreements.

4. Provide loan applications for the four loan applications not provided in the grantee response to the draft report. Also, obtain and retain written loan applications including appropriate supporting documents for all future RLF loan applicants

5. Obtain private leveraging with RLF funds of at least a 5 to 1 ratio in accordance with EDC's RLF Plan.

6. Fully document the RLF loan files, including private leveraging; credit reports; and number of jobs created or retained.

7. Submit all required semiannual reports to EDA and ensure that the reports are timely, complete and accurate. EDA should ensure that appropriate training takes place.

8. Submit annual RLF plan certifications and the 2004 income and expense statement to EDA.

9. Obtain single audits for each of the past 3 years and for future years as required by OMB Circular A-133.

We have summarized the grantee's draft report response and provided our comments in the appropriate report sections. We also have included EDC's complete response, excluding attachments, as Appendix I.

INTRODUCTION

In September 1978, the Economic Development Administration (EDA) awarded a $720,000 long-term economic deterioration assistance grant to the Economic Development Council of Southwest Vermont Incorporated, a local development district in Manchester, Vermont. The grant required no matching share.

The grant established a revolving loan fund (RLF) to redress an actual or threatened economic dislocation or other adjustment problem for the areas of Bennington and Rutland Counties in the State of Vermont. In July 1999, EDA amended the award and transferred the assets and responsibility for administration of the RLF to the EDC Fund, Inc., a non-profit corporation in Rutland, Vermont.

The EDC had 15 RLF loans outstanding, with principal balances totaling $274,911 as of December 31, 2004.

OBJECTIVES, SCOPE AND METHODOLOGY

We conducted a financial and compliance audit of the RLF at the EDC office in Rutland, Vermont during December 2004. Our objectives were to determine (1) the financial status of the RLF, (2) the propriety of administrative costs charged to the RLF, and (3) the EDC's compliance with applicable federal laws and regulations, grant terms and conditions and the RLF plan.

The audit covered the period from January 1, 2002, to December 31, 2004. We were unable to follow-up on activity from the last OIG audit, for the period ending December 1992, because EDC did not provide prior accounting and loan records. For the 3-year period audited, we examined pertinent EDA and EDC records, and interviewed agency and grantee officials. We reviewed the EDC's financial management of the RLF and the 15 loans outstanding as of December 31, 2004. We also reviewed two additional loans that had been closed out during the 3-year period.

We reviewed the EDC's most recent completed annual audit report for the fiscal year ending December 31, 2002. An independent certified public accounting firm conducted the audit in accordance with U.S. generally accepted auditing standards. Since this type of audit report does not include an opinion on internal controls we determined that we could best meet our audit objectives through testing of RLF transactions.

We relied on computer-processed data supplied by the EDC as the basis for some of our audit findings and recommendations. We determined the validity and reliability of computer-processed data by direct tests of the data to supporting documentation. Based on our tests, we concluded that the computerized data was sufficiently reliable for use in meeting our objectives.

We evaluated the EDC's compliance with federal laws and regulations applicable to the EDA grant project. We identified *Title IX of the Public Works and Economic Development Act of 1965, as amended*, as the applicable federal law. We also identified *Title 13 Code of Federal Regulations (CFR) Part 308, Requirements for Economic Adjustment Grants*, EDA's *Revolving Loan Fund Grants Standard Terms and Conditions*, and EDA's Special Terms and Conditions as the applicable federal requirements.

Since a nonprofit corporation administers the RLF, we also identified OMB Circular A-110 *Uniform Administrative Requirements for Grants and Agreements With Institutions of Higher Education, Hospitals, and Other Non-Profit Organizations*, and OMB Circular A-122 *Cost Principles for Non-Profit Organizations*, as additional requirements.

We found that the EDC was not in compliance with certain grant requirements. The noncompliance issues were deemed material and are detailed in the "Findings and Recommendations" section of this report.

We conducted the audit in accordance with generally accepted government auditing standards, and performed it under the authority of the Inspector General Act of 1978, as amended, and Department Organization Order 10-13, dated May 22, 1980, as amended.

FINDINGS AND RECOMMENDATIONS

Our audit found that the EDC had not complied with certain terms and conditions of the grant. We found that the EDC (1) had over $94,000 in excess cash; (2) made a $10,000 line of credit RLF loan to its executive director; (3) entered related party transactions without written contracts, required disclosures or prior approvals through written determinations; (4) failed to always obtain formal loan applications; (5) had RLF loan files without the required supporting documentation for private leveraging, credit reports, and jobs created or retained; (6) failed to submit most semiannual reports and others were not timely, complete and accurate; (7) failed to submit RLF plan certifications, and income and expense statements; and, (8) had not obtained single audits required by OMB Circular A-133.

THE EDC HAD OVER $94,000 IN EXCESS CASH

The RLF had over $94,000 in excess cash reserves as of December 31, 2004. The goal of the RLF program is to assist economically distressed areas by creating loan funds for use in making business loans designed to save or create jobs. RLF operators are expected to maximize the amount of capital loaned out or committed at all times in order to achieve the program's goals of job creation and retention in Bennington and Rutland Counties in the State of Vermont. Federal regulation 13 CFR Section 308.17(c) requires that at least 75 percent of an RLF's capital should be utilized by being loaned out or committed at all times. When the percentage of capital utilized falls below this standard, the amount of funds equivalent to the difference between the percentage of capital utilized and the standard represents excess funds.

The regulation further addresses prolonged excess funds and states that when a second consecutive RLF status report shows that the 75 percent standard has not been met, EDA may require an RLF operator to deposit the excess funds into a separate interest-bearing account. The regulation states that the interest earned on the account, attributable to the EDA grant, should be remitted to the U.S. Treasury. In addition, the regulation states that RLF operators who persistently fail to make maximum use of the available RLF capital will be required to return excess funds to the U.S. Treasury.

As the table on the next page shows, the RLF had cash reserves that exceeded EDA's allowable uncommitted cash by over $94,000 as of December 31, 2004. In addition, for calendar years 2002 and 2003 the RLF has had excess cash of more than $149,000. EDC made four RLF loans in 2002, zero loans in 2003 and only two loans in 2004. EDC officials stated that they have potential RLF loan applicants. However, based on the low number of loans made, the RLF apparently has little or no need for the excess cash.

RLF Excess Cash Balance
(December 31, 2004)

Fund Balance	$628,399 *		
Less: Current RLF Income	16,500	$611,899	
Less: Outstanding Loans	$274,911 *		
Committed Loans	90,000	364,911	
Available Cash Balance		$246,988	
Less: Uncommitted Cash Allowed		152,975	
Excess Cash			$94,013

* The fund balance contains outstanding loans of $274,911. These loans have not been reduced for uncollectable amounts included in the EDC's $128,437 reserve for loan losses.

Grantee Response

Officials also stated that the EDC may have had excess cash at the time of the audit because in previous years the local banks had become very aggressive and granted loans to people who contacted the EDC for loans. Officials stated that the market has changed in the last six to eight months and they now have increased demand for loans. Grantee officials stated they have made $75,000 in loans and that an additional $75,000 in loans are pending. Officials also submitted an independent accountant's schedule detailing the loan loss reserves of $128,437.

OIG Comments

Officials did not submit information, such as loan applications and approvals, to support the $75,000 in new loans they claim to have made or the $75,000 in additional loans pending. Therefore, we did not include these amounts in the calculation of excess cash.

However, we changed our computation of excess cash, to be consistent with EDA's methodology. The computation in the table above shows that the grantee included loans receivable of $274,911 in computing the RLF fund balance without reduction for uncollectable amounts included in its loan loss reserves of $128,437. Any uncollectable amounts included in loan loss reserves should be identified and written off to present a more accurate analysis of RLF funds available.

Recommendation

We recommend that EDA's Philadelphia Regional Director require the EDC to:

> Deposit the $94,013 in excess funds, as of December 31, 2004, into a separate interest-bearing account and remit the interest monthly to the U.S. Treasury; use the excess funds within six months to make direct loans or loan guarantees in accordance with RLF program objectives; and, remit any unused excess funds remaining in the account after six months to the U.S. Treasury. In determining excess funds, EDA should require EDC to write off the uncollectable portion of the $128,437 in reserve for loan losses.

Funds to Be Put to Better Use

By implementing the recommendation above, $94,013 in excess cash will be put to better use by either increasing the RLF's loan activity or returning the funds to the U.S. Treasury.

LINE OF CREDIT LOAN AND OTHER RELATED PARTY TRANSACTIONS CREATED CONFLICTS OF INTEREST

The EDC created conflicts of interest by issuing an RLF line of credit loan to its executive director and engaging in other related party transactions without written contracts, appropriate disclosures or prior approvals through written determinations. Also, a company owned by the executive director charged costs to the RLF for his services to the program. In addition, companies owned by the president charged costs to the RLF program for secretarial services and office space rental.

EDA's *RLF Standard Terms and Conditions*, Part II Section F.4.a. states:

> "No officer, employee, or member of the RLF Recipient's Board of Directors, or other Board (hereinafter referred to as "other board") that advises, approves, recommends or otherwise participates in decisions concerning loans or the use of RLF grant funds, or person related to the officer, another employee, or any member of the Board by immediate family, law, or business arrangement, may receive any benefits resulting from the use of the RLF loan or grant funds. In addition, the RLF Recipient may not lend RLF funds to an employee of the RLF Recipient or any member of the RLF Recipient's Board of Directors, or a member of any other Board."

The regulation also states:

> "Exception: A benefit or loan may be conferred if the officer, employee, or Board member affected first discloses to the RLF Recipient on the public record the proposed or potential benefit and receives the RLF Recipient's written determination that the benefit involved is not so substantial as to reflect adversely upon or affect the integrity of the RLF Recipient's decision process or the services of the officer, employee or board member."

Line of Credit Loan to Executive Director

The EDC made a $10,000 line of credit RLF loan to a company owned by its executive director, which created a conflict of interest. The executive director is also a member of the EDC Fund, Inc. Board of Directors. The purpose of the loan was to purchase inventory and operating expenses. The EDC Board reviews potential loan applications for RLF funding. As stated in the criteria above, neither an employee nor a board member may receive a benefit from the RLF program. This is a violation of the EDA regulations. EDC officials did not agree that the RLF loan was a conflict of interest. EDC officials stated that the executive director is not an employee but his position is under contract with the RLF program for part-time services on an as needed basis. Whether the executive director was a member of the board or an employee, his position is prohibited from receiving a benefit from the RLF program without meeting the exception rule above.

Related Party Transactions
For Contract Services

Two companies owned by EDC officials charged costs to the RLF program. The costs were for the services of the executive director and for secretarial services. One of the companies owned by the executive director charged costs for his part-time services at a rate of **[text removed]** per hour, plus mileage. The executive director stated that the EDC Board of Directors appointed him to this position in March 1998. During the audit period, the company charged $1,200 for his services to the RLF program. EDC has not provided a written contract agreement with this related company.

Another company, owned by the EDC president, charged costs to the RLF program for part-time secretarial services at a rate of **[text removed]** per hour, plus other related expenses**.** During the period from February 2002 through October 2004, the company charged $11,565 in costs to the RLF program. The president stated that there was no written contract agreement between the EDC and the company.

EDC officials did not have written contracts to support these services. In addition, officials had not made appropriate disclosures or obtained prior approvals through written determinations required by EDA's *RLF Standard Terms and Conditions*, as detailed on page 6, that the benefit involved is not so substantial as to reflect adversely upon or affect the integrity of their decision process or service of the officer, employee or board member.

Related Party Agreement
For Office Rental Space

The EDC also entered a rental agreement for office space with a company owned by the EDC President. The company charges the RLF **[text removed]** per month, plus quarterly common facilities fees. EDC officials stated that the rental rate was comparable for the local area. Based on our analysis of three comparable office rental spaces in the local area, the monthly rental rate appears to be reasonable. From January 2002 to December 2004, the company charged **[text removed]** to the RLF program.

EDC officials had a written contract but had not obtained the disclosure or prior approval through a written determination required by EDA's *RLF Standard Terms and Conditions*, as detailed on page 6, that the benefit involved is not so substantial as to reflect adversely upon or affect the integrity of their decision process or service of the officer, employee or board member.

Grantee Response

Grantee officials stated that the executive director was hired as a consultant directed to perform services under the direction of the EDC President on an as needed basis. Officials also stated that the board voted and discussed any and all conflicts of interest and felt the exceptions provided in the regulations were met. Officials also stated that the board voted not to renew the loan to the executive director at the last board meeting. Officials also submitted formal contract agreements for the two companies providing related party services to the EDC for the positions of executive director and secretary.

OIG Comments

We agree with the grantee board's decision not to renew the RLF loan to the executive director. The current loan term ends in February 2005; therefore, we recommend that EDA require the EDC to provide written support that the loan has not been renewed and to provide bank records showing the loan has been repaid in full.

The grantee submitted with its response, written related party contract agreements for the services of the executive director and the secretary. The grantee previously provided written contract agreements for the rental of office space. EDA's *RLF Standard Terms and Conditions,* described on page 6, provides the rules for related party exceptions. The rules do not require EDA's approval to obtain an exception to related party transactions. However, for an exception to apply, the rules require that the RLF recipient must first make a written determination that there would be no adverse effect on the RLF. Since EDC failed to make such a determination, we recommended that the grantee obtain EDA's approval or repay amounts charged to the RLF for the related party transactions. We continue our recommendation.

Recommendations

We recommend that the EDA Philadelphia Regional Director require that the EDC:

1. Provide written support that the RLF line of credit loan to the executive director has not been renewed and bank records showing the loan has been repaid in full.

2. Obtain EDA approval of all related party contracts. If EDA does not approve, we recommend that the Regional Director require EDC to repay the RLF for expenses charged under the related party agreements.

FORMAL LOAN APPLICATIONS NOT ALWAYS REQUIRED

The EDC failed to obtain and document formal loan applications for 9 of the 17 RLF loans reviewed. EDA's *RLF Standard Terms and Conditions*, Part II Section I.1., requires each RLF grantee to retain loan files and related documents and records over the life of a loan and for a three-year period from the final disposition of a loan.

Loan applications for the nine loans could not be located in the loan files. Officials stated that in most cases, a written application is not required from the borrower in applying for a loan. Officials stated that the borrower just has to present the loan purpose and use to the board of directors. However, EDC needs to require written loan applications for all RLF loan applicants.

Grantee Response

Grantee officials submitted formal loan applications for 3 of the 9 RLF loans that could not be located at the time of our fieldwork. Two additional loans did not have formal loan applications because the borrowers requested the loans by letter. EDC officials provided our office copies of the two letters.

OIG Comments

We accept the documentation for the three loan applications submitted. The two letter applications are not adequate substitutions for loan applications because they do not contain the basic application information requirements. The grantee needs to provide loan applications to EDA for the remaining four loans and to obtain and retain written loan applications with appropriate supporting documents for all future loan applications.

Recommendations

We recommend that the EDA Philadelphia Regional Director require that EDC:

1. Provide documentation for the four loan applications not provided in the grantee response to the draft report.

2. Obtain and retain written loan applications including appropriate supporting documents for all future RLF loan applicants.

RLF LOAN FILE DOCUMENTATION WAS INADEQUATE

EDA's *RLF Standard Terms and Conditions*, Part II Section I.1., requires each RLF grantee to retain loan files and related documents and records over the life of a loan and for a three-year period from the final disposition of a loan. In addition to 9 loan files not having loan applications, discussed in the previous section, our review of 17 RLF loan files revealed inadequate documentation for loan leveraging, proof of credit checks, and jobs to be created or retained.

Loan Leveraging Was Not Documented

The EDC failed to provide documentation to support loan leveraging for 15 of the 17 RLF loans reviewed. Leveraging is the participation by non-RLF funds in the RLF loan project. Leveraging for the 15 loans could not be identified in the loan files. Officials stated that in most cases no leveraging is required. However, the EDA *RLF Standard Terms and Conditions* Section II. F.3. requires RLF loans to leverage private investment at least two dollars for every dollar of RLF investment. The EDC RLF Plan also stated a ratio between other funds and RLF funds of 5 to 1. The EDC needs to ensure that the RLF loan portfolio is meeting the leveraging requirement and document that in its files.

Other Documents Not In RLF Loan Files

The EDC also did not have support for the following documents in the loan files. They did not have support for credit checks for any of the 17 RLF borrowers reviewed. The lack of credit reports also prevented the analysis of credit otherwise available to the borrowers. The officials stated that they do not conduct credit checks on potential borrowers. Officials stated that they examine the feasibility of the company, the use of funds and the ability of the borrower to repay the loan. In addition, the EDC did not provide support for the number of jobs created or retained for 16 of the 17 loans reviewed. The EDC needs to obtain required documents and retain them in the loan files.

Grantee Response

Grantee officials stated that they are working to obtain better collateral on loans but there is no mechanism available for them to leverage the RLF funds unless they are willing to take second or third mortgage positions behind other organizations. Officials stated that formal credit reports have never been obtained and the EDC is not a part of any credit bureau that would allow access to credit reports. Also, they stated that any personal reference and credit checks they obtain are by telephone. Officials also stated that they are revising their loan application form so that applicants can state the number of jobs to be created or retained.

OIG Comments

We have not changed our findings and recommendations. The grantee should leverage the RLF loans by requiring other entities to participate in a borrower's project. Also, the grantee needs to obtain and document credit checks for each borrower. We agree with the grantee revising the loan application to include statements regarding jobs to be created or retained.

Recommendations

We recommend that EDA's Philadelphia Regional Director require the EDC to:

1. Obtain private leveraging with RLF funds of at least a 5 to 1 ratio in accordance with EDC's RLF Plan.

2. Fully document the RLF loan files, including private leveraging, credit reports, and number of jobs created or retained.

THE EDC HAS NOT COMPLIED WITH CERTAIN OTHER RLF ADMINISTRATIVE REQUIREMENTS

Our audit disclosed that the EDC has not complied with certain other EDA RLF administrative requirements. Specifically, the EDC failed to submit most semiannual reports and others were not timely, complete and accurate. EDC did not submit annual RLF plan certifications and income and expense statements. In addition, single audit reports have not been performed as required.

The EDC Failed to Submit Most Semiannual Reports and Others Were Not Timely, Complete and Accurate

The EDC did not submit most required semiannual reports and others were not timely, complete, and accurate. EDA's *RLF Standard Terms and Conditions*, Part II Section J.1., requires that RLF operators submit semiannual reports on their operations to EDA. The EDA's *RLF Administrative Manual,* Section XI.A.2, states that the semiannual RLF status reports are due October 31 for the period ending September 30, and due April 30 for the period ending March 31.

EDA provides a standard report format and instructions that require RLF operators to report their cumulative loan operations through each semiannual period. EDA uses the semiannual reports to monitor the grant projects to ensure that RLF operators are managing funds in accordance with their RLF plans and the agency's administrative requirements. Therefore, it is essential that the reports are timely submitted.

The EDC did not submit four out of the last six required semiannual reports and the two reports submitted were late. A review of the reports submitted since March 31, 2002, revealed that the reports for the periods ending March 31 and September 30, 2002, and September 30, 2003, and September 30, 2004, were not submitted. Also, the report for the period ending March 31, 2003, was submitted seven months late on November 21, 2003, and the report for the period ending March 31, 2004, was submitted six months late on October 26, 2004. The EDC officials stated that the reports were either not prepared or late because the current officials of the RLF program were not given formal training on the preparation of the reports. Also, the reports submitted were not complete and accurate in the presentation of RLF loan numbers and outstanding loan balances. For example, the March 31, 2004, report did not accurately report total loans made by the RLF and the total outstanding loan amount did not agree with EDC's monthly internal financial reports.

The EDC Did Not Submit Annual RLF Plan Certifications

EDA's *RLF Standard Terms and Conditions*, Part II Section J.2., requires each RLF grantee to certify annually to EDA that (1) the grantee's RLF plan is consistent with and supportive of the area's current economic adjustment strategy, and (2) the RLF is being operated in accordance with the plan's policies and procedures, and that the loan portfolio meets the plan's standards. The annual certification procedure is intended to assure EDA that grantees are reviewing their RLF plans at least annually and that their operations conform to the plan. The annual certification should be submitted with the semiannual RLF report for the period ending September 30. There was no indication that the EDC had ever complied with this requirement.

The EDC Did Not Submit Annual RLF Income and Expense Statements

EDA's *RLF Standard Terms and Conditions*, Part II Section J.3., requires each RLF grantee that uses 50 percent or more of program income for RLF administrative expenses during a selected 12-month period, to submit a completed RLF income and expense statement to the EDA Regional Office within 90 days of either September 30 or the RLF's fiscal year end, whichever period is selected by the grantee. The income and expense statements are intended to reveal to EDA the amount of program income being earned, the percent of program income being spent on administrative expenses, and the amount of program income added to the RLF program for relending.

The EDC has exceeded the 50 percent requirement for use of program income for administrative expenses. A financial review of the three-year period for the RLF program revealed over 70 percent of program income being used to cover administrative expenses per year. During the audit fieldwork, the EDC had submitted the income and expense statements in the annual audit report for the fiscal year ending December 31, 2002. However, the audit reports for fiscal years 2003 and 2004 had not been completed.

Required Single Audits Have Not Been Conducted

OMB Circular A-133, Subpart B. 200, specifically requires grant recipients that expend at least $500,000 in total federal awards in any given fiscal year ending after December 31, 2003, to have a single audit performed. The requirement was $300,000 for the two prior years. The circular further explains the basis for determining federal awards expended. Generally, the calculation will include the RLF's balance of all outstanding loans, plus cash and investment balance, plus administrative expenses paid out of the RLF during the year. The EDC reported an RLF fund balance of more than $600,000 for each year of the three-year audit period.

The EDC has obtained yearly audit reports; however, there have not been any single audit reports conducted on the RLF funds. In addition, the independent audit report for the year ending December 31, 2003, had not been completed and the audit report for the year ending December 31, 2004, had not been started at the completion of our site visit.

Grantee Response

Grantee officials stated that they are working to improve the timely submission of semiannual reports. Officials stated that the reports have been difficult and burdensome because of few loans, no formal report training and different instructions on how to prepare the reports. However, officials stated that they plan to visit EDA's Philadelphia Regional Office to receive training.

Grantee officials also stated that they have no planning grant funding to pay for an RLF plan update or the preparation of a new certification. Officials stated that they submit the income and expense statement as part of their annual audit report as soon as it is received. Officials attached a copy of an independent accountant's 2003 financial statement review and stated that the accountant is beginning the 2004 audit. Grantee officials stated that they have used the same audit source since the grant was first issued.

OIG Comments

We believe the formal training grantee officials plan to receive from EDA's Philadelphia Regional Office should assist them in the preparation of semiannual reports and EDA should ensure that this training takes place. We continue our recommendation that the reports must be complete, accurate, and submitted in a timely manner.

EDA planning grants are not made for funding RLF Plan updates or preparation of new certifications. The grant agreement requires that the grantee review its RLF Plan, make needed updates and receive certification from the EDC board that the plan is being followed. We continue our recommendation that annual RLF Plan certifications be submitted to EDA as required.

We agree that the submission of an annual audit report satisfies the requirement to submit income and expense statements. However, the report for 2004 has not yet been prepared. We continue our recommendation that the 2004 income and expense report be submitted to EDA.

The financial statement review for the year ending December 31, 2003 does not satisfy the OMB A-133 requirement. Also, the grantee's response that it has always used the same audit source does not specifically address the finding. We continue our recommendation that EDC obtain single audits for each of the past 3 years and for future years as required.

Recommendations

We recommend that EDA's Philadelphia Regional Director require the EDC to:

1. Submit all required semiannual reports to EDA and ensure that the reports are timely, complete, and accurate. EDA should ensure that appropriate training takes place.

2. Submit annual RLF plan certifications and the 2004 income and expense statement to EDA.

3. Obtain single audits for each of the past 3 years and for future years as required by OMB Circular A-133.

Kathleen M. McKevitt Date
Regional Inspector General
for Audits

EDC Fund, Inc.

Telephone (802) 773-4333

Howe Center, Suite 40
1 Scale Avenue, Building #18
Rutland, Vermont 05701-4456

August 24, 2005

Regional Inspector General for Audits
Office of Inspector General
U S Department of Commerce
401 W. Peachtree St. N.W. Suite 2742
Atlanta, Georgia 30308

ATTN: William F. Bedwell, Jr.
Regional Inspector General for audits

Re: Draft Report ATL-17285-5-0001
Grant No. 01-39-01829

Dear Mr. Bedwell:

We are responding to the above referenced audit that was performed - - We have addressed the nine items in the executive summary - - - -

1. Enclosed are copies of letters dated March 30, 2005 from EDC and March 24, 2005 from A M Peisch & Company in reference to allowances for uncollectibles. We have made $ 75,000.00 in loans and have a couple of others pending totaling another $ 75,000.00. With the loan loss reserves we do not feel that we have any excess cash.

2. Page #5- states that there is an exception that we feel was met at the time of the loan being processed[text removed] is hired as a consultant, not an employee, and is directed to perform services under the direction of the president on an as needed basis - The board voted and discussed any and all conflicts of interest as per regulations for exceptions and felt that the exceptions were met. At the last board of directors meeting - the board voted not to renew the loan.

3. Enclosed are copies of formal contracts for: [text removed] MGI and Crestmark, Incorporated. Also enclosed is a copy of the 1991 lease, lease - relocation and renewal along with consecutive renewals of to current. The original lease and renewals - Item #1 has a termination clause of lessee may notify lessor in writing not less than Sixty (60) days in advance of the termination intent of the above stated term by registered or certified mail and the option is also granted to the Lessor.

4. Enclosed are copies of written loan applications that at the time of the audit could not be located -

Ocean Records, Sammy G Media, did not have applications they requested the loan in letter form, which both are attached - Bruno Auto, Dydo Auto and Homes Treats were applications and are attached.

5. We are working to get better collateral on loans but there is no mechanism available

RECEIVED
AUG 31 2005
BY:

EDC Fund, Inc.

Telephone (802) 773-4333

Howe Center, Suite 40
1 Scale Avenue, Building #18
Rutland, Vermont 05701-4456

for us to lever our funds unless we are willing to take a 2^{nd} & 3^{rd} mortgage position behind the following organizations

1. Private banks
2. REDC Rutland Economic Development Corp
3. BCIC - Bennington County Industrial Corp
4. VEDA Vt Economic Development Authority
5. FHA Farmers Home Adminstration
6. USSBA U.S. Small Business Adminstration
7. Private mortgage lenders

6. Please reference to item #5 for the leveraging. Credit reports have never been done - we make phone contacts as far as personal references and credit. We are not a member of any credit bureau that would allow us to access formal reports, we are from a small rural community where everybody knows everybody.

We are revising our application form so that applicants can state jobs created/retained. All loan approvals reflect the number of job to be created or retained. The jobs created/retained vary due to the economic climate of the area and the individual. Economic Development is a feast or famine business.

7. We have been working on improving the timely submission of the semi-annual report. This has become very difficult and burdensome for us due to the fact we only have a few loans and no formal training on how to fill out the report. We received some assistance from [text removed] and [text removed] our economic development represent - both of these people gave different instructions on how to fill it out and the IG auditor, [text removed] gave us a third set of how to's, the present time we don't know what we should be doing, starting from and the form is very confusing/complexing.

8. We submit the income and expense statement as part of our audit and is forwarded as soon as we receive it.

We have no planning grant funding to pay for an update of the RLF plan or preparation of a new certification.

9. We have used the same single source audit from A. M. Peisch who has performed the audit since the grant was first issued. This was approved by OIG at the time of our last audit they reviewed it. This audit was only back to the previous audit.

The 2003 financial statement is complete and will be forwarded to you. The accountant is beginning the 2004 audit - the delay is due to our accountant - we have continued to contact them.

We may have had excess cash at the time of the audit because in the previous years the local banks had become very aggressive and granted loans to people who contacted us for loans.

EDC Fund, Inc.

Telephone (802) 773-4333

Howe Center, Suite 40
1 Scale Avenue, Building #18
Rutland, Vermont 05701-4456

The bank took just about every opportunity to meet the loan plan and job creation which gave us a spike in our money this situation is now being corrected.

Please note that this fund uses interest from cash reserves in banks and our loan repayments for future loans and loan less reserve. This fund is run without reducing the principal of the grant for administrative cost, which is minimal, and as noted by the auditor below market rates.

The market has changed in the past 6 - 8 months, we now have increased demands for our loans.

We are planning to go the Philadelphia office to receive some training for the correct completion of the semi-annual reports

Very Truly,

Joseph A. Giancola
President

cc: Paul M. Raetsch
Regional Director