U.S. DEPARTMENT OF COMMERCE
Office of Inspector General

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RELEASE

ECONOMIC DEVELOPMENT ADMINISTRATION

Hennepin and Ramsey Counties Revolving Loan Fund

Audit Report No. DEN-13740-1-0001 /July 2001

Office of Audits, Denver Regional Office

UNITED STATES DEPARTMENT OF COMMERCE
Office of Inspector General/Office of Audits
Denver Regional Office
999 18th Street, Suite 765
Denver, Colorado 80202

(303) 312-7650 Fax (303) 312-7671

July 19, 2001

MEMORANDUM FOR: C. Robert Sawyer, Regional Director
Chicago Regional Office
Economic Development Administration

SUBJECT: EDA Grant Number 06-49-02821
Hennepin and Ramsey Counties
Final Audit Report No. DEN-13740-1-0001

This is the final report on our audit of the subject EDA Title IX Sudden and Severe Economic Dislocation Defense Conversion Assistance Revolving Loan Fund grant awarded to Hennepin and Ramsey counties, Minneapolis, and St. Paul, Minnesota. Hennepin County Department of Training and Employment Assistance (the county), which administers the grant for both Hennepin and Ramsey counties, provided a written response dated June 5, 2001, to the draft audit report, which is summarized in this report and included in its entirety as Attachment 3.

We have provided a copy of the final audit report to the county and requested the county to prepare a written response to EDA, addressing the audit report findings and recommendation, within thirty (30) days of the date of this report. A copy of our transmittal letter is also attached.

Under DAO 213-5, you have a maximum of sixty (60) days from the date of this memorandum to reach a decision on the actions that your agency proposes to take on the audit findings and recommendation and to submit an Audit Resolution Proposal to this office. The format for the proposal is shown in Exhibit 8 of the DAO. Under the DAO, the Office of 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.

Any information or inquiry regarding this final audit report should be directed to me at (303) 312-7650, or Carl S. Klein of this office at (303) 312-7657. We appreciate the cooperation and courtesies extended by EDA officials during our audit.

INTRODUCTION

On September 30, 1996, EDA awarded the counties a $1,820,000 Sudden and Severe Economic Dislocation Defense Conversion Assistance grant to establish a revolving loan fund (RLF), consisting of a $1,365,000 grant from EDA (75 percent), and a $455,000 contribution from the counties (25 percent). EDA awarded the grant to mitigate unemployment caused by reductions in U.S. Department of Defense contracts. The RLF was to be used to redirect production activities to non-defense purposes and the start-up of new businesses by persons displaced from defense industry employment.

According to the RLF semiannual report of September 30, 2000, the county awarded four RLF loans totaling $480,000, using $231,872 of EDA funds and $248,128 of matching funds contributed by Hennepin and Ramsey counties and the Minnesota Department of Trade and Economic Development - a 48 percent to 52 percent contribution ratio. In addition, as of June 19, 2001, the county awarded two new loans totaling $225,000. The RLF records indicated that $127,484 was available in the RLF fund as of September 30, 2000. We project that the county will require an additional $252,174 in EDA funds for the two new loans awarded and projected new loan activity (see Attachment 1).

PURPOSE AND SCOPE OF AUDIT

We performed a financial and compliance audit during January 2001 of the RLF at the Hennepin County Department of Training and Employment Assistance office in Minneapolis, Minnesota. The purpose of our audit was to (1) evaluate the financial management of the RLF, and (2) determine if the county complied with applicable RLF administrative and loan documentation requirements.

We examined pertinent EDA and county RLF records, and interviewed agency and county officials as deemed necessary. We reviewed the loan files for each borrower, and the administrative costs for the period of January 1, 1998, through September 30, 2000.

We examined the county's annual single audit reports for the periods ended December 31, 1998, and December 31, 1999, conducted by independent certified public accountants in accordance with OMB Circular A-133. The reports disclosed no material internal control weaknesses. However, rather than relying on the internal control review, we conducted detailed substantive testing of RLF transactions.

We did not rely on computer-processed data as a basis for making any audit conclusions. Consequently, we did not conduct tests of either the reliability of the data or the controls over the computer-based system that produced the data.

We reviewed compliance with legal and regulatory requirements and an assessment of internal controls, using as criteria OMB Circular A-87, *Cost Principles for State and Local Governments*, 15 CFR Part 24, *Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Governments*, and 15 CFR Part 29a, *Audit Requirements for State and Local Governments*. We also assessed compliance with the Department of Commerce Financial Assistance Standard Terms and Conditions, financial assistance award Special Award Conditions, RLF Administrative Manual, RLF Standard Terms and Conditions, and the RLF Plan. Instances of noncompliance with the above stated laws and regulations are noted in this audit report.

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

RESULTS OF AUDIT

EDA's *RLF Administrative Manual,* Section IX.D., contains general requirements for disbursing RLF grants. Loans in the initial round of lending, which generate drawdowns in the grant disbursement phase, are to be completed within three years of the grant award. In March 1999, EDA approved a time schedule extension requiring that at least 50 percent of both the grant funds and matching share be disbursed by September 30, 1999, 80 percent by March 31, 2000, and 100 percent by September 30, 2000.

The latest possible date for the county to disburse 100 percent of the grant funds, according to the rules of the RLF program, is one year after the EDA approved date. As stated in EDA's *RLF Administrative Manual,* Section IX.E., grant funds remain available to EDA for disbursement only until September 30th of the fifth year after the fiscal year of the grant award (September 30, 2001). No time extensions may be granted beyond that time and any undisbursed funds remaining will be deobligated.

As of September 30, 2000, the county had drawdowns of $231,872, only 17 percent of EDA's $1,365,000 share of the grant. In addition, as of June 19, 2001, the county has awarded two new RLF loans totaling $225,000. The county did not achieve any of the grant disbursement milestones, and failed to comply with the time schedule required by the grant amendment.

County officials cited the following reasons for noncompliance. First, the grant's leverage requirement of $2 private funds to $1 of RLF funds is too restrictive, especially in a period of declining commercial interest rates, and it is difficult to achieve the required level of private match and still establish a reasonable level of security for the loan. Second, because of the grant's restriction of eligible areas, the county was not able to serve affected subcontractors or dislocated defense workers living in adjacent counties.

In March 1999, EDA approved a change in the leverage requirement from $2 of private funds for every $1 of RLF funds, to no leverage requirement for loans less than $50,000; $1 of private funds for every $1 in RLF funds on loans from $50,001 to $100,000; and, on loans of more than $100,000, $1 to $1 for the first $100,000, and $2 of private funds for every $1 in RLF funds for the balance of the loan. This amendment has not significantly increased loan demand or enabled the county to use the full amount of the RLF grant. The county also requested the addition of two adjoining counties to the RLF eligible lending area. However, EDA did not approve this addition because sufficient information was not provided to EDA to support the eligibility of the two new counties.

We concluded that the county does not need, and cannot use, the remaining federal share of the RLF grant totaling $880,954, consisting of $1,133,128 undisbursed federal funds less $252,174 additional federal funds required for projected new loans, before the grant expires on September 30, 2001 (see Attachments 1 and 2).

COUNTY'S RESPONSE

The county agreed that it did not meet the lending deadlines required by the grant amendments, but stated that since 1998, they have sent several requests to EDA to expand the lending area, with little response. The county added the following additional reasons for not meeting lending deadlines: (1) many of the defense cutbacks were assimilated into the economy, (2) there was a hiring boom, and (3) private lending became more attractive as interest rates fell.

The county examined the figures from Attachment 1 of the draft audit report, *Projection of Additional EDA Funds Required Through 9/30/2001*, and believes that the $171,827 reported for projected repayments of principal and interest is incorrect. The county stated, "These funds will not be repaid by September of 2001 (one loan is completed, one loan runs through August of 2004, and two loans run through August of 2005). Only another $28,784.70 will be collected through September of 2001..."

In a letter dated June 11, 2001, the county stated that when projecting loan activity based on past performance of RLF lending activities, the period used for the calculation should begin in January 1, 1998, and not the beginning of the grant period. The county explained that lending activity did not begin until January 1, 1998, 15 months after the grant period began, because they needed to establish a loan review board and lending policies.

The county expressed concern regarding the $110,645 figure reported on Attachment 1 of the draft audit report for additional federal funds required for projected new loan activity. The county believes that this figure would allow only $80,000 to be used for new loan activity when there will be an occasion to lend an additional $200,000 to $400,000 in the next five months.

Finally, the county stated that they have requested permission from EDA, in a letter dated April 6, 2001, to modify the award and make existing funds available in another program cycle.

OIG COMMENTS

We reexamined the projected figures from Attachment 1 of the draft audit report and adjusted the (1) loan principal and interest payments, (2) new loans to be awarded, and (3) additional federal funds required.

As a result of additional documentation provided by the county in response to the draft audit report regarding cash flows from existing loans, we revised our projection for loan principal and interest payments from $171,827 to $110,410, a decrease of $61,417. We also agree with the county that the use of the period of January 1, 1998, through September 30, 2000 (33 months), for the projection of loan activity based on the county's past performance, is a more accurate representation than the use of the period from the grant inception. Therefore, we revised our projection for new loans to be awarded from $176,256 to $256,368, an increase of $80,112. As a result of the adjustments made to the projected figures for loan principal and interest payments and new loans to be awarded, we calculate that an additional $252,174 will be needed by the county for cash needs through September 30, 2001, when the EDA funds for the grant award expire by law (see Attachment 1).

The county's response requested that EDA transfer the existing RLF funds to another program cycle. We believe any transfer of the RLF funds for other purposes would be an impermissible change in the grant scope. In addition, the RLF funds, per the *RLF Administrative Manual*, will expire on September 30, 2001 (see page 3 of this report). Title 31, Subtitle II, Section 1552(a), of the U.S. Code states, "On September 30th of the 5th fiscal year after the period of availability for obligation of a fixed appropriation account ends, the account shall be closed and any remaining balance (whether obligated or unobligated) in the account shall be canceled and thereafter shall not be available for obligation or expenditure for any purpose." As of September 30, 2001, this grant will reach its 5th fiscal year, and undisbursed grant funds must be deobligated and cannot be available for obligation to a new program.

RECOMMENDATION

We recommend that the EDA Chicago Regional Director deobligate excess grant funds of $880,954 to reduce the risk of inappropriate use of funds (see Attachment 2).

FUNDS PUT TO BETTER USE

Should the Regional Director deobligate excess grant funds of $880,954, these funds will be put to better use.

William R. Suhre July 19, 2001
Regional Inspector General for Audits

Attachment

cc (w/att): William C. Brumfield, Director, Hennepin County Training and Employment Assistance
Kay Franey, Senior Program Analyst, Hennepin County Training and Employment Assistance
Mary Pleffner, Acting Assistant Secretary for Economic Development
David Temple, Acting Deputy Assistant Secretary, EDA
David F. Witschi, Director, Economic Adjustment Division, EDA
Patricia A. Flynn, Director, EDA Operations Review and Analysis Division

bc (w/att): Lisa Barlow, Counsel to the Inspector General
Larry B. Gross, Acting Assistant Inspector General for Audits
Bill Bedwell, Acting Deputy Assistant Inspector General for Regional Audits (2 Copies)
Ron Lieberman, Director, Science & Technology Audits Division
Tom McCaughey, Director, Financial Statements Audit Division
David Sheppard, Acting Seattle Regional Inspector General for Audits
Bob Hoy, Editor
Annie Holmes, Management Assistant
Jackie Day, Auditor
Pat Cervantes, Confidential Assistant to the IG (2 Copies)
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HENNEPIN AND RAMSEY COUNTIES
MINNEAPOLIS AND ST. PAUL, MINNESOTA

PROJECTION OF ADDITIONAL EDA
FUNDS REQUIRED THROUGH 9/30/2001

RLF Cash Balance as of 9/30/2000			$127,484
Add (Sources of Cash):	Monthly	Annually	
Loan Principal & Interest Repayments	$12,530(a)	$110,410(a)	110,410
Projected Funds Available:			$237,894
Less (Uses of Cash):			
Additional Loan Funds Committed			$225,000
Operating Expenses	$ 725(b)	$ 8,700(b)	
New Loans Awarded	21,364(b)	256,368(b)	
Cash Outflow	$22,089	$265,068	265,068
Total Cash Uses:			$490,068
Additional Federal Funds Required	($490,068 minus $237,894)		$252,174(c)

Notes:

(a) The monthly and annual amounts were based on actual sources of RLF funds received, and estimates based on loan funds committed but not yet disbursed during the 12 months from 10/01/2000 to 9/30/2001.

(b) The monthly and annual amounts were based on an average of actual expenses incurred during 33 months from 1/1/1998 to 9/30/2000.

(c) The county requires an additional $252,174 of federal funds for loan funds committed ($225,000), plus projected loan activity. This results in a total cost share using $484,046 of EDA funds and $248,128 of matching funds, a 66% to 34% contribution ratio. This is less than the 75% EDA federal share to 25% matching share contribution specified in the RLF grant; therefore, our calculation assumes the additional funds will come from EDA.

HENNEPIN AND RAMSEY COUNTIES
MINNEAPOLIS AND ST. PAUL, MINNESOTA

CALCULATION OF FUNDS TO BE DEOBLIGATED

Undisbursed Federal Funds as of 9/30/2000	$1,133,128
Less: Additional Federal Funds Required	(252,174) (a)
Total Federal Funds to be Deobligated	$ 880,954

Note:

(a) See Attachment 1.

Hennepin County

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June 5, 2001

William R. Suhre, Regional Inspector General for Audits
United States Department of Commerce
Office of Inspector General
Denver Regional Office of Audits
999 18th Street, Suite 765
Denver, CO 80202

RE: Draft Audit Report No. DEN-13740-1-XXXX
U.S. Department of Commerce Award #06-49-02821

Dear Mr. Suhre:

Thank you for your letter and draft audit findings sent on May 11, 2001. I have had Kay Franey, Senior Program Analyst, review the report. We have also talked with Susan Crismon, the auditor who visited the week of January 8, 2001. This is our response.

We do not disagree with the finding that lending deadlines have not been met, but I do offer a few words. Since 1998, we have sent several requests to expand our lending area, with little response. In April and September of 2000 we forwarded a good amount of information about layoffs and defense firms in another county which has a good number of residents and small machine shops (Anoka County). The staff was promised a response in early 2001, but none has come. In the critical period when we began marketing the program, there was no staff budget. Because the grant application of November 1995 was not funded until October of 1996, many of the defense cutbacks of 1993 had been assimilated into the economy. There was a hiring boom among dislocated workers who were potential entrepreneurs. In addition, private lending became more attractive as interest rates fell in 1998 and 1999. Marketing has included an article in a daily newspaper, several hundred mailings to two business associations, to 200 banks, and to 100 economic development officers in municipalities and neighborhoods. The Defense Conversion Contractor's Consortium and the Minnesota Precision Manufacturing Association have yielded a number of leads. However, the contracted vendor was not able to pursue other strategies, such as cold calling, speeches to the Chambers of Commerce, and meetings with lenders.

We examined the figures of the Auditor in the projection of *Additional EDA funds required through 9/30/01*. The cash balance appears to be correct, calculated at $127,484 in September 30, 2000. The current balance of principal payments as of 4/30/01 is $156,928. After $480,000 was lent out, $10,000 was repaid by Ken Nimmer dba C&E Planning, $68,897 repaid by Lowell Inc., $32,166 repaid by Metal Service Inc., and $45,865 repaid by U.M.C. Inc.

Hennepin County Training and Employment Assistance
First Level South Government Center
300 South Sixth Street
Minneapolis, Minnesota 55487-0012
(612) 348-8953 FAX (612) 348-3932

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Hennepin County
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The auditor added another $171,827 in projected repayments of principal and interest available through September of 2001. This is not correct. These funds will not be repaid by September of 2001 (one loan is completed, one loan runs through August of 2004, and two loans run through August of 2005). Only another $28,784.70 will be collected through September of 2001, for *a total cash balance of $185,712.70.*

The auditor calculated *Loan Funds Committed not disbursed* at $225,000. This is true. We are cutting two loan checks, one for $200,000 issued to Motion Control Group on May 1, 2001, and one for $25,000 issued to [redacted] to be issued on June 19th. After this is charged against the cash on hand, this leaves a deficit balance of ($39,287.30). We will be preparing a request for federal reimbursement, at about $30,000, with the balance from the local funders.

The auditor calculated *additional federal funds required* at $110,000 for loan funds committed, and for projected loan activity. This figure would allow only $80,000 to be loaned out in new loans in the next 5 months.

We disagree with this recommendation. There will be an occasion to lend out another $200,000 to $400,000 in the next 5 months. We have also requested permission to move the existing funds into a new area of need. John McLaughlin of my staff submitted a request on April 6, 2001 to Jack Arnold of the Economic Development Administration of the U.S. Department of Commerce. This is a proposal to modify the award to make funds available in another program cycle, to borrowers in the Community Investment Loan program, in the inner cities of Minneapolis and St. Paul. I attach a copy of the request for your information. Thank you for your consideration, and I await the final audit report. Please give me or John McLaughlin a call if you have any questions (612/348-8912).

Sincerely,

WCBrumfield
William C. Brumfield
Director

Cc: C. Robert Sawyer
U. S. Department of Commerce/Economic Development Administration
Chicago Regional Office
111 North Canal Street, Suite 855,Chicago IL 60606-7204

Jack Arnold, Economic Development Representative,
U.S. Department of Commerce,Room 104 Federal Building
515 West 1st Street, Duluth MN 55802

ATTACHMENTS NOT INCLUDED