DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General

Memorandum

Date DEC 19 1997

From June Gibbs Brown
Inspector General

June G Brown

Subject Review of Office of Community Services' Discretionary Grants Awarded to Delta Foundation, Inc. (A-04-96-00105)

To Olivia A. Golden
Assistant Secretary for
Children and Families

This is to alert you to the issuance of our final report on December 23, 1997. A copy is attached.

Our review showed that the Delta Foundation, Inc. (Foundation): (1) did not create full-time permanent jobs; (2) used Federal funds for a wide range of purposes unrelated to the objectives of the grants; (3) did not provide the private cash and in-kind services it proposed to insure the success of the grants; and (4) submitted programmatic and financial reports to the Office of Community Services (OCS) that were often untimely and inaccurate. As a result, $1.43 million of Federal funds provided little or no benefit to accomplishing program objectives.

The OCS discretionary awards are intended to promote, in part: (1) full-time permanent jobs for poverty level individuals; and (2) income and/or ownership opportunities for low-income individuals.

The Foundation is a private, non-profit, tax-exempt corporation located in Greenville, Mississippi. The Foundation was established in 1969 to promote and develop permanent employment opportunities through direct economic development activities. The Foundation's economic development activities were carried out primarily through two for-profit subsidiaries, Delta Enterprises, Inc. (Delta Enterprises) and Delta Capital Corporation (Delta Capital). The Foundation owns 100 percent of the issued and outstanding stock of Delta Enterprises and Delta Capital. Delta Enterprises is a holding company that, at the time of our review, owned five manufacturing businesses in Mississippi and Arkansas. Delta Capital is a for-profit venture capital company, created to provide financial and management services to locally based businesses.

Since October 1991, the Foundation has been awarded four OCS Discretionary Grants totaling $1.43 million. For each of the four grant awards, the Foundation proposed to either form or expand a for-profit manufacturing business through either Delta Enterprises or Delta Capital. The stated intent underlying each of the proposed enterprises was to create a specific number of jobs.

The objectives of our review were to determine if: (1) permanent full-time jobs were created for low-income individuals; (2) grant funds were properly distributed and expended; (3) private cash and in-kind services were provided; and (4) required fiscal and programmatic reports were accurately completed and submitted timely.

The Foundation created few full-time permanent jobs for low-income residents of the local community. The expenditures that actually related to grant activities were, in most instances, committed to subsidize sub-sidiary organizations which proved to have little or no prospects for success in creating jobs. While the Foundation submitted programmatic and financial reports to OCS indicating that grant objectives were being met or exceeded, those reports were often untimely and inaccurate. The Foundation regularly reported the creation of more jobs than actually existed and failed to report financial activities which may have alerted program officials to the actual uses of grant funds. As a result, more than $1.43 million intended to assist families in climbing from poverty has provided little or no benefit.

The Foundation's failure to accomplish grant objectives resulted from a number of operational and managerial deficiencies, including a lack of managerial controls and accountability to insure that the terms and conditions of the grants were followed and grant funds were expended only for purposes related to the grants.

The Foundation did not administer the grants in accordance with the grant proposals and may have misled program officials by submitting inaccurate progress reports. Therefore, we are recommending that the Foundation: (1) refund $1.43 million to the Federal Government; (2) strengthen its management controls to insure proper grant administration, and (3) demonstrate the capability to properly manage and expend Federal grant funds.

In written comments to our draft report, Foundation officials generally disagreed with our findings and recommendations, including our recommendation to repay $1.43 million in grant funds. However, Foundation officials did agree that their grants management controls needed strengthening. To strengthen controls, the Foundation plans to hire a management level employee responsible for grant/special program administration and is in the process of developing internal management controls.

Some of the findings in this report illustrate concerns raised in our alert memorandum dated September 25, 1997. In that memorandum, we reported a problem in assessing grantee accountability and performance relating to the award of equity investment grants. We recommended that the Administration for Children and Families review this funding mechanism to ensure that there are appropriate safeguards to protect the Government's interest.

Any questions or comments on any aspect of this report are welcome. Please call me or have your staff contact John A. Ferris, Assistant Inspector General for Children, Family, and Aging Audits, at (202) 619-1175.

Attachment

Department of Health and Human Services

OFFICE OF INSPECTOR GENERAL

REVIEW OF OFFICE OF COMMUNITY SERVICES' DISCRETIONARY GRANTS AWARDED TO DELTA FOUNDATION, INC.

JUNE GIBBS BROWN
Inspector General

DECEMBER 1997
A-04-96-00105

DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General
Office of Audit Services

REGION IV
P.O. BOX 2047
ATLANTA, GEORGIA 30301

CIN: A-04-96-00105

Mr. Richard Polk, Chairman
Board of Directors
Delta Foundation
819 Main Street
Greenville, Mississippi 38701

Dear Mr. Polk:

Enclosed are two copies of the U.S. Department of Health and Human Services (HHS), Office of Inspector General (OIG), Office of Audit Services' (OAS) final report entitled *Review of Office of Community Services' Discretionary Grants Awarded to Delta Foundation, Inc.* A copy of this report will be forwarded to the action official noted below for his/her review and any action deemed necessary.

Final determinations as to actions taken on all matters reported will be made by the HHS action official named below. We request that you respond to the HHS action official within 30 days from the date of this letter. Your response should present any comments or additional information that you believe may have a bearing on the final determination.

In accordance with the principles of the Freedom of Information Act (Public Law 90-23), OIG, OAS reports issued to the department's grantees and contractors are made available , if requested, to members of the press and general public to the extent information contained therein is not subject to exemptions in the Act which the department chooses to exercise (see 45 CFR Part 5).

To facilitate identification, please refer to Common Identification Number (CIN) A-04-96-00105 in all correspondence relating to this report.

Sincerely yours,

Charles J. Curtis

Charles J. Curtis
Regional Inspector General
for Audit Services, Region IV

Enclosures - as stated

Direct Reply to HHS Action Official:

Director
Division of Audit Resolution and Grants Oversight
Room 702 Aerospace Building
370 L'Enfant Promenade S.W.
Washington, D.C. 20447

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INTRODUCTION

BACKGROUND

The OCS makes discretionary awards under its Block Grant program to help alleviate the causes of poverty in distressed communities. These awards are intended to promote, in part: (1) full-time permanent jobs for poverty level individuals; and (2) income and/or ownership opportunities for low-income individuals. Those eligible to apply for economic development projects include private, locally initiated, nonprofit community development corporations governed by a board of directors consisting of community residents and business and civic leaders.

The Foundation is a private, non-profit, tax-exempt corporation located in Greenville, Mississippi. The Foundation was established in 1969 to promote and develop permanent employment opportunities through direct economic development activities. The Foundation's economic development activities were carried out primarily through two for-profit subsidiaries, Delta Enterprises and Delta Capital. The Foundation owns 100 percent of the issued and outstanding stock of Delta Enterprises and Delta Capital. See **Exhibit I** for the organizational structure of the Foundation and its subsidiaries.

Delta Enterprises is a holding company that, at the time of our review, owned five manufacturing businesses in Mississippi and Arkansas. The Delta Enterprises group of companies were concentrated in four industries - electronics, apparel, wood and rail-related products.

Delta Capital is a for-profit venture capital company. Delta Capital was created to provide financial and management services to locally based businesses.

Since October 1991, the Foundation has been awarded 4 OCS Discretionary Grants totaling $1.43 million. For each of the four grant awards, the Foundation proposed to either form or expand a for-profit manufacturing business through stock acquisitions of either Delta Enterprises or Delta Capital. The stated intent underlying the stock acquisitions was to either expand existing wholly-owned manufacturing businesses or create new business enterprises. Each of the proposed enterprises was to create a specific number of jobs. At least 75 percent of the jobs were to be for low-income individuals.

The Foundation was awarded:

- $320,000 in 1995 to create 30 jobs through the establishment of a manufacturing enterprise to rebuild, inspect and sell fuel cells and helicopter float bags;

- $430,000 in 1994 to create 43 jobs through the establishment of a company to assemble metal products and manufacture metal components for industrial customers;

- $460,000 in 1993 to create 62 jobs through the establishment of a company to manufacture blue denim jeans and other woven fabrics; and

- $220,000 in 1991 to create 25 jobs through the expansion of an existing company that manufactured railroad track spikes.

The companies formed to carry out the grant projects were either majority-owned or wholly-owned subsidiaries of Delta Enterprises or Delta Capital.

OBJECTIVES, SCOPE AND METHODOLOGY

The objectives of our review were to determine if:

- permanent, full-time jobs were created for low-income individuals;

- grant funds were properly distributed and expended;

- private cash and in-kind services were provided; and

- required fiscal and programmatic reports were accurately completed and submitted timely.

To accomplish our objectives, we reviewed the following:

- laws, uniform regulations for grant administration and cost principles;

- the OCS announcements published in the Federal Register concerning the availability of grant funds and eligibility for the grants;

- grant applications and the associated award documents, including grant provisions, terms, special conditions, goals and objectives, funding and periods of performance;

- organizational structure, corporate charters, stock purchases, and stock certificates;

- the flow of grant funds through the organizational structure, promissory notes and other evidence of loans between the organizational entities, accounting records, bank records, canceled checks, check registers, purchase orders and invoices; and

- internally and externally generated correspondence, fiscal and programmatic reports and reports prepared by the Foundation and its subsidiaries' independent auditors.

Our review was conducted in accordance with generally accepted government auditing standards. We did not rely on or test the Foundation's internal controls. Instead, we relied on substantive tests of administrative and financial transactions to ascertain whether the grants were properly administered and grant funds were properly expended.

Our field work was conducted at the Foundation's offices in Greenville, Mississippi and in the Tallahassee Field Office during July 1996 through June, 1997. We also made site visits in July 1996 to a proposed site for the 1995 grant project and the sites of the manufacturing companies established for the 1993 and 1994 grant projects. On August 19, 1997, we held an exit conference in Jackson, Mississippi with Foundation officials to discuss the draft report. On September 12, 1997, we received the Foundation's written comments to the draft report.

FINDINGS AND RECOMMENDATIONS

From 1991 through 1995, the Foundation received four grants funded by the OCS Discretionary Grants program. These grants provided $1.43 million of Federal funds to create permanent full-time jobs to low-income residents of the local community.

Our review showed that the Foundation:

- did not accomplish grant objectives of creating full-time permanent jobs;
- used Federal funds for a wide range of purposes unrelated to the objectives of the grants;
- did not provide the private cash and in-kind services it proposed to ensure the success of the grants; and
- submitted programmatic and financial reports to OCS that were often untimely and inaccurate.

The Foundation created few full-time permanent jobs for low-income residents of the local community. The expenditures that actually related to grant activities were, in most instances, committed to subsidize subsidiary organizations which proved to have little or no prospects for success in creating jobs. While the Foundation submitted programmatic and financial reports to OCS indicating that grant objectives were being met or exceeded, those reports were often untimely and inaccurate. The Foundation regularly reported the creation of more jobs than actually existed and failed to report financial activities which may have alerted program officials to the actual uses of grant funds.

As a result, more than $1.43 million intended to assist families in climbing from poverty has provided little or no benefit.

The Foundation's failure to accomplish grant objectives resulted from a number of operational and managerial deficiencies, including a lack of managerial controls to ensure that the terms and conditions of the grants were followed and grant funds were expended only for purposes related to the grants.

GRANT OBJECTIVES WERE NOT MET

Grant objectives to create full-time permanent jobs were not met:

- (1995 grant) 1 project that proposed to create 30 jobs was discontinued before it could be fully implemented;

- (1994/1993) 2 other projects that proposed to create 43 and 62 jobs, respectively, did not succeed because of insufficient business prospects and under-capitalization; and

- (1991 grant) the fourth project proposed to create 25 jobs did not succeed because sufficient employees could not be hired and retained, and the target manufacturing company had pre-existing financial problems.

The Community Services Block Grant Act authorized funding to support program activities of national or regional significance to alleviate the causes of poverty in distressed areas. Periodically, OCS published announcements in the Federal Register that solicited applications for the respective grant programs. Grant applicants were required to show that the proposed projects would create full-time permanent jobs. A further requirement was that at least 75 percent of the jobs were to be for low-income residents of the community.

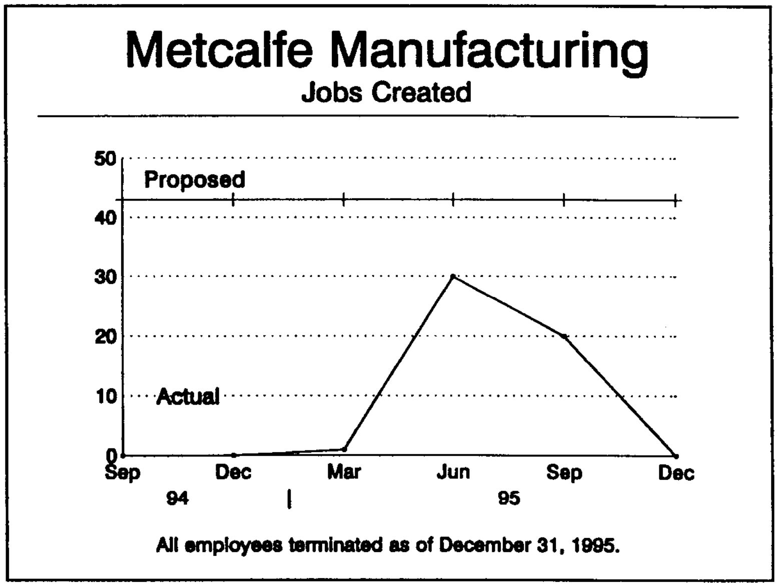
1995 Grant

The Foundation did not meet its objective to create 30 full-time permanent jobs as proposed in its application for the 1995 grant funds. The Foundation proposed to create the jobs through the establishment of Delta Eagle Fuel Cell, Inc. (Eagle). Eagle was to rebuild, inspect and sell fuel cells and helicopter float bags. Moeller Manufacturing, Inc. (Moeller) was to own 51 percent of Eagle and an unrelated partner in the joint venture was to own the remaining 49 percent. Moeller is a wholly-owned subsidiary of Action Communications, Inc. (Action). Action is a wholly-owned subsidiary of Delta Capital.

The jobs did not materialize because the Foundation discontinued the Eagle project after the grant was awarded. According to Foundation officials, they encountered irreconcilable differences with their proposed partner concerning acquisition of plant and equipment. Foundation officials stated that they planned to create the jobs with a substitute project. On February 10, 1997, the Foundation applied for a modification to the grant.

1994 Grant

The Foundation was unsuccessful in creating the 43 full-time permanent jobs proposed in the grant. They established a company called Metcalfe Manufacturing (Metcalfe). Metcalfe was never incorporated as a subsidiary of Delta Enterprises as proposed by the Foundation. Instead, Metcalfe was designated as a division of Electro National, a corporate subsidiary of Delta Enterprises.



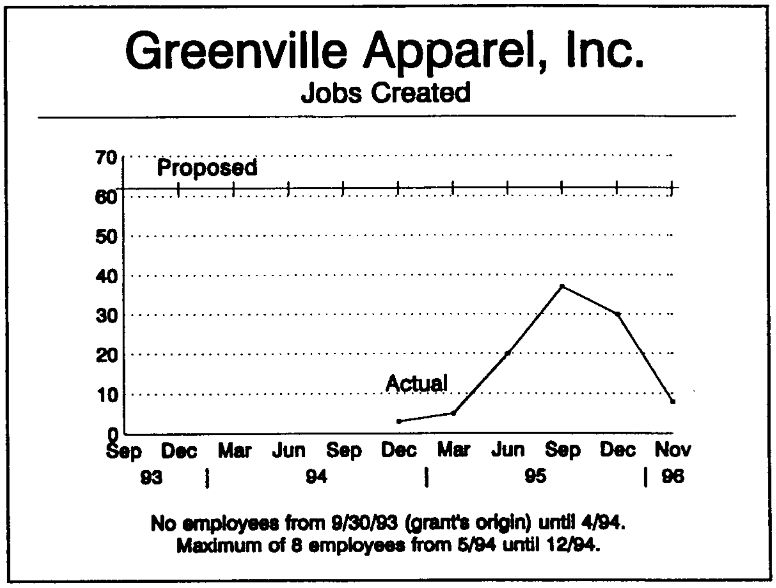
At peak employment on June 30, 1995, Metcalfe had created only 30 jobs. While jobs were created, they were not full-time permanent jobs. Fifty-three (67 percent) of the 79 individuals hired during the grant period were employed less than 90 days. By November 30, 1995, there were fewer employees than the 14 already employed at the beginning of the grant period. Just 1 month later (2 months prior to the end of the grant period), no jobs remained because Metcalfe terminated operations.

Grant objectives were not met because the Foundation overestimated Metcalfe's ability to develop sufficient business. Metcalfe's only customer terminated its contract and additional customers could not be found.

In addition, Metcalfe began its existence with only 27.6 percent of the total Federal and non-Federal funding proposed, $850,340. Metcalfe only received $235,000 of the $390,000 in grant funds proposed. The Foundation also did not ensure that Delta Enterprises provided the private cash and in-kind services ($460,340) committed to in the grant application.

As a result of Metcalfe losing its only customer, there was no realistic chance of creating 43 full-time permanent jobs.

1993 Grant



The Foundation was unsuccessful in creating the 62 full-time permanent jobs proposed through the establishment of a company called New Threads, Inc. (New Threads). New Threads was to manufacture blue denim jeans and other woven fabrics. New Threads was proposed as a stand-alone, separate enterprise located some two miles from the Foundation's existing apparel manufacturer, Fine Vines, Inc. (Fine Vines). The name New Threads was subsequently changed to Greenville Apparel, Inc. (Greenville Apparel). At peak employment (pay period ended September 30, 1995), Greenville Apparel had only 37 employees. However, by grant's end on November 30, 1995, the employment level had fallen to 30. Full-time permanent jobs were not created to the extent proposed.

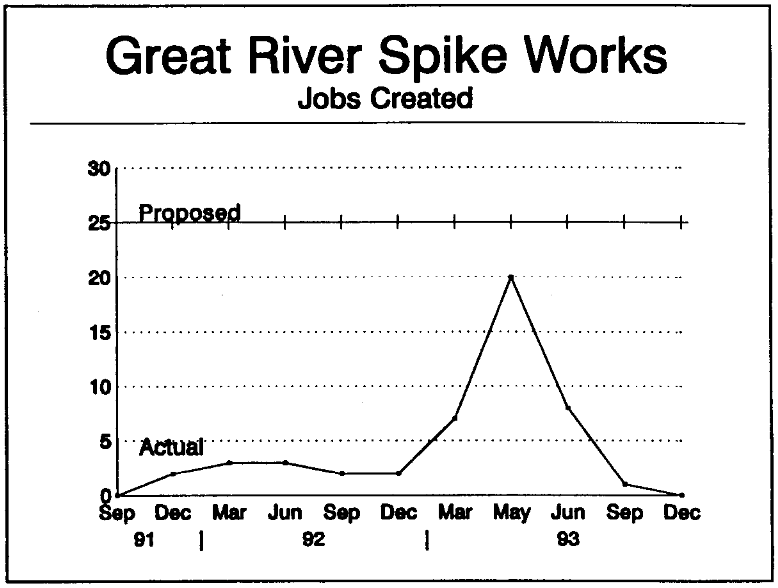
Jobs that were created were of short duration. Forty-seven (61 percent) of the 77 individuals hired during the grant period were not employed at grant's end; and 35 (74 percent) of the 47 were employed less than 60 days. As of November 8, 1996, Greenville Apparel was operating with 10 employees.

Permanent jobs were not created to the extent proposed because Greenville Apparel never realized the customer base identified in the grant application. Also, Greenville Apparel never became the separate, stand-alone entity proposed. Instead, it became a sub-contractor for and was co-located with Fine Vines. However, Greenville Apparel and Fine Vines maintained separate accounting records.

Finally, the Foundation did not ensure that Delta Enterprises provided the private cash and in-kind services ($260,340) committed to in the grant application. In our opinion, these funds were needed to successfully meet the grant objectives. We believe these conditions contributed to the Foundation's failure to achieve its goal of creating 62 full-time permanent jobs.

1991 Grant

The Foundation was unsuccessful in creating the 25 full-time permanent jobs proposed through the expansion of an existing company called Great River Spike Works Company (Great River). Great River was an existing manufacturer of railroad track spikes. The company was a joint venture owned 55 percent by Rail Products, Inc. (Rail Products), a wholly-owned subsidiary of Delta Enterprises, and owned 45 percent by an unrelated entity, Manitou Pass, Inc. (Manitou) of Ohio.



At peak employment on May 31, 1993, Great River had created only 20 jobs. However, a month later, (end of the grant close-out period) only eight of the new jobs remained.

Jobs that were created were of short duration. Twenty-nine (78 percent) of the 37 individuals hired during the grant period were not employed as of September 30, 1993 and 22 (76 percent) of the 29 were employed less than 60 days. Foundation officials did not provide employment files to show that individuals hired at Great River were low income.

The proposed full-time jobs were not created because the Foundation overestimated the ability of Great River to hire and retain sufficient employees. Great River encountered problems in hiring individuals willing to perform the type of work required in rail spike manufacture.

The plant manager told us that the only way the spike-making venture could be profitable was to have an average of 1.75 production lines working full-time, 3 shifts daily. Great River had trouble hiring and retaining the 14 employees required for each machine to meet profitable production levels.

Great River's independent auditor reported that the company discontinued operations in January 1994 because of significant operating losses and an inability to meet obligations to creditors. However, even before the application for the 1991 grant, Great River experienced financial problems which resulted in a loan default in 1991.

At the time the application was submitted, the independent auditor reported that Great River was in default on a $495,000 loan obtained in 1985. Great River defaulted on payments due on or after January 1, 1991. The Foundation did not disclose the loan's default status to OCS in the 1991 grant application.

We believe these events contributed significantly to Great River's failure to create the proposed jobs.

Foundation Comments - Full-Time Permanent Jobs

Foundation officials stated that full-time permanent jobs were created under three of the four grants. They stated that so long as the employer and employee intended that a job exist for as long as the employer could stay in business, and the employee performed adequately, OCS objectives had been satisfied.

Office of Inspector General (OIG) Response - Full-Time Permanent Jobs

We agree that in three of the four grants, full-time jobs were created. However, we do not consider these jobs to have been permanent. For example, under the 1994 grant, 53 (67 percent) of the 79 individuals hired were employed less than 90 days. By November 30, 1995, there were fewer employees than the 14 employed at the beginning of the grant period. Just 1 month later (2 months prior to the end of the grant period), no jobs remained because Metcalfe terminated operations.

Foundation Comments - 1995 Grant Objectives

Foundation officials stated that the OIG should not discuss the Foundation's success or failure in creating full-time permanent jobs under the 1995 grant. Job creation should not be discussed because the Foundation applied for a no-cost extension to the grant period.

OIG Response - 1995 Grant Objectives

A request for an extension does not preclude the OIG from reporting on the Foundation's progress in accomplishing grant objectives.

Foundation Comments - 1994 Grant Objectives

Foundation officials said that under the 1994 grant, neither the Foundation nor Delta Enterprises overestimated Metcalfe's ability to develop sufficient business.

OIG Response - 1994 Grant Objectives

We stand by our conclusion that the Foundation overestimated Metcalfe's ability to develop sufficient business. Our conclusion was based on information contained in the 1994 grant application. In the 1994 grant application, the Foundation said that "... it is not our intention to be a captive plant to Reliance." In addition, the application said the Foundation expected that Metcalfe would have approximately 20 customers. However, these 20 customers did not materialize.

Foundation Comments - 1993 Grant Objectives

Foundation officials stated that the OIG incorrectly concluded that Greenville Apparel did not succeed in creating the expected number of jobs because Greenville Apparel: (1) never became a stand-alone company; (2) was co-located with Fine Vines and (3) was not able to realize the customer base identified in the application.

Foundation officials also said that Greenville Apparel: (1) was never intended to operate solely on its own, (2) would have failed sooner if it had used the building originally proposed for its operations due to the cost of shipping goods to and from Fine Vines, and (3) was not able to realize the customer base identified in the grant application in large part, due to lower cost, overseas sewing operations.

OIG Response - 1993 Grant Objectives

Our draft report states that we believe the above conditions contributed to the Foundation's failure to achieve its goal of creating 62 full-time permanent jobs.

Foundation officials stated in the 1993 grant application that:

(1) New Threads (Greenville Apparel) would be a subsidiary of Delta Enterprises, not a division or expansion of Fine Vines;

(2) Greenville Apparel was to be in a separate facility located two miles from Fine Vines; and

(3) while Greenville Apparel would not be immune to the consequences of oversees apparel businesses, they were convinced that there was a profitable business niche for small plants like Fine Vines and New Threads.

Thus, the Foundation was aware early-on that low-cost overseas apparel manufactures posed a significant risk to the success of Greenville Apparel.

In regard to Greenville Apparel being a separate facility, we are not questioning the decision to reduce operational costs by not using the building purchased to house Greenville Apparel. Our point is that locating Greenville Apparel in the same building with Fine Vines was a deviation from what the Foundation proposed in its grant application. The grant application stated that: "Fine Vines is currently operating near capacity and will soon be at capacity. It is neither practical or economical to increase the floor space of the Fine Vines facility." No mention was made in either the grant application or in progress reports to OCS that shipping costs would preclude the use of the building purchased to house Greenville Apparel.

The grant application also indicated that J.C. Penney would not be Greenville Apparel's only customer. The application included commitment letters from three other customers. However, Greenville Apparel was never able to establish this customer base.

Foundation Comments - 1991 Grant Objectives

According to Foundation officials, the OIG erroneously stated that individuals hired at Great River were not low-income.

Also, Foundation officials acknowledged that at the time of grant application, Great River was in default on loan repayments. Foundation officials believed that the grant would enable Great River to operate profitably and thereby cure the default.

OIG Response - 1991 Grant Objectives

Our report has been clarified to state that Foundation officials did not provide employment files to show that individuals hired at Great River were low-income.

Foundation officials did not address the fact that the grant application did not disclose the loan's default status. Had OCS been aware of the default, the grant may not have been awarded.

GRANT FUNDS NOT PROPERLY EXPENDED

The Foundation did not properly account for and expend funds under the 1995, 1994 and 1993 grants. For example, expenditures totaling:

- $484,083 was not related to the grant projects,
- $153,572 was not supported by adequate documentation, and
- $157,314 was unexpended from the 1995 grant.

For the 1991 grant, the Foundation did not safeguard assets Great River purchased with grant funds. These assets were taken through foreclosure even though the debt foreclosed on was unrelated to the grant and was actually incurred prior to the grant award. In addition, the Foundation did not execute the basic grant requirement of purchasing stock in Delta Capital and Delta Enterprises as proposed in the 1995, 1994, 1993 and 1991 grant applications.

The Foundation did not have management controls to ensure adherence to the approved applications and grant awards. Further, expenditures were not in compliance with Office of Management and Budget (OMB) Circular A-122. Circular A-122, Attachment A, Paragraph A.2.,3. and 4. states, in part, that:

> "To be allowable under an award costs must: . . . Be reasonable for the performance of the award and be allocable. . . . Be adequately documented."
>
> "A cost is allocable to a . . . grant . . . in accordance with the relative benefits received . . . ."

Administrative Costs

The grant awards provided the Foundation $121,000 for administrative costs. However, administrative costs for salaries and fringe benefits of Foundation officials totaling $76,875 were not supported by adequate documentation. The OMB Circular A-122, Attachment B, Paragraph 6.1.1. states, in part, that "The distribution of salaries and wages to awards must be supported by personnel activity reports."

The Foundation did not prepare or maintain personnel activity reports. Therefore, we could not determine the extent the grants benefitted from these costs.

Foundation Comments

Foundation officials stated that they did not require management employees to maintain personnel activity reports. However, they contended that travel vouchers for two of their management employees adequately documented the employees' efforts. Therefore, allocation of grant funds for the employees' salaries and benefits were reasonable and in accordance with each of the grant applications. Foundation officials also said that because two assistants worked with the management employees, their salaries and benefits should also be considered reasonable.

In addition, Foundation officials said that the OIG incorrectly stated that administrative costs were withheld at each tier.

OIG Response

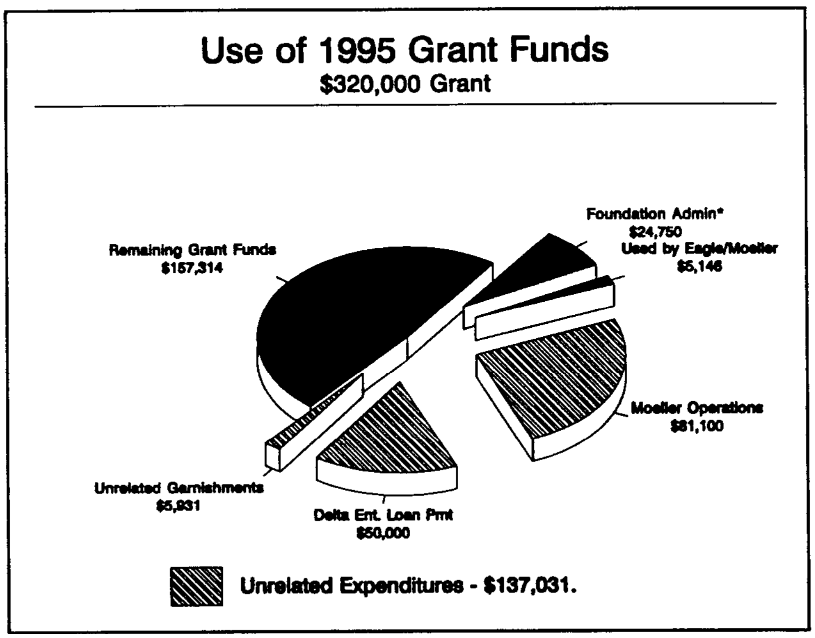
The travel vouchers Foundation officials provided with their written comments did not document the amount of time employees spent on the grants. The OMB Circular A-122 specifically states that "The distribution of salaries and wages to awards must be supported by personnel activity reports." Travel vouchers by themselves do not document the amount of time devoted to a project.

In regard to administrative costs being withheld at each tier, the CONCLUSIONS AND RECOMMENDATIONS section of our report has been clarified to show that only the Foundation withheld a portion of each year's grant funds for administrative costs.

Use of 1995 Grant Funds

Grant funds were not distributed as proposed and expenditures totaling $137,031 were not related to the grant project.

The Foundation proposed to channel $295,000 to Eagle through Delta Capital, Action and Moeller. Eagle was to receive the $295,000 from Moeller via a $76,000 stock purchase and a $219,000 term loan. Moeller purchased stock from Eagle for $76,000. However, Eagle never received the $219,000 term loan. Instead, Moeller expended $137,031 for purposes not related to the grant project. (See **Exhibit II** for details)



* The Foundation proposed to distribute $295,000 to Moeller and retain $25,000 for administration. The Foundation actually distributed $295,750 to Moeller and retained $24,750 for administration.

As of March 31, 1997, $157,314 of the $295,750 in 1995 grant funds was unexpended, even though the grant period ended February 28, 1997. This included $82,715 not used by Moeller, $3,741 in interest earned by Moeller, and $70,858 returned to Moeller by Eagle. The $157,314 was on deposit in two Action interest-bearing bank accounts. Action provided the original grant funds to Moeller.

Foundation Comments

Foundation officials stated that it was not proper for the OIG to report on the use of 1995 grant funds due to their pending request for a no-cost extension.

OIG Response

The Foundation's request for an extension does not preclude the OIG from reporting on the grantee's use of grant funds. Foundation officials did not specifically comment on our finding that $137,031 in expenditures were unrelated to the 1995 grant project.

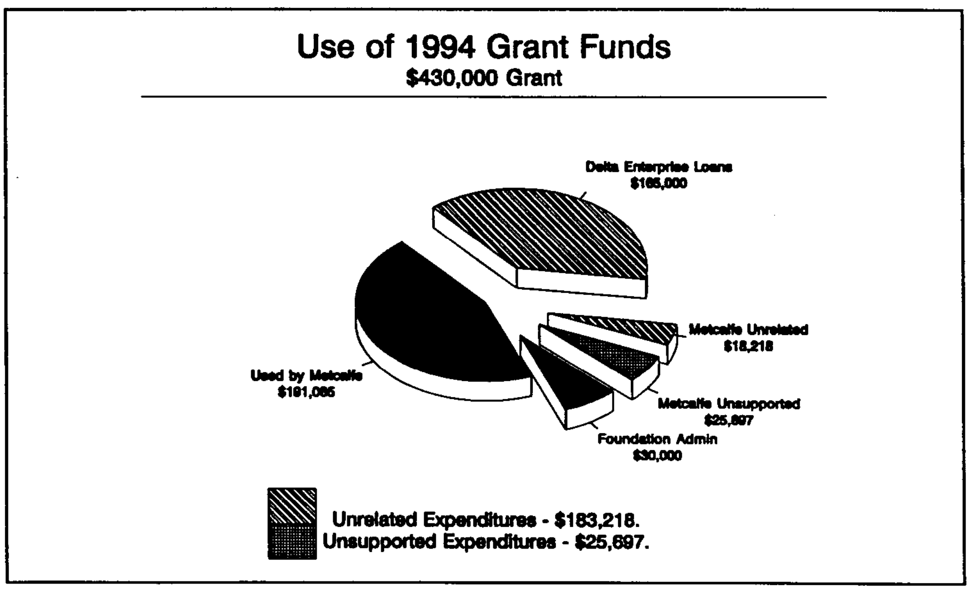
Use of 1994 Grant Funds

Grant funds were not distributed as proposed and expenditures totaling $208,915 were either not related to the grant project or not supported by adequate documentation.

The Foundation was to channel $390,000 through Delta Enterprises to Metcalfe in return for stock. Delta Enterprises actually received $400,000; but, Delta Enterprises provided Metcalfe only $235,000. The remaining $165,000 was loaned to Fine Vines and Electro National. (See "Delta Enterprises Expenditures" below)

Delta Enterprises and Metcalfe did not properly expend $208,915 as follows:

- $183,218 was not related to the grant project, and
- $25,697 was not supported by adequate documentation.



Delta Enterprises Expenditures

Delta Enterprises made unrelated expenditures totaling $165,000. These expenditures were loans made to other subsidiaries not related to the grant project. The loans included $115,000 to Fine Vines and $50,000 to Electro National (Electro).

Our analyses of the loan transactions to Fine Vines showed that $48,600 of the $115,000 was used to reimburse Greenville Apparel for loans made to Fine Vines using 1993 grant funds. The $115,000 was not repaid.

Electro received two $25,000 loans from Delta Enterprises, but only repaid $28,000. We were unable to determine how Delta Enterprises used the $28,000 repayment.

Foundation Comments

Foundation officials stated that the 1994 grant funds loaned to Electro National and Fine Vines were loaned to subsidiaries of the Foundation formed for the purpose of providing jobs to low-income persons.

OIG Response

The Foundation applied for and OCS awarded 1994 grant funds to establish Metcalfe Manufacturing and to create 43 new full-time permanent jobs. Electro National and Fine Vines were not parties to the job creation objectives of the 1994 grant. If the Foundation needed money to sustain the operations of Electro National and Fine Vines, other non-grant sources should have been used. In our opinion, borrowing grant funds from one project entity to fund another is not a prudent business practice. Moreover, OMB Circular A-122, Attachment A, Paragraph A.2. and 4. states, in part, that:

> "To be allowable under an award, costs must: . . . Be reasonable for the performance of the award and be allocable. . . . Be adequately documented."
>
> "A cost is allocable to a . . . grant . . . in accordance with the relative benefits received . . . ."

In our opinion, grant funds loaned to Electro National and Fine Vines did not assist Metcalfe in creating 43 new full-time permanent jobs.

Metcalfe Manufacturing Expenditures

Metcalfe expended $43,915 that was either not documented ($25,697[1]) or not related to the grant project ($18,218). (See **Exhibit III** for details)

Foundation Comments

Foundation officials only commented on the $18,218 the OIG reported as not related to the grant. First, $10,240 was used to retire a credit line secured by Metcalfe in anticipation of receiving the grant. The credit line was used prior to the grant period to purchase items necessary for the operation of Metcalfe. Second, Foundation officials agreed that $7,978 was improperly taken by or paid to employees of Metcalfe. Foundation officials stated that legal action has been or will be taken against the former employees.

OIG Response

We do not consider the $10,240 in expenditures made prior to the grant period to be proper. The OMB Circular A-122, Attachment B.34., states that costs incurred prior to the grant period are not allowable unless written approval was obtained from the granting agency. Foundation officials said they did not obtain OCS' written approval for these expenditures.

Foundation officials did not comment on or provide documentation to support $25,697 in expenditures we identified as not supported by adequate documentation.

Use of 1993 Grant Funds

Greenville Apparel did not properly expend $214,834. These costs included:

- $163,834 that was not related to the grant project (See **Exhibit IV** for details), and

- $51,000 that was not supported by adequate documentation.

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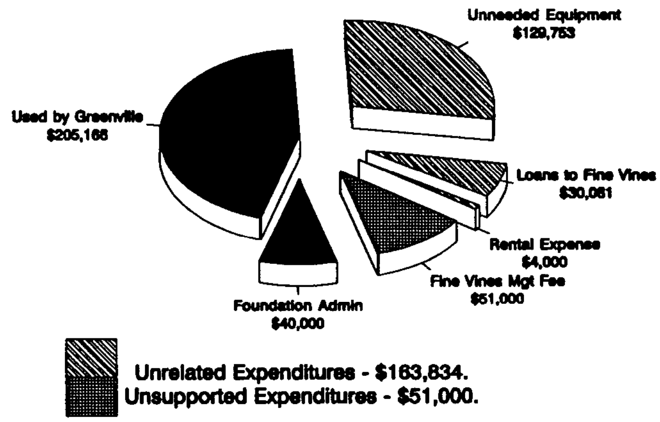
1 There were no invoices or other documentation, other than Metcalfe's check register, to support the allowability of these expenditures.

Use of 1993 Grant Funds
$460,000 Grant



The unsupported costs related to management fees charged by Fine Vines. According to a Foundation official, time records were maintained to support the fees. However, the time records were not provided. Accordingly, the management fees are considered unsupported.

Foundation Comments

Foundation officials commented on the following: (1) $129,753 for unneeded equipment, (2) $51,000 in expenditures not adequately documented and (3) $30,081 in outstanding loans to Fine Vines. They did not specifically comment on the $4,000 Greenville Apparel paid Fine Vines for rent on a building for months after the grant period ended.

Foundation officials stated that the $129,753 expended for equipment was related to the grant and in accordance with the grant application. The equipment would have been used if Greenville Apparel had secured the contracts described in the application. Because the contracts were not secured, many of the equipment items were not used or only used periodically.

Foundation officials said that Fine Vines actually provided Greenville Apparel management services totaling $82,650 and only charged $51,000.

In addition, Foundation officials stated that the $30,081 in outstanding loans to Fine Vines were repaid after the grant period ended. These loans were made to allow Fine Vines to continue to meet production demands. Since the grant period ended, Fine Vines has advanced Greenville Apparel $274,595. Foundation officials believe this constitutes repayment.

OIG Response

Our finding addressed the utilization of equipment purchased with grant funds and not the appropriateness of its acquisition. We do not dispute that the equipment was purchased in anticipation of being used by Greenville Apparel for the purposes of the grant. However, from our analysis of the equipment's use, we determined that none of the equipment was currently being used. In addition, 18 of 22 equipment items reviewed were either never installed or not normally used by Greenville Apparel employees. Thus, we continue to conclude that the equipment was unneeded.

The additional documentation provided by the Foundation did not adequately support the $51,000 in management services Fine Vines provided Greenville Apparel or the additional $31,650 of in-kind services the Foundation is currently claiming. The additional documentation consists of time sheets for five individuals for the period October 1993 through March 1995. The time sheets only show hours worked for each week. There is no indication that these hours related to Greenville Apparel business.

In addition, none of the time sheets, except for the Greenville Apparel/Fine Vines president, were signed by the employee or approved by a supervisor. The Greenville Apparel/Fine Vines president did not sign his time sheets; however, he did approve his own time sheets.

In regard to the $30,081 in outstanding loans made to Fine Vines, both the terms and conditions of the grant award and OMB Circular A-122 address transfer of funds to third parties. The terms and conditions of the grant award states, "No transfer of funds to third parties (subgrants and other pass through awards) other than for the purpose identified in the approved grant application shall be made without prior written approval of ACF." The OMB Circular A-122, Attachment A, Paragraph A.2. and 4. states, in part, that:

> "To be allowable under an award, costs must: . . . Be reasonable for the performance of the award and be allocable. . . . Be adequately documented."
>
> "A cost is allocable to a . . . grant . . . in accordance with the relative benefits received . . . ."

In our opinion, loans made to Fine Vines did not benefit the Greenville Apparel grant project.

In regard to the $274,595 provided to Greenville Apparel since the grant period ended, the Foundation provided copies of 80 canceled checks written on a Fine Vines bank account to Greenville Apparel between April 1995 and February 1997. Other than the canceled checks, no documentation was provided to show that these monies represented repayment of the $30,081 in outstanding loans. In addition, documentation was not provided to show whether these payments may have been normal post-grant expenses that Fine Vines paid to allow Greenville Apparel to continue its existence.

Use of 1991 Grant Funds

The Foundation channeled $204,000 through Delta Enterprises and Rail Products to Great River as proposed. However, the Foundation did not safeguard assets Great River purchased with grant funds. These assets were taken through foreclosure on October 31, 1994. The assets purchased with grant funds were taken even though the debt foreclosed on was unrelated to the grant and was actually incurred prior to the grant award.

On June 18, 1985, Great River obtained a loan of $495,000 from Jefferson County, Arkansas. Jefferson County assigned the loan to the Arkansas Industrial Development Commission on the same date. Great River pledged specific property as security for the $495,000 loan. The property pledged included " . . . all replacements thereof and all accessories, parts and equipment now or hereafter affixed thereto or used in connection therewith . . . ." Subsequently, Great River defaulted on monthly loan payments due on or after January 1, 1991. The Foundation did not disclose the loan default in their August 1991 grant application.

The independent auditor reported that on January 13, 1994, Great River discontinued its manufacturing operations due to significant operating losses and the inability to meet obligations to creditors.

On October 31, 1994, the Arkansas Industrial Development Commission foreclosed on the property pledged as collateral under the note, including the property procured using grant funds. Upon foreclosure, Spike Industries (a subsidiary of Manitou) acquired the equipment pledged under the note for $85,000, including the equipment purchased with 1991 grant funds. In this acquisition, Spike Industries (owned by Great River's partner) acquired equipment with an original cost of $905,149. Spike Industries currently uses the equipment in its Ohio plant.

The Foundation did not disclose to OCS that the equipment had been taken through foreclosure in October 1994. Instead, in a March 21, 1995 Property Inventory and Disposition Statement, the Foundation reported to OCS that Great River still possessed the equipment.

Foundation Comments

Because the grant funds were used as proposed in the application, Foundation officials said that the OIG's discussion of the use of 1991 grant funds was inappropriate. In addition, most of the equipment with an original acquisition price of $905,149 taken through foreclosure had been in use for approximately 10 years. Therefore, it was unreasonable to suggest that the $204,000 be repaid.

OIG Response

We did not suggest that the purchase of the equipment was inappropriate. Instead, our findings were that the Foundation:

- did not safeguard assets Great River purchased with grant funds,
- incurred the debt foreclosed on approximately 5 years prior to the grant period,
- did not disclose the loan default in the grant application,
- reported to OCS in March 1995 that Great River still possessed the equipment, and
- did not disclose to OCS that the equipment had been taken through foreclosure in October 1994.

In addition, the equipment purchased with grant funds was only in use about 2.5 years prior to Great River ceasing operations in January 1994.

Stock Purchases Were Not Made

The Foundation did not purchase stock in Delta Capital and Delta Enterprises as proposed in the 1995, 1994, 1993 and 1991 grant applications. Although we were provided copies of stock certificates indicating the Foundation received stock, the financial statements and accounting records of both Delta Capital and Delta Enterprises did not reflect the stock transfers. Instead, grant funds of $1.32 million were recorded in the accounting records and reported in the financial statements as additional paid-in capital.

When asked why stock certificates existed when stock was not actually issued, Foundation officials responded that "the issuances of stock and the recording of the receipt of grant funds in the accounting records occurred at separate times." No other explanation was provided.

The Foundation's management control procedures did not ensure that stock was purchased as proposed in the grant applications. Further, at the time grant funds were received, Foundation subsidiaries were administratively dissolved as corporations by the State of Mississippi. Under Mississippi law, corporations registered in the State are required to file annual reports and pay appropriate taxes. Failure to do so timely causes the company to be administratively dissolved by the Mississippi Secretary of State.

According to the Secretary of State, a dissolved corporation may continue its corporate existence but may not carry on any business except to wind up its business affairs. Upon correcting the deficiencies, the corporation may be retroactively reinstated, and the business may proceed as though there had been no dissolution.

According to the Secretary of State, Section 79-4-1405 of the Mississippi Code of 1972 means that an administratively dissolved corporation may not buy stock from a related for-profit corporation, sell stock to a wholly-owned subsidiary or conduct routine business activity in Mississippi except as these activities are considered part of the winding up and liquidation processes.

Prior to the grant applications, Foundation subsidiaries involved with all four grants were administratively dissolved as corporations by the State of Mississippi. The corporations were dissolved for failure to file the State-required annual reports and/or to pay State taxes. Each of the Foundation subsidiaries involved with three of the four grants have been retroactively reinstated. (See **Exhibit** V for details)

The Foundation did not disclose in its grant applications to OCS that the corporations were dissolved. Had the Foundation disclosed the corporations' dissolved status in the grant applications, OCS should not have awarded the grants since the companies could not legally do business.

Foundation Comments - Stock Purchase

Foundation officials stated that Delta Capital and Delta Enterprises issued the Foundation stock certificates even though all the authorized shares had been previously issued. As a result, the Foundation's auditor made appropriate adjustments to paid-in capital instead. They further stated that the Foundation's investment did not disappear, nor did the Foundation experience dilution of its ownership interest in either corporation because no new shares of stock were issued.

OIG Response - Stock Purchases

Our finding was that the Foundation did not purchase stock in Delta Capital and Delta Enterprises as proposed in the grant applications. The financial statements and accounting records of both Delta Capital and Delta Enterprises indicated that no stock was issued. Instead, Delta Capital and Delta Enterprises recorded the receipt of grant funds from the Foundation as paid- in capital. From the Foundation's written comments, it is still unclear why stock certificates were issued when all authorized shares had been previously issued.

Foundation Comments - Administrative Dissolution

Foundation officials also commented that the OIG incorrectly reported that each of the Foundation subsidiaries involved in grant transactions was administratively dissolved at one time or another during the respective grant periods. Foundation officials also believed the OIG exaggerated the effect of administrative dissolution.

OIG Response - Administrative Dissolution

Our finding on the administrative dissolution of Foundation subsidiaries contains a summary statement that "...Foundation subsidiaries involved with all four grants were administratively dissolved...." Our finding also refers the reader of the report to **Exhibit V,** which clearly identifies each subsidiary that was administratively dissolved and the period of dissolution.

In our opinion, the draft report does not exaggerate the effects of the State of Mississippi's administrative dissolution of Foundation subsidiaries. Our report addresses two points with respect to administrative dissolution. First, according to Mississippi law, an administratively dissolved corporation may not conduct routine business operations. Second, had the Foundation disclosed the corporations' dissolved status in the grant applications, OCS may not have awarded the grants since the companies could not legally conduct routine business operations.

PRIVATE CASH AND IN-KIND SERVICES

The Foundation did not provide the $1.19 million in private cash and in-kind services committed to in grant applications.

The grant announcements encouraged applicants to provide private cash and in-kind considerations up to the grant amount requested. The committed funds were not available for any of the grants. According to a Foundation official, they intended to secure bank loans using grant funds as leverage.

The Foundations' intentions were not disclosed in the grant applications. Instead, letters of commitment from Delta Enterprises and Delta Capital implied that the private cash and in-kind services were available. We were not provided with any evidence that the Foundation applied for the loans. In addition, the Foundation only provided documentation to support in-kind services for one of the grants.

Foundation officials contend that in-kind services were provided under the 1993 grant. These services were in the form of facilities to house the Greenville Apparel operations. Fine Vines purchased a building adjacent to its plant to house Greenville Apparel. However, Greenville Apparel only used the building to conduct two training courses for potential employees early in the grant period. At the time of our site work, the building was vacant. Instead, Greenville Apparel and Fine Vines were effectively one business jointly operated out of the Fine Vines plant. Therefore, we concluded that no in-kind services were provided.

Because the private cash and in-kind services were not provided, the Foundation established the projects with only about 55 percent, on average, of the proposed capitalization. The impact of the Foundation's failure to ensure that private cash and in-kind services were provided and the resulting undercapitalization is discussed separately in the section concerning "Grant Objectives."

Foundation Comments

Foundation officials said that despite good faith efforts, Delta Enterprises was unable to locate appropriate sources for some of the matching funding for the grants. The Foundation opined that securing the remaining sources of funding could have prolonged the operations of the subsidiaries for a negligible amount of time, but would not have assured success.

Foundation officials further asserted that substantial contributions of matching funds and services were made to each of the grants as follows.

- **1995 Grant -** Delta Capital has invested $155,000 in the project since requesting a no-cost extension.

- **1994 Grant -** Delta Enterprises provided the building for Metcalfe operations at no cost and considered this as in-kind services. The estimated rental value of the building was $58,000 (13 months at $4,500/month). In addition, Reliable Electric provided Metcalfe technical assistance and equipment at no cost during operations valued at $1,393,000. Also, Reliable Electric offered Metcalfe a paint system valued at $300,000 for $1.

- **1993 Grant -** According to Foundation officials, private cash and in-kind services were provided to Greenville Apparel as follows.

  - Fine Vines has contributed approximately $274,595 in cash and services to Greenville Apparel since the grant period ended.

  - Fine Vines provided Greenville Apparel management and clerical salaries and benefits totaling $31,650 at no charge. Fine Vines expended $44,000 to acquire the building next to its facility for Greenville Apparel's use. In addition, the Mississippi Department of Human Services provided Greenville Apparel $13,500 in Federal Job Opportunities and Basic Skills (JOBS) Program funds.

- **1991 Grant -** Manitou Pass provided Great River working capital loans of over $19,667,892.

OIG Response

From an analysis of the comments and additional documentation provided by Foundation officials, we concluded the following for each of the grants.

- **1995 Grant -** Adequate documentation was not provided to support the $155,000 the Foundation said was invested since the no-cost extension was requested. The Foundation's grant application indicated that the private cash and in-kind services were to be provided in conjunction with the grant funds in order to accomplish program objectives within the grant period. Therefore, any monetary support the Foundation provided beyond the grant period would not enable it to meet program objectives within the grant period.

  To support the $155,000 Delta Capital invested in the project, Foundation officials provided copies of 7 checks totaling $155,250 that had been written to Moeller. Three checks totaling $103,750 bore dates prior to the Foundation's request for an extension in

February 1997. The remaining 4 checks totaling $51,500 were dated June and August 1997.

Five of the checks totaling $55,250 were written on an Action Communication bank account. One check for $75,000 was written on the Foundation's HUD Urban Revolving Loan Fund bank account. The remaining check for $25,000 was written on the Foundation's Rural Development Loan Fund bank account.

Foundation officials did not provide any other documentation or explanation as to how these monies were used to further grant objectives. In addition, since the Foundation did not identify the source of these monies provided to Moeller, it is unclear whether the $55,250 disbursed from the Action Communications account was part of the unexpended grant funds Action retained.

- **1994 Grant** - No supporting documentation was provided regarding the $58,000 ($4,500/month for 13 months) rental value of the facilities provided for Metcalfe's use.

  Foundation officials provided a letter dated September 12, 1997 from Reliable Electric indicating they provided Metcalfe technical assistance and equipment at no cost during operations valued at $1,393,000. Also, the letter indicated that Reliable Electric offered to sell Metcalfe $300,000 of painting equipment for $1. However, Reliable Electric's "offer" to sell Metcalfe equipment did not result in the Foundation's provision of private cash and in-kind services.

  The grant application stated that Reliable Electric would provide both technical assistance and equipment as part of the business arrangement. Private cash and in-kind services committed by the Foundation in the grant application was to be over and above the services and equipment that were to be provided by Reliable Electric. The grant project at Metcalfe received no benefit from the painting equipment "offered" by Reliable Electric.

- **1993 Grant** - Foundation officials provided copies of 80 checks indicating Fine Vines provided Greenville Apparel $274,595. Of the $274,595, $198,295 was provided subsequent to November 30, 1995, the end of the grant period. The remaining $76,300 was provided between April 1995 and November 1995. Other than copies of the checks, no documentation or explanation was provided as to the nature of the payments. In addition, the Foundation's grant application indicated that the private cash and in-kind services would be provided in conjunction with the grant funds in order to accomplish program objectives within the grant period. Therefore, any monetary support the Foundation provided beyond the grant period would not relate to the accomplishment of program objectives within the grant period.

  The provision of $31,650 in management and clerical salaries was not adequately documented. Documentation provided consisted of time sheets for five individuals for the period October 1993 through March 1995. The time sheets only showed hours recorded for each week. There was no documentation to show that these hours related to Greenville Apparel business.

Greenville Apparel only briefly used the building Fine Vines purchased for $44,000 adjacent to its plant. Greenville Apparel only used the building to conduct two 6-week training courses. At the time of our review, the building was vacant and not being used. In our opinion, the use of a building for the two training courses does not justify the Foundation's $44,000 in-kind services claim.

In regard to the $13,500 in Federal JOBS Program funds provided by the Mississippi Department of Human Services, Foundation officials did not provide any documentation to support this claimed in-kind service. Included as Exhibit 20 of the Foundation's written comments was a note that said "To be provided under separate cover." However, the information was not provided.

- **1991 Grant** - Documentation provided did not support the Manitou Pass working capital loans to Great River totaling over $19,667,892. In their written comments, Foundation officials provided copies of 27 promissory notes between Great River as the payor and Manitou Pass as the payee. The notes were dated from January 31, 1991 through March 31, 1993. Foundation officials totaled the 27 notes and concluded that Manitou provided Great River over $19,667,892 in working capital loans. This was not the case. These notes were not exclusive of each other. Instead, each note replaced and canceled the previous one. The notes appear to have been created on approximately a monthly basis, but do not individually represent additional working capital for Great River.

  Regardless, the notes by themselves do not support Delta's contention that Manitou provided $19.6 million in working capital loans to Great River's operations. The Foundation did not provide Great River bank statements reflecting the proceeds from these working capital loans. In addition, neither the Great River audited financial statements nor Great River's accounting records covering the period of the notes reflected the receipt of $19.6 million in working capital loans.

GRANT REPORTING

The required financial and programmatic reports submitted to OCS were not always accurate and timely. In many cases, required reports were not submitted.

Each of the grant awards provided that the Foundation was to submit periodic financial status reports and progress reports. The reports were to be submitted at specified intervals throughout the respective grant periods and final reports after the grant expired. The grant awards expressed in varying language that the grant could be terminated if the reporting requirements were not met.

The most significant inaccuracies were contained in the progress reports. These reports frequently overstated the projects' progress in creating the new jobs. All the 1994 and 2 of the 1991 progress reports submitted were inaccurate. For example, in the first 1994 progress report, the Foundation reported that Metcalfe currently employed 42 people; however, Metcalfe records showed only 17 employees.

Also, information in the 1994 and 1991 progress reports may have misrepresented what actually occurred at Metcalfe and Great River. In the 1994 progress reports, the Foundation did not disclose that Metcalfe discontinued operations more than 2 months prior to the grant's end. In the 1991 progress reports, the Foundation reported that delays in hiring were caused by machine problems. According to the plant manager, the problems in hiring were caused by the inability to obtain and retain sufficient employees.

The Foundation never submitted 5 (29 percent) of the 17 financial reports and 9 (45 percent) of the 20 progress reports required by the grant awards. In addition, the Foundation submitted 9 (75 percent) of the 12 financial reports and 9 (82 percent) of 11 progress reports untimely.

Foundation Comments

Foundation officials agreed that they did not submit all the necessary programmatic and financial reports required under the grants. Foundation officials said that any inaccuracies contained in the reports were insubstantial. Foundation officials also said that failure to file or untimely file the reports was not a cause of loss of businesses and did not result in the loss of grant funds.

OIG Response

In our opinion, overstating progress in accomplishing the grants' job creation objectives is a substantial inaccuracy. Filing timely and accurate progress and financial reports is one of the basic terms and conditions of the grant awards. Also, progress reports are one of the primary mechanisms grant managers use to determine if grant objectives are being accomplished according to the approved grant application.

CONCLUSIONS AND RECOMMENDATIONS

The accomplishment of grant objectives was at risk from the very start of the funding period. Many of the problems occurred because the Foundation did not have effective managerial controls and accountability over grant activities. Additionally, adequate leverage funding was not provided to carry out grant objectives. Furthermore, we could not discern that any substantive value was added as a result of the Foundation's multiple organizational levels.

The Foundation proposed to create jobs in the local community through a complex interrelationship of corporate entities. The Foundation's multiple organizational layers added no apparent substantive value to the accomplishment of grant objectives. The Foundation received grants and transferred funds, less administrative costs, to either Delta Enterprises or Delta Capital. Either Delta Enterprises or Delta Capital then channeled the remaining grant funds through various Foundation subsidiaries until the tier of the project entity was reached.

In our opinion, the organizational structure of the Foundation was overly complex. The 1995 grant funds had to undergo transfer through four tiers of companies before reaching the project entity in the fifth tier. The 1994 and 1991 grant funds underwent similar transfers before reaching the project entity in the fourth tier, while the project entity for the 1993 grant was located in the third tier.

According to Foundation officials, the multiple tiers were necessary to isolate the Foundation from potential legal actions taken against its subsidiaries. However, in our opinion, distributing funds through multiple tiers created an additional element of complexity to the administration of the grants.

Nevertheless, we believe the Foundation was in a position, through its officers who served on many of the subsidiaries' boards, to exercise significant influence over the performance of each grant. However, the Foundation did not properly manage the expenditure of grant funds. As a result, grant funds were misused. Therefore, we are recommending that the Foundation refund to the Federal Government $1.43 million representing grant funds awarded to the Foundation from 1991 to 1995.

In addition, prior to receiving any future grants, the Foundation should:

- strengthen its administrative and financial controls to ensure proper grant administration, and

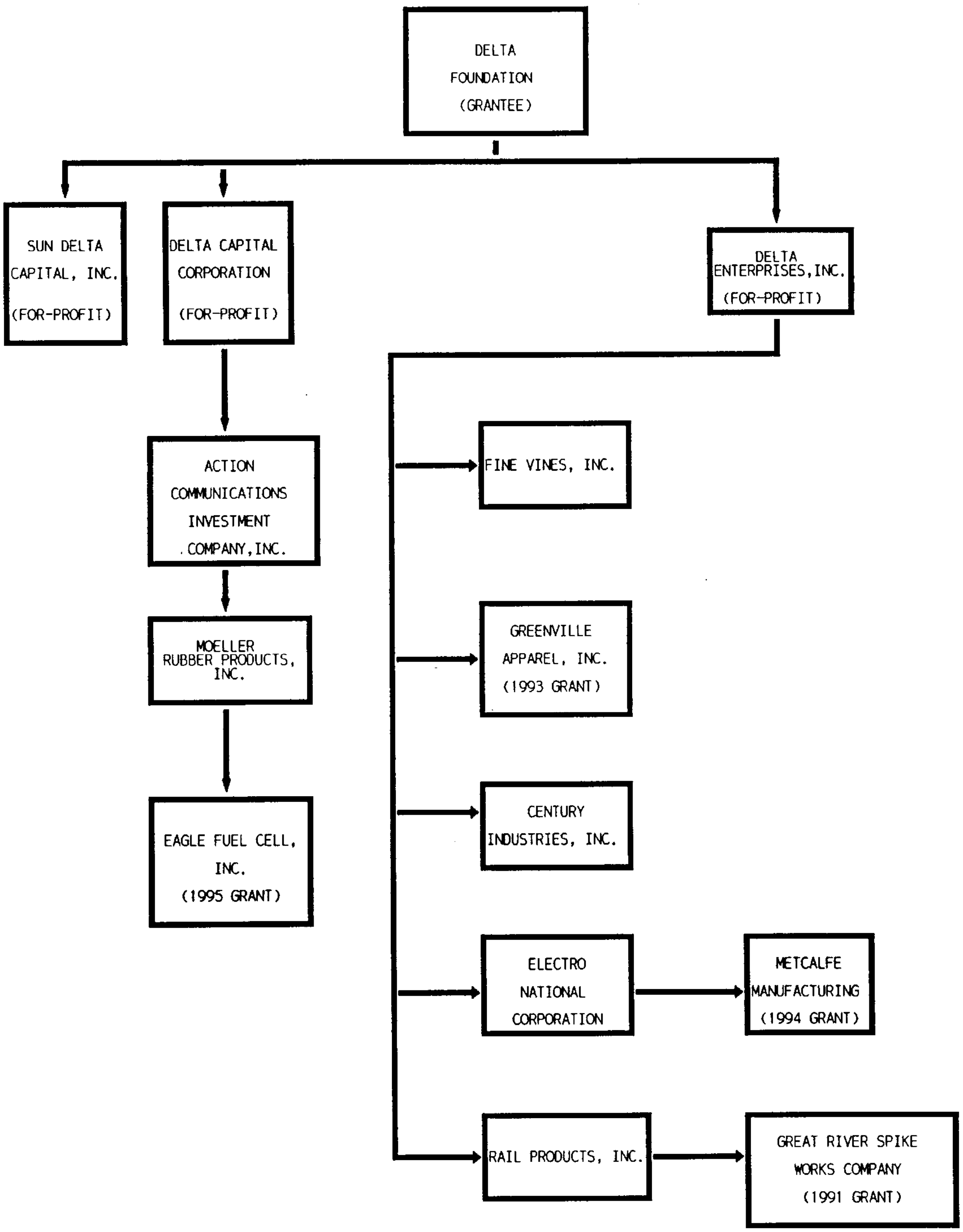
- demonstrate the capability to properly manage and expend Federal grant funds.

Foundation Comments

Foundation officials did not agree with the recommendation to refund $1.43 million. Foundation officials did agree that its grants management controls needed strengthening. Foundation officials said they hope to be in a position to hire a management level employee responsible for grant/special program administration. Foundation officials also said they are in the process of developing internal management controls to address many of the deficiencies identified in the report.

Exhibit I

DELTA FOUNDATION
AND SUBSIDIARIES



1995 GRANT
DETAILS OF MOELLER RUBBER PRODUCTS
UNRELATED EXPENDITURES

AMOUNT EXPENDED	HOW FUNDS WERE USED
$50,000	Repayment of Delta Enterprises loans. These loans did not relate to the grant project and were made prior to the grant period.
$81,100	Internal transfers unrelated to the grant. In the accounting records, $60,000 was described as "project implementation," and the remaining $21,100 as "loans" from Moeller to itself. According to a Moeller official, the entire $81,100 was used for the general operations of Moeller and did not relate to the grant project.
$5,931	Garnishments unrelated to the grant project. The majority ($5,604) of the garnishments related to a copier and facsimile machine leased by Metcalfe (1994 Grant).
$137,031	

1994 GRANT
DETAILS OF METCALFE MANUFACTURING
UNRELATED EXPENDITURES

AMOUNT EXPENDED	HOW FUNDS WERE USED
$10,240	Costs incurred prior to the grant.
$2,018	Outstanding employee advances/loans.
$1,358	Two checks with the plant manager shown as the payee on the canceled checks, but Metcalfe vendors were shown as payees on Metcalfe's check register.
$1,307	Cellular telephone services for a friend of the plant manager.
$1,220	Duplicate salary costs for the plant manager.
$1,110	Expenditures relating to the plant manager's personal car.
$492	Repair of a Metcalfe employee's car.
$474	Unreimbursed forged checks.
$18,218	

NOTE: Metcalfe's revenues during the 1994 grant period consisted of $235,000 in grant funds and $351,422 in sales revenue. Metcalfe commingled the grant funds and sales revenue in various accounts. Our analysis showed that the 1994 grant funds represented approximately 40 percent of total revenues. Accordingly, we considered 40 percent of each expenditure reviewed in various Metcalfe accounts to be grant funds.

Exhibit IV

1993 GRANT
DETAILS OF GREENVILLE APPAREL
UNRELATED EXPENDITURES

AMOUNT EXPENDED	HOW FUNDS WERE USED
$129,753	Unneeded equipment. None of the 22 equipment items reviewed were being used. According to Fine Vines officials, eight items were normally used by Fine Vines' employees, five items were never installed, five items were not normally used, and four items were normally used by Greenville Apparel employees.
$30,081	Greenville Apparel made a series of some 15 loans to Fine Vines using grant funds totaling $596,500. Of the $596,500, $30,081 remained outstanding at grant's end.
$4,000	Greenville Apparel paid Fine Vines $4,000 (8 months @ $500) for rent on a building for months after the grant period ended.
$163,834	

1991-1995 GRANTS
DETAILS OF DISSOLVED CORPORATIONS

1995 Grant

The Foundation applied for the grant on February 17, 1995. The grant was awarded for the period September 29, 1995 through February 28, 1997. The Mississippi Secretary of State administratively dissolved Action and Moeller as follows.

- Action, the wholly-owned subsidiary of Delta Capital was administratively dissolved October 14, 1994 for failure to file an annual report and pay State taxes. Action was reinstated on August 12, 1996.

- Moeller, the wholly-owned subsidiary of Action, was administratively dissolved October 8, 1993 for failure to pay State taxes. Moeller was not reinstated until August 15, 1996.

Both companies were administratively dissolved at the date of application for the 1995 grant. While both appeared to have been reinstated during the grant period, both engaged in the conduct of routine business and actively bought and/or sold its stock to related companies in apparent violation of the Mississippi statute.

1994 Grant

The Foundation applied for the grant on June 22, 1994. The grant was awarded for the period September 30, 1994 through February 28, 1996.

- Metcalfe was never incorporated as a subsidiary of Delta Enterprises as the Foundation proposed and OCS approved. Instead, Metcalfe was designated as a division of Electro, already a corporate subsidiary of Delta Enterprises. Electro was administratively dissolved October 8, 1993 for failure to pay taxes. This was nearly a year prior to the grant application. Electro was reinstated October 18, 1996.

- 1994 grant funds were loaned to both Electro and Fine Vines, both were administratively dissolved.

1991-1995 GRANTS
DETAILS OF DISSOLVED CORPORATIONS

1993 Grant

Greenville Apparel did not encounter administrative dissolution as did some of its sister entities; however, it loaned grant funds ($596,500) to Fine Vines, who was administratively dissolved on February 16, 1990.

1991 Grant

The Foundation applied for the grant on August 2, 1991. The grant was awarded for the period October 1, 1991 through September 30, 1992 with an extension through June 30, 1993.

Rail Products, a wholly-owned subsidiary of Delta Enterprises and a partner in Great River Spike, was administratively dissolved February 16, 1990. The dissolution occurred more than a year before the 1991 grant was awarded. To date, Rail Products has not been reinstated, and we were advised that the Foundation does not intend to have it reinstated.

Delta Foundation

September 12, 1997

Mr. Charles J. Curtis
Office of Inspector General
Office of Audit Services
Region IV
Post Office Box 2047
Atlanta, Georgia 30301

Re: **Comments of the Delta Foundation, Inc. to the Draft Review of Office of Community Services' Discretionary Grants Awarded to Delta Foundation, Inc. (A-04-96-00105) dated June 1997 by the United States Department of Health and Human Services, Office of Inspector General**

Dear Mr. Curtis:

The following are comments and supplementary materials in connection with the draft Review of Office of Community Services' Discretionary Grants Awarded to Delta Foundation, Inc. (the "Draft") prepared by the Department of Health and Human Services ("DHHS"), Office of Inspector General ("OIG") (A-04-96-00105). Following a brief summary of the context of the Draft, the second section of this response consists of comments and objections to the methodology -- and the implicit assumptions -- used by OIG in performing the audit and preparing the Draft. The third section of this response comments on specific provisions of the Draft to which Delta Foundation, Inc. (the "Foundation") takes exception.

I. BACKGROUND

The Foundation made application (each, an "Application") for and received grants (each, a "Grant") from DHHS, Office of Community Services ("OCS") pursuant to OCS's discretionary grants programs for each of the years 1991, 1993, 1994 and 1995. The 1991 Grant was for the purpose of beginning a second production line at Great River Spike Works, Inc. ("Great River"), a railroad spike manufacturing company, owned fifty-five percent (55%) by Rail Products, Inc. ("RPI"), a wholly owned subsidiary of Delta Enterprises, Inc. ("Enterprises"), a for-profit wholly owned subsidiary of the Foundation, and forty-five percent (45%) by Manitou Pass, Inc. ("Manitou"), an unaffiliated for-profit entity. The 1993 Grant was for the purpose of starting a second apparel manufacturing subsidiary of Enterprises to be known as New Threads, Inc. The name of the company was later changed to Greenville Apparel, Inc. ("Apparel"). Apparel was to work with, pick-up excess capacity from and capitalize upon market opportunities and expertise of Enterprise's other apparel manufacturing subsidiary, Fine Vines, Inc. ("Fine Vines"). The 1994 Grant was for the purpose of starting a metal products manufacturing company to be known as Metcalfe Manufacturing, Inc.

("Metcalfe"). Metcalfe was to receive extensive start-up assistance and initial operating contracts from Reliable Electric, a division of Reliance Comm/Tec, a leading manufacturer of metal components in the telecommunications industry. The 1995 Grant was for the purpose of starting Delta Eagle Fuel Cell, Inc. ("Eagle"), a company to be engaged in the business, initially, of repairing aircraft and helicopter rubber fuel cells and floatation devices. Eagle was to be owned: fifty-one percent (51%) by Moeller Rubber Products, Inc. ("Moeller"), a wholly owned subsidiary of Action Communications Investment Company, Inc. ("Action"), which is in turn a wholly owned subsidiary of Delta Capital Corporation ("Capital"), which in turn is a wholly owned for-profit subsidiary of the Foundation; and forty-nine percent (49%) by Simmie Brown, an individual experienced in the industry who would provide the expertise as well as certifications necessary from the Federal Aviation Administration ("FAA") to carry out the proposed business.

Although each business received Grant funds, each was also required to compete in the open market for capital, customers and employees. The Foundation could not and did not offer to OCS any guarantee that the businesses, or any of them, would succeed. What the Foundation could do, and what OCS funded through the Grants, was to extend an opportunity to improve conditions for persons of low income in a historically depressed area of the country. As it had done previously (through grants from OCS for Fine Vines and Electro National Corporation ("Electro") and through other subsidiaries for which it had not received OCS grants such as Century Industries, Inc., a highly successful manufacturer of fold-down attic steps), the Foundation had every hope and intention that each of the Grants would result in permanent employment opportunities to persons of low income. In keeping with Grant objectives, these enterprises were accompanied by significant risk, and none satisfied traditional lending requirements. In addition to make the risk, many of the new employees were first-time workers of limited education and low socio-economic status. Unfortunately, as discussed below, each of the new businesses encountered difficulties either in start-up or in operations. As also discussed below, however, the Foundation still has faith and belief that businesses funded with the 1993 and 1995 Grants will prove ultimately successful.

II. GENERAL COMMENTS

Rather than reporting its findings of fact from the audit process, OIG has throughout the Draft substituted its business judgment (with the benefit of hindsight) for that of the Foundation and its subsidiaries. The Foundation and its subsidiaries made well intentioned, prudent business decisions with respect to each of the Grants in a difficult and ever-changing business environment. It is not appropriate for OIG to substitute its judgment for that of the Foundation and its subsidiaries after the fact. Further, OIG chooses to ignore altogether the element of risk in these enterprises. By recommending repayment of the entire amount of each of the Grants OIG takes the position that the Foundation is an absolute guarantor of each of the businesses. There are no guarantees in a market economy with any business. If the results of operations were to be absolutely guaranteed, DHHS and the Foundation would not have set "objectives," but would have entered into performance guaranties.

OIG has also applied its own unsupported standards for determining whether the Foundation has met Grant objectives. For example, OIG has applied its own definition of "full-time, permanent job" to mean that if a job created during a Grant period did not exist at the end of the Grant period due to, for example, unexpected down-turns in business, it did not count toward meeting the objectives of a Grant. OIG has also, without reason or explanation, stated that the high turnover in each of these relatively low wage jobs demonstrates that the jobs were not "full-time, permanent jobs." The Draft should be revised to remove all references to these unsupported assertions

III. SPECIFIC COMMENTS

A. Summary of Findings (page ii of the Draft)

The OIG states in the Draft that:

> Our review showed that the Foundation:
>
> - did not create full-time permanent jobs;
> - used Federal funds for a wide range of purposes not related to the objectives of the grants;
> - did not provide the private cash and in kind services it proposed to ensure the success of the grants; and
> - submitted programmatic and financial reports to OCS that were often untimely, inaccurate, and misleading.

B. Full-Time Permanent Jobs

The statement that the Foundation "did not create full-time permanent jobs" is inaccurate. Three (3) of the four (4) Grants were used to create additional jobs for persons of low income. The Foundation created eighty-seven (87) of the one-hundred thirty (130) new jobs stated as objectives or 67% of its goal. OIG nevertheless concludes that each Grant was a complete failure. (As discussed on pages 5-6 of this response, the fourth Grant (1995 - for Eagle) is the subject of a request from the Foundation for a no-cost extension pending approval by DHHS (See Exhibit 1) and discussion thereof should be removed from the Draft.) From the Exit Interview concerning the Draft conducted on August 19, 1997, and discussions with members of OIG staff in Atlanta on September 2, 1997, we understand that OIG has, without statutory or regulatory basis, determined that any new job created during a Grant period that was not in existence at the end of the audit period did not constitute a "full-time permanent job," notwithstanding that such employees were hired with the expectation both themselves and by the Foundation, that the jobs would be full time, permanent jobs. It is not reasonable to state that a job is not "full-time" and "permanent" simply because an employer ceased business. So long as the employer and employee intended that the job exist for as long as the employer could stay in business and the employee performed adequately, OCS objectives has been satisfied. This statement by OIG shows a lack of objectivity, is unsupported and should be stricken.

C. Use of Federal Funds

The statement that the Foundation "used Federal funds for a wide range of purposes not related to the objectives of the grants" is not true and should be stricken. The Grant funds were used specifically to further the primary objective of the Grants: to alleviate poverty by providing jobs to low income individuals. Even the funds from the 1994 Grant loaned to Electro and Five Vines were loaned to subsidiaries of the Foundation formed for the purpose of providing jobs to persons of low income. Nowhere in the draft does OIG allege that the Foundation or any of its subsidiaries used Federal funds for any purpose other than alleviating the effects of poverty by increasing employment of low income individuals.

D. Cash and In-Kind Services

The statement that the Foundation "did not provide the private cash and in kind services it proposed to ensure the success of the grants" is not correct and should be stricken. As described in more detail below under "Private Cash and In-Kind Services," the Foundation and its subsidiaries provided or secured from third parties all or a substantial amount of the in-kind services and private funding for each of the projects to be funded with the Grants. Enterprises was not able despite numerous attempts to secure loans from banks or other lenders to in turn lend to Metcalfe and Apparel as proposed in the Applications and third party agreements. Other matching contributions made during or after the respective Grant period exceeded matching requirements for Apparel and Metcalfe. Manitou provided working capital loans in an amount over $19,667,891.66 to Great River, exceeding matching requirements. See Exhibit 2.

E. OCS Reports

Although not submitted timely in all cases, the Foundation submitted most of the required programmatic reports and financial reports required under the respective Grant. Any inaccuracies contained in the reports were insubstantial. Untimely and inaccurate reporting did not lead to the loss of a single dollar of Grant funds.

F. **CONCLUSIONS AND RECOMMENDATIONS** (page iii of the Draft)

As further discussed in this response, the Draft's conclusions and recommendations are not based on findings of fact. Many of the findings are misleading, inaccurate, unsupported and demonstrate bias against the Foundation. The Foundation believes that the Grant funds have been appropriately spent and accounted for and should not be subject to repayment.

G. **GRANT OBJECTIVES WERE NOT MET** (page 4 of the Draft)

The Draft states that the objectives of creating full-time jobs were not met because:

- (1995 grant) one project that proposed to create 30 jobs was discontinued before it could be fully implemented;
- (1994/1993) 2 other projects that proposed to create 43 and 62 jobs, respectively did not succeed because of insufficient business prospects and under capitalization; and
- (1991 grant) the fourth project proposed to create 25 jobs did not succeed because sufficient employees could not be hired and retained, and the target manufacturing company had preexisting financial problems.

1. **1995** (page 4 of the Draft)

All discussion of job creation under the 1995 Grant should be stricken from the Draft. Prior to the end of the Grant period, the Foundation applied for a no-cost extension for this Grant, which request has been taken under advisement by DHHS. See Exhibit 1. Until a decision is made on the no-cost extension, any discussion about success or failure of the Foundation to meet Grant objectives with this Grant is premature and unduly prejudicial and should be stricken.

Further, the Foundation has plans for this Grant which will lead to a significant number of new jobs in the same standard industrial classification through Moeller but which will not require FAA certification, which plans were communicated to both DHHS and OIG. Prior to developing these plans, the Foundation made good faith efforts to work with Mr. Brown in organizing Eagle. See Exhibit 3. However, Mr. Brown insisted upon adding Mr. James Bolden (with whom Mr. Brown had previous business dealings but was unknown to the Foundation or Capital) to the ownership and management team. Although the Foundation acquiesced to allowing Mr. Bolden a minority ownership interest in Eagle and elected him Secretary, Mr. Bolden quickly appointed himself as "Business Manager" and began negotiating with third parties on behalf of Eagle without the knowledge or consent of the Foundation. It appears that Mr. Bolden also entered into at least one lease agreement for Eagle in Topeka, Kansas which was never approved by the Board of Directors for Eagle. See Exhibit 4. From correspondence which the Foundation has received concerning the lease of space at the Mid-Delta Regional Airport where Eagle proposed operations, it also appears that Mr. Bolden's ambitions through Eagle were not predominantly for the purpose of furthering the Grant objectives, but to expand his own personal fixed-base operations business. See Exhibit 5. The Foundation determined that it would be in its best interest to restructure the business to operate directly through Moeller, advised DHHS accordingly and subsequently submitted the request for a no-cost extension. See Exhibit 6. Having sufficient reason to terminate its business relationship with Mr. Brown and terminate the planned operations for Eagle, the Foundation has requested the no-cost extension to allow Moeller to implement a project in the same standard industrial classification using the 1995 Grant with the same Grant objectives. Capital has invested over $155,000 in the project since requesting the no-cost extension from DHHS. See Exhibit 7. As the request was submitted prior to the end of the Grant period, discussion of the success or failure of this Grant is premature, unduly prejudicial and should be stricken.

2. 1994 (page 5 of the Draft)

Metcalfe created thirty (30) new jobs, seventy percent (70%) of the objective under the 1994 Grant. These were full-time, permanent jobs that would not have otherwise existed. These jobs, as well as the thirteen (13) additional new jobs still to be created, were lost when Reliable Electric, the principal initial customer for Metcalfe, withdrew its business and support. As the Foundation understands the facts, Reliable Electric withdrew its support primarily due to union disputes and demands. Therefore, the third paragraph is incorrect and should be stricken for the foregoing reasons and for the reasons described under "Summary of Findings" above.

The Foundation fully disclosed to DHHS in its Application that it would be relying in large part, at least initially, on work from Reliable Electric to stay in business until Metcalfe could develop a sufficient customer base. Furthermore, also as fully disclosed to DHHS, the Foundation anticipated relying on Reliable Electric providing expertise in start-up and initial operation, as demonstrated by Reliable Electric's involvement in the layout of Metcalfe's facility, assistance in determining necessary or appropriate equipment acquisitions and agreeing to provide a substantial amount of equipment at no cost to Metcalfe. See Exhibit 8. Although Enterprises attempted to keep Metcalfe functioning after losing the Reliable Electric support and work, it could not do so. However, neither the Foundation nor Enterprises "overestimated Metcalfe's ability to develop sufficient business" as stated in the Draft. Each was fully cognizant of the importance of Reliable Electric to the organization and start-up of Metcalfe and advised DHSS of the same. See Exhibit 9. Therefore, the first sentence of the fourth paragraph should be stricken.

Although Enterprises was not able to secure bank loans to in turn loan to Metcalfe as proposed in the Application, it did provide or secure in kind services and funding to Metcalfe in the form of technical assistance and low-or no-cost contributions of equipment with an approximate value of $1,693,000 from Reliable Electric. Without Reliable Electric to continue to provide steady work and allowing Metcalfe to keep the equipment, Metcalfe could not succeed. The Foundation does not believe that the failure of Enterprises to provide the private funding described in the Application resulted in the failure of Metcalfe. Therefore, the fifth paragraph is inaccurate and misleading and should be stricken.

Discussion of the organization of Metcalfe in this section is not appropriate. It was immaterial to the success of Metcalfe and the number of jobs created whether Metcalfe was organized as a division of Electro or as a separate subsidiary. Accounting records were separately kept for each, and there is no suggestion by OIG that funds were improperly used for or by Electro. Therefore, the second and third sentences of the first paragraph should be stricken.

3. 1993 (page 6 of the Draft)

Apparel created a total of 37 new jobs, sixty percent (60%) of the number expected. These were all expected to be full-time, permanent jobs. However, as is traditional in the apparel manufacturing industry, turnover was high. Additionally, as market conditions shifted and business turned for the worse, lost employees were not replaced. This does not mean that Apparel failed to create new full-time, permanent jobs. Therefore, the second paragraph and the first sentence of the third paragraph should be stricken as incorrect and inaccurate.

OIG states that Apparel did not succeed in creating the expected number of jobs because (i) it was not operated as a "stand-alone" entity from Fine Vines, (ii) it was located in the building next to Fine Vines, rather than in the building originally proposed which was two (2) miles away from Fine Vines, and (iii) because Apparel never realized the customer base identified in the Application.

First, in its Application the Foundation described Apparel as a new sewing operation to handle some of the excess business of Fine Vines. Apparel was never intended to operate solely on its own. Fine Vines had opportunities to participate in production of the J.C. Penney - Arizona line of jeans with potential annual sales of $3,000,000. Apparel was to perform this work while Fine Vines concentrated on its other established customers, all as described to DHHS in the Application. See Exhibit 10. Therefore, the third sentence of the first paragraph and the second sentence of the third paragraph should be stricken as inaccurate.

Second, the Fine Vines building (which Fine Vines acquired on behalf of Apparel as an in-kind service for $44,000) was to improve efficiencies by reducing shipping and operational costs and increasing managerial control. See discussion under "Grant Funds not Properly Expended - Use of

1993 Grant Funds." Items could be easily and inexpensively moved between Apparel and Fine Vines due to the proximity of their respective facilities. If Apparel had used the building originally proposed, shipping costs would have caused the failure of Apparel much sooner. With the decline in business, management determined that it was in the best interest of both Fine Vines and Apparel to share one facility, thereby also sharing overhead costs such as utilities, telephones, etc. To claim that Apparel did not succeed because Fine Vines and Enterprises made a prudent business decision to reduce operational costs defies common sense. Therefore, the third sentence of the first paragraph and the second, third and fourth sentences of the third paragraph should be stricken.

Third, Apparel was not able to realize the customer base identified in the Application in large part due to lower cost, overseas sewing operations. The North American Free Trade Agreement ("NAFTA") hastened the loss of these operations to overseas providers. See Exhibit 11. Apparel was not able to meet the objectives of the Grant because it could not secure contracts for its services due to lower price alternatives, mainly from overseas due to the reduction and/or elimination of tariffs pursuant to NAFTA. Apparel is not alone in its difficulties; Fine Vines has also experienced a loss of business. Both Fine Vines and Apparel have already undertaken manufacture of non-apparel items (e.g., hunters' decoy bags, fast food restaurant aprons, etc.) in an attempt to stay in business. NAFTA, the Foundation believes, also chilled the confidence of lending institutions in small, low-technology apparel manufacturing operations. Enterprises, Fine Vines and Apparel management worked to secure a line of credit or other financing which would have allowed Apparel to participate in the J.C. Penney - Arizona jeans program discussed in the Application. However, efforts to secure such financing from, among others, Planters Bank & Trust, Greenville, Mississippi, the Enterprise Corporation (not affiliated), Greenville, Mississippi, The Business Consortium Fund, New York, New York, Deposit Guaranty National Bank, Greenville, Mississippi, and Union Planters Bank of Northwest Mississippi, Greenville, Mississippi. Appropriate revisions should be made for the effects of the business environment, especially NAFTA and the plight of small apparel manufacturing firms in general, in the first sentence of the third paragraph.

4. 1991 (page 7 of the Draft)

Great River was successful in creating at least twenty (20) of the twenty-five (25) new jobs proposed. This equates to a success rate of eighty percent (80%) of the objective. As noted by OIG, Great River had difficulty in securing a sufficient number of employees willing to perform the metal foundry type work necessary for the pay offered in order to become successful. Furthermore, Great River experienced high turnover in its employees. Although this is a function of the work environment, OIG has implied that these jobs were not full-time, permanent positions and that the Foundation "overestimated" Great River's ability to secure employees. Further, OIG has stated that these jobs were not determined to be for low-income individuals. The pay scale for these jobs ranged from $4.50 to $6.00 per hour. See Exhibit 12. Therefore, the third paragraph and the first sentence of the fourth paragraph should be stricken as incorrect.

OIG has further stated that the Foundation failed to disclose a loan default by Great River at the time of Application. This loan was a "soft" loan of Community Development Block Grant funds secured by Great River from Jefferson County, Arkansas, which loan was subsequently sold to the Arkansas Industrial Development Commission ("AIDC"). Although Great River was delinquent in loan repayments at the time of submitting its Application, the Foundation believed that the Grant would enable Great River to operate profitably and thereby cure any defaults in payment. The equipment was sold in lieu of foreclosure and certain real property securing the loan was sold at sheriff's sale in November 1994, after the Grant period. Therefore, the sixth paragraph should be stricken as unrelated and inaccurate.

H. GRANT FUNDS NOT PROPERLY EXPENDED (page 8 of the Draft)

1. Administrative Costs (page 8 of the Draft)

Neither the Foundation, Enterprises nor Capital required management employees to maintain time sheets, work journals or other personnel reports. However, attached hereto as Exhibit 13 are travel and expense vouchers for Harold Hall and Willie Golliday. These records adequately document the efforts expended in the performance of their duties as officers of each of the subsidiaries and that allocation of Grant funds for their salary and benefits were reasonable and in accordance with each of the Applications. Lucille Deane and Josephine Taylor are assistants that work with Messrs. Golliday and Hall, and their efforts can be inferred from the same.

2. Use of 1995 Grant Funds (page 9 of the Draft)

As noted previously, any discussion of this Grant is improper at this time due to the pending request for a no-cost extension. The Foundation will duly account for all Grant funds.

3. Use of 1994 Grant Funds (page 10 of the Draft)

OIG has claimed that $10,240 was improperly used for costs incurred prior to the Grant period. This amount was used to retire a line of credit secured by Metcalfe in anticipation of receipt of Grant funds for items necessary for operation during the Grant period. Therefore, appropriate revisions should be made to pages 11 and 12 and any discussion of this amount in Exhibit IV should be stricken.

OIG has contended hat $7,979 in costs are not allowable. These are amounts that were improperly taken by or paid to employees of Metcalfe. The Foundation is or will be pursuing all legal remedies it may have against the former employees.

4. Use of 1993 Grant Funds (page 11 of the Draft)

OIG has claimed that $129,753 of the 1993 Grant were expended on "unnecessary equipment" and, therefore, this amount was improperly expended. See page 11 and Exhibit IV of the Draft. OIG has replaced its judgment for that of Apparel in the acquisition of this equipment. This equipment was acquired as part of the acquisition of $384,371 worth of equipment from the closed Big Yank operation in West Point, Mississippi and was fully documented as an appropriate use of Grand funds. See Exhibit 14. This equipment was purchased at sixty percent (60%) of value and would have been used had Apparel secured the contracts described in the Application. As the contracts were not secured, many of the items of equipment were not used (e.g., automatic pocket setters could only be used on certain items of manufacture) or were only used periodically. The expenditure of these funds were related to the Grant and were used for purchases made in accordance with the proposal set forth in the Application.

Therefore, appropriate revisions should be made to pages 11 and 12 and any discussion of unnecessary equipment or monies expended therefor in Exhibit IV should be stricken.

OIG contends that $51,000 paid to Fine Vines by Apparel for management and clerical services is not adequately documented. In fact, Fine Vines provided Apparel $82,650 in management and clerical services for the $51,000 ($3,000 per month) charged. See Exhibit 15. Therefore, Fine Vines actually provided $31,650 in kind services in addition to the documented $51,000 charged. Discussion of the $51,000 of undocumented expenditures should be stricken from page 11 of the Draft. OIG has also questioned $30,081 in loans made by Apparel to Fine Vines, which loans remained outstanding at the end of the Grant period. As previously discussed, Apparel was dependent upon Fine Vines for its continued existence. These loans were made to allow Fine Vines to continue to meet production demands. Since the end of the Grant period, Fine Vines has advanced Apparel approximately $274,595. See Exhibit 16. The Foundation believes that this constitutes repayment as well as provision of matching funds. Therefore, these expenditure are reasonable, have been documented, and any discussion of the same is improper and should be stricken from page 11 of the Draft.

5. Use of 1991 Grant Funds (page 12 of the Draft)

The discussion of the use of 1991 Grant funds is wholly inappropriate and biased. The Grant funds used were used as proposed in the Application. Unfortunately, Great River ran into operational difficulties and subsequently ceased operations due to operational losses. Expenses exceeded revenues leaving insufficient funds to pay operating costs and debt service. AIDC, as a creditor, foreclosed upon realty given as surety for its loan to Great River with a resulting sheriff's sale of the property at public outcry. The purchaser of the equipment was unrelated to the Foundation and purchased the same on terms that were reasonable to both Great River and AIDC. Also, OIG has recited an original acquisition price of the equipment of $905,149 in the Draft although most of this equipment had been in use for approximately ten (10) years at the time of the sheriff's sale and was of the type in use by only one (1) spike manufacturer (Spike Industries, Inc.) at the time of sale. The Foundation believes this is unduly prejudicial and improper considering (i) the age of the equipment, (ii) the nature of the sale, and (iii) the limited market for the equipment. Any discussion of these funds being improperly used should be stricken from the Draft. Further, it is unreasonable to suggest or recommend repayment of these amounts which were used in accordance with the Application and the Grant. Great River was unable to succeed due to market forces, not mismanagement of Grant Funds. This discussion should be stricken from the Draft.

6. **Stock Purchases Were Not Made** (page 13 of the Draft)

OIG has noted that the Foundation did not make stock purchases in Enterprises and Capital as proposed in each of the Applications. Although Enterprises and Capital officials issued stock certificates and appropriate resolutions were made by the board of directors of each, Enterprises and Capital had issued all the authorized stock of each of the corporations previously. The Foundation's auditor in preparing annual audits made appropriate adjustments in paid in capital instead. The distinction between paid in capital and issued stock is inconsequential as between wholly owned subsidiaries such as Enterprises and Capital. Both stock and paid in capital (together with retained earnings) are components of shareholders equity and represent the amount of investment in the corporation by the owner, in this case, the Foundation. See Exhibit 17. These Exhibits each show increases in paid in capital for Enterprises and Capital in connection with the Grants. The Foundation's investment in each did not disappear, nor did the Foundation experience dilution of its ownership interest in either corporation due to no new shares of stock being issued.

7. **Administrative Dissolution of Subsidiaries** (page 13 of the Draft)

OIG has noted that each of the subsidiaries in each of the transactions was administratively dissolved at one time or another during the respective Grant period. This is incorrect. Enterprises, Capital, Great River, Rail Products and Apparel were never administratively dissolved. Second, OIG exaggerates the effect of administrative dissolution. Administrative dissolution is a mechanism in the Mississippi Business Corporation Act and other similar state corporate acts meant to ensure that a corporation keeps the state advised as to its principal management (directors and executive officers) by filing of annual reports and pays required corporate franchise taxes (taxes based on the amount of capital employed in the state) for the privilege of doing business. An administratively dissolved corporation may be reinstated at any time within five (5) years of administrative dissolution by payment of all past due taxes and filing of a current annual report. Once reinstated, the corporation is treated as having never been dissolved, and all actions taken during the period of dissolution are binding, effective and legal obligations of the corporation. See Section 79-4-14.22(c) of the

Mississippi Code of 1972, as amended. (Exhibit 18). Administrative dissolution was not the cause of any of the difficulties with the Grants and did not result in the loss of any Grant funds.

I. PRIVATE CASH AND IN-KIND SERVICES (page 14 of the draft)

Enterprises was unable to locate appropriate sources for some of the matching funding for the Grants despite good faith efforts to locate the same. The Foundation does not believe that the failure to provide all the matching funds was a cause of the loss of the businesses and, hence, failure to meet Grant objectives. The Foundation is of the opinion that securing the remaining sources of funding could have prolonged the operations of the subsidiaries for a negligible amount of time, but would not have assured success. Great River was unable to locate appropriate employees willing to work at the labor rates payable. Loan funds could not be used to increase wages to the unprofitable levels it now appears would have been necessary. Apparel was not successful because of a general down-trend in domestic apparel manufacture. Fines Vines, an established and reputable company, with sufficient operating revenues has not been immune to this change in the market. Metcalfe did not succeed because it lost the support and business of Reliable Electric.

Further, substantial contributions of matching funds and services were made. As noted above, Fine Vines contributed $31,650 in management and clerical salaries. See Exhibit 15. Likewise, Fine Vines acquired the building next to its facility for Apparel's use for $44,000. See Exhibit 19. Even deducting $1,000 for rent paid, this represents a $43,000 investment for the benefit of Apparel. Enterprises secured funding from the Mississippi Department of Human Services Jobs program in the amount of $13,500. See Exhibit 20. Fine Vines has since the end of the Grant period contributed approximately $274,595 in money and services since the conclusion of the Grant period. See Exhibit 16. These contributions all show a commitment by Enterprises and Fine Vines to the success of Apparel. Likewise, Enterprises provided a 3,500 square foot building for Metcalfe's use and operations for a period of thirteen (13) months. Rental on this building would have been $4,500 per month for an in kind contribution of $58,000. In addition to the equipment described under "Grant Objectives Were Not Met - 1994," Reliable Electric offered to sell Metcalfe a paint spraying apparatus valued at $200,000 for $1, which would have provided a significant number of new jobs. See Exhibit 8. Therefore, discussion of failure to provide matching funds should be stricken.

J. GRANT REPORTING (page 14 of the Draft)

The Foundation admits that it did not make all the necessary programmatic and financial reports required under the Grants. Failure to file reports were inadvertent and not through any intent to deceive or mislead DHHS. Failure to file or untimely filing of reports were not a cause of loss of the businesses and did not result in the loss of Grant funds. Timely filing of required reports is addressed further in this response under "Controls to be Instituted."

K. CONCLUSIONS AND RECOMMENDATIONS (page 15 of the Draft)

1. Private Industry.

OIG notes that "accomplishment of grant objectives was at risk from the very start of grant funding." The Foundation agrees completely with this observation but disagrees entirely with OIG's rationale. Without paying any attention whatsoever to the markets and business environment in which the Foundation was attempting to work, OIG concludes that the Grants did not succeed because of (i) the "overly complex organizational structures" (see discussion below) and (ii) misuse and mismanagement of grant funds (see discussion above under "Grant Funds Not Properly Expended"). These opinions are not supported and should be stricken from the Draft.

2. Organizational Structure.

OIG has stated the organizational structure of the Foundation was overly complex and that having to distribute "funds through multiple tiers created an additional element of complexity to the administration of the grants." Here, again, OIG is attempting to substitute its own judgment for that of the Foundation. The Foundation determined many years ago that its best interests were served by a structure that isolated it and each of its individual subsidiaries from potential liabilities of the others. In the judgment of the Foundation, it is better to have a complex structure and not risk one operating subsidiary with potential claims against another than to provide a simple structure where one claim could devastate other operations. Also, OIG has incorrectly stated that administration costs were withheld at each tier. This is incorrect and should be stricken from the Draft. Administrative costs withheld never exceeded the amounts included in any Application. See Exhibits 9, 10, 21 and 22. Further, the structure is not overly complex. Contrary to OIG's claims, Apparel and Metcalfe were only second tier subsidiaries, Great River was a third tier subsidiary and Eagle was a fourth tier subsidiary. OIG concedes that it uncovered no evidence of fraud or malfeasance on the part of the Foundation. Hence, this discussion is unnecessary and inappropriate and the first four (4) paragraphs of this Section should be stricken from the Draft.

3. Controls to be Instituted

The Foundation acknowledges that management controls need to be tightened for grant administration purposes. The Foundation hopes to be in a position to hire a management level employee whose primary responsibility will be grant/special program administration and is in the process of developing internal management controls that will, at a minimum, address: compliance with the formalities of corporate existence; maintaining adequate accounting records, requiring appropriate daily personnel reports evidencing efforts expended on each operation; and documenting grant compliance.

IV. CONCLUSION

For the reasons stated above, the Foundation respectfully submits that the Draft is overly critical, incorrect and inaccurate in many respects, and demonstrates an improper bias against its operations. The Draft should be withdrawn in full. If not withdrawn, it should be modified as discussed herein.

Sincerely,

Harry J. Bowie

Harry J. Bowie
Chairman