U.S. DEPARTMENT OF COMMERCE
Office of Inspector General

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ECONOMIC DEVELOPMENT ADMINISTRATION

Tyler Economic Development Council
Tyler, Texas
Revolving Loan Fund
EDA Grant Nos. 08-39-02823
& 08-39-02823.01

Audit Report No. ATL-13734-1-0001 / March 2001

Office of Audits, Atlanta Regional Office

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EXECUTIVE SUMMARY

The Tyler Economic Development Council promotes economic growth by providing various programs for both new and existing businesses. One such program is a federally funded revolving loan fund (RLF) provided through the Economic Development Administration. In September 1992, EDA awarded the council a $500,000 grant to establish an RLF. In March 1996, EDA awarded the council another $500,000 grant to recapitalize the RLF.

We performed a financial and compliance audit of the council's RLF during August 2000. The main purpose of our audit was to determine the reasons for the council's delays in drawing down the RLF recapitalization grant award. Other audit objectives were to evaluate the council's financial management of its RLF, and to assess the council's compliance with applicable RLF administrative and loan documentation requirements.

We found that the council has not needed the recapitalization grant funds because there has been insufficient demand for loans. In fact, the original grant and subsequent loan repayments have provided more than enough monies to meet the council's loan demand. As of August 2000, more than four years after the second award, the council had not made any drawdowns on its $500,000 recapitalization grant. The grant agreement requires that all funds be drawn down and used to make loans within three years of the award, unless EDA approves a time schedule extension or the recipient meets other specified conditions not present here. We found no documentation to support that the council requested and EDA formally approved an extension. According to a council official, EDA verbally granted an extension through March 2000. However, as it turned out, the council did not need any of the grant funds for loans.

The grant agreement also reflects Federal law that requires EDA to automatically deobligate any grant funds not disbursed by September 30 of the fifth year after the year of the grant award, which in this case is September 30, 2001. Even if a demand for loans develops before that date, there is limited time for the council to adequately evaluate loan applications to ensure that any loans made are prudent and consistent with program objectives. Therefore, we believe that it would be in the government's best interest for EDA to immediately terminate the grant agreement and deobligate the grant funds (see pages 3-5).

In addition, the council did not follow certain EDA and OMB requirements in administering its RLF grant program. As a result, the council incurred $34,582 in questioned grant administration costs for the period April 1997 through March 2000 (see pages 6-7).

We are recommending that EDA's Austin Regional Director (1) immediately terminate the council's RLF recapitalization grant and deobligate the $500,000 in grant funds; (2) disallow $34,582 of questioned grant administration costs and require the council to reimburse the RLF for that amount; and (3) require the council to implement procedures to ensure that all employees' time sheets are appropriately prepared and maintained.

In response to the draft report, council officials did not concur with the findings or recommendations. They presented information regarding the council's recent and prospective lending activity, and concluded that the council would need to make drawdowns from the recapitalization grant in order to fund additional loans. In addition, the officials stated their corrective actions to document future RLF personnel costs, and provided information to support the reasonableness of the questioned costs.

Based on the council's response, we have incorporated into the report information regarding the council's recent and prospective lending activity. However, council officials did not provide a projected drawdown schedule to justify the need for grant funds, or any additional documentation to support the questioned costs. Therefore, after careful review and consideration of the remainder of the council's response, we did not substantively modify any additional portions of the draft report's findings or recommendations.

We have summarized the council's responses to individual issues and provided our comments after the appropriate sections of this report. We have included the council's complete response, with the exception of the attachments, as Appendix I.

INTRODUCTION

The Tyler Economic Development Council is a Texas non-profit corporation formed in 1989 to diversify the economic base of Tyler and Smith counties and create new job opportunities. Specifically, the council promotes economic growth by assisting and encouraging the retention and expansion of existing businesses, developing new and small businesses, targeting and attracting new businesses, and providing incentives and infrastructure for businesses. As one method of achieving its objectives, the council administers a federally funded revolving loan fund (RLF) provided through the Economic Development Administration.

In September 1992, EDA awarded the council a $500,000 Long-Term Economic Deterioration (LTED) grant, No. 08-39-02823, to establish an RLF. The grant was funded under Title IX of the Public Works and Economic Development Act of 1965, as amended. It required the council to provide a $167,000 matching share, which brought the RLF's capitalization to $667,000. The RLF was to be used to promote economic and business development in Smith County.

In March 1996, EDA awarded the council another $500,000 LTED grant, No. 08-39-02823.01, to recapitalize, or add funding, to the RLF. The grant required the council to provide a $166,667 matching share. The additional funding raised the RLF's total capitalization to $1,333,667. The recapitalization award was for the same purpose as the original grant.

According to its semiannual report to EDA as of March 31, 2000, the council had made 13 RLF loans totaling $1,218,264. Of those 13 loans, 6 had been fully repaid, 2 had been written off at a loss of $68,723, and 5 remained active with total outstanding balances of $371,193. In addition, as of that date, the council had $428,899 on hand for new loans, with $250,000 of that amount committed to one loan, which was subsequently made in August 2000. Also as of August 2000, the council had drawn down the entire $500,000 of the original grant but none of the $500,000 recapitalization award.

PURPOSE AND SCOPE OF AUDIT

We performed a financial and compliance audit of the RLF at the council's office in Tyler, Texas, during August 2000. The main purpose of our audit was to determine the reasons for the council's delays in drawing down the RLF recapitalization grant award. Other audit objectives were to evaluate the council's financial management of its RLF, and to assess the council's compliance with applicable RLF administrative and loan documentation requirements.

We examined pertinent EDA and council records, and interviewed agency and grantee officials as deemed necessary. We reviewed the council's loan files for each of its 13 RLF borrowers and its RLF administrative costs from April 1, 1997 through March 31, 2000.

We examined the council's recent annual single audit reports, which included the report for the fiscal period ended September 30, 1999. These audits were conducted by independent certified public accountants in accordance with the criteria contained in Office of Management and Budget Circular A-133. The reports disclosed no material internal control weaknesses. However, we did not rely upon the public accountant's internal control reviews but instead determined that we could better meet our audit objectives through detailed substantive testing of RLF transactions.

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

Except as disclosed in this report, the results of our tests indicate that, with respect to the items tested, the council complied in all material respects with applicable federal laws and regulations. With respect to items not tested, nothing came to our attention that caused us to believe that the council had not complied in all material respects with those laws and regulations.

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

FINDINGS AND RECOMMENDATIONS

COUNCIL HAS NOT DEMONSTRATED NEED FOR RECAPITALIZATION GRANT

The council has not demonstrated a need for the recapitalization grant funds. In fact, the original grant and subsequent loan repayments have provided more than enough monies to meet the council's loan demand. As of August 2000, more than four years after the award, the council had not made any drawdowns on its $500,000 recapitalization grant. Currently, the council has limited prospects for making additional loans. Federal law requires EDA to automatically deobligate any grant funds not disbursed by September 30 of the fifth year after the year of the grant award, which in this case is September 30, 2001. Even if a demand for loans develops before that date, there is limited time for the council to adequately evaluate loan applications to ensure that any loans made are prudent and consistent with program objectives. Therefore, we believe that it would be in the government's best interest for EDA to immediately terminate the grant agreement and deobligate the grant funds.

Council Has Not Achieved Grant Disbursement Milestones

EDA's RLF Standard Terms and Conditions, Section D.07, contains general requirements for disbursing RLF grants. Loans in the initial round of lending, which generate drawdowns in the grant disbursement phase, are to be completed within three years of the grant award. Within the three-year period, at least 50 percent of both the grant funds and matching share is to be disbursed within 18 months, and 80 percent within two years. If a grant recipient does not meet the prescribed deadlines, additional grant funds will not be disbursed unless EDA approves a time schedule extension, or the recipient meets other specified conditions not present here.

EDA's RLF Administrative Manual, Section IX.E., contains criteria for EDA to consider in granting time extensions. As soon as conditions become known that may materially affect its ability to meet any of the required disbursement deadlines, a grant recipient must provide EDA a written request for continued use of grant funds beyond the missed deadline. The extension request must demonstrate that: (1) the delay was unforeseen or generally beyond the recipient's control, (2) the need for the RLF still exists, (3) the current and anticipated use and benefits of the RLF remain consistent with the recipient's economic adjustment strategy and RLF Plan, and (4) achievement of a new proposed time schedule is reasonably possible with no further delays foreseen.

EDA's March 1996 grant award contained the general disbursement schedule referenced above. In April 1998, EDA notified the council that it had not met the 80 percent grant drawdown milestone date of March 1998. EDA further informed the council that it could request an extension of the milestones if it provided an explanation for the delay and a schedule of estimated drawdowns. In its response, the council advised EDA that since receiving the recapitalization grant award, it had funded five loans totaling $433,000 through the revolving

phase of its initial RLF award. The council also stated that any loan closed in the near future would require using the recapitalization grant funds, and that it expected to expend the full grant amount by March 15, 1999, which was the end of the three-year disbursement schedule.

Despite its response to EDA, the council did not need the grant funds during the first three years. According to a council official, EDA verbally granted an extension through March 2000. However, as it turned out, the council once again did not need any of the recapitalization grant funds for loans.

Since the council had made no drawdowns as of August 2000, obviously it did not achieve any of the grant disbursement milestones. Council officials cited several reasons for this. First, local financial institutions are either reluctant to make loans where gap financing is needed or prefer to make loans independently of federal funding. Second, the Tyler/Smith County area historically is very conservative regarding participation in federal programs. Finally, the council has been somewhat limited in marketing its various programs because of its relatively small staff.

The grant agreement reflects Federal law that requires EDA to automatically deobligate any grant funds not disbursed by September 30 of the fifth year after the year of the grant award, which in this case is September 30, 2001. Even if a demand for loans develops before that date, there is limited time for the council to adequately evaluate loan applications to ensure that any loans made are prudent and consistent with program objectives. Therefore, we believe that it would be in the government's best interest for EDA to immediately terminate the grant agreement and deobligate the grant funds.

RLF Loan Demand
Is Insufficient

A significant factor affecting the council's ability to make RLF loans is the lack of effectiveness of its RLF marketing program. The council's marketing program itself is actually well-defined, as evidenced by documentation council officials provided. This included specific marketing plans, listings of local contact persons, publicity material used, correspondence with area officials, records of various marketing events, a log of recent meetings with area commercial lenders, and schedules of prospective RLF borrowers.

However, the council's marketing program apparently has not been effective in terms of actual RLF loans generated. At the time of our field work, the council had made only one loan, for $250,000, from April 1998 through August 2000. In March 2001, council officials advised us that the council had made four more loans in the last 10 months from funds already available for lending, and had two prospective loans totaling $300,000. However, the officials did not clearly document the council's need for the recapitalization grant funds. Therefore, the council continues to be unable to make loans in accordance with EDA's grant disbursement milestones. EDA's RLF Standard Terms and Conditions, Section C.11, provides that EDA may terminate any grant based on the recipient's failure to comply with grant conditions.

Grantee Response

Council officials did not concur with our finding or recommendation. They stated that, after making four loans in the last 10 months, the council had $269,334 available for lending. Of that amount, $208,186 would be needed to fully fund loans already closed, leaving $61,148 available for new loans. The officials concluded that the council would need to make drawdowns from the recapitalization grant in order to fund two prospective loans totaling $300,000.

OIG Comments

We have incorporated in the report the information regarding the council's recent and prospective lending activity. However, the council's response does not adequately justify that the council will need any recapitalization grant funds. Similar to its April 1998 letter to EDA, the council's response is merely a representation that it will need the grant funds. It contains no projected grant drawdown schedule that would take into consideration the effects of (1) the rate of incoming payments for loans outstanding, (2) when the additional $208,186 would be disbursed for the loans already made, (3) when the two prospective loans totaling $300,000 would be disbursed, and (4) the matching share required upon disbursement of grant funds. Accordingly, we reaffirm our recommendation.

Recommendation

We recommend that EDA's Austin Regional Director immediately terminate the council's RLF recapitalization grant and deobligate the $500,000 in grant funds.

Funds to Be Put to Better Use

Implementing the above recommendation will allow $500,000 in unneeded grant funds to remain in the U.S. Treasury and be put to better use.

COUNCIL DID NOT FOLLOW CERTAIN RLF ADMINISTRATIVE REQUIREMENTS

The council did not follow certain EDA and OMB requirements in administering its RLF grant program. As a result, the council incurred $34,582 in questioned grant administration costs.

$34,582 in Administrative Costs Questioned

For April 1, 1997, through March 31, 2000, the council claimed $70,058 as administrative costs for its RLF grant program, which included $49,333 in salary costs. We are questioning $34,582, or 70 percent, of the salary costs claimed because the council did not use monthly time sheets to prepare time distribution reports for some employees. Instead, council management allocated salary costs to the RLF based on time estimates and budgeted amounts. OMB Circular A-122, Attachment B, Paragraph 7.m., requires that charges to awards for salaries and wages be based on documented payrolls, and be supported by personnel activity reports that reflect the distribution of activity of each employee whose compensation is charged to the awards.

Grantee Response

Council officials did not concur with our finding or recommendation. Although they agreed that inadequate time distribution reports had been maintained, the officials stated that future monthly time sheets would adequately document employees' time distribution. To substantiate the reasonableness of the $34,582 in costs questioned, the officials submitted documentation supporting their request for approval of an indirect cost rate for the RLF.

OIG Comments

We agree that the council's action should be sufficient to document future RLF personnel costs. However, we have questioned the $34,582 in personnel costs for lack of documentation. Since the council's response presents only budgeted amounts relating to a proposed indirect cost rate, it provides no additional documentation to support the costs questioned. Therefore, we reaffirm our recommendation.

Recommendations

We recommend that EDA's Austin Regional Director:

1. Disallow the $34,582 of questioned grant administration costs and require the council to reimburse the RLF for that amount.

2. Require the council to implement procedures to ensure that all employees' time sheets are appropriately prepared and maintained.

Funds to Be Put to Better Use

Implementing recommendation 1 will enable $34,582 of federal funds to be put to better use.

E. Jerry McMahan 3/28/01

E. Jerry McMahan
Acting Regional Inspector General
for Audits

Date

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March 9, 2001

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Re: Draft report ATL-13734-1-XXXX

Dear Mr. Bedwell:

This letter is in response to your letter of February 9, 2001, and the draft audit report ATL-13734-1-XXXX. We respectfully disagree with the proposed findings or recommendations, as follows.

NEED FOR RECAPITALIZATION GRANT

In March 1996 EDA awarded the Tyler Economic Development Council a $500,000 grant to recapitalize the RLF. Since that date, the RLF has closed 9 loans totaling $908,264. Four of them closed in the last 10 months.

Of the loans closed:

balance of funds available for lending	$ 269,334
not yet funded	208,186
net capital available	$ 61,148

RLF staff is currently working with applicants who have requested the following loans:

[redacted]	$ 100,000
	200,000
current applications	$ 300,000

The RLF will need to draw down funds from the second grant in order to fund these loans.

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ADMINISTRATIVE COSTS

We acknowledge that inadequate time distribution reports were maintained for part of the fiscal periods examined. Administrative actions have been taken to insure that monthly time sheets adequately document employees' time distribution. Although grant administration costs in the amount of $34,582 are being questioned, we believe the RLF's charges to the EDA grant to be reasonable.

In order to substantiate these costs, we have prepared the documentation required to request an indirect cost rate for the RLF. The documented payroll charges plus the proposed indirect costs for the fiscal periods being audited are shown on the attached sheet. While this is not the standard reporting method, these costs demonstrate that there was no intent to overcharge the RLF for administrative costs.

We respectfully request permission to negotiate an indirect cost rate to be used for fiscal year accounting beginning in this fiscal year.

Sincerely,

Thomas G. Mullins

Thomas G. Mullins, CED
President/CEO

c: Pedro R. Garza, Regional Director, Austin Regional Office, EDA
Bobby Curtis, Chairman of the Board, TEDC