U.S. DEPARTMENT OF COMMERCE
Office of Inspector General

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ECONOMIC DEVELOPMENT ADMINISTRATION

Miami Area Economic Development Service, Inc.
Miami, Oklahoma
Revolving Loan Fund
EDA Grant No. 08-39-02952.01

Audit Report No. ATL-14299-1-0001 / September 2001

Office of Audits, Atlanta Regional Office

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EXECUTIVE SUMMARY

The Miami Area Economic Development Service, Inc. assists existing industry and attracts new industry in order to increase employment in Miami, Oklahoma and the surrounding area. The corporation achieves its mission by operating six distinct revolving loan funds (RLF) including one RLF financed by two grants awarded to the corporation by the Economic Development Administration. Specifically, in September 1994, EDA awarded the corporation a $300,000 grant to establish an RLF and, in September 1997, EDA awarded the corporation a $350,000 grant to recapitalize the RLF.

We performed a financial and compliance audit of the corporation's EDA RLF during May 2001. Our primary audit objective was to determine the reasons for the corporation's delay in drawing down and using the RLF recapitalization grant funds to make loans. Our other objectives were to assess the corporation's continued need for the recapitalization funds and to review the corporation's compliance with selected EDA administrative requirements.

Our audit disclosed that the corporation:

- Has drawn down only $84,750, or about 24 percent, of the $350,000 recapitalization grant funds and therefore did not meet EDA's grant disbursement milestones.

- Has not requested a grant time extension from EDA for the continued use of the $265,250 in undisbursed grant funds even though the three-year grant award period ended in September 2000.

- Has limited current prospects for loaning the undisbursed grant funds and therefore has not demonstrated a definitive need for the funds.

- Did not timely submit semiannual RLF reports to EDA for the last two semiannual periods because of problems encountered in using new EDA-required report software.

We are recommending that EDA's Austin Regional Director immediately terminate the corporation's RLF recapitalization grant and deobligate the $265,250 in undisbursed grant funds. In the response to the draft report, corporation officials disagreed with our recommendation that EDA terminate the recapitalization grant, and responded that they need the grant funds for five current loan prospects and other possible prospects that may locate in a new city industrial park. The officials acknowledged that they did not request a grant time extension from EDA, and stated that they had submitted their two overdue semiannual RLF reports to EDA.

Based on the corporation's response, we deleted the recommendation pertaining to late RLF reporting. However, the response did not adequately document the corporation's justification for retaining the recapitalization grant, such as including an assessment of the likelihood of approving loans for the five current prospects. The response also did not include a projected time schedule

for drawing down and disbursing the remaining grant funds, or address the financial impact of future loan repayments and grant matching contributions. Because of these uncertainties, we did not modify our report finding and recommendation.

We have summarized the corporation's response to the draft report's finding and recommendation, and provided our comments at the end of this report. We have also included the corporation's complete response as Appendix I.

INTRODUCTION

The Miami Area Economic Development Service, Inc. is a private non-profit corporation created in 1985 to provide economic development services to the city of Miami, Oklahoma and the surrounding area. Currently, the corporation's mission is to assist existing industry and attract new industry in order to increase employment in the area. The corporation achieves its mission by operating six distinct revolving loan funds (RLF), including one RLF financed by two grants awarded to the corporation by the Economic Development Administration.

In September 1994, EDA awarded the corporation a $300,000 Long-Term Economic Deterioration (LTED) grant, No. 08-39-02952, to establish an RLF. The grant was funded under Title IX of the Public Works and Economic Development Act of 1965, as amended. The grant required the corporation to contribute $100,000 in matching funds, which brought the RLF's total capitalization to $400,000. The RLF was to be used to finance business start-ups and expansions with the objective of creating new jobs in three northeast Oklahoma counties.

In September 1997, EDA awarded the corporation a $350,000 LTED grant, No. 08-39-02952.01, to recapitalize, or add funding, to the RLF. The grant required the corporation to contribute $116,667 in matching funds, which increased the RLF's total capitalization to $866,667. The recapitalization grant was for the same general purpose as the original grant. At the time of our May 2001 audit, the corporation had drawn down the entire $300,000 of the original grant but only $84,750 of the recapitalization grant.

As of March 31, 2001, the corporation had made 11 RLF loans totaling $908,225. Of the 11 loans, 1 had been fully repaid, 1 was in default with an outstanding balance of $103,434, and 9 remained active with total outstanding balances of $441,473. As of that date, the corporation had $393,856 available for new loans, with none of the funds committed to new loans.

The corporation also administers another EDA funded RLF under a contract with the city of Miami. The RLF was established in March 1988, when EDA awarded the city a $500,000 LTED grant, No. 08-39-02580, to establish an RLF. The grant required $167,000 in matching funds, bringing the RLF's total capitalization to $667,000. The RLF funds were to be used to finance business start-ups and expansions in Ottawa County, Oklahoma.

PURPOSE AND SCOPE OF AUDIT

The primary objective of our financial and compliance audit was to determine the reasons for the corporation's delay in drawing down and using the EDA RLF recapitalization grant funds to make loans. Our other objectives were to assess the corporation's continued need for the grant funds and to review the corporation's compliance with selected RLF administrative requirements.

We performed our audit fieldwork in May 2001 at the corporation's office in Miami, Oklahoma. The audit covered the period from the September 30, 1997, recapitalization grant award date through March 31, 2001. We examined pertinent EDA and corporation RLF records, and interviewed agency and grantee officials as deemed necessary.

We also reviewed the corporation's annual single audit reports for the fiscal years ended September 30, 1998, 1999, and 2000. The audits were conducted by an independent certified public accounting firm in accordance with Office of Management and Budget Circular A-133. The reports disclosed several material internal control weaknesses that have been resolved or are in the process of being resolved. We did not rely upon the accounting firm's internal control reviews but instead determined that we could better meet our audit objectives through detailed substantive testing of RLF transactions.

We also did not rely on computer-processed data supplied by either EDA or the corporation as the 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 corporation 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 corporation 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.

FINDING AND RECOMMENDATION

CORPORATION HAS NOT DEMONSTRATED NEED FOR RECAPITALIZATION GRANT

The corporation has drawn down and used only $84,750 of its $350,000 in RLF recapitalization grant funds. The primary factor responsible for the corporation's delay in using the grant funds is that the original $300,000 grant and loan repayments have provided most of the needed loan funds. The three-year recapitalization grant award period ended in September 2000, but the corporation has not requested a grant time extension from EDA. However, even if a time extension were approved, the corporation's limited loan prospects restrict its ability to use the $265,250 in undisbursed grant funds. Because the corporation has not demonstrated a definitive need for the grant funds, we believe that it is in the government's best interest for EDA to terminate the grant and deobligate the undisbursed funds. In addition, the corporation did not timely submit its semiannual RLF reports to EDA for the last two semiannual reporting periods because of problems encountered in using new required report software.

Corporation Has Not Achieved Required Grant Disbursement Milestones

EDA's RLF Standard Terms and Conditions, Section D.07, and EDA's RLF Administrative Manual, Section IX.D., contain 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 grantee does not meet the prescribed grant disbursement milestones, additional grant funds will not be disbursed unless EDA approves a time schedule extension, or the grantee meets other specified conditions not present here.

EDA's RLF Administrative Manual, Section IX.E., contains the 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 milestones, a grantee must provide EDA a written request for continued use of grant funds beyond the missed milestone. The extension request must demonstrate that: (1) the delay was unforeseen or generally beyond the grantee's control, (2) the need for the RLF still exists, (3) the current or planned use, and anticipated benefits of the RLF remain consistent with the grantee's economic adjustment strategy and RLF plan, and (4) achievement of a new proposed time schedule is reasonably possible with no further delays.

EDA's September 30, 1997, RLF grant award incorporated the disbursement schedule referenced above. However, the corporation did not meet any of EDA's three grant disbursement milestones. In fact, as of September 30, 2000, when all of the recapitalization funds should have been disbursed, the corporation had drawn down and used only $84,750, or 24 percent, of the

$350,000 grant. The corporation made the drawdown in July 1998 to fund a new loan but since that date has not drawn down any of the $265,250 in remaining funds.

The RLF recapitalization grant's three-year award period ended on September 30, 2000, without the corporation having met EDA's final grant disbursement milestone. Despite this fact, the corporation, at the time of our May 2001 audit, had not requested, and EDA had not approved, a grant time extension for the continued use of the $265,250 in undisbursed grant funds.

According to the corporation's executive director, EDA's grant disbursement milestones were not met primarily because the $300,000 original RLF grant and loan repayments have provided most of the funds needed for the six new RLF loans made since September 1997. The director cited, as a major contributing factor, the fact that the corporation also operates five other RLFs that each have loan funds available. Other contributing factors, according to the director, are the reluctance by local financial institutions to make loans where gap financing is needed or their preference to make loans independently of federal funding.

Loan Applicant Prospects Are Limited

EDA's RLF Administrative Manual, Section IX.E., reflects the statutory requirement that any grant funds not disbursed by September 30 of the fifth year after the fiscal year of the grant award, in this case September 30, 2002, will be automatically deobligated. This requirement was incorporated into the recapitalization grant agreement.

The corporation, at the time of our May 2001 audit, had no pending RLF loan commitments or loans in process and had identified only one prospective loan applicant. The corporation's executive director stated that the prospective applicant is expected to submit a $100,000 loan application and that, if the loan is approved, the corporation would have to draw down about $50,000 of its undisbursed grant funds. The director stated that there is a high probability that the corporation would approve the loan since the prospective applicant is known to be qualified and currently has an RLF loan that is almost fully repaid.

However, if a $100,000 RLF loan were approved for the prospective applicant, the corporation appears to have at least two loan funding alternatives that do not require the use of the undisbursed grant funds. The first alternative is to use the current $43,000 in cash in the corporation's RLF plus the loan repayments that average about $6,900 per month. The second alternative is to fund the loan from the city of Miami RLF that, as of May 2001, had $92,000 in cash and monthly loan repayments of about $8,300.

Because the corporation continues to have only one immediate loan prospect, which does not appear to require the use of any undisbursed grant funds, we do not believe that the corporation has a definitive need for the recapitalization grant funds. Moreover, even if a grant time extension were approved, the corporation's limited loan prospects greatly restrict its ability to use the undisbursed grant funds before EDA's September 30, 2002, automatic deobligation date.

Semiannual Reports Were Not Timely Submitted

EDA's RLF Standard Terms and Conditions, Section F.01., and EDA's RLF Administrative Manual, Section XI.A.2., generally require that grantees submit semiannual reports on their RLF operations to EDA. However, at the time of our May 2001 audit, the corporation had not submitted to EDA the semiannual reports due for the periods ended September 30, 2000, and March 31, 2001. The corporation's executive director stated that the EDA Austin Regional Office required that grantees, beginning with the period ended September 30, 2000, electronically transmit their semiannual reports using EDA specified report software. The director stated that the corporation attempted to electronically transmit its semiannual RLF reports for the two periods but could not do so because of unresolved problems encountered in using the software.

In the response to the draft report, corporation officials stated that the two late reports had been submitted but not on the new software as they still were encountering problems with the software. Although the corporation must continue to resolve its automated reporting problems, we have deleted the recommendation pertaining to late RLF reporting.

Conclusion

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. Based on the foregoing, we believe that it is in the government's best interest for EDA to immediately terminate the grant and deobligate the $265,250 in undisbursed funds.

Grantee Response

Corporation officials disagreed with our recommendation that EDA terminate the recapitalization grant. The officials stated that the number and amount of loan requests they receive is cyclical and unpredictable. They also stated that they currently have five loan prospects needing $800,000 in funds but have only $327,000 in available loan funds, excluding the undisbursed grant funds. The officials further responded that they also need the undisbursed grant funds for other possible loan prospects that may locate in a new city industrial park. The officials acknowledged that they did not request a grant time extension from EDA. The corporation's complete response is included as Appendix I.

OIG Comments

The corporation's response does not adequately justify the corporation's need for the undisbursed recapitalization grant funds. Instead, the response simply states that the grant funds are needed to make loans to five current loan prospects, including four that the corporation identified after our May 2001 audit. However, the response does not indicate whether the four new prospects are regarded as serious and qualified prospects who plan to submit RLF loan applications. The

response also does not include the corporation's assessment of the likelihood of approving loans for the five current prospects, or a projected time schedule for drawing down and disbursing the remaining $265,250 in grant funds. Finally, the response does not address the financial impact of future monthly revenues generated by loan repayments, and required grant matching contributions on the corporation's loan plans. Because of these uncertainties, we have not modified our report finding and reaffirm our recommendation that EDA immediately terminate the recapitalization grant and deobligate the undisbursed grant funds.

Recommendation

We recommend that EDA's Austin Regional Director immediately terminate the corporation's RLF recapitalization grant and deobligate the remaining $265,250 in grant funds.

Funds to Be Put to Better Use

Implementing the above recommendation will allow $265,250 in unneeded grant funds to remain in the U.S. Treasury and be put to better use.

E. Jerry McMahan 9/24/01

E. Jerry McMahan
Acting Regional Inspector General
for Audits

Date

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August 2, 2001

Mr. E. Jerry McMahan
Acting Regional Inspector General for Audits
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U.S. Department of Commerce
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Re: Audit Report No. ATL-14299-1-XXXX

Dear Mr. McMahan,

This letter is in response to the Executive Summary dated July 2001. I agree that MAEDS did not request an extension from EDA for the continued use of the $265,250 in undisbursed grant funds. This was definitely an oversight on our part.

Limited Prospects: We have several prospects needing funds at this time. The request for funds continues to run in cycles. We cannot predict the number or the amount of requests we will receive on an annual basis. At this time we have five prospects needing a total of $800,000 in funding. MAEDS currently has $327,000 available. This does not include the undisbursed funds from EDA. The prospects include the following:

[redacted]	$100,000
	$ 75,000
	$ 25,000
	$100,000
	$500,000

The current unemployment rate for Ottawa County is 6.4 percent. This figure will increase significantly with the announcement of [redacted] closing in mid September unemploying an additional 150 people. We are also in the process of developing an industrial park located in northeast Miami. MAEDS has constructed a 50,000 square foot building at this site. Discovery Plastics has constructed a 33,000 square foot building and started production in mid July. This is a 158-acre site and has the possibility of housing facilities that will employ

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up to 1500 people. We project needing the EDA funds for current and future prospects locating in this industrial park.

RLF Reports: The RLF reports for September 30, 2000 and March 31, 2001 have been submitted. They are not on the new software. We are still encountering problems with the software and hope to have that resolved before the next report is due. We have been submitting these reports for the past twelve years and have never been late until the new software program was required. I hope you will take this into consideration.

We appreciate the opportunity to respond to this audit and ask your consideration in extending the draw down period for the recapitalization grant.

If you have any questions, please contact me a 1-800-256-0401.

Sincerely,

Judee Snodderly

Judee Snodderly
Executive Director

cc: Pedro Garza, Regional Director