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ECONOMIC DEVELOPMENT ADMINISTRATION

Audit of Monterey County's Contractor Revolving Loan Program Salinas, California EDA Grant No. 07-49-02640.01

Audit Report No. STL-13442-1-0001 / July 2001

Office of Audits, Seattle Regional Office

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EXECUTIVE SUMMARY

In May 1993, the Economic Development Administration (EDA) awarded Economic Adjustment Assistance grant No. 07-49-02640 to Monterey County, California. The award, a Defense Adjustment Implementation project, was to establish a revolving loan fund (RLF) to assist in mitigation of the effects on the local economy of the closing of nearby Fort Ord. The RLF established by the grant was known as the Countywide Revolving Loan Fund.

On April 21, 1997, EDA made a supplemental award which recapitalized the initial Countywide RLF, and which established a second Contractor Revolving Loan Fund (CRLF) which was to target small, disadvantaged contractors bidding for projects in the Fort Ord redevelopment. The federal share of the costs was $350,000 and Monterey County's share was $300,000. Monterey County's share came from the State of California Trade and Commerce Agency and Community Development Block grants.

The Contractor RLF was established by a settlement agreement filed by minority business organizations relating to redevelopment work at Fort Ord. As part of the agreement, an RLF was to be established to assist minority contractors in obtaining such work The Contractor Revolving Loan Program was to provide capital to small disadvantaged businesses (including female-owned, minority owned, disabled veteran owned and other small business enterprises) in pursuit of contracts solicited by CSUMB and other Fort Ord redevelopment projects. The program was to assist the target group in meeting the cost of construction performance bonds, general liability insurance and other costs related to contract startup expenses.

We performed a review of the County's CRLF during July 2000. The purpose of our audit was to determine if the County met the RLF program objectives, and complied with the terms and conditions of the grant agreements and federal regulations.

We found that there has been no demand for loans by the targeted contractor group, and that no loans have been made from the CRLF using the Federal funds. We also found management deficiencies including inadequate accounting procedures, inadequate documentation of internal controls, and inaccurate reporting.

We are recommending that the EDA Regional Director terminate the award and deobligate the unused $350,000 in EDA funds. This action will result in $350,000 being put to better use.

INTRODUCTION

In May 1993, the Economic Development Administration (EDA) awarded Economic Adjustment Assistance grant No. 07-49-02640 to Monterey County, California. The award, a Defense Adjustment Implementation project, was to establish a revolving loan fund (RLF) to assist in mitigation of the effects on the local economy of the closing of nearby Fort Ord. The RLF established by the grant was known as the Countywide Revolving Loan Fund.

On April 21, 1997, EDA made a supplemental award which recapitalized the initial Countywide RLF, and which established a second Contractor Revolving Loan Fund (CRLF) which was to target small, disadvantaged contractors bidding for projects in the Fort Ord redevelopment. The federal share of the costs was $350,000 and Monterey County's share was $300,000. Monterey County's share came from the State of California Trade and Commerce Agency and Community Development Block grants. Under the supplemental award, $250,000 of the funds available was dedicated to establish the CRLF. It was intended that the remaining RLF funds would be used for the same purposes as funds under the initial EDA Award No. 07-49-02640.

The Contractor RLF was established by a settlement agreement filed by minority business organizations relating to redevelopment work at Fort Ord. As part of the agreement, an RLF was to be established to assist minority contractors in obtaining such work The Contractor Revolving Loan Program was to provide capital to small disadvantaged businesses (including female-owned, minority owned, disabled veteran owned and other small business enterprises) in pursuit of contracts solicited by CSUMB and other Fort Ord redevelopment projects. The program was to assist the target group in meeting the cost of construction performance bonds, general liability insurance and other costs related to contract startup expenses.

The supplemental award included a disbursement schedule which required that 100 percent of the RLF capital (the EDA funds plus the recipient's matching share) be disbursed within 36 months. Monterey County was unable to meet the interim and final disbursement dates. EDA approved an amendment in April 2000 which extended the final disbursement date to October 31, 2001. The amendment authorized a revised budget for the award as follows:

	Revolving Loan Fund	Administration	Totals
Federal Contribution	$ 350,000	$ -0-	$ 350,000
Recipient Cash Contribution	243,026	56,974	300,000
Total Project Costs	$ 593,026	$ 56,974	$ 650,000

PURPOSE AND SCOPE OF AUDIT

The purpose of our audit was to determine if the County (i) met the RLF program objectives, and (ii) complied with the terms and conditions of the grant agreement, and the provisions of *Title 15 Code of Federal Regulation Part 24, Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Governments.*

We performed our audit fieldwork from July 17, 2000 to July 28, 2000 at the County offices in Salinas, California. Our review covered the period from April 21, 1997 to June 30, 2000.

We reviewed the County's policies and procedures for performing work under the grant and recording eligible costs. We also reviewed the grantee's financial and program records, and EDA documents and records. We interviewed the grantee's administrative analysts and financial staff.

We reviewed internal controls relating to the County's administration of the EDA grant, including controls over its financial management system and related payroll system, policies and procedures for procurement of goods and services, and property management. We found that the County needs to improve the internal controls relating to the financial area as discussed in the following section. Therefore, we did not rely on the controls in developing our audit approach. However, we conducted more substantive testing to achieve our objective of determining whether the grantee complied with the terms and conditions of the grant award.

We also evaluated the County's compliance with laws and regulations applicable to the grant. We identified *Title IX of the Public Works and Economic Development Act of 1965, as amended, Title 15, Code of Federal Regulation, Part 24, OMB Circular A-87*, and the terms and conditions of the grant as the applicable regulations. We found that the grantee was not in compliance with certain terms and conditions of the grant. The noncompliance was deemed material and is detailed in the next section of this report. With respect to items not tested, nothing came to our attention that caused us to believe that the grantee had not complied, in all material respects, with these provisions.

In conducting our review, we did not rely on computer processed data in the grantee's books of record. As such, we did not test the accuracy of the computer data by tracing the data to original source documents and by comparing the data in other documents.

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

FINDINGS AND RECOMMENDATIONS

EDA Funds Were Unused

We found there has been little if any demand for CRLF loans from the targeted group of contractors. In the four years since the CRLF was established, no loan has been made to a contractor working on the Fort Ord redevelopment. Monterey County did, however, expend its $300,000 matching share in making two loans through the county-wide RLF established by the initial EDA grant of 1993.

The grant award originally required Monterey County to make loans at a rate such that no less than 50 percent of the RLF capital (the EDA funds and the County's matching share) would be disbursed within 18 months, 80 percent within 24 months, and 100 percent within 36 months. Because of the lack of borrowers, the recipient requested two extensions of the milestone dates for disbursing the funds. In the latest amendment dated March 31, 2000, EDA revised *Section N* of the grant award to state that the recipient was to make loans at the rate of no less than 50 percent of the program capital by October 30, 2000, 80 percent by June 30, 2001, and 100 percent by October 31, 2001. Nonetheless, no loans have been made to date.

Inadequate Accounting Procedures

Our review disclosed that the County needed to improve its accounting procedures to meet the standards for financial management systems. The recipient did not establish accounting procedures to separate program income and expenses from the initial EDA revolving loan fund. *15 CFR, Section 24.20(1)* states:

> "Accurate, current, and complete disclosure of the financial results of financially assisted activities must be made in accordance with the financial reporting requirements of the grant or subgrant."

The recipient understood the program to be an extension of the previous EDA grant. Program income and expenses were indistinguishable from the previous grant. For example, at the time of review, the grantee made two loans under the award. However, the grantee did not recognize any program income or expenses related to the new grant award. The grantee instead commingled the program income and expenses with the previous Countywide revolving loan fund.

Inadequate Documentation of Internal Controls

The County did not have written procedures to document internal controls over loan transactions between the program administrator and the County. *15 CFR, Section 24.20(3)* states:

> "Effective control and accountability must be maintained for all grant and subgrant cash, real and personal property, and other assets. Grantees and subgrantees must adequately safeguard all such property and must assure that it is used solely for authorized purposes."

Specifically, the recipient did not have written procedures stating who will receive and deposit loan payment checks to the bank, how these deposits will be recorded by the County's accounting section, and how the bank interest income from the program will be recorded. During our review, we found that the recipient and current program administrator managers were still designing the appropriate procedures to ensure program funds are protected.

Inaccurate Reporting

Contrary to regulations, the County did not accurately report loans in the semiannual report to EDA. *The Revolving Loan Fund Grants Standard Terms and Conditions section F.01* states "The Recipient shall submit financial and status reports to the EDA Regional Office semiannually unless otherwise instructed by the Government." Typically, the reports included core performance measures, such as compliance with the implementation schedule for disbursement dollars and the number of loans made by the RLF.

As of June, 2000, the recipient made two loans from its previous county-wide RLF. The capital for these loans came from the County's $350,000 in marching funds. However, the recipient did not separately report one of the loans from the previous loans of the initial EDA revolving loan fund. The loan was made to a local dentist for acquiring dental equipment. RLF managers mistakenly interpreted that the grant allowed the program loans to be combined with the initial RLF. By combining the new loan with the other EDA loans, the financial ratios were distorted for the initial EDA revolving loan fund.

The second new loan was not included in the report for the six month period ended March 31, 2000. This loan was made to a company specializing in explosive response training for working capital purposes. A manager acknowledged that the lapse in reporting was due to an administrative error, and that an amended report will be prepared.

Recommendations

We recommend that the EDA Regional Director:

1) Terminate the award and deobligate the unused $350,000 in EDA funds.

Funds Put To Better Use
Implementing our recommendations will allow $350,000 in grant funds to be put to better use.

County's Comments

The County did not agree with most of the findings and recommendation in the draft report. However, the award recipient recognized the difficulty of making loans through the CRLF, and stated that the CRLF has not attracted borrowers until recently. On April 20, 2001, the recipient made a $30,000 loan to a small contractor using the CRLF funds.

The County agreed that, at the time of the OIG review, no federal funds had been expended. Also, the recipient stated that the County has fully spent the required local match and provided documentation of the expenses incurred in the award. To improve the grant performance, the recipient proposed to EDA that:

- *the grant should be amended so that the CRLF can be used on a countywide basis, and*
- *the final disbursement timeline should be extended to September 30, 2002.*

Relating to the findings concerning the accounting procedures and reporting policies, the County expressed concern and stated that the grant terms and conditions allowed the results of CLRF operations to be consolidated with the countywide RLF. The recipient said that, since the OIG review was completed, the County completed the consolidation process of the RLF programs and implemented new controls to ensure that the federal requirements were met. One of the controls required two signatures to withdraw funds or disburse loans from the RLF bank accounts.

On the finding about internal controls, the County agreed that California Coastal Rural Development Corporation, the contractor handling the administration of the RLF programs and fiscal management did not have written procedures for handling cash. The grant recipient submitted a draft of the contractor's cash handling policy for the OIG's review. Also, the recipient stated that the County Auditor-Controller performs a quarterly account reconciliation to ensure that all funds have been properly deposited and credited to the borrowers' accounts.

In summary, the County stated that steps have been taken to improve the management and marketing of the RLF programs. Specifically, the CRLF fills an important need in the county's economic development strategy. Termination of the grant would be counter productive and would hinder the county's ability to effectively support the independent contractor community. A copy of the County's response is included as Attachment 1.

OIG Comments

After reviewing the County's response, we reaffirm our findings and recommendation as stated in the draft report. None of the facts presented by the County has changed the status of the RLF. At the time of our review, the County did not use any of the federal funds from the grant. Although the County made a loan in April, 2001, we have determined that the loan is not significant to convince us that the RLF should continue as stated in the grant.

The County misinterpreted the grant terms and conditions in justifying its inadequate accounting and reporting procedures. Grant special award condition F specifies that the grant recipient can combine CRLF with the initial award. However, the award did not specify that any of the other federal regulations should be exempted. As such, we emphasize the need to

(i) establish accounting procedures to separate program income and expenses from the initial EDA revolving loan fund, and

(ii) accurately report loans in the semiannual report to EDA.

If the County has made procedural changes to address the issues above during the consolidation process of the RLF programs, we consider the intent of our report to have been satisfied. The draft cash handling procedures submitted by the County should strengthen the controls over cash when these procedures are officially established and followed.

Wm. F. Bedwell, Jr. JUL 10 2001

William F. Bedwell, Jr. Date
Acting Deputy Assistant Inspector General
for Regional Audits

MONTEREY COUNTY

ENVIRONMENTAL RESOURCE POLICY
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JAMES J. COLANGELO
ASSISTANT COUNTY ADMINISTRATIVE OFFICER

April 26, 2001

Mr. Ray McIntosh, Regional Inspector General
Office of the Inspector General
U.S. Department of Commerce
915 Second Avenue, Room 3062
Seattle, WA 98174

Dear Mr. McIntosh:

Thank you for the opportunity to review and comment on the draft Audit Report for EDA Project Number 07-49-02640.01 that was recently prepared by your office. The County disagrees with the majority of the audit report findings and the recommendation. The County does, however, acknowledge that there has been some difficulty making loans through the Contractor Revolving Loan Fund (CRLF) over the last four years. Despite marketing efforts, the program has not attracted qualified borrowers until recently. The County funded the first $30,000 loan to a small contractor through the CRLF on April 20, 2001, and the County is optimistic that this is just the beginning.

EDA Funds Were Unused

The County acknowledges that at the time of the OIG review, no federal funds had been expended. However, the County had fully expended the required local match and was able to provide documentation of the expenditures to the OIG reviewer.

To enhance the likelihood that the full grant is expended, the County will submit two proposals to EDA by May 1, 2001. The first proposal will request an amendment to the grant agreement so that the Contractor RLF may be used Countywide and so that the final disbursement be made by September 30, 2002. By expanding the area, we believe that there will be more eligible projects that will stimulate contractor demand for these loans. The second proposal is to extend the grant disbursement timeline through September 30, 2002. This extension will allow the County to either capitalize on the momentum that was generated by the first Contractor loan or roll the funds over to the County's regular Small Business RLF program. The County will closely monitor the loan pipeline to assess the level of demand for CRLF loans and request an amendment by September 2001. County staff has already discussed these proposals with EDA staff and they agree that these proposals are appropriate at this time.

The County and the program administrator, California Coastal Rural Development Corporation (CCRDC) have also begun an aggressive public information effort to increase awareness of all the RLF programs. The first press release that was issued resulted in more than 20 inquires about the three RLF programs. CCRDC is currently working with businesses seeking more than $650,000 in financing. The County issued a second press release on April 24, 2001 to announce the funding of the first Contractor RLF loan. The County will use the feedback from the second press release to determine if we need to roll the CRLF funds into the Small Business RLF in September 2001.

Inadequate Accounting Procedures & Inaccurate Reporting

The County is most concerned about these allegations. This award was specifically structured to supplement the County's existing Small Business RLF and provides the flexibility necessary to combine the supplemental award with the existing Small Business RLF if there was insufficient demand for the Contractor RLF. The County agreed to this condition specifically because of the flexibility it offered. A copy of the Award Special Conditions with the relevant sections highlighted is attached for your information. We believe that this condition was overlooked during the review.

At the time of the OIG review, the County was in the process of consolidating the management of the County's three RLF programs, and this may have caused some confusion regarding the County's accounting procedures and documented internal controls. Since the OIG review was completed, the County has completed the consolidation process and implemented new controls to ensure that all federal requirements are met. One example these controls is that two signatures are now required to withdraw funds or disburse loans from the RLF bank accounts. This issue only came up as a result of the consolidation of the program administration and fiscal management, and the OIG reviewer specifically identified it as an area of concern. A summary County's three RLF programs, their funding source, accounting information and any geographic limitations on the use of these funds is attached to this response.

Inadequate Documentation of Internal Controls

The County is contracting with California Coastal Rural Development Corporation (CCRDC) to handle the day-to-day administration of the RLF programs and fiscal management. During the OIG review, the lack of a written CCRDC cash handling policy was identified as a problem. CCRDC has developed a draft Cash Handling Policy, which is attached for your information. The County Auditor-Controller also performs its own quarterly account reconciliation, to ensure that all funds have been properly deposited and credited to the borrowers' accounts.

The County believes that the steps described above represent significant improvements in the management and marketing of all of the County's RLF programs, and that there is a very good probability that the full grant will be disbursed by September 30, 2002. The County also believes that the CRLF fills an important niche in the County's economic development strategy, and believes that terminating this grant just as the first loan is made will be counter productive and hinder the County's ability to effectively support the independent contractor community.

The County has enjoyed a long and productive relationship with the Economic Development Administration. One important reason that the County enjoys this relationship is due to the fact that each grant has been managed according to EDA requirements. This grant is no different. We hope that the information supplied in this response is sufficient to address your concerns with the County's ability to properly manage this, and all, EDA grants that it receives. If you need additional information, please contact Mary Claypool or Darby Marshall at (831) 755-5065.

Sincerely,

James Colangelo
Assistant County Administrative Officer – Environmental Resources Policy

Exhibits: Award Special Conditions
RLF Program Summary
CCRDC Draft Cash Handling Policy

cc: A. Leonard Smith, Regional Director
Dianne V. Church, EDR

Attachments to the auditee's response have been withheld from this report.