Report To

The Mississippi Legislature

REVIEW OF THE NORTHEAST MISSISSIPPI PLANNING AND DEVELOPMENT DISTRICT'S REVOLVING LOAN FUND

June 4, 1991

The Northeast Mississippi Planning and Development District (NMPDD) operates a revolving loan fund to promote long-term economic growth by creating jobs and stimulating private investment. The district's credit policies have not been consistent with federal and internal lending regulations or sound banking principles. The district made loans to parties related to district employees and agents by business or marriage, which may violate federal conflict of interest guidelines. NMPDD also has not followed federal grant agreement conditions prohibiting one district employee from association with certain grant programs, thus jeopardizing the district's funding from that federal agency.

The PEER Committee

REVIEW OF THE NORTHEAST MISSISSIPPI PLANNING AND DEVELOPMENT DISTRICT'S REVOLVING LOAN FUND

June 4, 1991

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Mississippi Legislature

PEER: THE MISSISSIPPI LEGISLATURE'S OVERSIGHT AGENCY

The Mississippi Legislature created the Joint Legislative Committee on Performance Evaluation and Expenditure Review (PEER Committee) by statute in 1973. A standing joint committee, the PEER Committee is composed of five members of the House of Representatives appointed by the Speaker and five members of the Senate appointed by the Lieutenant Governor. Appointments are made for four-year terms with one Senator and one Representative appointed from each of the U. S. Congressional Districts. Committee officers are elected by the membership with officers alternating annually between the two houses. All Committee actions by statute require a majority vote of three Representatives and three Senators voting in the affirmative.

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As an integral part of the Legislature, PEER provides a variety of services, including program evaluations, economy and efficiency reviews, financial audits, limited scope evaluations, fiscal notes, special investigations, briefings to individual legislators, testimony, and other governmental research and assistance. The Committee identifies inefficiency or ineffectiveness or a failure to accomplish legislative objectives, and makes recommendations for redefinition, redirection, redistribution and/or restructuring of Mississippi government. As directed by and subject to the prior approval of the PEER Committee, the Committee's professional staff executes audit and evaluation projects obtaining information and developing options for consideration by the Committee. The PEER Committee releases reports to the Legislature, Governor, Lieutenant Governor, and agency examined.

The Committee assigns top priority to written requests from individual legislators and legislative committees. The Committee also considers PEER staff proposals and written requests from state officials and others.

The Mississippi Legislature
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PEER Committee

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June 4, 1991

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At its meeting of June 4, 1991, the PEER Committee authorized release of the report entitled **Review of the Northeast Mississippi Planning and Development District's Revolving Loan Fund.**

Jerry Wilkerson
Representative Jerry Wilkerson, Chairman

This report does not recommend increased funding or additional staff.

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INTRODUCTION

In response to a legislative request, PEER reviewed the Northeast Mississippi Planning and Development District (hereinafter referred to as NMPDD) Revolving Loan Fund to determine whether NMPDD had established and operated the loan fund in accordance with applicable laws, rules, and regulations and sound management principles. Because the legislative request focused on procedural issues, PEER did not assess the program's effectiveness in achieving its stated goals and objectives.

Overview

Concerning NMPDD's compliance with federal and internal lending regulations, sound management principles and conflict of interest guidelines, PEER found that:

- NMPDD did not comply consistently with lending guidelines for advertisement of the loan fund, for regular reporting of delinquent loans, and for requiring borrowers to sign civil rights compliance statements.

- NMPDD did not comply with specific federal regulations for monitoring construction projects and requiring certification of the location of borrowers, or with a grant condition prohibiting one employee from association with Appalachian Regional Commission programs. NMPDD also has not set guidelines for maximum loan amounts for single borrowers, as required by the Economic Development Administration.

- Weaknesses exist in NMPDD's loan fund underwriting and monitoring. NMPDD often fails to research borrowers' repayment histories, an important underwriting step. PEER also found incomplete documentation of loan committee decisions, resulting in internal control weaknesses, and incomplete guidelines for the applications process. NMPDD's procedures for analyzing loans and acquiring and reviewing updated financial statements also need improvement.

- In the area of loan collection, procedures guidelines for handling problem loans are inadequate, NMPDD uses questionable restructuring practices, and poor collateral monitoring decisions have increased loan losses.

- NMPDD has made loans to parties related to NMPDD employees and agents by business or marriage, which may violate federal conflict of interest guidelines.

BACKGROUND

Organization of Northeast Mississippi Planning and Development District

NMPDD was incorporated as a non-profit agency in 1970 to plan and implement programs for economic development of Marshall, Benton, Tippah, Alcorn, Tishomingo, and Prentiss counties.

NMPDD is governed by a twenty-five-member Board of Directors consisting of community leaders from the six counties, including mayors, county supervisors, business people, and minority representatives. The membership of NMPDD's Board of Directors is appointed by each county's board of supervisors, with a maximum of five members from any one county.

The board's Revolving Loan Committee approves all loans and makes other loan fund policy decisions. The Board of Directors annually elects members of the Revolving Loan Committee, one from each county and the board president. Revolving Loan Fund Committee members are generally re-elected every year.

Revolving Loan Fund Organization and Guidelines

The NMPDD Revolving Loan Fund was created in December 1980 with a grant from the Economic Development Administration. The NMPDD revolving loan fund receives most of its funding from two federal agencies—the Economic Development Administration, an agency of the U. S. Department of Commerce, and the Appalachian Regional Commission, an independent agency (hereinafter referred to as EDA and ARC). The purpose of the federal loan funds is to promote long-term economic growth in areas with high unemployment rates and low per capita income. The increase in capital to the area creates jobs and stimulates private investment, therefore boosting economic development activity.

Description of Loan Portfolio

The loan portfolio as of September 30, 1990, consisted of forty-eight loans. NMPDD borrowers include furniture manufacturing businesses; an auto parts distributor; metal plating, power transmission and other manufacturers; and a recycling company. NMPDD claims to have created 1,608 jobs and saved 262 jobs in the six-county area by lending funds. The district's goal is to require that at least one job be created for every $5,000 loaned. According to NMPDD, it has created one job for every $2,547 loaned during the ten-year history of the program.

COMPLIANCE WITH FEDERAL LENDING REGULATIONS AND GRANT TERMS

PEER measured a sample of NMPDD loans for compliance and found that NMPDD failed to follow specific federal guidelines and the Revolving Loan Fund Plan (hereinafter referred to as the RLF Plan) in the areas of loan fund publicity, maximum loan amounts, delinquent loan reporting, civil rights compliance statements, monitoring of construction projects, certification of non-relocation, and loan fund employment.

NMPDD has not complied with RLF Plan requirements that loan fund advertisements be placed in all local newspapers yearly. Because NMPDD lacks an adequate plan to publicize its loan fund, some eligible borrowers may be unaware of the program, and therefore, do not have an equal chance of obtaining an NMPDD loan.

In its marketing plan, NMPDD lists four methods of publicity: word-of-mouth referrals, mailing information to interested parties, newspaper advertisements, and presentations in workshops sponsored by state and local agencies. In practice, NMPDD uses the primarily reactive methods of responding to outside referrals—word-of-mouth referrals and mailouts sent in response to outside requests. The word-of-mouth method of publicity favors those individuals already familiar with NMPDD board members and county development groups. The district rarely uses the pro-active marketing methods of newspaper advertising and workshop presentations to announce loan availability. The RLF Plan states that NMPDD will place an annual notice about the loan program in all local newspapers, but publicity appeared in only two of eight local newspapers in the NMPDD area from September 1989 through 1990. Articles or announcements about NMPDD generally have not appeared in newspapers more than once a year. The district could not provide a record of any workshops attended.

NMPDD has not established a maximum loan amount which can be loaned to a single borrower, as required by EDA.

One EDA requirement is that NMPDD set a maximum amount of RLF funds that can be loaned to a single borrower. Although NMPDD has set a maximum dollar amount per loan, the RLF Plan does not include a maximum amount which can be loaned to a single borrower. NMPDD has granted several borrowers more than one loan. At September 30, 1990, NMPDD had multiple loans outstanding to five borrowers.

NMPDD did not report all delinquent loans regularly at committee meetings as required by the RLF Plan.

According to NMPDD's internal guidelines, the district is required to report delinquent loans at each monthly Revolving Loan Fund Committee meeting. PEER reviewed committee minutes for a two-year period from August 31, 1988, to October 1, 1990. According to the minutes, NMPDD staff did not present monthly reports on the comprehensive list of delinquent loans as required by the RLF Plan Procedures Manual. According to the minutes, the committee discussed delinquent loans comprehensively at only four of twenty-three meetings during the two-year period.

NMPDD has not obtained civil rights compliance statements from borrowers on a consistent basis as required by the RLF Plan.

Federal guidelines for revolving loan funds require that NMPDD have a plan for insuring that borrowers do not discriminate against their employees on the basis of race, color, national origin, religion, age, handicap or sex. The NMPDD RLF Plan requires that borrowers sign a statement of compliance with all state and federal laws and regulations relative to civil rights. However, NMPDD has not consistently required its borrowers to certify their compliance with these laws. PEER reviewed twelve loan files for compliance; four of the twelve files did not contain a statement of compliance with civil rights laws.

NMPDD has not monitored loan recipient compliance with federal regulations governing handicapped access and wage rates which apply to funding of construction projects.

Economic Development Administration guidelines state that *"if an RLF finances a construction project to which the public will have access, the grantee must insure that accessibility to the handicapped is provided."* EDA guidelines also state that *"construction financed in whole or in part by the RLF must meet the requirements of the Davis-Bacon Act."* The Davis-Bacon Act requires that contractors on federally-funded projects pay their construction employees the prevailing wage rates set by the Secretary of Labor. After reviewing thirteen loan files, PEER found that NMPDD had not monitored for these federal requirements. NMPDD also violated its internal RLF Plan, which states that facilities constructed with RLF funds *"will be inspected for accessibility* [for the handicapped] *before closing."*

NMPDD has not complied consistently with federal regulations requiring borrower certification that loan projects will not be relocated.

EDA requires that loans cannot be made to borrowers which relocate project activities away from the geographic area of the planning district or which relocate jobs from one labor area to another. These regulations help insure that loan funds disbursed will be for economic development activities within the planning district area. The regulations require grantees such as NMPDD to obtain assurance from loan applicants that loan applicants will comply with EDA non-relocation regulations.

PEER reviewed thirteen NMPDD loans for compliance with EDA's non-relocation regulations. Eight of the thirteen loans were subject to the EDA non-relocation regulations. Six of the eight files reviewed did not contain a statement from the borrower that the borrower would comply with EDA non-relocation regulations.

NMPDD has not followed Appalachian Regional Commission grant agreement conditions prohibiting one NMPDD employee from association with ARC programs.

NMPDD's grant agreement with ARC includes special terms which NMPDD is expected to follow as a condition of receiving grant funds. During a review of NMPDD loan files, PEER found that NMPDD does not comply with a special condition of its grant agreement which prohibits an NMPDD employee, Sadie Hardin, from being associated with ARC programs. This prohibition resulted from the NMPDD employee's association with ARC funds during a period when Charles Spearman, a prior NMPDD Executive Director, was under investigation for mishandling of funds. A 1983 ARC audit disclosing fraud and embezzlement at NMPDD was referred to the Department of Justice. This led to the conviction of Mr. Spearman for mail fraud.

Ms. Hardin is employed as the loan administrator for EDA loans. Another individual is employed by NMPDD to administer ARC loans. Their duties include recording loan payments, mailing delinquency and insurance notices, and monitoring the loans. In some instances, the EDA coordinator is associated with ARC funds in violation of the ARC grant. In a review of seven loans funded with ARC grant funds, PEER found documentation in three of seven files that the named employee was involved in loan servicing or monitoring of ARC loans in certain instances. The ARC official responsible for loan programs confirmed to PEER that if the employee under prohibition is in any way involved with ARC loan programs, then the grant condition has been violated.

Recommendations

1. NMPDD should develop and implement a proactive plan for advertising to the business community, including regular newspaper advertising, yearly presentations in each county, and a contingency plan for more frequent advertising when funds become available.

2. NMPDD should set guidelines for a maximum loan amount to single borrowers, ask EDA to approve the new guidelines, and include the new guidelines in the RLF Plan.

3. NMPDD should follow consistently its monitoring procedures for delinquent loans.

4. NMPDD should revise its procedures manual to include actions the district will take when a borrower is past due.

5. NMPDD should tighten its controls and follow underwriting guidelines consistently. NMPDD could implement a system of checks and balances in which a district employee is responsible for obtaining all items listed on a checklist of required documents for each loan funded and a second district employee is responsible to see that the first employee properly fulfills these duties.

6. NMPDD should monitor for compliance of access to the handicapped regulations and Davis-Bacon laws, and require compliance and documentation as a condition of the loan.

7. NMPDD should obtain relocation statements for all loan applicants prior to funding in order to comply with the EDA regulations, and should obtain annual certification that borrowers have not relocated.

8. As part of semi-annual monitoring visits, NMPDD should observe workers at borrower locations to determine whether borrowers have relocated jobs.

9. NMPDD should rearrange its organizational structure so that the EDA loan fund coordinator is no longer responsible for administering or monitoring loans either partially or wholly funded by ARC grants.

EVALUATION OF LOAN FUND OPERATIONS IN ACCORDANCE WITH SOUND MANAGEMENT PRINCIPLES

PEER reviewed a sample of NMPDD loans and practices in regard to the loan fund. Management of the loan fund could be improved in the areas of loan underwriting and monitoring and loan collections.

NMPDD does not follow consistently the prudent lending practice of researching a potential borrower's repayment history.

The ARC requires that NMPDD obtain credit history information on loans funded with original ARC grant monies. NMPDD must certify to the ARC that the credit verifications have been obtained and are on file. Although no federal guidelines require that lenders obtain credit history reports when underwriting all loans, it is apparent that ARC places importance on obtaining credit history information. In PEER's review of NMPDD loan files for compliance, ten of thirteen files did not contain appropriate repayment history information on the borrower. For one particular loan, the NMPDD had certified to the ARC that a credit report or credit verification had been obtained when in fact no such credit report was on file.

NMPDD lacks a proper method for documenting the decisions of the Revolving Loan Fund Committee, resulting in a lack of control over staff implementation of committee decisions.

NMPDD's loan approval authority is vested in the Revolving Loan Committee, consisting of seven NMPDD board members. The NMPDD staff is responsible for implementing the decisions of the RLF Committee and booking the loans approved. However, NMPDD lacks documentation of some important loan decisions which the committee makes, resulting in a lack of internal control for insuring implementation of committee decisions.

The minutes contain only limited information regarding the way loans are to be booked; in most instances, the minutes include only the amounts, number of years to maturity, and interest rates. The minutes do not provide information such as description of the collateral to be acquired, value of the collateral, and names of individuals providing personal guarantees.

NMPDD's applications process lacks safeguards for insuring that the district gives all applications equal consideration.

NMPDD often has a waiting list of applicants. Because limited funds are available to be distributed to applicants, NMPDD must make judgements on which applications to approve. The NMPDD Revolving Loan Fund Committee meets regularly to discuss the applications and make lending decisions. However, NMPDD does not have guidelines to address the order in which the applications should be processed and reviewed and the procedures NMPDD should follow when applications exceed available funding.

NMPDD has not executed a formal, written agreement with the consultant who reviews potential NMPDD borrowers. As a result, the district pays for an incomplete work product which could result in a lack of uniformity in loan underwriting.

NMPDD uses a financial consultant, Willis D. Lindsey, CPA, to review the financial statements of borrowers who apply for NMPDD loans. The Revolving Loan Fund Committee considers the consultant's recommendations when making loan decisions. However, the district has not executed a formal, written contract specifying what is to be included in the consultant's final work product; the consultant's reports are deficient in several areas.

NMPDD's procedures for acquiring and reviewing borrowers' updated financial statements are inadequate.

In a compliance review of thirteen NMPDD loan files, eight of the thirteen files contained no updated financial statements. NMPDD's procedures to acquire updated financial statements are ineffective and the agency has no procedure in place to review financial statements when they are received.

NMPDD has not implemented adequate procedures and guidelines for handling problem loans, resulting in questionable collection practices.

NMPDD has not developed adequate guidelines to outline proper loan collection procedures and, as a result, has used some procedures which are not in the best interest of the loan fund. The district's procedures manual does not include procedures for restructuring loans or for handling delinquent loans over fifteen days, and the district has not followed its guidelines for foreclosure.

NMPDD uses questionable loan restructuring practices which conflict with recommendations of the Chief of the Economic Adjustment Division for EDA.

Both EDA and ARC guidelines allow restructuring of loans, but federal officials recommend that lenders not defer interest payments until the end of the loan. NMPDD frequently allows borrowers to suspend payments for several months when the borrowers have payment problems, deferring both the suspended principal and interest payments to the end of the note. The district has deferred principal and interest payments on thirteen of forty-eight loans in the portfolio of currently outstanding loans. NMPDD's deferral of interest payments results in its administrative costs as a percentage of loan fund program income being higher than federal and internal standards, with NMPDD loan fund administrative costs at 65 percent of program income for the twelve-month period ending September 30, 1990, according to an unaudited report to EDA.

NMPDD's series of collateral and loan monitoring mistakes contributed to an estimated loan loss of $216,773 in the revolving loan portfolio.

Weaknesses in NMPDD's collateral and loan monitoring have led to unnecessary losses in the portfolio. NMPDD made mistakes in assuring that its collateral was properly documented and protected. The district could have acted more aggressively in pursuing guarantors in a more timely manner, and in reporting missing collateral to authorities sooner; NMPDD has also waited extended periods before foreclosing on collateral. These mistakes contributed to a total of $216,773 in estimated losses as of December 1990.

Recommendations

1. NMPDD should acquire current repayment history information for every potential borrower so that the Revolving Loan Fund Committee may make more informed loan decisions.

2. NMPDD should develop a policy which gives a staff member or contractual employee responsibility for obtaining credit repayment history information on borrowers, and the policy should outline what type of credit payment histories will be acceptable.

3. NMPDD should take seriously federal grantors' requests for certification that loan documents have been obtained.

4. NMPDD should document the final terms of all loans agreed upon by the loan committee and include a detailed collateral description, names of guarantors, number of jobs to be created, and amount of capital contributed by other sources. Committee minutes could include documentation of the loan, or NMPDD could prepare separate loan approval documents for the loan files.

5. NMPDD should develop detailed guidelines for processing loan applications which would address the order in which applications should be listed and evaluated, ranking of applicants, detailed file notes, and conditions for reconsideration of loans.

6. NMPDD management should develop a detailed, comprehensive list of items required in the financial analysis of borrowers. This would include analyses of the borrower's cash flow, ability to service debt, financial position, collateral, and feasibility of cash flow statements; the guarantor's strength and financial position; borrower and guarantor credit histories; and a recommendation of whether the loan should be made, with an explanation of the recommendation.

7. NMPDD should detail the duties required of its financial consultant in a formal, written agreement, including a description of the final work product.

8. NMPDD should require its borrowers to submit updated financial statements yearly as a condition of the loan and the district should review these financial statements as part of its loan monitoring process.

9. NMPDD should implement guidelines describing actions to be taken when a borrower's financial condition shows serious deterioration.

10. NMPDD should evaluate both its actual practices for handling problem borrowers and its internal procedures to determine their effectiveness and their practicality. NMPDD should revise the procedures to include all acceptable collection practices. The revised guidelines should outline procedures for monitoring delinquent loans, alternatives to immediate foreclosure on loans and allowable methods of restructuring loans.

11. NMPDD should discontinue its practice of deferring interest payments to the end of the note as a method of restructuring loans.

12. NMPDD should set up a detailed collateral checklist and implement an internal system for reviewing loan collateral against the internal checklist.

13. NMPDD's decisionmaking process should include estimating whether the possibility of recovering the entire loan amount in a foreclosure sale is greater than the amount to be recovered from restructuring the loan. In the future, NMPDD should give greater weight to options which will protect the loan fund portfolio.

COMPLIANCE WITH CONFLICT OF INTEREST GUIDELINES

During its review of the NMPDD revolving loan fund, the PEER Committee found that NMPDD had made loans to related parties. PEER sought to determine if these loans to related parties were in violation of federal and internal guidelines and what deficiencies in the loan approval process allowed these loans to be made.

NMPDD made loans to related parties which may violate federal conflict of interest guidelines. The problem resulted from federal officials' lenient interpretations of federal guidelines and the lack of a management plan to identify potential conflicts.

ARC and EDA guidelines state that NMPDD is prohibited from lending to entities which are owned by NMPDD employees, officers and board members. The guidelines also prohibit lending to borrowers who are related to NMPDD employees, officers or board members by blood, marriage, law, or business relationship.

NMPDD's internal policy implemented in March 1989 states that *"loans to officers or employees"* of the NMPDD, or *"any member of the loan administrative board or anyone who reviews, approves, or participates"* in loan decisions *"shall be prohibited."* In addition, loans which benefit these individuals or persons related to them by blood, marriage, or law are prohibited. The internal guidelines do not define *"relationship."* However, the NMPDD Executive

Director defines *"relatives by blood or marriage"* to mean spouse, child or parent, based on MISS. CODE ANN. Section 25-4-103.

However, NMPDD has made the following loans to related parties which appear to violate federal guidelines:

- The district made an ARC-funded loan to a brother-in-law of an NMPDD employee involved in the loan program.

- NMPDD made an EDA-funded loan to a company partially owned by Thomas Keenum, an attorney who provided advisory services to NMPDD.

- The financial consultant employed by NMPDD, Willis D. Lindsey, CPA, conducted financial reviews of borrowers for which the consultant also performed monthly accounting work.

Other potential conflict of interest situations exist which do not appear to violate federal laws.

NMPDD's conflict of interest situations result from federal officials' lenient interpretation of federal guidelines, as well as the district's lack of a comprehensive management plan to identify potential conflicts of interest. Regardless of the guidelines which have been set by federal grantor agencies, lending to related parties by public entities is bad policy. Officials lending the money could be tempted to soften loan underwriting guidelines for relatives or to be more lenient in collecting problem loans from relatives. Because lending includes an element of subjective decisionmaking, loans to related parties could lead to charges of favoritism even when loans have been made on equal terms.

Despite the federal government's liberal interpretation of its own guidelines, NMPDD should have specifically defined "conflict of interest" and then followed its own guidelines.

Recommendations

1. NMPDD should develop internal guidelines for polling the district's representatives (board, staff, committee members and contractual employees) to determine whether they are related to NMPDD loan applicants. Prior to loan approval, NMPDD representatives should review lists of potential applicants for possible conflicts of interest. In instances of relationships by business, blood, marriage or law between NMPDD representatives and loan applicants, NMPDD should outline for the public record:

   - the exact relationship between the NMPDD representative and the applicant, and

   - a detailed explanation of the Revolving Loan Fund Committee's determination that no conflict of interest exists.

2. When relationships exist between NMPDD representatives and loan applicants, NMPDD should seek legal opinions regarding whether conflicts of interest exist.

3. The PEER Committee will refer information on potential conflict of interest loans to the Economic Development Administration and the Appalachian Regional Commission.

For More Information or Clarification, Contact:

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REVIEW OF THE NORTHEAST MISSISSIPPI PLANNING AND DEVELOPMENT DISTRICT'S REVOLVING LOAN FUND

INTRODUCTION

Authority

The PEER Committee authorized this review at its April 26, 1990, meeting in response to a legislative request. The Committee conducted the review pursuant to MISS. CODE ANN. Sections 5-3-51 and 5-3-57.

Scope and Purpose

PEER reviewed the Northeast Mississippi Planning and Development District (hereinafter referred to as NMPDD) revolving loan fund to determine whether NMPDD had established and operated the loan fund in accordance with applicable laws, rules, and regulations and sound management principles. Because the legislative request focused on procedural issues, PEER did not assess the program's effectiveness in achieving its stated goals and objectives, but did include a brief discussion of unaudited effectiveness data as provided by NMPDD in the background section of this report.

The report also includes sections evaluating the agency's compliance with federal and internal lending regulations, sound management principles, and conflict of interest guidelines.

Methodology

In conducting this review, PEER:

- reviewed Appalachian Regional Commission (ARC) and Economic Development Administration (EDA) grant terms and conditions;
- analyzed ARC and EDA revolving loan fund guidelines;
- analyzed NMPDD internal revolving loan fund guidelines and procedures;
- interviewed NMPDD staff members, auditor, and board members and ARC and EDA officials;
- surveyed NMPDD staff members, board members and contractual employees and county development association officials; and,
- reviewed a sample of NMPDD loan files for approval and collection procedures.

Overview

Concerning NMPDD's compliance with federal and internal lending regulations, sound management principles and conflict of interest guidelines, PEER found that:

- NMPDD did not consistently comply with lending guidelines for advertisement of the loan fund, for regular reporting of delinquent loans, and for requiring borrowers to sign civil rights compliance statements.

- NMPDD did not comply with specific federal regulations for monitoring construction projects and requiring certification of the location of borrowers, or with a grant condition prohibiting one employee from association with ARC programs. NMPDD also has not set guidelines for maximum loan amounts for single borrowers, as required by the Economic Development Administration.

- Weaknesses exist in NMPDD's loan fund underwriting and monitoring. NMPDD often fails to research borrowers' repayment histories, an important underwriting step. PEER also found incomplete documentation of loan committee decisions, resulting in internal control weaknesses, and incomplete guidelines for the applications process. NMPDD's procedures for analyzing loans and acquiring and reviewing updated financial statements also need improvement.

- In the area of loan collection, procedures guidelines for handling problem loans are inadequate, NMPDD uses questionable restructuring practices, and poor collateral monitoring decisions have increased loan losses.

- NMPDD has made loans to parties related to NMPDD employees and agents by business or marriage, which may violate federal conflict of interest guidelines.

BACKGROUND

Organization of Northeast Mississippi Planning and Development District

NMPDD was incorporated as a non-profit agency in 1970 to plan and implement programs for economic development of Marshall, Benton, Tippah, Alcorn, Tishomingo, and Prentiss counties. The NMPDD district office is located in Booneville, Mississippi. (See Exhibit 1, page 4.) NMPDD is one of ten planning and development districts in the state designated in 1971 by Executive Order No. 81. The development districts were organized so that federal, state, and local development programs could be coordinated effectively. The Mississippi planning districts are not considered to be public agencies due to their nonprofit corporation status.

NMPDD Board Membership

NMPDD is governed by a twenty-five member Board of Directors. The board membership consists of community leaders from the six counties, including mayors, county supervisors, business people, and minority representatives. The membership of NMPDD's Board of Directors is appointed by each county's board of supervisors, with a maximum of five members from any one county.

NMPDD's method of appointment of board members and election of officers is in accordance with the MISS. CODE ANN. Section 79-11-239 for nonprofit corporations. The nonprofit corporation statute does not contain specific rules, but allows for either appointment or election of board members in accordance with the nonprofit corporation's bylaws. The statute also allows for successive terms of election.

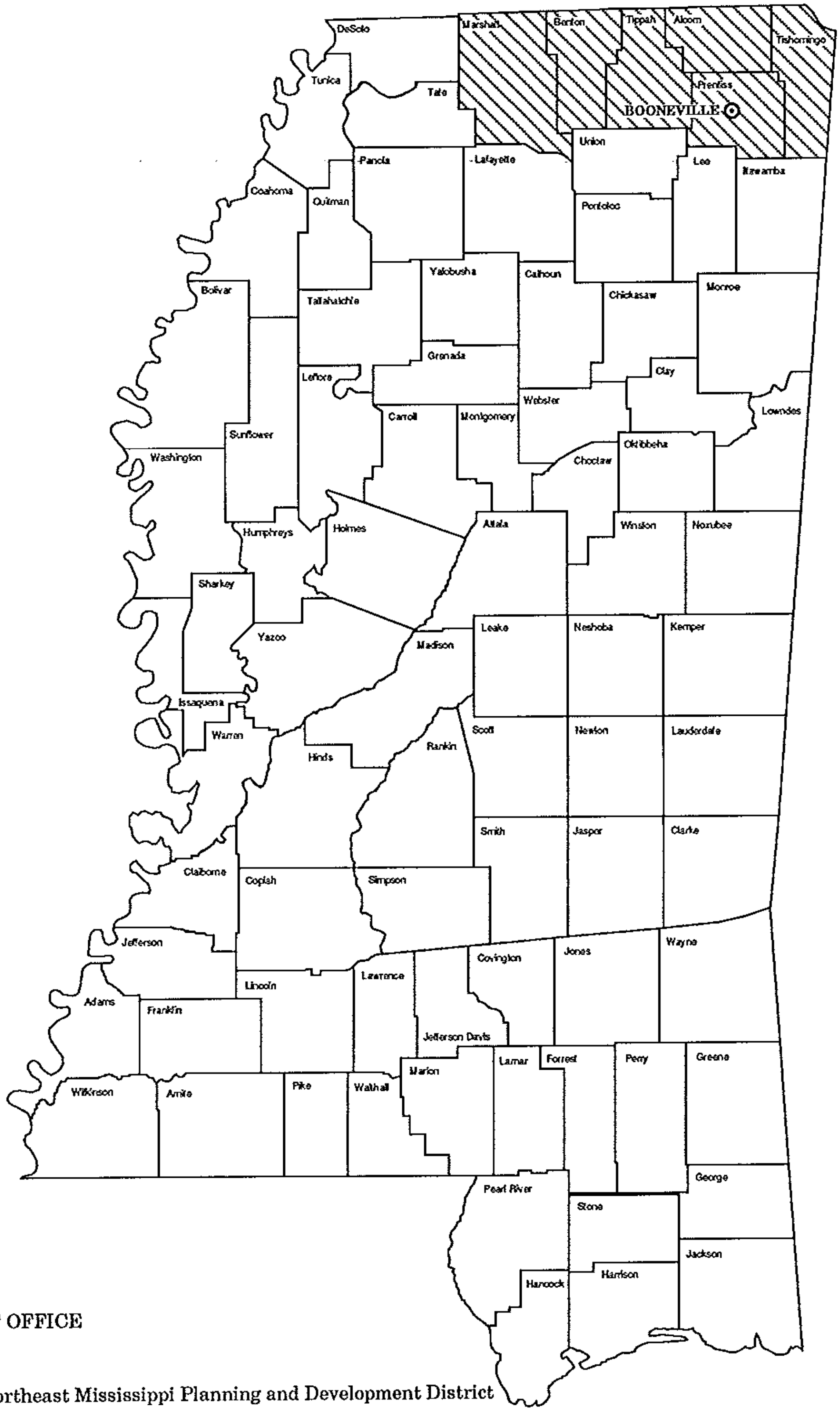
NMPDD Organization Structure

The NMPDD organization is governed by the Board of Directors which has two committees--the Management Committee and the Revolving Loan Fund Committee. The Executive Director is directly responsible to the Board of Directors. The Management Committee assists the Executive Director in management and administrative decisions while the Revolving Loan Committee approves all loans and makes other loan fund policy decisions. The Board of Directors annually elects members of the Revolving Loan Committee, one from each county and the board president. In June 1990 the NMPDD board re-elected the incumbent Revolving Loan Fund Committee members, who are generally re-elected every year.

Exhibit 2, page 5, gives details of NMPDD's organization structure. During PEER's review, NMPDD's staff consisted of fourteen employees,

EXHIBIT 1

NORTHEAST MISSISSIPPI PLANNING AND DEVELOPMENT DISTRICT GEOGRAPHICAL AREA

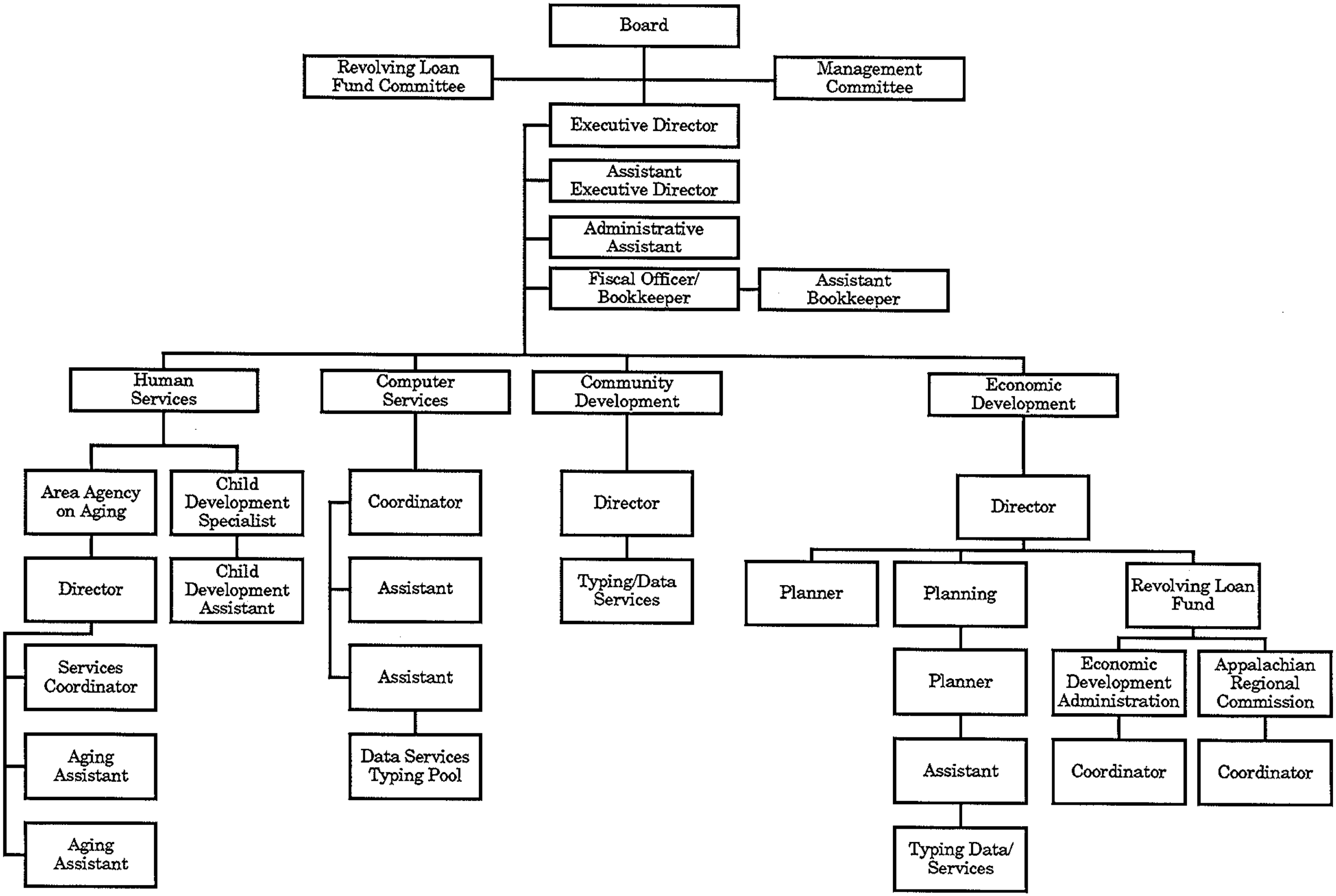


⊙ DISTRICT OFFICE

SOURCE: Northeast Mississippi Planning and Development District

EXHIBIT 2

NORTHEAST MISSISSIPPI PLANNING AND DEVELOPMENT DISTRICT ORGANIZATION CHART



SOURCE: Northeast Mississippi Planning and Development District

some of whom held more than one position included in the organization chart. The NMPDD staff has four divisions: Human Services, Computer Services, Community Development, and Economic Development. The Revolving Loan Fund Program is a part of the Economic Development Division. Five staff members in the organization have significant involvement in the revolving loan fund program, as noted in Appendix A, page 39.

Organization of the NMPDD Revolving Loan Fund

Federal Funding

The NMPDD Revolving Loan Fund was created in December 1980 with a grant from the Economic Development Administration. The NMPDD revolving loan fund receives most of its funding from two federal agencies, the Economic Development Administration, which is an agency of the U. S. Department of Commerce, and the Appalachian Regional Commission, an independent agency (hereinafter referred to as EDA and ARC). EDA and ARC provide grant funds to NMPDD for making revolving loans. As borrowers repay the loans, the money is returned to the revolving loan fund to make other loans. In this manner, the revolving loan fund becomes an ongoing or revolving financial tool.

NMPDD has also received small amounts of funding from Community Development Block Grants pledged by counties in the NMPDD area. The counties required that these funds be loaned to companies in the pledgor counties. Tennessee Valley Authority also provided funds to NMPDD.

In the ten-year period since the fund was created through September 1990, NMPDD received $1,250,000 in funds from EDA and $1,075,000 from ARC. During this period NMPDD also received $183,563 from Community Development Block Grants, $25,000 from the Tennessee Valley Authority (TVA), and $250,000 in TVA in-lieu funds provided by Tishomingo County, for a total of $2,783,563. As of September 30, 1990, NMPDD had $2,847,729 in loans outstanding, which included $64,166 in interest earnings which NMPDD had allocated into the fund. According to an unaudited report to EDA, NMPDD has earned an additional $782,552 on interest from loans and account balances and fees charged since the inception of the loan program. Of this amount, $501,663 has been used to cover administrative expenses, $13,703 has been written off for bad loans, and $267,186 has been earmarked for recently approved loans. See Exhibit 3, page 7, for sources and uses of the Revolving Loan Fund.

EXHIBIT 3

NORTHEAST MISSISSIPPI PLANNING AND DEVELOPMENT DISTRICT REVOLVING LOAN FUND (RLF) SOURCES AND USES DECEMBER 3, 1980, THROUGH SEPTEMBER 30, 1990

Program Income	$846,718	
Used for Administrative Costs	501,663	
		$345,055
Loan Grant Funds Received		$2,783,563
SOURCES OF FUNDS		$3,128,618
Loans Currently Outstanding	$2,847,729	
Funds Earmarked for Recently Approved Loans	267,186	
Loan Write-Offs	13,703	
USES OF FUNDS		$3,128,618
Number of Loans Currently Outstanding	48	

SOURCE: Northeast Mississippi Planning and Development District

Loan Fund Purposes

The purpose of the EDA and ARC loan funds is to promote long-term economic growth in areas with high unemployment rates and low per capita income. The increase in capital to the area creates jobs and stimulates private investment, therefore boosting economic development activity. Some of the funds received from these two federal agencies over the years have been designated for specific purposes, e.g., loans to minorities and females, loans to businesses for the purpose of energy conservation, and loans to Tishomingo County businesses in anticipation of the federal rocket plant expansion.

Because of the relatively small funding from Community Development Block Grants and the Tennessee Valley Authority, PEER did not research the loan fund purposes or any guidelines which may exist for these two entities.

Federal Guidelines

EDA and ARC guidelines require that NMPDD develop its own internal guidelines or Revolving Loan Fund (RLF) Plan. EDA and ARC require that NMPDD abide by its own RLF Plan, by making the RLF Plan a part of the federal grant agreements. ARC patterned its loan fund guidelines after the EDA guidelines. Therefore the guidelines of the two federal agencies are similar in most respects. ARC and EDA guidelines require NMPDD to develop guidelines based on the following criteria:

- Borrowers must create jobs. NMPDD requires that its borrowers create one job for every $5,000 in funding.

- Borrowers must provide private financing for the project in addition to the loan funds. Private financing can include commercial loans or equity investment. On average the ratio of private financing to NMPDD loan funds in the portfolio of loans must be 2:1.

- After July 1989 EDA required that borrowers provide proof that they were not able to obtain financing elsewhere on terms which would permit completion or successful operation of project activities. NMPDD requires that each borrower provide this proof with a letter from one banking institution.

PEER found contradictions in these basic federal guidelines. Borrowers who have access to private financing would conceivably be strong enough to obtain financing at banks. However, NMPDD is able to lend to some borrowers who have private financing at less than a 2:1 ratio, because federal guidelines do not require that each borrower have a private financing ratio of 2:1.

The Revolving Loan Fund is intended to be an alternative to traditional sources of financing. As a result, borrowers are not expected to be as financially strong as bank borrowers. In fact, an ARC official stated that ARC does not judge the administration of loan funds on the default history of its borrowers.

Other Eligibility Criteria

NMPDD management states that NMPDD gives priority to minority and female-owned businesses. The NMPDD guidelines further state that the district will give priority to businesses which will use local goods and services, projects with higher than average wages or growth potential, locally owned projects, and projects with significant export market potential.

Maximum Amount and Term of Loans

The federal grantors allow NMPDD to develop its own guidelines for loan amounts. NMPDD's guidelines are a $100,000 maximum per loan, except if a project involves a new industry start-up, the threatened shutdown of a major employer, or a minimum of 150 jobs. In these situations the maximum loan amount is $200,000. In deciding the loan amount, NMPDD considers the loan amount requested by the borrower, the number of jobs to be created by the borrower (maximum $5,000 per job guideline), and the amount of collateral provided by the borrower.

NMPDD usually grants loans with terms of ten years at 7%. NMPDD guidelines for interest rates, which are in line with federal guidelines, are a maximum of four percentage points below the money center bank prime rate, provided that the rate charged by NMPDD does not fall below 4%. Although prime rates fluctuate over time, NMPDD has been fairly consistent in granting loans at a minimum of 7%. The primary exceptions to the 7% rate floor were several loans made at 5% to companies with ARC energy grant funds. See Exhibit 4, page 10, for a summary of NMPDD's Revolving Loan Fund guidelines.

Description of Loan Portfolio

The loan portfolio as of September 30, 1990, consisted of forty-eight loans. NMPDD borrowers include furniture manufacturing businesses; an auto parts distributor; metal plating, power transmission and other manufacturers; and a recycling company. (See Appendix B, page 40, for a list of loans by name, amount, date, and source of funding.)

EXHIBIT 4

SUMMARY OF NMPDD REVOLVING LOAN FUND GUIDELINES

Loan Amount:	$0-$200,000
Interest Rate	No more than 4% below prime rate, no less than 4%
Term	Standard term of ten years
Collateral	125% collateral value to loan amount
Number of Jobs Created	No more than $5000 in funds per job for the portfolio
Certification Statements	Borrower required to sign: • civil rights form • certification of non-relocation • conflict of interest statement
Documentation	Inspection of construction for access to handicapped; compliance with Davis-Bacon prevailing wage rates; statement from banking institution that financing could not be provided to borrower on terms which would permit completion or successful operation of project activities
Advertising	The district will place an annual notice about the program in all local newspapers.

SOURCE: Northeast Mississippi Planning and Development District.

Program Effectiveness

NMPDD revolving loan fund program effectiveness can be measured by the number of jobs created and saved and the amount of private funds generated in the geographic area. According to NMPDD information provided to EDA at the September 30, 1990, semi-annual reporting date, NMPDD has been effective in creating jobs and generating private investment. This program effectiveness information is provided in Exhibit 5 on page 12. (PEER did not audit the information presented in this exhibit. However, the Office of Inspector General completed an audit dated March 27, 1991, which finds that NMPDD has not accurately reported jobs created and saved.)

NMPDD claims to have created 1,608 jobs and saved 262 jobs in the six-county area by lending funds. NMPDD's goal is to require that at least one job be created for every $5,000 loaned. According to NMPDD, it has created one job for every $2,547 loaned during the ten-year history of the program. Another goal is to lend to projects which generate twice as many private investment dollars as NMPDD loans to businesses. NMPDD figures show a 3.2:1 ratio over the history of the loan program which exceeds NMPDD's private investment leverage goal of 2:1.

EXHIBIT 5

NMPDD PROGRAM EFFECTIVENESS DATA ON JOB CREATION AND CAPITAL FORMATION

	NMPDD Plan	Total Loan Portfolio(a)	Active Loan Portfolio(b)
Number of Jobs Created	n/a	1,608	1,482
Number of Jobs Saved	n/a	262	262
Cost per Job (c)	$5,000	$2,547	$1,998
Private Leverage Ratio (d)	2:1	3.2:1	3.7:1
Loans Made in the NMPDD Area	100%	100%	100%

NOTE: PEER did not audit the information presented in this chart. However, the Office of Inspector General completed an audit dated March 27, 1991, which finds that NMPDD has not accurately reported jobs created and saved.

SOURCE: *Semiannual Report for EDA-Funded RLF Grants*, September 30, 1990.

(a) Based on loans made since origination of NMPDD loan program
(b) Based on original loan amounts of loans currently outstanding
(c) Loan funds distributed divided by the number of jobs created
(d) Amount of private financing generated by the NMPDD-funded projects divided by the amount of the NMPDD loans.

COMPLIANCE WITH FEDERAL LENDING REGULATIONS AND GRANT TERMS

As noted on page 8, the federal grantors have developed guidelines which loan fund operators must follow in order to use federal funds for loans. NMPDD's internal guidelines (the Revolving Loan Fund Plan) also become part of the federal grant agreement. In addition NMPDD must follow specific grant conditions provided by federal grantors. Failure to follow these guidelines and conditions could possibly lead to suspension of federal grants.

PEER measured a sample of NMPDD loans for compliance and found that NMPDD failed to follow specific federal guidelines and the Revolving Loan Fund Plan (hereinafter referred to as the RLF Plan) in several areas.

Loan Fund Publicity

NMPDD has not complied with RLF Plan requirements that loan fund advertisements be placed in all local newspapers yearly. Because NMPDD lacks an adequate plan to publicize its loan fund, some eligible borrowers may be unaware of the program, and therefore, do not have an equal chance of obtaining an NMPDD loan.

The Economic Development Administration, a federal grantor agency, outlines in the Revolving Loan Fund guidelines some acceptable methods for identifying potential borrowers. These methods include distribution of materials to financial intermediaries and business professionals, direct mailings to selected businesses, and presentations to local business associations. In its marketing plan, NMPDD lists four methods of publicity: word-of-mouth referrals, mailing information to interested parties, newspaper advertisements, and presentations in workshops sponsored by state and local agencies.

Word-of-mouth referrals and mailouts sent in response to outside requests are reactive methods of publicity. In practice, NMPDD uses primarily reactive methods of responding to outside referrals. According to NMPDD, local officials, NMPDD board members, county development groups, bankers, and state agencies are responsible for referring a large proportion of the loan applicants to the NMPDD.

Newspaper advertisements and workshop presentations are pro-active methods of marketing, which NMPDD apparently rarely uses to announce loan availability. The RLF Plan states that NMPDD will place an annual notice about the loan program in all local newspapers, but publicity appeared in only two of eight local newspapers in the NMPDD area from September 1989 through 1990. Articles or announcements about NMPDD generally have not appeared in newspapers more than once a year. During the last five years, exceptions occurred in 1988 and 1990, when two items of publicity appeared. However, these articles all announced loan funds targeted to specific potential borrowers, such as minorities and Tishomingo County businesses.

In addition to grants made for specific target loan recipients, other funds are available to be loaned. As NMPDD loans are paid off and funneled back into the revolving loan fund, these funds are available for loans for general job creation purposes in the six-county area. However, NMPDD has never bought newspaper advertisements announcing its loan funds which were not restricted to target groups nor has it secured any newspaper articles since 1987 regarding funds not restricted to target groups.

NMPDD claims to have given presentations concerning loan availability and guidelines in workshops. But because the district could not provide a record of any workshops attended, PEER concludes that NMPDD rarely uses this publicity method. In addition, NMPDD has discussed the loan program on occasion at public meetings such as board of supervisors and town council meetings. However, NMPDD has no plan for this method of advertisement to be conducted on a regular basis uniformly throughout the six-county area.

NMPDD uses primarily reactive methods of responding to outside referrals. The district does not have a pro-active plan for publicizing directly to those business owners who might use NMPDD's pool of loan funds not restricted to target groups. The word-of-mouth method of publicity favors those individuals familiar with NMPDD Board members and county development groups. Individuals who are not familiar with these channels of communication may be unaware of the loan fund.

The district has not developed a more pro-active marketing program largely because it has an ample number of loan applicants resulting from word-of-mouth referrals. NMPDD staff holds that advertising to the general public is not a well-directed way to publicize because general publicity results in NMPDD having to turn people away.

Without a management plan to insure that the loan fund is publicized in the business community in each of the six counties on a regular basis, there is no assurance that all sectors of the business community can become aware of the loan fund. As a result, NMPDD could appear to show favoritism to those aware of the program through inside channels.

Maximum Loan Amounts

NMPDD has not established a maximum loan amount which can be loaned to a single borrower, as required by EDA.

One EDA requirement is that NMPDD set a maximum amount of RLF funds that can be loaned to a single borrower. Although NMPDD has set a maximum dollar amount per loan (see page 9), the RLF Plan does not include a maximum amount which can be loaned to a single borrower. NMPDD has granted several borrowers more than one loan. At September 30, 1990, NMPDD had multiple loans outstanding to five borrowers, three of which have received funds totaling between $100,000 and $200,000.

The lack of guidelines in this area results from poor management control in setting internal loan policy and in insuring that the district follows all federal guidelines. In addition, EDA officials have not enforced the EDA rule that these guidelines be set.

Lending entities develop guidelines on maximum loan size to safeguard loan portfolios. If an extra large loan in comparison to the total portfolio is written off, the financial strength of the loan portfolio is jeopardized. Although NMPDD has not loaned any one borrower an excessive amount of total funds, NMPDD's lack of guidelines could allow this to happen.

Delinquent Loan Reporting

NMPDD did not report all delinquent loans regularly at committee meetings as required by the RLF Plan.

According to NMPDD's internal guidelines, NMPDD is required to report delinquent loans at each monthly Revolving Loan Fund Committee meeting. NMPDD has not reported regularly on all delinquent loans at RLF meetings as required by these guidelines.

PEER reviewed committee minutes for a two-year period from August 31, 1988, to October 1, 1990. According to the minutes, NMPDD staff did not present monthly reports on the comprehensive list of delinquent loans as required by the RLF Plan Procedures Manual. According to the minutes, the committee discussed delinquent loans comprehensively at only four of twenty-three meetings during the two-year period. NMPDD reported only on selected delinquent loans during other committee meetings. (In apparent response to PEER's review, NMPDD management began regularly presenting comprehensive delinquent loan lists to the Revolving Loan Committee beginning in December 1990.)

Federal guidelines require that NMPDD establish procedures for monitoring and servicing RLF loans. The district's internal procedures state that NMPDD staff "*will report to Committee on all delinquent loans at* *each meeting.*" But as a result of poor management planning, the NMPDD staff did not follow the RLF Plan procedures manual.

NMPDD's non-compliance with internal monitoring guidelines resulted in a violation of the grant agreement between federal grantors and NMPDD. Failure to comply with the terms of the grant is cause for termination of the grant and possible recovery of grant funds.

Civil Rights Compliance Statements

NMPDD has not obtained civil rights compliance statements from borrowers on a consistent basis as required by the RLF Plan.

Federal guidelines for revolving loan funds require that NMPDD have a plan for insuring that borrowers do not discriminate against their employees on the basis of race, color, national origin, religion, age, handicap or sex. The NMPDD RLF Plan requires that borrowers sign a statement of compliance with all state and federal laws and regulations relative to civil rights. However, NMPDD has not consistently required its borrowers to certify their compliance with these laws. PEER reviewed twelve loan files for compliance; four of the twelve files did not contain a statement of compliance with civil rights laws.

NMPDD's inconsistency in obtaining civil rights statements could be due to lack of management control in implementing underwriting requirements. In response to PEER's review of NMPDD files and citations of non-compliance, NMPDD contacted borrowers in December 1990 to obtain civil rights statements in an effort to comply with the regulations. According to the NMPDD Executive Director, statements are now in file for all outstanding loans. PEER has not audited the loan files for these recently obtained civil rights statements.

In defense of its practices, NMPDD management stated that the district explains federal and NMPDD guidelines to borrowers before funding. Nevertheless, NMPDD guidelines require written statements of compliance. In addition, if the district does not require borrowers to certify compliance in writing, there is a risk that the borrowers will not fully understand the guidelines or that they will not be informed of guidelines through oversight on the part of NMPDD personnel.

Monitoring of Construction Projects

NMPDD has not monitored loan recipient compliance with federal regulations. These regulations govern handicapped access and wage rates which apply to funding of construction projects.

According to federal guidelines, NMPDD must assure that federally-funded construction projects provide access to the handicapped. In addition, NMPDD must monitor contractors on these projects for compliance with prevailing wage rate requirements.

After reviewing thirteen loan files, PEER found that NMPDD had not monitored for these federal requirements. Economic Development Administration guidelines state that "*if an RLF finances a construction project to which the public will have access, the grantee must insure that accessibility to the handicapped is provided.*" EDA guidelines also state that "*construction financed in whole or in part by the RLF must meet the requirements of the Davis-Bacon Act.*" The Davis-Bacon Act requires that contractors on federally-funded projects pay their construction employees the prevailing wage rates set by the Secretary of Labor.

NMPDD also violated its internal RLF Plan, which states that facilities constructed with RLF funds "*will be inspected for accessibility* [for the handicapped] *before closing.*" NMPDD's internal guidelines also state that NMPDD "*will work with the applicant and the construction company to document Davis-Bacon compliance.*"

NMPDD lacks a management plan for monitoring these federal regulations. According to NMPDD management, federal funding agencies have not audited for these requirements. As a result of the lack of federal oversight and the draws on NMPDD staff time which would be required, NMPDD has not considered the monitoring as a priority.

Non-compliance with these federal requirements could result in the construction of projects which are inaccessible to the handicapped and which have been built by labor paid below the prevailing wage rates, thus undermining the federal government's intent to protect the handicapped and hourly paid workers.

Certification of Non-Relocation

NMPDD has not complied consistently with federal regulations requiring borrower certification that loan projects will not be relocated.

Beginning in April 1983, the Economic Development Administration implemented specific regulations regarding the location of financed activities. EDA requires that loans cannot be made to borrowers which relocate project activities away from the geographical area of the planning district or which relocate jobs from one labor area to another. The regulations require grantees such as NMPDD to obtain assurance from loan applicants that loan applicants will comply with EDA non-relocation regulations.

These regulations help insure that loan funds disbursed will be for economic development activities within the geographical planning district area. NMPDD requires that borrowers sign a certification statement that they will not violate the non-relocation regulations.

PEER reviewed thirteen NMPDD loans for compliance with EDA's non-relocation regulations. Eight of the thirteen loans were EDA loans funded after April 1983 and were therefore subject to the EDA non-relocation regulations. Six of the eight files reviewed did not contain a statement from the borrower that the borrower would comply with EDA non-relocation regulations.

NMPDD has failed to monitor for non-relocation because, according to NMPDD management, federal funding agencies have not audited for these requirements. As a result, NMPDD has not considered this monitoring as a priority. However, NMPDD's non-compliance with the EDA regulations could result in the loaning of federal funds to non-eligible borrowers.

In response to PEER's review of loan files and citations of non-compliance, NMPDD contacted borrowers in December 1990 to obtain non-relocation statements in an effort to comply with the regulations. According to the NMPDD Executive Director, statements are now in file for all outstanding loans. PEER has not audited the loan files for the recently obtained non-relocation statements.

Loan Fund Employment

NMPDD has not followed Appalachian Regional Commission grant agreement conditions prohibiting one NMPDD employee from association with ARC programs.

NMPDD's grant agreement with ARC includes special terms which NMPDD is expected to follow as a condition of receiving the grant funds. During a review of NMPDD loan files, PEER found that the NMPDD does not comply with a special condition of its grant agreement which prohibits an NMPDD employee, Sadie Hardin, from being associated with ARC programs.

The ARC Grant states that Ms. Hardin (now serving as the EDA loan coordinator) "*shall not participate directly or indirectly in any recommendations, judgements, decisions or actions, or in any other manner be associated with the administration or operation of any ARC* *funded program nor shall* [the employee] *have any supervisory authority over those who administer ARC grant funds.*" This prohibition resulted from the NMPDD employee's association with ARC funds during a period when a prior NMPDD Executive Director, Charles Spearman, was under investigation for mishandling of funds. A 1983 ARC audit disclosing fraud and embezzlement at NMPDD was referred to the Department of Justice. This led to the conviction of Mr. Spearman for mail fraud.

As noted in Appendix A, page 39, NMPDD employs two coordinators to administer loans. Ms. Hardin is employed as the loan administrator for EDA loans. Another individual is employed by NMPDD to administer ARC loans. Their duties include recording loan payments, mailing delinquency and insurance notices, and monitoring the loans. In some instances, the EDA coordinator is associated with ARC funds in violation of the ARC grant. For instance, the loan coordinators are responsible for monitoring NMPDD borrowers to determine how many individuals they employ. The EDA coordinator has monitored loans jointly-funded by EDA and ARC. In a review of seven loans funded with ARC grant funds, PEER found documentation in three of seven files that Ms. Hardin was involved in loan servicing or monitoring of ARC loans in certain instances. Ken Shepard, ARC Finance Director, who is in charge of ARC loan programs, confirmed to PEER that if the employee under prohibition is in any way involved with ARC loan programs, then the grant condition is in violation.

NMPDD management failed to exercise proper judgement in allowing the EDA coordinator to administer loans funded with ARC grant monies. During the period of review, PEER was not able to determine how much of Ms. Hardin's time was spent in administering ARC loans in proportion to total hours worked. Regardless of the time spent, involvement in any way with ARC loans is a violation of the ARC grant. As a result, failure to comply could be used by ARC as a basis to suspend or terminate the grant agreement. When grants are terminated for cause, ARC has the right to recover grant funds.

Recommendations

1. NMPDD should develop and implement a pro-active plan for advertising to the business community. This could include:

   - advertising in all eight newspapers in the six-county area on at least a yearly basis to describe the revolving loan fund. Loan restrictions could be included in the advertisements to discourage unqualified applicants.

   - making a yearly presentation in each county at an event sponsored by NMPDD or a local agency. The event should be advertised to the business community, with loan restrictions included in the advertisements.

- developing a contingency plan to advertise more frequently when funds become available. The plan should also detail how the waiting list of applicants will be handled when there is a shortage of loan funds.

2. NMPDD should set guidelines for a maximum loan amount to single borrowers, ask EDA to approve the new guidelines, and include the new guidelines in the RLF Plan.

3. NMPDD should follow consistently its monitoring procedures for delinquent loans. The Revolving Loan Fund Committee can then use this information to monitor borrowers more closely. Poor performance of a borrower can alert committee members to make timely decisions such as monitoring the condition of the collateral and reviewing the financial position of the borrower.

4. NMPDD should revise its procedures manual to include actions the district will take when a borrower is past due.

5. NMPDD should tighten its controls and follow underwriting guidelines consistently. NMPDD could implement a system of checks and balances in which a district employee is responsible for obtaining all items listed on a checklist of required documents for each loan funded and a second district employee is responsible to see that the first employee properly fulfills these duties.

6. NMPDD should monitor for compliance of access to the handicapped regulations and Davis-Bacon laws. NMPDD should require compliance as a condition of the loan and should require borrowers to supply documentation that contractors have complied with these regulations and laws. Documentation of handicapped regulations could include blueprints of the facility and on-site inspection by NMPDD. Documentation of Davis-Bacon laws should include a comparison of wage rates set by the Secretary of Labor with the wage rates paid to construction workers as certified by the contractor.

7. NMPDD should obtain relocation statements for all loan applicants prior to funding in order to comply with the EDA regulations, and should obtain annual certification that borrowers have not relocated. This would serve to remind borrowers of their responsibility in this area.

8. As part of semi-annual monitoring visits, NMPDD should observe workers at borrower locations to determine whether borrowers have relocated jobs.

9. NMPDD should rearrange its organizational structure so that the EDA loan fund coordinator is no longer responsible for administering or monitoring loans either partially or wholly funded by ARC grants.

EVALUATION OF LOAN FUND OPERATIONS IN ACCORDANCE WITH SOUND MANAGEMENT PRINCIPLES

PEER reviewed a sample of NMPDD loans and practices in regard to the loan fund. Management of the loan fund could be improved in the areas of loan underwriting and monitoring and loan collections.

Loan Underwriting

NMPDD does not follow consistently the prudent lending practice of researching a potential borrower's repayment history.

In the banking and finance industries, lenders generally research the current repayment histories of potential borrowers. Lenders can conduct credit history research by contacting companies directly which have lent to the borrower or by ordering a credit report from a credit rating agency. This banking practice is utilized so that a lender can better determine the potential borrower's ability to repay.

The ARC requires that NMPDD obtain credit history information on loans funded with original ARC grant monies. NMPDD must certify to the ARC that the credit verifications have been obtained and are on file. Although no federal guidelines require that lenders obtain credit history reports when underwriting all loans, it is apparent that ARC places importance on obtaining credit history information. If credit history information shows that a borrower has a poor loan repayment record, NMPDD would know that the borrower would probably be an unacceptable credit risk.

In PEER's review of loan files for compliance, ten of thirteen files did not contain appropriate repayment history information on the borrower. For one particular loan, the NMPDD had certified to the ARC that a credit report or credit verification had been obtained when in fact no such credit report was on file.

NMPDD has no policy in place regarding obtaining a credit history report on potential borrowers. A consultant engaged by NMPDD sometimes obtains credit history reports when preparing financial analyses on the borrowers. However, NMPDD has no formal agreement in place with the consultant outlining actual duties required (see page 24) and consequently has no assurance that the district obtains credit repayment histories for potential borrowers on a uniform basis. This results in NMPDD's loan committee not being fully informed when making lending decisions.

NMPDD lacks a proper method for documenting the decisions of the Revolving Loan Fund Committee, resulting in a lack of control over staff implementation of committee decisions.

NMPDD's loan approval authority is vested in the Revolving Loan Committee, consisting of seven NMPDD board members. The NMPDD staff is responsible for implementing the decisions of the RLF Committee and booking the loans approved. However, NMPDD lacks documentation of some important loan decisions which the committee makes, resulting in a lack of internal control for insuring implementation of committee decisions.

The committee minutes outline decisions of the Revolving Loan Committee on loans approved. However, the minutes contain only limited information regarding the way loans are to be booked. In most instances, the minutes include only the amounts, number of years to maturity, and interest rates. The minutes do not provide information such as description of the collateral to be acquired, value of the collateral, and names of individuals providing personal guarantees.

In some instances, the minutes stated that the committee will approve loans "*provided that all collateral requirements or guidelines are met.*" This method of approval allows NMPDD staff much flexibility in approving the final terms of loans--e.g., the actual type and value of collateral acquired. Federal guidelines state that the RLF Committee "*may not delegate authority to approve loans or make final policy decisions concerning RLF loan activities.*" However, with such limited documentation, PEER must question whether the committee always approves the final terms of the loans. If committee minutes documented complete loan terms, then there would be no appearance that the committee delegates its rightful authority to the NMPDD staff.

This inadequate method of documenting loan approval decisions exists because NMPDD management has not implemented a proper system of control for booking loans. The NMPDD board and management may not have considered the consequences of the lack of documentation of loan approval decisions. Unless the minutes or some other loan approval document states the complete terms under which the loans are to be booked, there is a risk that staff will misinterpret the terms under which the loans should be booked. The result of the lack of documentation of terms is that no control is in place to hold the staff accountable for closing loans as approved.

NMPDD's applications process lacks safeguards for insuring that the district gives all applications equal consideration.

NMPDD has limited resources available in its revolving loan fund to lend to qualified borrowers. In fact, NMPDD often has a waiting list of applicants. Because limited funds are available to be distributed to applicants, NMPDD must make judgements on which applications to approve. The NMPDD Revolving Loan Fund Committee meets regularly to discuss the applications and make lending decisions. However, NMPDD does not have guidelines to address the order in which the applications should be processed and reviewed and the procedures NMPDD should follow when applications exceed available funding.

Federal grantors have not developed guidelines for the applications process. Nevertheless, NMPDD's failure to develop guidelines results from poor management judgement. As a result of the lack of guidelines detailing the order in which NMPDD should process applications, it would be possible for NMPDD management to show favoritism toward certain applicants.

NMPDD has not executed a formal, written agreement with the consultant who reviews potential NMPDD borrowers. As a result, the district pays for an incomplete work product which could result in a lack of uniformity in loan underwriting.

NMPDD uses a financial consultant, Willis D. Lindsey, CPA, to review the financial statements of borrowers who apply for NMPDD loans. The Revolving Loan Fund Committee considers the consultant's recommendations when making loan decisions. However, the district has not executed a formal, written contract specifying what is to be included in the consultant's final work product. The consultant's reports reviewed by PEER averaged one-half page in length. During 1989 and 1990 the consultant billed $250 for each report. Some reports give financial ratio information on the borrower and state the net worths of the guarantors. The reports also state the cash flow projections given by the borrower.

The consultant's reports were deficient in several areas:

- The financial analysis reports contain no reference to the ability of the borrower to service the loan payments on its current or projected debt.

- The reports do not assess whether the guarantors have sufficient strength to service the borrower's debt if the borrower defaults.

- The reports refer to cash flow statements provided by the borrower but do not state whether the borrower's projections are feasible.

- The reports make judgements such as the following: "*assuming that the building, equipment, land and inventory will provide sufficient collateral, this loan should be satisfactory*." However, the reports do not explain why the borrower's financial standing was deemed to be satisfactory.

- The reports include no reference to whether credit history checks have been performed by the consultant. As noted on page 22, the consultant performs credit checks for some loans but not others.

The federal grantor agencies have not issued guidelines for the financial analysis to be performed by loan grantees. However, the district's management was imprudent in failing to set guidelines for the type of financial analysis needed for every loan. Because NMPDD has no formal, written agreement in place to specify the duties of the financial consultant, the district does not always conduct credit history checks, resulting in a lack of uniformity in loan underwriting.

Loan Monitoring

NMPDD's procedures for acquiring and reviewing borrowers' updated financial statements are inadequate.

It is common practice for lending institutions to acquire updated financial statements in order to monitor the repayment ability of commercial borrowers. But in a compliance review of thirteen NMPDD loan files, eight of the thirteen files contained no updated financial statements. NMPDD's procedures to acquire updated financial statements are ineffective and the agency has no procedure in place to review financial statements when they are received.

NMPDD sends annual form letters to its borrowers requesting updated financial statements. However, the district does not address these letters to appropriate individuals or even to specifically-named borrowers, but to "Revolving Loan Fund recipients." In addition, NMPDD files do not contain documentation of follow-up with additional verbal or other requests to assure that financial statements are received. As a result, the response rate from borrowers is low.

In general banking practice, it is usual for lenders to review updated financial statements on a yearly basis to determine the financial condition of the borrower. Any weakening in the financial position of the borrower will alert the lender that additional monitoring of the loan is needed. In line with these general standards, federal grantor officials and the NMPDD auditor have recommended to NMPDD that updated financial statements be received annually.

NMPDD management has not implemented adequate controls to insure that district employees obtain updated financial statements for all borrowers. Because NMPDD has no procedure in place to regularly review the financial position of its borrowers, NMPDD has not been fully informed of the repayment ability of its borrowers.

Loan Collection Practices

NMPDD has not implemented adequate procedures and guidelines for handling problem loans, resulting in questionable collection practices.

Delinquent loans are always a problem in the operation of a loan fund. Some borrowers will be delinquent in their payments or will stop payments altogether. As a result it is necessary for policies and procedures to be in place to monitor delinquent and defaulted loans.

In practice, NMPDD procedures for handling delinquent loans include contacting past due borrowers with letters, phone calls, and visits to bring loan payments current, and also deferring payments of problem borrowers. NMPDD's process for handling defaulted loans includes working with borrowers to arrange the sale of collateral, the use of realtors and auction companies to liquidate property foreclosed upon by NMPDD, and court action to enforce personal guarantees. However NMPDD has not developed adequate guidelines to outline proper procedures. As a result NMPDD staff has used some procedures which are not in the best interest of the loan fund.

NMPDD's procedures manual is inadequate for the following reasons:

- *The manual does not include procedures for handling delinquent loans over fifteen days.*

The NMPDD Procedures Manual states that "*loan recipients will be notified of payment due. . .after 15 days from due date*" of the loan. The procedures manual does not list appropriate actions which the district should take when the loan becomes more seriously delinquent than fifteen days past due.

- *Although the manual includes guidelines for foreclosing on loans which were developed over two years ago, NMPDD has never followed those guidelines.*

NMPDD engaged an attorney, Mr. Fred Permenter, Jr., to develop foreclosure procedures in August 1988 and included the procedures in its guidelines in March 1989. However, NMPDD in practice does not follow these procedures, which require that foreclosure proceedings begin on borrowers whose loans are sixty days past due. This is because restructuring the loan or allowing the borrower to sell the collateral to obtain a better price may be more beneficial to the NMPDD in ultimate collection of loan balances. Although NMPDD decided not to follow the procedures, the agency has made no effort to revise the procedures in the two years since they were proposed in August 1988. NMPDD paid Mr. Permenter $225 to develop these procedures.

- *The manual does not include procedures for restructuring loans.*

NMPDD's procedures for handling defaulted loans are incomplete. NMPDD did not develop specific written procedures for restructuring loans. For example, NMPDD restructures loans by allowing borrowers to defer loan payments to the end of the note. But these loan workout methods are not included in the procedures for handling defaulted loans.

The federal guidelines for the loan fund state that NMPDD must "*establish and describe policies and procedures for handling delinquencies and defaults*" in its internal loan fund guidelines. The federal guidelines suggest that the procedures include provisions for "*late notices (indicate frequency), telephone contacts and meetings with the borrower and/or other interested parties.*" NMPDD's procedures must require "*prompt action in order to minimize the potential dilution of the collateral*" held by the loan fund.

NMPDD showed poor management judgement by failing to implement proper procedures. NMPDD management never followed some procedures which it adopted into its procedures manual. NMPDD possibly could have "gone through the motions" to develop procedures because federal guidelines required them. NMPDD management was negligent in adopting procedures which were never intended to be followed.

The lack of guidelines for handling delinquent loans has resulted in the use of questionable practices which are not always in the best interest of the loan fund:

- NMPDD management resolves some loan delinquencies by suggesting to borrowers that NMPDD will allow them to defer loan payments if a request is sent in writing.

- NMPDD has deferred borrowers' payments to the end of the loan without being requested by the borrower to do so. NMPDD has sent letters to borrowers stating that if payments are not brought current, payments will automatically be restructured for them. An example of a letter containing lenient language is shown in Appendix C, page 41.

- In at least one instance, NMPDD failed to contact a borrower by telephone or in person despite the fact the loan was five months past due.

- NMPDD has restructured loans without reviewing the financial positions of borrowers. The effect could be that financially strong borrowers take advantage of NMPDD's lenient collection policies.

NMPDD uses questionable loan restructuring practices which conflict with recommendations of the Chief of the Economic Adjustment Division for EDA.

NMPDD frequently allows borrowers to suspend payments for several months when the borrowers have payment problems. In these cases NMPDD defers the suspended principal and interest payments to the end of the note. Both EDA and ARC guidelines allow restructuring of loans. But Mr. Westlake has recommended that lenders not defer interest payments until the end of the loan. Nevertheless, NMPDD defers both principal and interest payments of ailing borrowers.

NMPDD has deferred principal and interest payments on thirteen of forty-eight loans in the portfolio of currently outstanding loans. The effect of deferring payments is that the payments deferred will be due at the maturity of the loan, the balance outstanding on the loan is refinanced, and the loan is no longer past due.

Monthly loan payments usually include both principal and interest payments. Federal agencies require that principal payments be returned to the loan fund to be lent to future borrowers. Interest payments returned to the loan fund may be used for future loans or can be used for administrative costs. When NMPDD allows borrowers to defer principal payments, the loan fund grows at a slower pace. Therefore fewer loans may be made in the future. When NMPDD allows borrowers to defer interest payments, this lessens the ability of the loan fund to cover salaries and other costs associated with the loan fund and also reduces the pool of money available for loans.

Mr. Westlake stated to PEER that EDA recommends that grantees not defer interest on their loans. He stated that even on a restructured basis, it is desirable that borrowers be able to pay interest. EDA recommends that deferral of payments be allowed only for principal payments and not interest payments. Despite the verbal recommendations of federal officials, the written federal grantor guidelines offer little guidance in defining allowable restructuring techniques. The ARC and EDA guidelines provide that loan terms may be changed (restructured) to enhance program objectives. As the primary program objectives of the EDA and ARC Revolving Loan Fund Programs are "*private-sector job creation and capital formation,*" the agencies appear to allow wide latitude in restructuring the loans.

NMPDD liberally interprets the language in the federal grantor guidelines regarding restructuring loans. NMPDD seeks to help borrowers in order to fulfill the program goal of job creation and therefore encourages borrowers to defer payments if they are having payment difficulties. As long as borrowers are in business, showing the ability to make some payments and providing some jobs, then NMPDD does not want to threaten their continued existence by foreclosing.

But placing the needs of the borrower above the integrity of the loan fund is poor management. While the desire to help borrowers and therefore economic development may be in line with the objectives of the loan fund, the practice of deferring interest payments to the end of the loan weakens the financial strength of the loan fund and thus is detrimental to other potential borrowers.

NMPDD's deferring interest payments results in its administrative costs as a percentage of loan fund program income being higher than federal and internal standards. The lenient payment deferment practices apparently contribute to NMPDD exceeding its standards. EDA guidelines set a standard of administrative costs of the loan fund at no more than fifty percent of loan fund program income. NMPDD internal guidelines state that "*administrative costs will not exceed 50% of program income.*" In contrast to the guidelines, NMPDD loan fund administrative costs were sixty-five percent of program income for the twelve-month period ending September 30, 1990, according to an unaudited report to EDA. In effect NMPDD has fewer dollars to be used for administration of the loan fund on a current basis.

NMPDD's series of collateral and loan monitoring mistakes contributed to an estimated loan loss of $216,773 in the revolving loan portfolio.

On November 28, 1990, NMPDD estimated that it would lose a total of $192,883 on defaulted loans. At the December 1990 loan committee meeting, NMPDD decided to write off an additional amount of $23,890 for a total of $216,773 in estimated losses.

It is expected that NMPDD would sustain some losses in its loan portfolio. A cost of doing business in the area of lending is the default of borrowers, which leads to the inability of the lender to collect its loan funds. However, weaknesses in NMPDD's collateral and loan monitoring have led to unnecessary losses in the portfolio.

NMPDD made mistakes in assuring that its collateral was properly documented and therefore protected. In some instances, NMPDD failed through oversight or miscommunication to obtain first liens on collateral, but instead obtained second liens. When the loans went bad, NMPDD then did not have sufficient collateral to prevent losses. NMPDD could have acted more aggressively in other cases, such as pursuing guarantors in a more timely manner, and reporting missing collateral to authorities sooner. NMPDD has also waited extended periods before foreclosing on collateral. Because property can depreciate if not in use, NMPDD may have been able to obtain higher sale prices if the collateral had been sold earlier. NMPDD expects losses on five loans in its portfolio. Several of the district's actions decreased its chances of recovering the total loan amounts. These loan transactions are detailed in Appendix D, page 42.

Federal grantors have not provided guidelines on procedures for foreclosing on borrowers. The federal guidelines also allow the lender flexibility in determining how to restructure loans. This lack of federal guidance may be because decisions concerning the best time to foreclose on collateral and when and how to restructure loans are inherently subjective. In making these decisions, NMPDD management weighs heavily its concern that the district's actions will lead to the shutdown of businesses and decreased jobs. NMPDD uses as its authority the federal guidelines which state that loans may be restructured in order to "*enhance the capability of the RLF* [Revolving Loan Fund] *in achieving program objectives*," i.e., job creation. However additional federal guidelines state that the grantee "*shall use prudent judgment and sound management procedures in the approval, disbursement, monitoring and prompt collection of RLF loans to protect the assets of the RLF*."

In some instances, NMPDD made poor decisions or careless mistakes in handling its loans (see Appendix D, page 42). These mistakes, which stemmed from poor management judgement and/or lack of experience, contributed to the losses occurring in the loan portfolio. Because some funds will not be paid back into the loan fund, NMPDD has a smaller pool of funds available to be loaned to other area businesses.

Recommendations

1. NMPDD should acquire current repayment history information for every potential borrower so that the Revolving Loan Fund Committee may make more informed loan decisions.

2. NMPDD should develop a policy which gives a staff member or contractual employee responsibility for obtaining credit repayment history information on borrowers. The policy should outline what type of credit payment histories will be acceptable or unacceptable for the granting of loans.

3. NMPDD should take seriously federal grantors' requests for certification that loan documents have been obtained. NMPDD should carefully monitor ARC certification statements to insure no false statements are made.

4. NMPDD should document the final terms of all loans agreed upon by the loan committee and include a detailed collateral description, names of guarantors, number of jobs to be created, and amount of capital contributed by other sources. Committee minutes could include documentation of the loan. However, a preferable method of documentation would be a separate loan approval document to be included in the loan files. Appropriate representatives of the Loan Committee, such as the Chairman and the Secretary, should sign the

loan approval document. This final document would then be in place as a control mechanism authorizing the booking of the loan as approved by the committee.

5. NMPDD should develop detailed guidelines for processing loan applications. This could include:

    - listing applicants in the order in which completed applications are received;

    - ranking the waiting list based on those applicants which NMPDD has stated will be given priority (minority and female-owned businesses, businesses that use local goods and services, projects with higher than average wages or growth potential, locally owned projects, and projects with significant export market potential);

    - evaluating the loan applications in the order received;

    - keeping detailed explanations on file describing the reasons loans were turned down; and,

    - developing guidelines for reconsideration of loans rejected for reasons of inadequate funding when new funds are available, and whether these loans will be given priority over applications received when loan funds are available.

6. NMPDD management should develop a comprehensive list of items required in the financial analysis of borrowers. This analysis, which should be documented and included in the loan files, should include:

    - an analysis of whether the borrower has sufficient current cash flow to service its current debt and the additional NMPDD debt;

    - an analysis of whether the borrower will be able to service debt in the future based on statements of projected cash flow provided by the borrower;

    - an analysis of the borrower's financial position, including debt and liquidity positions;

    - an analysis of whether the cash flow statements provided by the borrower are feasible;

    - an analysis of whether the guarantors have sufficient strength to service the borrower's debt if the borrower defaults;

    - an analysis of the financial positions of the guarantors, including net worth, debt ratios and liquidity ratios;

- an analysis of the collateral of the borrower, giving a loan to value coverage ratio and making an assessment of whether the appraisal is acceptable and feasible;

- a credit history check on the borrower and guarantors, including ordering reports from credit rating agencies and contacting banking references; and,

- a recommendation of whether the loan should be made, based on the financial and collateral position of the borrower, with an explanation of why the recommendation has been made.

7. NMPDD should detail the duties required of its financial consultant in a formal, written agreement. The agreement would be beneficial for the consultant, as well as NMPDD, in defining what NMPDD expects from the final work product.

8. NMPDD should require its borrowers to submit updated financial statements yearly as a condition of the loan and should review these financial statements as part of its loan monitoring process.

9. NMPDD should implement guidelines describing actions to be taken when a borrower's financial condition shows serious deterioration--for instance, when a borrower's earnings and/or cash flow are insufficient to cover debt service. Actions could include:

   - discussions with the borrower to determine if the borrower is expected to remain in operation.

   - loan committee discussions about whether the borrower's projected ability to remain in operation and repay the debt has a higher probability of occurrence than NMPDD's ability to be repaid from sale of the collateral.

10. NMPDD should evaluate both its actual practices for handling problem borrowers and its internal procedures to determine their effectiveness and their practicality. NMPDD should revise the procedures to include all acceptable collection practices. The revised guidelines should outline procedures for monitoring delinquent loans, alternatives to immediate foreclosure on loans and allowable methods of restructuring loans. Updated procedures could include :

    - minimum time frames for sending delinquency notices;

    - minimum time frames for making personal telephone calls to delinquent borrowers;

    - guidelines and minimum time frames for meetings with delinquent borrowers;

- the appropriate number of months allowed for a borrower to find a buyer for its collateral;
- acceptable terms for restructured loans; and,
- requirement of a financial statement review before loans are restructured.

In developing the procedures, NMPDD should solicit the help of bankers specializing in problem loan workouts.

11. NMPDD should discontinue its practice of deferring interest payments to the end of the note as a method of restructuring loans.

12. NMPDD should set up a detailed collateral checklist and implement an internal system for reviewing loan collateral against the internal checklist.

13. NMPDD's decisionmaking process should include estimating whether the possibility of recovering the entire loan amount in a foreclosure sale is greater than the amount to be recovered from restructuring the loan. In the future, NMPDD should give greater weight to options which will protect the loan fund portfolio.

COMPLIANCE WITH CONFLICT OF INTEREST GUIDELINES

During its review of the NMPDD revolving loan fund, the PEER Committee found that NMPDD had made loans to related parties. PEER sought to determine if these loans to related parties were in violation of federal and internal guidelines and what deficiencies in the loan approval process allowed these loans to be made.

NMPDD made loans to related parties which may violate federal conflict of interest guidelines. The problem resulted from federal officials' lenient interpretations of federal guidelines and the lack of a management plan to identify potential conflicts.

In determining whether loans to related parties conflict with federal guidelines, PEER studied conflict of interest guidelines and interpretations of the ARC and the EDA. The guidelines of the two agencies vary, with EDA's interpretation of conflict of interest being stricter than that of the ARC. Federal officials' interpretation of the laws are even more lenient than the guidelines.

In general, ARC and EDA guidelines state that NMPDD is prohibited from lending to entities which are owned by NMPDD employees, officers and board members. The guidelines also prohibit lending to borrowers who are related to NMPDD employees, officers or board members by blood, marriage, law, or business relationship. Despite the seemingly strong conflict of interest language in the guidelines, federal interpretation has made the law harder to understand:

- Federal officials have opined that some relatives (such as children of sisters- or brothers-in-law) are too distantly related to be included in conflict of interest situations.

- Federal officials have stated that they may not consider all situations falling under the guidelines as conflicts and reserve the right to make judgements based on each individual case.

- If the related NMPDD employees or officers recuse themselves from participating in loan decisions and disclose the relationship in the public record, conflicts of interest may not exist.

NMPDD's internal policy implemented in March 1989 states that "*loans to officers or employees*" of the NMPDD, or "*any member of the loan administrative board or anyone who reviews, approves, or participates*" in loan decisions "*shall be prohibited.*" In addition loans which benefit these individuals or persons related to them by blood, marriage, or law are prohibited. The internal guidelines do not define "*relationship.*" However, the NMPDD Executive Director defines "*relatives by blood or marriage*" to mean spouse, child or parent, based on the MISS. CODE ANN. Section 25-4-103.

Prior to 1990, NMPDD had no system in place to identify all potential conflict of interest loans. By early 1990, NMPDD had devised a conflict of interest statement which loan applicants were required to sign. This conflict of interest statement required the borrower to certify that no one owning an interest in the borrower's enterprise was "*related by blood, marriage, law or business arrangement to any officer, director, or employee of NMPDD.*" However, corporate officers of two different borrowers certified there was no relationship, when in fact owners of those companies were related to an NMPDD employee. Thus NMPDD's conflict of interest policy was not stringent enough to locate all potential problems.

Listed below are the NMPDD's loans to related parties and the reasons why they appear to violate federal guidelines:

- *The district made an ARC-funded loan to a brother-in-law of an NMPDD employee involved in the loan program.* Committee minutes disclose that members of the loan committee discussed this relationship at a meeting occurring after the district approved the loan but before the loan was booked. The minutes also state that the NMPDD employee, who was present at the committee meetings, did not participate in the discussion of the loan application.

  ARC regulations state that loans directly benefiting people related to employees of the loan grantee by blood or marriage are prohibited. However, federal officials have stated that a loan may not be a conflict of interest under the circumstances cited above when the employee excuses himself or herself from discussing the loan during the decision-making process and when the loan is disclosed for the public record.

- *NMPDD made an EDA-funded loan to a company partially owned by Thomas Keenum, an attorney who provided advisory services to NMPDD.* Although the attorney was not on retainer, he did perform some employee functions during the year the loan was approved. Mr. Keenum, who was compensated by the borrower to close the NMPDD loan, served on the board of the borrower when the loan was made.

  EDA regulations state that NMPDD should not make loans to businesses owned in part by officers or employees of NMPDD, members of the NMPDD board, or members of any other board which advises, approves, recommends or otherwise participates in decisions concerning loans. Mr. Keenum could be considered an NMPDD employee because he was paid by NMPDD to attend four loan committee meetings in an advisory capacity during the twenty-six months prior to funding of the loan. Although the attorney was not officially a member of the board, he attended their meetings and participated in decisions concerning loans by being paid to review loan files. Thus a loan was made to a business partially owned and controlled by an individual serving in the capacity of an NMPDD employee.

- *The financial consultant employed by NMPDD, Willis D. Lindsey, CPA, conducted financial reviews of borrowers for which the consultant also performed monthly accounting work.*

  Both EDA and ARC regulations apply in this situation. The EDA regulations state that NMPDD should not make loans to businesses related to NMPDD representatives by business arrangement. NMPDD representatives include employees of the district or members of any board which advises, approves, recommends or otherwise participates in decisions concerning loans. The consultant, Willis D. Lindsey, CPA, may possibly be considered an NMPDD employee because NMPDD hires Mr. Lindsey to conduct financial reviews of all loans. Although Mr. Lindsey is not on an NMPDD board, he participates in decisions concerning loans because the reports provide opinions as to whether the loans are satisfactory. As a result, NMPDD has made a loan to a borrower which has a business relationship with someone serving in an employee's capacity.

  The ARC regulations which apply to this loan state that a conflict arises when an employee or agent of the grantee has a financial or other interest in the firm selected for a federal contract. Mr. Lindsey appears to be an agent of the grantee and has an interest in the firm selected for the loan because of the business relationship.

(EDA officials may or may not regard the preceding two loans as conflicts, depending in part on whether they consider the attorney and the consultant to be employees of NMPDD.)

Other potential conflict of interest situations exist which do not appear to be in violation of the federal laws:

- *The district made two loans to relatives (nephews-in-law) of NMPDD employees involved in the loan program.* Federal officials stated that this relationship is too distant to be a conflict. The loan committee also disclosed in the minutes that the loans were not conflicts of interest. (However, one of these loans was made after March 1989 and therefore violated the written internal conflict of interest policy implemented in March 1989.)

NMPDD's conflict of interest situations result from federal officials' lenient interpretation of federal guidelines, as well as the district's lack of a comprehensive management plan to identify potential conflicts of interest. The vague federal conflict of interest policy contributed to the likelihood that conflict of interest situations could occur. Regardless of the guidelines which have been set by federal grantor agencies, lending to related parties by public entities is bad policy. Officials lending the money could be tempted to soften loan underwriting guidelines for relatives or to be more lenient in collecting problem loans from relatives. Because lending includes an element of subjective decisionmaking, loans to related parties could lead to charges of favoritism even when loans have been made on equal terms.

Despite the the federal government's liberal interpretation of its own guidelines, NMPDD should have specifically defined "conflict of interest" and then followed its own guidelines. Instead NMPDD made at least two loans which, although not in conflict with federal policy, violate internal policy guidelines.

ARC and EDA guidelines state that conflict of interest violations can result in recovery of grant funds by the federal agencies. EDA's sanction for a conflict of interest violation is less stringent than that stated in the federal guidelines. A regional EDA official stated that, as a penalty for a violation, the grantee must arrange for refinancing the loan at another institution and then return the loan funds to the revolving loan fund.

Recommendations

1. NMPDD should develop internal guidelines for polling the district's representatives (board, staff, committee members and contractual employees) to determine whether they are related to NMPDD loan applicants. Prior to loan approval, NMPDD representatives should review lists of potential applicants for possible conflicts of interest. In instances of relationships by business, blood, marriage or law between NMPDD representatives and loan applicants, NMPDD should outline for the public record:

    - the exact relationship between the NMPDD representative and the applicant, and

    - a detailed explanation of the Revolving Loan Fund Committee's determination that no conflict of interest exists.

2. When relationships exist between NMPDD representatives and loan applicants, NMPDD should seek legal opinions regarding whether conflicts of interest exist. NMPDD has access to services of the staff attorneys of the federal granting agencies in these situations.

3. The PEER Committee will refer information on potential conflict of interest loans to the Economic Development Administration and the Appalachian Regional Commission.

APPENDIX A

DUTIES OF NMPDD STAFF MEMBERS

Executive Director--The administrative responsibilities of the executive director include preparing the administrative budget, supervising personnel, and overseeing NMPDD programs and regional development and local planning activities. The Director assists the Board of Directors in establishing the priorities of NMPDD and in retaining NMPDD's designation as a local development district, an economic development district, an area-wide planning organization, and an area agency on aging. The Director also works with city, county, state and federal officials; private citizens; and other individuals in promoting economic growth and social improvement within the district.

Director of Economic Development and Planning--This individual implements the planning program at federal, state, and local levels for the six county area. This employee prepares regional plans, extends technical assistance to members of government, executes planning contracts for the ARC, EDA and other entities, and coordinates the Revolving Loan Fund Program.

Bookkeeper/Fiscal Officer--The bookkeeper keeps a complete set of financial records and verifies and enters all transactions in account and cash journals, balances the books and compiles reports. Duties include recording loan information in the computer, entering loan and payment amounts in the loan accounting system, and writing checks to borrowers.

Administrative Assistant/EDA Revolving Loan Fund Coordinator--This position is under the direction of the Executive Director. The Administrative Assistant services all EDA Revolving Loans, including recording payments, mailing delinquent notices, insurance notices, and monitoring. This staff member assists in the preparation of the EDA Semi-Annual report and performs other Revolving Loan Fund responsibilities as needed.

Assistant Bookkeeper/ARC Revolving Loan Fund Coordinator--This employee files documents and correspondence, types, takes shorthand, operates various office machines, and maintains an organized filing system. This staff member performs Revolving Loan Fund coordination duties for ARC loans.

Appendix B

NORTHEAST MISSISSIPPI PLANNING AND DEVELOPMENT DISTRICT REVOLVING LOAN FUND LOANS OUTSTANDING AT SEPTEMBER 30, 1990

LOAN RECIPIENT	DATE ISSUED	AMOUNT	OUTSTANDING AMOUNT	SOURCE OF FUNDING
A-1 Parts Distributors	7/18/89	$65,000.00	$59,538.32	EDA/ARC
American Electric	5/5/89	200,000.00	181,471.61	ARC
Autry Construction #2	4/24/90	100,000.00	97,668.66	EDA/ARC
Belmont Homes	4/14/88	250,000.00	219,274.55	TVA
Benchcraft	5/10/85	100,000.00	55,331.71	EDA
Benton, Inc.	4/2/85	100,000.00	65,220.55	EDA
Blue Mountain Frames #2	12/21/89	59,945.98	56,667.32	EDA/CDBG
Byhalia Processors	5/23/88	50,000.00	49,697.06	ARC
Classic Decors	7/10/87	60,000.00	46,049.84	EDA
Concepts in Comfort	8/10/90	100,000.00	99,422.24	ARC
Corinth Plating	1/8/86	96,000.00	68,269.45	EDA
Corinthian Paddle Boats	3/27/85	47,800.00	2,021.95	EDA
Custom Furniture	10/30/88	200,000.00	175,659.84	EDA/ARC
Easy Rest Furniture	8/28/89	60,000.00	57,571.35	EDA/ARC
Elliott/Gibson	3/31/86	18,000.00	13,198.71	EDA
Foster Cosmetology	12/31/87	100,000.00	79,738.32	EDA
Gentry Gallery #1	8/19/88	22,062.00	19,233.41	CDBG
Gentry Gallery #2	5/19/88	50,000.00	41,585.98	ARC
Gentry Gallery #3	5/15/89	130,000.00	117,442.26	EDA/ARC/CDBG
Golden Furniture	8/10/89	20,000.00	16,199.08	EDA
Golden Sales	10/5/82	100,000.00	25,512.94	EDA
Halsen #1	3/14/86	40,000.00	25,381.23	EDA/CDBG
Halsen #2	11/4/88	15,000.00	11,749.54	EDA
HBI (Timbes Tire and Exhaust)	7/2/87	52,000.00	39,260.09	EDA
Jeff & Sharon Latch	1/1/84	20,750.25	20,013.29	OTHER
King Manufacturing	9/30/88	100,000.00	85,822.77	EDA/ARC
Magnolia Industries	4/20/89	35,000.00	31,397.19	EDA/ARC
Mathis Sawmill and Lumber Company	3/25/85	100,000.00	71,211.96	EDA
Mauroy #1	9/2/87	100,000.00	77,074.88	EDA
Maurey #2	7/24/90	100,000.00	98,841.11	EDA
Metal Enterprises	3/6/86	75,000.00	33,693.83	EDA
Mid-South Ambulance #1	8/11/88	50,000.00	42,249.03	EDA
Mid-South Ambulance #2	12/1/89	50,000.00	47,338.56	EDA
Mike & Mary Faulk	2/23/90	13,800.00	13,404.67	OTHER
Mr. Green Jeans	4/26/89	35,000.00	31,636.25	EDA/ARC
North MS Recycling	9/29/87	50,000.00	42,079.96	EDA
Parklane	6/6/84	100,000.00	29,938.94	EDA
Phil Jones	4/15/89	14,000.00	10,000.00	OTHER
Productive Screw Machine	12/28/88	50,000.00	43,890.67	ARC/CDBG
S&M Furniture	9/16/88	70,000.00	59,647.55	ARC/CDBG
Schnadig	10/31/88	100,000.00	85,823.02	ARC
Southern Classic #1	2/12/90	100,000.00	95,884.28	EDA
Southern Classic #2	4/12/90	50,000.00	48,538.64	EDA
Stylemark	8/1/90	117,979.84	117,352.99	EDA/ARC/TVA
Thomas Forrester	7/25/90	10,000.00	8,000.00	OTHER
Vick Etheridge	10/31/88	33,143.75	27,286.15	OTHER
Vikki's Happy Wheel	7/18/83	80,000.00	33,991.32	EDA
Yates Furniture Manufacturing	4/9/86	100,000.00	69,396.56	EDA
TOTAL			$2,847,729.63	

SOURCE OF FUNDING:
EDA - Economic Development Administration
ARC - Appalachian Regional Commission
CDBG - Community Development Block Grant
TVA - Tennessee Valley Authority
OTHER - These loans represent financing of collateral foreclosed upon by NMPDD or loans to guarantors of defaulted borrowers who have agreed to reduce the defaulted loans. These transactions did not result in newly disbursed funds.

APPENDIX C

LETTER SENT TO PAST DUE BORROWER BY NMPDD

NORTHEAST MISSISSIPPI PLANNING & DEVELOPMENT DISTRICT
P.O. BOX 600
BOONEVILLE, MISSISSIPPI 38829

TELEPHONE (601) 728-6248

J. EUGENE TAYLOR
Executive Director

September 25, 1990

[redacted]

Dear [redacted]

According to our records you are five (5) payments behind on your loan with the Northeast Mississippi Planning and Development District.

In order to bring your account up to date, the District will balloon your delinquent payments to end of note if the five (5)) payments are not received immediately.

If you have any questions, please feel free to call.

Sincerely,

J Eugene Taylor

J. Eugene Taylor
EXECUTIVE DIRECTOR

JET/sh

APPENDIX D

LOAN HISTORIES OF NMPDD PROBLEM LOANS

Borrower A

This loan for $100,000 was made on May 23, 1986, and secured by a second lien on equipment used in the company's furniture manufacturing business. The company made its payments through November 1986 and reduced the loan to $96,482.55. On May 4, 1987, the manufacturing building burned, causing substantial damage to NMPDD's secured collateral. NMPDD collected $22,762 from the sale of a portion of the equipment salvaged from the fire. NMPDD collected only $8,500 from the equipment insurance. This was because NMPDD was a second lienholder and because NMPDD was not named as an insured party on the policy, which is contrary to standard lending practice. NMPDD could not account for another $28,916.16 in equipment which was missing. NMPDD management reported in a December 1990 loan committee meeting that the missing equipment had been reported to the U.S. Attorney General's office and the FBI.

A judgement in favor of NMPDD was rendered against the borrower and the three guarantors in circuit court in February 1990. An NMPDD attorney is pursuing collection against the defendants. The loan balance is currently $65,220.55. On November 28, 1990, management estimated that NMPDD would lose $40,000 on the loan.

Several steps followed by NMPDD could have decreased NMPDD's chances of recovering the balance of the loan amount:

- NMPDD failed to get a first lien on the equipment as planned because there was already a lien filed on the equipment. This could have been an oversight on the part of NMPDD management as well as miscommunication with the closing attorney.

- NMPDD failed to get named as an insured party on the equipment insurance policy.

- Although the fire occurred in May 1987, NMPDD did not report missing equipment to federal authorities until late 1990.

- NMPDD did not acquire a lien on the furniture manufacturing building or other real estate, but acquired a lien on equipment only.

Borrower B

This $100,000 loan was made in June 1984 to a furniture manufacturer. The loan was secured by a second lien on real estate valued at $715,000. The property was secured by a first lien of about $350,000, leaving an approximate value of $365,000 in the property. Payments totaling $12,867.31 were made through January 1986. Shortly thereafter, in March 1986, the company changed ownership. NMPDD agreed to defer payments through October 1986, but the borrower never made additional payments. In April 1987 the first lienholder offered the foreclosed property for sale, but there were no bids on the property. Because the market value at the time of the sale was not greater than the first mortgage, NMPDD lost its equity value in the property. NMPDD pursued the four guarantors and negotiated that they repay the following amounts to NMPDD:

- Guarantor 1--$10,000 note repayable to NMPDD. The note was closed on 7/25/88, 15 months after the first lienholder foreclosed on the property and 30 months after the borrower's last payment.

- Guarantor 2--$33,143.75 note closed on 10/31/88, 18 months after the first lienholder foreclosed and 33 months after the borrower's last payment.

- Guarantor 3--$14,000 note closed on 4/15/89, 23 months after the first lienholder foreclosed and 38 months after the borrower's last payment.

- Guarantor 4--Declared bankruptcy, no settlement.

In December 1990 the NMPDD loan committee voted to write off the remaining loan balance of $29,988.94. If the district had taken the following steps, the loss to NMPDD would have been minimized:

- NMPDD could have obtained a first lien on another piece of property, rather than a second lien. However it is understandable that management would believe it was sufficiently collateralized, since management believed it had $365,000 in equity in the secured property for the $100,000 loan.

- NMPDD could have more aggressively pursued collection from the guarantors. A two and one-half to three year time lag between the date of the last loan repayment and the dates NMPDD settled with the guarantors seems excessive.

Borrower C

This $100,000 loan was made on February 25, 1985, to a sawmill business. There were repayment problems from the beginning because the first payment was six months late. Due to financial problems of the borrower the loan committee allowed the borrower to postpone 17 payments to the end of the note. The payments were to resume on 10/25/86. On 4/15/88 and 6/23/88 NMPDD sold the borrower's sawmill equipment for a total of $22,418.75. To that date the borrower had reduced the loan by $7,369.29, and the total loan balance was $70,211.96. Rather than foreclose on the land securing the loan, NMPDD allowed the borrower to continue in operation as a wooden pallet manufacturer. In December 1988, NMPDD renegotiated the loan at a lower monthly payment, but the borrower never made a payment on the restructured loan. In December 1988, NMPDD had allowed the borrower to defer a total of 38 payments. By September 1989 the attorney had proceeded to foreclose on NMPDD's secured property. However in October 1989, the borrower filed chapter 11 bankruptcy.

The latest status on the loan was that the borrower remained in bankruptcy court and NMPDD had instructed an attorney to pursue collection. On November 28, 1990, NMPDD estimated the loss on the $70,211.96 balance would be $50,000.

NMPDD management stated NMPDD tried to work with the borrower to keep the business in operation and save jobs. However there was a period of over 4 years between the time the borrower first showed repayment problems, in March 1985, and September 1989, when foreclosure proceedings began. It is possible that if NMPDD had foreclosed on all of the property at an earlier date, the borrower would have been in better financial condition and would not have filed bankruptcy. Another option would have been to require the borrower to offer its collateral for sale.

Borrower D

This $50,000 loan was made May 23, 1988, to a tomato growing and processing plant. The borrower immediately began to have financial problems and never made a payment on the loan. NMPDD was supposed to obtain a first lien on real estate. However, due to a miscommunication between NMPDD management and the closing attorney, NMPDD obtained a second lien. The borrower later filed for bankruptcy. Because NMPDD had not properly secured its collateral position, NMPDD received an unsecured creditor position of only ten cents on the dollar in the bankruptcy settlement. After four loan payments received after the bankruptcy settlement, the loan balance was $49,394.12 in November 1990, when NMPDD estimated a total loss on the loan.

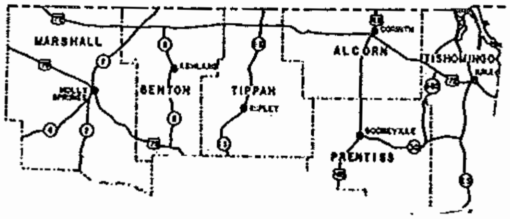
NMPDD was careless in not insuring that the closing attorney understood the collateral to be acquired. NMPDD should also have reviewed the contents of the collateral documents through an internal monitoring process.

Borrower E

NMPDD made this $75,000 loan on March 6, 1986, to a metal products manufacturer. Three payments were made, and after this time the owner had a heart attack. NMPDD allowed the borrower to defer 15 monthly payments through 10/1/87. During this period the borrower closed down the business for health reasons. After 10/1/87, NMPDD allowed the borrower to advertise the business for sale. NMPDD management believed that a better price might be received from an owner sale rather than a foreclosure sale. The borrower was not able to sell the property, so NMPDD foreclosed in May 1988. NMPDD received $26,303.50 from sale of the building and equipment, leaving a loan balance of $47,390.33. The borrower filed bankruptcy and was discharged from paying NMPDD the remainder of the loan balance. In December 1990, the NMPDD loan committee voted to write-off the debt.

If NMPDD had required the borrower to sell the property at an earlier date, the collateral value may not have deteriorated as greatly. If NMPDD had tried to pursue final collection on the loan at an earlier date, then the borrower's financial position may have been stronger, and NMPDD may have been able to settle the debt through a renegotiated loan with the guarantors.

AGENCY RESPONSE



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J. EUGENE TAYLOR
Executive Director

RECEIVED
MAY 20 1991
PEER COMMITTEE

TO: The PEER Committee

FROM: J. Eugene Taylor, Executive Director, NEMPDD JET

DATE: May 10, 1991

SUBJECT: RESPONSE TO EXECUTIVE SUMMARY OF REPORT ON NEMPDD RLF

During the past ten years, the NEMPDD has made 69 loans totaling $5,441,935.84 resulting in a private sector investment of over $27,500,000 and directly creating or retaining 1933 jobs in Alcorn, Benton, Marshall, Prentiss, Tippah and Tishomingo Counties. Of the $5,441,935.84 loaned, 1.42% or $77,380 has been written-off as of this date.

Job Creation and Capital Formation Standards of the program require a cost per job ratio of $5,000.00 or less and private investment of at least two dollars for each dollar loaned. The District has consistently exceeded these standards with a $2815.28 cost per job and leverage ratio of $2.75 in private funds for each RLF dollar effective March 30, 1991.

During the past 5 years, the NEMPDD RLF staff has been audited and reviewed 9 times by 5 different agencies. The most recent audit was performed by the Inspector General's Office of the U.S. Department of Commerce. Their report was issued March, 1991. The findings and recommendations of those 9 audits and reviews have been used to strengthen the program. The findings and recommendations of merit in the PEER Review will be used in the same manner (see attachment).

In our opinion, the RLF Program is one of the most important and effective economic development tools in Northeast Mississippi. The goal of the NEMPDD Board of Directors and staff is to see this program and every other NEMPDD Program achieving the maximum success and meeting all applicable federal, state, and local compliance guidelines.

cc Mr. Ken Shepard, APPALACHIAN REGIONAL COMMISSION
Mr. Jim Westlake, ECONOMIC DEVELOPMENT ADMINISTRATION

FINDING #1:

NEMPDD has not complied with RLF Plan requirements that loan fund advertisements be placed in all local newspapers yearly. Because NEMPDD lacks an adequate plan to publicize its loan fund, some eligible borrowers may be unaware of the program, and therefore, do not have an equal chance of obtaining an NEMPDD loan.

RESPONSE:

In addition to promotions by Regional Development Offices, County/City Development Offices, Business Communities, Minority Communities and State Legislators, staff estimates that during the past five (5) years an average of more than one article per year has been published in newspapers having circulation in six (6) NEMPDD Counties. Television and radio news reports also have publicized the NEMPDD RLF.

Staff acknowledges that complete documentation of the Articles and pro-active activities have not been maintained.

NEMPDD will develop a plan to advertise in all local papers annually and will document other pro-active activities being conducted.

FINDING #2:

NEMPDD has not established a maximum loan amount which can be loaned to a single borrower, as required by EDA.

RESPONSE:

Effective September 30, 1990, 64 loans have been closed by NEMPDD with an average loan amount being $78,975.56.

NEMPDD will set guidelines for maximum loan amounts.

FINDING #3:

NEMPDD did not report all delinquent loans regularly at committee meetings as required by the RLF Plan.

RESPONSE:

NEMPDD Minutes do not reflect every reporting of delinquent loans. NEMPDD will report delinquent loans at every committee meeting and record in Minutes. Also, effective March 31, 1991, NEMPDD had no delinquent loans to industries or businesses.

FINDING #4:

NEMPDD has not obtained civil rights compliance statements from borrowers on a consistent basis as required by the RLF Plan.

RESPONSE:

All NEMPDD borrowers have signed Civil Rights Compliance Statements. Also, the loan closing process requires execution of Civil Rights Compliance documents to insure timely satisfaction of this requirement.

FINDING #5:

NEMPDD has not monitored loan recipient compliance with federal regulations governing handicapped access and wage rates which apply to funding of construction projects.

RESPONSE:

NEMPDD will develop and implement a plan to improve monitoring and documentation of construction projects for federal regulation compliance.

FINDING #6:

NEMPDD has not complied consistently with federal regulations requiring borrower certification that loan projects will not be relocated.

RESPONSE:

All NEMPDD borrowers have signed Non-Relocation Certification Statements. Also, the loan closing process requires execution of Non-Relocation Compliance documents to insure timely satisfaction of this requirement.

FINDING #7:

NEMPDD has not followed Appalachian Regional Commission grant agreement conditions prohibiting one NEMPDD employee from association with ARC programs.

RESPONSE:

NEMPDD does not agree with this finding. PEER cites three violations as follows:

1. On August 13, 1990, EDA Coordinator sent an amortization schedule to borrower. Borrower was funded as follows: EDA- $27,744.96, TVA- $25,744.96, ARC- $66,489.92.

2. EDA Coordinator picked up closing documents at attorney's office. Borrower was funded as follows: EDA- $50,000, ARC- $50,000.

3. EDA Coordinator called Attorney and left message for Executive Director as noted in Attorney's letter of April 13, 1990.

Borrower made application for an EDA loan February 2, 1990. The Executive Director authorized the closing of the loan from ARC funds on August 8, 1990.

In the opinion of the Executive Director an EDA employee paid from EDA funds to perform an EDA function does not violate the ARC restrictions.

To prevent any future misunderstandings or the appearance of prohibition violations, in December, 1990, NEMPDD developed an organizational structure so that EDA loan fund coordinator is no longer responsible for administering or monitoring of EDA funds included in a project funded partially by ARC.

FINDING #8:

NEMPDD does not follow consistently the prudent lending practice of researching a potential borrower's repayment history.

RESPONSE:

In PEER's review of loan files, PEER cited ten (10) of the thirteen (13) files that did not contain repayment history information. The circumstance concerning these ten are as follows:

LOAN 1 NEMPDD did research repayment history of borrower. Applicant had repayment history with NEMPDD.

LOAN 2 NEMPDD did research repayment history of borrower. Credit Bureau report was requested 2-20-84.

LOAN 3 This applicant was a new company. At the time of the loan closing on August 10, 1990, the building was approximately 98% complete. The industrial building was valued at $250,000 on September 13, 1990. The NEMPDD loaned $100,000 and received first position on this property.

LOAN 4 NEMPDD had obtained a house held as collateral at foreclosure sale of borrower. After advertising for approximately 12 months, the house was sold by a professional realtor with the District receiving approximately 2% down payment.

LOAN 5 A loan was made to this applicant with local government guaranteeing loan.

LOAN 6 A loan of $70,000 was made to this applicant who provided first position on real estate valued at $90,089 and equipment valued at $8,870.

LOAN 7 NEMPDD loaned $15,000 to applicant who assumed an additional indebtedness of $102,979.84 for industrial property available because of foreclosure. Applicant's total indebtedness to NEMPDD is $117,979.84 with NEMPDD holding first position of industrial building valued at $183,775 and equipment valued at $110,500.

LOAN 8 NEMPDD did research repayment history of borrower. Applicant had repayment history with NEMPDD.

LOAN 9 NEMPDD did research the repayment history of this borrower. Credit review is dated October 24, 1988.

Note: The credit review is available for this ARC Loan.

LOAN 10 NEMPDD did research the repayment history of this borrower. Credit Bureau report was requested 10-16-85.

Federal guidelines do not require NEMPDD to obtain credit history reports but NEMPDD will continue prudent lending practices. NEMPDD will improve documentation of these actions.

FINDING #9:

NEMPDD lacks a proper method for documenting the decisions of the Revolving Loan Fund Committee, resulting in a lack of control over staff implementation of committee decisions.

RESPONSE:

NEMPDD agrees more information contained in applications could have been included in Minutes. During Spring of 1990, a loan summary document with pertinent information was developed to be included in Minutes and to be used as information source document for loan closing, programmatic and accounting computer file purposes, and loan monitoring purposes.

FINDING #10:

NEMPDD's application process lacks safeguards for insuring that the district gives all applications equal consideration.

RESPONSE:

To the best of NEMPDD staff's knowledge, every approvable RLF application submitted to the NEMPDD has been approved and NEMPDD informally follows first approved to be first funded except approved minority applications are automatically first to be funded. This guideline will be committed to writing.

FINDING #11:

NEMPDD has not executed a formal, written agreement with the consultant who reviews potential NEMPDD borrowers. As a result, the district pays for an incomplete work product which could result in a lack of uniformity in loan underwriting.

RESPONSE:

CPA has discussed with NEMPDD staff limited information available in applications particularly for new businesses, industries, and small projects. Staff requested report from CPA, based upon available information.

NEMPDD will execute a formal contract with the CPA with a defined scope of work to insure consistent analysis for all loans.

FINDING # 12:

NEMPDD's procedures for acquiring and reviewing borrower's updated financial statements are inadequate.

RESPONSE:

NEMPDD acknowledges that extreme difficulty has been experienced in acquiring updated financial statements. NEMPDD will continue its efforts to acquire updated financial statements and has been researching for approximately one year available software programs used for analyzing financial statements.

FINDING #13:

NEMPDD has not implemented adequate procedures and guidelines for handling problem loans, resulting in questionable collection practices.

RESPONSE:

NEMPDD agrees that guidelines for handling problem loans can be improved, nevertheless, during the past ten (10) years, NEMPDD has made 69 loans totaling $5,441,935.84 and has experienced only $77,380 write-offs. NEMPDD has been particularly lenient with minority and female borrowers.

FINDING # 14:

NEMPDD uses questionable loan restructuring practices which conflict with recommendations of the Chief of the Economic Adjustment Divisions for EDA.

RESPONSE:

NEMPDD restructuring practices and purposes for restructuring are consistent with published ARC and EDA guidelines.

The EDA defines the difference between RLF financing and conventional bank financing as follows: "For conventional financing institutions, the goal is profit. For the RLF, the goal is private sector job creation and capital formation."

EDA guidelines state "Modifications of the terms under which RLF financing has been extended may be approved by the grantee to enhance the capability of the RLF in achieving program objectives." (Job Creation and Capital Formation)

FINDING # 15:

NEMPDD's series of collateral and loan monitoring mistakes contributed to an estimated loan loss of $216,773 in the revolving loan portfolio.

RESPONSE:

NEMPDD agrees that collateral monitoring can be improved, however, NEMPDD has experienced only 1.5% write-off of $5,441,935.84 loaned for first ten years of program and an additional 2% of total dollars loaned are considered doubtful collections. Nationwide, write-offs for all EDA RLF's are approximately 10%. Write-offs for EDA RLF's in operation for more than 10 years exceed 10%.

FINDING #16:

NEMPDD made loans to related parties which may violate federal Conflict of Interest guidelines. The problems resulted from federal official's lenient interpretations of federal guidelines and the lack of a management plan to identify potential conflicts.

RESPONSE:

NEMPDD has used Mississippi Code ANN. Section 25-4-103 and summaries of Conflict of Interest Statutes 18 USC Section 202-209 to interpret federal guidelines. NEMPDD will develop additional internal guidelines to help prevent Conflict of Interest or the appearance of Conflict of Interest. These internal guidelines will include a means of polling District staff, officers and Board Members.

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Janet Moore, Administrative Assistant

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Ann Hutcherson
Debbie McNeill

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Danny Miller
David Mitchell
● Katherine Stark
Larry Whiting

● *Indicates project manager*

• *Indicates staff with primary assignment to this project*