ECONOMIC DEVELOPMENT ADMINISTRATION

EDA Faces Challenges in Effectively Monitoring Its Revolving Loan Funds

FINAL REPORT NO. OIG-15-031-A

JUNE 5, 2015

U.S. Department of Commerce
Office of Inspector General
Office of Audit and Evaluation

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UNITED STATES DEPARTMENT OF COMMERCE
Office of Inspector General
Washington, D.C. 20230

June 5, 2015

MEMORANDUM FOR: Jay Williams
Assistant Secretary of Commerce for Economic Development

FROM: Andrew Katsaros
Principal Assistant Inspector General for Audit and Evaluation

SUBJECT: *The Economic Development Administration Faces Challenges in Effectively Monitoring Its Revolving Loan Funds*
Final Report No. OIG-15-031-A

Attached is our final report on our audit of EDA's Revolving Loan Fund (RLF) program. As part of our FY 2014–15 Audit and Evaluation Plan, we assessed EDA's current oversight of RLF projects in three of the six regional offices. Our audit objectives were to determine whether EDA effectively responds to performance problems and changes to distressed or underserved communities within the RLF program.

We found:

1. EDA did not aggressively respond to noncompliant RLFs, exposing agency funds to misuse and economic loss. More specifically, we found that
   - EDA did not address persistent noncompliance with capital utilization requirements.
   - EDA has not consistently required corrective action plans and milestones to address RLFs with high loan default rates.
   - EDA did not ensure grantee compliance with semiannual reporting requirements.
   - At least two EDA regional offices do not use single audit report results to monitor RLF performance.
   - EDA has not required grantees to submit updated RLF plans.
2. Inflexibility in current RLF regulations and limited resources reduce EDA's ability to effectively oversee problematic or underutilized RLFs.

With the significant effort it takes to adequately monitor a large portfolio of longstanding RLFs, limited staff time and tools currently available do not allow for proper oversight. EDA should explore opportunities to simplify or reform the program's management.

We have summarized EDA's response to our draft report and included its entire formal response as appendix D. The final report will be posted on OIG's website pursuant to section 8M of the Inspector General Act of 1978, as amended.

In accordance with Department Administrative Order 213-5, please provide us your action plan within 60 days of this memorandum. The plan should outline the actions you propose to take to address each audit recommendation. If you have any questions about this report, please contact me at (202) 482-7859 or Chris Kapek, Acting Regional Inspector General for Audits, at (206) 220-4717.

Attachment

Report In Brief

JUNE 5, 2015

Background

The Revolving Loan Fund (RLF) program, established in 1975, is designed to provide grants to state and local governments, political subdivisions, and nonprofit organizations to operate a lending program that offers low-interest loans to businesses that cannot get traditional bank financing. Grant recipients are required to manage their RLF according to their RLF administrative plan, a document that describes the lending strategy and administrative procedures for a specific RLF project.

As of September 2013, EDA had awarded approximately $555 million in grants for the 558 RLF programs then operating. Those awards had a capital base of approximately $843 million, including recipient contributions.

Why We Did This Review

In response to a 2007 OIG report on the program, EDA developed and began using the Revolving Loan Fund Management System (RLFMS) in April 2010. However, the system was unavailable to most EDA regions and to all RLF grantees since January 2012, due to a cybersecurity incident detected in December 2011. Most regional offices regained access to the system in August 2013 but, at that time, the system excluded semiannual reports and other current information and therefore could not be used effectively as a monitoring tool. Most regional offices created workarounds of various levels in lieu of having RLFMS, while others did not.

We conducted this audit of EDA's Revolving Loan Fund program as part of our fiscal year (FY) 2014–15 audit and evaluation plan to assess EDA's current oversight of RLF projects in three of the six regional offices. Our objectives were to determine whether EDA effectively responds to performance problems and changes to distressed or underserved communities within the RLF program.

ECONOMIC DEVELOPMENT ADMINISTRATION

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WHAT WE FOUND

We found that

EDA did not aggressively respond to noncompliant RLFs, exposing agency funds to misuse and economic loss. The agency did not address persistent noncompliance with capital utilization requirements; as of the semiannual reporting period that ended September 30, 2013, most of the RLFs we reviewed (30 of the 35) had two or more consecutive reporting periods of noncompliance with the capital utilization standard. Also, it has not consistently required corrective action plans or set milestones to address RLFs with high loan default rates. In addition, EDA did not ensure grantee compliance with semiannual reporting requirements; of the 210 semiannual reports we reviewed, we found 19 instances of past due reports without the region sending a past due notice to the RLF recipient. Further, at least two EDA regional offices do not use single audit report results to monitor RLF performance. Finally, the agency has not required grantees to submit updated RLF plans.

Inflexibility in current RLF regulations and limited resources reduce EDA's ability to effectively oversee problematic or underutilized RLFs. The sustained low utilization of some RLFs may be evidence that those RLFs are operating in communities that no longer need them or do not require an RLF of that size. With the significant effort it takes to adequately monitor a large portfolio of long-standing RLFs, EDA's limited staff time and tools currently available do not allow for proper oversight. EDA should explore opportunities to simplify or reform management of the program.

WHAT WE RECOMMEND

We recommend that the Assistant Secretary for Economic Development direct the appropriate EDA regional officials to do the following:

1. Reimplement RLFMS or a replacement system that includes standard grantee reporting, program monitoring, and file maintenance.
2. Develop an improved process for monitoring grantee sequestrations of excess funds, default rates, and semiannual reporting requirements, as well as timely corrective actions for noncomplying RLFs.
3. Document determinations on whether RLFs with multiple periods of excess funds should be terminated, transferred, or consolidated—or have funds partially deobligated or transferred from them.
4. Develop a staffing plan to balance the workload of RLF administrators.
5. Develop an improved process for identifying required single audits and enforcing the consequences of noncompliance.
6. Identify projects with RLF plans more than 5 years old and document determinations on whether those plans require modifications—including determinations on whether a need for the RLF still exists in a particular location or whether funds should be transferred.
7. Document considerations and potential consequences of possible RLF program adjustments, including defederalization of funds, transferring funds to other EDA programs, and sunset provisions.
8. Evaluate conditions related to the grantee identified in this report that executed a loan exceeding the maximum amount allowed in its RLF plan.

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COVER: Detail of fisheries pediment,
U.S. Department of Commerce headquarters,
by sculptor James Earle Fraser, 1934

Introduction

For nearly 50 years, the Economic Development Administration (EDA) has worked to foster job growth in distressed communities across the United States by promoting entrepreneurship and business development, as well as investing in infrastructure to attract private capital and higher-skill, higher-wage jobs to these areas. The Revolving Loan Fund (RLF) program, established in 1975, helps EDA accomplish these goals.

The RLF program is designed to provide grants to state and local governments, political subdivisions, and nonprofit organizations to operate a lending program that offers low-interest loans to businesses that cannot acquire traditional bank financing. Entities interested in administering an RLF must present EDA with a comprehensive economic development strategy that demonstrates how the loan fund fits specific economic development goals in a geographic region. Grant recipients are required to manage their RLF according to their RLF administrative plan (RLF plan), a document that describes the lending strategy and administrative procedures for a specific RLF project.

The RLF program consists of two stages, the disbursement and revolving phases. In the disbursement phase, grant recipients have up to 3 years to lend EDA grant funds to borrowers. Typically recipients voluntarily contribute matching funds, adding to the total capital available to make loans, and the sum of both funds is known as the initial capital base.[1] The revolving phase refers to the period when the grant recipient has completed the initial round of loans and disbursed the EDA grant award. As borrowers repay loans with interest and other loan-related fees, the fund is replenished and new loans are extended to qualified businesses. Since RLF funds retain their federal character in perpetuity, the grant recipient's obligation to the federal government remains as long as the federal interest in RLF assets exists.

Examples of RLFs in the Community

Portland Development Commission, Portland, OR:

The RLF was established to provide loans with reduced interest rates and flexible repayment terms to small businesses to expand and create new employment opportunities that pay competitive wages and benefits. Also, it would help retain jobs that (a) would otherwise be lost to the city, (b) create wealth, or (c) increase minority and woman ownership of businesses city-wide. Active loans include borrowers in the service, industrial, and commercial industries.

City of San Jose, CA:

The RLF was originally established to assist small businesses in upgrading, expanding, and establishing commercial enterprises. The lending area has expanded due to economic changes and now includes the entire city of San Jose. Active loans include borrowers in the service and commercial industries.

[1] The RLF capital base is the value of RLF assets administered by the recipient. It is equal to the amount of grant funds used to capitalize (and if applicable, recapitalize) the fund, plus the matching funding committed to the RLF at the time of award (and any subsequent additions, but not withdrawals), plus RLF income added to the fund less loan losses. (Office of Management and Budget, March 2013. *OMB Circular A-133 Compliance Supplement*, Department of Commerce Catalog of Federal Domestic Assistance 11.307 Economic Adjustment Assistance. Washington, DC: OMB, 4-11.300-9.)

EDA regional offices oversee the RLFs in their geographic areas (see figure 1). Regional directors assign RLF administrators to monitor compliance with grant requirements for the RLFs in EDA's regional office portfolios. An RLF coordinator located at EDA headquarters distributes grant policy and functions as a liaison between the regional offices and EDA management.

Figure 1: EDA Headquarters and Regional Offices

Source: EDA

As of September 2013, EDA had awarded approximately $555 million in grants for the 558 RLF programs then operating. As shown in table 1 below, as of September 30, 2013, those awards had a capital base of approximately $843 million, including recipient contributions (see table 1, next page). Changes in capital base over the years are due to events such as loan losses, additions of new loans, income from existing RLFs, and recapitalization of existing loans. Appendix B lists new RLFs and federal funds EDA added to existing RLFs during the 5 years from 2008 to 2013.

Table 1: Regional RLF Profiles, as of September 30, 2013

EDA Regional Office	No. of RLFs	EDA's Portion of Original Award Amount	Local Match and Voluntary Contributions	Capital Base as of September 30, 2013[a]	Number of EDA Employees (FTE) Monitoring the Program[b]
Atlanta	70	$75,035,967	$24,409,606	$121,437,008	<1
Austin	36	34,743,781	5,735,613	42,938,231	<1
Chicago	107	86,011,499	24,175,725	123,605,721	<2
Denver	105	61,987,725	26,798,078	85,995,474	<2
Philadelphia	153	194,634,544	55,206,760	332,945,246	<2[c]
Seattle	87	102,090,791	26,565,400	136,256,149	<3
TOTAL	**558**	**$554,504,307**	**$162,891,183**	**$843,177,829**	

Source: Self-reported information from EDA
[a] The capital base represents grant awards over a 40-year period. In total, capital base has increased by $125,782,339, from $717,395,490 to $843,177,829. See footnote 1 for further description of the RLF capital base.
[b] Amounts are based on EDA employee estimates of their percent of time worked on the program.
[c] As of August 31, 2014, one of the two RLF administrators in the Philadelphia regional office retired, leaving only one RLF administrator to oversee the region's entire portfolio.

In our March 2007 report on the RLF program, we recommended that EDA develop and implement a reporting and monitoring system that provides the critical information EDA needs to manage the RLF program and protect its assets.[2] In response, EDA developed and began using the Revolving Loan Fund Management System[3] (RLFMS) in April 2010. The RLFMS, accessible to both EDA and grantees, allowed grantees to submit semiannual reports online, as well as submit and update grantee loan lists. Based on new and historical data in RLFMS, the system performed functions such as tracking workflow; performing data analysis and approval actions; and tracking of audit information, capital utilization, and sequestration of excess funds, which aided EDA in monitoring the program. However, the system was unavailable to most EDA regions and to all RLF grantees since January 2012, due to a cybersecurity incident detected in December 2011.[4] Most regional offices regained access to the system in August 2013 but, at that time, the system excluded semiannual reports and other current information and therefore

[2] U.S. Department of Commerce Office of Inspector General, March 2007. *Aggressive EDA Leadership and Oversight Needed to Correct Persistent Problems in RLF Program*, OA-18200-7-0001. Washington, DC: DOC OIG, 15.

[3] RLFMS was designed to automate grant recipient reporting, keep better track of the RLF portfolio, generate automated data reports for EDA staff, and provide a data analysis mechanism for managers.

[4] The incident resulted in termination of EDA's network services and suspension of electronic reporting through important business support systems such as RLFMS. OIG reported on this incident in 2013. See DOC OIG, June 26, 2013. *Malware Infections on EDA's Systems Were Overstated and the Disruption of IT Operations Was Unwarranted*, OIG-13-027-A. Washington, DC: DOC OIG, 26.

could not be used effectively as a monitoring tool. Most regional offices created workarounds of various levels in lieu of having RLFMS, while others did not.

As noted in our previous audit report, EDA has encountered problems managing the RLF program and struggled to ensure the effectiveness and accountability of RLF funds. Specifically, we found that EDA did not consistently ensure that RLF grantees (1) complied with capital utilization rate requirements, (2) sequestered excess funds, and (3) submitted required reports in a timely manner. Our previous report also recognized that the RLF program employed too few staff members to handle too many competing responsibilities to effectively monitor the program.

Objective, Findings, and Recommendations

We conducted this audit of EDA's Revolving Loan Fund program as part of our fiscal year (FY) 2014–15 audit and evaluation plan to assess EDA's current oversight of RLF projects in three of the six regional offices. Our audit objectives were to determine whether EDA effectively responds to performance problems and changes to distressed[5] or underserved communities within the RLF program. The scope of the audit included FYs 2012 and 2013 and was limited to the Chicago, Philadelphia, and Seattle EDA regional offices. For further detail on our objective, scope, and methodology, see appendix A. In appendix B, we chart new and recapitalized RLFs, by region, between 2008 and 2013. Appendix C provides details of the claimed funds to be put to better use by EDA regional office.

Although EDA took action to correct problems covered in our 2007 report, circumstances (e.g., interruption to EDA's information technology [IT] systems in 2012, an economic decline nationwide starting in 2008, and lending changes that altered marketing and lending activities to eligible borrowers) have made it difficult for EDA to ensure that grantees comply with RLF operating guidelines. Additionally, while we recognize that EDA regional offices have broad authority in managing their RLF portfolios,[6] there are RLFs that have been out of compliance with multiple RLF award terms and conditions for several years. We found that EDA regions respond to compliance issues inconsistently and sometimes not at all. While some EDA regional offices have required RLF recipients to develop a corrective action plan, or transferred and suspended RLFs, other regional offices have not. EDA has not reacted aggressively to poorly performing RLFs that fail to comply with grant requirements, and actions such as disallowance of a portion of federal funds[7] and termination have occurred irregularly. Our report offers recommendations to improve EDA's monitoring and management of the RLF program.

[5] Economically distressed areas have one or more of the following characteristics: an unemployment rate that is, for the most recent 24 month period for which data are available, at least one percentage point greater than the national average unemployment rate; per capita income that is, for the most recent period for which data are available, 80 percent or less of the national average per capita income; or a special need, as determined by EDA (13 CFR § 301.3(a)(1)).

[6] For example, regional directors can give RLF recipients additional time to lend excess funds and to comply with other program requirements. (Economic Development Administration, February 2011. *Fiscal Year 2011 Revolving Loan Fund (RLF) Program Policy and Operational Guidance*, "II. Setting Capital Utilization Standards for RLF Grantees, Extension Requests to Delay Sequestration of Excess Cash." Washington, DC: EDA.)

[7] In such cases part of the funds are removed (or de-obligated) from a grant award and transferred to another RLF or returned to the Department of the Treasury. Although the grant award remains open, the funds the grantee can access are reduced by the amount de-obligated.

I. EDA Did Not Aggressively Respond to Noncompliant RLFs, Exposing Agency Funds to Misuse and Economic Loss

A. EDA did not address persistent noncompliance with capital utilization requirements

Federal regulations require that, with certain exceptions, at least 75 percent of an RLF's capital must be loaned or committed at all times.[8] When the percentage of capital utilized falls below this standard, the dollar amount of funds equal to the difference between the actual percentage of capital utilized and the standard represents excess funds. When an RLF recipient has not met the standard for two consecutive semiannual reporting periods, EDA may require the recipient to deposit the excess funds in a separate interest-bearing account.[9] EDA's portion of interest earned on the excess (or sequestered) funds is required to be remitted semiannually to the Department of the Treasury.[10] EDA regulations provide that the agency may suspend or terminate an RLF for persistent noncompliance with the capital utilization standard.[11]

As of the semiannual reporting period that ended September 30, 2013, there were 30 of the 35 RLFs we reviewed that had 2 or more consecutive reporting periods of noncompliance with the capital utilization standard. This represents $20 million in excess funds that should be deposited into a separate bank account, unless the RLF recipient has commitments to lend the funds to an eligible borrower by the next semiannual reporting period. If excess funds are sequestered, recipients must obtain EDA approval to withdraw funds from the bank account holding sequestered funds. Table 2 (see next page) shows excess funds subject to sequestration from the three regions tested in RLFs. We calculated the excess funds based on amounts reported in September 2013 semiannual reports submitted by grantees. Due to a lack of documentation, EDA was not able to demonstrate what amount of the excess funds subject to sequestration had actually been sequestered by the grantees. As a result of the missing documentation, EDA cannot conclude that it fully understands the value of its sequestered funds.

[8] 13 CFR § 307.16(c).

[9] 13 CFR § 307.16(c)(2)(i) states that "EDA may require the RLF recipient to deposit excess funds in an interest bearing account" and EDA has made this a general practice if a recipient has excess funds.

[10] EDA, *Fiscal Year 2011 RLF Program Policy and Operational Guidance*, "II. Setting Capital Utilization Standards for RLF Grantees, Remittance of Interest," 1. During our audit we noticed that some regional offices were requesting interest to be remitted quarterly.

[11] 13 CFR § 307.16(c)(2)(ii) .

Table 2: Results of OIG Tests of Excess RLF Funds Subject to Sequestration

EDA Regional Office	Total EDA Funds Tested	Excess Funds Subject to Sequestration[a]	Percent of Total Tested
Chicago	$8,739,808	$3,593,000	41
Philadelphia	$33,880,286	$9,359,135	28
Seattle	$18,789,509	$6,586,991	35
TOTAL	**$61,409,603**	**$19,539,126**	**32**

Source: EDA, OIG
[a] Due to the lack of documentation for RLFs tested, EDA was unable to demonstrate how much of these funds, if any, were actually sequestered.

In one EDA regional office, 3 of the 10 RLFs included in the audit had sequestered excess funds for more than 4 years and—as of September 30, 2013—had excess funds subject to sequestration totaling approximately $2.8 million. However, since 2012, the regional office has not required RLF recipients with ongoing excess funds to request time extensions that are meant to give the recipients additional time to come into compliance with the capital utilization standard.[12] In the most extreme case of funds being sequestered we noted, one RLF that began in 1976 had sequestered excess funds since 2006 (more than 7 years as of September 2013). As of September 30, 2013, the RLF had excess funds subject to sequestration totaling almost $2 million. The regional office has not taken more forceful action such as transferring or consolidating the RLF, de-obligating the federal portion of the RLF award, or terminating the RLF award. Allowing RLFs to hold onto excess funds for a long time leaves the cash less active, as loans would pay higher interest than interest-bearing accounts, and the federal government may not receive interest payments on the sequestered funds. While we recognize the need for some flexibility when it comes to sequestration decisions, funds sequestered for long periods of time are not being used to achieve the goals of the RLF program and could be put to better use.

EDA was not able to demonstrate whether funds were sequestered or whether interest payments were made due to the lack of documentation in some RLF files. In 11 of the 35 RLFs tested, there was no evidence to determine whether interest payments were made—and, for 3 of those 11 files, there was also no documentation to demonstrate whether funds had even been sequestered. The rate at which missing RLF documentation was identified demonstrates the lack of controls that exist within the RLF program. It also shows that the data EDA compiles and calculates on RLF interest payments and sequestration, at a minimum, are not reliable. Consequently, EDA does

[12] Regional directors can give RLF recipients additional time to lend excess funds and to comply with other program requirements. (Economic Development Administration, *Fiscal Year 2011 RLF Program Policy and Operational Guidance*, "II. Setting Capital Utilization Standards for RLF Grantees, Extension Requests to Delay Sequestration of Excess Cash," 1.)

not have a complete understanding of its RLF portfolio and there are potentially funds that could have been put to better use (see part 1 of this subfinding).The limited availability of dedicated staff resources might have contributed to the insufficient monitoring of excess funds (see part 2 of this subfinding).

1. ***Potential arises for funds to be put to better use.*** EDA does not exercise its discretion to terminate or de-obligate funds in response to underperforming RLFs that have had persistent excess funds. One explanation that EDA provided is that doing so takes money away from the economically distressed communities, which would be counterproductive to EDA's goal to help them. The agency is willing to transfer RLF funds to another RLF recipient—if it can find one that will accept the funds. However, when de-obligating or terminating RLF funds and transferring them to another RLF recipient is not possible, the funds must be returned to the Department of the Treasury and consequently become inaccessible to EDA. Although funds would no longer be used by EDA, we believe they could be put to better use instead of potentially sitting idle with an RLF recipient.

   By not sequestering funds, there is a risk that funds will not be used in accordance with applicable requirements or be paid back to EDA or returned to the Department of the Treasury. When one RLF recipient in the Philadelphia region was allowed to hold onto excess funds without depositing those amounts into a separate bank account, the recipient loaned $800,000 to a single borrower—an amount that substantially exceeds the $200,000 maximum loan amount stated in its RLF plan, as well as a transaction that resulted in avoiding a third consecutive semiannual period of noncompliance with capital utilization requirements. EDA did not have documentation showing it was made aware of and approved this significantly higher loan amount. In reviewing the RLF recipient's loan list, we noted no other loans above $200,000.[13]

   Whether or not funds are properly sequestered, funds that remain excess for significant periods of time are not being used to further the goals of the RLF program. Therefore, we consider these funds that could be put to better use. From the three regional offices we visited, we identified approximately $46 million in RLF funds for the March 31, 2014, reporting period, which had been reported by grantees as being excess for 2 or more reporting periods. We excluded RLFs in the process of being transferred or terminated, as well as those granted extensions by an EDA regional director to delay sequestration or deobligation and allow additional time for the RLFs to come into compliance with capital utilization regulations. However, we found that several RLFs had received multiple approved

[13] When we inquired about this large loan, the EDA regional office responded that the loan was made using the flexibility regarding loan size and interest rates addressed in the recipient's updated RLF plan submitted to EDA for review. EDA had not approved the RLF plan and the maximum loan amount according to the draft updated RLF plan is $200,000. The EDA employee indicated that this regional office allows flexibility in administering RLFs despite the terms stated in their plans. In contrast, in another EDA region, we observed one-time waiver requests to the maximum loan amount stated in the RLF plan and EDA's written approval of the waiver requests.

extensions, which indicates that these excess RLF funds could also be considered funds to be put to better use (see appendix C for further details).

One RLF recipient in the Seattle region had been receiving notices from EDA to sequester funds since 2008. The only documentation EDA had from the grantee related to sequestered funds was from 2009, when the grantee provided documentation indicating that $218,201 had been sequestered. EDA is currently in the process of terminating this particular RLF and is determining the amount due to the federal government. As of September 2014, EDA was unsure how much money, if any, would be returned by the recipient due to a lack of documentation and sequestered funds no longer being available in the designated account. We did not find any documentation indicating EDA approved the use of the sequestered funds. Had the recipient been sequestering funds as required, EDA would be guaranteed some return of funds.

2. ***Limited availability of staff resources make monitoring excess funds challenging.*** As stated above, our previous audit report found that EDA had not employed enough RLF staff to handle competing responsibilities, leading to an inability to effectively monitor the program. During our current audit, all three regional directors stated that they needed more staff in their regions to effectively monitor the RLF program. Currently, regional staff does not have the time and resources to dedicate to the program to ensure it is run as effectively as it should be. The amount of time RLF administrators dedicate to the RLF program varies by regional office. However, in one regional office, an RLF administrator spent only about 60 percent of available time on the RLF program, overseeing more than 100 RLFs and did not have any other assistance available. (See table 1 in the introduction for regional office comparisons.)

   During this audit, we also found incomplete records in several RLF files in the three regional offices we visited, making it difficult to determine (a) when sequestration of excess funds began for some RLFs and (b) whether EDA's portion of the interest earned on excess funds was accurately calculated and remitted to the Department of the Treasury. The problem caused by an absence of correspondence in some of the files is compounded by the fact that some regional staff responsible for monitoring the program have been in their positions for only a short time. As a result, they do not have historical knowledge about the particular RLFs in the region's portfolio. Moreover, their predecessors may not have maintained copies of some of the documentation.

   Since the disruption to EDA systems in 2012, which left RLFMS inaccessible to most EDA regions and to all RLF recipients, one EDA region has not consistently notified grantees that excess funds need to be sequestered. Moreover, this region has not consistently maintained worksheets or used other workarounds to calculate and track excess funds, as well as help to identify grantees that should be sequestering excess funds. We found that RLF recipients in this region that were sequestering funds and remitting interest to the Department of the Treasury did so unprompted by EDA. These issues, combined with staff having competing responsibilities (e.g., other program duties or engineering projects), have resulted in incomplete records—making it challenging for OIG and current EDA staff to follow the agency's actions and monitoring of the RLF program.

B. *EDA has not consistently required corrective action plans or set milestones to address RLFs with high loan default rates*

EDA is required to monitor the RLF recipient's loan default rate[14] to safeguard its federal share in the RLF property.[15] During this period of RLFMS inaccessibility, EDA has instructed regional offices to use information from semiannual reports to calculate loan default rates. According to agency policy, when RLFs achieve a default rate greater than 20 percent, the regional offices should send a written notice to the RLF recipient and request a written analysis of loans in default and actions taken to collect past due amounts.[16]

We found that, for the FY 2012 and 2013 semiannual reporting periods, two of the three EDA regions we visited consistently requested and obtained written analyses from RLF recipients with high loan default rates. However, in one of the two compliant regional offices, EDA could not document whether it concluded that the explanation received and the actions taken to pursue collection of past due amounts was acceptable; the regional office did not have written responses to the recipients stating that it approved grantees' written analyses.

In the third region we visited, EDA has not consistently requested that its grantees with high default rates submit written analyses. Consequently, the region did not have explanations for two RLF grantees with 100 percent loan default rates for the semiannual reporting period ending September 30, 2013. EDA obtained the explanations when OIG asked for additional information. In each instance, the RLF had one active loan and that loan was in default status. Table 3 (next page) illustrates default rates for all the RLFs that were tested during the audit.

[14] Loan default rate is the dollar value of the loans in default divided by the dollar value of total loans outstanding, expressed as a percentage (Economic Development Administration, *Fiscal Year 2011 RLF Program Policy and Operational Guidance*, "III. Default Rate Monitoring," footnote 3).

[15] 13 CFR § 307.16(d).

[16] Economic Development Administration, *Fiscal Year 2011 RLF Program Policy and Operational Guidance*, "III. Default Rate Monitoring," 2.

Table 3: Default Rates for RLFs Tested, as of September 30, 2013

Default Rate (percentage)	RLFs Tested
Under 20	9
20–50	9
51–75	8
75–100	9
TOTAL	**35**

Source: OIG audit test results, using EDA data

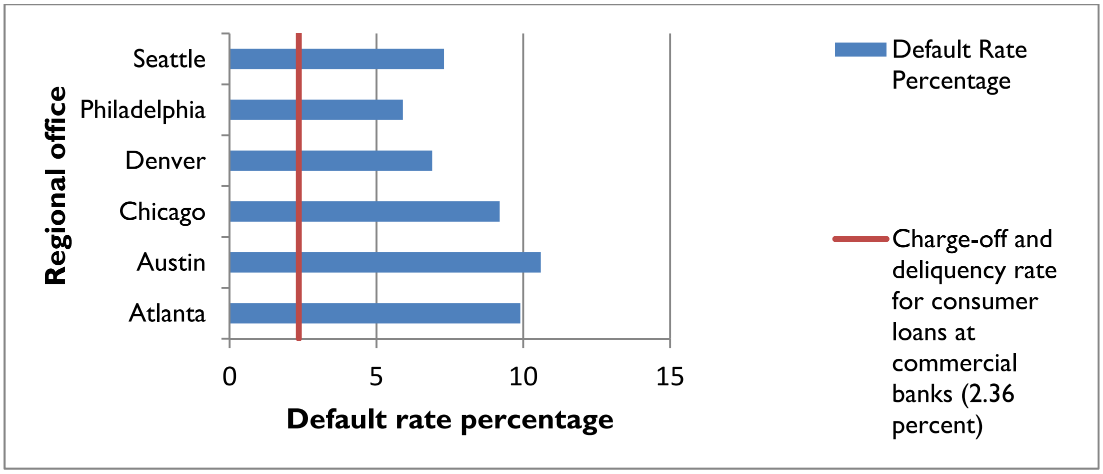
Explanations for why some RLFs experience high loan default rates vary. One factor driving up the default rate for some RLFs is the decline in the balance of outstanding loans in good standing, while the balance of defaulted loans increases or remains unchanged. If new loans in good standing are not added, this condition inevitably results in a rising default rate. In spite of outreach efforts and attempts to market the loans to potential eligible borrowers, some of the small- and mid-sized RLFs have not made new loans in recent years, and their loan portfolios consist of only a few loans. When one or two of those loans becomes delinquent and eventually the borrower defaults, the outcome is a high default rate for what was already a small loan portfolio.

Although some RLFs have high loan default rates, EDA stated that overall the default rate for the program as of September 30, 2013 was below the 20 percent benchmark, totaling 7.6 percent (see figure 1, next page, for rates by regional office). By comparison, the charge-off[17] and delinquency rate for consumer loans at commercial banks for the same time period was 2.36 percent.[18]

[17] A charge-off is the value of loans and leases removed from the books and charged against loss reserves. Charge-off rates are annualized net of recoveries. (Board of Governors of the Federal Reserve System, *Charge-Off and Delinquency Rates on Loans and Leases at Commercial Banks* [online]. www.federalreserve.gov/releases/chargeoff/ (accessed September 24, 2014).

[18] Board of Governors of the Federal Reserve System. *Charge-Off and Delinquency Rates on Loans and Leases at Commercial Banks* [online]. www.federalreserve.gov/releases/chargeoff/delallsa.htm (accessed September 25, 2014).

Figure 1: Default Rate at September 30, 2013, by EDA Region



Source: EDA, Board of Governors of the Federal Reserve System

A higher than expected loan default rate alone, without other indicators of an underperforming RLF, is not necessarily cause for formal corrective action—given that the RLF program provides loan financing for businesses who have been turned down by commercial lenders. In fact, a higher default rate would be expected, becasue the RLF program lends to a population of borrowers at a higher risk of default compared to borrowers of commercial loans. However, instances of long-term high loan default rates combined with noncompliance with other RLF program requirements suggests more aggressive corrective action is warranted.

C. *EDA did not ensure grantee compliance with semiannual reporting requirements*

Twice annually, for the 6-month periods ending March 31 and September 30, RLF recipients are required to submit to EDA a "Revolving Loan Fund Semi-Annual Financial Report" (ED-209).[19] If the RLF used 50 percent or more (or more than $100,000) of RLF income for administrative expenses during the 6-month period, EDA requires a second report called the "RLF Income and Expense Statement" (Form ED-209I). RLF recipients can submit written requests to EDA regional offices to obtain approval to submit reports past the due date.[20]

We tested whether semiannual reports were submitted on time for calendar years 2011, 2012, and 2013. Of the 210 semiannual reports we reviewed, we found 19 instances of past due reports without the region sending a past due notice to the

[19] The OMB Circular A-133 Compliance Supplement related to the RLF program refers to the semiannual report as the Semi-Annual Report for EDA-Funded RLF Grants. However, the ED-209 semiannual report is titled Revolving Loan Fund Semi-Annual Financial Report.

[20] The semiannual reports for the periods ending March 31 and September 30 are due on April 30 and October 31, respectively.

RLF recipient.[21] In one region, 3 of the 10 RLFs reviewed were more than 60 days late in submitting the report, and there was no correspondence in the file indicating EDA approved more time to submit the report.

We found a lack of correspondence in some of the files, because written notices and e-mails were lost or not retained in some regions. As a result, EDA could neither verify whether it notified RLF recipients about past due semiannual reports nor confirm that it considered terminating the RLF when reports were more than 60 days late without an approved extension.[22]

Since implementing the RLFMS system recommended in our 2007 report, EDA improved its procedures for tracking semiannual report submissions, documenting requests for and approving report extensions, and notifications for when reports are past due, when the RLFMS was functioning. However, without a functioning RLFMS, two of the three regions we visited did not have a reliable alternative tool for verifying the historical validity and mathematical accuracy of the semiannual reports it receives from RLF recipients.

Of the 21 RLFs that we included in the audit and that were required to submit an RLF Income and Expense Statement with the semiannual report, 7 did not turn in the report to EDA. Without semiannual and RLF Income and Expense Statement reports, EDA lacks important information about the program and the particular RLF's performance for the reporting period. The absence of the reports limits EDA's ability to effectively monitor compliance with certain terms and conditions of the grant.

D. At least two EDA regional offices do not use single audit report results to monitor RLF performance

RLF recipients are required to report outstanding RLF loan balances at the end of each year on their Schedule of Expenditures of Federal Awards (SEFA).[23] Grant recipients that spend \$750,000[24] or more in federal awards per fiscal year, which include RLF loan balances, must have a single audit performed in accordance with OMB Circular A-133.[25] Alternatively, if the recipient's only federal award is from EDA's RLF program, a

[21] EDA, *Fiscal Year 2011 RLF Program Policy and Operational Guidance*, "I. Ensuring Grantee Compliance with Critical Reporting Requirements," 1, 2.

[22] 13 CFR § 307.21(a)(1)(iv).

[23] EDA, *Fiscal Year 2011 RLF Program Policy and Operational Guidance*, "IV. Ensuring that EDA Utilizes Single Audit Reports to Improve Grantee Monitoring," OMB Circular No. A-133 Audit Requirements, 2. For the purposes of the SEFA, the RLF balance reported is calculated as follows: (1) balance of the RLF loan outstanding at the end of the fiscal year plus (2) cash and investment balance in the RLF at the end of the fiscal year plus (3) administrative expenses paid out of RLF income during the fiscal year. This sum is then multiplied by the federal share of the RLF, which is also defined as the federal participation or grant rate.

[24] For fiscal years beginning prior to January 1, 2015, the single audit threshold was \$500,000 or more.

[25] OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, issued pursuant to the Single Audit Act of 1984 (Pub. L. No. 98-502), as amended by the Single Audit Act Amendments of 1996 (Pub. L. No. 104-156).

program-specific audit is allowed. EDA requires submission of a copy of the single or program-specific audit to the Federal Audit Clearinghouse (FAC) Image Management System, where federal agencies can access the audit reports online. Following issuance of our last report on the RLF program[26]— and in response to OIG's recommendation that EDA use single audit reports to improve grantee monitoring—EDA distributed policy and operational guidance to regional directors and their staff, advising them of specific ways to use audit reports to improve management and oversight of the RLF program. For example, the operational guidance emphasizes use of single audits to obtain information about a grantee's internal controls over RLF assets, grantee compliance with award terms and conditions, and the accuracy of information in the grantee's reports.

OIG reviewed files to determine whether regions use single and program-specific audits to monitor the RLF activities in their portfolio. We found that two of the three regional offices did not have sufficient controls to ensure that RLF recipients submit single audit or program specific reports when required. Additionally, we found that audit findings impacting the RLF program are not consistently identified and the RLF recipient was not contacted for follow-up.

Procedures for monitoring compliance with single audit report submissions and audit findings impacting the RLF vary in their effectiveness. One region tracked single audit report submissions and federal audit findings directly related to or impacting the RLF program, and had a tool for determining whether the RLF program was correctly recorded and valued on the SEFA. Another region used a spreadsheet to track whether a report was submitted to the FAC but did not identify and follow up on audit findings relating to the RLF program. The third region had not verified whether its RLF recipients submitted single audit reports when required, instead relying on the single audit self-certification in part IV of the ED-209 "Semi-Annual Report" with follow-up on RLF program audit findings only if it received correspondence from OIG as part of the audit resolution process.

Some regional EDA officials we interviewed stated that they generally rely on OIG's review of single audit reports to alert them to audit findings at the recipient's organization. While a useful tool, an OIG single-audit review should not be relied upon exclusively or significantly as part of EDA's programmatic internal controls. When regional offices do not use single and program-specific audits as a tool to monitor RLF performance, they miss an opportunity to identify operational and programmatic issues that indicate problems in administering the RLF program. Furthermore, as of December 2014, OMB guidance provided for increased oversight of single audit finding resolutions by departments and their bureaus.[27] Therefore, OIG transferred responsibility for the processing and review of nonfederal audit findings to the Department and its bureaus—

[26] DOC OIG, *Aggressive EDA Leadership and Oversight Needed to Correct Persistent Problems in RLF Program*, 19.

[27] OIG sent a memorandum on December 22, 2014, to the Assistant Secretary of Administration stating that effective December 26, 2014, OIG will no longer download or review nonfederal audit reports. After that date, bureaus will be responsible for reviewing and resolving any audit findings.

and EDA can no longer rely on an OIG review as its control over how recipient organizations are monitored.

E. EDA has not required grantees to submit updated RLF plans

Grantees manage their EDA-funded RLFs according to the financing strategy and portfolio standards described in written and EDA-approved RLF plans. These plans are initially submitted to EDA as part of the grant application and contain administrative procedures for operating the RLF. Recipients must submit updated plans to EDA at least every 5 years—or more often as prompted by changing economic conditions. Recipients also must obtain preapproval from EDA to modify their RLF plan if it requires substantial revisions due to changes in surrounding operation and administration of the projects taking place.[28]

Several projects included in our audit had RLF plans more than 5 years old. For one project in the Chicago region, we found that EDA had not approved the addition of a lending area. For one project in the Philadelphia region, we observed a large increase in the maximum size of the loan amount (see finding I.A.). For significant revisions such as these, the grantees should have submitted requests to EDA and obtained approval in advance. Arguably, those revisions amend the grant and, at a minimum, should have been disclosed in an updated RLF plan approved by EDA.[29]

Because many of EDA's RLFs are old (some were originally funded in the mid-1970s) and economic changes have occurred since their inception, modifications to the RLF plans are especially relevant to ensuring the intended purposes of the RLFs are met and the loans managed according to EDA's expectations. Updated RLF plans would also indicate whether a region is still considered economically distressed or whether the special need the RLF was originally created for still exists to determine whether funding is still needed in the area.

II. Inflexibility in Current RLF Regulations and Limited Resources Reduce EDA's Ability to Effectively Oversee Problematic or Underutilized RLFs

When evaluating whether a proposed project is eligible for an RLF award, EDA uses three criteria to measure economic distress in the affected community where loans might become available to businesses. As of the application date, one or more of the following conditions must exist in the region where the RLF project is located:[30]

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[28] 13 CFR § 307.9(c) discusses changes to RLF plans.

[29] 13 CFR § 307.9 (c)(2) says, "Any material modification [to the plan], such as a merger, consolidation, or change in the EDA-approved lending area under § 307.18, a change in critical management staff, or a change to the strategic purpose of the RLF, must be submitted to EDA for approval prior to any revision of the Plan. If EDA approves the modification, the RLF Recipient must submit an updated Plan."

[30] 13 CFR § 301.3(a)(1).

- the unemployment rate, for the most recent 24-month period for which data are available, is at least one percentage point greater than the national average unemployment rate;
- per capita income, for the most recent period for which data are available, is 80 percent or less of the national average per capita income; or
- a special need[31] exists.

Additionally, projects located in an economic development district (EDD) can qualify for an RLF award if EDA finds that the project will provide significant employment opportunities for unemployed, underemployed, or low-income residents in a geographic area within the EDD that meets the distress criteria outlined above.[32] According to RLF administrators, once EDA concludes that a project is located in an economically distressed area, and when an RLF award is offered and accepted in that area, EDA considers the region eligible permanently.

For this audit, OIG looked at unemployment rates and per capita income in the lending areas for all 35 RLFs reviewed. We found that 12 of those programs, totaling approximately $50 million in capital base as of September 30, 2013, operate in lending areas that are no longer distressed based on an average of median incomes and unemployment rates during the period 2009–2012. We did not consider whether a special need existed; however, if EDA consistently reviewed RLF plans every 5 years, which it currently is not doing, it should be able to determine whether special needs continue to exist in specific RLF lending areas.

EDA regulations do not instruct the regional offices to periodically evaluate whether the communities with RLFs are still distressed. Further, unlike other EDA programs, RLFs do not have a predetermined end. The loan fund continues until it is transferred to another RLF recipient, consolidated with another RLF, or terminated by EDA or the grantee. Consequently, the oldest RLFs may have begun over 30 years ago and revolved[33] many times—making them subject to the same semiannual reporting and many of the other requirements that apply to newer RLFs.

With the significant effort it takes to adequately monitor a large portfolio of long-standing RLFs, EDA's limited staff time and tools currently available do not allow for proper oversight. EDA should explore opportunities to simplify or reform management of the program. This could include defederalization of RLFs, inclusion of sunset provisions in RLF

[31] As defined in EDA regulations, a special need means "a circumstance or legal status arising from actual or threatened severe unemployment or economic adjustment problems resulting from severe short-term or long-term changes in economic conditions." 13 CFR § 300.3. Examples include substantial population loss, underemployment, military base closures or realignments, natural or other major disasters, extraordinary depletion of natural resources, closing or restructuring of an industrial firm or loss of a major employer, and negative effects of changing trade patterns.

[32] 13 CFR § 301.3(a)(2).

[33] Each RLF has a disbursement phase and a revolving phase. During the revolving phase, all grant funds have been disbursed and the recipient cannot draw down new funds from EDA.

awards, allowing the funds to be transferred to another EDA program, or assigning additional staff to oversight of the RLF program.

EDA has sought the ability to defederalize RLFs, whereby RLFs lose their federal identify once they have been loaned out a set number of times and specific conditions are met. Similarly, they have sought the ability to transfer RLF funds to other EDA programs. However, in order for these actions to occur, the agency must collaborate with Congress and other stakeholders. Allowing RLFs to continue indefinitely, and attaching federal requirements to RLFs that have revolved over an extensive period of time, restricts EDA's ability to adequately oversee all of its RLF projects, given the limited resources allocated to management of the program. EDA and RLF recipients are also at a disadvantage when oversight is deficient, as it potentially exposes the program to undetected mismanagement (including misuse and loss of funds).

The sustained low utilization of some RLFs may be evidence that the RLFs are operating in communities that no longer need them or do not require an RLF of that size. Inclusion of a sunset provision in RLF awards—under which RLFs would be required to demonstrate the continued need within the community on a recurring basis—may allow the agency to focus its resources in regions that are currently distressed or underserved. If an RLF is found no longer to be serving a distressed or underserved community, or the community can be served by a smaller RLF, EDA could transfer those resources to new RLFs or recapitalize existing RLFs serving communities with greater need.

Recommendations

We recommend that the Assistant Secretary of Commerce for Economic Development improve the internal controls for the RLF program in the Chicago, Philadelphia, and Seattle regional offices. EDA should also verify whether improvements should be made in the regional offices not included in our audit. Specifically, we recommend that the Assistant Secretary of Commerce for Economic Development direct the appropriate EDA regional officials to do the following:

1. Reimplement RLFMS or a replacement system that includes standard grantee reporting, program monitoring, and file maintenance.
2. Develop an improved process for monitoring grantee sequestrations of excess funds, default rates, and semiannual reporting requirements, as well as timely corrective actions for noncomplying RLFs.
3. Document determinations on whether RLFs with multiple periods of excess funds should be terminated, transferred, or consolidated—or have funds partially deobligated or transferred from them.
4. Develop a staffing plan to balance the workload of RLF administrators.
5. Develop an improved process for identifying required single audits and enforcing the consequences of noncompliance.
6. Identify projects with RLF plans more than 5 years old and document determinations on whether those plans require modifications—including determinations on whether

a need for the RLF still exists in a particular location or whether funds should be transferred.

7. Document considerations and potential consequences of possible RLF program adjustments, including defederalization of funds, transferring funds to other EDA programs, and sunset provisions.
8. Evaluate conditions related to the grantee identified in this report that executed a loan exceeding the maximum amount allowed in its RLF plan, including but not limited to (a) verifying that the grantee's RLF plan is current and EDA-approved, (b) determining whether the loan met the requirements in the approved RLF plan, and (c) either acquiring a waiver from the maximum loan amount allowed in its RLF plan or pursuing corrective action.

Summary of Agency Response and OIG Comments

OIG issued the draft report on April 3, 2015. On May 20, 2015, OIG received EDA's response, which we include as appendix D of this final report. The Assistant Secretary of Commerce for Economic Development concurred with all but one of our eight recommendations—and noted the bureau has begun to make progress on implementing corrective action for the improved use of funds on a subset of RLFs, established a policy that new RLF funding requires final approval by the Assistant Secretary, and started implementing new internal controls in all their programs, including the RLF program, based on guidance from new manuals.

EDA did not agree with our recommendation to further review a specific grantee's loan discussed in the report. We reaffirm our recommendation and advise EDA to continue to improve in their efforts to ensure that RLF plans are current and approved in a timely manner—and that the type of information contained is consistent throughout all plans. We will address EDA's efforts in these areas during the audit resolution process.

EDA also submitted technical comments to the draft report, and we made some changes to the final report based on these comments and suggestions. In particular, we adjusted the capital base reported for one regional office and clarified our comparison of RLF default rates to commercial lender default rates.

Appendix A: Objective, Scope, and Methodology

Our objectives were to determine, within the RLF program, whether EDA effectively responds to performance problems or changes to distressed or underserved communities.

We performed the following procedures to accomplish our audit objectives:

- Interviewed regional directors and staff in the six EDA regional offices whose duties include oversight of RLF projects to understand their practices for monitoring RLFs in their regions
- Interviewed the RLF coordinator at EDA headquarters to understand the monitoring of RLFs nationwide
- Analyzed RLF financial and operational data provided by EDA
- Reviewed relevant laws and regulations, including Department of Commerce Catalog of Federal Domestic Assistance 11.307, "Economic Adjustment Assistance" and EDA's *Fiscal Year 2011 Revolving Loan Fund Program Policy and Operational Guidance*
- Used the Federal Audit Clearinghouse Image Management System to obtain single audit reports and to identify audit findings impacting the RLF program
- Judgmentally selected RLF projects to include in the audit based on risk indicators
- Reviewed EDA's RLF project files and correspondence between EDA and RLF recipients that show EDA's efforts to monitor compliance with terms and conditions of the RLF grant

No specific instances of fraud, illegals acts, significant violations, or abuse were identified in our audit. However, due to the amount of missing documentation noted, EDA has a more limited assurance that such activity has not occurred within the RLF program. We did not solely rely on computer-processed data to perform this audit. Although we could not independently verify the reliability of all the information we collected, and did not test for historical validity in the semiannual reports, we compared the information with other available supporting documents to determine data consistency and reasonableness. Based on these efforts, we believe the information we obtained is sufficiently reliable for this report.

Our audit was not a statistical sample of all RLF programs in all EDA regions. Therefore, the results should not be used as conclusive evidence of the controls in place for the RLF programs or EDA regional offices not included in our audit.

We conducted our audit from February 2014 through September 2014 and performed fieldwork in three of EDA's regional offices: Chicago, Philadelphia, and Seattle. The scope of our audit was FYs 2012 and 2013. The audit was conducted under the authority of the Inspector General Act of 1978, as amended, and Department Organizational Order 10-13, dated April 26, 2013. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence that provides a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Appendix B: Federal Funds Added to EDA RLFs, 2008–2013

Table 2: New and Recapitalized[a] RLFs, by EDA Region, 2008–2013[a]

		Atlanta	Austin	Chicago	Denver	Philadelphia	Seattle	TOTAL
New RLFs		2	3	7	19	8	1	40
		$3,515,168	$10,700,000	$5,691,307	$12,185,000	$7,900,000	$1,000,000	$40,991,475
Recapitalized RLFs		0	2	0	2	0	1	5
		-	$960,000	-	$1,065,051	-	$500,000	$2,525,051
TOTAL		2	5	7	21	8	2	45
		$3,515,168	$11,660,000	$5,691,307	$13,250,051	$7,900,000	$1,500,000	$43,516,526

Source: EDA

[a] EDA occasionally provides additional financial assistance to an existing RLF grant award. Whether a recipient's RLF is recapitalized depends on successful management of the RLF and whether Congressional appropriations exist to grow the RLF program.

Appendix C: Funds to Be Put to Better Use

Table 3: Funds to Be Put to Better Use by EDA Regional Office

EDA Regional Office	Funds to Be Put to Better Use
Chicago	$11,552,338[a]
Philadelphia	$24,356,220[b]
Seattle	$10,550,112[a]
Total Funds Put to Better Use	**$46,458,670**

Source: EDA

[a] Amount includes only RLFs with EDA approved extension requests to delay sequestration. We did not take into account RLFs being terminated, transferred or those with excess funds that did not need to be sequestered during the March 2014 period.

[b] Amount does not include RLFs being terminated or transferred.

Appendix D: Agency Response

UNITED STATES DEPARTMENT OF COMMERCE
The Assistant Secretary for Economic Development
Washington, D.C. 20230

MEMORANDUM FOR: Andrew Katsaros
Principal Assistant Inspector General for Audit and Evaluation

FROM: Roy K.J. Williams J. Guerra for Asst. Sec. Williams
Assistant Secretary of Commerce for Economic Development

SUBJECT: Response to Draft OIG Report (April 3, 2015)—"EDA Faces Challenges in Effectively Monitoring its Revolving Loan Funds"

DATE: May 20, 2015

The Economic Development Administration (EDA) appreciates the opportunity to review and comment on the Office of Inspector General (OIG) Draft Report concerning EDA's Revolving Loan Fund (RLF) program.

At the outset, EDA appreciates the OIG indicating that "[n]o specific instances of fraud, illegal acts, significant violations, or abuse" were identified in the audit. Furthermore, we note that the OIG audit findings address whether RLF funds should have been put to better use, not whether RLF funds were misused.

We highlight that EDA has already taken steps to address corrective issues for improved use of funds and is executing a long-term action plan to institutionalize needed controls and program improvements. EDA is committed to ensuring that the RLF program is well managed according to the highest standards expected of us by our community grantees and the American taxpayer.

We also emphasize that for more than forty years, the RLF program has proven to be an invaluable tool in helping communities all across the United States foster job creation and business growth. The RLF program is a staple in EDA's suite of economic development programs designed to build capacity in distressed communities. Specifically, the RLF program enables community non-profits to help small businesses obtain capital when traditional lenders are not an option.

Since its inception, RLF program non-profit operators have made more than 27,000 loans to small businesses, leading to the creation of more than 340,000 jobs while leveraging more than $12 billion in private investment. The program is self-renewing, creates additional access points to capital for businesses, and is a low-cost way to provide credit assistance to otherwise challenged borrowers. EDA's RLF program has sustained viability through many national business cycles.

It is in this context that we provide the following response to the Draft Report.

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General Comments

EDA Has Already Taken Immediate Corrective Action

Starting in July 2014, EDA performed an in-depth review of its entire RLF portfolio to identify RLFs for additional potential corrective action for improved use of funds. This review included the thirty-five (35) specific RLFs from three regional offices that the OIG selected for auditing[1]. Together with the 35 OIG-selected RLFs, EDA began implementing corrective action for improved use of funds on a sub-set of RLFs totaling $175 million in combined capital base, with an EDA share of $139 million. This represents 19.8% of the total RLF portfolio capital base and 24.9% of the total EDA share.

To date, EDA can report that it has completed corrective action for improved use of funds for RLFs with $88 million in combined capital base, and resolution for improved use of funds is underway on the remaining RLFs representing $87 million in capital base.

In addition, beginning in July 2014, EDA established a policy that all new RLF funding applications require final approval by the Assistant Secretary in order to provide an additional layer of oversight.

Furthermore, in 2014, EDA began implementing more robust internal controls across all of its programs, including the RLF program, with a new *Policy and Operations Manual* and a new *Grants Procedures and Best Practices Manual*.

EDA Has Already Developed a Comprehensive Long-Term Action Plan

To strengthen our oversight process and sustainably improve the RLF program itself, EDA has developed and is executing a comprehensive and longer-term action plan. The centerpiece of the action plan is a risk-based evaluation and monitoring methodology that will be used to analyze and evaluate an RLF's capital base, asset (loan quality), management, earnings and administrative expenses, liquidity, strategic results (including job creation and stimulating private investment), and audit and reporting compliance. This risk-based monitoring approach will provide a systematic risk profile for every EDA RLF and thereby identify, on a regular basis, those RLFs with high-risk profiles that may be in non-compliance and require corrective action. EDA intends to solicit feedback from the OIG on our new approach and work closely with the OIG as details are fleshed out and implementation progresses.

The action plan has other key components, including improvements to staffing, training, and the IT monitoring system. Additionally, in order to address the administrative burden and policy limitations associated with maintaining oversight of RLFs in perpetuity as currently required by law (recognized and cited in the Draft Report), EDA is seeking legislation that will expand the agency's authority to release the Federal Interest in RLF assets.

More specific details on the elements of our long-term action plan are provided below.

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[1] The 35 RLFs audited by the OIG had a combined capital base of $92 million, with an EDA share of $81 million. This represents 10.4% of the total RLF portfolio capital base and 14.5% of the total EDA share.

EDA Generally Agrees with the OIG Recommendations, But Believes That a Number of the Conclusions are Overbroad

While EDA concurs with all but one of the recommendations in the Draft Report, we point out that the conclusions described in the cover memorandum, section headers, and certain discrete sections of the Draft Report are overbroad. Broad mention of "EDA" deficiencies are not qualified to reflect more accurately that only a small sample of RLFs were audited. Furthermore, the cover memorandum and section headers often use the broad-brush phrase "EDA has not" when the phrase "EDA has not consistently" would be more accurate and appropriate. Finally, the cover memorandum and section headers do not provide, in our view, appropriate context. Significant qualifying facts are not mentioned prominently, including any reference to the longstanding "challenges" that have confronted the agency in its oversight efforts.

Specific Responses to the OIG Recommendations

Recommendation 1: Re-implement RLFMS or a replacement system that includes standard grantee reporting, program monitoring, and file maintenance.

EDA Response: EDA agrees with the recommendation.

In January 2012, EDA's IT disruption resulted in the discontinued use of the Revolving Loan Fund Management System (RLFMS) because the system was deemed at that time to be an IT security threat. In August 2013, access to the regional offices was substantially restored and measures were put in place to ensure required grantee information was received.

Nevertheless, it is EDA's position that, even when RLFMS was operational, it was flawed and, on balance, has impeded our management and oversight efforts from both the grantee/operator and RLF Administrator perspective.

Therefore, EDA is actively working to acquire a more robust, user-friendly automated reporting and data management system that will facilitate compliance for RLF grantees and support the agency's oversight efforts. Such a system will allow RLF grantees to enter information concerning individual loans in their lending portfolio more quickly, timely, and accurately, and complete reporting requirements and revisions as required. For EDA, the system will enable individual loan data to be easily aggregated at various levels of reporting from RLF grantee level to program-wide level, analyzed and reported for program and grantee management purposes.

To achieve those results, EDA has prepared a Statement of Work for a contractor to develop business, functional and reporting requirements as identified by EDA RLF program and information technology staff that will be used to solicit proposals from qualified vendors for the provision of an RLF reporting and data management system. EDA expects to have procured a contractor by September 2015. Upon completion of the requirements gathering phase, EDA expects to implement its new information system by August 2016.

Recommendation 2: Develop an improved process for monitoring grantee sequestrations of excess funds, default rates, and semiannual reporting requirements, as well as timely corrective actions for noncomplying RLFs.

EDA Response: EDA agrees with the recommendation.

EDA agrees with the OIG that the agency faces on-going challenges in its efforts to effectively monitor its RLF grant portfolio. As discussed above, this is precisely what has motivated EDA to develop its long-term plan for a comprehensive overhaul of the RLF program, including a transition to a risk-based performance model program approach and a more robust, user-friendly automated reporting and data management system.

In the short term, EDA has taken substantive steps to improve its oversight process. For example, with respect to RLFMS, EDA has placed RLFMS in a "read-only" mode where it will be used primarily for historical data purposes. In place of the limited role for RLFMS, EDA has proactively created a reporting tool, accessible by both regional and headquarters staff, that aggregates RLF reporting data from the fillable PDF version of the semi-annual report (Form ED-209) submitted by RLF grantees. EDA believes this interim approach will help to provide a consistent mechanism for monitoring and ensuring program compliance until the long-term solution is implemented.

On a related note, one of the most significant challenges that EDA must overcome is institutional and not in the agency's control; namely, the very heavy volume of EDA's RLF portfolio, which itself stems from the fact that, since RLFs exist in perpetuity, many RLFs are extremely old. EDA estimates that approximately 79 percent of EDA RLF awards are more than 20 years old. The "de-federalization" of RLF funds (*see* Response to Recommendation 8) through an amendment to EDA's enabling statute, the Public Works and Economic Development Act of 1965 (42 U.S.C. § 3121 *et seq.*) (PWEDA), would significantly decrease the volume of RLFs that require monitoring. As the OIG itself recognizes, de-federalization would allow EDA to focus its limited resources on more recently established RLFs and those that might be having problems operationally and/or with compliance.

Recommendation 3: Document determinations on whether RLFs with multiple periods of excess funds should be closed or have funds de-obligated or transferred from them.

EDA Response: EDA agrees with the recommendation.

As a threshold matter, and to establish a baseline for terminology, EDA does not "close" RLFs. RLFs are terminated, transferred or merged/consolidated. Additionally, for clarification, EDA does in fact de-obligate RLF funds if they have not been fully disbursed within the usual three-year disbursement period or in the period provided for if an amendment to extend the disbursement period has been executed.

However, EDA concurs that it must make and document determinations to address the issue of excess funds in order to position the RLF Operator for improved performance and compliance with the capital utilization standard resulting from a reduced size and more manageable RLF capital base.

EDA believes it can be successful in reducing the excess cash balance of its overall portfolio by taking the appropriate actions to disallow, de-obligate, or partially terminate the excess cash portion of an RLF grant. As outlined above, EDA's movement to a risk-based monitoring approach will systematically identify those RLFs with high-risk profiles that may be in non-compliance and require corrective action, including those with excess cash balances. EDA will revise its excess cash policies to align with the proposed risk-based methodology.

Recommendation 4: Evaluate conditions related to the grantee identified in this report which executed a loan exceeding the maximum amount allowed in its RLF plan, including but not limited to (a) verifying that the grantee's RLF plan is current and EDA-approved, (b) determining whether the loan met the requirements in the approved RLF plan, and (c) either acquiring a waiver from the maximum loan amount allowed in its RLF plan or pursuing corrective action.

EDA Response: EDA does not agree with the recommendation.

This recommendation focuses on one specific loan made by one un-named grantee. The recommendation indicates that EDA should have taken one of three actions to remedy the approval of a loan that purportedly exceeded the RLF maximum.

EDA acknowledges that the RLF plan of the grantee, as submitted in an amendment dated March 1, 2013, was not approved by the Philadelphia Regional Office until April 7, 2015. However, the approved RLF plan contains no reference to a maximum loan amount and contains a provision that allows for one-time exceptions to a lending parameter in the event of exceptional economic benefits with the approval of the Senior Lending Officer and the concurrence of the RLF Loan Committee and the Board of Directors. Per the grantee, these conditions have been met. Therefore, EDA has found the loan in question to be consistent with the RLF plan.

The focus on this specific loan raises a larger, program-wide issue that should be mentioned. Inclusions of such exception provisions in RLF plans are relatively frequent. These permissible exceptions give RLF grantees the ability to react to unanticipated, exceptional and nonrecurring circumstances without delays caused by the EDA approval process. This makes the RLF more capable of quick action, if required, without EDA approval and in no way impedes proper oversight, nor puts federal funds at additional risk. Such flexibility, in the end, allows the RLF program to better serve small businesses in need of capital and communities seeking jobs and investment.

Recommendation 5: Develop a staffing plan to balance the workload of RLF administrators.

EDA Response: EDA agrees with the recommendation.

EDA agrees that challenges exist with respect to balancing the workload of RLF Administrators, and we have already taken steps to address this issue in the immediate-term while also developing a longer-term action plan.

In the short term, EDA has already added additional staff in its regional offices for the RLF program, boosting the resources available. EDA is exploring the possibility of bringing on additional permanent staff, as well as temporary staff (i.e., detailed employees) from other federal agencies with similar revolving loan fund programs. This approach will benefit EDA by onboarding experienced staff with specific expertise in banking, finance and revolving loan funds to immediately assist with RLF oversight and policy revision and provide useful guidance and recommendations to our existing staff.

EDA is researching appropriate external training courses to strengthen the RLF knowledge base of EDA employees. EDA also plans to develop an internal training program focusing on effectively and efficiently monitoring RLFs to cross-train EDA employees who do not currently administer RLF grants.

Furthermore, EDA's movement to a risk-based monitoring approach will systematically identify those RLFs with high-risk profiles that may be in non-compliance and require corrective action. Such methodology would provide the basis of a system of triage, by which attention and limited resources can be effectively applied to RLFs requiring most significant and/or urgent action, and relieve a portion of the administrative burden associated with the program.

Lastly, as mentioned earlier, EDA is cognizant of the positive effects of de-federalizing RLF funds (*see* Response to Recommendation 2 and 8) on our staffing and workload challenges. EDA's analysis indicates that approximately 79% of EDA RLF awards are greater than 20 years old. As the OIG has noted, de-federalization will allow EDA to focus its limited resources on nascent RLFs and those that might be having problems with operations and/or compliance. If de-federalization were to occur, the significantly smaller RLF portfolio would be factored into EDA's staffing plan.

Recommendation 6: Develop an improved process for identifying required single audits and enforcing the consequences of noncompliance.

EDA Response: EDA agrees with the recommendation.

Improvements at EDA for identifying required single audits and enforcing the consequences of noncompliance are already moving forward. EDA has created and will continue to develop effective and efficient tools to enhance Single Audit Report (SAR) identification and monitoring as part of its phased RLF overhaul plan.

Enforcement actions for non-compliance with SAR requirements currently available to EDA are suspension of lending, de-obligation, and termination for cause or convenience. While implementation of existing punitive policies and procedures has historically been difficult, EDA plans to implement measures to address the enforcement of non-compliance through training and additional guidance.

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Recommendation 7: Identify projects with RLF plans more than 5 years old and document determinations on whether those plans require modifications – including determinations on whether the original need for the RLF still exists in a particular location or whether funds should be transferred.

EDA Response: EDA agrees with the recommendation.

EDA has developed a strategy to ensure that RLF plans are current. EDA regional office staff will require RLF grantees to provide the date of their current RLF plan and all dates will be documented in the newly created reporting tool for RLFs. Each regional office will establish a review schedule, which will set forth a timeline for reviewing RLF plans and providing feedback (including required modifications) to RLF grantees that have plans that are more than 5 years old.

With respect to determinations on whether the "original need" for the RLF still exists in a particular location, EDA emphasizes that there is no statutory authority that requires EDA to take this factor into consideration after the grant is awarded. So long as the RLF operator complies with applicable legal requirements and the provisions of its approved lending plan, there is no reason to compel a transfer simply because the "original need" does not exist. What should dictate the continuing use of RLF funds is not "original need," but rather the existing need of businesses who cannot obtain traditional commercial financing and whether those funds will create jobs and investment.

Recommendation 8: Document considerations and potential consequences of possible RLF program adjustments, including de-federalization of funds, transferring funds to other EDA programs, and sunset provisions.

EDA Response: EDA agrees with the recommendation.

For a number of years, EDA has recognized that statutory limitations have inhibited the agency's ability to remain flexible in response to changing economic circumstances and to efficiently oversee the program. Our priority is to obtain an amendment to Section 601 of PWEDA that will allow EDA to de-federalize qualifying RLFs.

Property acquired or improved using federal grant funds remain property of the United States. The Federal Government can "release" or relinquish its interest in grant-acquired or improved property after a certain period of time if there is statutory authority to do so; without such authority, the Federal Interest in such property continues in perpetuity. What this means for the grantee (or here, the operator of the RLF) is that its flexibility to use RLF funds for different economic development purposes over time remains severely restricted and RLF reporting/documentation requirements remain in effect for as long as the RLF exists. This is why EDA has been seeking a means to release the Federal interest after an appropriate period of time, providing an exit strategy that will alleviate an unmanageable and unnecessary administrative burden on the RLF operators.

Currently, EDA has statutory authority under PWEDA to release its interests associated with real and personal property, but not RLF assets. EDA has proposed legislative language (based on the Administration's formal EDA Reauthorization proposal submitted to Congress in April 2010) that would authorize EDA to release the Federal Interest in RLF assets seven (7) years after final disbursement of the grant proceeds (usually within 36 months of the grant award) provided that EDA determines that the recipient has carried out the terms of the award in a satisfactory manner, that the RLF funds will continue to be used for economic development purposes that are consistent with PWEDA and that the recipient continues to comply with the Davis-Bacon Act. This new authority will increase local autonomy with respect to RLFs and also relieve a portion of the administrative burden associated with the program.