

WASHINGTON PARISH GOVERNMENT
REVOLVING LOAN PROGRAM



COMPLIANCE AUDIT
ISSUED JUNE 7, 2006

**LEGISLATIVE AUDITOR
1600 NORTH THIRD STREET
POST OFFICE BOX 94397
BATON ROUGE, LOUISIANA 70804-9397**

LEGISLATIVE AUDIT ADVISORY COUNCIL

SENATOR J. "TOM" SCHEDLER, CHAIRMAN
REPRESENTATIVE CEDRIC RICHMOND, VICE CHAIRMAN

SENATOR ROBERT J. BARHAM
SENATOR WILLIE L. MOUNT
SENATOR EDWIN R. MURRAY
SENATOR BEN W. NEVERS, SR.
REPRESENTATIVE RICK FARRAR
REPRESENTATIVE HENRY W. "TANK" POWELL
REPRESENTATIVE T. TAYLOR TOWNSEND
REPRESENTATIVE WARREN J. TRICHE, JR.

LEGISLATIVE AUDITOR

STEVE J. THERIOT, CPA

DIRECTOR OF COMPLIANCE AUDIT

DARYL G. PURPERA, CPA

Under the provisions of state law, this report is a public document. A copy of this report has been submitted to the Governor, to the Attorney General, and to other public officials as required by state law. A copy of this report has been made available for public inspection at the Baton Rouge office of the Legislative Auditor and at the office of the parish clerk of court.

This document is produced by the Legislative Auditor, State of Louisiana, Post Office Box 94397, Baton Rouge, Louisiana 70804-9397 in accordance with Louisiana Revised Statute 24:513. Six copies of this public document were produced at an approximate cost of \$15.48. This material was produced in accordance with the standards for state agencies established pursuant to R.S. 43:31. This report is available on the Legislative Auditor's Web site at www.la.state.la.us. When contacting the office, you may refer to Agency ID No. 2549 or Report ID No. 05404063 for additional information.

In compliance with the Americans With Disabilities Act, if you need special assistance relative to this document, or any documents of the Legislative Auditor, please contact Wayne "Skip" Irwin, Director of Administration, at 225/339-3800.



STEVE J. THERIOT, CPA
LEGISLATIVE AUDITOR

OFFICE OF
LEGISLATIVE AUDITOR
STATE OF LOUISIANA
BATON ROUGE, LOUISIANA 70804-9397

1600 NORTH THIRD STREET
POST OFFICE BOX 94397
TELEPHONE: (225) 339-3800
FACSIMILE: (225) 339-3870

June 7, 2006

M.E. "TOYE" TAYLOR, PRESIDENT
WASHINGTON PARISH GOVERNMENT
Franklinton, Louisiana

We have audited certain transactions of the Washington Parish Revolving Loan Program in accordance with Title 24 of the Louisiana Revised Statutes. Our audit was performed to evaluate compliance with United States Department of Agriculture (USDA) program guidelines and to determine the propriety of certain allegations received. While a portion of the grant funds was spent for purposes not allowed by the grant guidelines, we found no evidence to indicate noncompliance with state or federal law. We therefore offer the following information to assist you in the recovery of grant funds and the administration of future grant programs.

Our audit consisted primarily of inquiries and the examination of selected financial records and other documentation. The scope of our audit was significantly less than that required by *Government Auditing Standards*; therefore, we are not offering an opinion on the Parish's financial statements or system of internal control nor assurances as to compliance with laws and regulations.

The accompanying report presents our findings and recommendations as well as management's response. Copies of this report have been delivered to the District Attorney for the Twenty-second Judicial District, the United States Department of Agriculture, and others as required by law.

Respectfully submitted,

Steve J. Theriot, CPA
Legislative Auditor

GD:JLM:DGP:ss

[WASPG06]

	Page
Findings:	
Background.....	3
Inadequate Loan Review	3
Inadequate Cash Management Procedures	5
Lack of Monitoring.....	5
Improper Expenditures	6
Recommendations.....	7
Background and Methodology.....	9
Management’s Response	Appendix A

Background

On December 17, 2001, the USDA approved a Rural Business Enterprise Grant for \$975,000 for the Parish. The purpose of the grant was to set up a “revolving loan program.” The loans would “encourage economic development, tourism and agricultural marketing, and education” through “business expansion and new business development in Washington Parish.”

Breedlove Farms submitted a loan application on March 22, 2002. The amount requested was \$975,000. On April 19, 2002, the Parish’s Loan Application Review Committee (advisory committee) adopted a resolution recommending approval of the Breedlove Farms application. The recommendation was unanimous and specifically cited the “favorable feasibility, pay back, participation, marketing, and financial information” supplied by Breedlove Farms as factors in the decision. The Parish Council subsequently approved the loan. The promissory note allowed Breedlove Farms 10 years for repayment with 120 monthly payments of \$9,320.57 each.

Breedlove Farms received the \$975,000 loan on October 21, 2002. The loan funds were used to build a tourist facility focusing on dairy operations. The facility included a welcome center, educational building, farmers market, and viewing room. Construction on the facility has been largely completed. Breedlove Farms made regular monthly loan payments from November 2002 until July 2003, when it failed to make that month’s payment. To complete construction and catch up on its payments, Breedlove Farms obtained a \$190,000 loan from Central Progressive Bank in December 2003. The Parish subordinated its interest, with USDA approval, in the original loan so that Breedlove Farms could obtain this new loan. Out of the \$190,000 loan proceeds, Breedlove Farms made two more loan payments on the original loan. Since then, Breedlove Farms has failed to make any further loan payments.

Subsequently, Breedlove Farms defaulted on the \$975,000 loan. Based on our analysis, three general factors contributed to the default: an inadequate review process, poor cash management practices, and poor monitoring activities.

Inadequate Loan Review

Although the Parish president is the loan officer for this program and ultimately responsible for administering the loan fund, the USDA has an obligation to supervise grant recipients as necessary to “assure that projects are completed in accordance with approved plans and specifications and that funds are expended for approved purposes.” The Parish and USDA review processes failed to ensure that the business plan was based on realistic estimates and projections and allowed over \$100,000 in loan funds to be spent on paying off a private mortgage, which is an unallowable cost.

Visitor Projections

The feasibility study submitted by Breedlove Farms projects 95,000 visitors the first year with 10% annual growth. Specific projections included 15,000 student visitors; 25,000 visitors for special events; 15,000 out-of-state visitors; and 40,000 visitors from Louisiana/Mississippi.

However, the study does not provide a detailed basis for any of the projections. The Parish's advisory committee and USDA does not appear to have questioned the projections.

The feasibility study does reference a study by S.W. Leader & Associates. This study was made to "determine the interest and enthusiasm for an attraction of this type." According to the S.W. Leader & Associates study, the projected number of visitors to Breedlove Farms was 46,200--less than half the projected number used in the feasibility study supporting the Breedlove Farms loan application. Had this projection been used in the Breedlove's feasibility study, there would have been insufficient revenue to cover projected expenses and the project likely would not have been feasible. In addition, it does not appear that the advisory committee or USDA had access to the S.W. Leader & Associates report during its review of the Breedlove Farms loan application.

According to Breedlove Farms' business records, Mr. Donald Crist prepared the business plan and the accompanying feasibility study. We attempted to speak with Mr. Crist to determine the basis of the visitor projections but have been unable to contact him.

Construction Projections

According to the Breedlove Farms' budget, of the \$975,000 loan, \$500,000 was for new construction and \$100,000 was for machinery and equipment. The new construction included four buildings: a welcome center, farmers market, education building, and viewing room. Based on the square footage of the buildings and the cost figures in the budget, the cost of these buildings ranged from \$8.33 to \$30.25 per square foot.

The budget does not include estimates supporting the cost projections. However, Breedlove Farms obtained a construction estimate approximately six months before submitting the loan application and budget. The estimate included square footage costs of \$15 to \$60, approximately double the estimates in the budget. Breedlove Farms also obtained three additional construction estimates after submitting its loan application. Each of these estimates indicates costs well in excess of the \$500,000 budgeted by Breedlove Farms. The fact that Breedlove Farms was later forced to acquire private financing to complete construction suggests that the original budget was not realistic. At no point did the advisory committee or USDA review any construction estimates to evaluate the budget supplied by Breedlove Farms.

Prepaid Rent

The original Breedlove Farms loan application included \$150,000 for the line-item "Existing debt to be paid." The debt to be paid was one of two personal outstanding mortgages (one at Hibernia and one at Citizens Bank) on the Breedlove's property. During its review of the loan application, the USDA disallowed this expenditure concluding that it contributed to farm operations, which is not allowed according to the grant regulations.

The revised Breedlove Farms loan application did not include a line-item for "Existing debt to be paid." However, there was a new \$150,000 line-item for "Pre-paid Rent." The pre-paid rent was based on a lease agreement between Penny and Richard Breedlove and Breedlove Farms.

According to the agreement, the Breedloves would lease 5.83 acres of their land to Breedlove Farms. The lease amount was \$150,000 (\$15,000 per year for 10 years) paid in advance. The tourist facilities were to be built on this land.

The Parish and the USDA approved the revised loan application despite the highly questionable nature of this expenditure. Ms. Breedlove confirmed that she used the pre-paid rent to pay off the personal Hibernia Bank mortgage as well as other personal expenditures. The characterization of this \$150,000 as “Pre-paid Rent” appears to have been an effort to circumvent the USDA’s refusal to allow loan funds to be used to pay off the personal mortgage. This expenditure should have been disallowed through the review process of the Parish and the USDA.

Inadequate Cash Management Procedures

The Parish disbursed the entire loan amount of \$975,000 to Breedlove Farms in one lump-sum payment on October 21, 2002. Disbursement of the entire loan amount up-front is unusual, especially considering that the bulk of the loan amount was budgeted for new construction. Normal practice on construction loans is the use of a “draw system,” where funds are allocated at intervals and new disbursements are contingent upon satisfactory progress.

Code of Federal Regulations (CFR) Title 7 Part 3015.61 states that “there shall be specific procedures established to minimize the time elapsing between the advance of the Federal grant or subgrant funds and their subsequent disbursement by the recipient.” The Parish does not appear to have put in place any procedures to minimize this interval. Breedlove Farms was still making expenditures from the original loan amount of \$975,000 as late as June 2003, seven months after receipt of the loan funds.

In addition, Breedlove Farms accrued approximately \$2,255 of interest during this seven-month period. According to CFR Title 7 Part 3015.46, loan recipients “shall remit to the Federal government any interest or other investment income earned on advances of USDA grant funds.” This interest was not remitted to either the Parish or the USDA.

Lack of Monitoring

In its Scope of Work, the Parish states that “it has no experience operating a revolving loan fund” and that “The Parish President will contract with a fiscal agent to employ that expertise and to perform servicing functions.” This deficiency was noted by the USDA which asked the Parish for a fiscal agency agreement.

The Parish signed a fiscal agency agreement with Central Progressive Bank (CPB) on January 31, 2002. According to the agreement, CPB was the Parish’s agent in administering the revolving loan program. CPB’s responsibilities under the agreement were to handle loan closings, service the loan, and provide loan status reports. CPB’s compensation was a \$1,000 fee at closing and a \$25 service fee to be included with each payment. The agreement does not require CPB to manage the loan as it would manage other loans in its portfolio, e.g., requiring

periodic inspections of construction progress and withholding future disbursements until progress is satisfactory.

Parish President M.E. Taylor wanted CPB to assume more responsibility for managing the loan. His office had minimal experience with managing loans and he wanted CPB to manage this loan like any other loan in its portfolio. According to Mr. Taylor, CPB refused to be responsible for the day-to-day management of the loan.

CFR Title 7 Part 3015.90 places the burden of monitoring loan recipients on the grantee, the Parish in this instance. The regulations specifically state that “responsibility [is] on recipients to manage the day-to-day operations of their grant and sub-grant supported activities.” There is no evidence that the Parish implemented any policies or procedures to ensure proper monitoring of the loan recipients. For example, expenditures were not reviewed, construction progress was not assessed periodically, comparisons of actual versus budgeted expenditures were not made, and performance criteria were not developed.

Improper Expenditures

Breedlove Farms used \$23,000 of grant funds for grant writing, preparing loan applications, and an appraisal. None of these expenditures appear appropriate given the grant guidelines which specifically require that expenditures be for the development of the project itself.

Philadelphia Consulting received \$20,000 of this amount. Philadelphia Consulting is a company that appears to be owned by Donald Crist. Invoices supporting this expenditure indicate that \$10,000 was for preparing the Parish’s initial grant application to USDA; \$5,000 was for preparing the application to obtain an Economic Development Award Program grant that was never received; and \$5,000 was for preparing the loan application for Breedlove Farms. In addition, Breedlove Farms paid \$3,000 to obtain an appraisal on the collateral used to support the loan application. All of these expenditures were paid with loan proceeds.

RD Instructions Part 1942 Subpart G - Rural Business Enterprise Grants and Television Demonstration Grants allow “reasonable fees and charges for professional services necessary for the planning and development of the project.” However, the expenses noted above pertain to the grant and loan application process and not to the actual planning and development of the project itself; therefore, these expenditures may be improper uses of loan proceeds.

The Washington Parish Government should adopt the following recommendations with regard to its revolving loan program:

1. Ensure that the advisory committee has individuals with the requisite loan experience to make sound recommendations to the Parish. If this is not practical, consideration should be given to contracting the advisory role to a bank or other financial institution.
2. Discontinue the practice of disbursing all loan funds up-front in one lump-sum. Loan funds should be disbursed at intervals. The use of intervals gives the grantee the leverage to ensure adequate performance by denying future disbursements.
3. Ensure that proper monitoring and supervision is exercised over all loan recipients. If the Parish does not have employees with sufficient skill or available time to manage this process, consideration should be given to contracting this process to a bank or other financial institution or hiring an employee with the requisite skill.
4. Review all expenditures to ensure proper documentation and adherence to budget guidelines and federal regulations.
5. Develop performance criteria that can be used to evaluate progress on future loans. On construction projects, for example, there should be a clear timetable for completion of the construction.
6. Take appropriate legal action upon advice of counsel to recover public funds due to the parish.

This page is intentionally blank.

The Washington Parish Government is a political subdivision of the State of Louisiana. On November 17, 1998, Washington Parish adopted a home-rule charter. The charter provides for a council president and seven elected councilmen representing districts throughout the parish. The current council president is Mr. M.E. Taylor.

The legislative auditor was asked to assess possible improprieties in the Revolving Loan Program administered by the Washington Parish Council. The procedures performed during this audit consisted of (1) interviewing employees of the Washington Parish Council, (2) interviewing employees of Breedlove Farms, (3) examining selected documents and records of the Washington Parish Council and Breedlove Farms, and (4) reviewing applicable state and federal laws and regulations.

This page is intentionally blank.

Management's Response



WASHINGTON PARISH

M.E. "Toye" Taylor, Parish President

Fax (985) 839-7827 • E-mail: toyetaylor@i-55.com

* * * *

Leo Lucchesi
Director of Public Works

5-17-06

Office of the Legislative Auditor
State of Louisiana
1600 North Third Street
Post Office Box 94397
Baton Rouge, Louisiana 70804-9397

Attention: Mr. Steve Theriot

Re: Washington Parish Revolving Loan Program

Dear Mr. Theriot:

I concur with your report faxed to me on 5-2-06 regarding the preliminary draft of your audit on the Washington Parish Revolving Loan Program. I agree and will comply with your recommendations, as printed, on page 6 of the report.

Thank you and your staff for performing this audit for us.

Sincerely,

M.E. "Toye" Taylor
Parish President

MET/cm