

OFFICE OF ECONOMIC DEVELOPMENT

**Monitoring Report
of
SEEDCO FINANCIAL SERVICES, INC.**

**Part 1: Financial Records and Systems
Date of Report: October 29, 2008**

This is a financial monitoring review report of the Community Development Block Grant (CDBG) contract between **SEEDCO Financial Services, Inc. (SEEDCO)**, Contractor and the **City and County of Denver, Office of Economic Development (OED)**, with the following contract information:

Contract Number	Contract Period	Contract Amount
GE71078	07/01/2007 – 12/31/2008	\$ 3,000,000.00

SEEDCO provides and administers community and economic development loans within the City and County of Denver with funds from private corporations leveraged with federal funds. OED contracts with SEEDCO to provide CDBG funded loans to businesses and developers, and provide technical assistance to support this loan activity.

The financial management review is to ensure the CDBG funds are allocated and expended in accordance with the terms of the contract and federal regulations. On September 9, 2008, OED monitors: Ria de Dios, Sr. Financial Management Analyst; and Victoria Lindsay, Contract Administrator; met with SEEDCO - Denver staff: Peter Chapman, Executive Director; Alan Nazzaro, Sr. Financial Services Manager; and Gemma North, Sr. Program Assistant, to review the accounting system and internal control procedures in place.

SEEDCO's financial policies and procedures are on file. SEEDCO uses the *Blackbaud Financial Edge* software to maintain accounting records and produce financial statements. The system accommodates the following financial records: General Ledger, Cash Receipts Journal, Cash Disbursement Journal, General Journal, Accounts Receivable Ledger, and Accounts Payable Ledger. The accounting system is capable of separately identifying individual programs. Payroll is processed through a service bureau called *Paylocity*; the service relies upon software known as *Millennium*. *Norridge* is used to process loan information. *Track it* is used to allocate payroll and collect time sheet data. SEEDCO's time reporting system is highly commendable.

Of the organization's annual budget, approximately 27% comes from the OED contract. Funds are centrally administered and are identified by program codes. The SEEDCO National Office commits to reimburse costs that might be disallowed.

SEEDCO's most recent Audited Financial Statements on OED's file were for the fiscal year ended December 31, 2007. Included in the audit report was an audit finding that was a significant deficiency in internal control over financial reporting. This finding could relate to OED funds in this audit.

The SEEDCO Denver office was established in 2007; management has not disposed of any records since then.

SEEDCO generates program income from the funds received from OED.

The Segregation of Duties Worksheet was completed and reviewed along with existing policies and procedures.

It appears that the current accounting system, Blackbaud Financial Edge, which SEEDCO uses to maintain its financial transactions, is adequate. To determine the adequacy of the system and to ensure that the Contractor is in compliance with federal and state regulations as well as with policies and procedures as prescribed by the City and County of Denver, the following methods were used:

1. Completed the prescribed checklist of Financial Systems and Internal Controls to:
 - a. obtain an overview of the contractor's accounting system;
 - b. examine how disbursements are processed and recorded;
 - c. determine if there is adequate internal control to safeguard assets;
2. Traced a sample of transactions through the contractor's accounting system and documents maintained on file. Since the financial management systems are all maintained at the national office in New York, copies of financial documents and system-generated reports were obtained via email.

The vouchers/invoices relating to SEEDCO's reimbursement requests for the period January 1, 2007 to March 31, 2008 were used in reviewing cash receipts and disbursements.

Findings and Concerns

This report uses two terms to define the results of the monitoring component; ***Findings and Concerns***. A ***Finding*** indicates that the Contractor is not in compliance with an applicable law, regulation, or the terms and conditions of the Contract. A finding requires immediate corrective action to remedy the situation, and timelines are proposed in the recommendation. A ***Concern*** indicates observation of a potential issue that should be addressed to result in increased efficiency or effectiveness. Concerns are also followed by recommendations.

Outcome

Finding 2008-01: Program Income

Criteria: SEEDCO is required to establish a separate Revolving Loan Fund per 24 CFR 570.500 (b) to account for program income. Program income must be spent prior to making additional draw downs from the City per CFR 570.489 (f) (1).

Condition: Per the general ledger, on June 17, 2008, SEEDCO received loan payoff from Inner City Health Center that constitutes program income in the amount of \$800,000. This amount was co-mingled with other funds.

Cause: A separate Revolving Loan Fund was not established to account for program income.

Effect: Seedco made additional draw downs from the City, without first spending program income.

Recommendation: SEEDCO must establish a separate Revolving Loan Fund and provide accounting of program income on or before November 30, 2008. Program income must be spent prior to making additional draw downs from the City.

Views of responsible officials and planned corrective actions:

As soon as it was determined that the CDBG portion of our Loan Repayments were classified as Program Income, the process was started to set up the Account. At the time of this review, the first program income from the Denver CDBG program had just revolved back to Seedco Financial, and was being accounted for in line with our protocols which were provided to OED as part of this review. We are continuing to follow its program income protocols, which are inclusive of all recommendations made by OED regarding program income. A separate interest-bearing account is being established with Wells Fargo here in Denver, where all of our CDBG loan repayments will be deposited. Here is the accounting process:

All Denver CDBG loans will be designated with the grant project code and tracked as such in both Financial Edge (our accounting software) and Northridge (our portfolio management software). This is to ensure that program income is reserved for and spent on only items that are allowable under OMB rules and our agreement with the City of Denver. Loan principal repayments will be reconciled monthly between the accounting and loan portfolio systems and transferred to the new Wells Fargo Interest bearing account in Denver. As we only received our first program income from this project over the summer we are in the process of setting up this set of procedures now.

Anticipated completion date: November 30, 2008

Finding 2008-02: Cash Management

Criteria: 24 CFR 85.21.c. “Advances. Grantees and subgrantees shall be paid in advance, provided they maintain or demonstrate the willingness and ability to maintain procedures to minimize the time elapsing between the transfer of the funds and their disbursement by the grantee or subgrantee.” For CDBG loan funding, all requests for advancement of funds must be supported by documentation evidencing an award, acceptance of the award for funding by the final borrower and the scheduled closing date. In addition, documentation that funds were disbursed must be submitted to OED prior to any additional requests for funds. This documentation will include the executed promissory note, a copy of the check and/or any additional documentation reasonably requested by OED.

Condition: There was no adequate loan closing documentation provided to OED for a \$400,000 economic development loan to Challenges, Choices & Images (CCI) for which SEEDCO received reimbursement. SEEDCO intended to apply the amount to future loan closing, however, no loans have been closed since then.

Questioned Costs: \$400,000.

Cause: The loan did not close after loan approval.

Effect: Cash management regulations were not followed; the funds were not disbursed as requested.

Recommendation: SEEDCO must refund the amount of \$400,000 to OED on or before November 15, 2008. SEEDCO should not, and OED personnel can not authorize, a reallocation of specific loan funds to different loan projects.

Views of responsible officials and planned corrective actions:

CCI loan: This loan was rejected for funding after late revelations about the applicant’s financial status became known. OED staff was notified of the situation and asked about the CDBG funding. On at least two separate occasions meetings were held with James Busby and Terry Ware in which this situation was discussed. In both meetings we were advised to reallocate the CDBG funding to other project loans with notes to the files regarding the transactions, which we proceeded to do. We are about to close on the final \$100,000 for a portion of a Micro-business Loan Fund Capitalization Loan to Colorado Enterprise Fund.

We are in the process of making restitution of the \$400,000 of CDBG drawn down for this loan.

Anticipated completion date: November 28, 2008 (but could be as early as November 24)

Finding 2008-03: Allowable Cost/Cost Principles

Criteria: OMB Circular A-122, Attachment A. A. 2. " Factors affecting allowability of costs. To be allowable under an award, costs must meet the following general criteria:...g. Be adequately documented." Contract Exhibit B.3.1.6 provides that source documents such as cancelled checks, paid bills, payrolls, time and attendance records, contract documents, etc shall be provided for all disbursements. Further, general reimbursement requirement for the SEEDCO contract provides that copies of checks written by the Contractor shall be submitted to verify that the goods or services are on a reimbursement basis, per Contract Exhibit B.1.5.e.

Condition: SEEDCO billed OED for travel reimbursements utilizing the per diem rate while it paid its staff based on actual expenses in accordance with its travel policies and procedures.

Questioned Costs: \$7,294.18

Cause: Not all documentation for staff travel expense statements and reimbursements were submitted to allow verification of actual travel costs chargeable to the grant.

Context: A review of travel expenses for the months of February, June, July, and September, all in 2007, revealed that certain billings to OED were in excess of actual amounts paid to staff. Some verification was made possible because some staff travel expense statements were included as documentation to the bills, but not all. No additional documentation could be provided to allow verification of the rest of the travel expenses reviewed.

Effect: Disallowed costs may have been charged to the grant.

Recommendation: SEEDCO must reconcile all travel expenses billed to OED from the start of the grant in January, 2007. SEEDCO must bill OED only allowable and reasonable travel expenses actually paid to its employees; all expenses must be adequately documented. SEEDCO may bill OED utilizing the per diem rate if it actually paid its staff that rate and if it is consistent with its travel policies and procedures. Depending on the result of the travel reconciliation, SEEDCO must refund disallowed travel expenses, if any, on or before December 31, 2008.

Views of responsible officials and planned corrective actions:

Travel Reimbursements: As discussed with OED reviewer, during the period under review, Seedco billed some travel costs based on estimates, then periodically reconciled amounts to ensure that amounts billed could be substantiated in aggregate by actual costs. A separate schedule was provided to OED during the review that detailed all travel costs incurred under this project and established that Seedco financial had not billed in excess of these allowable costs. We therefore argue that there should be no disallowance of travel costs.

Schedule 1: Summary: This schedule provided to OED staff summarizes Invoicing and actual costs during the period under monitoring. It demonstrates that Seedco has incurred costs of about

\$36K in excess of budget. When indirect is capped at the amount allowable in the budget, however, Seedco billing is \$6,892.00 over actual expenses incurred, due primarily to an over-estimation of fringe costs. We believe this amount should be adjusted out of future invoicing.

Anticipated completion date: December 31, 2008

Finding 2008-04: Allowable Cost/Cost Principles

Criteria: OMB Circular A-122, Attachment A.E.2.c. "Organizations that have previously established indirect cost rates must submit a new indirect cost proposal to the cognizant agency within six months after the close of each fiscal year."

Condition: SEEDCO does not have an updated indirect cost rate agreement with its cognizant agency, the Department of Housing and Urban Development. Its indirect cost rate letter dates back to August 7, 2006.

Questioned Costs: Undeterminable

Cause: SEEDCO has not submitted a new indirect cost proposal to the cognizant agency.

Context: Verification with the Department of Health and Human Services (HHS), as well as with the Department of Housing and Urban Development (HUD), revealed that the latest indirect cost rate proposal by SEEDCO on their file was the one referred to in the indirect cost rate letter dated August 7, 2006. On the other hand, SEEDCO provided OED with a copy of its letter of submission of Indirect Cost Proposal dated September 27, 2007; SEEDCO informed OED that it is awaiting response from HUD.

Effect: By not having an updated indirect cost rate, certain cost items may be doubly counted or overcharged to the grant.

Recommendation: We recommend that SEEDCO submit a new indirect cost rate proposal to the cognizant agency on or before December 31, 2008, and provide a copy of the approval letter to OED as soon as it is available. We also recommend that SEEDCO be proactive in following up with the cognizant agency if no response is received in due time.

Views of responsible officials and planned corrective actions:

Seedco Financial submitted an indirect cost rate proposal to HUD, its cognizant agency, in the fall of 2007. A copy of this submission was provided to OED during the review (see attached copy). We ask that the comment "Verification with the Department of Health and Human Services, as well as with the Department of Housing and Urban Development, revealed that no new indirect cost proposal has been submitted by Seedco to the cognizant agency since then." be removed from the finding. Schedule 2: Direct support: This Schedule provided to OED staff shows the method by which allocable direct items were charged to the CDBG project. An additional GL report was also attached as documentation for these aggregate allocable costs.

Anticipated completion date: December 31, 2008

Finding 2008-05: Allowable Cost/Cost Principles

Criteria: OMB Circular A-122. A.A.3. "Reasonable costs. In determining the reasonableness of a given cost, consideration shall be given to:...b. The restraints or requirements imposed by such factors as generally accepted sound business practices, arms length bargaining, Federal and State laws and regulations, and terms and conditions of the award." The costs that have been treated as indirect costs shall not be claimed as direct costs. Similar types of costs should be accorded consistent accounting treatment; prior approval must be obtained for changes in the charging of a particular type of cost from indirect to direct. Failure to obtain approval may result in cost disallowance.

Condition: SEEDCO billed for Legal and Audit as direct costs; it also billed for these costs in the Administrative Support and OTPS (Other Than Personnel Services) in varying rates from January, 2007 to June, 2007. Aside from the provisional indirect cost rate of 34%, SEEDCO billed 18.4% of personnel costs for OTPS starting in July 2007.

Disallowed Costs: \$82,062.59 (\$12,200 in Legal and Audit costs and \$69,862.59 in OTPS charged from July, 2007 to March, 2008)

Context: In its Indirect Cost Proposal Submittal dated September 27, 2007, reported to have been sent to HUD, SEEDCO combined Support Expenses and Management & General Expenses as the basis for the computation of indirect cost rate. It appears that Legal & Accounting (it is assumed that Audit costs are included in this item) and Supplies, etc., were among the items included in the above cost categories. There was no additional documentation provided for a request to change accounting treatment of the cost items included in the calculation of indirect cost rate, from indirect cost to direct cost; it is inferred that those cost items were accorded consistent treatment. No other cost allocation documentation was provided for other items of costs including Legal & Accounting.

Cause: SEEDCO did not have proper controls in place to ensure that costs were charged appropriately to the grant.

Effect: SEEDCO may have overcharged the grant for expenses incurred.

Recommendation: SEEDCO must refund the disallowed costs of \$82,062.59, on or before December 31, 2008. We recommend that SEEDCO use only one rate for indirect costs, as approved by the Federal Government and as accepted by the awarding agency.

Views of responsible officials and planned corrective actions:

Costs are not incurred in a straight-line fashion, but instead occur unevenly over the course of the year. A full reconciliation of all costs billed during the entire period of the budget will demonstrate the following:

- 1) Seedco Financial did not bill its full indirect cost of 34.6%, but instead billed an amount substantially below that.
- 2) Additional OTPS items billed are not included in Seedco's indirect cost billing and are supported by the general ledger and other backup.

Seedco financial is prepared to provide additional backup and documentation to substantiate these points if required to do so. Schedule 3: Indirect: This schedule provided to OED staff shows costs, which go into indirect, and substantiates indirect costs incurred for the project. In addition to this schedule, we also provided an OTPS Allocations Schedule for further clarification. This will be discussed in much greater detail during the reconciliation of this report with OED. However, we believe that "disallowed cost" be changed to "questioned cost."

Anticipated completion date: December 31, 2008

Finding 2008-06: Procurement

Criteria: Contract Exhibit B.6.1.1. "The Contractor shall follow the City Procurement Policy to the extent that it requires at least 3 documented quotations be secured for all purchases or services including insurance supplies, or other property that costs more than \$5,000 in the aggregate."

Condition: SEEDCO did not maintain documentation of at least 3 quotations or records sufficient to detail the significant history of procurement on two service contracts, each for over \$5,000, that were charged to the grant.

Cause: SEEDCO did not have controls in place to properly review procurement activities to ensure compliance with contract requirements.

Effect: Lack of competitive bidding process could increase the cost of services charged to the grant.

Recommendation: We recommend that SEEDCO establish and implement procedures to ensure 3 quotations are obtained for procurement of \$5,000 and above.

Views of responsible officials and planned corrective actions:

Seedco Financial followed the City Procurement Policy in regards to the bidding our of its audit. Seedco issued an RFP and solicited bids from over 10 different firms. It entered into a final round of bidding with 3 different firms, accepting formal proposals and sending them to evaluation by Seedco's Board. It then selected one auditor from the group, awarding them a 3 year contract for the audits for Seedco and Seedco Financial. We are prepared to provide any additional documentation required.

In the case of the Consultation Contract with Barbara Connors, this was done by the previous President of SFS, Bill Grinker, who enlisted the aid of a local entity in the search process for the VP/executive Director of the Denver office. In an effort to expedite creation of a fully functional

Denver operation, he chose Ms. Connors, who came highly recommended by several Colorado stakeholders. All consulting contracts in the future will follow City Procurement Policy.

Anticipated completion date: Immediately

Finding 2008-07: Financial Administration

Criteria: Contract Exhibit B.1.1.2. "...The Contractor must submit expenses and accruals to OED/DHND on or before the last day of each month for the previous month's activity."

Condition: All 15 draws for the period January, 2007 through March, 2008, were submitted to OED beyond the last day of each month for the previous month's activity.

Cause: SEEDCO did not have adequate controls and procedures in place to ensure billings for reimbursement requests are submitted to OED in a timely manner.

Effect: Lack of adequate controls and procedures on billings could lead to billing inaccuracies, cash shortage and possible non-reimbursement of costs especially if the delay extends beyond 45 days of the agreement end date to allow for correct and prompt closeout.

Recommendation: We recommend that SEEDCO establish and implement controls and necessary procedures to ensure monthly reimbursement billings are submitted to OED in a timely manner.

Views of responsible officials and planned corrective actions:

Seedco Financial recognizes the importance of timely submission of billings and will ensure that future billings are submitted within the required timeframe.

Anticipated completion date: Immediately

Finding 2008-08: Financial Administration:

Criteria: Contract Exhibit B.3.1.6. "...The Contractor will maintain auditable records - i.e., records must be current and traceable to the source documentation of transactions." Further, Contract Exhibit B. 8.1.2. "The awarding agency and the Comptroller General of the United States, or any of their authorized representatives, shall have the right to access, upon reasonable notice, to any pertinent books, documents, papers, or other records pertinent to the contract, in order to make audits, examinations, excerpts, and transcripts."

Condition: The SEEDCO New York Office had provided many documents that were subjects of monitoring requests, via email. However, some documents were difficult to obtain; some were not available.

Cause: The SEEDCO Denver Office does not maintain financial records onsite. All financial documents including checks received are transmitted to New York for processing. The New York Office maintains SEEDCO's financial management system. It also performs almost all financial functions for the Denver operations including depositing receipts in bank accounts maintained in New York, ordering supplies, maintaining petty cash funds, preparing monthly billings to OED, etc.

Effect: Limited access to records pertinent to the contract impedes the ability to allow for an adequate review of selected transactions and make examinations or audits.

Recommendation: We recommend that SEEDCO establish and implement necessary procedures to allow records pertinent to the contract accessible for review at the Denver location. We also recommend that SEEDCO utilize Denver banking resources such as maintaining local bank accounts, at least for its revolving loan fund operations and petty cash.

Views of responsible officials and planned corrective actions:

- a. Seedco financial provided the vast majority of requested materials within the timeframe given. A small number of items could not be provided for review, such as petty cash management, as this was not tracked separately at the time (Denver petty cash has since been given its own GL account).
- b. The vast majority of documentation from the Denver Office is transmitted electronically and can be tracked via email. Other original legal documents are sent via Fed-Ex and are tracked through their systems with receipts maintained in our files.
- c. Denver staff will attempt to obtain "read-only" access to the SFS financial accounting systems during the next contract year.
- d. The RLF account is being set up at Wells Fargo in Denver (see Finding #1 PI above).

Anticipated completion date: Immediately

Finding 2008-09 Allowability/Allocability:

Criteria: Per OMB Circular A-122.A.4.a, a cost is allocable to a particular objective, such as a grant, contract, project, service or other activity, in accordance with relative benefits received.

Condition: In the testing of Salaries and Wages, which included bonuses, there were instances of erroneous allocation that caused the grant to be overcharged. Due to time constraints in monitoring, the analysis did not include expenditure vs. budget comparison at the full time equivalency (FTE) level. Furthermore, the monetary effects on fringes and other cost relationships have not been determined.

Disallowed Costs: \$7,695.70

Cause: SEEDCO did not have adequate procedures and controls in place to ensure that billings are done correctly.

Effect: Inaccurate billings could lead to disallowed costs which would need to be refunded by SEEDCO.

Recommendation: We recommend that SEEDCO develop and implement an internal review process on billings to ensure that costs are billed properly. SEEDCO must refund the disallowed amount of \$7,695.70, by December 31, 2008.

Views of responsible officials and planned corrective actions:

Seedco Financial does not dispute OED's analysis and will refund the disallowed funds by December 31. We have since undertaken improvements to our time-charging system to ensure that all time allocated to projects is billed appropriately.

Anticipated completion date: December 31, 2008

Concern 2008-01: Financial Administration

Criteria: Contract Exhibit B. 3.1.3. "Effective internal controls and accountability must be maintained for all contract cash, real and personal property, and other assets. Adequate safeguards must be provided on all property and it must be assured that it is used solely for authorized purposes." Further, the contractor must have mechanisms in place to prevent unauthorized purchases and disbursement of funds; and safeguards its cash and other assets so no one person controls the order, receipt, payment and reconciliation of an asset.

Condition: (a) A testing of bank reconciliation statements for the months of January 2007 and April 2007 reveals that they were purportedly reviewed on October 2, 2007 and October 3, 2007, respectively; the latter dates indicate significant delay in the review of the reports.

Recommendation: We recommend that the staff person preparing the bank reconciliation indicate his name on the report and that the report be reviewed by another responsible staff in a timely manner. Such review should be documented.

Response (a): While our banking statements are reviewed and reconciled, monthly, financial staff has not indicated which staff has completed which reports. We will endeavor to do so in the future, as recommended.

Condition: (b) Per the accounting manual, reconciliation of the Northbridge loan system with the Blackbaud accounting system is done annually.

Recommendation: We recommend that SEEDCO reconcile the Northbridge loan system with the Blackbaud accounting system more frequently than annually, such as, monthly or at least quarterly.

Response (b): We are currently overhauling our entire financial tracking system and we commit to conducting more frequent reconciliations of Blackbaud and Northridge, as recommended by OED.
