March 7, 2011

TO: Federal Co-Chair
ARC Executive Director

FROM: Clifford Jennings
ARC Inspector General

SUBJECT: Compliance Audit of Kentucky Highlands Investment Corporation Energy, Technology and Services Business Accelerator, ARC Grant KY-15648-07
OIG Report Number, 11-02

GRANTEE: Kentucky Highlands Investment Corporation

The OIG engaged Tichenor & Associates, LLP, Certified Public Accountants, to conduct an audit of a grant made to Kentucky Highlands Investment Corporation. The grant was made for the purposes of providing funding for the development and feasibility testing of a business incubator service which would provide intensive technical assistance to start up businesses.

The grant period covered by the audit was from September 1, 2007 through August 31, 2009. The report had five recommendations; management concurred with three of the recommendations and declined to require the grantee to implement the other two. Since management's action was final, the auditor closed all recommendations.

In connection with the audit of Kentucky Highlands Investment Corporation Energy, Technology and Services Business Accelerator grant, conducted by Tichenor & Associates, LLP, the OIG does not express an opinion on Kentucky Highlands Investment Corporation, Energy, Technology and Services Business Accelerator's activities, internal controls, or conclusions on compliance with laws and regulations. The OIG had no involvement in the review of Kentucky Highlands Investment Corporation Energy, Technology and Services Business Accelerator grant. The OIG's involvement was with Tichenor & Associates, who was contracted to audit and report on grant compliance and other matters as outlined in the report's scope section. Tichenor & Associates is responsible for the attached auditor's report and the opinions, conclusions, and recommendations expressed in the report.

Clifford H. Jennings
Inspector General
Attachment

COMPLIANCE AUDIT OF
KENTUCKY HIGHLANDS INVESTMENT CORPORATION
LONDON, KENTUCKY

ENERGY, TECHNOLOGY AND SERVICES BUSINESS ACCELERATOR

ARC Grant Number: KY-15648-07

Grant Period: September 1, 2007 through August 31, 2009

CAUTION: *Certain information contained herein is subject to disclosure restrictions under the Freedom of Information Act, 5 U.S.C. 552 (b) (4). Distribution of this report should be limited to Appalachian Regional Commission and other pertinent parties.*

Report Number: 11-02

Date: March 3, 2011

COMPLIANCE AUDIT OF
KENTUCKY HIGHLANDS INVESTMENT CORPORATION
LONDON, KENTUCKY

ENERGY, TECHNOLOGY AND SERVICES BUSINESS ACCELERATOR

ARC Grant Number: KY-15648-07

Grant Period: September 1, 2007 through August 31, 2009

Prepared By:

Tichenor & Associates, LLP
Certified Public Accountants
304 Middletown Park Place, Suite C
Louisville, Kentucky 40243

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TICHENOR & ASSOCIATES, LLP

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TO:	Appalachian Regional Commission (ARC) Office of Inspector General (OIG)
FROM:	Tichenor & Associates, LLP Louisville, Kentucky
REPORT FOR:	The Federal Co-Chairman ARC Executive Director OIG Report Number: 11-02
SUBJECT:	Compliance Audit Report on Kentucky Highlands Investment Corporation (KHIC), Energy, Technology and Services Business Accelerator, ARC Grant Number: KY-15648-07.

OBJECTIVE: The objective of our audit was to determine if (a) the total funds provided to KHIC for its Energy, Technology and Services Business Accelerator grant were expended in accordance with the ARC approved grant budget and did not violate any restrictions imposed by the terms and conditions of the grant; (b) the accounting, reporting, and internal control systems were appropriate, operating effectively, and implemented in accordance with generally accepted accounting principles; and (c) that the objectives of the grant were met.

BACKGROUND: ARC awarded Grant Number KY-15648-07 to KHIC for the period September 1, 2007 through August 31, 2009. Total grant funding was for an amount not to exceed $199,000 or 72.4% of actual, reasonable, and eligible project costs. ARC required that the grant be matched with $76,000 or 27.6% in cash, contributed services, or in-kind contributions, as approved by the ARC. ARC made six payments totaling $189,588.

The purpose of the grant was to provide funds to develop an Energy, Technology and Services Accelerator, a service and technology-oriented business incubator. The business incubator would provide intensive, hands-on technical assistance to 40 start-up businesses from the Kentucky Highlands region and create a program of services for four small business tenants, who would occupy a remodeled section of KHIC's headquarters, and a larger number of affiliate clients. This project would also be used as a test facility to determine the feasibility of developing a larger facility on property adjacent to KHIC. It was expected that 40 new jobs would be created.

SCOPE: We performed a compliance audit of the grant, as described in the Objective above, for the period September 1, 2007 through August 31, 2009, at KHIC's office in London, Kentucky, on April 12, 2010 through April 23, 2010. Our audit was based on the terms of the grant agreement and on the application of certain agreed-upon procedures previously discussed with the ARC OIG. Specifically, we determined if the accountability over ARC funds was in accordance with applicable Office of Management and Budget (OMB) Circulars, if KHIC was in compliance with the requirements of the grant agreement and the ARC Grant Administration Manual, and if the objectives of the grant were met.

METHODOLOGY: We reviewed the grant agreement and KHIC's work plan, ARC Project Guidelines, the ARC Grant Administration Manual, pertinent OMB circulars, and the ARC Code. We interviewed KHIC personnel including the chief financial officer, the controller, the development director, and the current director of the business incubator.

All grant expenditures were tested to determine if the costs were within the approved budget, reasonable, and related to the grant. Indirect and matching costs were audited to determine if the costs were allowable, reasonable, and supported by adequate documentation. Receipts were tested to determine whether any program income was used to reduce grant program expenditures or to further the program, and if the use was approved by ARC.

We obtained an understanding of KHIC's accounting system and internal controls to determine if KHIC has the capability to accurately accumulate, record, and report revenues and costs associated with the grant.

We reviewed KHIC's interim and final progress reports, and supporting documentation to determine if the objectives of the grant were met.

We conducted this compliance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide 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.

RESULTS: The following results are based on our audit of ARC Grant Number KY-15648-07 – Energy, Technology and Business Services Accelerator.

A. Incurred Costs

KHIC's financial records report total program costs of $325,000 (see **Appendix A – Worksheet for Reimbursement Request - as Reported by Grantee**) for the period from September 1, 2007 through August 31, 2009. Of these costs, $189,588 (58.3%) was attributed to ARC expenditures, with the remaining $135,412 (41.7%) attributed to matching and in-kind expenditures.

During the course of the audit, we tested the direct, indirect, and matching costs claimed and noted the following instances of noncompliance which are described in the accompanying findings.

1. Improper Calculation of Indirect Costs

The ARC Grant Agreement, Part II General Provisions, Article 14 Records/Audit, requires that grantees establish procedures to ensure that all records pertaining to costs, expenses, and funds related to the grant shall be kept in a manner consistent with generally accepted accounting procedures.

During our audit we noted that KHIC misapplied its Department of Health and Human Services (HHS) approved indirect cost rate in calculating allowable indirect costs. KHIC overstated Indirect Costs, and therefore, actual matching costs and total program outlays, by $3,922 (see **Appendix B – Auditor's Recalculation of Indirect Costs**). Adjusting for this error, total program costs were $321,078, total costs attributable to ARC expenditures were $189,588 (59.0%), and total costs attributable to matching and in-kind expenditures were $131,490 (41.0%). KHIC's match was still greater than the 27.6% required by the grant agreement.

KHIC management noted the indirect calculation error but did not submit a corrected report to ARC because the error did not affect the use of ARC funds or the required match.

Improperly calculated indirect costs could result in ARC program charges being misstated and program performance measures being reported incorrectly.

Recommendation:

We recommend that ARC require that KHIC revise its final Reimbursement Request Worksheet to show indirect costs of $61,078, actual matching costs of $131,490, and total program outlays of $321,078.

ARC's Response:

ARC concurred with our finding and will implement our recommendation. KHIC has agreed to provide a revised final Reimbursement Request Worksheet to reflect the proper application of its indirect cost rates. (See **Appendix D – ARC's Response**.)

Auditor's Conclusion:

ARC concurred with our finding and will require KHIC to revise its final Reimbursement Request Worksheet to reflect the proper application of its indirect cost rates. As a result, this recommendation is considered closed.

2. <u>Program Income Not Reported</u>

The ARC Grant Agreement, Part II General Provisions, Article 12 Grant-Related Income, states that all grant-related income, including rental fees, shall be reported to ARC in the progress and final reports. OMB Circular A-110, Appendix A, Section 24 (b) states that in the event the Federal awarding agency does not specify in its regulations or the terms and conditions of the award how program income is to be used, then program income shall be deducted from the total program allowable cost in determining the net allowable costs on which the Federal share of costs is based.

During our audit we noted that KHIC did not report rental income of $22,791 received from program participants leasing incubator office space during the period of grant performance.

KHIC management stated that it was an oversight that they did not mention the program income in the progress and final reports. KHIC management further stated that one of their greatest concerns was the incubator's long-term sustainability and that they used program income for that purpose, by providing training, coaching, and making space available to entrepreneurs.

Failure to report program income, and reduce program costs accordingly, could result in the grantee utilizing funds that they were not entitled to use and funds being expended for purposes contrary to the grant's objectives.

<u>Recommendation:</u>

We recommend that ARC require that KHIC revise the final Request for Advance or Reimbursement (Standard Form 270) submitted to ARC to show program income of $22,791, net program outlays of $298,287, non-federal share of $125,199, and federal share of $173,088 (see **Appendix C – Worksheet for Reimbursement Request - as Adjusted by Auditor**).

We also recommend that ARC require KHIC return $16,501 (72.4% of program income – based on ARC's share of program costs as stated in the grant agreement) of program income not used to reduce program costs.

<u>ARC's Response:</u>

ARC disagreed with our finding that lease payments from businesses that rented space in KHIC's office building represented program income and declined to implement our recommendation.

ARC stated that under this grant, ARC funds were used exclusively for a services contract to provide training and business technical assistance to area firms and that KHIC had requested no support for its physical incubator facility. See the full text of ARC's response in **Appendix D**.

Along with its response, ARC also provided a memorandum, approved January 13, 2011, clarifying for the record that the supported activity under this grant was the training and technical assistance provided to area firms and not the general operations of KHIC's incubator. (See **Appendix E – Clarifying Memorandum**.)

Auditor's Conclusion:

ARC's primary reason for non concurrence with our recommendation, i.e., the grant was not provided in support of a physical incubator facility and therefore associated rent (program income) should not reduce grant funds, was not supported by the grant documents. See item 1 through 4 below. In addition, absent any grant terms and conditions concerning the disposition of program income, as is the case in this grant, OMB Circular A-110 requires the return of funds to the grantor (ARC). However, the issuance of a clarifying memorandum stating that "...the Commission was aware of KHIC's rental income at the time of the original approval and that it did not intend to treat that income (rental income) as program income..." is sufficient for us to consider this recommendation closed.

Item 1*

The description of the project proposal contained in the grant application states that one of the program's accomplishments would be to furnish and populate a new, four-suite business accelerator. From the Grant Application: Section 2 - Project Proposal Summary, we note the following project description:

Description:

The Energy, Technology and Services Accelerator (ETSA) at Kentucky Highlands project will accomplish four things: 1) raise the profile of entrepreneurial efforts in Appalachian Kentucky counties; 2) provide an entrepreneurial support system continuum with classroom training, individualized instruction and networking opportunities, especially those related to energy and technology; 3) furnish and populate a new, four-suite business accelerator at Kentucky Highlands Investment Corporation (purchasing office furnishings and equipment)...

Item 2*

The grant application also states that one of the project outcomes was 75% accelerator occupancy. From the Grant Application: Section 2 - Project Proposal Summary, we note the following performance measurement criteria:

Performance Measurement:

Goal: Increase job opportunities and per capita income.

Project Output	Project Outcome	Project Outcome
Business Accelerator & Program	40 businesses assisted 30 businesses get coaching 45 individual participants 15 businesses capitalized 75% accelerator occupancy	5 businesses created 30-60 jobs created/ sustained 3 businesses awarded SBIR/STTR funding 15 strategic execution plans developed

Item 3*

The Statement of Purpose in the grant agreement calls for occupancy by four tenants in a remodeled section of KHIC's headquarters and that the incubator will be used as a test facility to determine the feasibility of developing a larger facility. From the Grant Agreement, we note the following:

Grant Agreement
Between
Appalachian Regional Commission
and
Kentucky Highlands Investment Corporation

Part I- Special Provisions

1. Statement of Purpose- Incorporation of Proposal... The four tenants will occupy a remodeled section of the applicant's headquarters. This small incubator will be used as a test facility to determine the feasibility of developing a larger facility on property adjacent to the KHIC office.

*Item 4**

The management services agreement with the contractor providing training and technical assistance states that the contractor will assist in securing tenants for the incubator and will work to build a backlog of potential tenants. From the management services agreement, we note the following:

MANAGEMENT SERVICES AGREEMENT

This MANAGEMENT SERVICES AGREEMENT ("Agreement") is effective October 1, 2007 through September 30, 2009, by and between KENTUCKY HIGHLANDS INVESTMENT CORPORATION (hereinafter referred to as "KHIC" or "Company") a Kentucky not-for-profit corporation, with its principal office and place of business at ____________, and __________ (hereinafter referred to as "________" or "Contractor"), a Tennessee not-for-profit corporation, with its principal office located at ___________.
. . .

1. Services to be provided. "Contractor" will provide the following services to "Company", at designated times and on a schedule of deliverables as detailed in earlier proposal attached herein as "Attachment A". It is understood that "Contractor" is engaged in other similar activities and programs in the region and that this agreement will not restrict those activities in any manner.

a.

b.

c.

d. Assist "KHIC" resources in securing tenants for KHIC Incubator, managing relationships with tenant companies, providing services to tenant companies, and addressing issues mentioned in the Incubator feasibility study. Work to build a backlog of potential tenants to support expanded incubator operations.

B. Internal Controls

During the course of the audit, we reviewed KHIC's system of internal controls. Weaknesses were identified that could have affected the accountability of costs or compliance with the terms and conditions of the grant agreement.

3. Internal Control over Compliance

Proper internal control procedures allow management or employees, in the normal course of performing their assigned functions the ability to prevent, detect or correct grant compliance issues or other errors on a timely basis.

*(The examples provided under each discussion item (above) were excerpted and/or recreated from the original documents and present the actual data from those sources; underlining was added to emphasize referenced items.)

As noted in Findings 1 and 2 above, KHIC misapplied its HHS approved indirect cost rate in calculating allowable indirect costs and did not report rental income received from program participants leasing incubator office space during the period of grant performance.

Recommendation:

We recommend that ARC require KHIC to implement internal control policies to ensure the proper indirect cost rate is charged to federal grants and that program income is reported and used to offset program costs in accordance with grant requirements.

ARC's Response:

ARC concurred with our finding related to indirect cost rates and will require KHIC to implement internal controls to prevent a recurrence of the conduct that resulted in the indirect costs finding.

As noted in Finding 2, above, ARC disagreed with our finding that lease payments from businesses that rented space in KHIC's office building represented program income and declined to implement our internal control recommendation related to this finding. (See **Appendix D – ARC's Response**.)

Auditor's Conclusion:

ARC will require KHIC to implement internal controls to prevent a recurrence of the conduct that resulted in the indirect costs finding and has issued a clarifying memorandum stating that it was never ARC's intention to include rental income from incubator tenants as program income. As a result, this recommendation is considered closed.

C. Program Results

Our audit of KHIC's Energy, Technology and Services Business Accelerator grant indicated that the specific objectives identified in the grant were achieved. Sixty-one businesses received technical assistance and 52 jobs were created or sustained. At the time of our audit, five businesses had graduated from the incubator and moved to their own facilities and a total of two incubator businesses were under lease agreements with KHIC. In addition, KHIC management has accepted the viability of the incubator model and therefore, as discussed in the Background section of this report, has begun construction of a larger incubator facility.

Tichenor & Associates, LLP

Tichenor & Associates, LLP
Louisville, Kentucky
April 23, 2010

APPENDIX A

WORKSHEET FOR REIMBURSEMENT REQUEST - AS REPORTED BY GRANTEE

Worksheet for Reimbursement Request - as Reported by Grantee

Kentucky Highlands Investment Corporation
Energy, Technology and Services Business Accelerator
ARC Grant #: KY-15648-07

Reimbursement Period from 9/1/2007 to 8/31/2009

Approved Budget Category	Approved Budget	Actual Matching (Non-ARC) Cost	Actual ARC Cost	Total Cost	Total Program Outlays to Date	Budget Balance Remaining
Personnel	$ -	$ -	$ -	$ -	$ -	$ -
Fringe Benefits	-	-	-	-	-	-
Travel	-	-	-	-	-	-
Equipment	15,000.00	-	-	-	-	15,000.00
Supplies	-	-	-	-	-	-
Contractual	260,000.00	70,411.55	189,588.45	260,000.00	260,000.00	-
Other	-	-	-	-	-	-
Total Direct	275,000.00	70,411.55	189,588.45	260,000.00	260,000.00	15,000.00
Indirect Cost	-	65,000.00	-	65,000.00	65,000.00	(65,000.00)
Totals	$ 275,000.00	$ 135,411.55	$ 189,588.45	$ 325,000.00	$ 325,000.00	$ (50,000.00)

Note: See Appendix C for the Worksheet for Reimbursement Request - as Adjusted by Auditor

APPENDIX B

AUDITOR'S RECALCULATION OF INDIRECT COSTS

Auditor's Recalculation of Indirect Costs
(as noted in Finding #1)

	FY 2008	FY 2009	FY 2010	Totals
Direct Costs	89,128.17	103,785.83	67,086.00	260,000.00
Subtotals	89,128.17	103,785.83	67,086.00	260,000.00
HHS Approved Indirect Cost Rate	20.6%	25.0%	25.0%	
Allowable Indirect Costs	18,360.40	25,946.46	16,771.50	61,078.36
Reported Indirect Costs				65,000.00
Difference				(3,921.64)

Note: See Appendix C for the Worksheet for Reimbursement Request - as Adjusted by Auditor

APPENDIX C

WORKSHEET FOR REIMBURSEMENT REQUEST - AS ADJUSTED BY AUDITOR

Worksheet for Reimbursement Request - as Adjusted by Auditor

Kentucky Highlands Investment Corporation
Energy, Technology and Services Business Accelerator
ARC Grant #: KY-15648-07

Reimbursement Period from 9/1/2007 to 8/31/2009

Approved Budget Category	Approved Budget	Actual Matching (Non-ARC) Cost	Actual ARC Cost	Total Cost	Total Program Outlays to Date	Budget Balance Remaining
Personnel	$ -	$ -	$ -	$ -	$ -	$ -
Fringe Benefits	-	-	-	-	-	-
Travel	-	-	-	-	-	-
Equipment	15,000.00	-	-	-	-	15,000.00
Supplies	-	-	-	-	-	-
Contractual	260,000.00	70,411.55	189,588.45	260,000.00	260,000.00	-
Other	-	-	-	-	-	-
Total Direct	275,000.00	70,411.55	189,588.45	260,000.00	260,000.00	15,000.00
Indirect Cost (see Finding #1 and Appendix B)	-	61,078.36	-	61,078.36	61,078.36	(61,078.36)
Less Program Income (see Finding #2)	-	(6,290.32)	(16,500.71)	(22,791.03)	-	-
Totals	$ 275,000.00	$ 125,199.59	$ 173,087.74	$ 298,287.33	$ 321,078.36	$ (46,078.36)

APPENDIX D

ARC'S RESPONSE

APPALACHIAN
REGIONAL
COMMISSION

A Proud Past,
A New Vision

Date: January 13, 2011

To: Clifford Jennings, Inspector General

From: Thomas Hunter, Executive Director

Subject: Inspector General Compliance Audit of Kentucky Highlands Investment Corporations (KHIC) Energy, Technology and Services Business Accelerator (KY-15648)

The attached audit from Tichenor and Associates contains three findings and recommendations. Two of the findings relate to grant costs; one to the calculations of indirect costs and the other to program income. We concur with the finding concerning indirect costs and will implement the auditor's recommendation. We disagree with the finding relating to program income, however, and accordingly, will not implement that recommendation. The other finding relating to internal controls is predicated on the two costs findings and we agree with it in part and disagree with it in part. We will require KHIC to implement internal controls to prevent a recurrence of the conduct that resulted in the indirect costs finding.

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APPALACHIAN
REGIONAL
COMMISSION

A Proud Past,
A New Vision

ARC

Date: January 6, 2011
To: Thomas Hunter, Executive Director
From: Charles Howard, General Counsel
Subject: Inspector General Compliance Audit of Kentucky Highlands Investment Corporation (KHIC) Energy, Technology and Services Business Accelerator (KY-15648)

The attached audit from Tichenor and Associates contains three findings and recommendations. Two of the findings relate to grant costs; one to the calculation of indirect costs and the other to program income. We concur with the finding concerning indirect costs and will implement the auditor's recommendation. We disagree with the finding relating to program income, however, and, accordingly, will not implement that recommendation. The other finding relating to internal controls is predicated on the two costs findings and we agree with it in part and disagree with it in part. We will require KHCI to implement internal controls to prevent a recurrence of the conduct that resulted in the indirect costs finding.

Indirect Cost

The auditor found that KHIC applied the incorrect indirect cost rate for a portion of the total grant period. Apparently, this was the result of KHIC's decision to amend its budget late in the grant period to include indirect costs for matching purposes. When the action was taken, KHIC applied its current indirect rate for the entire grant period although a different rate had applied earlier in the grant. The difference in applying the two rates is relatively minor and, because KHIC considerably overmatched the ARC grant, the action did not affect the level of ARC's participation in the project.

KHIC has agreed to provide a revised final Reimbursement Request Worksheet to reflect the proper application of its indirect rates and will implement internal controls to ensure the proper charge of indirect rates in the future.

Program Income

ARC disagrees with the auditor's finding that the lease payments from four businesses that rented space in KHIC's office building represented program income. Under this grant, ARC funds were used by KHIC exclusively for a services contract with Technology 2020 to provide training and business technical assistance to area firms, including but not limited to the four that leased space from KHIC. None of the firms that received the training and technical assistance under this contract were charged a fee for these services.

Program income is defined in OMB Circular A-110 (Section 215.2) as gross income earned by a grantee "that is directly generated by a supported activity or earned as a result of the award." In this instance, the activity supported by the ARC grant—the training and technical assistance contract between KHIC and Technology 2020—generated no income. The lease payments, which the auditor mistakenly designated as program income, were made under lease agreements for the rental of space (including utilities, maintenance and cleaning services) with no mention of training and technical assistance services as being covered by the payments. The tenants received these services on the same basis as other area businesses—free of charge.[1]

KHIC requested no support for its physical incubator facility under this grant and the costs and revenues from the physical incubator were not included in the project budget. In addition, although ARC was fully aware that KHIC was leasing space to several start-up businesses, anticipated revenues from those leases were not considered either for matching purposes or to offset the amount of KHIC's grant request. ARC assistance was requested and approved for "contractual services identified…as 'entrepreneurial programming'…[including]… delivery of customized training sessions, intensive and individualized consulting to area firms, and generation of business leads to support the core function of KHIC." These services did not directly generate income for KHIC.

In this analysis, it is important to distinguish between ARC's general purpose in making this grant—to assist in the establishment of a service and technology-oriented business incubator at KHIC—and the specific activity that ARC's grant funds were used to support—the training and technical assistance contract between KHIC and Technology 2020. In this connection, I have attached a memorandum for approval by the ARC Federal Co-Chair clarifying for the record that the supported activity under this grant was the training and technical assistance contract and not the general operations of the KHIC incubator. The memorandum further clarifies that there was no intention to treat KHIC's rental revenue as program income for this project and that the Commission has no objection to the use of those funds by KHIC to support its physical incubator facility.

Because the auditor's finding relating to program income in this audit is in error, ARC declines to implement the auditor's recommendation resulting from that finding.

[1] While the terms of the engagement between KHIC and Technology 2020 included a reference to assistance with "managing the Incubator," it appears that this task was focused on identifying suitable tenants and helping KHIC work toward the establishment of a larger stand-alone incubator facility in the future. Day-to-day building management, services and maintenance, for which a portion of rental payments could logically be expected to contribute, do not appear to have been among Technology 2020's responsibilities under their contract with KHIC.

APPENDIX E

CLARIFYING MEMORANDUM

To: Earl F. Gohl
Federal Co-Chair

Subject: Amendment to KY-15648; Energy, Technology & Services Business Accelerator
Grantee: Kentucky Highlands Investment Corporation (KHIC)
Purpose: To clarify aspects of the original approval memorandum.

The original award for this project was approved in 2007 to fund the delivery of training and business technical assistance to firms in Appalachian Kentucky. The services to be provided under the grant were procured by KHIC from a contractor, Technology 2020, selected for their demonstrated proficiency in entrepreneurial training. As stated in the grantee's original proposal, the desired outcome was to broaden KHIC's portfolio of business services while determining the feasibility of developing a larger facility devoted to "incubating" a larger number of startups than would be possible at KHIC's existing site.

During the grant period, KHIC was leasing space to several area businesses in its office building in London, Kentucky. This activity was intended to help KHIC test the feasibility of developing the larger incubator facility. Although the existence of these leases was noted in the original project approval memorandum, no funding assistance under the grant was available to subsidize them or support KHIC's physical incubator in any way. Funding assistance under the grant was reserved exclusively for the training and technical assistance provided by Technology 2020, which KHIC offered free of charge to all area businesses including those who were tenants in the KHIC building.

Currently, the Commission is responding to a Compliance Audit from Tichenor and Associates that contains a finding that the rental income described above should be treated as program income for this project and returned to the Commission. The response of ARC's General Counsel to the Compliance Audit disagreeing with the auditor's finding relating to program income is attached.

The purpose of this memorandum is to clarify for the record that the supported activity under this grant was the training and technical assistance contract and not the general operations of the KHIC incubator. The memorandum further clarifies that the Commission was aware of KHIC's rental income at the time of the original approval and that it did not intend to treat that income as program income for this project. Finally, the Commission has no objection to the use of that rental income by KHIC to support its physical incubator facility.

Recommended:

Thomas M. Hunter
THOMAS M. HUNTER
Executive Director

Approved:

Earl F. Gohl
EARL F. GOHL
Federal Co-Chair

1-13-11
Date Approved