A SPECIAL AUDIT
OF THE
OFFICE OF THE BUDGET'S

REDEVELOPMENT ASSISTANCE CAPITAL PROGRAM GRANT FOR THE MOUNTAIN LAUREL CENTER FOR THE PERFORMING ARTS

APRIL 2007

TABLE OF CONTENTS

JACK WAGNER

AUDITOR GENERAL

OFFICE OF THE BUDGET – REDEVELOPMENT ASSISTANCE CAPITAL PROGRAM

BACKGROUND

On May 4, 2004, the Department of the Auditor General (Department) informed the Office of the Budget (OB) that it would conduct a special audit of the $15 million Redevelopment Assistance Capital Program (RACP) grant agreement between the Commonwealth of Pennsylvania (Commonwealth) and the Pike County Industrial and Commercial Development Authority (Authority) for the Mountain Laurel Center for the Performing Arts (Mountain Laurel) project located in Pike County. The project, which began in 2001 until it was sold in 2006, spanned three administrations. The decision to conduct this audit was based on inquiries received by the Department, as well as several newspaper stories indicating that Mountain Laurel had severe financial problems, including owing millions of dollars to creditors.

RACP is a Commonwealth grant program established by law and administered on behalf of the Governor by OB. The Governor, with the authorization of the General Assembly, decides who shall receive RACP grants. Accordingly, OB prepares and executes tax-exempt debt instruments and utilizes the proceeds to fund the RACP grants and provides other support services. The RACP grant program is to be used exclusively for the acquisition and construction of regional economic, cultural, historical, or civic improvement projects. It is funded through proceeds from legislatively authorized increases to the Commonwealth's general obligation borrowing authority, and has received steadily increasing funding since 1993. The extent of the Commonwealth's commitment includes the original amount of the grants in addition to debt service and related expenses. The RACP grant program supports long-term multi-year projects. Under the enabling legislation, a Capital Budget Project Itemization Act must first authorize all projects.

Accordingly, **Act 35 of 1999** included a line item for a $17.5 million RACP project in Pike County entitled the Keystone Center of Music and the Arts, which later became known as the Mountain Laurel Center for the Performing Arts. The requirement of inclusion in a Capital Budget Act requires early-stage cooperation and communication between supporting members of the General Assembly and the Governor's Office. In addition, the Commonwealth uses a minimum 36-month funding accumulation schedule for RACP projects unless the Secretary of the Budget authorizes a shorter period.

Based on information submitted by the Authority, prior to the Governor's authorization to release RACP funding, OB expressed concerns regarding the size of the amphitheater in terms of seating capacity. These concerns were based on independently conducted marketing studies that cautioned about minimum sizes of venue in order to remain profitable. A summary of the report prepared by OB's RACP manager indicated that 12,000 to 15,000 seats were desirable in order to attract larger popular concerts. The Authority had planned some 5,000 outside seats that were external to the amphitheater on a nearby hillside and 5,000 to be built inside the amphitheater. Accordingly, the venue's seating capacity was estimated at 10,000.

OFFICE OF THE BUDGET – REDEVELOPMENT ASSISTANCE CAPITAL PROGRAM

BACKGROUND

On **September 12, 2001**, OB notified the Authority that then-Governor Tom Ridge had authorized the release of $15 million in RACP grant funding for the Mountain Laurel project. Funding would be provided through a grant agreement to be executed between OB and the Authority. Preparation of the grant agreement would require the submission of a completed RACP application from the Authority.

On **April 15, 2002**, the Authority made an application for RACP grant funding to the Commonwealth. At the time of the Authority's application, the RACP program instructions identified 16 items that needed to be addressed by applicants. Some of these items included project resources, project budget, project specifications, a projected cash flow schedule, and project description. Based on input from OB's engineering consultant (Consultant) for this project, seven additional items were requested to be addressed in the application.

On **October 1, 2002**, using the application information and the additional information submitted at the request of its Consultant, OB developed and fully executed the $15 million RACP grant for the Mountain Laurel project. The grant agreement contained 19 special conditions that had to be satisfied before the Commonwealth would disburse any grant funding. These conditions included revised project resources and costs, documentation showing all local matching funds being secured, and an executed cooperation agreement between the Authority and its sub-grantee, Mountain Laurel. The cooperation agreement was to ensure compliance with the requirements of the RACP program by Mountain Laurel.

However, only one month later, in **November of 2002,** two material changes occurred when the Authority changed construction contractors and significantly downsized the facility. After entering into a construction contract in February 2002, the Authority replaced the initial contractor in November 2002 because, according to interviews, the initial contractor could not come to a final agreement on contract price.

The Guaranteed Maximum Price construction contract awarded to the new contractor, totaling $21.8 million, included the following:

- Construct a 2500-seat amphitheater (with the addition of the estimated 5,000 outside seats, the total seating capacity would be 7,500);
- Site work, including parking for the amphitheater;
- Renovate the existing Cabaret building; and
- Renovate existing Administrative Offices.

OFFICE OF THE BUDGET – REDEVELOPMENT ASSISTANCE CAPITAL PROGRAM

BACKGROUND

During project construction, OB's Consultant monitored the progress of the project. The Consultant submitted six construction phase reports to OB that included the status of the 19 special conditions, including updated project resources and costs, cash flow schedules, compliance with various laws, and status of project construction.

On **May 5, 2003**, OB informed Mountain Laurel that the 19 special conditions had been satisfied, allowing the Commonwealth to begin disbursing funds to the Authority. The local match resources for the project in 2003 totaling $21,872,670, included $10,510,000 for construction, 675 acres of land (including equity) valued at $7,250,000, private donations of $2 million, a federal Economic Development Administration (EDA) grant totaling $1.3 million, interest earned during construction and start-up totaling $412,670, and corporate contributions totaling $400,000. Total project resources, including the $15 million RACP grant, at that time were $36,872,670.

Reimbursable costs that are eligible for reimbursement with RACP funds can include construction, interest during construction, permits, land, and other items. Non-reimbursable costs, though project-related, are not eligible for reimbursement with RACP funds.

When a payment request is submitted to OB, it is forwarded to the Public Protection and Recreation Comptroller's Office (Comptroller's Office) for review prior to payment. The Comptroller's Office reviews the payment request and related support. Once approved, it is forwarded to the RACP Program Manager at OB for approval. After approval, it is sent for payment.

The table below shows the date and amount of each payment request from the Authority and the date and amount paid by the Commonwealth:

PAYMENTS MADE TO THE AUTHORITY

Payment	Date Authority Requested	Adjusted Amount Requested	Date Paid	Amount Paid
Payment 1	April 16, 2003	$ 6,396,646	May 12, 2003	$ 6,396,646
Payment 2	June 29, 2003	2,949,297	September 10, 2003	2,949,279
Payment 3	December 12, 2003	1,701,310	February 27, 2004	1,701,310
Payment 4	March 19, 2004	1,805,267	May 21, 2004	1,805,267
Payment 5	June 16, 2004	828,246	August 31, 2004	828,246
Payment 6	September 30, 2004	994,926	January 4, 2005	994,944
Payment 7	June 8, 2005	324,308	July 22, 2005	224,290
Total		**$15,000,000**		**$14,899,982**

OFFICE OF THE BUDGET – REDEVELOPMENT ASSISTANCE CAPITAL PROGRAM

BACKGROUND

As shown in the above table, the Authority requested the full $15 million amount of the grant but OB approved and paid reimbursements totaling $14,899,982, or $100,018 less than the grant amount. The $100,018 difference is the amount being withheld pending OB's final close-out audit of the grant. Project construction was completed in August 2003.

In **August 2003**, Mountain Laurel opened the amphitheater. During calendar year 2003, Mountain Laurel held 9 performances at the amphitheater.

However, in **December 2003**, Mountain Laurel cancelled its 2004 season.

In **2004**, Mountain Laurel hired Bryant Associates, LLC to work out an operational/financial recovery plan. As part of the plan to encourage fundraising, it opened for Labor Day weekend in 2004 for four performances. With local support from a newly enacted local hotel tax and with the assistance of two Commonwealth Community Revitalization Grants, (CRP) totaling $500,000, Mountain Laurel held 12 performances during calendar year 2005.

Despite these efforts, Mountain Laurel's debt continued to increase. With millions of dollars of debt owed to several entities, including the construction contractor, Mountain Laurel and the Authority entered into negotiations with Mountain Laurel Development Group, LP (MLDG), a private, for-profit entity.

As a result of these negotiations, in **2005**, a series of legal provisions were developed and formalized into an agreement called a "Term Sheet." The Term Sheet included a proposal for a deed in lieu of foreclosure transaction, which allows the ownership of the property to be transferred without having to foreclose on the property. Additionally, Mountain Laurel admitted in the Term Sheet that it could not pay its debts and the Authority admitted that it could not pay future principal and interest payments on the $17 million in bonds it had floated to finance the Mountain Laurel project. Mountain Laurel, the Authority, and MLDG acknowledged that certain obligations may require approval by the federal EDA relating to EDA's $1.3 million grant, and/or by the Commonwealth for the Commonwealth's approval of conditions that would maintain the tax-exempt status of financing provided by the $15 million state RACP grant.

OFFICE OF THE BUDGET – REDEVELOPMENT ASSISTANCE CAPITAL PROGRAM

BACKGROUND

In **March 2006**, two significant events occurred. Mountain Laurel and the Authority requested a termination of the federal EDA grant, citing that the contemplated transfer of the federal EDA-improved property to a private sector developer was not permissible by EDA regulations or by the EDA grant agreement. Therefore, because the federal EDA requirements could not be met, the entire $1.3 million grant was repaid. Also, in March 2006, the deed in lieu of foreclosure was transferred to MLDG from the Authority and a ground lease was signed that allowed Mountain Laurel to use the amphitheater and approximately 42 acres surrounding it for $1 per year for 29.5 years. This allowed the Mountain Laurel Center for the Performing Arts, a Pennsylvania non-profit corporation, to continue to operate the amphitheater as a performing arts center. The agreement, in turn, required MLDG to assume most of the $23 million of Mountain Laurel's debt. MLDG plans to build condominiums on the land.

In May 2006, we requested an interview with the RACP Program Manager within OB. The Comptroller's Office stated that before an interview was scheduled we needed to submit the list of questions we were going to ask. After we submitted the questions, the Comptroller's Office stated that it did not expect to schedule the interview. Finally, in September 2006, four months later, we received a written response answering only five of the seven sets of questions posed. The letter stated that "we will not be providing answers because we do not believe they bear any relevance to the audit being performed." We disagree. The first question unanswered was why did then-Governor Tom Ridge authorize $15 million when the Capital Budget Project Itemization Act approved $17.5 million. The second set of questions unanswered requested the RACP Program Manager's opinion on whether the Commonwealth should have awarded the Mountain Laurel grant and whether the Commonwealth should have received a portion of the $15 million grant back when the Mountain Laurel property was transferred to a for-profit entity.

Given the significant amount of taxpayer dollars vested in this grant program, it is of concern that the Commonwealth plays only a minimal role in ensuring the success of RACP grant projects. In current printed material that it distributes, the Commonwealth defines its role as limited to selecting grant awardees and providing partial reimbursement of funds for approved acquisition and construction expenditures. The material also indicates that the Commonwealth simply reviews projects and provides guidance. In addition, a program manual provided by OB for the use of applicants indicates that the Commonwealth does not approve any designs, plans, specifications, estimates, or other components related to the development and execution of the projects. Furthermore, interviews with Commonwealth staff reflect a very limited approach to the management and administration of these grants. As our findings reflect, the Commonwealth needs to improve its application approval process, monitoring of the projects, and the grant payment process, in order to help assure that taxpayers' expectations are met. Additionally, these grant awards are based on *anticipated* economic, cultural, or civic improvements and not on what is actually created. There are few, if any, provisions to measure and return the grant award if expectations are not achieved.

JACK WAGNER
AUDITOR GENERAL

April 13, 2007

The Honorable Edward G. Rendell
Governor
Commonwealth of Pennsylvania
225 Main Capitol Building
Harrisburg, PA 17120

Dear Governor Rendell:

We have conducted a special audit of a $15 million Redevelopment Assistance Capital Program (RACP) grant agreement between the Commonwealth's Office of the Budget (OB) and the Pike County Industrial and Commercial Development Authority (Authority) for the Mountain Laurel Center for the Performing Arts (Mountain Laurel) project located in Pike County, for the period September 8, 2000 through March 20, 2006. The audit was conducted pursuant to authority derived from Sections 402 and 403 of the Fiscal Code and in accordance with *Government Auditing Standards* applicable to performance audits, issued by the Comptroller General of the United States.

The objectives of this special audit were to determine:

1. whether the procedures used to evaluate the viability of this project for state funding were adequate;

2. whether the Authority was entitled to the funds it received based on the terms and conditions of the grant agreement; and

3. whether the Authority complied with material nonpayment related contract terms and program requirements.

The methodology in support of the audit objectives included:

1. reviewing appropriate laws, RACP Application Materials Handbook and Procedures for Drawdown, grant agreement, grant application, construction contracts, monitoring reports, related information from OB's website, and newspaper articles;

2. reviewing external information, including audits by independent CPA firms, business plans, financial market analyses, and documentation related to the deed in lieu of foreclosure transaction;

3. examining various correspondence, memorandums, invoices and grant agreement payments;

4. interviewing and/or corresponding with management at OB, the Comptroller's Office, the Authority, Mountain Laurel, and various other individuals who were involved with the project's early phases; and

5. conducting site visits to both Mountain Laurel and the offices of the construction contractor.

The overall conclusions of our audit are as follows:

Objective One: The procedures used to evaluate the viability of this project for state funding were not adequate. See Findings 1, 2, and 3 for further details and recommendations.

Objective Two: Our audit of the Commonwealth's grant reimbursement payments to Mountain Laurel found:

1. OB did not address warning signs evident in the monitoring reports, either due to policy or otherwise. See Finding 4 for further details and recommendations.

2. Certain grant policies and procedures were not adhered to, segregation of duties concerns were noted, and deficiencies in payment review were disclosed. See Finding 5 for further details and recommendations.

Objective Three: We did not find any material concerns related to this objective.

Sincerely,

JACK WAGNER
Auditor General

FINDINGS AND RECOMMENDATIONS

JACK WAGNER
AUDITOR GENERAL

OFFICE OF THE BUDGET - REDEVELOPMENT ASSISTANCE CAPITAL PROGRAM

FINDING NO. 1 - In 2001 the Governor's Office Should Have Addressed Concerns Raised by the Office of the Budget Before Authorizing a $15 Million Redevelopment Assistance Capital Program Grant for the Mountain Laurel Center for the Performing Arts

Our review of information obtained from the Office of the Budget indicated that the Governor's Office authorized a $15 million Redevelopment Assistance Capital Program grant for the Mountain Laurel Center project in 2001, even though a number of significant concerns were not resolved. These concerns included uncertainty as to the size of the facility that would be built with the funds requested by the Pike County Industrial and Commercial Development Authority, and questions as to the amount of debt that the Authority had already undertaken for the Mountain Laurel project. If these concerns had been properly addressed, the Governor's Office may have concluded that Mountain Laurel could not financially sustain operations and meet the economic and cultural expectations of the grant. Accordingly, it is our conclusion that the Governor's Office should not have authorized the $15 million RACP grant.

As part of our audit, we requested and obtained documentation that OB and the administration used to analyze the feasibility of the Mountain Laurel project before the Governor's Office authorized the grant. The documentation consisted of the following:

- Correspondence regarding a proposal to conduct a Market and Financial Analysis for Mountain Laurel, dated September 2000;

- A Market and Financial Analysis report (report) prepared by an independent accounting firm. This report provided summary information regarding the proposed project, market data, review of comparable performing arts centers and venues, estimates on utilization, and financial performance, dated January 2001;

- Correspondence from the RACP Program Manager requesting Mountain Laurel to address questions and/or issues resulting from his review of the report, dated February 2001; and

- A response from Mountain Laurel addressing the February 2001 request, dated March 2001.

OFFICE OF THE BUDGET - REDEVELOPMENT ASSISTANCE CAPITAL PROGRAM

FINDING NO. 1

According to the RACP Program Manager, for most RACP projects, project feasibility is conducted within the Governor's Office and does not directly involve OB or the RACP Program Manager. However, for the Mountain Laurel project, "OB was asked by the Governor's Office to perform a pre-award review of the project and to request that a market and financial analysis [report] be conducted by an appropriate outside entity."

Once received, the RACP Program Manager analyzed and summarized the report for the Governor's Office. The summary discussed the size of the planned pavilion (amphitheater) of 10,000 seats. It indicated that an amphitheater with 10,000 seats would result in "middle of the road" acts agreeing to perform. However, an amphitheater with 12,000 to 15,000 seats would permit larger, popular concerts. Therefore, the summary questioned the size of the amphitheater.

The RACP Program Manager also sent Mountain Laurel his summary of the report. He stated that the report "provided additional useful information necessary for the Governor's Office to continue to consider this project for possible funding. These documents have also generated a number of questions and/or issues to be further addressed prior to a decision regarding the Commonwealth's funding participation." These additional questions and issues included:

- The threat/competition from other nearby facilities in Scranton and New York with similar venues.
- The aggressiveness in Mountain Laurel's estimates on its utilization rates.
- The status on enclosing the pavilion.
- The size of the indoor theater to accommodate larger Broadway shows.
- Status and schedule of fundraising, debt financing, and land acquisition.
- Preliminary financial statements should include not only operational revenues and costs, but all related costs, including debt service, administration, marketing, and endowment.

OFFICE OF THE BUDGET - REDEVELOPMENT ASSISTANCE CAPITAL PROGRAM

FINDING NO. 1

- Interim financing requirements.
- Endowment requirements.
- Additional detailed construction cost estimates.
- The projected economic impact on the region.

After the RACP Program Manager reviewed Mountain Laurel's response to the concerns, he e-mailed the Governor's Office that no new information was gained regarding the project, thus implying that the concerns/issues still existed. Because previous Mountain Laurel management believed that fundraising could not begin until the Commonwealth committed funding, the RACP Program Manager wrote to the Governor's Office, "It's a policy decision as to whether you want to fund and how long funds may be tied up as they start fundraising."

Based on the documentation the Governor's Office provided to us regarding project feasibility, we question the basis on which the Governor's Office authorized the release of the $15 million grant. According to current Mountain Laurel management, projects such as Mountain Laurel are not self-sustaining. For this type of venue to break even, 40 percent of the total revenue needs to be raised annually through public and private means. According to United States Census Bureau statistics, symphony orchestras and chamber music organizations rely on private contributions for approximately 34 percent of their total revenue. Current management also stated that, due to the need to rely heavily on contributions, a project such as Mountain Laurel should not be funded with debt because it would require additional contributions to remain solvent. As a result, it appears that authorization to release RACP grant monies for Mountain Laurel should not have occurred until issues brought up by the RACP Program Manager, including size of the pavilion, debt, and fundraising, were addressed.

Furthermore, it is unclear as to whether this authorization to release RACP funds was based on the Governor's Office approving specific aspects of the project, such as the size of various facilities, or whether the overall "concept" of developing a performing arts center in northeast Pennsylvania simply appeared worthwhile. If specific aspects were approved, it is reasonable that any changes to them would need to be approved. Alternatively, if authorization was based on a "concept," it is reasonable that the Commonwealth would need to approve material concept changes at some point prior to construction. However, according to the RACP Program Manager, "After the Governor approved the project, no additional feasibility or due diligence was requested or required and OB's function was to implement the approved project."

OFFICE OF THE BUDGET - REDEVELOPMENT ASSISTANCE CAPITAL PROGRAM

FINDING NO. 1

Project implementation began when Mountain Laurel submitted application materials for OB's review. Beginning in February 2002, Mountain Laurel submitted various items, including details of the proposed project, construction contract, bond documentation, and a listing of resources and uses of funds for the project. Additionally, OB hired a consulting firm to review the technical aspects of the project. Based on OB's review of these materials, the RACP Program Manager drafted a grant agreement that incorporated certain concerns into a special condition section requiring all special conditions to be satisfied before the Commonwealth approved the release of any grant money. The grant agreement, with 19 special conditions, was fully executed on October 1, 2002. OB determined the special conditions to be satisfied on May 5, 2003, prior to the first grant payment made on May 12, 2003.

According to the RACP Application Materials Handbook, "The Commonwealth does not approve any designs, plans, specifications, estimates or other components related to the development and execution of the project. . . ." Rather, the Commonwealth provides RACP guidance, reviews information to determine if project meets financial and program requirements, and provides reimbursement. After the Governor's Office authorized the grant, OB no longer questioned certain aspects of the project, including the size of the facility and the substantial amount of debt. However, if the authorization to release funding is based on a concept and OB does not approve specific project specifications, including material concept changes, we fail to see how the Commonwealth ensures that the project will achieve the economic and cultural benefits expected and that the Commonwealth's money is wisely spent.

The Governor's Office has not maintained adequate control over the Mountain Laurel RACP grant. As a result, the RACP grant should not have been approved until concerns raised by the RACP Program Manager were addressed. Once approved, material changes to the concept needed to be better monitored and addressed by the Governor's Office. As a result, the Governor's Office needs to improve its responsibilities under RACP with respect to grant approval and oversight.

OFFICE OF THE BUDGET - REDEVELOPMENT ASSISTANCE CAPITAL PROGRAM

FINDING NO. 1

RECOMMENDATIONS

We recommend that the Governor's Office not authorize RACP grants and the subsequent release of RACP funding until all concerns have been adequately addressed. Additionally, in the future, the Governor's Office and OB should ensure that RACP projects are built for an appropriate size to maximize the intended purpose and are operationally self-sustaining, considering the amount of debt undertaken by grantees.

AGENCY RESPONSE

The Department of the Auditor General's (AG) position that the Mountain Laurel Center for the Performing Arts (MLCPA) project should not have been funded is offered with the benefit of hindsight. The MLCPA project was duly authorized in a Capital Budget Project Itemization Bill by the General Assembly. The MLCPA project was enthusiastically supported by the State Senator from the area. It was supported by the Pike County Commissioners and the Pike County Industrial and Commercial Development Authority (PCICDA) as well as the Pocono Mountains Visitors Bureau and many of the most prominent resort facilities in the Pocono Mountains area. Further, at the time the MLCPA project was released by the prior Administration, the MLCPA had received letters of intent to perform at the completed facility from numerous, prestigious performing arts organizations such as: the Pittsburgh Symphony Orchestra; the Philharmonic Society of Northeastern PA; the Philadelphia Orchestra; the American Ballet; the Pennsylvania Ballet; the Pittsburgh Ballet; New York University Tisch School of the Arts and several other such organizations.

The decision to release the MLCPA project was made by the prior Administration and, as such, there are no individuals remaining within the Governor's Office nor are there any remaining pertinent documents from the prior Administration to determine the rationale for releasing the project after OB raised its concerns regarding potential project viability.

It is OB's staff understanding that the prior Administration approved the overall "concept" of MLCPA and that the decision to fund the project was not based on the specific number or mix of venues, their seating capacity or other such items. As such, based on direction received during the prior Administration, changes in the seating capacity did not warrant a reconsideration of the grant award.

OFFICE OF THE BUDGET - REDEVELOPMENT ASSISTANCE CAPITAL PROGRAM

FINDING NO. 1

AGENCY RESPONSE

All RACP projects are, by their very nature, somewhat speculative in that they are selected for funding based upon estimated or expected community and economic outcomes. These projects are selected for public sector grant funding because they cannot obtain 100 percent private financing. If they could, the RACP program would not be needed. The RACP requires at least 50% of the project cost must be match participation and grantees must secure at least one-half of the match (non-state) participation at the time of application. RACP projects cannot attract sufficient private sector investments or financing due to either project mission (not solely revenue generating, for-profit endeavors) or to some degree an uncertainty regarding projected economic outcomes. If the Commonwealth invested only in projects that could generate sufficient revenues to repay 100 percent of the cost of construction, most community and cultural projects such as libraries, museums and performing arts centers would never be constructed and the public would never benefit from the services and cultural enrichment they provide.

To date, OB has implemented over 500 RACP projects totaling over $2.6 billion. These projects have been funded and implemented throughout every part of the Commonwealth and, in general, with resounding success. Clearly, the MLCPA project failed to meet the expectations from a business perspective that its supporters promised. From a RACP project perspective, the facility that was constructed was substantially consistent with what was proposed by MLCPA. This evolution in project scope is consistent with many other RACP projects that vary over time from concept to completion. Many factors contribute to the evolution of project scopes, not the least of which are things like construction cost inflation and the availability of funds. While the surrounding property has been conveyed to a private entity, the MLCPA still retains a lease to operate the amphitheatre and control the immediate 42 acres of property upon which it is situated. At present, the MLCPA is operating for the 2007 season, with a schedule to be announced in April, according to its website.

OFFICE OF THE BUDGET - REDEVELOPMENT ASSISTANCE CAPITAL PROGRAM

FINDING NO. 1

AUDITORS' CONCLUSION

Contrary to OB's comments, we did not state that the "project should not have been funded." The Governor's Office should not have authorized the $15 million RACP grant until concerns raised by OB's RACP Program Manager were addressed. This was based on our review of the RACP Program Manager documentation and other related reports provided to us by the Governor's Office regarding the project's feasibility. Regarding OB's comments that indicate the Auditor General's position is offered with the benefit of hindsight, we would like to point out that the Auditor General, as the Commonwealth's independent watchdog has the responsibility to audit Commonwealth funds/programs so as to improve the performance of government and ensure accountability. The issues identified in the finding concern lack of proper management response, at the time, to concerns raised by staff early in the application process.

In response to OB's statement that no personnel or pertinent documentation are remaining from the prior administration to determine the rationale for releasing the funding, we understand that individuals initially involved with the project may no longer be available to respond. However, pertinent documentation regarding such decisions should have remained intact subsequent to the administration change, because the project was not complete and grant not fully paid.

We also disagree that the facility constructed was substantially what was proposed. When a $35 million project utilizing $15 million in state grant funds is portrayed in "concept" as a 10,000-seat amphitheater (5,000 inside and 5,000 outside), and one month after the grant agreement is executed, utilizing the same amount of funds, materially changes to a 7,500-seat amphitheater (2,500 inside and 5,000 outside), the grantor should at minimum have policies and procedures in place to be aware of such material "concept" changes, and have authority to "react" to such significant changes. This is especially true in this case, as OB's own RACP Program Manager had initially expressed concerns in the application process that even the 10,000 seating capacity "concept" would result in "middle of the road" acts agreeing to perform and that 12,000 to 15,000 seats were more desirable in order to permit larger, popular concerts. As a result, it is reasonable to expect the Commonwealth to have policies and procedures in place to approve material concept changes, prior to and during construction.

OFFICE OF THE BUDGET - REDEVELOPMENT ASSISTANCE CAPITAL PROGRAM

FINDING NO. 1

AUDITORS' CONCLUSION

OB's position that all RACP projects are, by their very nature, somewhat speculative in that they are selected for funding based upon estimated or expected community and economic outcomes and the premise that projects expecting to generate revenues to repay the costs of construction would never be constructed, thus the public would never benefit from the services they provide, is missing the point of the finding and attempts to justify the lack of OB oversight and responsibility. We believe that the Governor's Office should maintain adequate control over RACP grants to ensure that the project will achieve the economic and cultural benefits expected and that the Commonwealth's money is wisely spent.

Finally, we applaud management's successful funding of 500 projects. However, we question the "RACP project perspective" whereby the facility built is "substantially consistent" with what was originally proposed and, as long as the amphitheater is currently operating, the project has been successful. Although an amphitheater was built and is planning to operate in 2007, the original proposal also included the renovation of a theater that never materialized as well as the renovation of a cabaret that was built with taxpayer dollars, which is not available for use.

Therefore, the finding and recommendations remain as previously stated.

OFFICE OF THE BUDGET - REDEVELOPMENT ASSISTANCE CAPITAL PROGRAM

FINDING NO. 2 - Commonwealth Oversight of RACP Grants Needs Improvement to Help Ensure Grant Objectives, Including Taxpayers' Expectations, Are Met

Based on our review of contract and economic impact documentation, two on-site visits to Mountain Laurel, and interviews, we found that:

- the size of the amphitheater and extent of facility renovations were less than originally planned;
- the completed facilities and grounds indicate mismanagement, poor decision making, and wasteful spending; and
- the number of anticipated performances far exceeded actual performances, resulting in limited economic impact and cultural benefits to taxpayers.

Subsequent to the administration's authorization to release RACP grant funding for the Mountain Laurel project, the Authority was required to submit application materials to OB. Mountain Laurel's application for the RACP grant in April 2002 included a copy of the original contract between the Authority and the contractor of the facilities. One month after OB fully executed the RACP grant agreement, in November 2002, because the Authority and the original contractor could not agree upon a final contract price, the Authority entered into a contract with another contractor who was to construct/renovate the Mountain Laurel project by July 2003. Our review of the two contracts noted two major differences: Mountain Laurel opted to reduce the number of seats in the amphitheater from 5,000 to 2,509 seats (50 percent) and eliminate the renovation of a second theater that had a seating capacity of 1,100 seats.

As previously noted in Finding Number 1, according to the Materials Handbook, the Commonwealth has determined that it does not approve project scope changes, as evidenced by OB's failure to obtain and review a copy of the Authority's contract with the second contractor, even though it was required in the language of the grant agreement. OB stated it was not its duty to review the second contract. According to Comptroller management, RACP projects are managed locally and Commonwealth participation is generally similar to that of a financial contributor. Even though OB did not review the second contract, it should have been aware of the reduced scope through construction phase monitoring reports being submitted to OB.

OFFICE OF THE BUDGET - REDEVELOPMENT ASSISTANCE CAPITAL PROGRAM

FINDING NO. 2

Furthermore, it is unclear as to whether this approval to release RACP funds was based on the Governor's Office approving specific aspects of the project, such as the size of various facilities, or whether the overall "concept" of developing a performing arts center in northeast Pennsylvania simply appeared worthwhile. If specific or conceptual aspects were approved, it is reasonable that any material changes to them would need to be approved by the grantor. However, according to the RACP Program Manager, "After the Governor approved the project, no additional feasibility or due diligence was requested or required and OB's function was to implement the approved project." As discussed later in this finding, the reduction in scope contributed to the Mountain Laurel project not meeting taxpayers' economic and cultural expectations.

During our tour of the Mountain Laurel project, we noted several instances of mismanagement or wasteful spending. We observed that the main entrance to the amphitheater was accessible by only one driveway that did not allow buses and other vehicles to continue proceeding in the direction they entered because the driveway ends at the building. Current management stated that this creates a major traffic jam when buses try to turn around and exit after dropping off show-goers. It indicated that the driveway should have continued around the amphitheater to the other side of the parking lot.

Inside the amphitheater, we noticed that plastic covered approximately one-third of the stage because moisture drops fall from the roof panels. We were also told that the stage had no sound and lighting systems. Current management stated that money was not available for these systems and, therefore, the systems have to be rented when needed.

We also toured the Cabaret, a 500-seat theater costing taxpayers $1.5 million to renovate. We found that it was equipped with a large kitchen with expectations that dinner could be provided to patrons attending the nearby 1,100-seat theater. As stated earlier, the theater renovations were eliminated from the second contract but the plans for the large Cabaret kitchen were not changed. Current management told us that the Cabaret is located too far from the amphitheater for the kitchen to be used to its fullest potential. As a result, management indicated that the kitchen should have been downsized because of its lack of use. Therefore, we concluded that the large kitchen, costing $259,000, was unnecessary and a waste of taxpayer monies.

OFFICE OF THE BUDGET - REDEVELOPMENT ASSISTANCE CAPITAL PROGRAM

FINDING NO. 2

Additionally, the road leading to the Cabaret is narrow and potholed and the Cabaret has no parking lot, making it virtually useless. Management indicated that not having a parking lot is a major problem that adversely affects planning events at the Cabaret. During calendar years 2003, 2004, and 2005, no performances that generated revenue were held at the Cabaret. Management commented that the lack of funds may have been a factor in non-construction of the parking lot. Based on our observation and interviews, the Cabaret, built at a cost of $1.5 million, essentially serves no practical benefit and is a waste of taxpayer monies.

In summary, not only did Mountain Laurel construct and renovate fewer facilities than originally planned, poor management decisions were made with respect to the sizes, locations, contents, and usefulness of the facilities. OB's inadequate oversight throughout the Mountain Laurel project allowed Mountain Laurel to carry out its poor decisions.

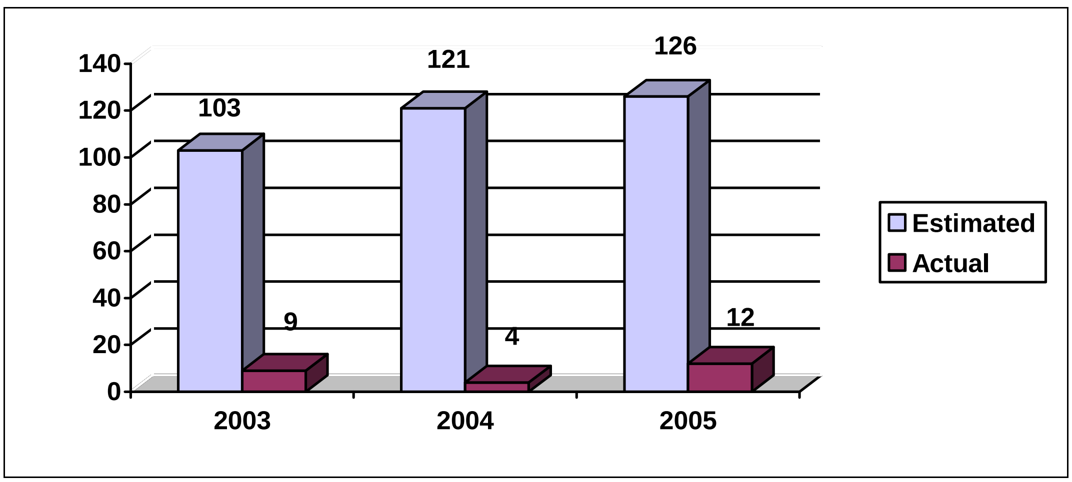
Finally, according to RACP program criteria, projects receiving RACP funding must "generate substantial increase in employment, tax revenues, or other measures of economic activity." Mountain Laurel, through an economic impact report provided to OB in March 2001 as part of the pre-grant authorization process and its response to OB's questions noted in Finding Number 1, anticipated that 350 performances would be held during the first three years of operations.

OFFICE OF THE BUDGET - REDEVELOPMENT ASSISTANCE CAPITAL PROGRAM

FINDING NO. 2

However, as illustrated in the following chart, during calendar years 2003 through 2005, the 25 total performances over three years fell short of Mountain Laurel's anticipated performance of 350 by 93 percent (325) and, as a result, had very little economic and cultural impact on the surrounding region:

Mountain Laurel Performances
Estimated versus Actual

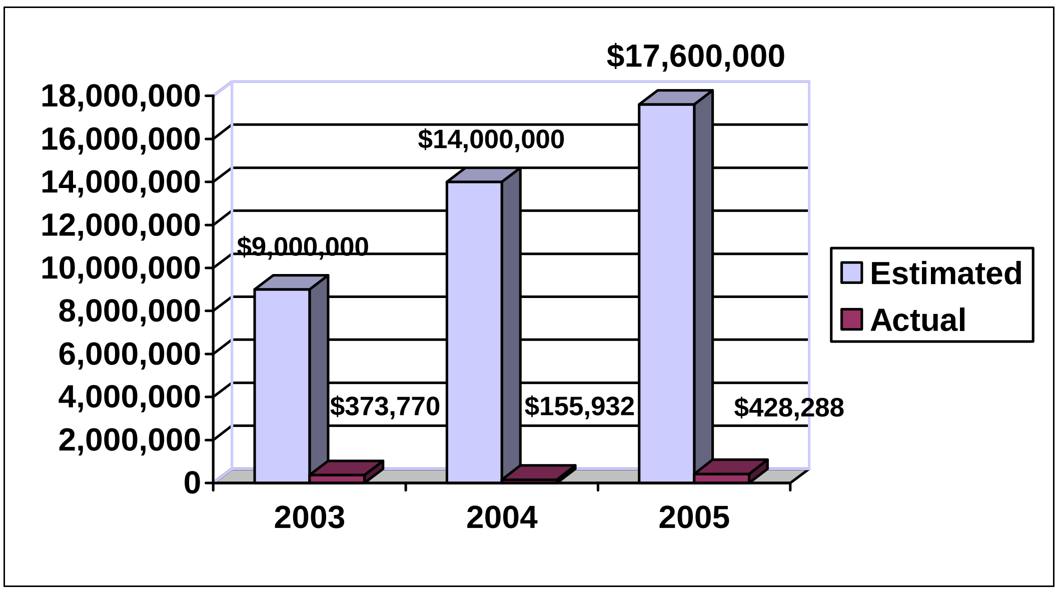


OFFICE OF THE BUDGET - REDEVELOPMENT ASSISTANCE CAPITAL PROGRAM

FINDING NO. 2

Based on the anticipated 350 performances during the first 3 years of operation the economic impact report estimated $40.6 million in revenue. However, as illustrated in the following chart, during calendar years 2003 through 2005, Mountain Laurel fell well short of its revenue estimates of $40.6 million by 98 percent ($39,642,010) and had very little economic impact on the surrounding region:

Mountain Laurel Revenue
Estimated versus Actual



In addition to the number of anticipated performances and expected revenue, the pre-grant authorization economic impact report also indicated that Mountain Laurel was to generate a regional impact of $113 million during its first five years of operation. Additionally, the facility was estimated to create more than 4,000 jobs in the region that would generate an estimated $3 million of state income tax during this period. However, due to the actual number of performances held and revenue generated, it appears that the number of jobs created and income tax generated would have also fallen exceptionally short.

OFFICE OF THE BUDGET - REDEVELOPMENT ASSISTANCE CAPITAL PROGRAM

FINDING NO. 2

One of the reasons for the shortfall in the number of performances held during the first three years, in addition to the 1,100 seat theater not being renovated, is the reduced size of the amphitheater. During our on-site visit, current Mountain Laurel management stated that the amphitheater, with its 2,509 indoor seats, is inadequate to accommodate large events. Management also stated that even with the moveable back walls, which allow for an additional seating area on a grass hill for 5,000 spectators, total seating is not large enough to cover the costs of well-known entertainers/artists. (OB cited this same concern in the pre-grant authorization document provided to the Governor's Office.) Current management indicated the indoor seating should have been at least 5,000 seats, as originally contracted for, and the area on the grass hill should have accommodated an additional 7,500 spectators. This would have allowed additional venue options. Management stated that organizations similar to Mountain Laurel need to bid on entertainers to get shows; many of the larger shows require more than $200,000 up-front for the show. Therefore, if there are not enough seats to cover that cost, well-known entertainers/artists cannot be booked.

The Governor's Office and OB had an obligation to taxpayers to ensure that the project was properly managed and that all significant deliverables are appropriate, necessary, and beneficial to the taxpayers. If the project could not have been completed as designed, the continued funding of the facility should have been reconsidered and renegotiated. Mountain Laurel represented an investment of taxpayer monies, and therefore the Governor's Office and OB need to improve their monitoring of the return on the grant investment.

RECOMMENDATIONS

In future RACP projects, we recommend that OB be directly involved with the review of applicable contracts and other documents that support significant changes in project deliverables. If grant authorization is based on specific or conceptual proposals, the RACP policy of the Governor's Office, as grantor, should be to review and approve any significant changes.

Additionally, because these grant dollars are based on *anticipated* economic, cultural, or civic improvements, and not on what is actually created, the Governor's Office should give consideration to including provisions as part of the grant agreement to measure and return the grant award or portions thereof, if significant expectations are not achieved.

OFFICE OF THE BUDGET - REDEVELOPMENT ASSISTANCE CAPITAL PROGRAM

FINDING NO. 2

AGENCY RESPONSE

The AG's Finding No. 2 has the benefit of hindsight. The decision to fund the MLCPA project as a concept was made by the Governor's Office and it was OB's responsibility to implement the project. The project venues that were built were those that were achievable given the cost of the second Guaranteed Maximum Price (GMP) Contract in comparison to the amount of funds that were available.

The General Assembly and prior Administrations dating back to 1985 and Governor Thornburgh have made the policy decision through the parameters of the Capital Facilities Debt Enabling Act (CFDEA). The creation, development and management of RACP projects is best done locally by the RACP grant recipients. While decisions of the MLCPA staff and directors to reduce the size of venues were, in hindsight, unwise, OB and the Governor's Office had no way of knowing that during the project construction period or early reimbursement period in 2003.

The Governor's Office and OB recognize the importance of maximizing the benefits derived from the Commonwealth's investment in RACP projects with its grant monies, and implementing the program as efficiently and effectively as possible. In fact, during the last four years, an additional emphasis has been placed on the economic development impact associated with each project via a request for additional information regarding economic impacts with each grant application. Each applicant must include the following economic impact information in their respective RACP applications:

ECONOMIC IMPACT
Regional And/Or Multi-Jurisdictional Impact. All Applications shall thoroughly discuss the regional and/or multi-jurisdictional economic impact of the project. Provide all available and projected information about the areas below. Explain any assumptions. The Applicant is encouraged to use maps to explain the project's impact.

- Number of direct (permanent, non-construction) jobs created by the project.
- Number of indirect (permanent) jobs created by support/supplier industries and secondary industries attracted by the project.
- Average wage for direct and indirect jobs.
- Economic circumstances of the host municipality's and county's population.
- Project's potential to enhance regional vitality.
- Annual spending generated by the project during normal operations. Exclude construction spending.

OFFICE OF THE BUDGET - REDEVELOPMENT ASSISTANCE CAPITAL PROGRAM

FINDING NO. 2

AGENCY RESPONSE

- Annual spending that would be generated by support/supplier industries and secondary businesses attracted by the project.
- Total state and local tax generation (payroll, sales, real estate, etc.)
- Benefit to regional population that, either directly or indirectly, from the project as a result of its day-to-day operations.
- Blighted Area And/Or Facility elimination and/or reuse.

Moreover, in response to RACP program growth, positions have been added to the offices providing RACP program services. Additional improvements will be considered as the program moves forward. We view the AG's independent audit of the MLCPA grant as an opportunity to once again evaluate this vitally important program.

OB does have a policy of requiring the submission of all applicable construction contracts to either OB or its consultants for review prior to beginning RACP reimbursements. In this example, OB did obtain the original GMP contract as part of the RACP application. Since RACP projects are locally managed, MLCPA was not required to submit the second GMP contract to OB prior to its execution locally in November 2002. By the time MLCPA submitted its first payment request in March 2003, construction under the second GMP was already well underway. OB, through its consultant, did obtain for review the final plans, specifications and bid tabulations in early 2003.

Grantees are not required to submit plans and specifications, construction contracts and bid tabulations to OB in advance for prior approval. The General Assembly has not mandated these actions or level of oversight through the requirements of the CFDEA. To do so would require an administrative organization, consisting of teams of architects, engineers and attorneys in comparable size to the existing Department of General Service's Public Works deputate. Such a centralized, Harrisburg-based control system is not in keeping with the delegation of responsibilities to the over 2,600 units of local government in Pennsylvania. Such a centralized system is not consistent with the CFDEA or any prior Administration's policies for RACP management. The General Assembly and all Administrations since 1985 have believed that decisions regarding RACP project implementation are best made locally at the grantee level.

OFFICE OF THE BUDGET - REDEVELOPMENT ASSISTANCE CAPITAL PROGRAM

FINDING NO. 2

AUDITORS' CONCLUSION

Regarding OB's comment concerning the Auditor General having the benefit of hindsight, we again state that the Auditor General, as the Commonwealth's independent watchdog, has the responsibility to audit Commonwealth funds/programs so as to improve the performance of government and ensure accountability.

We acknowledge and support OB's improvement to the RACP program concerning its new requirement of requesting additional information from the grantee as part of the grant application approval process. However, we have not audited this information since this is outside the scope of this audit.

We disagree that OB and the Governor's Office had no way of knowing that during the project construction period or early reimbursement period in 2003 that the size of the venues were reduced. As noted in the finding, the Authority entered into a final contract with a contractor to construct/renovate the Mountain Laurel project in November 2002. This contract clearly documented that the number of seats in the amphitheater were reduced from 5,000 to 2,509 (50 percent) and the renovation of a second theater that had a seating capacity of 1,100 seats was eliminated. At this same time, in November 2002, the Commonwealth, via OB's contracted Consultant, met with MLCPA to discuss and collect information to assist the Consultant in preparation of the Construction Phase Monitoring Report. This report was formally issued in January 2003 to OB's RACP Program Manager and the Comptroller's Office.

Management's response also stated that grantees are not required to submit plans and specifications, construction contracts, and bid tabulations to OB in advance for prior approval and to do so would require a large centralized administrative organization. We are not recommending such an organization. We believe OB's current use of contracted consultants should suffice in most circumstances, as long as OB properly instructs them on what it believes is important to monitor. In this case, it is reasonable to expect the Commonwealth to have policies and procedures in place to assist in monitoring the construction of RACP projects. Contracting with a consultant should include a provision to report on any signs of material changes to the overall "concept" of a project that would need to be approved by the grantor and should include a provision to monitor the overall financial condition and solvency of the project throughout the construction.

OFFICE OF THE BUDGET - REDEVELOPMENT ASSISTANCE CAPITAL PROGRAM

FINDING NO. 2

AUDITORS' CONCLUSION

Finally, we disagree with management's response that decisions regarding the RACP project implementation are best made locally at the grantee level. We agree that, as the grantor, Commonwealth management does not need to monitor insignificant detail at the local level. However, it is reasonable to expect the grantor to provide adequate oversight and monitoring to ensure material "concept" changes are not occurring and that the project is progressing in a significant sense, as planned.

Accordingly, our finding and recommendations remain as previously stated.

OFFICE OF THE BUDGET - REDEVELOPMENT ASSISTANCE CAPITAL PROGRAM

FINDING NO. 3 - Inadequate Grant Agreement Language Allowed a Foreclosure Agreement That Transferred Ownership of the Mountain Laurel Center for the Performing Arts From a Government Entity to a For-Profit Entity Without Recovering Any Taxpayer Dollars

After spending $14.9 million in RACP grant funding to purchase approximately 675 acres of land ($2.9 million), construct the amphitheater ($10.5 million), and renovate the Cabaret ($1.5 million), the Governor's Office allowed, as part of a foreclosure agreement, the transfer of property from the Authority to the Mountain Laurel Development Group, LP, a for-profit entity, without recovering any taxpayer dollars. As part of this transaction, MLDG leased only the amphitheater and 42 acres of land to Mountain Laurel's management. As a result, Mountain Laurel lost use of the Cabaret and 633 acres of land.

In addition to the RACP grant funding, Mountain Laurel received two other resources of public funding:

- Economic Development Administration (federal government agencies) grant totaling $1.3 million for the construction of infrastructure improvements. The Authority received the $1.3 million on August 10, 2004; and

- Two Commonwealth Community Revitalization Program grants totaling $500,000. Mountain Laurel used these grants to pay for some of the operating expenses for the 2005 season.

Mountain Laurel opened in August 2003, but, according to Authority management, could not financially sustain operations. As a result, Mountain Laurel shut down operations in December 2003 and, except for temporarily being opened for fund-raising purposes in the fall of 2004, cancelled its 2004 season. In 2004, Mountain Laurel hired Bryant Associates, LLC to work out an operational/financial recovery plan. Additionally, Mountain Laurel began receiving local support through a newly-enacted county-level hotel tax. Still, Mountain Laurel's management was aware of its "going concern" issue, as cited in its audited financial statements by an independent CPA firm for the 2003 and 2004 calendar years. "Going concern" is a term describing a situation where financial data indicates that the continuation of the business is questionable.

OFFICE OF THE BUDGET - REDEVELOPMENT ASSISTANCE CAPITAL PROGRAM

FINDING NO. 3

Due to its financial condition, a series of legal provisions were developed and documented in 2005 in an agreement called a "Term Sheet" signed by Mountain Laurel, the Authority, and MLDG. The Term Sheet included a proposal for a deed in lieu of foreclosure transaction, which allows the ownership of the property to be transferred without having to foreclose on the property. Mountain Laurel admitted in the Term Sheet that it could not pay its debts and the Authority admitted that it could not pay future principal and interest payments on the $17 million in bonds floated to finance the construction of Mountain Laurel. The parties involved with the Term Sheet also acknowledged that certain obligations may require approval by the EDA relating to its grant agreement, and/or by the Commonwealth for its approval of conditions that would maintain the tax-exempt status of financing provided by the $15 million RACP grant.

In a July 29, 2005 letter to the EDA, Mountain Laurel stated that MLDG planned to enter into an agreement for the acquisition of the bonds from the bondholders and had requested the Authority to provide a deed in lieu of foreclosure. The letter requested EDA to affirm that the proposed transaction was in compliance with the $1.3 million EDA grant.

On August 15, 2005, EDA responded to Mountain Laurel's request, identifying concerns that needed to be addressed prior to concurrence of the "closing" of the proposed transaction. These concerns included the following:

1) any sale of Mountain Laurel must be at current fair market value;

2) the transfer of title to the Mountain Laurel site was only allowable to an entity eligible for EDA assistance and approved by EDA; and

3) ground leases could only be considered by EDA if the Authority retained full site control of the entire benefiting site.

EDA's response also noted that the transfer of the land and facilities to a private entity may be found by EDA to be inconsistent with the public purpose of the EDA project. If that were found, EDA would demand repayment in full of its $1.3 million grant investment.

OFFICE OF THE BUDGET - REDEVELOPMENT ASSISTANCE CAPITAL PROGRAM

FINDING NO. 3

On March 1, 2006, Mountain Laurel and the Authority requested a termination of the EDA grant and proposed a repayment of the $1.3 million. The reason cited in the correspondence was that the contemplated transfer of the EDA-improved property to a private sector developer was not permissible by EDA regulations or by the EDA grant agreement. Therefore, because EDA's requirements could not be met, the entire $1.3 million grant was repaid.

Inconsistent with the requirements of the EDA grant, the Commonwealth's RACP grant did not include similar security provisions. The RACP grant agreement stipulated certain provisions in Article 8 that covered conditions to ensure that Commonwealth debt retained its tax-exempt status under federal income tax laws. In other words, bondholders of Commonwealth debt are not required to pay federal income tax on interest earned. Furthermore, Article 8 stated that "in the event of any breach of the provisions of this Article," the Authority would immediately repay to the Commonwealth any and all amounts paid by the Commonwealth ($14.9 million).

Based on the Authority's legal counsel review of Article 8 and the transactions contemplated by the Term Sheet, the Authority believed that the provisions of Article 8 would not be violated. OB's chief counsel also agreed with the Authority's counsel by issuing a statement, which stated in part, "Relying on the contents of the Opinion, the Commonwealth believes that the requirements of the above-referenced Grant Agreement, including those of Article 8 of the Grant Agreement, have been satisfied."

Therefore, OB determined that no grant agreement provisions were breached and, as a result, the Commonwealth would not attempt to recover any taxpayers' dollars from Mountain Laurel, even though the Commonwealth contributed $1.5 million and $2.7 million for Cabaret renovations and land purchase, respectively, that would be owned by a for-profit entity and no longer available for public use. It is unclear why the Governor's Office would allow the Authority to transfer property that had been purchased and/or improved using taxpayers' dollars to MLDG for private business use. Mountain Laurel's management stated that MLDG intends to build condominiums on the land. The grant agreement should have contained additional terms requiring that a portion of the grant should be repaid when Commonwealth monies are used to pay, in part, for land or facilities that are sold or transferred to a for-profit entity for private use.

OFFICE OF THE BUDGET - REDEVELOPMENT ASSISTANCE CAPITAL PROGRAM

FINDING NO. 3

RECOMMENDATIONS

We recommend that the Governor's Office and OB consider legal action to recover RACP grant monies.

We also recommend that the Governor's Office and OB ask the General Assembly to amend legislation to require all RACP grant agreements to include additional language that would allow the Commonwealth to recover grant funds if land or facilities, purchased, constructed, or renovated with Commonwealth funds, are sold or transferred to a for-profit entity for private use, similar to EDA regulations, or not used for the purpose of the original grant. In the meantime, we recommend immediately modifying all RACP grant agreements to include such language.

AGENCY RESPONSE

Provisions of Article 13 of the MLCPA Grant Agreement, as do all other RACP Grant Agreements, provide for instances in which the Commonwealth can terminate the Grant Agreement and attempt to recoup the grant proceeds. These include:

1. Failure to fulfill obligations of the grant;
2. Violation of any covenant of the grant;
3. Violations of law; and
4. Misuse of funds, gross mismanagement, criminal activity or malfeasance.

None of the aforementioned violations occurred on the MLCPA project and as such OB had no basis to terminate the Grant Agreement. Further, Article 8 of the Grant Agreement provides procedures to ensure that the bonds sold by OB to fund the RACP grant retain their tax-exempt status in the event the project is sold. The sale of the property as proposed and later completed did not violate any provisions of Article 8 of the Grant Agreement. Therefore, OB had no basis upon which to terminate the grant and attempt to recoup any portion of the grant as result of the sale of the property.

OFFICE OF THE BUDGET - REDEVELOPMENT ASSISTANCE CAPITAL PROGRAM

FINDING NO. 3

AGENCY RESPONSE

From a practical perspective, there are and were no available funds as result of the sale from which OB could have attempted to recoup the grant. OB's understanding of the transfer of property was that the Mountain Laurel Development Group (MLDG) agreed not to foreclose on PCICDA and MLCPA on behalf of the bondholders in exchange for a transfer of 633 acres of MLCPA property. MLDG became responsible for making payments to the bondholders of the locally issued debt. As such, no cash changed hands during the sale, rather MLCPA was relieved of a debt obligation and as such, there are no revenues or other infusion of funds to MLCPA from which the Commonwealth could attempt to recoup RACP funds. At present, the amphitheatre and 42 acres of land surrounding it are leased to MLCPA from which it can still operate a performing arts center. Had OB objected to the sale, MLCPA would have defaulted on the bonds and the bondholders would have foreclosed and taken possession of the entire MLCPA property. Had this occurred, MLDG would have been within its legal rights to demolish MLCPA. The sale of 633 acres preserved the MLCPA for possible success in operating the facility. Additionally, had OB objected to the sale, local contractors, who were owed millions of dollars, would never have been paid by MLDG thereby adversely impacting the local economy.

AUDITORS' CONCLUSION

Contrary to management's assertion, we did not state the sale should not have occurred. Unlike the grant agreement executed by the federal government, the RACP grant agreement did not contain additional terms protecting the Commonwealth's monies when land and facilities were transferred to a for-profit entity for private use. The Authority and Mountain Laurel repaid the entire $1.3 million federal grant when they determined that the sale to a private sector developer was not permissible by EDA regulations or by the EDA grant agreement. Had the RACP grant agreement contain similar provisions, the sale price or terms of the sale may have been different and may have allowed the Commonwealth to recover a portion of the grant monies. As a result, taxpayers' dollars are no longer available for public use. It is reasonable to expect the Commonwealth to include language in all RACP grant agreements that would include such security provisions.

Our finding and recommendations remain as stated above.

JACK WAGNER

AUDITOR GENERAL

OFFICE OF THE BUDGET - REDEVELOPMENT ASSISTANCE CAPITAL PROGRAM

FINDING NO. 4 - The Office of the Budget Did Not Address Warning Signs Evident in the Monitoring Reports, Either Due to Policy or Otherwise

OB did not adequately address numerous warning signs contained in its consultants' six monitoring reports and changes to local match amounts. It also placed little emphasis on ensuring that Mountain Laurel had enough resources and working capital to maintain solvency while constructing and operating the facility. As a result, the risk of loss of taxpayers' monies was increased.

OB is responsible for ensuring that the grantee is in compliance with the grant agreement and that the requests for payments are accurate and sufficiently supported. To assist in monitoring the construction of the Mountain Laurel project, OB contracted with a consultant. Between January 2003 and August 2003, the consultant issued six construction phase monitoring reports to OB. These reports included the status of construction, updated project resources and cost estimates, cash flow schedules, and status of compliance with various laws, such as steel specifications and labor policies. The consultant was not required to report on the operating costs and other construction costs that were an integral part of ensuring the success of the Mountain Laurel project.

A review of the six monitoring reports showed the following warning signs:

- Local Match amounts continually changed, from a high of $22.9 million in report #1 to a low of $20.2 million in report #5.

- Total Project Costs changed three times, from a high of $37.9 million in report #2 to a low of $35.2 million in report #5.

- Cash Flow was reported as: positive, then a $4.4 million deficit, then sufficient but relying on RACP reimbursements, and finally negative.

- Interim Financing originally reported as not required, then the next report recommended interim financing, then no financing required, then reported relying on RACP reimbursement, and finally no action required.

- Fidelity Bond---all six reports indicated that, although required by grant agreement, no bond was ever obtained.

OFFICE OF THE BUDGET - REDEVELOPMENT ASSISTANCE CAPITAL PROGRAM

FINDING NO. 4

With respect to the local matching funds, the third construction phase monitoring report identified all $21,872,670 as being secured. However, as shown in the following table, $3.3 million (15%) of the local matching funds were later determined to be not available or not used:

Mountain Laurel
Local Matching Funds

Local Matching Funds	Amount	Amount Not Available or Not Used For the Mountain Laurel Project	Adjusted Local Matching Funds
Authority bond proceeds	$10,510,000	$1,130,000 (1)	$ 9,380,000
Land (including equity)	7,250,000	-	7,250,000
Private donations	2,000,000	2,000,000 (2)	-
Corporate contributions	400,000	109,000 (3)	291,000
Interest during construction	412,670	61,000 (4)	351,670
Federal EDA grant	1,300,000	-	1,300,000
Total	**$21,872,670**	**$3,300,000**	**$18,572,670**

As noted in the table, $3.3 million was not available or not used for the project:

(1) The amount of bond proceeds was overstated by approximately $350,000 due to a clerical error and approximately $780,000 was transferred to operate the facility and, therefore, not used to pay for project costs.

(2) The private donations secured by a letter of credit totaling $2 million were not used to pay for project costs. OB’s consultant questioned the letter of credit as a resource for the project because the letter of credit itself states that the proceeds were to be used for operations.

(3) Of the $400,000 in corporate contributions received, we could only confirm that $291,000 was used for construction costs.

(4) Of the $412,670 in interest expected to be earned with bond proceeds, $61,000 was never realized.

OFFICE OF THE BUDGET - REDEVELOPMENT ASSISTANCE CAPITAL PROGRAM

FINDING NO. 4

Even though available local matching funds were reduced to $18,572,670, this did not affect the availability of the $15 million RACP grant, because local matching funds have to only be equal or greater than RACP grant funding in order to receive the RACP grant funding. However, the local match reduction of $3.3 million appeared to have affected Mountain Laurel's ability to pay project contractors. In fact, according to the Authority, as of January 2006, the construction manager was still owed $3.3 million.

Furthermore, even though the RACP Program Manager approves changes in resources of funds, OB indicated that it does not evaluate every resource because there is not sufficient Commonwealth/consultant staff or time available. OB is more concerned with making sure that there remains a sufficient amount of local resources to allow the Commonwealth to reimburse the entire grant amount. However, had OB questioned the reduction of resources, it would have recognized that Mountain Laurel had overall cash flow problems.

As signs of financial trouble became evident in December 2003, through Mountain Laurel's cancellation of its 2004 season, OB should have taken steps to assess whether the five remaining grant payments (totaling $5.6 million and paid between February 2004 and July 2005) should have continued, been modified, or been suspended. Additionally, OB should have ensured that a sufficient amount of funds was available and reserved for intended construction and operational purposes. Because OB considers itself to be a revenue source for the project, it does not get involved with the management and operations of the facility. However, OB has an obligation to taxpayers to invest and account for Commonwealth funds in a prudent manner.

The Governor's Office and OB are not adequately performing ongoing monitoring of grantee operations, including monitoring of grantee overall cash flow to ensure a grantee's ability to continue as an entity. The current policy of not monitoring the overall financial conditions/solvency of grantees will continue to put taxpayers' monies at risk in future RACP grants.

OFFICE OF THE BUDGET - REDEVELOPMENT ASSISTANCE CAPITAL PROGRAM

FINDING NO. 4

RECOMMENDATIONS

We recommend, with respect to future RACP projects, that the Governor's Office and OB:

- monitor and address significant changes to all grant resources, including a grantee's overall cash flow, financial condition and solvency throughout project funding;
- obtain all issued financial audit reports of the grantee during the term of the grant agreement to assess the grantee's ability to operate a constructed facility;
- upon the first sign of financial instability, take steps to assess whether grant payments should continue, be modified, or stopped until concerns are addressed; and
- ensure that all grant agreement terms are met, including the requirement for grantees to procure the appropriate fidelity bonds.

AGENCY RESPONSE

The RACP enabling legislation (CFDEA) requires a minimum of a 1-1 ratio of RACP grant to matching funds. This threshold was maintained throughout the MLCPA project.

OFFICE OF THE BUDGET - REDEVELOPMENT ASSISTANCE CAPITAL PROGRAM

FINDING NO. 4

AGENCY RESPONSE

AG suggests that OB should have stopped reimbursing MLCPA for the RACP grant after MLCPA cancelled its 2004 season in December 2003. MLCPA was legally obligated to pay its contractors for work incurred and services rendered. Under the terms of the Grant Agreement, OB was legally obligated to make reimbursements to MLCPA based on validly presented reimbursement requests. MLCPA was not in default of any terms or conditions of the Grant Agreement and therefore was entitled to reimbursements under the terms of the Grant Agreement. Failure by OB to process RACP reimbursements could have resulted in legal action against the Commonwealth from MLCPA, PCICDA and the various MLCPA contractors and sub-contractors. RACP contracts are legally binding documents applying to both the Commonwealth and the local grant recipient (PCICDA and MLCPA). The Commonwealth cannot withhold reimbursement at its discretion once the grant conditions are met and the grantee has submitted valid reimbursement requests. OB's position is that to do so would have totally eliminated MLCPA ability to pay local contractors for construction work already incurred for the completed facility. This action would have lead to the filing of liens by contractors against MLCPA and likely to protracted legal battles with their correspondingly high legal bills. To stop reimbursements and prevent MLCPA from paying its contractors with RACP reimbursements would have had a detrimental impact on the local economy, local contractors and their suppliers and employees. The elimination of RACP reimbursements in early 2004 would not have precluded MLCPA from canceling its 2004 season nor would it have aided MLCPA in its attempts to return to financial solvency. To the contrary, such actions would have further damaged MLCPA and also adversely impacted the local economy.

The Commonwealth fulfilled its obligation to the taxpayers of the Commonwealth with respect to the MLCPA project in that a performing arts facility was proposed and constructed with the RACP grant. That facility remains in existence today and the MLCPA has access to the facility along with 42 acres of surrounding land from which it can operate for the 2007 season and beyond. These facilities are to be open to the public for its use as events are scheduled at MLCPA.

OFFICE OF THE BUDGET - REDEVELOPMENT ASSISTANCE CAPITAL PROGRAM

FINDING NO. 4

AUDITORS' CONCLUSION

For the most part, we understand OB's comments that RACP contracts are legally binding documents and the failure to make reimbursement could result in legal action against the Commonwealth. However, we believe OB should have been concerned with the financial troubles of Mountain Laurel and should have taken a proactive approach to protecting taxpayers' monies. We disagree with the notion that management was unaware of Mountain Laurel's financial problems. Numerous warning signs or "red flags" were ignored by OB during the construction and reimbursement of the project. As such, these red flags should have caused OB to initiate some sort of action, at least to conduct an investigation as to potential mismanagement. OB's role in the RACP program after a project is approved and funding made available should go beyond the current approach.

Furthermore, during the spring of 2004, there were more than 10 newspaper articles identifying Mountain Laurel's severe financial problems, including millions of dollars of debt owed to creditors. In a March 24, 2004 letter, the Department of the Auditor General asked OB for information regarding this project as to what monitoring and auditing OB had done or planned to do, as well as what actions OB would take before releasing the remaining grant agreement funds, which amounted to approximately $4 million. This letter also identified Mountain Laurel's severe financial problems. OB responded in an April 20, 2004 letter stating that it would conduct a close-out audit when the final payment request was submitted. It is clear that OB was aware of Mountain Laurel's financial difficulties and did not intend to take action. OB should have taken steps to assess whether the remaining grant payments should have continued, been modified, or been suspended.

OFFICE OF THE BUDGET - REDEVELOPMENT ASSISTANCE CAPITAL PROGRAM

FINDING NO. 4

AUDITORS' CONCLUSION

We also disagree with management's position that the Commonwealth cannot withhold reimbursement at its discretion. According to the grant agreement, OB can give notice to suspend any and all project activities for items including contract breaches, law violations, audit exceptions, misuse of funds and gross mismanagement. This allows OB to retain any funds previously approved until the grantee can correct the circumstance that resulted in the suspension. We believe the suspicion of mismanagement was evident prior to all grant payments being paid to Mountain Laurel. We also disagree with management's perspective that the Commonwealth fulfilled its obligation to the taxpayers with respect to the MLCPA project in that a performing arts facility was proposed and constructed with the RACP grant. Clearly, as warning signs became evident of Mountain Laurel's financial trouble through six monitoring reports provided to OB between January 2003 and August 2003 and in December 2003 through Mountain Laurel's cancellation of its 2004 season, and numerous media articles, OB should have assessed whether the remaining grant payments should have continued, been modified, or been suspended. OB has an obligation to taxpayers to account for Commonwealth funds in a prudent manner.

Management states that the facility remains in existence today and the MLCPA has access to the facility along with 42 acres of surrounding land. These facilities are to be open to the public for the 2007 season and beyond as events are scheduled. However, as noted in the findings, current MLCPA management indicated to us that the amphitheater with its seating capacity is inadequate to accommodate large events. Management stated that organizations similar to MLCPA need to bid on entertainers; many of the larger shows require more than $200,000 up-front for a show. Therefore, if there are not enough seats to cover that costs, well-known entertainers/artists cannot be booked. In addition, although the public will have access to the amphitheater along with 42 acres, the taxpayers lost the use of the Cabaret and an additional 633 acres of land, costing the Commonwealth $1.5 million and $2.7 million, respectively.

Our finding and recommendations remain as stated above.

JACK WAGNER

AUDITOR GENERAL

OFFICE OF THE BUDGET - REDEVELOPMENT ASSISTANCE CAPITAL PROGRAM

FINDING NO. 5 - Certain Grant Policies and Procedures Were Not Adhered to, Segregation of Duties Concerns Were Noted, and Deficiencies in Payment Review Were Disclosed

Our audit of the $15 million RACP grant to the Authority for Mountain Laurel found:

1. although the RACP grant program is a reimbursement program, certain prepayments were made rather than reimbursements;

2. actual costs were removed from project monitoring reports by OB, which then misrepresented overall total project costs;

3. segregation of duties concerns; and

4. deficiencies with regard to the Comptroller's Office payment review of the Authority's payment requests.

According to the RACP Application Materials Handbook, RACP grant funds, administered by OB, are paid to the grantee on a reimbursement basis as expenses are incurred and paid. Because it is a matching program, the amount of grant funds reimbursed is based on a reimbursement factor that is computed by dividing the local match amount by the RACP grant. The reimbursement factor is pre-approved by OB and is allowed to be revised throughout the project. The reimbursement factor is included on the payment request to ensure that the grant reimbursement amount is correct.

The RACP Procedures for Drawdown, which stipulates the types of expenses allowed to be reimbursed by RACP grant funds, including land, construction, interest during construction, and permit fees, requires grantees to submit copies of invoices and proof of payment for reimbursable expenses with each payment request. It also includes the types of non-reimbursable expenses that are submitted by the grantee and used to calculate the reimbursement factor. These include administrative costs, architecture/engineering fees, legal and accounting costs, and future maintenance and operation costs.

OFFICE OF THE BUDGET - REDEVELOPMENT ASSISTANCE CAPITAL PROGRAM

FINDING NO. 5

As part of our audit, we tested the Authority's seven payment requests, totaling $15 million, submitted to the Comptroller's Office between April 2003 and June 2005. The Comptroller's Office is responsible for reviewing payment requests to ensure that they are in compliance with appropriate guidelines, including the reimbursement factor. After approval, the payment request is forwarded to OB for its approval. Based on our review, we found:

1. <u>OB prepaid debt service payments rather than reimbursing debt service payments after they were made</u>

   With the submission of the first payment request, OB considered $3.9 million of bond proceeds, placed into a debt reserve fund to pay three years' of interest expense, as incurred and paid when only $1.2 million had actually been paid to bondholders. In other words, OB considered money that was set aside and reserved for future interest expense as paying that interest expense now instead of when it was actually paid. We disagree with OB's definition of incurred and paid as it applies to this grant agreement. Interest should be considered incurred and paid as payments are made to the bondholders from the debt reserve fund.

   Although this situation did not follow RACP payment policy in which advance payments are prohibited, at the end of three years, the total state share of the debt service payments equaled what should have been reimbursed by the state.

2. <u>OB removed actual costs from the project monitoring reports</u>

   OB removed $2.3 million of administrative expenses from the fourth payment request even though these expenses are eligible to be used as part of local match. According to OB, the extent of reviewing the invoices to support the administrative expenses would have been too time-consuming and difficult to evaluate.

OFFICE OF THE BUDGET - REDEVELOPMENT ASSISTANCE CAPITAL PROGRAM

FINDING NO. 5

To compensate for this disallowance, the RACP Program Manager suggested to the Authority that, if it submitted a reduction in total project costs, OB would approve the reduction. This would in effect lower the reimbursement factor and allow the Commonwealth to reimburse the Authority quicker. According to the Comptroller's Office, the reduction in the reimbursement factor was acceptable because the construction of the project was complete. We disagree. Even though the reimbursement factor can be adjusted as estimated resources change, reimbursement factors should not be negotiated once a project is complete. Completing construction does not ensure that sufficient local match funds are available to pay for the project. Removing known uses/costs also masks the need for securing sources of the local match monies, which in turn can mask cash flow problems. Therefore, OB's decision may not have been in the best interest of the taxpayers.

3. Segregation of duties concerns

Based on the above issues, we believe there are segregation of duties concerns in that the RACP Program Manager has too many overlapping responsibilities, including among other things, the following:

- receiving and reviewing grant applications;
- drafting grant agreements;
- drafting and approving special conditions;
- approving changes to budget forms and resultant reimbursement factor changes when requested by the grantee or deemed necessary for project completion; and
- approving RACP grant payment requests.

OB's reliance on one individual and the failure to properly segregate RACP management duties and authority may lead to inappropriate uses of RACP funds. Among the duties, the approval of the budget form and resultant reimbursement factor and approving RACP grant payment requests should be segregated.

OFFICE OF THE BUDGET - REDEVELOPMENT ASSISTANCE CAPITAL PROGRAM

FINDING NO. 5

4. <u>Deficiencies were also noted with regard to the Comptroller's Office payment review of the Authority's payment requests</u>

   The Comptroller's Office admitted that it does not have standard procedures to review RACP payment requests nor does it have established procedures in place to perform closeout audits for RACP projects.

   We noted during our review of the seven payment requests that Comptroller's Office staff appear to act inconsistent in what information is considered sufficient when performing payment request reviews. For example, Mountain Laurel bank statements and support for construction manager expenses were required by one Comptroller's Office staff member and not considered necessary by another staff member. The Comptroller's Office indicated that it has insufficient staff to perform detail reviews of supporting documentation, including contractor invoices, related to this project.

   The Comptroller's Office also stated that consideration has to be given as to whether to delay or not delay payment based on the dollar amount involved. Our review of the seven payments found the following deficiencies that the Comptroller's Office either failed to detect or detected but refused to delay payment:

   - land purchase documentation was incomplete; documentation did not exist to support the $280,000 in option payments required as a result of a delay in closing on the land purchase and to support $51,900 for title insurance;

   - proof of payment was missing for three construction invoices totaling more than $3 million. However, we were able to obtain proof of payment directly from Mountain Laurel;

   - a construction invoice was overpaid by $73,000; however, because other construction invoices had not been paid, this did not result in overpaying the construction manager;

   - interest paid on a loan totaling $50,000 was overstated by approximately $35,000;

OFFICE OF THE BUDGET - REDEVELOPMENT ASSISTANCE CAPITAL PROGRAM

FINDING NO. 5

- the required listing of invoices relating to financing and accounting fees, totaling approximately $47,000, was not included for these non-reimbursable expenses;

- two construction manager invoices lacked required signatures by the project's architect and engineer; and

- actual invoices totaling approximately $18 million from the construction manager were not reviewed. The Comptroller's Office accepted the amount listed on the construction manager's summary sheet as correct. This led to the administration paying $98,400 of the construction manager's performance bond fee. Even though the Authority agreed to reimburse the construction manager for that cost, the Commonwealth should not have reimbursed the Authority because the performance bond fee is not part of the grant agreement.

The Comptroller's Office relies heavily on its closeout audit to determine proper classification and/or eligibility of costs and to adjust for any discrepancies. According to the Comptroller's Office, OB expects to initiate the closeout audit after we complete this audit. We disagree with OB's waiting to perform the closeout audit. Waiting to conduct the closeout audit would affect obtaining repayments, if applicable, and may also make it more difficult to acquire necessary information.

RECOMMENDATIONS

We recommend that OB and the Comptroller's Office:

1. Follow RACP grant payment policy to reimburse "paid" project expenses and not provide for advance payments;

2. Refrain from disallowing eligible local match expenses because of being "too time-consuming" to review and then using the reimbursement factor as a negotiation tool to increase the reimbursement;

3. Consider segregating RACP program management responsibilities to ensure that one person is not responsible for overseeing and controlling the program;

4 Ensure adequate time and personnel are available to sufficiently review all payment request documentation, including subcontractor invoices;

OFFICE OF THE BUDGET - REDEVELOPMENT ASSISTANCE CAPITAL PROGRAM

FINDING NO. 5

RECOMMENDATIONS

5. Establish standard procedures for reviewing RACP payment requests and conducting closeout audits; and

6. Consider withholding a larger dollar amount prior to the completion of the closeout audit. Additionally, the closeout audit should be performed nearer to the completion of the project.

AGENCY RESPONSE

OB only reimburses for paid expenses and no violation of this policy occurred on the MLCPA project or any of the over 500 other RACP projects. OB allowed MLCPA to utilize the "Pre-Paid" debt service costs or "capitalized interest" costs to be counted as a portion of the required non-state matching funds. By its very nature and name, "Pre-Paid" debt service or interest are those costs which have already been **PAID**. These funds were paid out of available MLCPA funds and placed into a debt service reserve account over which MLCPA did not have control. As result, these costs were paid from the perspective of MLCPA and OB as the funds were in a restricted account which could only be used to pay debt service costs to the bondholders as the occurred. Therefore, MLCPA and OB was within its bounds and discretion to recognize these costs as paid for RACP purposes. The "Pre-Paid" interest costs were ultimately utilized as matching costs and therefore no RACP reimbursements were ultimately allocated to these costs.

The removal of certain administrative costs from the RACP scope of the project was within the discretion of OB and such action did not adversely affect the MLCPA project. All minimum 1-1 funding ratios were maintained throughout the course of the project.

In response to the AG comments on the segregation of duties, the CFDEA legislatively conveys the responsibility for RACP to the Secretary of the Budget. The further segregation of duties and responsibilities beyond the Secretary of the Budget is an executive decision.

OFFICE OF THE BUDGET - REDEVELOPMENT ASSISTANCE CAPITAL PROGRAM

FINDING NO. 5

AGENCY RESPONSE

The Comptroller's Office has, for approximately thirteen years, consistently approached payment request reviews in the same manner with the same basic requirement: a properly completed payment request with reasonable and appropriate supporting documentation for reimbursable costs and adequately summarized payment information for non-reimbursable match costs. Payment to the general contractor is verified; however, it is the opinion of the Comptroller's Office that the review of sub-contractor invoices that underlie the general as proposed by the AG is an unnecessary and inefficient use of resources.

The AG identified, in some cases sparse detail that precluded a more specific response, seven alleged deficiencies related to the review by the Comptroller's Office of seven payment requests associated with this RACP grant. The Comptroller's Office believes the alleged deficiencies identified by the AG are inaccurate or inconsequential. For example, it is: inaccurate that land purchase documentation did not exist to support the option payments since the Comptroller's Office was satisfied with a copy of the land option agreement and proof of payment for the option and had proof of payment for the title insurance; inaccurate to state proof of payment was missing for three construction payments since the Comptroller's Office was able to verify all payments were made to the general contractor with copies of checks and bank statements; inconsequential that interest was overstated since the Comptroller's Office, with information it requested and received, reduced the next payment request by a similar amount; inconsequential that the listing of invoices related to the financing and accounting fees was not submitted since far more match costs were appropriately submitted than were necessary to satisfy the minimum match requirement; inconsequential that signatures were missing since the project was complete and the final general contractor invoice submitted with payment request no. 5 was appropriately signed; inaccurate to state the performance bond fees were not part of the grant agreement, particularly since Article 27 of the grant agreement requires performance bonds. One identified alleged deficiency, an overpayment of a construction invoice, lacked the detail necessary for us to even attempt a response.

The Comptroller's Office routinely performs final close out audits in a manner consistent with generally accepted government auditing standards. These legislatively mandated close out audits include clearly stated objectives and an established audit program. Close out audits are scheduled as soon as practical after the completion of the RACP funding period. When, on May 4, 2004, the AG initiated its audit of the grant, nearly $4,000,000 of the grant had not been disbursed. As noted above, OB and the Comptroller's Office chose to defer its audit until such time as the AG completed its audit. This fairly common practice is a courtesy to the auditee.

OFFICE OF THE BUDGET - REDEVELOPMENT ASSISTANCE CAPITAL PROGRAM

FINDING NO. 5

AUDITORS' CONCLUSION

With respect to the $3.9 million of funds placed into the debt service fund, we agree that these funds were no longer in control by the Authority and we agree that these monies as management puts it "were in a restricted account which could only be used to pay debt service costs to the bondholders as they occurred." However, because the requirement to reimburse includes both incurred and paid, our finding was disputing the fact that the interest expense relating to $2.7 million of these funds had not yet been incurred, (i.e. not yet paid to bondholders) and, as a result, should not have been considered eligible expenses. Furthermore, just because these monies were placed in a restricted account does not guarantee that these monies will only be used for this purpose. In fact, an agreement was reached between the Authority and the Trustee of this restricted account that the bondholders of the $17,000,000 bonds agreed to allow approximately $500,000 of this account to be made available in June 2004, to pay certain current expenses, instead of paying capitalized interest. As a result, we believe it is unwise to continue this practice of reimbursing expenses that have not been incurred even though they may be classified as restricted.

Regarding OB's comment on its discretion to remove administrative costs because the minimal 1-1 funding ratio was maintained and "such action did not adversely affect" the project, we disagree. As previously stated in the finding, even though the reimbursement factor can be adjusted as estimated resources change, reimbursement factors should not be negotiated once a project is complete. Completing construction does not ensure that sufficient local match funds are available to pay for the project. Removing known uses/costs also masks the need for securing sources of the local match monies, which in turn can mask cash flow problems. Furthermore, OB failed to comment on the "bigger issue" of the RACP Program Manager having the authority to "negotiate" how RACP recipients can be paid more quickly when project construction is complete.

Regarding the RACP Program Manager's segregation of duties concerns, we disagree with management's response. If the responsibility for RACP is legislatively conveyed to the Secretary of the Budget, OB is not prohibited from ensuring that there are necessary segregation of duties within OB. We were not implying that these duties should be segregated to individuals outside OB.

With respect to the Comptroller's Office opinion that the review of the subcontractor invoices is unnecessary and inefficient, we disagree. To ensure propriety of contractor invoices and to reduce the risk of fraud, it is necessary to, at least on a sample basis, review subcontractor invoices.

OFFICE OF THE BUDGET - REDEVELOPMENT ASSISTANCE CAPITAL PROGRAM

FINDING NO. 5

AUDITORS' CONCLUSION

With regard to the comment that some of the detail we presented in the finding concerning Comptroller's Offices deficiencies is "sparse," we adamantly disagree. Given the Comptroller's Office is responsible to review all payment requests, it should be able to respond to payment inquiries based on information available. This is an indication of inadequate payment processing controls. For the other deficiencies that the Comptroller's Office considers "inaccurate" or "inconsequential," we respond as follows:

- As part of our test work, we requested from the Comptroller's Office each payment request and all documentation. During our review of the support for payment request No. 1, we noted incomplete and missing documentation to support the land option payments and relating proof of payment to support the title insurance. As a result, we had to request this documentation directly from the Authority to satisfy our test work. Additionally, with respect to the missing payment documentation for three construction manager invoices, the documentation received from the Comptroller's Office for payment requests 6 & 7 did not contain proof of payment. We again had to obtain this documentation directly from the Authority. Given the Comptroller's Office is responsible to review payment requests, we believe it should maintain adequate documentation to support all payments. The incomplete and missing documentation indicates inadequate/deficient approval/payment processing controls.

  With respect to the performance bond fee, we agree that Article 27 of the grant agreement requires contractors to have a performance bond. However, the performance bond fee is not listed as a reimbursement category.

- Management responded that it classified certain items in our finding as inconsequential. As part of auditing, sampling occurs. We believe these deficiencies found as a result of our sampling payment transactions are symptomatic of overall processing control weaknesses found in the Comptroller's Office grant payment process. Furthermore, with respect to the overstatement of interest, we brought that issue to the Comptroller's Office attention, which in turn corrected it on the next payment request received.

OFFICE OF THE BUDGET - REDEVELOPMENT ASSISTANCE CAPITAL PROGRAM

FINDING NO. 5

AUDITORS' CONCLUSION

Finally, we disagree with the Comptroller's Office delaying the close-out audit as a courtesy practice to the auditee until the Auditor General completed this audit. As noted in our findings, this project was mismanaged, contained control weaknesses, and resulted in wasteful spending of taxpayers' monies. Therefore, the immediate necessity to audit the Authority due to the high risk of abuse and potential fraud should have outweighed the practice of courtesy to the auditee.

Our finding and recommendations remain as stated above.

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