


VIRGINIA SMALL BUSINESS FINANCING AUTHORITY

REPORT ON AUDIT FOR THE YEAR ENDED JUNE 30, 2014

Auditor of Public Accounts
Martha S. Mavredes, CPA
www.apa.virginia.gov
(804) 225-3350

AUDIT SUMMARY

Our audit of the Virginia Small Business Financing Authority for the fiscal year ended June 30, 2014, found:

- proper recording and reporting of all transactions, in all material respects, in the Commonwealth Accounting and Reporting System and its internal accounting system and records;

- certain matters involving internal control and its operation necessary to bring to management's attention; and

- no instances of noncompliance with applicable laws and regulations or other matters that are required to be reported.

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AUDIT FINDINGS AND RECOMMENDATIONS

Improve Controls over Financial Reporting Process

The Virginia Small Business Financing Authority (Authority) does not have sufficient controls over its financial reporting process. While the Authority does have a series of notes and comments within its accounting spreadsheets to aid in the preparation of its financial statement trial balance, the Authority does not have a written policy over its presentation of its required year-end financial report to the General Assembly nor does it follow any specific accounting framework for presenting its year-end financial report. As a result, the year-end financial report is at risk for inconsistencies and contains some misrepresentative language. For example, the Authority references Governmental Accounting Standards Board (GASB) Statement 34 within its report; however, the report is not presented in accordance with governmental accounting standards. While we did not perform procedures to opine to the accuracy of the financial report, our limited review over its compilation also found that the Authority overstated its balance of loan loss reserve accounts by $338,199 in one of its program footnotes.

Section 2.2-2312 of the Code of Virginia dictates that the Authority shall submit an annual report of its activities setting forth a complete operating and financial statement. The Code of Virginia does not require the Authority's special-purpose financial statements to be in accordance with Generally Accepting Accounting Principles (GAAP). However, information reported should be presented in a manner that is reliable and does not unintentionally mislead users of the report.

The Authority establishes the financial report from its accounting spreadsheets, which are prepared based on a series of notes within the spreadsheets. Management believes this process is sufficient to ensure reliability and consistency between periods given the simplicity of the Authority's financial activity. While we agree that this process does serve as a useful tool in developing financial statements, we believe the absence of a reporting framework warrants a more formal and encompassing reporting policy on how the financial activity should be presented in the year-end report.

The Authority's lack of a written policy over the presentation of the year-end report in connection with the absence of an applicable accounting framework increases the risk of inconsistent presentation and fails to provide verifiable criteria against which the presentation may be compared. References to accounting standards, which the Authority only partially follows, diminish the understandability of the report and is misleading to users, and errors undermine its reliability. In addition, the lack of a formal internal policy increases the risk, in the event of the departure of a key employee, that the agency will be unable to prepare consistent, reliable, financial reports in an efficient, effective, and timely manner.

We recommend that the Authority develop a policy over its presentation of the year-end financial report to ensure consistency and clarify what should be presented since no specific accounting framework is followed. The Authority should apply a more rigorous financial reporting review process to detect and correct significant errors prior to report issuance. In addition, we recommend that the Authority remove references to GASB standards it does not follow and label its year-end financial report as "unaudited."

Strengthen Controls over Off-CARS Disbursements

The Authority does not have sufficient controls over off-CARS (Commonwealth Accounting and Reporting System) disbursements. During our review, we found that the Authority did not complete and approve an internal purchase request form for eight out of ten (80 percent) purchases for goods and services reviewed. In addition, we found issues with supporting documentation in two out of 35 (6 percent) disbursements reviewed. In one instance, the Authority could only provide a copy of the check written but could not provide additional documentation to substantiate the purpose for the disbursement. In the second instance, the Authority could not provide the support timely due to a misfiling, providing the documentation over one month after the original request. The 35 transactions sampled included ten administrative expenses and 25 loan distributions.

During the first half of fiscal year 2014, the Authority was required to follow the Department of Business Assistance (Business Assistance) procurement policy. According to that policy, an internal purchase request form is to be used internally to initiate and ensure accountability for a purchase, as well as to ensure a purchase is appropriately authorized prior to an employee obligating the Authority to it. After Business Assistance merged with the Department of Minority Business Enterprise to form the Department of Small Business and Supplier Diversity (Supplier Diversity), it is unclear whether the policy continued to be active during the remainder of the fiscal year; however, our review found issues throughout the entire fiscal year. In addition, the Commonwealth Accounting Policies and Procedures (CAPP) Manual Topic 20310 requires expense documents to be maintained on file for a period of three years.

An internal purchase request form is a method of ensuring that spending is carefully controlled at the Authority. The primary reason the Authority did not comply with this policy is that management viewed the language in the policy as conflicting and; therefore, interpreted the policy differently. In addition, management does not view the form as a significant control since management is responsible for signing all checks and is aware of all purchases. However, without the use of internal purchase request forms or some other mechanism for front-end approval, management cannot assess the reasonableness of a purchase until after it has already been obligated to the Authority, increasing the risk of inappropriate transactions. In addition, without maintaining adequate supporting documentation, the Authority cannot substantiate a disbursement or support the purpose for a payment, increasing the risk of inappropriate or fraudulent transactions.

We recommend that the Authority communicate with Supplier Diversity to establish a policy regarding purchase approvals based on current operations, risks, and activity. Once a new policy has been adopted, management should require purchasing staff to comply with the policy. Additionally, the Authority should maintain adequate supporting documentation for all disbursements in accordance with the CAPP Manual.

AUTHORITY BACKGROUND

The Virginia Small Business Financing Authority (Authority) has been in existence since 1984 and provides financial assistance to Virginia-based businesses through bond issuances, direct loans, loan guarantees, and portfolio loan loss reserves as well as other technical assistance. The Governor appoints the Authority's 11 member Board of Directors.

During fiscal year 2014, the Department of Business Assistance and the Department of Minority Business Enterprise merged to form the Department of Small Business and Supplier Diversity (Supplier Diversity). The Director of Supplier Diversity appoints the Authority's Executive Director, who oversees the Authority's operations. The Authority's staff, who are also Supplier Diversity employees, but paid entirely by the Authority's revenues, support the Authority by marketing the Authority's programs and services, reviewing program applications, conducting credit analyses, monitoring the progress of projects that have received funding, servicing loan receivables, administering the Authority's fund and bank accounts, and preparing the Authority's financial statements and reporting to state and federal funding sources. The Authority is included as part of Supplier Diversity's general fund appropriations; however, various fees and interest earnings cover the majority of the Authority's administrative expenses.

PROGRAM HIGHLIGHTS

The exact nature and number of programs administered by the Authority have continually changed over time based on market need and funding resources available. The Authority's financing programs fall into three broad categories: bonds, direct assistance, and indirect assistance.

Through the bond program, the Authority provides Virginia businesses and 501(c)3 non-profits with access to low cost bond financing which they would otherwise not be able to obtain on their own. The direct assistance programs provide loans to qualified Virginia businesses and 501(c)3 organizations, while the indirect assistance programs provide support to Virginia businesses through loan guarantees, cash collateral, and loan insurance programs. The goal of these programs is to encourage economic development through either job creation or retention by small businesses while striving to recapture public funds over time for future credit requests.

Detailed below is more information about the various programs administered by the Authority.

Bond Programs

The *Industrial Development Bond Program* is a financing vehicle in which the Authority serves as a conduit issuer of tax-exempt and taxable industrial development bonds for qualifying businesses and 501(c)3 entities. The Authority also has the ability, through specific language in the Code of Virginia, to assist Virginia's transportation initiatives through the issuance of bonds for qualified private-sector companies working with the Virginia Department of Transportation in public-private partnerships. The nature of the entity and consideration of the Commonwealth's available allocation of private activity bonds determine whether or not the bond issuance will be tax-exempt.

The private sector provides the bond financing, not the Authority or the Commonwealth, and the respective small business or non-profit has responsibility for debt service. As such, the Authority takes on no risk as a result of this program. The Authority is responsible for collecting application and administration fees associated with the bond issuances. These funds support the ongoing operating expenses of the Authority and also provide additional funding to other programs administered by the Authority.

Since the program's inception, the Authority has facilitated the issuance of 162 bonds; however, no new bonds were issued in fiscal year 2014. With interest rates at low levels, bond financing is not as attractive and some of the previous years' bond activity had been tied to benefits in the Federal Stimulus Act.

Direct Assistance Programs

The following revolving loan programs provide loans, generally up to $1 million in value, to bridge the gap between private debt financing and private equity or, in the case of the Microloan Program, to provide direct loans to fund very small business financing needs which banks sometimes prefer not to offer. As borrowers repay the loan principal and interest, the Authority uses the proceeds to issue new loans. The remaining interest earned supports the Authority's ongoing operating expenses.

- The *Federal Economic Development Loan Fund Program (EDLF)* provides loans to new and expanding businesses or local or regional economic development authorities in qualified geographical areas that create or save jobs in Virginia, or provide economic and "quality of life" development within the community. Included within this program is the Virginia Defense Conversion Loan Fund Program, which provides loans to defense dependent Virginia businesses, which have suffered losses as a result of military downsizing, and are seeking to transition to private sector markets and diversify their operations. Since the program's inception, the program has issued 87 loans, with one new loan issued in fiscal year 2014.

- The *State Direct Loan Program* provides loans to a variety of Virginia businesses as market needs dictate and without the geographical restrictions of the Economic Development Loan Fund Program. Since the program's inception in 2007, the program has issued nine loans, with three new loans issued in fiscal year 2014.

- The *Small Business Microloan Program* is designed to assist Virginia's existing small businesses across the Commonwealth. Short-term loans are provided to help established businesses create new jobs and retain existing "at risk" jobs in Virginia. The underwriting process for the Microloan Program is not as intensive as other loan offerings. Credit decisions are based primarily on credit history of the owners and outside recommendations. Since the program's inception in 2012, the authority has issued 85 loans, with 31 new loans issued in fiscal year 2014. During the 2015 session of the General Assembly, House Bill 1757 was signed which will abolish the Providing Access to Capital for Entrepreneurs Program (see Indirect Assistance Programs section below for more information on this program) and merge it into the Small Business Microloan Program. In addition, the Small Business Microloan Program will be renamed the Small, Women-owned, and Minority-owned Business Loan Fund. This new legislation will be effective July 1, 2015 (fiscal year 2016).

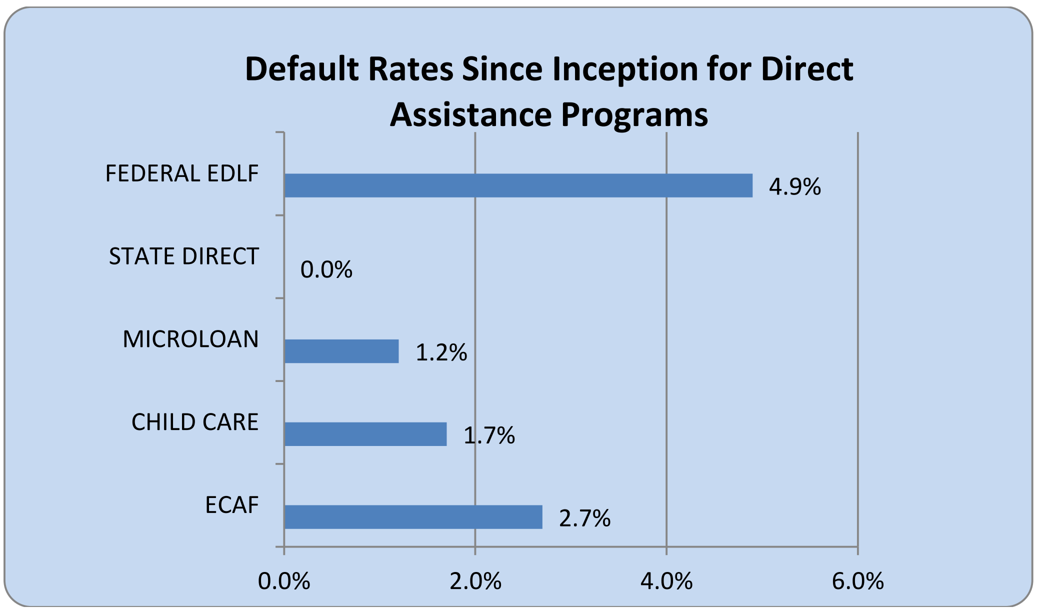
In addition to the economic development oriented loan programs described above, the Authority also administers two smaller direct assistance programs on behalf of other state agencies, which provide loans to specific types of businesses for restricted purposes.

- The *Child Care Financing Program* provides assistance to licensed home based daycare providers and childcare centers through installment loans. The borrower can use the loans to either enhance the quality of care, or meet or maintain state or local childcare requirements, including health, safety, and fire codes. The Authority administers this revolving loan program on behalf of the Department of Social Services. Since the program's inception in 1994, the Authority has issued 310 loans, with three new loans issued in fiscal year 2014.

- The *Small Business Environmental Compliance Assistance Fund (ECAF)* is a revolving loan program for small businesses that need equipment to comply with the Clean Air Act or for voluntary pollution prevention. The Authority administers this program on behalf of the Department of Environmental Quality (DEQ). Since the program's inception in 2000, the Authority has issued 43 loans. The Authority has issued no new loans in this program since 2009 and is currently only administering the remaining portfolio. The Authority is currently communicating with DEQ to determine the future of the program.

Direct Assistance Program Default Rates

Default rates since inception for direct assistance programs remained constant or declined in fiscal year 2014, with the exception of the Microloan Program, which experienced its first default during the year. With the direct assistance programs, the Authority performs the credit underwriting and approval of applicants for the direct assistance programs. For approved program participants, the Authority performs all loan closing, billing, accounting, reporting, and collection functions. The Authority works with both the bank and program participants to encourage timely payments. The Authority charges off loans when it can ascertain the amount of loss, or when a loan reaches a 120 day delinquency status and repayment appears highly unlikely. For non-bankruptcy cases, the Authority sends the loan to the Office of the Attorney General and to the Commonwealth's debt set-off program to facilitate collection. The following chart provides information on default rates since inception related to the Authority's direct assistance programs as of the end of fiscal year 2014.



Indirect Assistance Programs

The Authority's various indirect assistance programs provide guarantees, cash collateral, and loan loss reserve insurance to banks to assist them in making loans to small businesses. These programs mitigate a bank's risk, which enables it to make more loans.

- The *Virginia Capital Access Program (VCAP)* encourages banks to lend to small businesses by providing a form of loan portfolio insurance through loan loss reserve accounts. Loan enrollment premiums fund the program and payments come from the bank, borrower, or both, with a premium match by the Authority. The reserve account then offsets default losses as they occur. Since the program's inception, there have been 1,130 loans, with one new loan issued in fiscal year 2014.

- The *Tobacco Capital Access Program (TCAP)* is similar to the Virginia Capital Access Program, with the exception that it solely provides assistance to small businesses located within the Southside Tobacco Region. Since the program's inception, there have been 207 loans, with 18 new loans issued in fiscal year 2014. The Authority believes the increased activity of the last several years reflects the Southside region banks becoming more comfortable and familiar with the program.

  Within the Authority's agreements with participating Capital Access Program banks, the Authority states that it may withdraw (clawback) the money after 24 months of inactivity and after the last enrolled loan(s) have been repaid; however, there is no requirement that the Authority clawback under any certain timeframe. In fiscal year 2014, the Authority clawed back inactive VCAP and TCAP monies totaling $360,528 and $63,967, respectively. The Authority transferred the VCAP clawbacks to its operating account to refund the Authority for previous fundings that have occurred over the life of the program. In addition, the Authority transferred the TCAP clawback to the TCAP Fund.

- The *Loan Guaranty Program* provides participating banks deficiency guarantees for loans made to Virginia businesses that do not qualify for conventional bank financing. Borrowers work with participating Virginia banks to apply for this assistance. The program encourages the banks to work with borrowers as the banks have some guarantee of recouping a portion of the loan funds. Since the program's inception, there have been 254 loans, with eight new loans issued in fiscal year 2014.

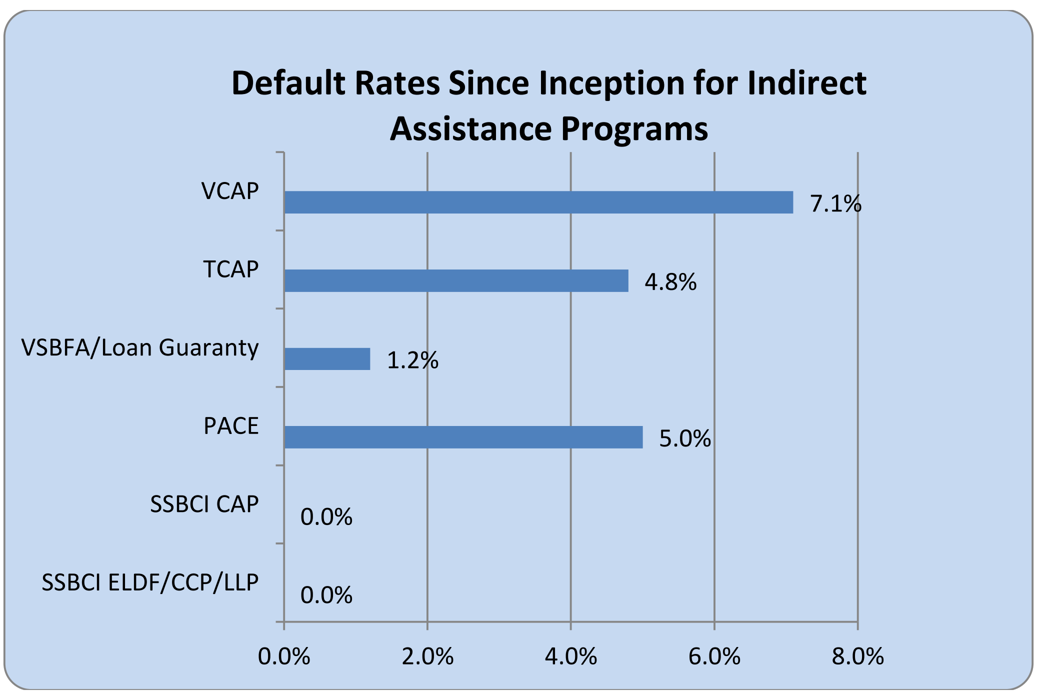
- The *Providing Access to Capital for Entrepreneurs (PACE) Program*, administered on behalf of the Department of Small Business and Supplier Diversity by the Authority, provides credit enhancements to participating banks through either loan portfolio insurance or loan guarantees. Participants must meet certain eligibility criteria established by the Department of Small Business and Supplier Diversity. Since the program's inception, there have been 56 loans, with no new loans issued in fiscal year 2014. As noted above, during the 2015 session of the General Assembly, House Bill 1757 was signed which will abolish the Providing Access to Capital for Entrepreneurs Program and merge it into the Small Business Microloan Program. This legislation will be effective July 1, 2015 (fiscal year 2016).

- The *State Small Business Credit Initiative (SSBCI)* strengthens state programs that support lending to small businesses. Under SSBCI, federal funds for programs that leverage private lending are used to help finance small businesses in the interest of expanding and creating jobs. In fiscal year 2014, the Authority received the second of three installments of funding from the U.S. Department of Treasury for the SBBCI program. The second installment of funding received totaled $5,924,554, equal to the first installment received in fiscal year 2012. SSBCI is administered through the new Cash Collateral Program (CCP) and Loan Participation Program (LLP) in addition to already existing programs such as VCAP and EDLF. Since the program's inception in 2013, there have been 99 loans issued, with 67 new loans issued in fiscal year 2014.

<u>Indirect Assistance Program Default Rates</u>

Over the last few years, the Authority anticipated economic conditions to have an impact on default rates in the TCAP and VCAP programs since they facilitate access to financing for riskier borrowers. During fiscal year 2014, defaults in loans for the programs have stabilized with the VCAP program remaining constant and the TCAP program experiencing a decrease since inception. With both TCAP and VCAP, the Authority enters into participation agreements with certain banks who then determine the creditworthiness of the program participants. The SSBCI program has not experienced any defaults since its inception in 2013. Participating banks are responsible for determining creditworthiness since they, not the Authority, underwrite the loans for approved participants.

Additionally, reserve accounts are set up with participating banks, which lessens the bank's loss in the event of a default. The following chart provides information on default rates since inception related to the Authority's indirect assistance programs for fiscal year 2014.



FINANCIAL HIGHLIGHTS

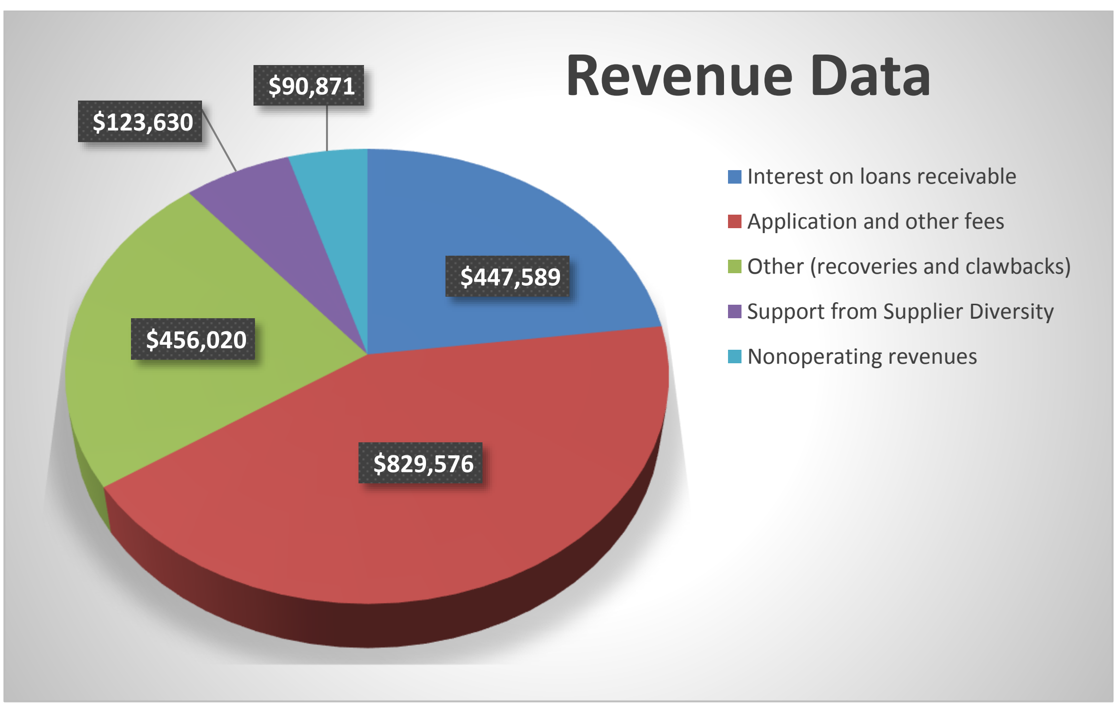
Operating Activities

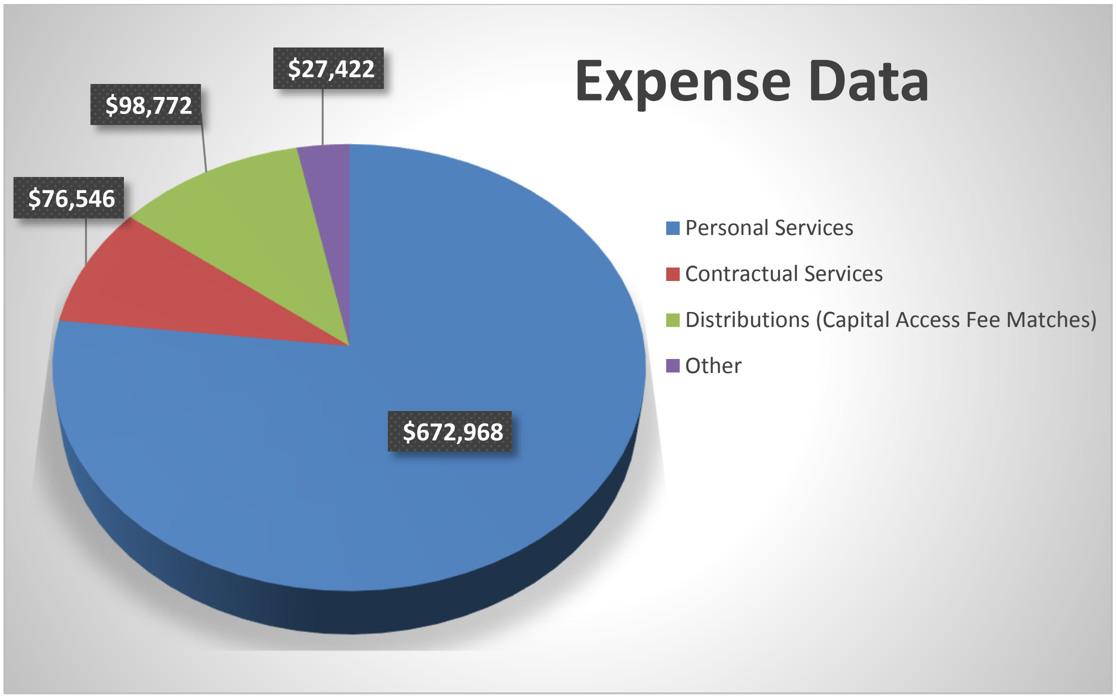
The Authority funds the majority of its operational expenses through the collection of annual bond fees, bond and loan application fees, and late payment penalties, as well as interest earned on the loans themselves and cash on hand. In addition, as mentioned previously, Supplier Diversity provides some financial support to the Authority to support the operating expenses. The Authority received $123,630 during fiscal year 2014 from Supplier Diversity. This is a line item in the annual state budget and covers just 16 percent of the Authority's administrative expenses.

To ensure the principal within each program is available to support the program's goals, most have limitations as to the amount and timing of when the Authority can use their revenues to offset operating expenses. For example, only 50 percent of the current revenues generated from the Federal Economic Development Loan Fund Program can support operating costs.

The charts below present the Authority's operating activities for fiscal year 2014. Payroll costs make up the majority of the Authority's operating expenses. Distributions reflect transfers to banks in support of the loan loss reserve programs. The remaining income carries forward to cover future administrative costs or provide additional principal for the programs.

Operating Activities
For the fiscal year ending June 30, 2014




Expense Data
$27,422
$98,772
$76,546
$672,968
Personal Services
Contractual Services
Distributions (Capital Access Fee Matches)
Other

Commonwealth of Virginia

Auditor of Public Accounts

Martha S. Mavredes, CPA
Auditor of Public Accounts

P.O. Box 1295
Richmond, Virginia 23218

April 7, 2015

The Honorable Terence R. McAuliffe
Governor of Virginia

The Honorable John C. Watkins
Chairman, Joint Legislative Audit
and Review Commission

We have audited the financial records and operations of the **Virginia Small Business Financing Authority (Authority)** for the year ended June 30, 2014. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Audit Objectives

Our audit's primary objectives were to evaluate the accuracy of recorded financial transactions in the Commonwealth Accounting and Reporting System and the Authority's internal accounting system and records, review the adequacy of the Authority's internal controls, and test compliance with applicable laws, regulations, contracts, and grant agreements.

Audit Scope and Methodology

The Authority's management has responsibility for establishing and maintaining internal control and complying with applicable laws and regulations. Internal control is a process designed to provide reasonable, but not absolute, assurance regarding the reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws, regulations, contracts, and grant agreements.

We gained an understanding of the overall internal controls, both automated and manual, sufficient to plan the audit. We considered significance and risk in determining the nature and extent of our audit procedures. Our review focused primarily on policies and procedures over the administration of loan and loan guaranty programs, including controls over cash receipting and collections of accounts receivable. In addition, we reviewed certain controls over financial reporting.

We performed audit tests to determine whether the Authority's controls were adequate, had been placed in operation, and were being followed. Our audit also included tests of compliance with provisions of applicable laws, regulations, contracts, and grant agreements. Our audit procedures included inquiries of appropriate personnel, inspection of documents, records, and contracts, and observation of the Authority's operations. We tested transactions and performed analytical procedures, including budgetary and trend analyses.

Conclusions

We found that the Authority properly stated, in all material respects, the amounts recorded and reported in the Commonwealth Accounting and Reporting System and its internal accounting system and records. The Authority records its financial transactions on the cash basis of accounting, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. The financial information presented in this report came directly from the Commonwealth Accounting and Reporting System or other Authority financial records.

We noted certain matters involving internal control and its operation that we consider necessary to be reported to management and require corrective action. The results of our tests of compliance with applicable laws, regulations, contracts, and grant agreements disclosed no instances of noncompliance or other matters that are required to be reported under Government Auditing Standards.

Exit Conference and Report Distribution

We discussed this report with management on April 10, 2015. Management's response to the findings identified in our audit is included in the section titled "Authority Response." We did not audit management's response and, accordingly, we express no opinion on it.

This report is intended for the information and use of the Governor and General Assembly, management, and the citizens of the Commonwealth of Virginia and is a public record.

AUDITOR OF PUBLIC ACCOUNTS

ZLB/clj

VSBFA
Virginia Small Business
Financing Authority

P.O. Box 446
Richmond, VA 23218-0446
804-371-8254 / f 804-225-3384
sbsd.virginia.gov

April 28, 2015

The Auditor of Public Accounts
P. O. Box 1295
Richmond, Virginia 23218

Dear Ms. Mavredes:

Thank you for allowing me the opportunity to review your draft of the audit findings and recommendations. I am providing this management response to each of the audit findings and recommendations listed in the draft audit.

1. *Improve Controls over Financial Reporting Process* – Specifically cited: Lack of written policies and procedures over the financial reporting process; does not follow any specific accounting framework for its year-end financial report; the Authority references Governmental Accounting Standards Board (GASB) Statement 34 even though the report is not presented in accordance with governmental accounting standards; the Authority overstated its balance of loan loss reserve accounts by $338,199 in one of its program footnotes.

In response, I would point out that the Virginia Small Business Financing Authority (the "Authority") does include very detailed comments in each entry of its financial statement spreadsheet. Anyone who was required to compile the Authority's financial statements would have no difficulty in following our process as each entry is thoroughly explained in our comments embedded within our financial statement spreadsheet. The Authority's financial process is quite straightforward. The assets of the Authority consist of the following items: Cash held in bank accounts (these accounts are settled monthly and the process is described on the back of the bank statement), investments (managed by the state Treasury Department through the Local Government Investment Pool), notes receivable (our loans which are settled through our loan accounting and fund accounting processes), and a very small amount of accrued interest and fees. Liabilities consist of: Accounts payable (due to timing issues regarding outstanding checks), accrued payroll (which we get from Payroll Services), and funds held in restricted bank accounts for our Capital Access Programs (which are settled monthly). There are no capital assets, leases, inventory, prepaid items, or anything that is commonly found in much more complex financial statements. Ninety-one percent of the VSBFA's total operating expenses ($965,172) are for three items, payroll ($595,528), allowance for doubtful accounts ($213,094), and matching fees paid for our Virginia Capital Access Program ($98,772), reflecting that our income statement is also very simple and straightforward. I contend that the Authority does have the appropriate level of instruction and explanation in its financial statement process to meet the level of complexity and risk associated with its accounting framework. I would further contend that the Authority's accounting framework is consistent, understandable, and reliable as it follows the framework of the Commonwealth's Comprehensive Annual Financial Report (CAFR) and the Commonwealth's Accounting Policies and Procedures Manual (CAPP). However, if the APA believes that written policies and procedures are indeed required, then any guidance the APA can provide the Authority as to the scope and type of policies and procedures necessary would be greatly appreciated.

It is further mentioned in your memorandum that the Authority has misrepresented its statements by including a reference to GASB 34 when our statements are not required to be in accordance with GASB. The Authority included those GASB references only because they were discussion points with the Department of Accounts and we were striving for the maximum amount of clarity. Further, the Authority has included these GASB references in its financial statements since 2005. Previous auditors and previous readers of our financial statements have never brought to our attention any confusion or belief that the Authority was misrepresenting its financial statements by including this reference. If the references cause the reader to believe we are misrepresenting our financial reporting, we will gladly remove those references from future financial statements; however, I do not believe that the inclusion of the GASB reference should mislead a user of the report or should be construed as the Authority attempting to mislead the user.

It is also recommended that the Authority "should apply a more rigorous financial reporting review process to detect and correct significant errors prior to report issuance." While the footnote error mentioned was indeed made, this was a typographical error that in no way impacted the financial condition of the Authority. While I appreciate the APA catching the typographical error, I do not believe it to be material since the correct figure was shown in our actual financial statements. Therefore, there was no misrepresentation of our actual financial condition and I do not believe that this should have been included in our audit finding. While we have two of our seven staff members read these financial statements thoroughly prior to publishing, we will employ a more rigorous review system in the future in order to avoid future such occurrences.

2. *Strengthen Controls over Off-CARs Disbursements* – Specifically cited: The Authority did not complete and approve an internal purchase request form for eight out of ten purchases for goods and services reviewed; Issues found with supporting documentation in two out of 35 disbursements reviewed.

During the first half of FY '14, the Authority was a part of the Department of Business Assistance (DBA) and subject to DBA's policies and procedures. DBA's procurement policy read, in part, as follows, "*The Department of Business Assistance is authorized to procure goods & printing up to its delegated $50,000 dollar limit. And $100,000 dollar limit for Services. Division Directors are responsible for the approval and compliance of purchases up to $5000. Purchases above $5,000 will be coordinated with the Director / Senior Operations Manager and the Department of Purchases and Supply to ensure compliance prior to the issuance of a Purchase Order or Contract by the Senior Operations Manager or agency Director.*" As the Executive Director of the Authority, I was considered to be a "Division Director" within DBA and therefore had the authority to approve purchases up to $5,000. None of the items cited in the audit were of an amount exceeding $650. Further, the vast majority of the expenditures made by the Authority were paid for with funds derived from revenues earned by the Authority, not DBA general funds. Prior to the dissolution of DBA, §2.2-2284 of the Code of Virginia provided the Executive Director of the VSBFA the authority to "*approve all accounts for allowable expenses for the Authority or of any employee or consultant or other person providing services to the Board, and for expenses incidental to the operation of the Authority subject to approval of the Director of the Department of Business Assistance.*" Now that the Department of Small Business and Supplier Diversity (DSBSD) has been formed, the Code language remains except that DBA has been replaced with DSBSD. As these expenses were paid for with Authority funds, not DBA funds, and as I had the authority to approve those purchases under the agency policy approved by the Director of DBA, it is my belief that I was following agency policy and that the finding is unjustified. Further, I contend that an internal purchase request form was not required since I was the approving authority and my approval of the purchase was reflected in my signature on the check for payment. In those instances where the Executive Director is the sole required approving authority, no additional front-end approval form, such as an internal purchase request form is necessary to "assess the reasonableness of a purchase" as your audit states. There is no increase in the risk of the approval of "inappropriate or fraudulent transactions" because the Executive Director of the Authority must still review the appropriateness of the transaction prior to obligation. Until the check has been signed and sent, the transaction is not complete. In spite of my belief that the Authority's actions were within policy, going forward, every effort will be made to stress to the new Department of Small Business and Supplier Diversity, of which the Authority is now a part, the importance of having a clear procurement policy. When DSBSD drafts such a policy, I assure you the Authority will follow it as we have always done.

Sincerely,

Scott E. Parsons

Scott E. Parsons
Executive Director
Virginia Small Business Financing Authority

Cc: Tracey Jeter, Director, Department of Small Business and Supplier Diversity
Gail Letts, Chairman of the Board of Directors, Virginia Small Business Financing Authority

APPENDIX A – APA COMMENTS TO AUTHORITY'S RESPONSE

Below is our response to certain aspects of the Authority's response that require additional clarification:

<u>Improve Controls over Financial Reporting Process</u>

- *I contend that the Authority does have the appropriate level of instruction and explanation in its financial statement process to meet the level of complexity and risk associated with its accounting framework. I would further contend that the Authority's accounting framework is consistent, understandable, and reliable as it follows the framework of the Commonwealth's Comprehensive Annual Financial Report (CAFR) …*

The Authority provides the Department of Accounts (DOA) the information it needs to present the Commonwealth's CAFR in accordance with the generally accepted accounting principles (GAAP) framework, but the Authority does not present its own statements within the same framework as the CAFR. For example, the Authority presents a condensed statement of net position instead of providing the line items making up those amounts. In its fiscal year 2014 financial report, the Authority did not recognize the liability associated with Governmental Accounting Standards Board (GASB) Statement 70 - *Accounting and Financial Reporting for Nonexchange Financial Guarantees*, in part, because it does not produce GAAP financial statements. In addition, the Authority does not plan to recognize its proportionate share of the Commonwealth's net pension liability in fiscal year 2015 in accordance with GASB Statement 68 - *Accounting and Financial Reporting for Pensions*. The objective of the finding is not to prescribe what the Authority must present, but is rather to encourage a policy that establishes what should be presented and how it should be presented.

- *… however, I do not believe that the inclusion of the GASB reference should mislead a user of the report or should be construed as the Authority attempting to mislead the user.*

As our report indicates, the <u>Code of Virginia</u> does not require the Authority's special-purpose financial statements to be in accordance with GAAP. However, we believe the information reported should be presented in a manner that is reliable and does not unintentionally mislead users of the report. We understand that the Authority has made a good faith effort to represent its financial activities as clearly as possible, but believe the report is misleading nonetheless. GASB Statement 34 – *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments* establishes financial reporting standards for state and local governments, including requirements for how to present Management's Discussion and Analysis (MD&A), basic financial statements, and notes to the financial statements. The Authority's financial report asserts that the Authority follows GASB Statement 34 and uses terminology required in the statement, such as MD&A, basic financial statements, and notes to the financial statements, yet does not present its information in accordance with the standard. Therefore, we believe users of the Authority's financial report may assume that they are GAAP level financial statements, when in fact they are not.

<u>Strengthen Controls over Off-CARS Disbursements</u>

- *DBA's procurement policy read, in part, as follows, "The Department of Business Assistance is authorized to procure goods and printing up to its delegated $50,000 dollar limit. And $100,000 dollar limit for Services. Division Directors are responsible for the approval and compliance of purchases up to $5,000. Purchases above $5,000 will be coordinated with the Director/Senior Operations Manager and the Department of Purchases and Supply to ensure compliance prior to the issuance of a Purchase Order or Contract by the Senior Operations Manager or agency Director." As the Executive Director of the Authority, I was considered to be a "Division Director" within DBA and therefore had the authority to approve purchases up to $5,000.*

The applicable policy requirement on which we based our recommendation reads, "*An internal purchase request form is to be used internally within the Department of Business Assistance to initiate and ensure accountability for a purchase, as well as to ensure a purchase is appropriately authorized and approved. Unless specifically requested by the vendor, a purchase order is not required for a purchase under $5,000 (unless a mandatory source is used – check the contract). To account for purchases, a Purchase Order, or other control-number will be provided by cost center managers. Purchase logs will be maintained by each division for the issuance of purchase orders, contracts, and internal purchase requests. Internal Purchase Requests are to be submitted to the Director of Administration for approval prior to purchases."* Regardless of who is responsible for approving purchases less than $5,000, it does not preclude the Authority from following the policy requirement to initiate an internal purchase request. Our review found that this requirement was followed in certain circumstances, but not in others. We acknowledge that the policy could be clearer and that management may make future policy decisions to change this requirement based on its evaluation of associated risk.

VIRGINIA SMALL BUSINESS FINANCING AUTHORITY

Scott Parsons, Executive Director