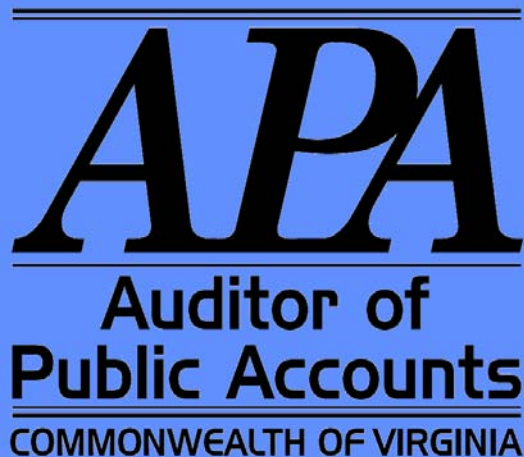


**VIRGINIA SMALL BUSINESS  
FINANCING AUTHORITY  
LOAN AND  
LOAN GUARANTY FUNDS**

**REPORT ON AUDIT  
FOR THE YEAR ENDED  
JUNE 30, 2008**



## **AUDIT SUMMARY**

Our audit of the Virginia Small Business Financing Authority (the Authority) focused primarily on the various programs they administer and considered the efficiency and effectiveness of those programs, including the operating costs incurred to manage the programs. Specifically, we reviewed policies and procedures over each program and tested for their compliance with those policies and procedures and analyzed operating revenues and expenses incurred by the Authority in administering the programs.

Overall, we found that

- the Authority has implemented controls to administer their loan and loan guaranty fund programs;
- the Authority properly administered these programs; and
- the revenues and expenses of Authority's operating activities are properly reported by the Authority.

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## AUTHORITY BACKGROUND

The Authority has existed 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 eleven members of the Authority's Board of Directors.

The Director of the Department of Business Assistance (Business Assistance) appoints the Authority's Executive Director, who oversees the Authority's operations. The Authority's staff, who are also Business Assistance employees, support the Authority by reviewing program applications, conducting credit analysis, monitoring the progress of projects that have received funding, and servicing loan receivables.

Various fees and interest earnings cover the majority of the Authority's administrative expenses. Business Assistance provides space for the Authority's staff and pays certain administrative expenses, to the extent that Business Assistance has the resources available to assume these costs; however, they do not have a requirement to cover these costs.

## AUDIT OBJECTIVES

The Code of Virginia requires that the Auditor of Public Accounts audit the books and accounts of the Authority and any loan fund or loan guarantee fund the Authority administers or manages annually. The objectives of the fiscal year 2008 audit were to determine that:

- the Authority properly administers their programs; and
- the Authority has adequate internal controls over the administration of the programs.

As a part of these objectives we also considered the accuracy of the financial information reported by the Authority as they relate to program administration and the availability of resources to support each program. Below are specific observations that resulted from our audit.

## PROGRAM HIGHLIGHTS

The exact nature and number of programs administered by the Authority have changed over time and continues to do so. 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 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 or 501(c) 3 organizations, while the indirect assistance programs provide support to Virginia businesses through loan guarantee and loan insurance programs. The goal of these programs is to encourage economic development through either job creation or retention by small businesses.

More detail about the various programs follows below, including performance metrics in various forms for each program since the program's inception.

### 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

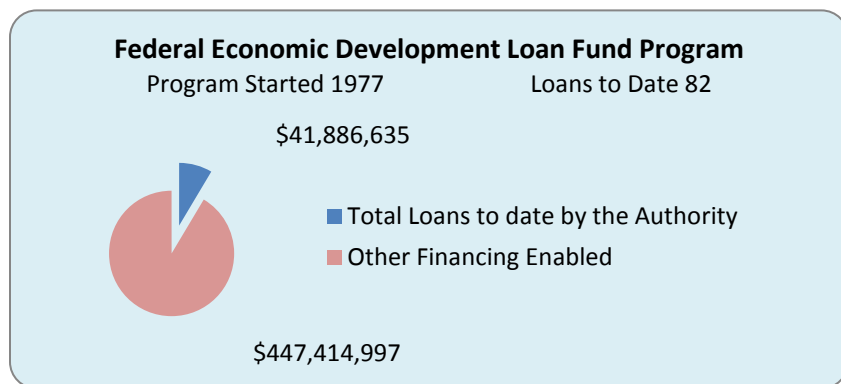
entities. The nature of the entity and consideration of the Commonwealth's available allocation of private activity bonds will determine whether the bond issuance is tax-exempt or not.

The private sector provides the bond financing, not the Authority or the Commonwealth, and the respective small business has responsibility for debt service. As such, the Authority takes on no risk as result of this program.

Since the program's inception, the Authority has facilitated the issuance of 104 bonds, averaging five bond issuances per year over the past five years. At June 30, 2008, there were 40 bond issuances outstanding. The Authority collects application and administration fees associated with the bond issuances. These funds support the ongoing operating expenses of the Authority and may also provide additional funding to other programs administered by the Authority.

### Direct Assistance Programs

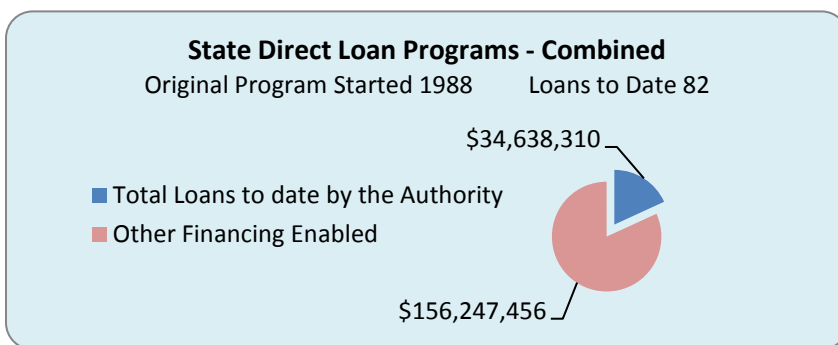
The following revolving loan programs provide loans generally up to \$1 million in value to bridge the gap between private debt financing and private equity. As borrowers repay the loan principal and interest the Authority uses the proceeds to issue new loans. The remaining interest earned supports the ongoing operating expenses of the Authority.



The Federal Economic Development Loan Fund Program provides loans to new and expanding businesses or 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.

The State Direct Loan Program provides loans to Virginia businesses as market needs dictate and without the geographical restrictions of the Economic Development Loan Fund Program. The original program started in 1988 and ceased making new loans in 2005. The program's existing assets were then used to fund a separate but similar Commonwealth initiative outside of the Authority's purview. In 2007, the Authority used internal resources to re-establish the program.



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, it has provided 286 loans, averaging \$21,800 per loan.
- The Small Business Environmental Compliance Assistance Fund 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. Since the program's inception in 2000, it has provided 41 loans, averaging \$51,000 per loan.

Like the other revolving loan programs, existing loan and interest payments provide funding for new loans. Further, a portion of the interest earnings support the ongoing operating expenses of the Authority.

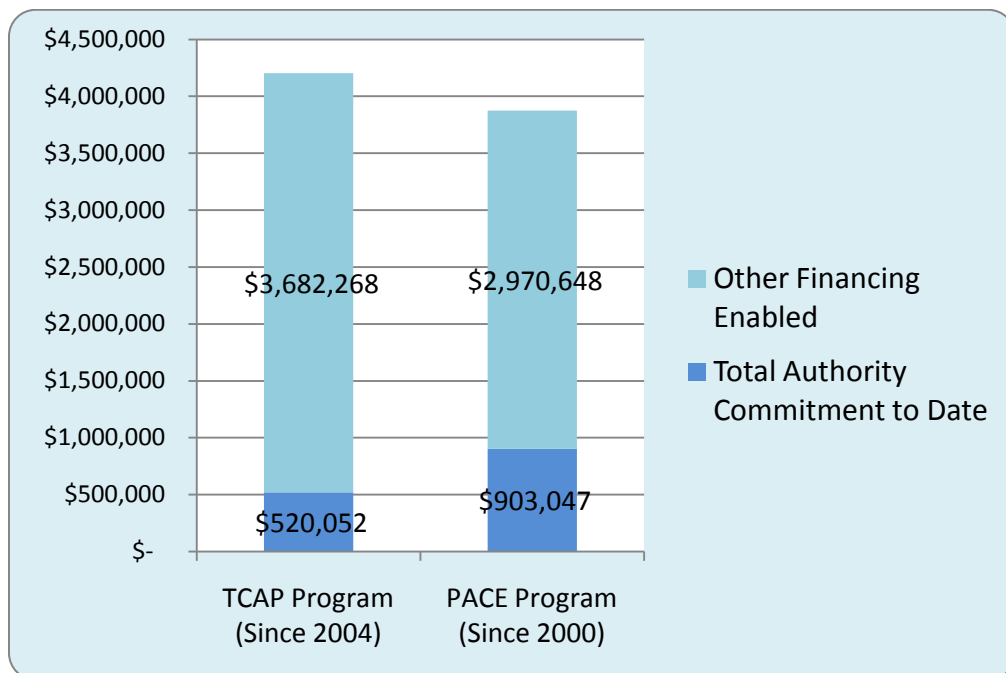
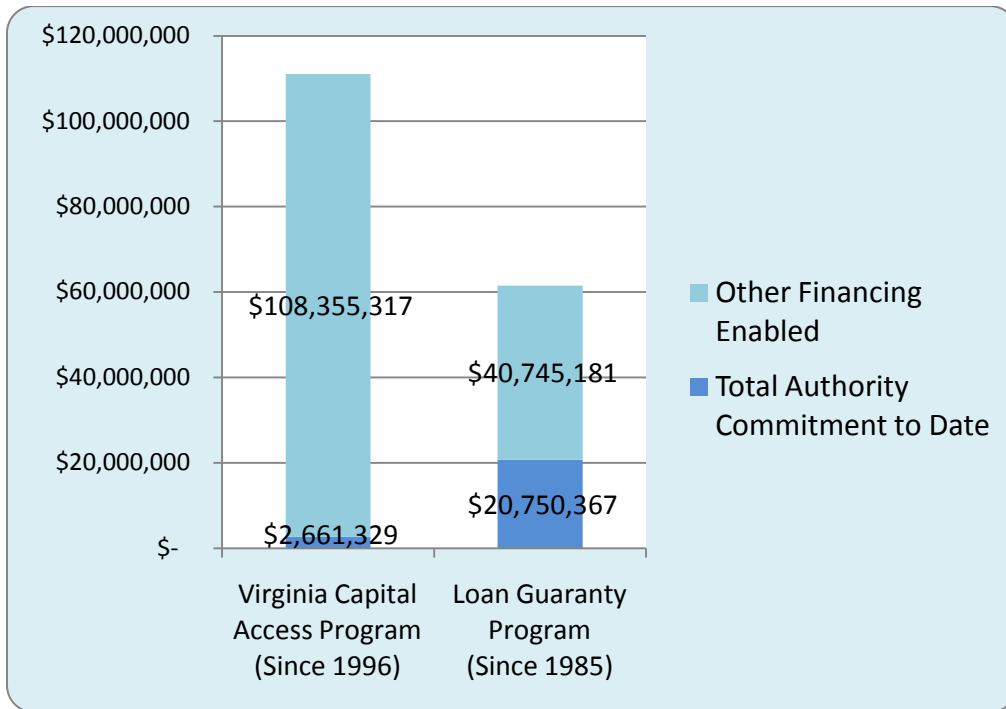
#### Indirect Assistance Programs

Through their various indirect assistance programs, the Authority provides access to capital by encouraging banks to make loans that they would otherwise not make due to an individual borrower's riskier profile. These programs provide loan insurance or loan guarantees to the banks as described further below.

- The Virginia Capital Access Program 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, should they occur.
- The Tobacco Capital Access Program (TCAP) is very similar to the Virginia Capital Access Program, with the exception that it solely provides assistance to small businesses located within the Southside Tobacco Region.
- 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 as designed encourages the banks to be more patient with borrowers as they have some guaranty of recouping funds.
- The Providing Access to Capital for Entrepreneurs (P.A.C.E.) Program, administered on behalf of the Department of Minority Business Enterprises 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 Minority Business Enterprises.

The following exhibits reflect the other financing multiplier that each program has generated since inception. The funding available to Virginia Capital Access Program and Loan Guaranty Program has been leveraged 43:1 and 49:1, respectively, to realize the other financing. Meanwhile, the TCAP and PACE programs have been leveraged 5:1 and 14:1, respectively.

**Authority Commitments verses Other Financing Enabled**  
Since the Program's Inception



Other Programs

Over time the Authority has introduced other financing mechanisms. The Authority initiated in fiscal year 2006 two such programs through a partnership with the Community Reinvestment Fund. The Authority essentially served as a marketing arm for the Community Reinvestment Fund rather than a lender or servicer

of loans. The programs were to provide the Authority with an indirect, no-cost funding source for economic development projects. The Authority has facilitated one loan through the programs. However, as these programs did not have the desired activity or impact that the Authority hoped and they are more difficult to underwrite, the Authority discontinued the programs in fiscal year 2008.

#### Program Performance

The Authority primarily evaluates its performance based on four indicators across the programs rather than on a program by program basis. Below are the Authority's goals and actual performance against these indicators for fiscal year 2008.

#### **Performance Measures for Fiscal Year 2008**

<b>Performance Measure</b>	<b>Goal</b>	<b>Actual</b>
Dollar amount of private and other public financing enabled	\$28 million	\$35.2 million
Dollar amount of loans committed	\$7.25 million	\$5.4 million
Number of loans committed	130	145
Number of jobs created	2,250	2,654

The Childcare Financing Program and the Small Business Environmental Compliance Assistance Fund are the exception. These programs, which are administered on behalf of other state agencies, have separate measures based on the creation of childcare spaces and reduction of pollutants into the environment, respectively.

The following exhibit provides additional statistical information concerning the Authority's various programs. While the programs have experienced some defaults by program participants, overall the default rates are not exceptionally high. The Authority works with the program participants, including the banks, to encourage the borrowers to make their payments. However, the Authority expects some defaults to occur as the programs do facilitate access to financing for riskier borrowers.

#### **Program Activity from Inception through June 30, 2008**

<b>Program Statistics</b>	<b>Federal Direct Loan Program</b>	<b>State Direct Loan Program (Original)</b>	<b>State Direct Loan Program (New)</b>	<b>Child Care Financing Program</b>	<b>Small Business Environmental Compliance Assistance Fund</b>
<b>Inception date</b>	1977*	1988	2007	1994	2000
<b>Total number of loans</b>	82	80	2	286	41
<b>Default rate</b>	4.6%	14.3%	0.0%	2.7%	2.6%

\*This program, while initiated in 1977, did not become a revolving loan fund until 1985.

#### **Program Activity from Inception through June 30, 2008**

<b>Program Statistics</b>	<b>Virginia Capital Access Program</b>	<b>Tobacco Capital Access Program</b>	<b>Loan Guaranty Program</b>	<b>PACE Program</b>
<b>Inception date</b>	1996	2004	1985	2000
<b>Total number of loans</b>	1026	66	201	36
<b>Default rate</b>	2.8%	1.6%	1.9%	4.9%



The Authority charges offs loans when it can ascertain the amount of loss or when a loan reaches a 120 day delinquency status and repayment is deemed highly unlikely. For non-bankruptcy cases, the Authority then sends the loan to the Office of the Attorney General and to the Commonwealth's debt-set off program to facilitate collection. The Authority anticipates that the current economic conditions may lead to new defaults in the next year or so; however, they have not experienced a significant rise in this statistic as of the date of fieldwork.

## FINANCIAL HIGHLIGHTS

### Program Assets

As of June 30, 2008, the authority had over \$26 million in program assets. Those assets are either in the form of accounts receivable or cash and cash equivalents, as reflected in the table below. The Authority has restricted those cash balances depending on the program requirements, outstanding loans or guarantees, and any commitments made but not yet completed as of June 30<sup>th</sup>. The final amount reflects program resources available for future awards as of June 30, 2008.

#### **Program Assets as of June 30, 2008**

	Federal Economic Development Loan Fund <u>Program</u>	State Direct Loan Program	Child Care Financing <u>Program</u>	Small Business Environmental Compliance Assistance Fund
Program resources:				
Accounts receivable	\$11,280,012	\$1,731,575	\$1,170,693	\$708,948
Cash & cash equivalents	<u>5,506,385</u>	<u>80,627</u>	<u>2,604,339</u>	<u>250,472</u>
Total program resources	16,786,397	1,812,202	3,775,032	959,420
Less:				
Loans outstanding	(11,280,012)	(1,731,575)	(1,170,693)	(708,948)
Financing commitments	(2,172,649)			(50,200)
Operating commitments	<u>(40,186)</u>	<u>-</u>	<u>(50,000)</u>	<u>(84,575)</u>
Net resources available:	<u>\$ 3,293,550</u>	<u>\$ 80,627</u>	<u>\$2,554,339</u>	<u>\$115,697</u>

#### **Program Assets as of June 30, 2008**

	Virginia Capital Access <u>Program</u>	Tobacco Capital Access <u>Program</u>	Loan Guaranty <u>Program</u>	PACE <u>Program</u>
Program resources:				
Cash & cash equivalents	\$173,728	\$107,263	\$2,464,543	\$141,442
Less:				
Guaranties outstanding	-	-	(2,567,740)	(122,380)
Operating commitments	<u>-</u>	<u>(2,500)</u>	<u>-</u>	<u>-</u>
Net resources available:	<u>\$173,728</u>	<u>\$104,763</u>	<u>(\$ 103,197)</u>	<u>\$ 19,062</u>

Source: Virginia Small Business Financing Authority's Fund Accounting

### Operating Activities

The Authority funds the majority of its operational expenses through the collection of program application fees and late payment penalties as well as interest earned on the loans themselves and cash on hand. In addition, as mentioned previously, the Department of Business Assistance provides some financial support to the Authority. On average this support totals \$250,000 per year.

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 following schedule presents the Authority's operating activities for fiscal year 2008. Payroll costs make up the majority of the Authority's operating expenses. Program disbursements 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, 2008

**Revenues:**

Interest earned on loans	\$ 571,946
Interest earned on cash and investments	563,676
Return of program funds	281,480
Fees and penalties	259,490
Support from Department of Business Assistance	250,306
Transfer in from Department of Environmental Quality	78,893
Other revenues	<u>48,932</u>
<b>Total Revenues</b>	<b>2,054,723</b>

**Expenses:**

Personal services	539,060
Program disbursements	501,435
Contractual services	35,454
Other Miscellaneous expenses	<u>24,122</u>
<b>Total Expenses</b>	<b>1,100,071</b>

<b>Net Income</b>	<b><u>\$ 954,652</u></b>
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Source: Virginia Small Business Financing Authority's Fund Accounting



# Commonwealth of Virginia

**Walter J. Kucharski, Auditor**

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

April 14, 2008

The Honorable Timothy M. Kaine  
Governor of Virginia  
State Capital  
Richmond, Virginia

The Honorable M. Kirkland Cox  
Chairman, Joint Legislative Audit  
and Review Commission  
General Assembly Building  
Richmond, Virginia

We have audited the loan and loan guaranty funds of the **Virginia Small Business Financing Authority** and are pleased to submit our report entitled "Virginia Small Business Financing Authority Loan and Loan Guaranty Funds." 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 Scope

Our audit examined activities for the period July 1, 2007 through June 30, 2008. We focused primarily on the policies and procedures over the Authority's administration of their loan and loan guaranty fund programs. In addition we reviewed certain controls over the Authority's information systems and financial reporting.

## Audit Methodology

Our work consisted of management and departmental inquiries, gaining an understanding of processes and controls by reviewing current policies and procedures, making inquiries of management and accounting staff, examining program administration documentation, and selecting and testing various transactions.

## Audit Conclusion

Overall, we found that the Authority has implemented controls to administer their loan and loan guaranty fund programs, properly administers these programs; and the revenues and expenses for the Authority's operating activities as reported by the Authority are materially correct.

Exit Conference and Report Distribution

We discussed this report with the Authority's management on May 15, 2009. 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

JPS/alh

VIRGINIA SMALL BUSINESS FINANCING AUTHORITY

Scott Parsons, Executive Director

BOARD OF DIRECTORS

Leon Moore, Chairman

Hattie Hamlin, Vice Chairman

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Jane-Scott Cantus	Michael Joyce
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The Honorable Manju Ganeriwala, ex-officio voting member

Lynda Sharp Anderson, ex-officio voting member

Scott Parsons, Secretary and Treasurer