VIRGINIA SMALL BUSINESS FINANCING AUTHORITY

REPORT ON AUDIT

FOR THE YEAR ENDED

JUNE 30, 2013

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AUDIT SUMMARY

Our audit of the Virginia Small Business Financing Authority (the Authority) for the fiscal year ended June 30, 2013, 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;
- no 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.

Additionally, we found that the Authority has implemented controls to administer their loan and loan guaranty fund programs and properly administers these programs.

-T A B L E O F C O N T E N T S-

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.

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, but paid entirely by the Authority's revenues, support the Authority by marketing the Authority's programs and services, reviewing program applications, conducting credit analysis, 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 Business Assistance'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.

Virginia's economic condition has impacted loan volume within the programs. There has been a general increase in the issuance of new loans and guarantees during fiscal year 2013. The increased activity within the programs reflect an increase in participation by banking institutions during fiscal year 2013. Bond issuance to non-profit entities increased during fiscal year 2013 largely due to an improved interest rate environment which caused many borrowers to refinance existing bonds.

Detailed below is more information about the various programs since their inception as 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, issuing nine new bonds in fiscal year 2013. The increased use of the Bond Program by non-profit entities during fiscal year 2013 occurred as the result of borrowers taking advantage of the current low interest rate environment.

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 86 loans, with two new loans issued in fiscal year 2013. The default rate for the program decreased from 5.2 to 5.0 percent between fiscal years 2012 and 2013.

- 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 went 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. Since the program's inception, the program has issued 86 loans; however, no new loans were issued in fiscal year 2013. The default rate for the program remained constant at 14.3 percent between fiscal years 2012 and 2013.

- 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. Since the program's inception in 2012, the authority has issued 54 loans. The default rate for the program remains at a constant zero percent between fiscal years 2012 and 2013.

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 307 loans, with three new loans issued in fiscal year 2013. The default rate for the program decreased from 1.9 to 1.8 between fiscal years 2012 and 2013.

- 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 default rate for the program decreased from 2.8 to 2.7 percent between fiscal years 2012 and 2013.

Direct Assistance Program Default Rates

Default rates for direct assistance programs remained constant or declined between fiscal years 2012 and 2013. With the 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.

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 1,129 loans. The default rate for the program increased from 7.0 to 7.1 percent between fiscal years 2012 and 2013.

- 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 188 loans, with 17 new loans issued in fiscal year 2013. The Authority believes the increased activity reflects the Southside region banks becoming more comfortable and familiar with the program. The default rate for the program decreased from 5.5 to 5.2 percent between fiscal years 2012 and 2013.

- 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

246 loans, with 17 new loans issued in fiscal year 2013. The default rate for the program decreased from 1.5 to 1.2 percent between fiscal years 2012 and 2013.

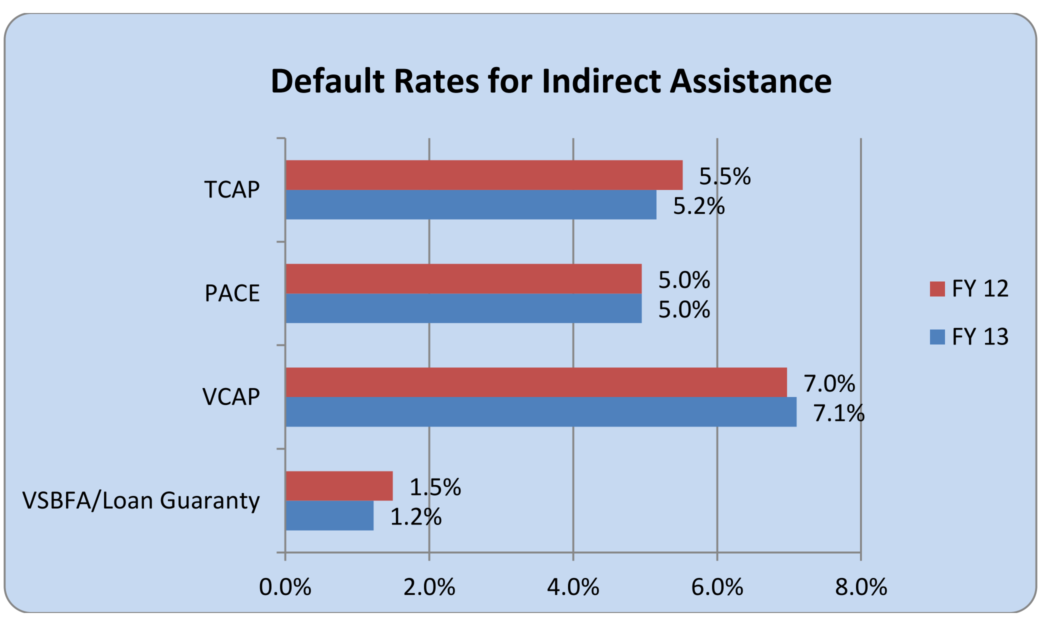
- The *Providing Access to Capital for Entrepreneurs (PACE) Program*, administered on behalf of the Department of Minority Business Enterprises by the Authority, provides credit enhancements to participating banks through either loan portfolio insurance or loan guarantees. Participants must meet certain eligibility criteria established by the Department of Minority Business Enterprises. Since the program's inception, there have been 56 loans, with no new loans issued in fiscal year 2013. The default rate for the program remained stable at 5.0 percent between fiscal years 2012 and 2013.

- 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 that are creditworthy, but are not getting the loans they need to expand and create jobs. 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 32 loans issued. The default rate for each program has remained at constant 0 percent since the program's inception.

Indirect Assistance Program Default Rates

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 2013, defaults in loans for the programs have stabilized with the VCAP program experiencing a slight increase and the TCAP program experiencing a slight decrease. With both TCAP and VCAP, the Authority enters into participation agreements with certain banks who then determine the creditworthiness of the program participants. 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 comparative information on default rates related to the Authority's indirect assistance programs for fiscal year 2013.



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, the Department of Business Assistance provides some financial support to the Authority that pays the Executive Director's salary as well as some of the Authority's operating expenses. The Authority received $147,264 during fiscal year 2013 from Business Assistance. This is a line item in the annual state budget and covers just 20 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 schedule below presents the Authority's operating activities for fiscal year 2013. 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, 2013

Revenues:	
Interest earned on loans	$ 484,214
Fees and penalties	912,929
Interest income	143,770
Support from Department of Business Assistance	147,264
Other revenues	20,623
Total revenues	$1,708,800
Expenses:	
Personal services	$ 543,443
Program disbursements	107,683
Expenses from Department of Business Assistance	147,264
Contractual services	63,783
Supplies and materials	6,111
Equipment	3,218
Other miscellaneous expenses	38
Total expenses	$ 871,540
Net income	$ 837,260

Source: Virginia Small Business Financing Authority's Accounting Records

Commonwealth of Virginia

Auditor of Public Accounts

Martha S. Mavredes, CPA
Auditor of Public Accounts

P.O. Box 1295
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February 25, 2014

The Honorable Terence R. McAuliffe
Governor of Virginia

The Honorable John M. O'Bannon, III
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, 2013. 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 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.

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. Additionally, we found that the Authority has implemented controls to administer their loan and loan guaranty programs and properly administers these programs.

We noted no matters involving internal control and its operation that we consider necessary to be reported to management. 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 March 26, 2014.

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

LJH/clj

VIRGINIA SMALL BUSINESS FINANCING AUTHORITY

Scott Parsons, Executive Director

BOARD OF DIRECTORS

Song Park, Chairman
James Thomas, Vice Chairman

John Jacquemin	Monica Rao
Doña Storey	Prescott Sherrod
Shawn Boyer	Neil Amin

Tonya Mallory

The Honorable Manju Ganeriwala, ex-officio voting member

Ida McPherson, ex-officio voting member

Scott Parsons, Secretary and Treasurer