



VIRGINIA SMALL BUSINESS FINANCING AUTHORITY

REPORT ON AUDIT FOR THE YEAR ENDED JUNE 30, 2015

Auditor of Public Accounts
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AUDIT SUMMARY

Our audit of the Virginia Small Business Financing Authority for the fiscal year ended June 30, 2015, found:

- proper recording and reporting of all transactions, in all material respects, in the Commonwealth Accounting and Reporting System and the Authority's 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.

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AGENCY HIGHLIGHTS

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.

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. This report will broadly discuss activity in these three categories below. For more information about the individual programs and financial activity of the Authority, please see the Authority's Financial Statements which are located on Virginia's Legislative Information System website under the "Reports to the General Assembly" section.

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.

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. The Authority has facilitated the issuance of 169 bonds since the program's inception, including 7 bonds in fiscal year 2015 issued for a total of \$206,221,000.

Direct Assistance Programs

The following revolving loan programs provide loans, generally in amounts up to \$1 million, 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.

- Federal Economic Development Loan Fund Program (EDLF)
- State Direct Loan Program
- Small Business Microloan Program

Note: 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, as follow.

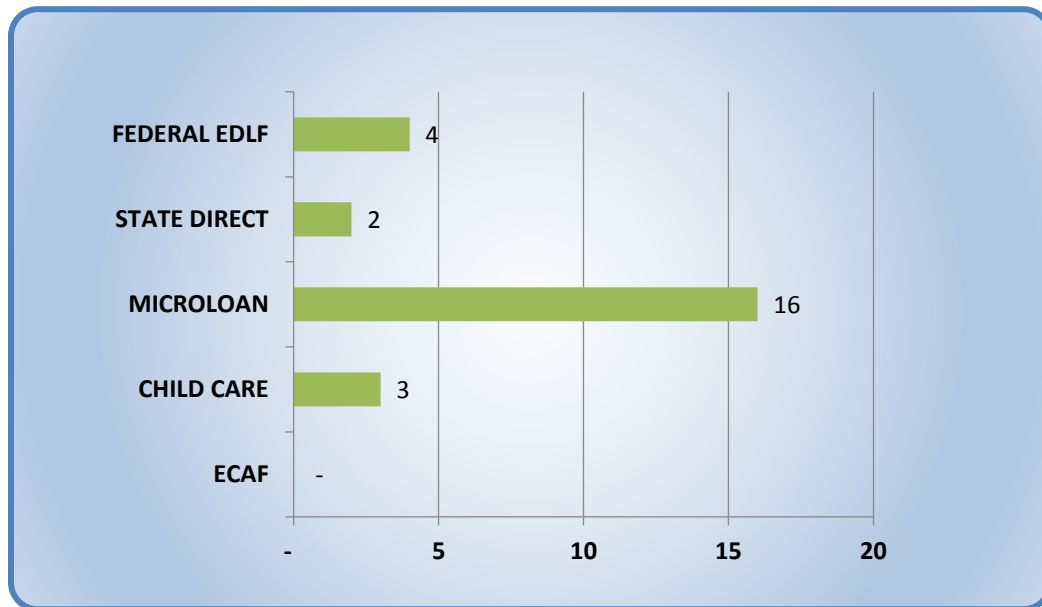
- Child Care Financing Program
- Small Business Environmental Compliance Assistance Fund (ECAF)

Note: The Authority administers this program on behalf of the Department of Environmental Quality (DEQ). The Authority has issued no new loans in this program since 2009, and as of December 2015 this program has been discontinued and the remaining cash on hand has been transferred back to DEQ. The Authority will continue to service the one outstanding loan remaining from this program, which matures in 2020. Cash collections on that loan will be transferred to DEQ semi-annually.

Charts 1 and 2 provide information on the dollar value and number of new loans issued by the Authority related to direct assistance programs during fiscal year 2015. In total the Authority issued \$5,290,751 of new loans in fiscal year 2015.

**Number of New Loans
Fiscal Year 2015**

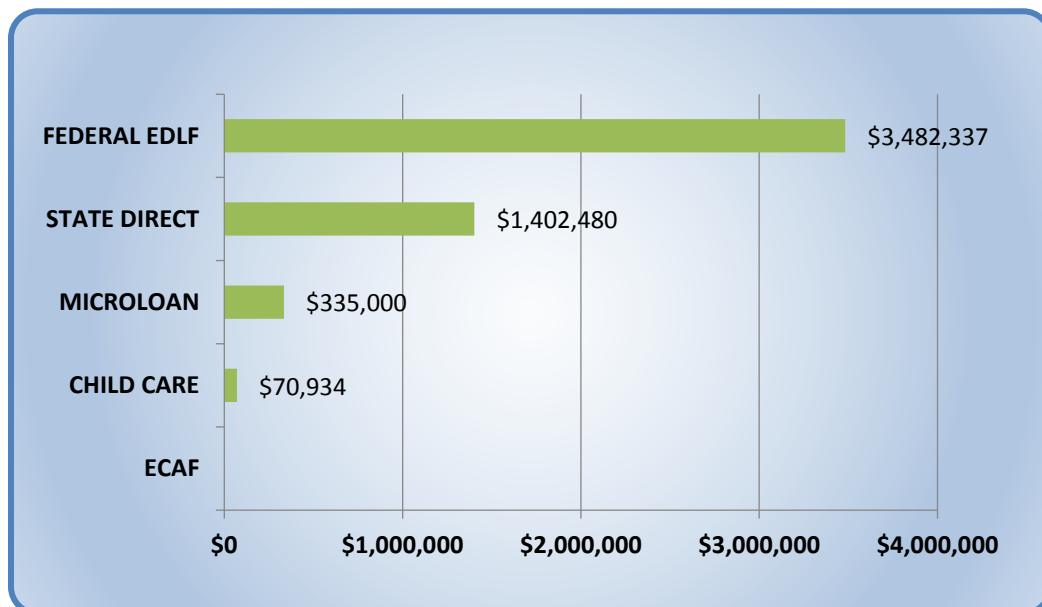
Chart 1



Source: Authority LA Pro System

**Amount of Loans Disbursed
Fiscal Year 2015**

Chart 2



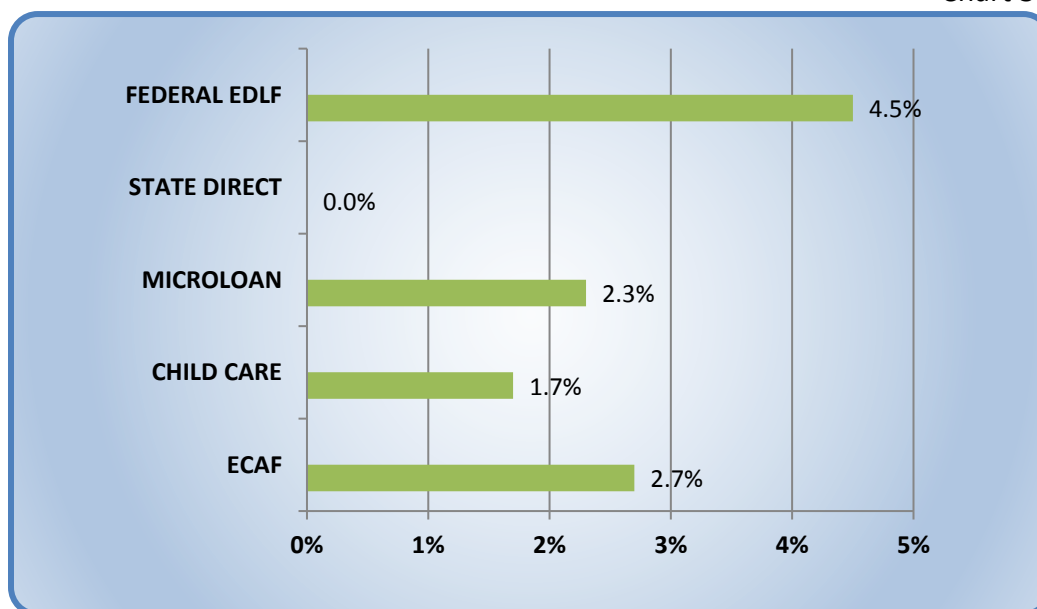
Source: Authority LA Pro System

Direct Assistance Program Default Rates

Default rates since inception for direct assistance programs remained constant or declined in fiscal year 2015, with the exception of the Microloan Program. The Microloan Program experienced its second and third default during the year and experienced a slight increase in the default rate. 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. Chart 3 provides information on default rates since inception related to the Authority's direct assistance programs as of the end of fiscal year 2015.

Default Rates Since Inception for Direct Assistance Programs

Chart 3



Source: Calculated from Authority Internal Records

Indirect Assistance Programs

The Authority's various indirect assistance programs as listed below 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.

- Virginia Capital Access Program (VCAP)
- Tobacco Capital Access Program (TCAP)

- Loan Guaranty Program
- Providing Access to Capital for Entrepreneurs (PACE) Program

Note: In September 2015, the remaining cash in this program was transferred and combined with new funding from the General Assembly for the new Small, Women-owned, Minority-owned Business Loan Fund.

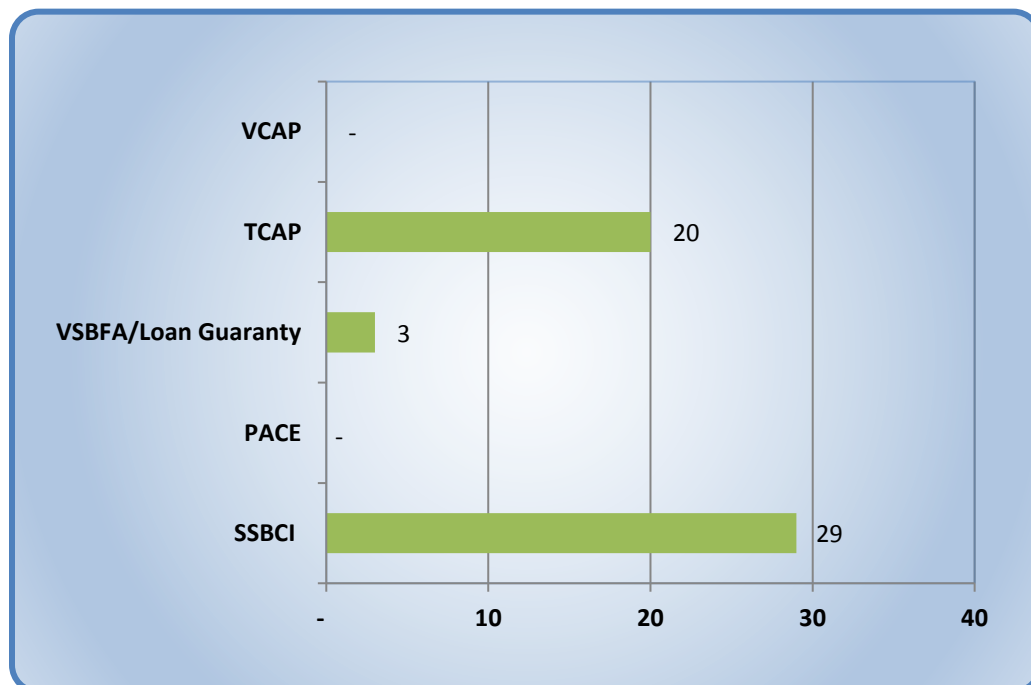
- State Small Business Credit Initiative (SSBCI)

Note: 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 2015, the Authority received the third and final installment in funding from the U.S Department of Treasury for the SSBCI program. The third installment received was in the amount of \$6,104,803, and in total the Authority has received \$17,953,191 in funding from the U.S Department of Treasury.

Chart 4 provides information on the number of new loans supported by the Authority related to indirect assistance programs during fiscal year 2015.

**Number of New Loans Supported
Fiscal Year 2015**

Chart 4



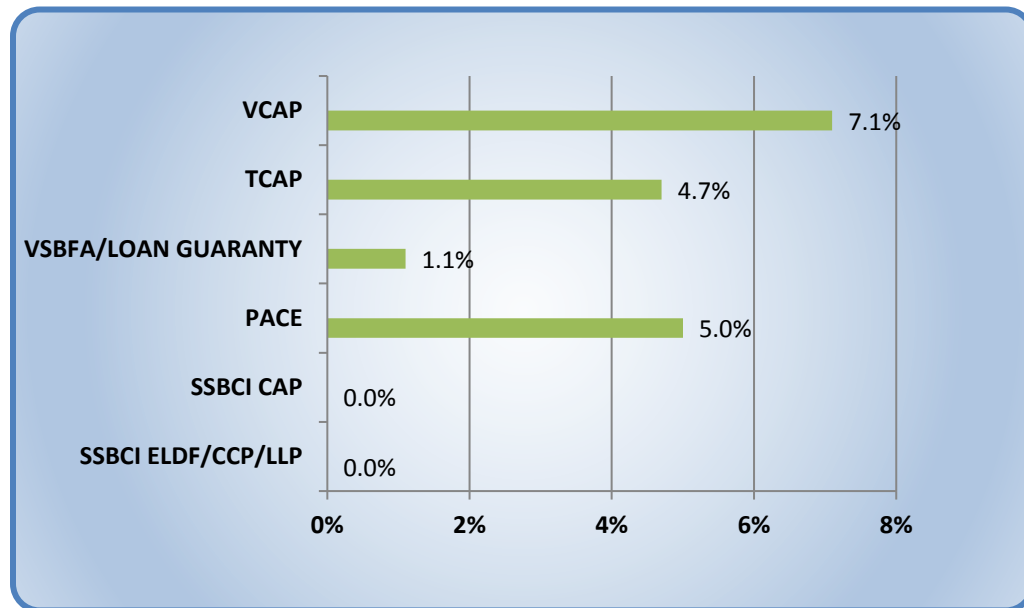
Source: Authority LA Pro System

Indirect Assistance Program Default Rates

Chart 5 provides information on default rates since inception related to the Authority's indirect assistance programs. All program default rates remained constant or slightly decreased in 2015.

Default Rates Since Inception for Indirect Assistance Programs

Chart 5



Source: Calculated from Authority Internal Records



Martha S. Mavredes, CPA
Auditor of Public Accounts

Commonwealth of Virginia

Auditor of Public Accounts

P.O. Box 1295
Richmond, Virginia 23218

August 29, 2016

The Honorable Terence R. McAuliffe
Governor of Virginia

The Honorable Robert D. Orrock, Sr.
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, 2015. 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, test compliance with applicable laws, regulations, contracts, and grant agreements, and review corrective actions of audit findings from prior year reports.

Audit Scope and Methodology

The Authority's management has responsibility for establishing and maintaining internal control and complying with applicable laws, regulations, contracts and grant agreements. 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 Authority internal system and financial records.

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.

The Authority has taken adequate corrective action with respect to audit findings reported in the prior year that are not repeated in this letter.

Exit Conference and Report Distribution

We discussed this report with management on September 14, 2016.

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

KJS/alh

VIRGINIA SMALL BUSINESS FINANCING AUTHORITY

Scott Parsons, Executive Director

BOARD OF DIRECTORS

Gail Letts, Chairman

James Thomas, Vice Chairman

Neil Amin

Tonya Mallory

John Hopper

Monica Rao

Nicholas Jordan

Doña Storey

Prescott Sherrod

Manju Ganeriwala, State Treasurer

Ex-officio voting member

Tracey Jeter, Director

Department of Small Business and Supplier Diversity

Ex-officio voting member