



Audit Report



Report Number: OIG-SBLF-14-002R

STATE SMALL BUSINESS CREDIT INITIATIVE:
Florida's Use of Federal Funds for Capital Access and
Other Credit Support Programs

November 15, 2013

This Report was revised on June 26, 2015, to reflect changes made on pages 2, 13, and 14. The changes clarify the amount of administrative costs that were reviewed by the Office of Inspector General as part of a sample. These corrections do not affect the findings, conclusions, and recommendations as reported.

Office of Inspector General

Department of the Treasury

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Abbreviations

The Act	The Small Business Jobs Act of 2010
EFI	Enterprise Florida, Inc.
FDEO	Florida Department of Economic Opportunity
FLVCP	Florida Venture Capital Program
OCSP	Other Credit Support Programs
OIG	Office of Inspector General
OMB	Office of Management and Budget
SSBCI	State Small Business Credit Initiative

*The Department of the Treasury
Office of Inspector General*

November 15, 2013

Don Graves, Jr.
Deputy Assistant Secretary for Small Business, Housing, and
Community Development

This report presents the results of our audit of the state of Florida's use of funds awarded under the State Small Business Credit Initiative (SSBCI), which was established by the Small Business Jobs Act of 2010 (the Act). In August 2011, Treasury awarded Florida approximately \$97.7 million,¹ and as of December 31, 2012, the State had received its first allocation of approximately \$32.2 million² of the awarded funds. As of December 31, 2012, Florida had obligated or spent approximately \$52 million³ of its first allocation, of which \$37 million went to the Florida Venture Capital Program (FLVCP), approximately \$9.8 million⁴ went to the Florida Loan Participation Program, \$3.5 million went to the Florida Direct Loans Program, approximately \$1.4 million⁵ went to the Florida Loan Guarantee Program, and \$780 went to the Florida Capital Access Program. The State also incurred approximately \$379,000⁶ in administrative costs.

The Act requires the U.S. Treasury Office of Inspector General (OIG) to audit the use of funds made available under SSBCI to identify any instances of reckless or intentional misuse. Treasury has defined reckless misuse as a use of allocated funds that the participating state

¹ Rounded up from \$97,662,349.

² Rounded down from \$32,228,575.

³ Rounded down from \$52,006,735. This number is in excess of the State's first allocation, as Treasury permits states to obligate funds awarded but not yet allocated.

⁴ Rounded up from \$9,757,321.

⁵ Rounded up from \$1,370,000.

⁶ Rounded up from \$378,634.

or administering entity should have known was unauthorized or prohibited, and which is a highly unreasonable departure or willful disregard from the standards of ordinary care. Intentional misuse is defined as a use of allocated funds that the participating state or its administering entity knew was unauthorized or prohibited.

Our audit objective was to test participant compliance with program requirements and prohibitions to identify any reckless or intentional misuse of funds. To accomplish our objective, we reviewed all 24 financings made with SSBCI funds between the signing of the Allocation Agreement on August 24, 2011, and December 31, 2012. This included: 7 investment commitments made by FLVCP, totaling \$37 million; and 17 loan commitments made by the remaining loan programs, totaling approximately \$14.6 million.⁷ Of the 17 loans, 11 were enrolled in the Florida Loan Participation Program, 3 were enrolled in the Florida Loan Guarantee Program, 2 were enrolled in the Florida Capital Access Program, and 1 was enrolled in the Florida Direct Loan Program.

We reviewed the investments and loans to determine whether they complied with program requirements for use of proceeds, capital-at-risk, and other restrictions in the Act or *SSBCI Policy Guidelines*. We also interviewed management and staff from the Florida Department of Economic Opportunity (FDEO), Enterprise Florida, Inc. (EFI), and the Florida Opportunity Fund who administer, account for, and report on SSBCI funding. We also reviewed about \$258,000, or 68 percent, of the approximately \$379,000 of administrative costs that the State, EFI, and Florida Opportunity Fund charged against SSBCI funds to ensure they were allowable and allocable in accordance with *SSBCI Policy Guidelines* and Office of Management and Budget (OMB) Circular A-87, *Cost Principles for State, Local, and Indian Tribal Government*.⁸

We performed our audit from January 2013 to August 2013 in accordance with *Government Auditing Standards*. Those standards

⁷ Rounded down from \$14,628,101.

⁸ Office of Management and Budget Circular Number A-87, revised May 10, 2004.

require that we plan and perform the audit to obtain sufficient and appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained to address our audit objective provides a reasonable basis for our findings and conclusions. A more detailed description of our audit objective, scope, and methodology is contained in Appendix 1 to this report.

Results in Brief

Florida appropriately used most of the SSBCI funds it had expended or obligated as of December 31, 2012, and complied with program requirements when funding 23 of the 24 transactions we tested. However, the State participated in a \$34.7 million FLVCP investment that exceeded the \$20 million restriction imposed by the Act on the amount of credit support that can be extended to an investee. Treasury's *SSBCI Policy Guidelines*, which extend the credit restriction to investments, do not specifically address how the credit support restriction should be applied when the investment involves multiple equity instruments. For this reason, we did not find Florida's investment to constitute a misuse of funds. Nevertheless, in the absence of clear guidance, the State should have sought clarification from Treasury prior to making the investment.

The audit also disclosed that Florida overstated administrative expenses in its Quarterly Reports by approximately \$55,000.⁹ The overstatements occurred as a result of incorrect selection criteria used to pull administrative cost information from the state accounting system following the formation of FDEO. The State identified and reported the overstatement to Treasury, and Treasury allowed Florida to make the necessary adjustments to its Quarterly Reports to correct its error. Our review of the adjusted Quarterly Reports confirmed that the correct amounts were reported.

Additionally, in its June 30, 2012, September 30, 2012, and December 31, 2012 Quarterly Reports to Treasury, the State

⁹ Rounded up from \$54,973.

overstated by approximately \$23 million¹⁰ the amount of SSBCI funds that had been obligated because it included FLVCP reserves that were set aside for future follow-on investments to existing investees. Subsequent to submitting the reports, Treasury informed Florida that the FLVCP reserve commitments did not meet Treasury's criteria for designating the funds as obligated because the commitments were not firm. At Treasury's direction, Florida removed the reserve funds from the State's reported program activity.

We recommend that Treasury revise its guidelines to clarify how the \$20 million credit support restriction should be applied when the investment involves multiple equity instruments. We also recommend that Treasury determine whether there has been a general event of default under Florida's Allocation Agreement resulting from the State's inaccurate reporting of obligated funds. If such an event has occurred and has not been adequately cured, determine whether it warrants a reduction, suspension, or termination of future funding to the State.

Treasury officials accepted both report recommendations, stating that it was revising program guidance on the \$20 million credit support restriction, would determine whether Florida has adequately cured its inaccurate reporting of obligated funds, and would take additional action, if warranted. Formal written responses from Treasury and the state of Florida are included in their entirety in Appendix 2.

Background

SSBCI is a \$1.5 billion Treasury program that provides participating states, territories, and eligible municipalities with funds to strengthen Capital Access Programs and other credit support programs (OCSP) that provide financial assistance to small businesses and manufacturers. Capital Access Programs provide portfolio insurance for business loans based on a separate loan loss reserve fund for each participating financial institution. OCSPs include collateral support, loan participation, loan guarantee, and venture capital programs.

¹⁰ Rounded up from \$22,670,003.

Each participating state is required to designate specific departments, agencies, or political subdivisions to implement the programs approved for funding. The designated state entity distributes the SSBCI funds to various public and private institutions, which may include a subdivision of another state, a for-profit entity supervised by the state, or a non-profit entity supervised by the state. These entities use funds to make loans or provide credit access to small businesses.

Primary oversight of the use of SSBCI funds is the responsibility of each participating state. To ensure that funds are properly controlled and expended, the Act requires that Treasury execute an Allocation Agreement with each state, setting forth internal controls and compliance and reporting requirements before allocating SSBCI funds. SSBCI disbursements to states are made in three allocations: the first when the Secretary approves the state for participation, and the second and third after the state certifies that it has obligated, transferred, or spent at least 80 percent of the previous allocation. In addition, the participating state is required to annually certify that it has complied with program requirements.

Florida's Participation in SSBCI

On August 10, 2011, Treasury approved the state of Florida as a participant in SSBCI, awarding it approximately \$97.7 million. The Allocation Agreement between the State and Treasury was signed on August 24, 2011, authorizing use of the SSBCI funds for five small business development programs: FLVCP, the Florida Loan Participation Program, the Florida Direct Loans Program, the Florida Loan Guarantee Program, and the Florida Capital Access Program. That same month, Treasury disbursed Florida's first allocation of approximately \$32.2 million. As of December 31, 2012, Florida had obligated or spent approximately \$52 million of the first allocation. Of the \$52 million, approximately \$379,000 was for administrative expenses incurred for its five programs.

Florida Venture Capital Program

The FLVCP provides equity and convertible debt instruments to

emerging Florida companies with perceived growth potential in targeted industries. EFI, Florida's primary economic development organization, administers the FLVCP for the State, and has contracted with the Florida Opportunity Fund to increase the availability of seed-stage and early-stage venture capital investments in Florida. As of December 31, 2012, Florida had committed \$37 million of its first allotment of SSBCI funding on FLVCP.

Florida Loan Participation Program and Loan Guarantee Program

The Florida Loan Participation Program and Loan Guarantee Program enable small businesses to obtain medium- to long-term financing to help grow and expand their businesses. Both programs are available to businesses that demonstrate adequate historical and/or proposed cash flow coverage plus other credit underwriting metrics. The Loan Participation Program permits the State to act as a lender, in partnership with financial institution lenders, to provide small business loans at attractive terms. The Loan Guarantee Program provides loan guarantees between 5 percent and 80 percent of the total amount required by small businesses for financing.

Florida contracted the administration of both programs to EFI. As of December 31, 2012, Florida had obligated or spent \$9.8 million of its first allotment of SSBCI funding on the Loan Participation Program, and \$1.4 million on the Loan Guarantee Program.

Florida Direct Loan Program

The Florida Direct Loan Program provides loans to qualified businesses that demonstrate adequate historical and/or proposed cash flow coverage plus other solid credit underwriting metrics. EFI administers the program for the state of Florida. As of December 31, 2012, Florida had obligated or spent \$3.5 million of its first allotment of SSBCI funding on the Direct Loan Program.

Florida Capital Access Program

The Florida Capital Access Program provides portfolio insurance for

business loans based on a separate loan loss reserve fund for each participating financial institution. The reserve fund is used to provide portfolio insurance for all loans enrolled in the program by participating financial institutions. The Capital Access Program works on a pooled reserve concept where each loan enrolled by a specific financial institution is protected by a reserve account in the institution's name. As of December 31, 2012, Florida had obligated or spent \$780 of its first allotment of SSBCI funding on the capital access program.

Florida Generally Used SSBCI Funds Appropriately, but Exceeded the \$20 Million Credit Support Restriction on One Investment

We determined that the state of Florida properly used the majority (92 percent) of the SSBCI funds it expended. Also, 23 of the 24 transactions we sampled were compliant with program guidelines related to prohibited relationships, maximum transaction amounts, use-of-proceeds, capital-at-risk, and other restrictions noted in the Act and *SSBCI Policy Guidelines*. However, the State participated in a \$34.7 million investment that involved multiple equity instruments, which we determined exceeded the \$20 million restriction that the Act intended be placed on the amount of credit support that may be extended to a recipient.

According to the Act, SSBCI funds allocated cannot extend credit support to loans that exceed a principal amount of \$20 million. Treasury's *SSBCI Policy Guidelines* extended this restriction to investments and equity instruments, stating that "The OCSP...cannot extend credit for loans with principal amounts in excess of \$20 million nor participate in an **investment** in which the **resulting equity instrument** is in excess of \$20 million."

The \$34.7 million investment consisted of two equity instruments – \$4 million of non-voting equity purchased with SSBCI funds, and \$30.7 million of voting equity purchased with private capital. We concluded that although two equity instruments were involved, the transaction constituted one investment package that extended \$34.7 million in credit to one business because if the business were to fail, both equity

instruments would be affected. Therefore, the \$20 million restriction would apply to the entire \$34.7 million in equity purchased.

Our finding that the \$20 million restriction on credit support should apply to the principal or investment amount an individual investee can receive versus the size of each investment instrument is further supported by accompanying language in the Act that restricts the extension of credit to businesses. Specifically, the Act states that for a State OCSP to be approved, the OCSP program must be one that uses Federal funds allocated to extend credit support that, among other things:

- Targets support towards loans with an average principal amount of \$5 million or less; and
- Does not extend credit support to loans that exceed a principal amount of \$20 million.

A Florida Opportunity Fund official told us that the State understood the Act and *SSBCI Policy Guidelines* to mean that the \$20 million restriction applied to each equity instrument versus the total investment. That is, they believed the equity purchase made with SSBCI funds was separate and distinct from equity purchased by private investors; and therefore the \$20 million restriction applied only to the \$4 million purchase of non-voting equity made by the State.

Although the intent of the Act is clear with respect to how the \$20 million credit restriction applies to a loan, we note that Treasury's *SSBCI Policy Guidelines*, which extend the credit restriction to investments, do not specifically address how the \$20 million restriction should be applied when the investment involves multiple equity instruments. As a result, we believe participating states may not understand whether *each* equity instrument purchase cannot exceed \$20 million; or whether the total investment in a business from all equity instruments should not exceed \$20 million. Because the *SSBCI Policy Guidelines* do not address how the credit restriction should be applied to multiple equity instruments, we did not find Florida's investment to be a misuse of funds.

Due to the lack of clarity in Treasury's guidance, we recommend that

Treasury revise the *SSBCI Policy Guidelines* to clarify how the \$20 million credit support restriction should be applied when an investment involves multiple equity instruments.

Florida Did Not Accurately Report Funds Used for Administrative Expenses, but Corrected the Administrative Expense Inaccuracies

As of December 31, 2012, Florida had overstated administrative expenses in its Quarterly Reports by approximately \$55,000, which was comprised of \$34,468 in direct costs and \$20,505 in indirect costs. According to FDEO officials, the overstatement occurred because of incorrect selection criteria used to pull administrative cost information from the state accounting system following a merger in November 2011 between the Governor's Office of Tourism, Trade, and Economic Development, the Agency for Workforce Innovation, and the Department of Community Affairs, which formed the FDEO.

In February 2013, Florida officials notified Treasury that they had identified some errors in their reported administrative expenses and inquired about methods to correct the errors. Treasury officials informed Florida that they were making revisions to the quarterly reporting process to include an "adjustments" column to correct for reporting errors, and that training and information on this enhancement would be forthcoming. Once the revisions were made, Florida was expected to correct the errors that it had identified.

The OIG reviewed Florida's March 31, 2013 Quarterly Report and verified that the State had made adjustments to its administrative expenses for the \$55,000. Because Florida reported the overstatement, sought guidance from Treasury on what corrective actions to take, and made the proper adjustments to its latest Quarterly Report, no further action is needed by Treasury.

Florida Did Not Accurately Report Obligated Funds, but Corrected the Reporting Inaccuracies

Florida prematurely and inaccurately reported approximately \$23 million in funds reserved for future FLVCP follow-on investments as

“obligated” in its June 30, 2012, September 30, 2012, and December 31, 2012 Quarterly Reports to Treasury. Per Treasury’s April 2012 *Frequently Asked Questions*, SSBCI funds are considered obligated once the funds have been committed to pay for orders placed, contracts awarded, goods and services received, and similar transactions during a given period that will require payment by the approved state program during the same or a future period.

However, the FLVCP reserve commitments did not meet Treasury’s criteria for designating it as obligated funds because the commitments were not firm based on language in the reserve commitment letters indicating that:

- The amount of the commitment may be increased or decreased from time to time by the Fund;
- Any investment of capital from the commitment is contingent upon successful due diligence by the Florida Opportunity Fund and its advisors; approval by the Fund board, the Florida Department of Economic Opportunity, and the investment committee of the Fund’s advisors; negotiation of the terms of definitive documents; and completion of any additional conditions required by the Fund;
- The Florida Opportunity Fund may reallocate the committed funds for other purposes at its discretion; and
- The company has no rights conferred by the commitment and may not rely upon the commitment in financing discussions with investors and creditors.

Under Section 6.1 of the *SSBCI Allocation Agreement* signed by Florida, inaccurate Quarterly Reporting can trigger a general event of default of the State’s *SSBCI Allocation Agreement* with Treasury.

The use of funds is an important program performance measure. Accurate reporting by states is imperative to ensure that Treasury can effectively monitor each state, and that Congress has accurate data

with which it can evaluate the overall effectiveness of SSBCI in improving credit access for small businesses.

Treasury identified the misreporting of SSBCI funds as obligated in January 2013, and on February 12, 2013, required Florida to remove the reserve obligated amounts from their second disbursement request. Treasury confirmed that Florida's revised disbursement request, which was submitted on March 26, 2013, did not include the reserve obligated amounts to meet the 80 percent expended, obligated, or transferred threshold. However, under Section 6.1 of the *SSBCI Allocation Agreement* signed by Florida, inaccurate quarterly reporting can trigger a general event of default of the State's agreement with Treasury. As a result, Treasury will need to determine whether such an event has occurred, and whether future funding to Florida should be suspended, reduced, or terminated.

Recommendation

We recommend that the Deputy Assistant Secretary for Small Business, Housing, and Community Development:

1. Revise the *SSBCI Policy Guidelines* to clarify how the \$20 million restriction on credit support should be applied when an investment involves multiple equity instruments.
2. Determine whether there has been a general event of default under Florida's *SSBCI Allocation Agreement* resulting from the State's inaccurate reporting of obligated funds. If such an event has occurred and has not been adequately cured, determine whether it warrants a reduction, suspension, or termination of future funding to the State.

Management Comments and OIG Response

We provided a draft of the report to Treasury on October 2, 2013, and received formal written comments on November 8, 2013 from Florida and November 14, 2013 from Treasury. Treasury accepted both report recommendations, stating that it was revising program guidance

on the \$20 million credit support restriction, would determine whether Florida has adequately cured its inaccurate reporting of obligated funds, and would take additional action, if warranted.

We believe that Treasury's planned actions are fully responsive to all of the recommendations. Formal written responses from Treasury and the state of Florida are included in their entirety in Appendix 2.

* * * * *

We appreciate the courtesies and cooperation provided to our staff during the evaluation. If you wish to discuss the report, you may contact me at (202) 622-1090, or Lisa DeAngelis, Audit Director, at (202) 927-5621.

/s/

Debra Ritt

Special Deputy Inspector General for

Office of Small Business Lending Fund Program Oversight

Appendix 1: Objective, Scope, and Methodology

The objective of our audit was to test participant compliance with program requirements and prohibitions to identify any reckless or intentional misuse of funds. As of December 31, 2012, the state of Florida had received its first disbursement of \$32.2 million¹ and had obligated or spent approximately \$52 million² of the funds disbursed, of which \$37 million went to the Florida Venture Capital Program (FLVCP), approximately \$9.8 million³ went to the Florida Loan Participation Program, \$3.5 million went to the Florida Direct Loans Program, approximately \$1.4 million⁴ went to the Florida Loan Guarantee Program, and \$780 went to the Florida Capital Access Program. The State also incurred approximately \$379,000⁵ in administrative costs.

To test participant compliance, we reviewed all seven investments, totaling \$37 million, financed by FLVCP and all seventeen loans, totaling approximately \$14.6 million, financed by the remaining loan programs between the signing of the Allocation Agreement on August 24, 2011, and December 31, 2012. Of the seventeen loans, 11 were enrolled in the Florida Loan Participation Program, 3 were enrolled in the Florida Loan Guarantee Program, 2 were enrolled in the Florida Capital Access Program, and 1 was enrolled in the Florida Direct Loans Program. We performed testing to ensure all of the investments and loans complied with the requirements and prohibitions of the Act and associated Treasury guidelines. During March 2013, we conducted an on-site review of the investment and loan files at Enterprise Florida, Inc. (EFI) and the Florida Opportunity Fund and compared the documentation to specific requirements and prohibitions of the Act and associated Treasury guidelines.

We interviewed management and staff designated by the state of Florida, EFI, and the Florida Opportunity Fund that were responsible for administering, managing, accounting for, and reporting on the programs. We sampled and reviewed about \$258,000,⁶ or 68 percent, of the approximately \$379,000⁷ of

¹ Rounded down from \$32,228,575.

² Rounded down from \$52,006,735. This number is in excess of the State's first allocation, as Treasury permits states to obligate funds awarded but not yet allocated.

³ Rounded up from \$9,757,321.

⁴ Rounded up from \$1,370,000.

⁵ Rounded up from \$378,634.

⁶ Rounded down from \$258,168.

⁷ Rounded up from \$378,634.

administrative costs that the State, EFI, and Florida Opportunity Fund charged against SSBCI funds to ensure they were allowable and allocable in accordance with *SSBCI Policy Guidelines* and Office of Management and Budget Circular A-87, *Cost Principles for State, Local, and Indian Tribal Government*.⁸ Our sample included all personnel costs, all administrative costs incurred by EFI, and select other administrative costs. We reviewed policies, procedures, and other written guidance provided by FDEO, EFI and the Florida Opportunity Fund. We conducted our audit between January 2013 and August 2013, in accordance with *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 to address our audit objectives provides a reasonable basis for our findings and conclusions.

⁸ Office of Management and Budget Circular Number A-87, revised May 10, 2004.

Appendix 2: Management Response



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

November 14, 2013

Debra Ritt
Special Deputy Inspector General for
Office of Small Business Lending Fund Program Oversight
U.S. Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Dear Ms. Ritt:

Thank you for the opportunity to review the Office of the Inspector General's (OIG) draft report entitled *State Small Business Credit Initiative: Florida's Use of Federal Funds for Capital Access and Other Credit Support Programs* (the Report). This letter provides the official response of the Department of the Treasury (Treasury).

We appreciate the Report's finding that Florida generally used State Small Business Credit Initiative (SSBCI) funds appropriately and that all but one of the sampled loans complied with SSBCI program requirements. The OIG transmitted a copy of the Report to Florida program officials on October 17, 2013. The OIG asked Florida to provide a narrative response describing measures it has taken or plans to take to address the deficiencies noted in the Report.

In its reply, enclosed, Florida addressed the three findings and two recommendations in the Report. Florida disagreed with the finding that Florida used SSBCI funds in a transaction that exceeded the \$20 million restriction on credit support but agreed with the OIG's recommendation that Treasury should revise the SSBCI Policy Guidelines to clarify the restriction. Florida accepted the finding that administrative funds were inaccurately reported and stated that the state has procedures in place to prevent similar issues in the future. Finally, Florida stated that it does not believe that it prematurely or inaccurately reported funds as obligated but agreed to not categorize funds subject to reserve commitment letters as obligated.

Treasury accepts each of the Report's recommendations. With respect to the first recommendation, SSBCI is in the process of revising program guidance on this issue. Regarding the second recommendation, Treasury will determine whether Florida has adequately cured its inaccurate reporting of obligated funds. Treasury will also determine whether additional action is warranted.

Thank you once again for the opportunity to review the Report. Treasury appreciates our work together throughout the course of the SSBCI program.

Sincerely,



Don Graves
Deputy Assistant Secretary
Small Business, Community Development, and
Housing Policy

Enclosure

Rick Scott
GOVERNOR



Jesse Panuccio
EXECUTIVE DIRECTOR

November 8, 2013

Mr. Don Graves, Jr.
Deputy Assistant Secretary
Small Business, Community Development
and Affordable Housing Policy
Department of the Treasury
Washington, D.C. 20220

Re: State Small Business Credit Initiative: Florida's Use of Federal Funds for Capital Access
and Other Credit Support Programs

Dear Mr. Graves:

We have received the audit report from the Treasury Office of the Inspector General (OIG) entitled State Small Business Credit Initiative: Florida's Use of Federal Funds for Capital Access and Other Credit Support Programs (OIG Report), and appreciate the opportunity to respond.

You have requested that the state of Florida provide a narrative response describing the measures that Florida has taken or plans to take to address the deficiencies noted in the OIG Report. First, you request that Florida describe any previous, current, or planned efforts to ensure that all investment transactions are compliant with the Small Business Jobs Act of 2010 (the Act) and SSBCI Policy Guidelines regarding the \$20 million restriction on extending credit support to investees in accordance with the requirements of the Allocation Agreement dated August 24, 2011 between Florida and the U.S. Department of Treasury. Second, you request that Florida describe any previous, current, or planned efforts to ensure the accuracy of the state's quarterly certification on Use-of-Allocated Funds.

To effectively respond to the conclusions made by the OIG, Florida reviewed the rules of the SSBCI program codified in the following documents: the Act, SSBCI Policy Guidelines, and SSBCI FAQs. These documents provide the framework in which Florida relied upon to determine: (1) eligible uses of program funds; and (2) how such funds should be reported.

OIG Finding #1: "Florida Generally Used SSBCI Funds Appropriately, but Exceeded the \$20 Million Credit Support Restriction on One Investment"

Florida agrees with the recommendation of the OIG that Treasury revise the *SSBCI Policy Guidelines* to clarify how the \$20 million credit support restriction should be applied when an

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investment involves multiple equity instruments. However, Florida disagrees with the OIG conclusion that SSBCI funds were used in a transaction that exceeded the credit support restriction on one investment.

According to the current SSBCI Policy Guidelines, "Under the Act, OCSPs must target an average borrower or investee size of 500 employees (as defined in CFR Part 121.106) or less and cannot extend credit support to borrowers with more than 750 employees. The OCSP must target loans or investments with an average principal amount of \$5 million or less and cannot extend credit for loans with principal amounts in excess of \$20 million nor participate in an investment *in which the resulting equity instrument is in excess of \$20 million.*"

As stated in the OIG report, "The \$34.7 million investment consisted of *two equity instruments*- \$4 million of non-voting equity purchased with SSBCI funds, and \$30.7 million of voting equity purchased with private capital. We concluded that although two equity instruments were involved, the transaction constituted one investment package that extended \$34.7 million in credit to one business because if the business were to fail, both equity instruments would be affected. Therefore the \$20 million restriction would apply to the entire \$34.7 million in equity purchased."

Florida relied upon Treasury's guidance to determine eligible uses of program funds. Treasury's guidance does not define "investment package," as that term is used in the OIG Report. Rather, the guidance states that OCSPs cannot, "participate in an investment in which the resulting equity instrument is in excess of \$20 million," and as the OIG has confirmed, SSBCI funds were used to purchase a \$4 million equity instrument.

Communications between Florida and Treasury indicate that Treasury concluded that the transaction, as structured, was compliant with the \$20 million credit support restriction; however, because Florida was the sole recipient of an equity instrument comprised of non-voting equity, Treasury deemed the transaction as non-compliant with the 20% capital at-risk requirement. Accordingly, with the support of Treasury, Florida brought the \$4 million equity instrument into compliance with the capital at-risk requirement.

OIG Finding #2: Florida Did Not Accurately Report Funds Used for Administrative Expenses, but Corrected the Administrative Expense Inaccuracies.

Florida accepts the finding that administrative funds were inaccurately reported due to incorrect selection criteria used to pull administrative information from the state's accounting system and that the deficiency was corrected. Florida has procedures in place that will prevent similar issues in the future.

OIG Finding #3: Florida Did Not Accurately Report Obligated Funds, but Corrected the Reporting Inaccuracies.

Florida does not believe that it prematurely or inaccurately reported funds as obligated funds on its June 30, 2012, September 30, 2012, and December 31, 2012 quarterly reports. The Allocation Agreement requires states to report quarterly on the use of Allocated Funds and Florida relied upon guidance provided by Treasury to report Allocated Funds Used on its June 30, 2012, September 30, 2012, and December 31, 2012 quarterly reports.

Pursuant to the Policy Guidelines, "SSBCI funds used are those SSBCI funds that have been (a) deposited with a lender to cover the SSBCI contributions to a CAP reserve fund, (b) disbursed or committed to a specific borrower as part of a loan participation, collateral support, or direct lending program, (c) set aside to cover obligations arising from individual loan guarantees, loan participations, or collateral support agreements to specific borrowers, or **(d) invested or committed to be invested in specific businesses, pursuant to a venture capital investment.**"

In addition, pursuant to the FAQs, "Obligated SSBCI funds, are those funds that have been committed to pay for the amounts of orders placed, contracts awarded, goods and services received, and similar transactions during a given period that will require payment by the Approved State Program during the same or a future period. Examples of obligated funds include: a) SSBCI funds that have been committed, pledged, or otherwise promised, in writing, to a specific borrower as part of a loan participation, collateral support, or direct lending program; **b) SSBCI funds that have been committed, pledged, or otherwise promised, in writing as part of a venture capital investment transaction (e.g., a promissory note);** c) SSBCI funds that have been set aside to cover obligations arising from loan guarantees, loan participations, or collateral support agreements as part of an approved program; or, d) SSBCI funds that have been committed, pledged, or promised in writing for allowable administrative expenses (e.g. an executed contract for services)."

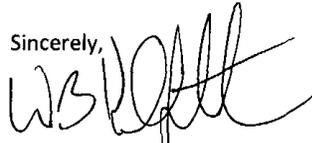
At the time of submission of the quarterly reports for June 30, 2012, September 30, 2012, and December 31, 2012, Florida believed it accurately accounted for SSBCI Funds Used according to the definitions provided in the Policy Guidelines and FAQs. Florida committed FLVCP funds to specific small business investees pursuant to an FLVCP Reserve Commitment Letter that pledged that capital would be held in reserve for future financings of the investee, subject to certain terms and conditions. It is common practice for the venture capital industry to reserve funds for future follow-on investments. Florida has reserved funds in accordance with such practices, and has made follow-on investments from such FLVCP reserve commitments to its investees. Funds committed, which included both funds disbursed and funds reserved for future disbursement, were reported on Florida's quarterly reports.

In January 2013, in connection with Florida's request for its second tranche of SSBCI funding, Treasury staff performed a review of the commitment letter used for all FLVCP transactions, and informed Florida on February 12, 2013 that, as structured, its reserve commitment letters did not meet Treasury's criteria for designation as obligated funds. Florida met the 80% allocation threshold absent any FLVCP reserve commitments, and submitted an updated disbursement request for its second tranche of funding, which Florida received in June 2013.

Subsequently, Florida elected to adjust its quarterly reports for June 30, 2012 September 30, 2012, and December 31, 2012 to exclude amounts shown as "obligated" pursuant to the FLVCP reserve commitment letters. In addition, Florida will continue to exclude such amounts in its ongoing quarterly reports until such time as Florida and Treasury agree on a form of reserve commitment letter that meets their criteria for designation as obligated funds.

Again, we appreciate the opportunity to respond to the conclusions in the OIG Report and we look forward to working collaboratively with the U.S. Department of the Treasury. If you have questions or need additional information related to the response, please do not hesitate to contact the Florida Department of Economic Opportunity.

Sincerely,



William B. Killingsworth, Director
Division of Community Development

WBK/bp

cc: Mr. Jesse Panuccio, Director
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Appendix 4: Distribution List

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