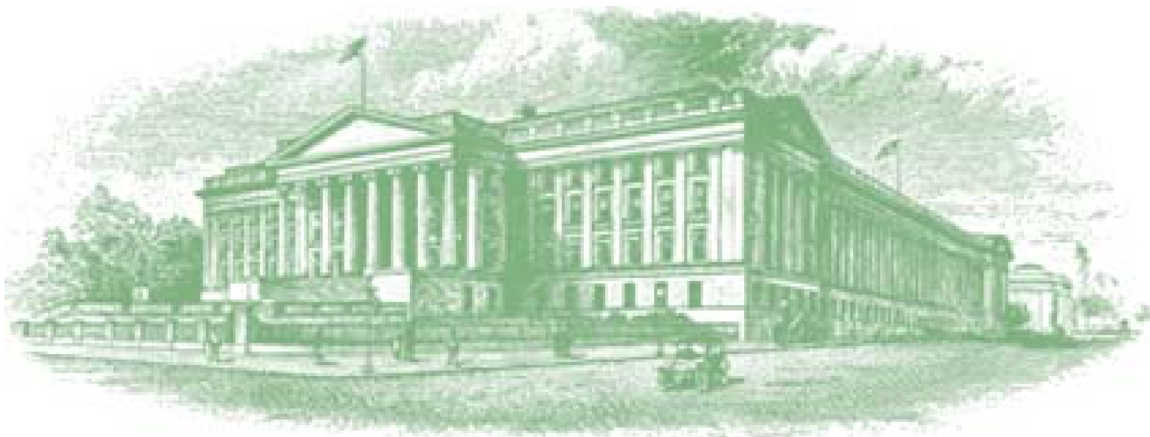
Audit Report



OIG-17-049

STATE SMALL BUSINESS CREDIT INITIATIVE

Oregon's Use of Federal Funds for Capital Access and Other Credit Support Programs

July 25, 2017

Office of Inspector General

Department of the Treasury

Contents

Abbreviations

Act	Small Business Jobs Act of 2010
Business Oregon	Oregon Business Development Department
CAP	capital access program
CEF	Credit Enhancement Fund
Treasury	Department of the Treasury
OBDF	Oregon Business Development Fund
OCSP	other credit support program
SSBCI	State Small Business Credit Initiative

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July 25, 2017

Kipp Kranbuhl
Deputy Assistant Secretary for Small Business, Community Development, and Housing

As part of our ongoing oversight of the Department of the Treasury's (Treasury) State Small Business Credit Initiative (SSBCI), authorized by the Small Business Jobs Act of 2010 (the Act),[1] we conducted audits of awards made to select States, Territories, and eligible Municipalities (hereinafter referred to as States) to support their capital access and small business credit programs. The purpose of these audits was to assess States' compliance with SSBCI program requirements and prohibitions to identify any reckless[2] or intentional[3] misuse of funds.

In this report, we provide our assessment of the State of Oregon's (Oregon) compliance with the SSBCI program requirements and prohibitions with respect to its approximately $16.5 million SSBCI funds awarded in August 2011.[4] The scope of our audit comprised approximately $10.2 million[5] of SSBCI funds spent by the State for its small business programs and administrative expenses as of March 2014. Appendix 1 provides more detail of our audit objective, scope, and methodology.

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[1] Pub. L. 111-240, 124 Stat. 2568-2582 (Sept. 27, 2010).
[2] Reckless misuse as defined by Treasury is a use of Allocated Funds that the Participating State or its administering entity/ies should have known was unauthorized or prohibited. A "reckless misuse of funds" is a highly unreasonable departure or willful disregard from the standards of ordinary care, and may be a single instance or a series of instances.
[3] Intentional misuse as defined by Treasury is a use of Allocated Funds that the Participating State and/or its administering entity/ies knew was unauthorized or prohibited. An "intentional misuse of funds" may be a single instance or a series of instances.
[4] Actual amount is $16,516,197.
[5] Actual amount is $10,185,305.

In brief, we found that Oregon generally complied with the SSBCI program requirements and prohibitions with respect to the State's three small business development programs and administrative expenses. However, Oregon contributed $6,750 in SSBCI funds to a reserve fund for a $225,000 capital access program (CAP) loan that refinanced[6] a line of credit made to the borrower by the same lender. This was a misuse of funds because the refinancing of existing debt is prohibited by the Act and *SSBCI Policy Guidelines*. Although the use of SSBCI funds for the loan in question was prohibited, we did not find that the misuse was "intentional" or "reckless," because Oregon obtained a lender assurance affirming the loan was not a refinancing of a loan previously made to that borrower by the financial institution lender, which is required by *SSBCI Policy Guidelines*. Additionally, upon learning of the use of loan proceeds to refinance an existing debt, the State agreed that it was prohibited and told us they would request approval from Treasury to un-enroll the loan from the CAP portfolio and replenish[7] its SSBCI account in the amount of $6,750. As such, we question $6,750 of SSBCI funds misused as this was in violation of the Act and *The SSBCI Guidelines*. See appendix 2 for the definition of a questioned cost included as part of the schedule of questioned cost.

Accordingly, we recommend that the Deputy Assistant Secretary for Small Business, Community Development, and Housing verifies that $6,750 in SSBCI funds has been withdrawn from the prohibited loan and that the SSBCI account has been reimbursed for the same amount; and requests that the State amend its 2013 Annual Report and appropriate Quarterly Report to reflect the un-enrolled loan.

[6] A refinancing of a loan is the process of replacing one loan with another by moving debt to a different loan, including paying off a previous debt. This includes any existing outstanding balance or previously made line of credit.

[7] SSBCI Frequently Asked Questions (FAQ) 17 states a Participating State may wish to un-enroll a particular transaction and replenish its SSBCI program account in the amount of funds found to be noncompliant or misused: (1) when the Participating State itself or SSBCI identifies a potentially noncompliant use of funds; or (2) when the Office of Inspector General identifies an instance of noncompliance or misuse not characterized as reckless or intentional. Treasury's written approval is needed for replenishment and un-enrollment.

As part of our reporting process, we provided Oregon Business Development Department (Business Oregon) management an opportunity to comment on a draft of this report. In a written response, Business Oregon management generally agreed with our audit finding and stated that it has taken steps to implement the recommendations in the audit report. Specifically, management noted that it has submitted evidence to Treasury of the replenishment of its SSBCI account in compliance with the recommendation. Management also intends to obtain verification that the appropriate adjustments to un-enroll the loan have been made to the Annual and Quarterly reports. Business Oregon management's response, in its entirety, is included as appendix 3 of this report.

In its written response to this report, Treasury management stated it was pleased that the report found that Oregon generally complied with SSBCI program requirements. Regarding our recommendations, management responded that it will work with Oregon to (1) verify that the $6,750 in SSBCI funds is reimbursed to the SSBCI account and (2) amend its reporting. Treasury management's response, in its entirety, is included as appendix 4 of this report.

Background

SSBCI is a $1.5 billion Treasury program that provides participating States funding to strengthen CAPs and other credit support programs (OCSP) that provide financial assistance to small businesses and manufacturers. CAPs 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, credit support, and venture capital programs.

Loans and investments made with SSBCI funds must comply with the program requirements detailed in the Act, *SSBCI Policy Guidelines*, *SSBCI National Standards for Compliance and Oversight,* and the *Allocation Agreement*. With respect to CAPs, portfolio insurance for business loans is provided by a reserve fund. Federal contributions into the reserve fund may be used to match the contributions made by the borrower and lender at a level of a 1:1 match. For any loan enrolled in a CAP, the lending financial institution is required to bear at least 20 percent private capital at risk. For a loan to be eligible, the borrower must have 500 employees or less and the loan cannot exceed $5 million.

The Deputy Assistant Secretary for Small Business, Community Development, and Housing administers the SSBCI program. Details of the program are provided as appendix 5.

Oregon's Participation in SSBCI

Oregon was awarded approximately $16.5 million of SSBCI funds upon Treasury's approval of its participation in the program in August 2011. The *Allocation Agreement*, among other things, authorized the use of SSBCI funds for the following three small business development programs: the Oregon CAP, the Credit Enhancement Fund (CEF), and the Oregon Business Development Fund (OBDF). The State designated Business Oregon, a State department, to administer the approved State programs on behalf of the Office of the Governor. In December 2016, Treasury disbursed an additional $74,704[8] to Oregon in accordance with Section 3008(b) of the Act, which provides for the deallocation and reallocation of funds across the States participating in the SSBCI program. Oregon's revised allocation of $16.6 million[9] was disbursed in its entirety by Treasury as of December 31, 2016. Oregon, in turn, spent or obligated all the funds.

Oregon's CAP (total allocation of approximately $150,000) provides portfolio insurance for business loans made by participating financial institutions. When a loan is enrolled, both the borrower and lender contribute between two to seven percent of the loan amount to a reserve fund. Oregon contributes a matching amount to the reserve fund using SSBCI funds. The lender can be reimbursed from the reserve fund if the borrower defaults on the loan. Oregon's CEF (total allocation of approximately $12.5 million) is a loan guarantee program whereby Oregon guarantees payment of up to 80 percent of the principal value of a loan made by a

[8] The additional allocation was not within the scope of this audit.
[9] Actual amount is $16,590,901.

participating financial institution in the event that a borrower defaults on the loan. The OBDF (total allocation of approximately $3.4 million) is a loan participation program whereby Oregon makes a direct loan that closes at the same time as a larger private sector loan to the same borrower.

Of its $16.6 million allocation, Oregon used approximately $500,000 for administrative expenses as of December 31, 2016.

Finding

Oregon Generally Complied with SSBCI Program Requirements but Misused $6,750 on a CAP Loan

We found that Oregon generally complied with SSBCI program requirements and prohibitions governing its three State small business development programs and administrative expenses. That is, 27 of 28 loans in our sample covering Oregon's CAP, CEF, and OBDF were found to be in compliance with SSBCI program requirements. Furthermore, all administrative expenses in our sample were determined to be reasonable, allowable, and allocable in accordance with *SSBCI Policy Guidelines* and the Office of Management and Budget (OMB) Circular A-87, "Cost Principles for State, Local, and Indian Tribal Governments"[10] in effect at the time of our audit. That said, Oregon contributed $6,750 of its SSBCI allocation to a reserve fund for a $225,000 CAP loan that refinanced a line of credit made to the borrower by the same lender, which is a misuse of funds.

The refinancing of an existing debt in certain instances is prohibited by the Act and *SSBCI Policy Guidelines*. Specifically, the Act "prohibits the enrollment of a loan to a borrower that is a refinancing of a loan previously made to that borrower by the financial institution lender or an affiliate of the financial institution lender." Additionally, the *SSBCI Policy Guidelines* state that "each participating state must obtain an assurance from the financial institution lender affirming the loan is not a refinancing of a loan

[10] OMB Circular A-87 is codified in 2 C.F.R. Part 200 (effective December 2014)

previously made to that borrower by the financial institution lender or an affiliate of the financial institution lender."

In January 2013, Business Oregon authorized a participating financial institution to enroll a $225,000 term loan to a borrower in the State's CAP. Upon authorization of the CAP loan, Oregon contributed $6,750 of SSBCI funds to a reserve fund that provided portfolio insurance for the financial institution in the event the borrower defaulted on the loan. However, we noted in the lender's loan file that a portion of the loan proceeds was used to pay off the borrower's existing line of credit with the same financial institution. When we brought this to the attention of an Oregon official, he stated that Business Oregon's practice was to rely on the lender's CAP application to authorize the loan, which did not include the lender's loan file. In the event a claim is submitted against the reserve fund, Business Oregon would require from the lender a comprehensive documentation package permitting a thorough review of all aspects of the transaction, to ensure compliance prior to paying a claim using SSBCI funds. We also noted that, as required by *SSBCI Policy Guidelines*, Business Oregon obtained assurance from the participating lender that the SSBCI funds would not be used to refinance an existing debt, and the State relied on that assurance.

Although the use of SSBCI funds for this loan was prohibited, we did not find that the misuse was "intentional" or "reckless," because Business Oregon obtained the lender assurance required by *SSBCI Policy Guidelines*. In this instance, we believe Oregon followed the established guidance in accepting the assurance and that guidance does not require participating States to verify the accuracy of lender assurances. Additionally, upon learning of the use of loan proceeds to refinance an existing debt, the State agreed that it was prohibited and told us it would request approval from Treasury to un-enroll the loan from the CAP portfolio and replenish its SSBCI account in the amount of $6,750.

Accordingly, we question $6,750 of SSBCI funds misused as it was in violation of the Act and *The SSBCI Guidelines*.

Recommendations

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

1. Verifies that $6,750 in SSBCI funds has been withdrawn from the prohibited loan and that the SSBCI account has been reimbursed for the same amount.

   Management Response

   Management responded that Treasury will work with Oregon to verify that the $6,750 in SSBCI funds is reimbursed to the SSBCI account.

   OIG Comment

   Management's response meets the intent of our recommendation.

2. Requests that Oregon amend its 2013 Annual Report and the appropriate Quarterly Report to reflect the un-enrolled loan.

   Management Response

   Management responded that Treasury will work with Oregon to amend its reporting.

   OIG Comment

   Management's response meets the intent of our recommendation.

* * * * *

We would like to extend our appreciation for the cooperation and courtesies extended to our staff during the audit. Major contributors to this report are listed in appendix 6. A distribution list for this report is provided as appendix 7. If you have any questions, please contact me at (202) 927-1011.

/s/

Theresa Cameron
Audit Director, Financial Assistance Audits

Pursuant to Section 3003 of the *Small Business Jobs Act of 2010* (Act), we conducted audits of awards made to select States, Territories, and eligible Municipalities (hereinafter referred to as States) as part of our ongoing oversight of the Department of the Treasury's (Treasury) State Small Business Credit Initiative (SSBCI), authorized by the Act, to support their capital access and small business credit programs. The objective of these audits was to assess States' compliance with SSBCI program requirements and prohibitions to identify any reckless or intentional misuse of funds.

To accomplish our audit objective, we selected a sample of loans enrolled in Oregon's Capital Access Program (CAP), Credit Enhancement Fund (CEF), and the Oregon Business Development Fund (OBDF), as well as certain administrative expenses. Our audit scope comprised loan and administrative transactions of approximately $10.2 million from Oregon's approval to participate in the SSBCI program in August 2011 through March 2014. We used a non-statistical, high dollar approach to identify enrolled loans and administrative expenses representing approximately $5.4 million or 50 percent of the $10.2 million of SSBCI funds spent through March 2014. Accordingly, the following enrolled loans and administrative expenses were tested:

- 12 of 78 loans enrolled in the CAP comprising $65,401 of $129,416 in reserves (or approximately 51 percent);
- 13 of 88 loans enrolled in the CEF comprising approximately $3.9 million of $8.1 million (or approximately 48 percent);
- 3 of 5 loans comprising $1.3 million of $1.6 million in the OBDF (or 77 percent); and
- 120 of 211 payroll transactions comprising $301,702 of the total $341,295 in administrative expenses (or approximately 88 percent).

We conducted fieldwork at Oregon Business Development Department (Business Oregon) headquarters in Salem, Oregon; and the Treasury Office of Inspector General office in Washington, D.C. between July 2014 and November 2016. We performed the following steps:

- We reviewed the following documents:

- *SSBCI National Standards for Compliance and Oversight* (May 15, 2012);
- *SSBCI Policy Guidelines* (October 21, 2011);
- SSBCI Frequently Asked Questions;
- SSBCI Fact Sheet;
- *Regulation O: Loans to Executive Officers, Directors, and Principal Shareholders of Member Banks;*
- Business Oregon beneficiary intake forms;
- Payroll transaction lists and supporting documentation;
- SSBCI Quarterly Reports;
- SSBCI Annual Reports (2012, 2013, and 2014);
- SSBCI Investee and Investor Certifications;
- SSBCI Loan Enrollment Filing Forms; and
- Financial institution loan files.

- We interviewed key officials at Business Oregon.

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.

A questioned cost is a cost that is questioned by the auditor because of an audit finding: (1) which resulted from an alleged violation or possible violation of a provision of a law, regulation, contract, grant, cooperative agreement, or other agreement or document governing the use of Federal funds, including funds used to match Federal funds; (2) where the costs, at the time of the audit, are not supported by adequate documentation; or (3) where the costs incurred appear unreasonable and do not reflect the actions a prudent person would take in the circumstances. Questioned costs are to be recorded in the Joint Audit Management Enterprise System (JAMES). The questioned costs will also be included in the next Office of Inspector General Semiannual Report to the Congress.

Recommendation Number	Questioned Cost
Recommendation 1	$6,750

The questioned cost relates to funds that Treasury awarded to the State of Oregon under the SSBCI Program. As discussed in the audit report, the questioned cost of $6,750 was placed in a reserve account for a $225,000 loan that refinanced a line of credit made to the borrower by the same lender, which is a misuse of funds. The refinancing of an existing debt is prohibited by the Small Business Jobs Act of 2010 and *SSBCI Policy Guidelines*.

May 22, 2017

Theresa Cameron
Director, Financial Assistance Audits
United States Department of the Treasury
875 15th St. NW
Washington, DC 20005

RE: Management response to the OIG Audit Report of the Oregon SSBCI program

Dear Director Cameron,

Thank you for the opportunity to respond to the United States Department of the Treasury (Treasury), Office of Inspector General (OIG) audit of Business Oregon's State Small Business Credit Initiative (SSBCI) program, valued at approximately $16,600,000. We generally agree with the audit findings and have already taken steps to implement the recommendations included in the audit report.

Below you will find Business Oregon's management response to the following audit finding:

- ***Oregon Generally Complied with SSBCI Program Requirements and prohibitions but misused $6,750 by refinancing existing debt on a CAP Loan. The misuse of funds was neither "intentional" nor "reckless" because Oregon obtained lender assurance affirming the loan was not a refinancing of a previously made loan.***

The OIG audit determined that all administrative expenses reviewed were determined to be reasonable, allowable, and in accordance with SSBCI Policy Guidelines and the Office of Management and Budget Circular A-87. The review of 28 loans enrolled in the Capital Access Program (CAP), Credit Enhancement Fund (CEF), and Oregon Business Development Fund (OBDF) determined that 27 were found to be in compliance with SSBCI program requirements; one loan within CAP was determined to be out of compliance with program rules. This loan contributed $6,750 of the SSBCI allocation to a reserve fund for a $225,000 CAP loan that refinanced a line of credit made to the borrower by the same lender. The decision to use the SSBCI funds in this manner was made only after securing lender assurance affirming the loan was not a refinancing of a previous loan.

In January 2013, Business Oregon received an application from a lender requesting to enroll a $225,000 term loan in the State's CAP program. As accurately reflected in the Audit Report, the CAP application provided by the lender did not disclose the refinance of a loan previously made to that borrower by the same financial institution.

Business Oregon does require that the lender certify that the enrolled loan meets the terms and conditions of the program, source of funding, and that the information provided, including use of proceeds, is accurate at the time the loan is enrolled. As such, Business Oregon does not require that the

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Theresa Cameron
Director, Financial Assistance Audits
May 23, 2017

lender provide the lender's loan file at the time of application. In the event that a claim is submitted, Business Oregon does require that the lender provide sufficient documentation to allow for a comprehensive review of the transactions to ensure compliance prior to paying a claim using either SSBCI or State Funds.

Upon discovery and disclosure of the ineligible use of proceeds by the OIG audit, Business Oregon has taken the following steps to correct the error and comply with program requirements:

1. **Verify that $6,750 in SSBCI funds has been withdrawn from the prohibited loan and that the SSBCI account has been reimbursed for the same amount.**

Business Oregon has submitted notification to SSBCI Compliance of the Audit Finding and Recommendation to reimburse $6,750 to the SSBCI account. Business Oregon has submitted evidence to Treasury of the transfer of funds to replenish the SSBCI account in compliance with the recommendation.

2. **Request that Oregon amend its 2013 Annual Report and the appropriate Quarterly Report to reflect the un-enrolled loan.**

Business Oregon has submitted notification to SSBCI Compliance of the Audit Finding and Recommendation to unenroll the loan from the appropriate Annual and Quarterly Report. Once approved by SSBCI Compliance, SSBCI Reporting will be notified and Business Oregon will obtain verification that the appropriate adjustments have been made to the aforementioned reports.

Conclusion

Thank you for the opportunity to work together to review Oregon's compliance of program requirements and prohibitions with regard to Oregon's SSBCI allocation. We are committed to taking the feedback and recommendations that were provided and implementing them to maintain compliance with the SSBCI program regulations.

Sincerely,

Chris Harder
Director

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

June 15, 2017

Theresa Cameron
Department of the Treasury
Office of Inspector General
875 15th Street, NW
Washington, DC 20005

Dear Ms. Cameron:

Thank you for the opportunity to review the Office of the Inspector General's (OIG) draft report regarding Oregon's use of SSBCI funds (the Report). This letter provides the official response of the Department of the Treasury (Treasury). We are pleased with the Report's finding that Oregon generally complied with SSBCI program requirements.

It is our understanding that OIG transmitted a copy of the Report to Oregon program officials and they provided you with a response.

Regarding Recommendation 1, Treasury will work with Oregon to verify that the $6,750 in SSBCI funds is reimbursed to the SSBCI account.

Regarding Recommendation 2, Treasury will work with Oregon to amend its reporting.

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

Sincerely,

Kipp Kranbuhl
Deputy Assistant Secretary for Small Business,
Community Development and Housing

Under the State Small Business Credit Initiative (SSBCI), States, Territories, and eligible Municipalities (hereinafter referred to as States) were allocated funds based on formulas that measured the States' unemployment rates between 2007 and 2009. The Department of the Treasury (Treasury) disburses SSBCI funds allocated to each participating State in three increments referred to as tranches. The first tranche was disbursed upon Treasury's approval for participation in the SSBCI program. Disbursements of the second and third tranches are dependent upon the participating State's certification that it has obligated, transferred, or spent at least 80 percent of the previous tranche and has complied with all applicable program requirements.

Each participating State is required to designate specific departments, agencies, or political subdivisions to administer the funding. The State may distribute SSBCI funds to 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 State's designated entity. To ensure that funds are properly controlled and expended, the Act required that Treasury execute an Allocation Agreement with participants setting forth internal controls and compliance and reporting requirements before receiving SSBCI funds.

Nadine Forgenie, Audit Manager
Dennis B. Orsini, Auditor
Patrick Arnold, Referencer

Department of the Treasury

Deputy Secretary
Deputy Assistant Secretary for Small Business, Community Development, and Housing
Office of Strategic Planning and Performance Improvement
Office of the Deputy Chief Financial Officer, Risk and Control Group

Office of Management and Budget

OIG Budget Examiner

Business Oregon

Director

United States Senate

Committee on Agriculture, Nutrition, and Forestry
Committee on Appropriations
Committee on Banking, Housing, and Urban Affairs
Committee on the Budget
Committee on Finance
Committee on Small Business and Entrepreneurship

United States House of Representatives

Committee on Agriculture
Committee on Appropriations
Committee on the Budget
Financial Services Committee
Small Business Committee
Committee on Ways and Means

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