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|  | State of Rhode Island and Providence PlantationsOffice of Management and BudgetOFFICE OF INTERNAL AUDIT One Capitol HillProvidence, Rhode Island 02908-5889TEL #: (401) 574-8170 www.audits.ri.gov  |

September 26, 2019

Mr. Jesse Saglio

President

Rhode Island Commerce Corporation

315 Iron Horse Way, Suite 101

Providence, RI 02908

Dear Mr. Saglio:

The Office of Internal Audit has completed its limited scope performance audit of the Small Business Loan Fund Corporation (SBLFC). OIA reviewed SBLFC’s compliance with the Quasi-Public Corporations Accountability and Transparency Act as well as the efficiency and effectiveness of operations. The audit was conducted in conformance with the Institute of Internal Auditors (IIA) International Standards for the Professional Practice of Internal Auditing and by the authority given to the unit as stated in accordance with Rhode Island General Laws (RIGL) § 35-7.1-2(a) – Establishment of office of internal audit. The recommendations included herein have been discussed with members of management, and we considered their comments in the preparation of this report.

RIGL § 35-7.1-10(d), entitled Annual and interim reports, states that, “Within twenty (20) calendar days following the date of the issuance of the management-response copy of the draft audit report, the head of the department, agency, public body, or private entity audited shall respond, in writing, to each recommendation made in the audit report.” Accordingly, management submitted its response to the audit findings and recommendations on September 24, 2019, and such response is included in this report. Pursuant to this statute, the OIA may follow up regarding recommendations included in this report within one year following the date of issuance.

We would like to express our sincere appreciation to the SBLFC staff for the cooperation and courtesy extended to the members of our team during this audit.

Respectfully yours,

Dorothy Z. Pascale, CPA

Chief

c—Honorable William J. Conley Jr., Chairperson, Senate Committee on Finance

 Honorable Marvin Abney, Chairperson, House Finance Committee

 Internal Audit Advisory Group

 Steven Whitney, Senate Fiscal Office

 David Trembly, Senate Fiscal Office

 John Pagliarini, Chair, Small Business Loan Fund Corporation Board of Directors

**To Strengthen Controls, the Small Business Loan Fund Corporation should:**

**Audit Executive Summary**

**Why the Office of Internal Audit Did This Review**

Rhode Island General Law 42-155-7, Audit of quasi-public corporations, requires the Office of Internal Audit (OIA) to conduct a performance audit of all quasi-public corporations once every five years. The OIA established an initial five-year schedule; this audit of the Small Business Loan Fund Corporation (SBLFC) was performed in compliance with the statue and the established schedule.

The OIA conducted a limited scope audit of the SBLFC to review its compliance with the Quasi-Public Corporations Accountability and Transparency Act as well as evaluate whether operations were being administered efficiently and effectively and in accordance with applicable rules and regulations.

**Background Information**

The Small Business Loan Fund Corporation (SBLFC) provides small business with direct, fully secured loans up to $500,000 for working capital to existing manufacturing, processing, and selected service businesses.

The primary goal of the SBLFC is to act as a financing source to catalyze additional private sector capital formation and combine with other State financing and economic development programs to expand the high wage and job growth industry sectors of the State’s economy, e.g. health & life sciences, defense & national security, marine & environmental technology, information technology, and advanced manufacturing.

* Maintain required loan eligibility documentation.
* Comply with requirements of Quasi-Public Corporations Accountability and Transparency Act.
* Review, update, and approve policy manual timely
* Comply with annual loan review requirements.

Contents

[Introduction 4](#_Toc20723677)

[Recommendations and Management’s Responses 4](#_Toc20723678)

[Maintain Required Loan Eligibility Documentation 4](#_Toc20723679)

[Comply with Requirements of the Quasi-Public Corporations Accountability and Transparency Act 5](#_Toc20723680)

[Review, Update, and Approve Policy Manual Timely 7](#_Toc20723681)

[Comply with Annual Loan Review Requirements 7](#_Toc20723682)

[Objective and Scope 8](#_Toc20723683)

[Methodology 8](#_Toc20723684)

# Introduction

The Small Business Loan Fund Corporation (SBLFC) was created in 1986 by the Economic Development Corporation (EDC)[[1]](#footnote-1) as subsidiary pursuant to Rhode Island General Law (RIGL) §42-64 to assist small business growth in Rhode Island. Although SBLFC is governed by a Board of Directors (Board), the Rhode Island Commerce Corporation (“Commerce RI”) provides administrative support and office space to the entity. Commerce RI manages the administration, business and policy decisions of the financial service program to assure compliance with Board actions and policies.

The SBLFC provides small businesses with direct, fully secured loans up to $500,000 for working capital to existing manufacturing, processing, and selected service businesses. Additionally, manufacturers seeking to finance the acquisition of land, buildings, and equipment may qualify for loans in excess of $500,000. Interest rates are fixed, repayment terms are flexible, and there is an expectation that at least one job will be created for each $50,000 borrowed.

The primary goal of the SBLFC is to act as a financing source to catalyze additional private sector capital formation and combine with other State financing and economic development programs. In this effort, its goal is to expand the high wage and job growth industry sectors of the State economy, e.g. health & life sciences, defense & national security, marine & environmental technology, information technology, and advanced manufacturing.

# Recommendations and Management’s Responses

## Maintain Required Loan Eligibility Documentation

To be eligible for a Small Business Loan, the following eligibility requirements must be met:

* A pre-qualification form completed by the client and approved by SBLF management
* If eligible, the prospect submits a completed long form application and SBLF Underwriter conducts extensive due diligence and structures a loan in accordance with approved lending policy.

The loan policy manual states that the loan:

* Does not exceed the maximum amount of $500,000
* Is used for approved use -Plant, Property, Equipment or Working Capital
* Does not exceed the maturity and amortization limits as outlined in the loan policy
* Lending rates are in accordance with the financing policies
* Collateral requirements are in accordance with the financing policies.

In a sample of five of the nine loans issued during the audit period, one loan file did not include the required pre-qualification form.

Management did not maintain the required documentation for loan eligibility. Without the necessary documentation, the OIA is unable to verify that the loan met all eligibility requirements.

#### Recommendations:

1. Ensure required eligibility documentation is maintained.

*Management’s Response:* Loan eligibility under the SBLFC is established by Title 13 of the Code of Federal and Regulation and an Administrative Plan developed by staff which is presented and approved by the US Economic Development Administration (“EDA”) every 5 years (last approved by EDA on August 29, 2018). Neither *require* a pre-qualification form be completed in order to qualify for financing. The purpose of the form is not to verify that a loan meets all eligibility requirements. The policy of using a pre-qualification form stems from staff’s desire to have potential clients provide a “snapshot” of their financing request and allow staff to determine if the project *may* be a viable transaction based on answers on a short form rather than submitting a formal application which requires numerous documents and may be time consuming to the client and result in excessive unproductive work by SBLFC Staff. At times pre-qualification forms are submitted, a formal application is sent to a client for completion and the result is a denial of the funding request. The pre-qualification form does not replace any of the due diligence conducted by Administrators of the SBLFC. Completion of the form simply initiates the dialogue with a potential client. Eligibility for financing is only determined after a full, formal application is submitted, with all required documentation and SBLFC undertakes a comprehensive underwriting process. Approval of a loan is subject to a favorable vote by the Board of Directors of the SBLFC only after eligibility is verified and the request is recommended by an Administrator of the SBLFC at the conclusion of the due diligence and underwriting process.

 In the case of the one file which did not contain the pre-qualification form, the borrower was an existing client seeking additional capital. They had an established relationship with SBLFC which began in 2014, around the time the Pre-qualification process was established. It was not customary at that time to complete this form, nor would the completion of this form have verified that the loan met all eligibility requirements. It was established that the loan met all eligibility requirements when the request was presented at the completion of the due diligence and underwriting process and approved by the Board of Directors.

Note that loans may be structured in a form not specifically prescribed in the Administrative Plan. As an example, a loan may have a five-year maturity term with a seven-year amortization. This is acceptable provided board approval is obtained.

*Responsible Party: Not applicable*

#### Anticipated Completion Date: Completed prior to report issuance.

## Comply with Requirements of the Quasi-Public Corporations Accountability and Transparency Act

RIGL §42-155 Quasi-Public Corporations Accountability and Transparency Act (Quasi Act) establishes requirements that quasi-public corporations must follow to increase transparency of operations. The SBLFC is included as an entity subject to the Quasi-Public Corporations Accountability and Transparency Act. Therefore, amongst others, it must adhere to the following requirements:

* Adopting a list of performance measures
* Publishing a self-evaluation based on performance measurements at least once every three years
* Providing certain information directly, or via direct link, on its website.

The SBLFC did not provide documentation of identified performance measures for its mission as required by the Act. Further, there was no documentation provided to support a self-evaluation based on established measurements.

Finally, the SBLFC did not publish to its website all required information per RIGL §42-155-6. The following is not posted:

* Quarterly financial statements
* Capital improvement plans
* Strategic plan
* Quarterly contracting reports

The SBLFC could not provide all required documentation stipulated in the RIGL and does not have all required transparency information available to the public. As a result, the SBLFC is not fully adhering to the Quasi-Public Transparency Act requirements.

#### Recommendations:

1. Identify performance measures and establish monitoring procedures.
2. Publicly post all required information in compliance with 42-155-6.

*Management’s Response:* At a meeting of the SBLFC Board of Directors held on February 26, 2015 the board reviewed the Quasi-Public Transparency Act and adopted policies relating to the Act, including performance measures. Results of the performance of the program are captured in SBLFC’s semi-annual report which is submitted to the US EDA and The Strategic plan is contained within the Administrative plan of SBLFC.

 SBLFC does not maintain a website on which to publish information requested in the Act. SBLFC also does not have any activity to report regarding capital improvement plans or quarterly contracting, as these would be activities would be performed by the Rhode Island Commerce Corporation, of which SBLFC is a subsidiary. SBLFC does not prepare quarterly independent financial statements as the Accounting Department for the Rhode Island Commerce Corporation does not have the staffing capacity to compile and provide these and they are currently contained within the financial statements of the Rhode Island Commerce Corporation.

 Going forward, the SBLFC can work with the Rhode Island Commerce Corporation to create a link on its website to post information required by the Act relating to the SBLFC and indicate that it does not, and will not, have any activity to report regarding capital improvements or contract reports. It can also link to the financial statements of the Rhode Island Commerce Corporation.

*Responsible Party: SBLFC Operations Manager, Stacy* Farrell

#### Anticipated Completion Date: 12/31/19

## Review, Update, and Approve Policy Manual Timely

The SBLFC policy manual is established to define and reflect current operational processes. The policy manual is reviewed and approved by the Board. Policies are needed because they set a general plan of action used to guide desired outcomes and serve as a fundamental guideline to help decision makers. Policy review ensures the policies are current, consistent and effective, and therefore, timely review and approval is critical.

The SBLFC policy manual has not been updated or approved by the board since March 2014. Management did not ensure the policy manual was timely reviewed or approved. Processes defined in the policy manual may not reflect current processes performed in the operational environment if not reviewed and updated timely. In the event of turnover, there may be processes that are not performed in accordance with current practices and standards.

#### Recommendations:

1. Ensure policy manual is reviewed, updated, and approved annually.

*Management’s Response*: SBLFC’s Administrative Plan defines and reflects current operational processes. The plan is presented and approved by the Board of Directors prior to submitting to US Economic Development Administration (“EDA”) every 5 years (last approved by EDA on August 29, 2018). The SBLFC Board of Directors last approved this plan at a public meeting, held by the SBLFC Board of Directors on August 23, 2018.

*Responsible Party: Not applicable*

#### Anticipated Completion Date: Not applicable

*Auditor note: During field work the SBLA provided policy manual dated March 2014 not August 2018. Best practice is an annual review of policies and procedures. We believe the five-year requirement, although acceptable by federal regulation, is too long a period for review.*

## Comply with Annual Loan Review Requirements

The SBLFC is required per the policy and procedure manual to perform annual reviews for each loan and document the review details in the system. The annual review consists of a financial statement evaluation, follow up if required, as well as, completion of a review memorandum documenting the current loan amount and any changes to the business and/or collateral. In a sample of five loans, three (60%) did not have the annual loan review documentation on file.

The SBLFC is not complying with its annual loan review requirements defined in its policy manual. Without performing annual reviews, there is an increased risk that SBLFC would be unaware if businesses have fallen out of compliance with the SBLFC requirements defined in its policy after the loan was originally approved and underwritten.

#### Recommendations:

1. Comply with annual loan review requirements.

*Management’s Response:* The SBLFC Operations Manager requests Fiscal Year End (“FYE”) financial statements from all borrowers. Some borrowers are delinquent in providing financial statements and in some cases, it may take 10 to 12 months to receive the FYE statements if the company has filed an extension for their taxes. All credit files maintain a record of the requests made and additional correspondence regarding these requests via email is captured in SBLFC’s client management system, Salesforce.

In the case of the files that were reviewed, all missing annual reviews were to be performed by an Administrator who was moved to another department within the Rhode Island Commerce Corporation and no longer had access to files or the client management records. Additionally, one of the borrowers has yet to provide their financial statements. Also, the Administrator that SBLFC anticipated would take on the work load of the one departing was on an extended medical leave and has recently returned.

*Responsible Party: SBLFC Loan Underwriter / Administrator staff*

#### Anticipated Completion Date: 12/31/2019

# Objective and Scope

The Office of Internal Audit (OIA) conducted a limited scope audit of the Small Business Loan Fund Corporation for the period of January 1, 2018 through March 31, 2019. OIA reviewed SBLFC’s compliance with the Quasi-Public Corporations Accountability and Transparency Act and reviewed compliance with loan eligibility and underwriting terms as stipulated in policy. The objective of the audit was to determine if the SBLFC complied with the requirements of the Quasi-Public Corporations Accountability and Transparency Act and internal policy and procedures related to loan eligibility and administration.

# Methodology

As part of our audit work, the OIA gained an understanding of the SBLFC and its operations. To address our audit objective, we performed the following:

* Requested supporting information required by the Quasi Act
* Searched website for adequate transparency disclosures
* Reviewed loan underwriting process and terms
* Tested a sample of loans for the following:
	+ Required underwriting procedures
	+ Loan filing and disbursement documentation
	+ Loan pre-qualification and eligibility requirements
	+ Appropriate post-closing and annual review procedures
	+ Proper handling of delinquent loans

The results of this limited scope audit are communicated within this report. The OIA used an external audit firm, CliftonLarsonAllen, LLP (CLA), to supplement its staff during the performance of this audit. CLA performed the detailed audit work and was selected using a competitive bidding process.

1. Organization name changed during 2014 to Rhode Island Commerce Corporation, referred to as “Commerce RI.” [↑](#footnote-ref-1)