



May 18, 2009

Mr. Glenn Stober, Director  
Small Business Loan Guarantee Program  
California Business, Transportation,  
and Housing Agency  
980 Ninth Street, Suite 2450  
Sacramento, CA 95814

Dear Mr. Stober:

**Final Report—Agreed-Upon Procedures, Valley Small Business Development Corporation**

The Department of Finance, Office of State Audits and Evaluations (Finance), has completed its agreed-upon procedures review of the Valley Small Business Development Corporation's (Valley) compliance with the Small Business Loan Guarantee Program for the period July 1, 2006 through June 30, 2007.

The enclosed report is for your information and use. Valley's response to the report findings is incorporated in the report as well as our evaluation of the response. We appreciate Valley's willingness to implement corrective actions. The findings in the report are intended to assist management in improving the effectiveness and efficiency of its operations. In accordance with Finance's policy of increased transparency, the final report will be placed on our website.

We appreciate the assistance and cooperation of Valley's staff during the review. If you have any questions regarding this report, please contact Kimberly Tarvin, Manager, or John Rogers, Supervisor, at (916) 322-2985.

Sincerely,

Original signed by:

David Botelho, Chief  
Office of State Audits and Evaluations

Enclosure

cc: Ms. Debbie Raven, Chief Executive, Officer Valley Small Business Development Corporation  
Ms. Karen Kawada, Program Analyst, California Business, Transportation, and Housing Agency

AGREED-UPON PROCEDURES

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Valley Small Business  
Development Corporation

Small Business Loan Guarantee Program  
For the Period July 1, 2006  
through June 30, 2007

Prepared By:  
Office of State Audits and Evaluations  
Department of Finance

## **MEMBERS OF THE TEAM**

Kimberly Tarvin, CPA  
Manager

John Rogers, CPA  
Supervisor

Staff  
Kweku Atta-Mensah

Final reports are available on our website at <http://www.dof.ca.gov>

You can contact our office at:

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# INDEPENDENT ACCOUNTANT'S REPORT ON APPLYING AGREED-UPON PROCEDURES

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Mr. Glenn Stober, Director  
Small Business Loan Guarantee Program  
California Business, Transportation,  
and Housing Agency  
980 Ninth Street, Suite 2450  
Sacramento, CA 95814

The Department of Finance, Office of State Audits and Evaluations, performed the procedures enumerated below, which were agreed to by the California Business, Transportation, and Housing Agency (BT&H) to assist in evaluating Valley Small Business Development Corporation's (Valley) compliance with the Small Business Loan Guarantee Program (SBLGP). Valley's management is responsible for compliance with these requirements. This review covers the period July 1, 2006 through June 30, 2007.

This agreed-upon procedures engagement was conducted in accordance with the *Statements on Standards for Attestation Engagements* published by the American Institute of Certified Public Accountants. These standards require that we report all findings from the application of the agreed-upon procedures. For findings that include questioned costs, materiality was defined as items with errors or omissions of \$1,000 or more. The sufficiency of these procedures is solely the responsibility of the BT&H. Consequently, we make no representation regarding the sufficiency of the procedures described below either for the purpose for which this report has been requested or for any other purpose.

## **BACKGROUND**

The SBLGP was created by the Legislature to encourage lenders to provide funds to small businesses and farming enterprises that need additional collateralization in the form of a loan guarantee. The loan guarantees provide the following:

- Encourage the development of small business opportunities for minority, women, and disabled persons.
- Alleviate unemployment.
- Allow participation in state public works contracts by small and emerging contractors.

The SBLGP was established within the California Technology, Trade, and Commerce Agency (CTTCA) and administered by the Office of Small Business Loan Guarantee Program. The CTTCA created a Loan Guarantee Trust Fund (Fund) to collateralize the guarantees on loans to

small businesses made by local lending institutions. Under a contractual agreement with the CTTCA, which was subsequently transferred to BT&H, program administration and direction of certain Fund account transactions were assigned to eleven regional financial development corporations. Each corporation issues guarantees on behalf of the state and manages its share of the Fund and portfolio of outstanding guarantees.

Valley was established in October 31, 1977, and is one of the 11 regional financial development corporations. Valley's mission is to deliver educational and financial services to small businesses most in need in Fresno County and 10 county areas including Mariposa, Madera, Merced, Kern, Kings, Stanislaus, Tulare, and Tuolumne, Inyo and Mono. During the period July 1, 2006 through June 30, 2007, Valley claimed and was paid from the SBLGP \$488,050, which consists of \$125,000 for personnel costs including salaries, fringe benefits, payroll taxes, and facility expenses and \$363,050 in loan guarantee fees.

## **PROCEDURES PERFORMED AND RESULTS**

### **1. Verification of Allowable Costs**

#### **a. Operational Expenses**

Valley claimed \$125,000 for reimbursement of operational and administrative costs. To determine whether the costs claimed were allowable as stipulated in the contract, we performed the following procedures:

- Reviewed the grant agreement to identify authorized positions and allowable salary rates.
- Verified personnel expenses claimed were supported by payroll records and did not exceed the actual salaries paid.
- Determined that the fringe benefits claimed were supported by financial records and did not exceed the allowable amount.
- Reviewed the general ledger for facilities expenses to ensure expenses claimed were reasonable, and verified that the costs did not exceed the allowable amount in the contract.

Based on the procedures performed, the fringe benefits and facilities costs claimed are allowable, except for \$13,534 in ineligible salary expenses. See Finding 1 in the *Findings and Recommendations* section of this report for further details.

#### **b. Loan Guarantee Fees**

Valley claimed \$363,050 for loan guarantee fees based on 65 new loans issued at \$3,250 per loan and 66 in renewal loans at \$2,300 per loan. To verify that the loan guarantee fees claimed were allowable, we performed the following procedures:

- Identified the loan guarantees issued from the Monthly Loan Guarantee Registration Report.
- Reviewed a sample of borrower files, promissory notes, and Board of Directors and Loan Committee minutes to confirm that the loan was made and determined whether it was a new loan or a renewal.

- Recalculated the variable fees to determine whether the loan guarantee fees were accurately claimed.

Based on the procedures performed, we determined that the loan guarantee fees were accurately claimed and allowable.

## 2. **Contracting Practices**

We verified that contracting practices were appropriate by determining whether related-party relationships existed with contractors. Specifically, we performed the following procedures:

- Interviewed Valley's staff to gain an understanding of contracting practices.
- Reviewed the Statement of Economic Interest forms completed by Valley's staff and officers.
- Determined whether any of Valley's staff or officers reported any economic interest in any of the contractors.
- Reviewed the contract agreements and financial records to identify any transactions that indicate the existence of related-party relationships.

Based on the procedures performed, no related-party relationships were identified.

## 3. **Cost Allocation**

To determine whether Valley's cost allocation plan methodology was reasonable and appropriately applied, we interviewed staff and reviewed Valley's financial records.

We determined that Valley administers other programs and has developed a cost allocation plan to allocate costs to each of the programs. However, Valley overcharged the SBLGP \$13,534 in personnel and fringe benefit costs due to billing the state based on the contract budget amount instead of billing based on actual costs in accordance with Valley's cost allocation plan. See Finding 1 in the *Findings and Recommendations* section of the report.

## 4. **Record Maintenance**

To verify all required records are maintained, we performed the following:

- Interviewed Valley's staff to obtain an understanding of the records maintained.
- Reviewed the Loan Guarantee Program Database, Board of Directors and Loan Committee minutes, and loan portfolio records.

Overall, Valley maintained the required records. However, the Loan Guarantee Program Database is not updated when the corporation grants an extension to a line of credit. See Finding 2 in the *Findings and Recommendations* section of the report.

## 5. **Collection Costs**

We interviewed staff and reviewed the general ledger and the Loan Guarantee Program Database to determine whether:

- Collection costs were charged correctly.
- Out-of-pocket costs were paid for each collection effort with the monies received by a single successful collection.

Based on the procedures performed, Valley did not incur any collection costs or receive any recoveries from loan defaults during the period July 1, 2006 through June 30, 2007.

## 6. **Timely Deposit of Recovery Funds**

To determine the length of time between the receipt of recoveries and when funds are forwarded to the trustee for deposit, we interviewed staff and reviewed the Loan Guarantee Program Database and the general ledger.

Based on the procedures performed, Valley did not receive any recovery funds during the review period July 1, 2006 through June 30, 2007.

## 7. **Accuracy and Reconciliation of Loan Guarantee Portfolio Records**

To determine whether the loan guarantee approval process is adequately documented and whether the portfolio records are accurate and reconcile with bank records, we performed the following procedures:

- Interviewed Valley's staff to obtain an understanding of the approval process for loan guarantees and records maintained.
- Reviewed a sample of loan guarantee files to evaluate the adequacy of the loan guarantee approval process documentation.
- Reviewed the Loan Guarantee Program Database to determine whether it was updated when an extension was granted to a matured line of credit.
- Determined whether the loan guarantee portfolio records were accurate and reconciled with bank records.

The loan guarantee approval process is adequately documented in the loan guarantee files. Valley receives periodic confirmation reports from lenders on the status of loans and reconciles the information provided to the Loan Guarantee Program Database. Any variance is resolved with the lender and reported to BT&H. However, the database was not updated when extensions were granted to matured lines of credit. See Finding 2 in the *Findings and Recommendations* section of the report.

## 8. **Monitoring of Collateral Holdings**

To determine whether Valley communicates the status of the collateral holdings and identify Valley's monitoring efforts, we performed the following procedures:

- Interviewed Valley's staff to identify communication and monitoring procedures.

- Reviewed lender confirmation reports to determine whether the information is reconciled to the Loan Guarantee Program Database.

Valley regularly communicates with the lenders, receives quarterly reports from the lenders for monitoring collateral holdings, and updates the Loan Guarantee Program Database accordingly.

## 9. Accounting Procedures

To determine whether Valley's accounting procedures are designed to prevent double billings and ensure the separation of duties are adequate, we performed the following procedures:

- Interviewed Valley's staff regarding the accounting processes.
- Reviewed the cash receipts, accounts payables, and SBLGP program invoice procedures.
- Reviewed Valley's organization chart.

Based on our review, most of Valley's bookkeeping duties, including the bank reconciliations, are performed by the Controller. In addition, the bank reconciliation is not reviewed and approved by another individual in the organization. This significant control deficiency increases the risk of errors and fraud occurring without timely detection. As a result, Valley's current accounting procedures are inadequate to safeguard state assets. See Finding 4 in the *Findings and Recommendations* section of this report.

## 10. Review of Independent Auditor's Report

We reviewed the single audit reports prepared by Valley's Certified Public Accountant (CPA) for the fiscal periods ending June 30, 2006 and June 30, 2007. Additionally, we reviewed the CPA's working papers to identify internal control weaknesses in the accounting procedures.

Our review of the audit reports and working papers did not identify any internal control deficiencies.

We were not engaged to and did not conduct an examination, the objective of which would be the expression of an opinion on compliance with SBLGP requirements. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

This report is intended solely for the information and use of BT&H, and is not intended to be and should not be used by anyone other than the specified parties. However, this report is a matter of public record and its distribution is not limited.

Original signed by:

David Botelho, CPA  
Chief, Office of State Audits and Evaluations  
(916) 322-2985

March 2, 2009

## FINDINGS AND RECOMMENDATIONS

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- FINDING 1**                      **Valley Over-claimed \$13,354 in Personnel and Fringe Benefit Costs**
- Condition:                      Valley claimed and was paid \$14,727 for the Commercial Loan Officer's services when only \$3,900 was eligible based on the cost allocation plan. The over-claimed costs total \$13,534 and include \$10,827 in salaries and \$2,707 in related fringe benefits. This occurred because Valley claimed the budgeted costs instead of the actual costs incurred and allocated in accordance with the cost allocation plan.
- Criteria:                              Contract Agreement, Exhibit B, Section 3 (C) indicates that the state agrees to compensate the contractor for actual costs that are supported by company financial records.
- Recommendation:              Develop procedures to ensure that personnel costs are charged to the SBLGP based on services provided and in accordance with the cost allocation plan. Furthermore, the costs must be supported by the accounting system and financial records. BT&H will make the final determination regarding the resolution of the ineligible costs.
- FINDING 2**                      **Loan Guarantee Program Database Is Not Updated When A Matured Line of Credit Is Extended**
- Condition:                              None of the ten extensions or modifications to lines of credit that we reviewed was reported in the Loan Guarantee Program Database. Without the information updates, BT&H cannot effectively monitor changes to existing loan contracts and ensure that the state's interests are protected.
- Criteria:                              SBLGP Policies and Procedures Manual, Section VI states that if an extension is granted, the existing database record shall have the maturity date and comments reported and updated in the system.
- Recommendation:              Ensure that the Loan Guarantee Program Database is timely updated to include all loan modification terms, agreements, and repayment dates.
- FINDING 3**                      **Inadequate Segregation of Duties over Key Accounting Responsibilities Increases the Risk of Loss of State Assets**
- Condition:                              The Controller performs the bank reconciliations, posts transactions to the accounting system, and maintains the accounting records. In addition, the bank reconciliations are not reviewed by another individual in the

organization. The lack of segregation of duties increases the risk of loss of state assets due to errors or fraud that may not be detected timely.

Criteria: Contract Agreement, Exhibit D, Section 10 requires that the Corporation's accounting system conform to generally accepted accounting principles, which include maintaining an adequate system of internal control.

Recommendation: Implement procedures to strengthen the internal control by ensuring that key accounting responsibilities are not performed by the same employee.



# Valley Small Business Development Corp.

*A Business and Financial Company*

March 27, 2009

Mr. David Botelho, Chief  
Office of State Audits and Evaluations  
Department of Finance  
300 Capitol Mall, Suite 801  
Sacramento, CA 95814

RE: Response to Audit/Agreed Upon Procedures

Dear Mr. Botelho;

Thank you for providing us a chance to respond to your findings in the draft of the review of Valley Small Business Development Corporation's compliance report of the Small Business Loan Guarantee Program for the period of July 1, 2006 through June 30, 2007.

Our comments and response is as follows:

Regarding Finding 1, Operational Expenses, we do not feel that we owe \$13,534 in what has been determined as ineligible salary expenses according to the review findings. These findings were based on timesheets that were designed to monitor FICA tax schedules and workman's compensation rates. They were not designed to be utilized for billings to the state for work performed under the contract. As you can see in the attached schedule, there was \$459,115.18 of salaries allocated to the Loan Guarantee Program that were not invoiced and paid by the state contract.

# Valley Small Business Development Corp.

Valley Small Business Development Corporation  
 Analysis of Salary Allocations  
 Fiscal Year July 1, 2006 to June 30 2007

GF DOF Audit Response

Employee	Position	Total Salaries and Wages Paid	Less Amount Allocated to Other Programs	Loan Guarantee Program		
				Amount Associated with the Program	Amount Invoiced Under the Contract	Amount Not Invoiced Under the Contract
M. Foley	President	162,437.50	(49,382.40)	113,055.10	13,635.00	99,420.10
G. Haney	Controller	114,354.10	(40,949.85)	73,404.25	9,273.00	64,131.25
D. Raven	Sr. Ag Loan Officer	120,854.10	0.00	120,854.10	20,182.00	100,672.10
S. Tom	Coml. Loan Officer	83,753.76	(779.16)	**82,974.60	10,024.39	72,960.21
R. Mostert	Coml. Loan Officer	75,449.92	(70,747.31)	**4,702.61	4,702.61	0.00
L. Caro	Clerical	1,416.67	0.00	1,416.67	0.00	1,416.67
I. Garza	Administrative Assistant	42,500.00	(23,368.75)	19,131.25	10,910.00	8,221.25
S. Foley	Asst Ag Loan Officer & Loan Closing Officer	48,531.74	(30,936.41)	17,595.33	16,364.00	1,231.33
B. Foley	Clerical	24,500.00	(16,640.00)	7,860.00	0.00	7,860.00
T. Dostalík	Admin/Database Clerk	39,500.00	(387.95)	39,112.05	5,455.00	33,657.05
G. Williams	Ag Assistant	25,330.00	0.00	25,330.00	0.00	25,330.00
T. Stangle	Asst Ag Loan Officer	23,950.76	0.00	23,950.76	4,909.00	19,041.76
S. Her	Loan Officer Intern	2,475.00	0.00	**2,475.00	0.00	2,475.00
S. Gribben	Ag Loan Officer	22,708.46	0.00	22,708.46	0.00	22,708.46
		<u>787,762.01</u>	<u>(233,191.83)</u>	<u>554,570.18</u>	<u>95,455.00</u>	<u>459,115.18</u>

An analysis of salaries and wages paid during the period in question, less amounts allocated to other programs, shows \$554,570.18 to be associated with the operation of the General Fund and the Farm Fund. Both these funds are involved with activities of the Small Business Loan Guarantee Program. Of this amount, only \$95,455.00 was invoiced to the state as salary expenses under the contract.

Included in the \$95,455.00 invoiced amount was \$14,727.00 for Commercial Loan Officer's services. The amount invoiced was split between two employees - R. Mostert and S. Tom. Not included in the invoiced amounts was an additional \$75,425.21 incurred as salaries for commercial loan officers and an intern.

The internal accounting records of Valley Small Business Development Corporation show all of the \$14,727.00 in question to have been allocated to R. Mostert. This is correct. It was. But, in the past, it was not necessary for accounting purposes to allocate this expense to any particular employee as the invoice was not based on the particular identity of the person filling the position, but rather on the position itself. The allocation to a particular employee was only used as a means of allocating FICA tax and workman's compensation insurance expense, and since these rates are the same for all employees, there was no accounting reason to change the allocation between employees as they rotated their duties between the Guarantee Program and other activities. At the beginning of the year, it was anticipated that R. Mostert would fill the position all year. When this service was rotated between him and an additional employee, there was no accounting purpose served by changing the allocation as labor costs, FICA tax and workman's compensation insurance expense would be the same either way.

This situation had no effect on the allocation of salaries between funds and to attempt to document the actual services of these two employees as relates to the Guarantee Program would serve no purpose other than creating additional work. The cost of services rendered the Guarantee Program would be the same either way. Services were rendered as per the contract and were invoiced correctly. This is so because we did not charge for actual costs, as this was far in excess of the contracted amount.

The Company elected to invoice the State for employee costs based on a constant amount per month rather than actual costs as a way to even out our revenue flow. If the Company had based its invoice on actual costs, the contracted amount would have been exhausted in the first few months. As we had more than enough qualified employee expenses, our election to forgo early invoicing is our prerogative. It was our choice to invoice in this manner to maintain a more even revenue stream.

Please Note: The billing invoices have been prepared historically in this fashion. Moving forward, if this accounting process needs to be readjusted, we will be glad to consider an alternative method for reporting purposes.

## *Valley Small Business Development Corp.*

Regarding Finding 2, Valley maintains a complete transaction history of each loan guarantee. However, the extensions had not been entered into the database. That over-site has been discussed with Karen Kawada at the state office and she suggested updating the extensions in the comments section. The database has been corrected and we will continually update the database from this point forward.

Regarding Finding 3, Valley's operational guidelines have been in effect since the beginning of our corporation. To date, we have had no instances of fraud. We have strict procedures in place such as the requirement of two signatures on every check, the CFO cannot sign on any bank account as well as the fact that he is not authorized to speak with any bank representative regarding our accounts. We have several checks and balances in place to minimize the potential for fraud and errors. We also participate in a full audit every year in which no material or adverse findings have been made to date. We will carefully consider other options to implement changes to reduce the potential risk of fraud or errors for the corporation.

I am hopeful that you will reconsider your comments in Finding 1. It is important to note that we successfully funded all of the loan guarantees allowed in our contract on a timely basis. We were able to accomplish that utilizing considerably more staffing than was billed for and compensated by the State. Your issue appears to be with the supporting time sheet documents internally prepared for other purposes for the individual loan officers, when in fact; those time sheets have never been audited under the state contract. I don't think that you can deny the fact that Valley has done a tremendous job in providing short and long-term capital to the small business and small farms in the San Joaquin Valley. We have done so utilizing the funding provided by the State contract but we also have devoted a substantial amount of our own capital to accomplish that reputation.

I look forward to your response and comments.

Sincerely,

Original signed by:

Debbie Raven  
President/CEO

## EVALUATION OF RESPONSE

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We received the Valley Small Business Development Corporation's (Valley) response to the report findings. The following is our evaluation of the response:

### **Finding 1—Valley Over-claimed \$13,354 in Personnel and Fringe Benefit Costs**

Valley disagrees with the finding and asserts that the disallowed costs were based on timesheets used to monitor payroll taxes, and that an additional \$459,115 in salary costs were incurred but not billed to the loan guarantee program. Finance disagrees. During the review, Valley provided financial documents supporting the personnel costs incurred on the Small Business Loan Guarantee Program and allocated in accordance with the cost allocation plan. Valley has not provided financial records supporting the \$13,354 in personnel costs charged to the program. Additionally, supporting records were not provided for the \$459,115 in program costs that Valley asserts were incurred but not billed. As a result, Finding 1 remains unchanged.

### **Finding 2—Loan Guarantee Program Database Is Not Updated When A Matured Line of Credit Is Extended**

Valley concurs with Finding 2 and has agreed to implement corrective action.

### **Finding 3—Inadequate Segregation of Duties over Key Accounting Responsibilities Increases the Risk of Loss of State Assets**

Valley disagrees with the finding and asserts that sufficient internal controls are in place to prevent fraud from occurring. Finance disagrees. When the same person completes the bank reconciliations and performs most of the accounting functions, the risk of fraud or significant errors increases. Therefore, Finding 3 remains unchanged.