



April 22, 2009

Mr. Glenn Stober, Director
California 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, California Coastal Rural Development Corporation

The Department of Finance, Office of State Audits and Evaluations (Finance), has completed its agreed-upon procedures review of the California Coastal Rural Development Corporation's (Corporation) Small Business Loan Guarantee Program for the period July 1, 2007 through June 30, 2008.

The enclosed report is for your information and use. The Corporation's response to the report findings are incorporated into this final report. The Corporation agreed with our findings, and we appreciate its willingness to implement corrective actions. The findings in our 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 the Corporation'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: Mr. Herb Aarons, President, California Coastal Rural Development Corporation
Ms. Karen Kawada, Program Analyst, California Business, Transportation, and Housing Agency

AGREED-UPON PROCEDURES

California Coastal Rural
Development Corporation

Small Business Loan Guarantee Program
For the Period July 1, 2007
Through June 30, 2008

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

MEMBERS OF THE TEAM

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

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(916) 322-2985

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INDEPENDENT ACCOUNTANT'S REPORT ON APPLYING AGREED-UPON PROCEDURES

Mr. Glenn Stober, Director
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 California Coastal Rural Development Corporation's (Corporation) compliance with the Small Business Loan Guarantee Program (SBLGP). The Corporation's management is responsible for compliance with these requirements. This review covers the period July 1, 2007 through June 30, 2008.

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 identified during the application of the agreed-upon procedures. For findings that include questioned costs, materiality was defined as 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.

The Corporation was established in 1982 and is one of the eleven regional financial development corporations. The Corporation's mission is to create and retain jobs and promote economic development within communities by assisting small businesses to obtain financing through local banks in the central coast area. During the period July 1 2007 through June 30, 2008, the Corporation claimed and was paid \$707,350, consisting of \$200,000 for personnel costs, fringe benefits, and rent expenses and \$507,350 in loan guarantee and direct farm loan fees.

PROCEDURES PERFORMED AND RESULTS

1. Verification of Allowable Costs

a. Operational Expenses

The Corporation claimed \$200,000 in reimbursement for 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 timesheets and payroll records, and that expenses claimed did not exceed the actual salaries paid.
- Analyzed the fringe benefits claimed to ensure that expenses claimed did not exceed the allowable amount in the contract.
- Verified that rent expenses were supported by the rental agreements and canceled checks.

Based on the procedures performed, we determined that the operational and administrative costs claimed are allowable.

b. Loan Guarantee Fees

The Corporation claimed and was paid \$507,350 for guarantee fees based on the issuance of 91 new loans at \$3,250 per loan and 92 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 Loan Committee minutes to confirm 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 and allowable.

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

2. Contracting Practices

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

- Interviewed the Corporation's staff to gain an understanding of contracting practices.
- Reviewed the Statement of Economic Interest forms completed by the Corporation's staff and officers to determine whether any of the Corporation's staff or officers reported any economic interest in any of the subcontractors.
- Reviewed the subcontract agreements and general ledger, to identify any transactions that indicate the existence of related-party relationships.

Based on the procedures performed, we did not identify any related-party relationships.

3. Cost Allocation

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

Based on the procedures performed, the Corporation's cost allocation plan methodology is reasonable and appropriately applied.

4. Record Maintenance

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

- Interviewed the Corporation's staff to obtain an understanding regarding the records maintained.
- Reviewed the general ledger, Loan Guarantee Program Database, Loan Committee minutes, and loan portfolio records.

Overall, the Corporation maintained the required records. However, the Loan Guarantee Program Database was not updated when recoveries occurred from loan defaults and when extensions were granted for lines of credit. See Finding 2 in the *Findings and Recommendations* section of this report for further details.

5. Collection Costs

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

- Collection costs are 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, we determined that the Corporation charges a \$25 administrative fee for collection costs that is deducted from the gross loan proceeds recovered.

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 and Guarantee Program Database, the statement of transactions from the trustee, and the general ledger.

Based on the procedures performed, we determined that the Corporation did not promptly forward \$9,729 in loan default recoveries to the state or trustee. See Finding 1 in the *Findings and Recommendations* section of this report for further details. In addition, the Corporation had not reported the loan default recoveries in the Loan Guarantee Program Database. See Finding 2 in the *Findings and Recommendations* section of this report for further details

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 the Corporation's staff to obtain an understanding of the loan guarantee approval process 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.

Based on our review, the loan guarantee approval process was adequately documented in the loan guarantee files. The loan portfolio records were accurate and reconciled with the bank records. The Corporation receives periodic confirmation reports from lenders on the status of loans and reconciles this information with the Loan Guarantee Program Database. Any variances identified during the reconciliation process are resolved with the lender and reported to BT&H. However, the Loan Guarantee Program Database was not updated when mature lines of credit were granted extensions. See Finding 2 in the *Findings and Recommendations* section of this report for further details.

8. Monitoring of Collateral Holdings

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

- Interviewed the Corporation'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.

The Corporation regularly communicates with the lenders and receives monthly updates on loan status, compares the information to the Loan Guarantee Program Database, investigates variances on loan status changes, and updates the Loan Guarantee Program Database accordingly. In addition, the Corporation performs regular on-site visits to the farms and businesses who have direct farm loans.

9. Accounting Procedures

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

- Interviewed the Corporation's staff regarding accounting processes.
- Reviewed the Corporation's organization chart and job descriptions for the staff.

The Corporation has an accounting procedures manual. Based on the Corporation's description of its accounting procedures through inquiry and observation, the Corporation's accounting procedures are adequate to prevent double billing including the adequate separation of duties for key accounting functions.

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.

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

March 9, 2009

FINDINGS AND RECOMMENDATIONS

FINDING 1 Loan Default Recoveries Were Not Timely Remitted

The Corporation did not promptly forward \$9,729 to the trustee for the following loan default recoveries:

- Recoveries made from two defaulted loans totaling \$5,253 occurred during July 26, 2006 through January 17, 2007, but were not received by the trustee until July 5, 2007.
- Recoveries made from several defaulted loans totaling \$4,476 occurred during August 9, 2007 through April 23, 2008, but were not received by the trustee until November 10, 2008.

This practice increases the risk that loan recoveries could be misappropriated without timely detection.

Criteria: Contract Agreement, Exhibit D, Section 17 (D) states that all funds received by the contractor totaling \$10,000 or more pursuant to a guarantee default shall be remitted within ten working days. The contract agreement also stipulates that funds totaling less than \$10,000, pursuant to the same guarantee default or payoff shall be remitted at least quarterly.

Recommendation: Implement procedures to ensure loan recoveries are remitted to the trustee within the timeframes stipulated by the Contract Agreement.

FINDING 2 Loan Guarantee Program Database is Not Updated to Reflect Recoveries or Extensions Granted on Lines of Credit

The Corporation did not update the Loan Guarantee Program Database for loan recoveries discussed in Finding 1. Furthermore, for seven loan modifications reviewed, the Corporation extended the maturity date on lines of credit, but did not record the extensions in the Loan Guarantee Program Database comments section. Without the information being entered into the Loan Guarantee Program Database, a risk exists that loan recoveries could be misappropriated without timely detection. Additionally, the Business, Transportation, and Housing Agency (BT&H) cannot effectively monitor changes to existing loan contracts without the loan extension information.

Criteria: The SBLGP Policies and Procedures Manual, Section 111 states that information pertaining to loan recoveries must be entered into the recovery section of the Loan Guarantee Program Database.

Additionally, Section VI states that if an extension is granted, the existing database record shall have the maturity date updated and comments entered.

Recommendation: Ensure that the Loan Guarantee Database is updated timely to include all recoveries, loan modification terms, and repayment dates.



CALIFORNIA COASTAL
RURAL DEVELOPMENT CORPORATION

March 31, 2009

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

**Re: Draft Report—Agreed Upon Procedures, California Coastal Rural
Development Corporation dated March 23, 2009**

Dear Mr. Botelho:

Thank you for your department's review of our procedures surrounding our Small Business Loan Guarantee Program for the time period of July 1, 2007 to June 30, 2008. Here are our responses to the "findings" therein:

Finding #1:

Loan default recoveries were not timely remitted.

Response to Finding #1:

Though the funds were ultimately remitted they were indeed outside the 10 day 1 quarter threshold. We agree with and understand this finding. There are now new procedures in place to meet these time requirements per the contract agreement. Your review helped us to better understand the time requirements surrounding remitting recovery payments to the Trust.

Finding #2:

Loan guarantee program database is not updated to reflect recoveries or extensions granted on lines of credit.

Response to Finding #2:

Due to staff turnover and workload prioritization we were not timely in our updating of the loan guarantee program database. We agree with and understand this finding. Again, your review provided us the opportunity to put in place new procedures and to better understand the requirements necessary to update the database in a timely manner per the SBLGP Policies and Procedures Manual, Section 111. The new procedures are now part of our monthly closing process.

In reviewing your report, we noted that in Item #9 "Accounting Procedures", it is stated that, "because the Corporation did not have accounting procedures manual we relied upon the Corporations description of its accounting procedures through inquiry and observation". Please note that we indeed do have an accounting policy and procedures manual which was adopted by our Board of Directors in 2001. Would you please reflect this fact in your report?

We hope our responses to the "findings" are sufficient. Should you have any questions, please feel free to contact us. Please convey our appreciation to the review staff for the insight, training, and guidance. We look forward to the same objective council in the future.

Respectfully,

Original signed by:

Herb Aarons
President