



# Audit Report



Report Number: OIG-SBLF-14-004R

STATE SMALL BUSINESS CREDIT INITIATIVE:  
West Virginia's Use of Federal Funds for Other Credit  
Support Programs

March 19, 2014

This Report was revised on July 2, 2015, to reflect changes made on pages 1, 2, 5, 6 and 7. The changes clarify the sample population of loans and investments tested and the amount of administrative costs that were reviewed by the Office of Inspector General as part of the 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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## Contents

Background .....	3
West Virginia’s Participation in SSBCI.....	3
West Virginia’s Other Credit Support Programs .....	4
West Virginia Generally Used Its SSBCI Funds Appropriately .....	5
Administrative Costs Charged to SSBCI Were Reasonable, Allowable, and Allocable .....	5
Management Comments and OIG Response .....	6
Appendix 1: Objective, Scope, and Methodology .....	7
Appendix 2: Management Response.....	9
Appendix 3: Major Contributors .....	12
Appendix 4: Distribution List .....	13

## Abbreviations

WVJIT	West Virginia Jobs Investment Trust
WVCAP	West Virginia Capital Access Program
National Standards	SSBCI National Standards for Compliance and Oversight
OCSF	Other Credit Support Programs
OIG	Office of Inspector General
OMB	Office of Management and Budget
SSBCI	State Small Business Credit Initiative
The Act	Small Business Jobs Act of 2010
CD	Certificate of Deposit

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*The Department of the Treasury  
Office of Inspector General*

March 19, 2014

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 West Virginia'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). Treasury awarded West Virginia approximately \$13.2 million<sup>1</sup> in September 2011, and as of September 30, 2013, the State had received all of its awarded funds. West Virginia has obligated or spent approximately \$12.3 million<sup>2</sup> of the funds disbursed, including approximately \$6.5 million<sup>3</sup> for the Seed Capital Co-investment Fund, \$797,000 for the West Virginia Collateral Support Program, \$5.2 million<sup>4</sup> for the Subordinated Debt Program and, \$139,723 for the West Virginia Loan Guarantee Program. The State also incurred \$181,784 in administrative costs.

Our audit objective was to test participant compliance with program requirements and prohibitions to identify any reckless or intentional misuse of funds. To test participant compliance, we reviewed a sample of 28 small business loans and investments, totaling approximately \$9.5 million<sup>5</sup> that were obligated or spent under the four approved State programs, as noted in the Allocation Agreement signed on November 18, 2011. Of the 28 loans and investments reviewed, 13 were from the Seed Capital Co-Investment Fund, 11 were from the Subordinated Debt Program, 3 were from West Virginia

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<sup>1</sup> Rounded up from \$13,168,350.

<sup>2</sup> Rounded down from \$12,339,500.

<sup>3</sup> Rounded down from \$6,537,257.

<sup>4</sup> Rounded down from \$5,212,409.

<sup>5</sup> Rounded up from \$9,469,000.

Collateral Support Program and 1 was from the West Virginia Loan Guarantee Program.

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

We reviewed the loans and investments to determine whether they complied with the Act and *SSBCI Policy Guidelines*. We interviewed management from the West Virginia Jobs Investment Trust (WVJIT) who administer, account for, and report on SSBCI funding. We also reviewed a sample of the State's administrative costs charged against SSBCI funds to ensure they were reasonable, allowable and allocable in accordance with the *SSBCI Policy Guidelines*, and Office of Management and Budget (OMB) Circular A-87, *Cost Principles for State, Local, and Indian Tribal Government*.<sup>6</sup>

We determined that West Virginia appropriately used the SSBCI funds tested and accurately reported its program activity to Treasury. Additionally, administrative costs in our sample charged to the SSBCI program as of June 30, 2013 were reasonable, allowable, and allocable.

We performed our audit from October 2013 to January 2014 in accordance with *Government Auditing Standards*. Those standards 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

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<sup>6</sup> Office of Management and Budget Circular Number A-87, revised May 10, 2004.

our audit objective, scope, and methodology is contained in Appendix 1 of this report.

## **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.

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 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 participating 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.

### **West Virginia's Participation in SSBCI**

On September 20, 2011, Treasury approved the state of West Virginia's application for participation in SSBCI, awarding it

approximately \$13.2 million.<sup>7</sup> The Allocation Agreement between West Virginia and Treasury was signed on November 18, 2011, and authorized use of the SSBCI funds for the WVJIT, which provides eligible businesses with investment funds through four programs; the West Virginia Seed Capital Co-investment Fund, West Virginia Collateral Support Program, Subordinated Debt Program, and West Virginia Loan Guarantee Program. The State designated the WVJIT to administer the approved state programs on behalf of the Office of the Governor. The SSBCI funds are held in escrow by the West Virginia Treasury's Office, then disbursed by the WVJIT to the investee upon approval of an investment.

In November 2011, Treasury disbursed the State's first allocation of approximately \$4.3 million.<sup>8</sup> The second and third allocations for approximately \$4.3 million<sup>9</sup> and \$4.5<sup>10</sup> million were disbursed in October 2012 and January 2013, respectively. As of June 30, 2013, West Virginia had obligated or expended approximately \$12.5 million<sup>11</sup> of the three allocations.

### **West Virginia's Other Credit Support Programs**

The WVJIT is the designated state agency for implementing, monitoring and reporting on SSBCI on behalf of the state of West Virginia. The WVJIT operates with a standing committee that reports directly to its Board of Directors. Through the Board, the State assists businesses that are creditworthy, but do not fit traditional lending models. As of June 30, 2013, the State had obligated or expended \$12.3 million in SSBCI funds on 55 loans/investments enrolled in its Other Credit Support Programs.

The West Virginia Seed Capital Co-Investment Fund was established to enable small businesses to obtain early stage venture capital financing. Under the program, the State contributes up to \$500,000 per individual company over the life of the investment.

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<sup>7</sup> Rounded up from \$13,168,350.

<sup>8</sup> Rounded down from \$4,345,556.

<sup>9</sup> Rounded down from \$4,345,555.

<sup>10</sup> Rounded up from \$4,477,239.

<sup>11</sup> Rounded down from \$12,521,284.

The Collateral Support Fund offered by the State augments the collateral of the borrower by up to 20 percent of the loan amount, with a maximum loan guarantee amount of \$250,000. The loan term will not exceed 3 years, regardless of the loan amount.

The State's Subordinated Debt Program has eight participating lenders who provide "gap" financing for businesses to purchase equipment, expand facilities, or obtain permanent working capital. The participating lenders fund up to 50 percent of the first lien holder loan amount, with a maximum of \$500,000 and a loan term ranging between 1 and 5 years. The Fund requires a \$1 for \$1 match from a private source. The loans, subordinate to the first lien holder, are secured with a promissory note and may have additional collateral. The borrower is obligated to pay back the principal and any interest on the funds.

Finally, the State's Loan Guarantee Program provides lenders guarantees of up to 20 percent on loans approved by private sources. Each guarantee is secured by a certificate of deposit (CD), held at the lending bank, whose term is normally 2 years, but can be extended up to a maximum of 5 years if the upfront leverage ratio is 10:1. The interest earned on the CD is paid directly to the SSBCI program participant. Once the CD has matured, the guarantee is no longer in effect.

### **West Virginia Generally Used Its SSBCI Funds Appropriately**

We determined that West Virginia complied with the Act and *SSBCI Policy Guidelines* for the 28 loans and investments we tested, and accurately reported its use of \$12.3 million in funds used.

### **Administrative Costs Charged to SSBCI Were Reasonable, Allowable, and Allocable**

Administrative costs charged to the SSBCI program totaling \$181,784 as of June 30, 2013, were reasonable, allowable, and allocable. Of the reported amount, \$106,810 was for payroll, \$56,358 was for



legal invoices, \$12,810 was for meeting and consulting expenses, and \$5,806 was for travel. We reviewed a sample totaling \$170,533, or 94 percent, of the administrative costs. West Virginia provided supporting documents, such as timesheets, expense reports, and invoices, for the sampled administrative costs charged to the SSBCI program. We determined all sampled costs were in accordance with *SSBCI Policy Guidelines* and OMB Circular A-87.

Our reconciliation of administrative costs to the quarterly reports also showed that the costs did not exceed allowable amounts per the State's SSBCI Allocation Agreement.

### **Management Comments and OIG Response**

We provided a draft of this report to Treasury on February 21, 2014, and received formal written comments on March 14, 2014, in which Treasury and West Virginia officials concurred with the report's findings. Both also stated they were pleased the audit found that West Virginia accurately reported its use of SSBCI funds and complied with the Act and *SSBCI Policy Guidelines*. We consider management's comments to be responsive to the report findings and conclusions. Formal written responses from Treasury and the state of West Virginia 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

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## 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 June, 30, 2013, the state of West Virginia had received three disbursements totaling approximately 13.2 million.<sup>12</sup> Of the \$13.2 million, \$797,000 went to 4 loans enrolled in the West Virginia Collateral Support Program, approximately \$6.4 million<sup>13</sup> went to 35 investments in the Seed Capital Co-Investment Fund, approximately \$5.1 million<sup>14</sup> went to 15 loans enrolled in the Subordinated Debt Program, and \$28,000 went to 1 loan in the West Virginia Loan Guarantee Program.

To test compliance, we reviewed a sample of 28 loans/investments (3 from the West Virginia Collateral Support Program, 13 from the Seed Capital Co-Investment Fund, 11 from the Subordinated Debt Program and 1 from the West Virginia Loan Guarantee Program that were enrolled as of June 30, 2013.

We performed testing to ensure all of the sampled loans and investments complied with the requirements and prohibitions of the Act and *SSBCI Policy Guidelines*. Our review consisted of examining loan and investment files and comparing the documentation to specific requirements and prohibitions of the Act and *SSBCI Policy Guidelines*. We interviewed management designated by the state of West Virginia as responsible for administering, managing, accounting for, and reporting on the SSBCI programs. We reviewed policies, procedures, and other written guidance provided by West Virginia and the WVJIT. We also reviewed a sample of the State's administrative costs charged against SSBCI funds to ensure they were reasonable, allowable and allocable in accordance with the *SSBCI Policy Guidelines*, and Office of Management and Budget (OMB) Circular A-87, *Cost Principles for State, Local, and Indian Tribal Government*.<sup>15</sup> Our sample included all personnel costs and other select administrative costs.

We conducted our audit between October 2013 and January 2014, in accordance with *Government Auditing Standards*. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to

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<sup>12</sup> Rounded up from \$13,168,350

<sup>13</sup> Rounded down from \$6,407,500

<sup>14</sup> Rounded down from \$5,107,000

<sup>15</sup> Office of Management and Budget Circular Number A-87, revised May 10, 2004.

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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.

## Appendix 2: Management Response



DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

March 14, 2014

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 *West Virginia's Use of Federal Funds for Other Credit Support Programs* (the Report). This letter provides the official response of the Department of the Treasury (Treasury).

We are pleased with the Report's finding that West Virginia complied with all State Small Business Credit Initiative (SSBCI) program requirements. We also appreciate that the Report attributes West Virginia's success to appropriately using the funds for loan investments and accurately reporting its use of the \$12.3 million in SSBCI funds and complied with the Act and *SSBCI Policy Guidelines*. As part of Treasury's efforts to share successful program management practices among SSBCI participants, we will continue to encourage Participating States to create, design, implement, and manage their SSBCI allocation in the most responsible and professional manner.

Enclosed, please find a letter from the West Virginia SSBCI program concurring with the Report's findings. Thank you once again for the opportunity to review the Report. Treasury appreciates our work together throughout the course of the SSBCI program.

Sincerely,

Cliff Kellogg  
Director of the State Small Business Credit  
Initiative

Enclosure



## *West Virginia Jobs Investment Trust Board*

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March 11, 2014

Mr. Don Graves, Jr.  
Deputy Assistant Secretary for Small Business, Community Development and Housing Policy  
United States Department of Treasury  
1500 Pennsylvania Ave., NW  
Room 2313  
Washington DC 20220

Dear Mr. Graves:

Thank you for providing the State of West Virginia the opportunity to respond to the draft report titled "West Virginia's Use of Federal Funds for Other Credit Support Programs". The report is the summation of the audit performed by the OIG's office during the fourth quarter of 2013 and first quarter of 2014 specifically reviewing the West Virginia Capital Access Program's (WVCAP) four funds that were created and implemented using SSBCI program;

- Seed Capital Co-investment Fund
- Collateral Support Fund
- Subordinated Debt Fund
- Loan Guaranty Fund

In addition to reviewing the loan and equity funds, the OIG office also reviewed the administrative costs charged to the SSBCI program.

The State of West Virginia has worked extremely hard to create, design, implement, and manage their SSBCI allocation in the most responsible and professional manner, utilizing best practice standards so to comply with the U.S. Treasury's rigorous criteria and high expectations. To that end, we are proud and honored to learn that the OIG has determined West Virginia has appropriately used the funds for loan investments and accurately reported its use of the \$12.3 million in SSBCI funds and complied with the Act and SSBCI policy guidelines.

Mr. Graves, you should know that up until the SSBCI program was established these four programs did not exist in West Virginia. The SSBCI program provided our state, and the West Virginia Jobs Investment Trust Board (WVJITB) as program administrator, the opportunity to design and create credit and equity programs that simply were not available to small business owners in our state. With the support and guidance of the Governor's Office, WV Department of Commerce, Natural Capital Investment Fund, INNOVA, WV Small Business Development Center and Tech Connect, the WVJITB set out to establish a

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network of lending agencies in our state that had prior lending and investing experience to help deploy the funds in a professional and responsible manner. We now have a collaborative infrastructure whereby these groups work together to not only provide financing but to also assist entrepreneurs and small business owners with operational support in the area of business plan development, financial modeling, market research and legal expertise. These operational assistance efforts would not be possible without the financial support of the Claude Worthington Benedum Foundation who provided grants to WVCAP for these critical projects.

I would like to acknowledge the efforts of the OIG's audit team staff who worked closely with WVJITB staff to conduct the audit. The group was professional, courteous and responsive to our inquiries and efforts to support their review.

Lastly, I would be remiss if we did not acknowledge the tireless efforts of the U.S. Treasury's team to implement the SSBCI program. Mr. Kellogg, Ms. Love and her staff are to be commended for their efforts, guidance and professionalism in helping the State of West Virginia in designing a unique program that catered to the needs of our small business community. We did not make it easy on them, but they never wavered from their earnest and sincere desire to make this program a success from the very beginning.

Sincerest regards,



Andrew Zulauf  
Executive Director

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### Appendix 3: Major Contributors

Debra Ritt, Special Deputy Inspector General

Lisa DeAngelis, Audit Director

Joe Berman, Audit Manager

Kim McKeithen, Auditor-In-Charge

Safal Bhattarai, Auditor

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Karin Beam, Referencer

<p>The Office of Inspector General also acknowledges the contributions of the following individuals who worked on the revisions to the report: Susan Barron, Theresa Cameron, William Malloy, and Myung Han.</p>
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## Appendix 4: Distribution List

### Department of the Treasury

Deputy Secretary  
Office of Strategic Planning and Performance Management  
Risk and Control Group

### Office of Management and Budget

OIG Budget Examiner

### United States Senate

Chairman and Ranking Member  
Committee on Small Business and Entrepreneurship

Chairman and Ranking Member  
Committee on Finance

Chairman and Ranking Member  
Committee on Banking, Housing and Urban Affairs

Chairman and Ranking Member  
Committee on Homeland Security and Governmental Affairs

Chairman and Ranking Member  
Appropriations Subcommittee on Financial Services and General  
Government

### United States House of Representatives

Chairman and Ranking Member  
Committee on Small Business

Chairman and Ranking Member  
Committee on Financial Services

Chairman and Ranking Member



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Committee on Oversight and Government Reform

Chairman and Ranking Member  
Appropriations Subcommittee on Financial Services and General  
Government

**Government Accountability Office**

Comptroller General of the United States