DIVISION OF LOCAL GOVERNMENT AND SCHOOL ACCOUNTABILITY

REPORT OF EXAMINATION | 2021M-57

Washington County Local Development Corporation

Revolving Loan Program

JULY 2021

OFFICE OF THE NEW YORK STATE COMPTROLLER
Thomas P. DiNapoli, State Comptroller

Contents

Report Highlights

Washington County Local Development Corporation

Audit Objective

Determine whether Washington County Local Development Corporation (Corporation) officials provided adequate approval and oversight of the revolving loan program.

Key Findings

Corporation officials did not provide adequate approval and oversight of the revolving loan program:

- Six of the 11 loans reviewed were approved and paid but lacked required documentation of a commercial loan denial letter.
- The Director did not adequately follow up with seven of the 14 businesses in order to verify that funds were used for the approved purpose.
- Loan agreements do not have job creation or retention enforcement mechanisms.
- Business job creation and retention numbers were not verified.

Key Recommendations

Officials should:

- Ensure commercial loan denial letters are on file.
- Ensure businesses are creating and retaining jobs and using loan funds in compliance with the terms of the agreements.
- Develop written policies and procedures outlining the actions to be taken when job creation and retention goals are not met.

Corporation officials generally agreed with our recommendations and have initiated or indicated they planned to initiate corrective action.

Background

The Corporation was established in 1985 by the Board of Washington County (County).

The Corporation is governed by a 17-member Board of Directors (Board), composed of the County Board of Supervisors or their designee(s). The Board-appointed Executive Director (Director) is the chief executive officer and responsible for the day-to-day activities of the Corporation.

The Corporation has a seven-member Loan Review Committee (Committee) to review, approve and modify loans up to $150,000 from its revolving loan programs. Loans exceeding $150,000 are sent to the entire Board to review, approve and modify.

The County contracts with the Corporation annually to administer the revolving loan program.

Quick Facts	
Current Loans	42
Balance of Outstanding Loans	$3.1 million

Audit Period

January 1, 2019 – October 31, 2020

We extended our scope to January 1, 2018 to include loans that were written off due to non-payment.

Revolving Loan Program

Local development corporations (LDCs) are private, not-for-profit corporations often created by, or for the benefit of, local governments for economic development or other public purposes. LDCs are used to finance local government operations and projects. LDCs may be created pursuant to New York State Not-For-Profit Corporation Law, Section 1411 for various reasons including to promote and enhance employment opportunities.

The Corporation's mission is to stimulate economic development activities, retain and increase employment opportunities, encourage the expansion and growth of existing business and attract new business to the County through the provision of low interest loans to businesses. The Corporation has four revolving loan programs available to businesses in the County: an economic development loan fund, community development loan fund, microenterprise assistance program and intermediary relending program. Loan eligibility is dependent on loan amount requested, business size and intended use of the loan (e.g., equipment, property, renovations, etc.). The economic development loan fund, community development fund and microenterprise assistance program were capitalized in the early 2000s by funds received through the Community Development Block Grant program. To support the Corporation's mission, the County provides $80,000 annually to cover administrative expenses.

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How Should Officials Approve, Disburse and Monitor Loan Funds?

A board is responsible for ensuring loans are issued to eligible borrowers for allowable purposes, and that repayments are made in a timely manner according to loan agreements. Policies and procedures should be developed and adopted for approving, collecting, monitoring and enforcing loan agreements. These program policies and procedures should include eligibility requirements for applicants to participate in the program, as well as criteria for how the loan funds may be used. A board should only approve loans that meet both of these requirements.

According to Corporation officials, in order to obtain a loan from the Corporation, an interested business must complete an application and provide required documents outlined on the application checklist, including a description of the business's operations, proposed project, tax returns and credit report, among other items. Additionally, the business must provide a loan denial letter indicating they have been denied a loan from a commercial lender. Businesses located in an Empire Zone, or that have completed a business course provided by the Corporation for loans issued from the micro assistance program, are not required to provide a loan denial letter.

The Director works with the business to ensure they have all necessary documents. Once the application is complete, the business is charged a $150 application fee. The application then must be approved by the Committee if the loan is up to $150,000, or by the full Board if over $150,000.

After the approval process is complete, the Director prepares a loan term sheet for the business to accept and sign. The agreement outlines conditions such as what the project loan funds will be used for, the total amount of the loan, the date the funds are to be disbursed, how many jobs are to be created or retained, the terms of the loan, interest rate and monthly payment.

At the loan closing the business is required to pay the remaining closing fee. After the closing, the Corporation distributes the loan funds and files any liens on business property used as loan collateral, if appropriate, with the County Clerk and New York State Department of State. The loan checks are prepared by the Director and signed by two Board members. The Director then submits the required paperwork to the Corporation's bank to establish the loan in their system and send out the coupon book that has the payment due dates and payment amount.

As a best practice, the Director should follow-up with businesses to ensure loan proceeds are used as intended. The follow-up should at a minimum verify the proceeds were used as intended. Additionally, the Director should review records (e.g., payroll registers, year-end tax filings) to ensure promised job creation is fulfilled.

Officials Approved Loans That Lacked Commercial Lender Denial Letters

We reviewed the loan files for 14 businesses in our sample[1] with original loan amounts totaling $2.5 million. We found all loans had a completed application, had sufficient collateral pledged, received approval through the Committee and Board (if applicable) and were disbursed properly with the appropriate signatures. Additionally, the Corporation's counsel properly submitted all liens to the County Clerk and New York Department of State. However, six loans were approved without a commercial lender denial or commitment letters being submitted or considered prior to loan approval. According to the Director, she will verify with commercial lenders by telephone that a business was denied for a commercial loan; however she does not always obtain a formal denial letter as required by loan policy. By not following established policies for obtaining denial letters, the Board cannot be assured that loans are issued to only eligible borrowers for allowable purposes.

1 See Appendix C for information on our sampling methodology

Loan Payments for Loans Reviewed Were Adequately Enforced

Monthly loan payments are collected by the Corporation's bank, with collections reported to the Corporation through a loan statement detailing payments received and remaining balances. These statements include a record of all past due loans, the number of days the loan payment is past due and the balance past due. If a loan is delinquent, the Corporation's bank sends a notice after the borrower is 15 days late. If no payment is received, further notices are sent after 30 days, 60 days, and then again after 90 days. In addition, the Director receives notification of the initial delinquency from the bank and contacts the delinquent borrower to inform them of the payment delinquency. Delinquencies that continue past 30 days are referred to the Corporation's counsel for further action.

Requests by the borrower for adjustment to any of the terms and conditions of the loans will be reviewed by the Director and the Corporation's counsel to determine whether adjustments are in the best interest of the Corporation. Any such adjustment will require approval of the Committee or Board (if applicable) and the payment of a $100 modification fee.

We reviewed all payments from 12 businesses during our audit period to determine if payments were made in accordance with loan agreements. We obtained the borrower's loan payment transaction history from the Corporation's bank to verify that payments were made in a timely manner and according to loan agreements. We determined payments are generally made according to loan payments agreements and loan adjustments are approved by the Committee or Board (when applicable). For five businesses, we observed late payment penalties were properly assessed in all 24 instances loan payments were late. We found two instances where modifications had to be made and went into effect during the audit period and were approved by the Board.

Officials Did Not Adequately Follow Up on Loans

We found that the Director did not adequately follow up with businesses in order to verify that funds were used for the approved purpose after loan funds were disbursed. We examined the disbursement records for 14 businesses to determine how funds were disbursed.

While in some cases it was evident the funds were used for the approved purpose per the loan closing documentation (e.g., purchasing equipment or property), we found that for seven of the businesses with original loans totaling $1.3 million, there was a lack of documentation on how $487,000 of the loan funds were used. For example, one loan for $145,000 was to be used for working capital and property renovations and to purchase equipment. However, the Director could not provide any evidence of verification on how these funds were used, such as supporting invoices for equipment purchased. Without adequate verification, the Corporation has no assurance that the loan funds were used for approved purposes.

We also found that the Corporation does not have enforcement mechanisms in the loan agreements to ensure promised job creation or retention goals are met. Additionally, the Director did not adequately follow up with businesses to verify job creation and retention goals. Of the 14 businesses we reviewed, 12 pledged in their loan applications to create or retain 129 jobs; however, these 12 businesses self-reported the creation or retention of just 84 jobs (see Appendix A).

According to the Director, information on job creation and retention is collected annually from businesses by either making a site visit to the business to discuss their current employment numbers and complete a standard job creation/retention reporting form, or sending the form to the business for them to complete. However, the Director does not request or review any records to support businesses' self-reported job creation and retention numbers, such as payroll registers, quarterly payroll tax reports to the Federal or State taxing authorities or annual W2s issued to employees. The Director told us that she did not review those records because she was unsure what records she should review. Without an effective process for verifying job creation and retention, the Board cannot be assured that business are meeting their job creation and retention goals.

Without adequate verification, the Corporation has no assurance that the loan funds were used for approved purposes.

What Do We Recommend?

The Board should:

1. Follow established policies requiring all documents, including commercial loan denial letters, are submitted and considered prior to loan approval to ensure that loans are only issued to eligible borrowers for allowable purposes.
2. Establish a written policy for oversight of individual agreements including:
    - Obtaining reporting from businesses on jobs created and retained as required by agreements, ensuring loan funds are used for the approved purpose and ensuring the Director is monitoring compliance.
    - Requiring the Director to provide the Board with regular updates on the status of projects, including businesses' job creation and retention and whether loan funds are being used for approved purposes.
3. Develop enforcement mechanisms for loan agreements to ensure promised job creation or retention goals are met and loan funds are used for approved purposes.

The Director should:

4. Ensure appropriate documentation of a commercial loan denial is on file.

5. Follow up with businesses to ensure they are using funds for approved purposes and creating and retaining jobs in compliance with the individual agreements.

Appendix A: Summary of Projects Tested

Business Type & Loan Purpose	Loan Amount	Loan Denial Letter		Job Creation & Retention			
		Required	Provided	Pledged		Self-Reported	Variance
Manufacturing Expansion (Building Purchase)	$390,000	No	Not Required	Create	24	34	+10
Manufacturing Finance Move & Expansion	350,000	No	Not Required	Retain	26	16	-10
Restaurant Start-Up	300,000[a]	Yes	Yes	Create	21	1	-20
Eye Care Real Estate Acquisition/ Working Capital	250,000	Yes	Yes	Create	5	2	-3
Food Retail Business Acquisition (Retention)	235,000	Yes	No	Create Retain[b]	2 Not Stated	5	Unknown
Restaurant Property Purchase	150,000	Yes	No	Create	10	0	-10
Food Retail Renovations	150,000	Yes	Yes	Create Retain	3 9	0 5	-3 -4
Brewery Renovations/ Equipment/ Working Capital	145,000	Yes	Yes	Create	4	5	+1
Food Retail Expansion	140,000	Yes	No	Not Indicated[c]		0	0
Child Care Center Property Purchase/ Renovations	125,000	Yes	Yes	Create Retain	1 14	0	-15
Cleaning Service Start-Up (Equipment Purchase)	110,000	Yes	No	Create	2	4	+2
Food Retail Expansion	100,000	Yes	No	Create Retain	5 3	9 3	+4 0
Restaurant Start-Up	10,000	Yes	No	Not Required[d]			
Totals	**$2,455,000**				**129**	**84**	**-48**

a) The original application was for $300,000 with a pledge to create 21 jobs. The Board chose to break it up into two $150,000 loans but did not break out the 21 jobs between the two loans. Separate business names were used on the two loans, but they are owned by the same individual. The one employee at the time of reporting worked for both businesses.

b) The application indicated the business would retain the current staff but did not state how many staff they had at the time. In 2019 the business self-reported 5 current employees but did not break down the number retained or created.

c) The loan files did not indicate any pledged job creation or retention numbers.

d) Due to the loan type (Micro Assistance) there was no pledge of employee job creation or retention in the application, nor was one required.

Appendix B: Response From Corporation Officials

WASHINGTON COUNTY
Local Development Corporation

July 7, 2021

Gary G. Gifford
Chief Examiner
Office of the New York State Comptroller – Glens Falls Regional Office
Division of Local Government and School Accountability
One Broad Street Plaza
Glens Falls, New York 12801-4396

RE: Draft Audit Report 2021M-57

This letter is in response to the above referenced report received by the Washington County Local Development Corporation (WCLDC) on June 21, 2021. We have reviewed the report and are in the process of taking the following corrective actions in accordance with your office's recommendations.

Finding 1: Six of the 11 loans reviewed were approved and paid but lacked required documentation of commercial loan denial letter. Corrective action: the loan application checklist will include a line item for ensuring the loan denial letter has been received and is on file.

Finding 2: The director did not adequately follow up with seven of the 14 businesses to verify that the funds were used for the approved purposes. Corrective action: The WCLDC will formulate a policy to ensure that appropriate procedures are put in place to ensure loan proceeds are used in the appropriate manner. In situations where there is equipment being purchased with the loan proceeds the policy may include requiring an invoice be submitted for the equipment prior to release of funds.

Finding 3: Loan agreements do not have job creation or retention enforcement mechanisms. Corrective action: The WCLDC governance committee will work to establish requirements for enforcement mechanisms. While job creation is important, this is only one factor in evaluating the success of the business. The total performance of the loan recipient should be reviewed. Other factors such as business environment, owner efforts, being current on all loan payments or payables are important factors to include in the evaluation process. Once the policy is developed and put in place then loan agreements will be modified to reflect the policy.

Finding 4: Business creation and retention numbers were not verified. Corrective action: Loan documentation will be amended to include annual reporting of jobs numbers. The appropriate documentation will be requested in these annual reports. Subsequently during the annual site visits the director will verify these job numbers.

Sincerely,

Deanna L. Derway
President/Executive Director

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Appendix C: Audit Methodology and Standards

We conducted this audit pursuant to Article V, Section 1 of the State Constitution and the State Comptroller's authority as set forth in Article 3 of the New York State General Municipal Law. To achieve the audit objective and obtain valid audit evidence, our audit procedures included the following:

- We gained an understanding of the Corporation's revolving loan program and recording practices and reporting requirements by interviewing the Director, Board and Committee members and reviewing by-laws, policies and applicable source documentation.
- We used our professional judgement to select a sample of 14 approved loans to determine if the loan application was complete and all required supporting documentation was submitted, the applicant pledged an appropriate amount of collateral, a quorum of Committee and/or Board members, the loan was intended to support local economic development, the loan was for an eligible project/activity and post loan follow-up was completed. Additionally, we reviewed the disbursements to confirm they were for the amount of the approved loan. The sample of 14 loans included 11 current loans, two loans that were paid in full during the audit period and one loan that was written off during the audit period due to non-payment.
- From the original sample of 14 loans, we then reviewed payment history for all 12 loans that we expected regular payments for during the audit period. The remaining two business were not selected because they were either written off prior to our audit period or in the process of write-off due to business closure. To verify that loan payments were made in full and accurately recorded, we traced the payment of loans from the bank collection statement to the Corporation accounting records. We also verified loan modifications were made by the Committee and/or Board by reviewing Committee and Board minutes.
- From the original sample of 14 loans, we then reviewed the two loans that had modifications to the original loans. To determine if the Committee and/or Board approved the modification, we reviewed Committee and Board minutes.
- We selected the only loan that was written off due to non-payment and reviewed Board minutes to determine if the Board had authorized writing off the loan in the accounting records.

We conducted this performance audit in accordance with generally accepted government auditing standards (GAGAS). 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 objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

Unless otherwise indicated in this report, samples for testing were selected based on professional judgment, as it was not the intent to project the results onto the entire population. Where applicable, information is presented concerning the value and/or size of the relevant population and the sample selected for examination.

The Board has the responsibility to initiate corrective action. We encourage the Board to prepare a written corrective action plan (CAP) that addresses the recommendations in this report and forward it to our office within 90 days. For more information on preparing and filing your CAP, please refer to our brochure, *Responding to an OSC Audit Report*, which you received with the draft audit report. We encourage the Board to make the CAP available for public review.

Appendix D: Resources and Services

Regional Office Directory
https://www.osc.state.ny.us/files/local-government/pdf/regional-directory.pdf

Cost-Saving Ideas – Resources, advice and assistance on cost-saving ideas
https://www.osc.state.ny.us/local-government/publications

Fiscal Stress Monitoring – Resources for local government officials experiencing fiscal problems
www.osc.state.ny.us/local-government/fiscal-monitoring

Local Government Management Guides – Series of publications that include technical information and suggested practices for local government management
https://www.osc.state.ny.us/local-government/publications

Planning and Budgeting Guides – Resources for developing multiyear financial, capital, strategic and other plans
www.osc.state.ny.us/local-government/resources/planning-resources

Protecting Sensitive Data and Other Local Government Assets – A non-technical cybersecurity guide for local government leaders
https://www.osc.state.ny.us/files/local-government/publications/pdf/cyber-security-guide.pdf

Required Reporting – Information and resources for reports and forms that are filed with the Office of the State Comptroller
www.osc.state.ny.us/local-government/required-reporting

Research Reports/Publications – Reports on major policy issues facing local governments and State policy-makers
https://www.osc.state.ny.us/local-government/publications

Training – Resources for local government officials on in-person and online training opportunities on a wide range of topics
www.osc.state.ny.us/local-government/academy

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