

Finger Lakes Horizon Economic Development Corporation

Revolving Loan Fund Program

JULY 2022



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

Contents

- Report Highlights 1**

- Revolving Loan Fund Program 2**
 - How Should the Board Manage and Monitor Program Activities? . . . 2
 - The Board Did Not Adopt Policies and Procedures to Evaluate and Approve Loan Applications. 2
 - The Board Did Not Adequately Monitor Program Activity 4
 - What Do We Recommend? 5

- Appendix A – Response From Corporation Officials 7**

- Appendix B – OSC Comment on the Corporation’s Response 10**

- Appendix C – Audit Methodology and Standards 11**

- Appendix D – Resources and Services 13**

Report Highlights

Finger Lakes Horizon Economic Development Corporation

Audit Objective

Determine whether the Finger Lakes Horizon Economic Development Corporation (Corporation) Board properly managed and monitored the revolving loan fund program.

Key Findings

The Board did not properly manage and monitor the revolving loan fund program. As a result, the Board cannot ensure the loan proceeds were used to further the Corporation's mission.

- Revolving loan fund activity was not adequately monitored to ensure loan recipients' performance goals were achieved. Officials requested follow-up information from loan recipients to verify job creation/retention goals but did not enforce these goals if not achieved.
- No practices were in place to ensure penalties were assessed when warranted.
- No formal written policies and procedures were in place for officials to monitor whether loan disbursements were used for their intended purposes.
- Clear, written guidance was not developed for loan project eligibility, how loan applications should be reviewed or approved, confirming loan funds were used for approved purposes and goals, or how collections should be enforced.

Key Recommendations

- Develop and adopt written policies and procedures governing the process for managing and monitoring the revolving loan fund program.

Except as specified in Appendix A, officials generally agreed with our recommendations and indicated they would take corrective action. Appendix B includes our comment on an issue raised in the Corporation's response.

Background

The Corporation was established as a local development corporation in Yates County (County) in 2010 by the Yates County Industrial Development Agency (YIDA). The purpose of the Corporation is to promote community and economic development and the creation of jobs for the County's residents.

The YIDA Board appointed themselves as the Corporation's seven-member Board of Directors (Board). The Board is responsible for the general management and oversight of the Corporation's operations.

The Corporation uses the YIDA's employees to handle the day-to-day operations, in exchange for a management fee.

Quick Facts

Loans as of December 31, 2021

| | |
|-------------------------------|----------------|
| Number | 19 |
| Outstanding Principal Balance | \$1.29 million |

Audit Period

January 1, 2020 – February 16, 2022. We extended the audit period back when necessary to review applications for current loans included in our sample.

Revolving Loan Fund Program

The Corporation's mission is to promote community and economic development and create jobs in both the non-profit and for-profit sectors for the County's residents. It accomplishes this by undertaking projects within the County for the purpose of relieving and reducing unemployment, bettering and maintaining job opportunities and encouraging the development of, or retention of, an industry in the County and lessening the burdens of government and acting in the public interest. Officials stated that their main focus is to establish and retain businesses.

The Corporation operates a revolving loan fund program to carry out this mission by providing low interest loans to businesses. The revolving loan fund is primarily funded by the YIDA through the assignment of its proceeds from a host agreement.

The Board relies on an appointed six-member loan review committee (committee) to review completed loan applications and provide recommendations to the Board for approval. The committee includes the Board Chairman and the YIDA Chief Executive Officer. The YIDA's Director of Business and Community Development (Director) attends and records the committee minutes.

How Should the Board Manage and Monitor Program Activities?

A board is responsible for evaluating and approving loan applications which will achieve the program's performance goals and mission. A board should also develop written policies and procedures governing such things as the process for submitting, reviewing and approving loan applications, disbursing funds, depositing loan payments, charging late payment fees, handling loan defaults and renegotiating loan terms. It is essential for a board to monitor the program to ensure each loan recipient's performance goals are achieved and that the program's overall mission is achieved each year.

The Board Did Not Adopt Policies and Procedures to Evaluate and Approve Loan Applications

The Board did not adopt written policies and procedures to manage and monitor the revolving loan fund program. As a result, officials used informal procedures for:

- Loan application submission,
- Payment of the application fee,
- Evaluation criteria for loan application review and approval,
- Disbursing funds,
- Depositing loan payments,
- Charging late payment fees,

It is essential for a board to monitor the program to ensure each loan recipient's performance goals are achieved. ...

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- Handling loan defaults,
 - Renegotiating loan terms, or
 - Performance measures for program monitoring.

Officials stated that while written procedures were not established, the Corporation follows consistent informal procedures for managing and monitoring the revolving loan fund program. In particular we noted loan applicants must complete a loan application and provide all the required documents outlined in the application. The Director keeps a record of submitted applications and reviews the application and supporting documentation to ensure it is complete before preparing a loan application packet that contains the loan application, supporting documentation and a summary that details the loan's intended purpose and amount, projected number of jobs created or retained, potential interest rate and repayment details that is provided to the committee for review. The Director does not provide applications he deems incomplete to the committee for review but does notify the Board if any incomplete applications were received in his monthly management report to the Board.

During our audit period, there were 10 applications submitted. The Director stated two of the eight applicants did not submit the necessary documentation, so he did not prepare application packets for the committee to review.

A \$250 application fee is required as stated on the application form. However, because the Board did not adopt written policies and procedures, the process for when and how this fee should be paid is not defined. As a result, some applicants paid the application fee at time of submission, while others waited until after the Director reviewed their applications. The Director stated that the application fee is due prior to presenting the loan application to the committee. During our review of six loan applications that were submitted to the committee, we identified one applicant did not pay the required application fee.

According to the Board Chairman, the committee meets when the Director notifies them that a completed application packet is ready for review. The committee evaluates the loan application packets using the "four C's of credit" (Character of the borrower, Capacity to repay, Capital assets of the business and Collateral to secure the loan) and determines whether the overall purpose fits the Corporation's goals. However, no documentation was provided on the metrics used to analyze each of the C's. For example, the targets that would be acceptable for credit scores of the principals, cash flow and liquidity measurements, capitalization and collateral expectations and whether background checks would be employed.

For those applications that the committee recommends for financing, the Director forwards the committee meeting minutes to the Board with the committee's recommendation, the application summary and any proposed loan terms. For

those applications that the committee does not recommend financing for, the Board is notified of this determination, but not provided the application packet to perform its own review and determination. The Director stated he calls and notifies the applicant that their request was denied and provides the reason why based on his attendance at the committee meeting. During our audit period, the committee recommended seven of the eight applications for approval to the Board.

Because the committee did not have formal Board-approved evaluation criteria, such as a certain number of jobs created, a specified percentage of business growth or developing new types of businesses or industries in the area, it could not adequately determine the intentions of the Board during its review of applications and subsequent recommendations.

Upon Board approval, the YIDA's Chief Financial Officer (CFO) and Director enter the Board-approved loan terms into a loan management software program to generate amortization schedules and track loan payments. The Director also provides the necessary information to the Corporation's attorney to prepare closing documentation and liens on collateralized property. The CFO prepares loan checks for disbursement prior to closing, which require two signatures. The CFO prepares monthly invoices for all borrowers, and the Corporation encourages borrowers to set up automatic loan payments by offering a reduced interest rate.

Without formal, written policies and procedures, the Board did not ensure the application submission, review and approval process were uniform for all loan applicants.

As of December 31, 2021, the Corporation had 19 loans outstanding totaling \$1.29 million. We reviewed applications for six of the 19 loans with a total principal amount of \$460,000. We found that applications were generally complete and had required supporting documentation on file.

The Board Did Not Adequately Monitor Program Activity

The Board did not adequately monitor the revolving loan fund activity to ensure performance goals were achieved by loan recipients. While officials monitored loans to ensure repayment occurred in a timely manner, there were not adequate practices in place to review job creation data to ensure jobs were created as stated per the loan application, or to assess penalties if not created. We noted that officials request employment data for completing the required annual report but do not seek recourse if loan recipients do not provide the information or are not meeting job creation/retention goals. Officials stated that while job creation information is included in the loan applications, this is not a primary metric used in

measuring performance, and that the Corporation's main goal with this program is attracting and retaining businesses within the County.

In addition, there were no formal written policies and procedures in place for officials to monitor whether loan disbursements were used for their intended purposes as approved by the Board. Officials stated that informal procedures are in place to accomplish this by filing liens on collateralized property and through physical inspection performed via site visits. However, there is no formal documentation of these visits or reports to the Board.

Lastly, the CFO prepares and the Board reviews monthly revolving loan fund, capitalization and aging reports, which identify delinquent loans and the amount and number of days in arrears. The Director reaches out to loan recipients identified as delinquent to determine the cause and will update the Board and committee if there is no response or payment so that officials can determine whether a renegotiation of the terms is beneficial. In the event the borrower continues to be delinquent, the Board will declare the loan in default, and absent any repayment attempt, officials will begin the collection process. As of December 31, 2021, the Corporation had three loans in default totaling \$57,464 and has started the collection process with its attorney.

Because the Board did not adopt written policies and procedures to monitor the revolving loan fund activity, the Board cannot ensure the loan proceeds were in furtherance of the Corporation's mission or that the process to enforce and renegotiate loans is uniform.

What Do We Recommend?

The Board should:

1. Develop and adopt written policies and procedures governing the process for submitting, reviewing and approving loan applications, disbursing funds, depositing loan payments, charging late payment fees, loan defaults and renegotiating loan terms.
2. Ensure the Board receives and reviews all applications, regardless of Director and committee review.
3. Ensure that officials collect all loan application fees.
4. Establish written criteria for evaluating loan applicants and document the loan review process including discussions and approvals.
5. Establish and document the process for the write-off of any loans in default.

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6. Develop enforcement mechanisms for loan agreements to ensure businesses fulfill their promised job creation and/or retention goals and use loan funds only for approved purposes.
 7. Properly monitor all active loans to ensure they are meeting job and program goals.

Appendix A: Response From Corporation Officials



June 15, 2022

Mr. Edward V. Grant, Jr.
Chief Examiner
Division of Local Government and School Accountability
The Powers Building
16 West Main Street, Suite 522
Rochester, NY 14614-1608

RE: Finger Lakes Horizon Economic Development Corporation 2022M-36 Audit

Dear Mr. Grant,

Please accept this letter of formal response to the Finger Lakes Horizon Economic Development Corporation Revolving Loan Fund Program Audit performed by your office from January through May of 2022. We received draft findings audit report on May 31st, 2022.

The FLHEDC is committed to providing the best service possible to our local community while adhering to all standards applicable to our agency. As we stated during the audit process and exit interviews, we are proud of the impact our loan program has had for our community and stand by our procedures as the results have been incredibly positive.

The following represents our response for each recommendation resulting from the audit.

Unit Name: Finger Lakes Horizon Economic Development Corporation

Audit Report Title: Revolving Loan Fund Program

Audit Report Number: 2022M-36

For each recommendation included in the audit report, the following is the corrective action taken or in process. Where corrective action has not yet taken place, we have included our plans for addressing each recommendation.

Audit Recommendation 1:

Develop and adopt written policies and procedures governing the process for submitting, reviewing and approving loan applications, disbursing funds, depositing loan payments, charging late payment fees, loan defaults and renegotiating loan terms.

FLHEDC Response:

We agree with this recommendation. We are in the process of finalizing written policies and procedures that will be adopted by the Board. Policies and procedures are currently documented within the loan

application. Currently all renegotiated loan terms go to the Board of Directors for formal approval. This procedure will remain.

Members of the Loan Review Committee have been formally adopted by the Board of Directors.

Audit Recommendation 2:

Ensure the board receives and reviews all applications, regardless of Director and committee review.

FLHEDC Response:

We disagree with this recommendation. It is Staff's responsibility to ensure an application is complete and determine if it is appropriate to present the loan request to the Loan Review Committee and ultimately to the Board of Directors.

See
Note 1
Page 10

Staff has and will continue to inform the FLHEDC Board of directors of applications received on a monthly basis. A spreadsheet is being developed that will document loan applications received and will acknowledge if the required attachments (tax returns, financial statements, financial projections, business plan, resumes, etc.) have been received. This spreadsheet will document where in the process each loan request is, when the request is presented to Loan Review Committee, if loan application fee has been received, etc. The spreadsheet will be provided to the Board of Directors each month for review allowing the Board to know where each applicant currently stands and request more information if necessary.

Audit Recommendation 3:

Ensure that officials collect all loan application fees.

FLHEDC Response:

We agree.

Audit Recommendation 4:

Establish written criteria for evaluating loan applicants and document the loan review process including discussions and approvals.

FLHEDC Response:

We currently document all loan discussions and approvals with Loan Review Committee minutes, which are shared with the Board of Directors. A new policy is currently being finalized that will provide written general policies, procedures and criteria for evaluating loan applicants, which will be formally adopted by the FLHEDC Board of Directors.

Audit Recommendation 5:

Establish and document the process for the write-off of any loans in default.

FLHEDC Response:

The process for the write-off of any loans in default is currently documented in the loan commitment letter and loan closing documents. We will formally document the default loan and collections process to be adopted by the FLHEDC Board of Directors.

Audit Recommendation 6:

Develop enforcement mechanisms for loan agreements to ensure businesses fulfill their promised job creations and/or retention goals and use loan funds only for approved purposes.

FLHEDC Response:

Processes are currently in place to ensure businesses use loan funds for approved purposes. Where appropriate, UCC filings are legally filed on equipment purchased and securing the assets of the business. Where appropriate, secondary mortgages will be filed for property/real-estate acquisitions and site visits are completed for renovations.

We would like to point out that job numbers are projected by the businesses, not promised. We already conduct annual client audits for active FLHEDC loans requiring loan recipients to submit total payroll hours for the year along with completed NYS-45 forms as backup documentation. Those job creation numbers are inputted into the NYS PARIS system annually. A section outlining our job monitoring process will be included within the new FLHEDC loan policy currently being finalized.

Audit Recommendation 7:

Properly monitor all active loans to ensure they are meeting job and program goals.

FLHEDC Response:

We do properly manage active loans and ensure they are meeting our job and program goals which is to help businesses create jobs and make capital investments in Yates County. According to ACT Rochester, Yates County has led the 9-county Rochester/Finger Lakes Region in percentage growth of total new business establishments, total job growth, manufacturing job growth, median household income and poverty reduction among other key economic metrics. Our loan fund has played a significant role in that growth.

We will have discussions with the Board of Directors on editing our mission statement to match our general strategy of focusing on the larger picture of creating and attracting new businesses to Yates County and helping existing businesses grow.

Please do not hesitate to contact me with any questions you have on our response to the draft findings report.

Sincerely,

Stephen G. Griffin
CEO
Finger Lakes Economic Development Center

Appendix B: OSC Comment on the Corporation's Response

Note 1

While the process noted is adequate, the committee and its responsibilities were not formally established by the Board, nor has the Board formally relinquished its duties for reviewing applications for completeness and adequacy to YIDA staff or the committee.

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 interviewed Corporation Board members, committee members and YIDA officials and reviewed Board meeting minutes and monthly reports to the Board to gain an understanding of the Corporation's revolving loan fund program.
- We reviewed and evaluated the Corporation's bylaws and articles of incorporation to determine the intended purpose of the revolving loan fund program.
- We reviewed the Corporation's Board-adopted policies and procedures as well as the universal loan application form to identify any established criteria for evaluating loan applications.
- We randomly selected five loans using a random number generator and judgmentally selected the one emergency loan of the 19 active loans with outstanding balances totaling \$1.29 million as of December 31, 2021, to review and assess the loan application and approval process. The total outstanding principal for the six loans we reviewed was \$317,809. We also reviewed UCC filings for two of the loans reviewed to determine if liens on collateralized property were filed.
- We inquired with officials about loan applications that were submitted, deemed incomplete and denied during the approval process, and the process for handling delinquent loans and monitoring loans for performance goals and intended use of loan funds.
- We reviewed payroll reports and annual disclosure forms filed by select loan recipients in 2020 and 2021 to determine if job information was being reported.

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 the plan 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

www.osc.state.ny.us/files/local-government/pdf/regional-directory.pdf

Cost-Saving Ideas – Resources, advice and assistance on cost-saving ideas

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

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

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

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