



Audit Report



Report Number: OIG-SBLF-14-013R

STATE SMALL BUSINESS CREDIT INITIATIVE:
North Dakota Mandan Consortium's Use of Federal Funds
for its Loan Participation Program

August 29, 2014

This Report was revised on June 26, 2015, to reflect changes made on pages 2, 3, 5, and 8. The changes correct the number and total dollar amount of State Small Business Credit Initiative obligated or spent loans we reviewed. These corrections do not affect the findings, conclusions, and recommendations as reported.

Office of Inspector General

Department of the Treasury

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Abbreviations

The Act	The Small Business Jobs Act of 2010
CDC	Certified Development Company
LPP	Loan Participation Program
Mandan	North Dakota Mandan Consortium
National Standards	<i>SSBCI National Standards for Compliance and Oversight</i>
OIG	Office of Inspector General
OMB	Office of Management and Budget
SBA	Small Business Administration
SSBCI	State Small Business Credit Initiative
Treasury	Department of the Treasury

*The Department of the Treasury
Office of Inspector General*

August 29, 2014

Ms. Jessica Milano
Deputy Assistant Secretary for Small Business, Community
Development, and Housing

This report presents the results of our audit of the state of North Dakota Mandan Consortium's (Mandan) 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). The Department of the Treasury (Treasury) awarded Mandan approximately \$9.7 million¹ in SSBCI funds in June 2012, and as of March 31, 2014, Mandan had received all of the awarded funds. As of March 31, 2014, Mandan had obligated or spent approximately \$8.9 million² of the funds disbursed, all in Mandan's Loan Participation Program (LPP). The State also incurred \$194,101 in administrative costs, which brings total funds used to \$9.1 million.³

The Act requires Treasury's Office of Inspector General (OIG) to conduct audits of the use of funds made available under SSBCI and identify any instances of reckless or intentional misuse. Treasury has 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 from or a willful disregard of 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.

¹ Rounded down from \$9,710,768.

² Rounded down from \$8,943,872.

³ Rounded down from \$9,137,974.

Our audit objective was to test participant compliance with program requirements and prohibitions to identify any reckless or intentional misuse of funds. To accomplish our objective, we reviewed 13 loans totaling approximately \$7.4 million⁴ in SSBCI funds, which were obligated or spent under the approved Mandan program from the signing of the *Allocation Agreement* on August 31, 2012, to March 31, 2014. Of the 13 loans reviewed, all were from the LPP, as Mandan allocated all of its SSBCI funds to that program.

We reviewed the loans to determine whether they complied with program requirements for use-of-proceeds, capital-at-risk, and other restrictions in the Act, *SSBCI Policy Guidelines*, or the *SSBCI National Standards for Compliance and Oversight* (National Standards). We also reviewed all of the \$194,101 in administrative costs Mandan charged against SSBCI funds to ensure they were allowable, reasonable, and allocable in accordance with *SSBCI Policy Guidelines* and Office of Management and Budget (OMB) Circular A-87, *Cost Principles for State, Local, and Indian Tribal Government*.

We performed our audit from April 2014 to August 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.

Results in Brief

We determined that Mandan properly used the \$7.4 million in SSBCI funds we reviewed. Of that amount, \$2.8 million⁵ financed bridge loans to businesses approved for the Small Business Administration (SBA) Certified Development Company (CDC)/504 loan program. Because the SSBCI-supported loans provided interim financing until

⁴ Rounded down from \$7,429,872.

⁵ Rounded down from \$2,827,644.

the SBA loans could be secured, the transactions were permissible under the *SSBCI Policy Guidelines*. However, Treasury's reporting of estimated jobs created or retained as a result of the interim SSBCI loans may duplicate data reported by the SBA loan program.

OIG previously noted its concern about duplicate reporting of SBA and SSBCI job creation in a report about the audit of Idaho's SSBCI program.⁶ In its management response to the Idaho report, Treasury proposed that it would explain clearly in the *Summary of States' Annual Reports* that there is a possibility for duplicate reporting of job creation and retention figures. We found Treasury's response to our Idaho audit report responsive to our concerns in Mandan as well.

We also reviewed the administrative costs that Mandan charged to SSBCI, which totaled \$194,101 as of March 31, 2014. We found the expenditures were reasonable, allowable, and allocable in accordance with *SSBCI Policy Guidelines* and OMB Circular A-87.

Treasury and Mandan officials concurred with the report findings. Treasury also expressed appreciation that our report noted Mandan's success in appropriately using and accurately reporting its use of the \$7.4 million in SSBCI funds. Formal written responses from Treasury and Mandan are included in their entirety in Appendix 2.

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 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. Other credit support programs include collateral support, loan participation, loan guarantee, direct lending, and venture capital programs.

⁶ OIG-SBLF-14-010, *Idaho's Use of Funds for its Collateral Support Program*, May 15, 2014.

Each participating state is required to designate specific departments, agencies, or political subdivisions to administer the funds. 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 participating 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 certify that it has complied with all applicable program requirements.

Mandan Consortium's Participation in SSBCI

Municipalities in North Dakota had permission to apply for SSBCI funds because by November 27, 2010, no state agencies had filed a notice of intent to apply for funds, as required in order for a state to be eligible for SSBCI funding. A consortium of 38 municipalities, led by the City of Mandan, North Dakota, applied for SSBCI funds. On June 28, 2012, Treasury approved the Mandan Consortium's application for participation in SSBCI, and awarded it approximately \$9.7 million. The *Allocation Agreement* between the Mandan Consortium and Treasury was signed on August 31, 2012, and authorized use of the SSBCI funds to support Mandan's LPP. In August 2012, Treasury disbursed Mandan's first allocation of approximately \$3.2 million,⁷ and in July 2013, Treasury approved a second allocation, equal to the first, after Mandan certified it had expended or obligated over 80 percent of its first disbursement.

⁷ Rounded down from \$3,204,553.

In January 2014, Treasury approved a third allocation of approximately \$3.3 million⁸ after Mandan certified it had obligated over 80 percent of its second disbursement. As of March 31, 2014, Mandan had obligated or expended approximately \$9.1 million of the 3 allocations.

Mandan Consortium's Loan Participation Program

Mandan designated the Lewis and Clark Regional Development Council, a non-profit entity, to administer, account for, and report on the approved LPP on behalf of and in conjunction with the City of Mandan Business Development and Communications Department. The LPP assists borrowers in financing start-up costs, working capital, business procurement, franchise fees, equipment, and inventory, as well as the purchase, construction, renovation, or tenant improvements of an eligible place of business. In the LPP, a lender originates a senior loan and the SSBCI funds provide for a second, subordinate loan to the same borrower.

The Mandan Consortium Used Funds Appropriately, but Financed Loans that May Cause Duplicate Reporting of Benefits from an SBA Loan Program

We determined that Mandan properly used the SSBCI funds we reviewed. All 13 transactions reviewed complied with program guidelines related to use of proceeds, capital-at-risk, maximum transaction amounts, and other restrictions noted in the Act and *SSBCI Policy Guidelines*. Mandan also collected complete borrower and lender assurances.

However, we identified 5 bridge loans totaling approximately \$10.2 million⁹ and supported by \$2.8 million¹⁰ in SSBCI funding that provided interim financing of real estate acquisitions, construction projects, or equipment purchases that had been approved for the SBA

⁸ Rounded down from \$3,325,535.

⁹ Rounded down from \$10,201,382.

¹⁰ Rounded down from \$2,827,644.

CDC/504 loan program. SBA's CDC/504 loan program provides small businesses with long-term, fixed-rate financing to acquire major fixed assets, such as equipment or real estate. Under the CDC/504 program, a CDC provides the borrower two loans – one secured from a private lender and one from the CDC that is backed by a 100-percent SBA-guaranteed debenture. Interim financing is typically needed to bridge the period between SBA approval of the project and replacement of the interim financing with a permanent debenture.

As we noted in our audit of Idaho's SSBCI Collateral Support Program, "*SSBCI Policy Guidelines* explicitly prohibit the enrollment of SBA-guaranteed loans in states' SSBCI programs. However, Treasury officials stated that an SSBCI-supported bridge loan is permitted because the SBA-supported loan would repay the loan supported by SSBCI funding. Therefore, SBA does not support the transaction at the same time as the SSBCI-supported loan."

Additionally we found in Idaho "that the SBA CDC/504 loan program and SSBCI have similar goals of helping small businesses and manufacturers create and maintain jobs, and both programs report these job statistics as program accomplishments. All SSBCI participants are required to annually report the borrower's estimate of jobs created and jobs retained with SSBCI funding. Treasury reports these estimates annually as a summary of states' annual reports. Businesses assisted by the CDC/504 program must create or retain one job for every \$65,000 provided by the SBA, and small manufacturers must create or retain one job for every \$100,000 guaranteed by the SBA. Therefore, Treasury's reporting of jobs created or retained by recipients of SSBCI-supported loans may duplicate the accomplishments reported by the SBA."

In its management response to the Idaho report, Treasury proposed that it would explain clearly in its summary of states' annual reports that there is a possibility of duplicate reporting of job creation and retention figures. As in the Idaho report, we consider Treasury's proposed action to be responsive to our concerns in Mandan.

Administrative Costs Charged to SSBCI and Reviewed by OIG Were Reasonable, Allowable, and Allocable

Our review of all \$194,101 in SSBCI funds expended by Mandan for administration of its SSBCI programs as of March 31, 2014, found that they were reasonable, allowable, and allocable in accordance with OMB Circular A-87. Section 4.2 of the North Dakota Mandan *Allocation Agreement* states that the participating municipality shall only use the allocated funds for the purposes and activities specified in the agreement and for paying allowable costs of those purposes and activities in accordance with principles set forth in OMB Circular A-87. Mandan provided supporting documentation for the sampled administrative costs charged to the SSBCI program, which showed that all sampled expenses were allowable, reasonable, and allocable to the program.

Management Comments and OIG Response

We provided a draft of the report to Treasury on August 14, 2014, and received formal written comments from Mandan on August 19, 2014, and from Treasury on August 29, 2014, concurring with the report findings. Formal written responses from Treasury and Mandan 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 Clayton Boyce, Audit Director, at (202) 927-5642.

/s/

Debra Ritt

Special Deputy Inspector General for

Office of Small Business Lending Fund Program Oversight

Appendix 1: Objectives, 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 March 31, 2014, the North Dakota Mandan Consortium had received its three disbursements totaling approximately \$9.7 million¹ and had obligated or spent \$8.9 million.² All of the funds went to loans enrolled in the Loan Participation Program. Furthermore, \$194,101 was expended for the administration of the program.

To test compliance with SSBCI program requirements, we reviewed the 13 largest loans for which SSBCI funds had been obligated or spent as of March 31, 2014, and performed testing to ensure all of the loans complied with the requirements and prohibitions of the Small Business Jobs Act of 2010 and *SSBCI Policy Guidelines*. In June 2014, we conducted a review of loan files at our Washington, D.C., office and compared the documentation to specific requirements and prohibitions of the Small Business Jobs Act of 2010 and *SSBCI Policy Guidelines*.

We reviewed policies, procedures, and other written guidance provided by Mandan and the Lewis and Clark Regional Development Council. We also reviewed the State's administrative costs charged against SSBCI funds to ensure they were reasonable, allowable, and allocable in accordance with *SSBCI Policy Guidelines* and Office of Management and Budget Circular A-87, *Cost Principles for State, Local, and Indian Tribal Government*. We conducted our audit between April 2014 and August 2014, in accordance with *Government Auditing Standards*. 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 objectives. We believe that the evidence obtained to address our audit objectives provides a reasonable basis for our findings and conclusions.

¹ Rounded down from \$9,710,768.

² Rounded down from \$8,943,872.

Appendix 2: Management Response



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

August 29, 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 *North Dakota Mandan Consortium's Use of Federal Funds for its Loan Participation Program* (the Report). This letter provides the official response of the Department of the Treasury (Treasury).

We are pleased with the Report's finding that North Dakota complied with all State Small Business Credit Initiative (SSBCI) program requirements. We also appreciate that the Report noted North Dakota's success in appropriately using the funds for loans and accurately reporting its use of the \$8.6 million in SSBCI funds. 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 North Dakota Mandan Consortium 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,

A handwritten signature in black ink, appearing to read "Cliff Kellogg", enclosed in a rectangular box.

Cliff Kellogg
Director of the State Small Business Credit
Initiative

Enclosure



CITY OF MANDAN

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August 19, 2014

Ms. Jessica Milano
Deputy Assistant Secretary of Small Business, Community Development and Housing Policy
United States Department of Treasury
1500 Pennsylvania Avenue NW
Room 2313
Washington, D.C. 20220

Dear Ms. Milano:

Thank you for providing the Mandan, N.D. led consortium of municipalities with an opportunity to respond to the draft audit report titled "North Dakota Mandan Consortium's Use of Federal Funds for its Loan Participation Program." The report summarizes an audit performed from April 2014 to August 2014 by the Office of Inspector General.

The audit covered the loan participation program and administrative costs charged to the State Small Business Credit Initiative. The City of Mandan, in combination with the 37 other participating communities and the Lewis and Clark Regional Development Council, has worked hard to establish, promote, and manage the N.D. Opportunity Fund loan participation program created with the SSBCI allocation. We utilize several check and balances and best practice standards to comply with the U.S. Treasury's regulations and program expectations.

We are proud and honored to learn that OIG has determined the North Dakota – Mandan Consortium has appropriately loaned funds to small businesses and accurately reported administrative costs through March 31, 2014, to account for use of \$9.1 million committed through that date of the \$9.7 million total allocation.

We appreciate the work of the OIG audit team who worked closely with our staff and employees of the Lewis and Clark Regional Development Council to conduct the audit. We appreciated the audit team's professionalism in requesting documentation and thoroughness in their review.

The SSBCI program has given our 38 participating municipalities the opportunity to better support the start-up and expansion of businesses to serve our communities and state. It has allowed for creation of a loan program that complements private lending and meets the needs of a wide variety of small businesses. Thank you for the opportunity!

Sincerely,

Arlyn Van Beek
Mayor
City of Mandan

Appendix 3: Major Contributors

Debra Ritt, Special Deputy Inspector General

Clayton Boyce, Audit Director

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The Office of Inspector General also acknowledges the contributions of the following individuals who worked on the revisions to the report: Susan Barron, James Hodge, and Myung Han.

Appendix 4: Distribution List

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Appropriations Subcommittee on Financial Services and General
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