State of New York
Office of the State Comptroller
Division of Management Audit and State Financial Services

DEPARTMENT OF ECONOMIC DEVELOPMENT

EXCELSIOR LINKED DEPOSIT PROGRAM

REPORT 98-S-81

H. Carl McCall

Comptroller

State of New York
Office of the State Comptroller

Division of Management Audit and State Financial Services

Report 98-S-81

Mr. Charles A. Gargano
Commissioner
Department of Economic Development
30 South Pearl Street
Albany, NY 12245

Dear Mr. Gargano:

The following is our report on the Department of Economic Development's Excelsior Linked Deposit Program.

This audit was performed pursuant to the State Comptroller's authority as set forth in Article V, Section 1 of the State Constitution and Article II, Section 8 of the State Finance Law. Major contributors to this report are listed in Appendix A.

Office of the State Comptroller
Division of Management Audit
and State Financial Services

September 7, 2000

Executive Summary

Department of Economic Development Excelsior Linked Deposit Program

Scope of Audit

The New York State Legislature created the Excelsior Linked Deposit Program (Program) to encourage banks to make affordable loans to a wide variety of small companies whose goal is to improve their productivity, profitability, and competitiveness. The Program is intended to target small companies that have limited access to capital at affordable lending rates. Eligible companies can obtain a loan from a participating bank at an interest rate that is two to three percentage points lower than the prevailing rate for the first two years of the loan. To induce a bank to charge a Program applicant a lower interest rate, the State "links" a bank deposit, usually in the form of a certificate of deposit, to a business loan at a participating bank. In return for the bank charging a lower interest rate on the loan for a specific time period, the State receives a reduced interest rate on the linked deposit for the same period of time. Since Program inception through December 31, 1998, the Department of Economic Development (Department) approved 631 projects for a total loan amount of more than $228.7 million.

Our audit addressed the following questions for the period February 11, 1994 to June 30, 1999 relating to the Program:

- Does the Program operate as intended?
- Does the Department adequately administer the Program?

Audit Observations and Conclusions

A major goal of the Program is to help small companies with limited access to capital obtain loans at affordable lending rates. Our audit found the Program may not always reach its goal. We recommended that the Program improve its administrative procedures to ensure program goals are met.

When applying for the Program, each company is required to certify that without the loan subsidy its project would be impeded (commonly referred to as the "impede statement"). Department staff review borrower applications to ensure the impede statements are complete and reasonable. However, they do not analyze the information provided with the application to determine whether it indicates the company needs the subsidy to proceed with its project. By not analyzing the data, there is less assurance that the companies selected are those the Program was intended to target. Our review of applications for 30 companies not accepted in the Program for reasons unrelated to the impede statement showed that 22 of them secured a loan without the Program's help after they were rejected. As a result, we believe there is a need for the Department to assess the documentation provided by the company to support the applicant's need for the Program. In addition, Bank officials told us that the Program was not a major factor when they review and approve loan applications.

The Program, as presently configured, places banks in the role of approving the credit worthiness of the loan, and the Department in the role of approving the subsidy. Thus, the bank's loan risk is reduced only by the interest subsidy amount, on average, $600 per month. The significance of the $600 is reduced because many applicants borrow much more from the bank than the amount requested through the Program. Thus, it is unclear if the Program loans make the difference all the time. The completion of the impede statement is required by Law, and, as such, the Department should make an effort to use the data on the application to assess the company's needs. (See pp. 3-6)

The Department requires companies to estimate the number of jobs that will be created and/or retained when they apply for Program assistance. In addition, the Department requests companies to complete surveys after the completion of the Program period to report jobs created or retained as a result of the subsidized loan. The key employment data received from the companies and published in the Department's Annual Report is either estimated or otherwise unverified. We did some testing of employment data and concluded that the reported number of jobs created or retained as a result of the Program is unreliable. We recommend that the Department take steps to ensure that the data submitted by applicants on both the Program funding application and customer survey, and contained in the Annual Report, are accurate. (See pp. 7-9)

Management should use performance measures to assess program outcomes, program success and to identify improvements. For example, when there is an application backlog, management would give preference to those applicants who have the potential for delivering the greatest economic benefit, if it was a performance measure developed for the program. However, the Department has traditionally approved Program funding applications on a first-come, first-served basis, and has approved applicants if they met the basic Program requirements. They have not established and used performance measures to assist them in this process. Subsequent to our audit, Program managers told us they began to use performance measures. We recommend they continue this effort to aid them in such areas as decision-making and approving funding. (See pp. 10-11)

Comments of Department Officials to Audit

We provided a draft copy of the matters presented in this report to Department officials for their review and comment. Their comments were considered in preparing this final report.

Department officials agree with most of our recommendations and indicate that they have or will implement them. However, they state that the Program is intended to be an incentive to small businesses to undertake projects and that the impede statement does not relate to financial need.

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Introduction

Background

The New York State Legislature created the Excelsior Linked Deposit Program (Program) to encourage banks to make affordable loans to a wide variety of small companies whose goal is to improve their productivity profitability, and competitiveness. The Program is intended to target small companies that have limited access to capital at affordable lending rates. Eligible companies can obtain a loan from a participating bank at an interest rate that is two to three percentage points lower than the prevailing rate for the first two years of the loan. To encourage a bank to charge a Program applicant a lower interest rate, the State "links" a bank deposit, usually in the form of a certificate of deposit, to a business loan at a participating bank. In return for the bank charging a lower interest rate on the loan for a specific time period, the State receives a reduced interest rate on the linked deposit for the same period of time.

The Department of Economic Development (Department) began approving linked deposit applications on February 11, 1994. The Legislature initially approved $100 million for linked deposits. This amount was subsequently changed to $150 million and, in October 1999, was increased to $200 million - $150 million from the State Treasury, and $50 million from various public authorities.

Ninety-four lending institutions participate in the Program. Since Program inception through December 31, 1998, the Department approved loans totaling more than $228.7 million for 631 projects. At the time of our audit, the Department had preliminarily approved loans for 106 additional projects totaling $38.7 million. Department officials report that the total cost of the Program since inception through the end of 1998 was about $7.9 million (primarily the value of interest which the State could have earned if it had invested the money in certificates of deposits at market interest rates). In March 1998, the Governor signed legislation that extended the date of April 1, 1998, when the Program was scheduled to expire (sunset date), to April 1, 2001. Linked deposit loans approved prior to the sunset date will continue to be honored.

Audit Scope, Objectives and Methodology

We audited the Department's administration of the Program for the period February 11, 1994 through June 30, 1999. The objectives of our performance audit were to determine whether the Program operates as intended and whether the Department adequately administers the Program.

To accomplish our objectives, we reviewed State laws, rules and regulations, and policies relevant to the Department's Program operations; interviewed Department officials and officials from selected participating lending institutions; contacted representatives of similar programs in other states; and

evaluated the Department's plan to assess its goals, objectives, and outcome measures related to economic growth and program benefits. We reviewed all of the Department's Annual Reports to the Legislature concerning the Program's performance and verified selected information in these reports. We also selected judgmental samples of linked loan applications to review documentation for companies that were approved and for companies that were denied Program participation. In addition, we selected a judgmental sample of lending institutions to discuss Program issues.

We conducted our audit in accordance with generally accepted government auditing standards. Such standards require that we plan and perform our audit to adequately assess those Department operations within the audit scope. Further, these standards require that we understand the Department's internal control structure and compliance with those laws, rules and regulations that are relevant to the operations included in our audit scope. An audit includes examining, on a test basis, evidence supporting transactions recorded in the accounting and operating records and applying such other auditing procedures as we consider necessary in the circumstances. An audit also includes assessing the estimates, judgments, and decisions made by management. We believe that our audit provides a reasonable basis for our findings, conclusions and recommendations.

We use a risk-based approach to select activities for audit. We focus our audit efforts on those activities we have identified through a preliminary survey as having the greatest probability for needing improvement. Consequently, by design, we use finite audit resources to identify where and how improvements can be made. We devote little audit effort reviewing operations that may be relatively efficient or effective. As a result, we prepare our audit reports on an "exception basis." This report, therefore, highlights those areas needing improvement and does not address activities that may be functioning properly.

Comments of Department Officials

Draft copies of this report were provided to Department officials for their review and comment. Their comments have been considered in preparing this final report and are included as Appendix B.

Within 90 days after the final release of this report, as required by Section 170 of the Executive Law, the Commissioner of the Department of Economic Development shall report to the Governor, the State Comptroller, and the leaders of the Legislature and fiscal committees, advising what steps were taken to implement the recommendations contained herein, and where recommendations were not implemented, the reasons therefor.

Assessing Borrower's Need for the Subsidy

Article 15, Sections 212 through 224 of the State Finance Law govern the operation of the Linked Deposit Program. Among the key provisions of the program are that the power to approve the lending of money rests with the banking institution that will be underwriting the loan while the power to approve the loan subsidy rests with the Department. Approval of the loan subsidy is based upon several requirements including:

- the applicant certifying that the inability to obtain the reduced interest rate would impede their ability to undertake the eligible improvement project (commonly called the impede statement);
- the significance of the project to improving the applicant's profitability and competitiveness;
- the materiality of the reduced cost of borrowing to the applicant's ability to undertake the project; and
- the number of jobs likely to be created or retained, or other substantial economic benefits to be achieved as a result of the linked loan.

Our review identified opportunities to improve the Program's operations. The major objective of the Program is to target small companies with limited access to capital or affordable lending rates. These companies can then undertake projects to improve their operation. When applying for a loan subsidy, the company is asked to certify that without the loan subsidy its project will be impeded, hence the completion of the impede statement is a significant factor in determining if the loan subsidy is granted. During the early years of the Program, numerous applications were submitted with inadequate impede statements, requiring Program staff to expend time correcting and seeking clarification of these statements. In an effort to reduce the administrative work required to correct such statements, Program staff provided banks with examples of acceptable impede statements to include in the funding applications. As the content of acceptable impede statements became better known in the banking community, the Department ceased the practice of providing examples of acceptable impede statements although the banks still do.

Although this action improved the quality of the applications, it left unaddressed the issue of accuracy. Department staff review borrower applications to ensure the impede statements are complete and reasonable, but they do not adequately analyze the information submitted in support of the

applicant's certification that the inability to obtain a reduced interest rate would effect their ability to undertake the eligible improvement project. By not doing so, there is less assurance that the Program is administered as intended. Department officials state that they do not confirm the borrower's impede statement because the Program only has two staff and applicants are responsible for submitting honest responses in their Program applications. We agree that the applicants are primarily responsible for the accuracy of their applications, and we also agree that the small number of staff assigned to the Program may be insufficient to allow for investigation of the applicants. However, the unique design of the Program warrants some additional work by the Department to make sure the objectives are met. Department officials should determine whether staff resources are sufficient to carry out the expressed intent of the Program, and, if they are not, identify options to remedy the situation.

The Program, as presently designed, places the bank in the role of approving the credit worthiness of the borrower. While the Program assists the loan recipient with smaller interest payments, it does not offer a guarantee to the bank should the loan recipient default on the loan. Thus, the bank may be reluctant to loan money to applicants who are truly in need. We noted that the average Program loan is slightly over $363,000. This makes the average reduction in interest slightly over $600 a month for the first two years. The relative significance of the interest savings to the companies is also further reduced because, on average, the companies borrowed twice as much as the linked deposit portion of the loans. In most cases, banks approve the business loans before the companies apply for Program assistance. We contacted 20 participating banks that Program managers considered representative of the banking industry. Officials from 16 of the 20 banks told us that the Program was not a major factor for their bank when they review and approve loan applications.

A review of rejected applications also supports this position. As of December 31, 1998, the Department rejected 79 Program applications for reasons other than the lack of an acceptable impede statement. They were rejected for reasons such as the company began the project before applying for Program assistance or the type of business was not eligible. We reviewed a judgmental sample of 30 of the 79 rejected applications and found that most applicants had completed an acceptable impede statement. We further surveyed the banks that received the 30 applications in our sample and received 25 responses. We found that the companies which the Department did not accept in the Program for various reasons had generally (22 of 25) secured a bank loan to undertake the same project. Twenty of the 22 continued with the same loan. This indicates that many of the companies who submitted projects for approvals were able to undertake their project

without the Program's assistance of the linked deposit loans even though most of the impede statements indicated otherwise.

This information highlights a potential conflict in the Program between the bank's need to protect itself from default, and the Program's desire to help companies that may be shut out from the credit markets with loans to make a difference. Thus, it becomes important that Program officials reconcile the differences between the goal of providing loans to companies who truly need the monies for a project, and the banks' objective of minimizing their risk. In addition, Program officials need to do additional work to analyze and confirm the information submitted for approval and the results obtained by the companies with the loans. This could be achieved if the Department reviewed financial information provided to the bank so it can evaluate whether the inability to obtain the reduced rate would actually impede the borrower's ability to undertake the project. This review must also be done in a timely manner so as not to slow down the loan-granting process.

Recommendations

1. Assess the need to allocate additional resources to the Program so that applicant-provided financial information used to approve the business loans may be reviewed. Evaluate whether the Program applicant's inability to obtain the reduced rate would actually impede the applicant's ability to undertake the project.

   (Department officials replied to our draft report that the impede statement is required because the Program is intended to induce companies to borrow in situations where they would not otherwise do so; the Program does not enhance the credit worthiness of borrowers. They therefore do not believe it is practical to determine whether borrowers are creditworthy.)

   Auditors' Comments: We are not recommending the Department establish a company's credit worthiness. However, we are recommending that Program staff do sufficient work to assure that the businesses selected to receive the loan subsidy are those the Program was intended to help. As indicated in the enabling legislation businesses were facing a serious shortage of bank credit when the law was passed. This impeded their ability to modernize operations, improve competitiveness, access markets, and increase export trade. The cost of financing combined with the shortage of bank credit discouraged many of them from undertaking such projects. The Legislature enacted the Program to provide financial incentives to help reduce the risks inherent in undertaking these projects. Accordingly, the Department's review process should evaluate the materiality of the reduced cost of borrowing through a linked loan to the business's ability to undertake the project as well as confirm the support for the applicant's impede statement.

2. Increase marketing efforts to reach small businesses, inform them of the Program, and encourage them to undertake business projects which would improve their competitiveness and create or retain jobs.

   (Department officials replied to our draft report that it promotes the Program widely in its advertising materials and its web site. In addition, Linked Deposit staff have joined with the Empire State Development's Small Business Division to market the Program throughout the State.)

Reporting of Jobs Data

The Law requires the Commissioner to submit an Annual Report to the Governor and the Legislature regarding Program activities. The Annual Report must include, among other things, a report on the number of jobs created or retained as a result of the Program. Although the Program is not intended to be a jobs creation program, it does appear that the Program relies heavily upon "jobs" to gauge the effectiveness of its performance. Three out of four benefits the Department includes in its Annual Report relate to jobs created, retained and affected. Therefore, accurate employment information is essential to the Department.

For example, the Department's 1998 Annual Report stated the following: the total Program cost as of December 31, 1998 was about $7.9 million; 631 companies were assisted at a total cost of $12,470 each; 11,591 jobs were retained at a cost of $679 each; 5,927 jobs were created at a cost of $1,328 each; and 17,518 jobs were affected at a cost of $449 each. Based on this data, the Department concluded that the Program was highly cost effective.

Our review noted that the system for collecting employment information could be strengthened. We found that the information used to prepare this report was estimated and/or uncorroborated employment data reported by the Program's applicants. The accuracy of this information is unknown by Department staff, and much of the information is collected based upon surveys of the Program applicants. On an ongoing basis, the Department's Program staff send surveys to borrowing companies that have completed their two-year linked deposit assistance period. The purpose of the survey is to determine the level of customer satisfaction with the Program, and to obtain feedback on the actual economic results of the lower-cost loans to companies. The Department receives responses to about 65 percent of its survey requests.

Because of the importance of this information, some verification appears to be essential as the Program moves forward. As of January 1999, the Department received 169 customer survey responses. We compared the data from the surveys to the data reported on the original applications and found significant differences. In total, the number of jobs retained declined by 33 percent (from 5,780 to 3,904) over what was originally anticipated; in 63 percent of the responses these differences exceeded 50 percent or more.

We also took the employment information reported by the companies in the original application and the survey and compared it to the New York State Department of Taxation and Finance wage reporting records. We sent the Department of Taxation and Finance officials a sample of 70 applicants; they

were able to identify 44 of these companies on their records. In 33 of these 44 cases, the tax records showed more jobs than what the companies reported to the Department on the funding applications. We would expect this because the number of jobs affected by a business improvement project would likely be less than the total workforce of the company. However, eight of the companies reported on the surveys to the Department that they employed more people than what they reported on their tax records. This may indicate that some companies are overstating the jobs affected by the projects subsidized by the Program. The remaining three companies reported exactly what the Department of Taxation and Finance had on its records. Department officials told us that they will ask future applicants to submit tax employment data with Program funding applications.

There are probably several explanations for the differences. For example, overly optimistic projections by the applicants, changes in the project scope, and use of subcontractors in place of applicant workers. The significant differences in the number of estimated jobs retained as reported on funding applications versus the number reported on the survey may also be due, in part, to an unclear definition of the term "retained." Although the Department defines jobs retained in its funding application, it does not define this term when it sends surveys to the companies. However, the reasons for these differences should be investigated by the Department, in the same way original applications should be verified. Program officials agreed to correct the problem related to the definition of “retained.”

Some other states with similar linked deposit programs also have a response rate to surveys of 90 percent or higher, much higher than the response rate achieved by the Department. There are 12 states that have linked deposit or similar programs; we contacted nine of them. Four of them told us they have a 90 percent or higher response rate. Department officials told us that they will follow up with non-respondents to try and improve the response rate, but they cautioned that they have no enforcement capability after the linked deposit assistance period is complete. However, in October 1999, the Department initiated Program changes that allowed companies to apply for a second loan. To improve the survey rates, the Department could consider making the survey a Program requirement, thereby precluding a company that does not respond from receiving a second linked deposit loan.

Recommendations

3. Develop a standardized definition of terms used in the survey to help improve the reliability and consistency of the information reported by Program participants.

   (Department officials replied to our draft report that it has revised the application and survey to accomplish this.)

4. Require companies to complete and submit surveys as part of the Program.

   (Department officials replied that based on modified program requirements second time applicants must demonstrate they reached the goals set in their first application. As for the first survey response enforcement is difficult because it is conducted after the loan period.)

5. Validate the data submitted by applicants on both the Program funding application and customer survey. This could be achieved by contacting one or more State agencies that have employment-related data such as the Department of Taxation and Finance and Department of Labor.

   (Department officials replied that applicants have to submit a copy of the NYS-45 (unemployment insurance tax) form. The form contains data reported to the tax department on company employment.)

Performance Measures

Department officials state that the Program was not intended to be a job creation program; other benefits listed in the Law are important, such as those dealing with productivity, profitability, and competitiveness. To assess the Program's other important benefits, as well as its performance in retaining and creating jobs, the Department should consider establishing a system of performance measures for the Program. Performance measures allow management to clarify its purpose and align its resources to support the program's mission. Management can use performance measures to:

- generate feedback on how the employees are doing;
- focus on results;
- identify criteria that will lead to successful outcomes; and
- identify program improvements.

We found that other States use performance measures as part of their linked deposit programs. Officials from six of the nine states we contacted told us they have developed performance measures to evaluate their projects, to aid decisions about the criteria they should consider when approving future projects, to identify program improvements, and to evaluate the success of the program.

For example, the Department has traditionally approved Program funding applications on a first-come, first-served basis, and has approved applicants that met the basic Program requirements (e.g., impede statement, type of business, number of employees, and description of project). During our audit, all of the Program funds were committed to companies, and there was an eight-month backlog of new Program applicants. If the Department had a performance measurement system, it could use this system to set funding priorities when sufficient funds are not available. When there is an application backlog, management could give preference to those applications which assert they will deliver the greatest economic benefit, according to the performance measures developed. (Subsequent to the completion of our fieldwork, the Legislature increased Program funding by $50 million, thus eliminating the backlog.)

For the Department to implement a performance measurement system, it will have to develop additional data collection capabilities, as well as develop the measures that will address areas of performance other than "jobs." The Department collects data from the applications and follow-up surveys of

Program participants. These surveys cover questions such as the number of jobs created and retained; however, this data has neither been used to develop performance measures, nor integrated into the Department's management and operational decision-making systems.

Program officials told us that they will modify their data collection process to include these other performance measures. Subsequent to our audit, Program managers told us they began to use performance measures to evaluate the Program or make changes in Program policy or operations. They said they will continue to identify useful measures and expand the Annual Report to include them.

Recommendations

6. Continue developing performance measures as an integral part of its management to aid in decision-making, assessing accountability, and setting priorities for approving funding applications.

7. Compile and report Program accomplishments based on other important Program factors, such as increased competitiveness and productivity.

   (Replying to our draft report, Department officials indicated they will evaluate the feasibility of doing this. However, they do not have an independent source of data, thus this information would probably be based on company statements.)

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July 26, 2000

Mr. Carmen Maldonado
Audit Director
Office of the State Comptroller
Division of Management Audit and State Financial Services
123 William Street, 21st Floor
New York, NY 10038

Dear Mr. Maldonado:

I am writing to provide you our response to draft audit report (98-S-81) concerning the Linked Deposit Program.

Empire State Development (ESD) appreciates the efforts of the Auditors to develop an understanding of this program, and provide suggestions for improvements in its administration. In response, we have implemented a number of modifications in the program approval process, as well as in program reporting.

As is noted in our response, we continue to feel that the Auditors' position concerning ESD evaluation of the "impede" statements provided by applicants reflects a misunderstanding of program design. Hence, we would appreciate it if you would review this element of the report.

Please feel free to contact us if you need additional information.

Sincerely,

Empire State Development Corporation
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EMPIRE STATE DEVELOPMENT RESPONSE TO AUDIT REPORT (98-S-81)

1. *Assess the need to allocate additional resources to the Program so that applicant-provided financial information used to approve the business loans may be reviewed. Evaluate whether the Program applicant's inability to obtain the reduced rate would actually impede the applicant's ability to undertake the project.*

➢ Although we appreciate the Auditors' desire to improve the program's ability to assess the validity of "impede" statements contained in loan applications, a brief review of the Linked Deposit Program's legislative design reveals why this is not possible. As the Audit notes, the program consists of a reduced cost source of funds for lenders that is passed through to borrowers. Thus, in effect, the program is a loan subsidy.

- In questioning the effectiveness of the administration of the program, the auditors determined that a large number of loans rejected by ESD program management went ahead anyway. Thus, the Auditors concluded that ESD should perform a more careful review of the creditworthiness of loan applications prior to approval.

- The Auditors' arguments contains two logical flaws:

  - First, it is inappropriate to conclude from the review performed by the Auditors that approved applications are as likely to contain false impede statements as those that were rejected. The fact that loans were rejected in some circumstances reveals that ESD staff was performing its function appropriately.

  - Second, and more fundamentally, the legislative design of the Linked Deposit Program provides no elements that enhance the creditworthiness of borrowers. An example of a credit enhancement is a bank requirement that a third party with good credit agree to pay back a loan in the event that the borrower defaults. Examples of government credit enhancements are government loan guarantees and so called "capital access programs." Both approaches provide government funding to reduce the potential cost of defaults to lending institutions.[1] Since the program does not significantly reduce the lender's exposure to risk, as the Audit acknowledges, it does not affect the creditworthiness of applicants. **In fact, ESD believes that given the program's design, virtually all successful loan applicants would be creditworthy without the availability of the program.**

  - Instead, the Linked Deposit program's only element is a cost reduction that is intended to entice creditworthy companies to borrow in situations where they would not otherwise do so. In effect, the program is analogous to the offers lenders make to consumers to induce them to borrow. For example, consumers frequently receive offers from banks to lend money through home equity loans or

[1] The reader should be aware that ESD is not advocating that the program be modified to include such an element. Government-sponsored credit enhancement programs are controversial because they reduce the efficiency of private credit markets and because they are frequently perceived to be unfair to competitors who are ineligible to receive them.

credit cards at reduced rates for a period of time. Auto companies also use reduced rates as a way to encourage potential buyers to make a purchase that they might not otherwise make.

- Because the program does not enhance the creditworthiness of borrowers, it would not be sensible for ESD to devote additional resources to determine whether borrowers are creditworthy. The law requires that the "impede" statement be requested of borrowers because the program is intended to induce them to borrow money when they would not otherwise do so, not to change their creditworthiness. If the purpose was to alter creditworthiness, logically, the legislation would require the bank to attest to this.

- ESD evaluates the veracity of "impede" statements through the use of a series of questions to lenders concerning the project's current status. These include: "Has equipment been purchased or ordered?" and "Has construction project been started?" In addition, borrowers are asked, "How would the borrower's ability to undertake the project be impeded without the subsidized loan interest rate available through the LDP?" Where these and other program requirements are met, it is impossible for ESD to determine whether statements that applicants make about the effect of the Linked Deposit loan discount on their willingness to proceed with projects are true because these statements reflect applicants' assessments of the impact of the program on their own business decisions. For these reasons, ESD requires both the borrower and lender to sign certifications that all information in their applications is true and correct.

2. *Increase marketing efforts to reach small businesses, inform them of the Program and encourage them to undertake business projects that would improve their competitiveness and create or retain jobs.*

   - ESD promotes the Linked Deposit Program widely, with the result that it does a substantial volume of loans. Information about the program is included in ESD's advertising materials and on its web site. In addition, Linked Deposit staff has joined with ESD's Small Business Division to market the program throughout the state.

3. *Develop a standardized definition of terms used in the survey to help improve the reliability and consistency of the information reported by program participants.*

   - In response to the Audit recommendation, ESD has revised the Linked Deposit application and the survey to accomplish this.

4. *Require companies to complete and submit surveys as part of the program.*

   - As we noted to the Auditors earlier, the 65 percent response rate for LDP surveys at the time of the Audit is much higher than is typical for survey research. It provides a very high degree of probability that findings from the survey sample are representative of those for the entire population of borrowers. Currently, we are getting an even higher rate of response (79%) from LDP surveys.

- ESD will include a statement in future surveys that borrowers are required to respond to the survey, based on Paragraph 1 of Section 222 of the State Finance Law. However, the Auditors should recognize that ESD has no ability to penalize companies that ignore this requirement, since the survey is conducted after the loan period is completed. Thus, except for those circumstances where applicants reapply for a loan, we cannot compel responses. We have modified program requirements in response to Audit recommendations to require second time applicants to demonstrate that they have reached goals set in their first application to be eligible for assistance a second time.

5. *Validate the data submitted by applicants on both the Program funding application and customer survey. This could be achieved by contacting one or more state agencies that have employment-related data such as the Department of Taxation and Finance and Department of Labor.*

   - In response to the Audit's recommendation, ESD now requires that applicants submit a copy of the NYS-45 (unemployment insurance tax) form. This form contains data reported to the tax department on company employment.

6. *Continue developing performance measures as an integral part of its management to aid in decision making, assessing accountability and setting priorities for approving funding applications.*

   - Staff has developed a regular reporting format to management containing a series of program performance measures. We continue to seek ways to improve ways to improve the program decision-making process, and have implemented a number of changes, including those that we have accepted from this Audit.

7. *Compile and note Program accomplishments based on other important Program factors, such as increased competitiveness and productivity.*

   - We will evaluate the feasibility of doing this. However, Auditors should be aware that we do not have access to independent ways to verify data in the same way that we do for employment. Thus, it is likely that reports of data on competitiveness and productivity would be based on company statements.

In addition to the above, we have the following observations about statements contained in the Audit Report:

Executive Summary

Most applicants generally borrow more from the bank than the amount requested from the program.

- Only 214 of 734 (29.2%) projects involve loans that are greater than the Linked Deposit loan. Thus, the statement is incorrect.

*** Note**

* See State Comptroller's Note, Appendix B-5

Program staff do not review the accuracy of the impede statements.

➢ This is not correct. Program staff evaluates borrowers' responses to the question on the application that asks how the borrower's ability to undertake the project would be impeded.

*** Note**

➢ ESD designed the Linked Deposit application to maximize the likelihood that applicants meet the requirements of the law. The application contains a series of questions used by program staff to determine program eligibility. These include:

- On the lender application, "Has equipment been purchased or ordered?" "Has construction project been started?"
- On the borrower application: "How would the borrower's ability to undertake the project be impeded without the subsidized loan interest rate available through the LDP?" (i.e., what problems will be incurred if LDP assistance is not provided?)
- On the borrower application, Borrowers are required to certify that "Inability to obtain the reduced rate of loan interest provided by the Linked Deposit Program would impede the ability of the borrower to undertake the project for which the loan will be used (relates to question No. 5 on previous page describing how the borrower would be impeded from undertaking this project without LDP assistance)." Staff reviews this information.

State Comptroller's Note:
Certain matters addressed in the draft report have been revised for the final report based on the Department's response.