A REPORT BY THE NEW YORK STATE OFFICE OF THE STATE COMPTROLLER

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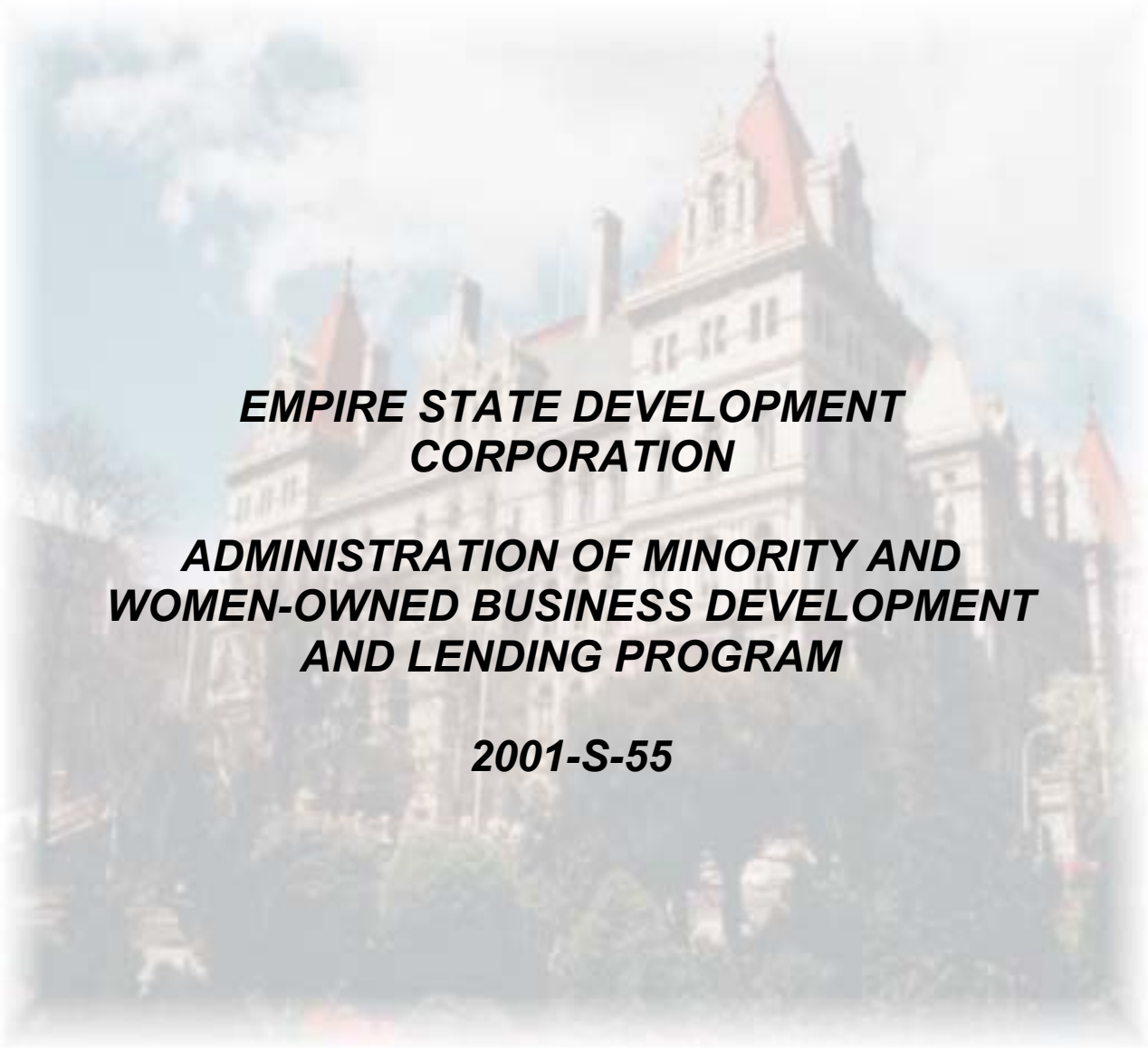

EMPIRE STATE DEVELOPMENT CORPORATION

ADMINISTRATION OF MINORITY AND WOMEN-OWNED BUSINESS DEVELOPMENT AND LENDING PROGRAM

2001-S-55

DIVISION OF STATE SERVICES

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Report 2001-S-55

Mr. Charles Gargano
Chairman/Chief Executive Officer
Empire State Development Corporation
30 South Pearl Street
Albany, New York 12245

Dear Mr. Gargano:

The following is our report on the Empire State Development Corporation's administration of the Minority and Women-Owned Business Development and Lending 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 State Services

June 24, 2004

EXECUTIVE SUMMARY

EMPIRE STATE DEVELOPMENT CORPORATION
MINORITY AND WOMEN-OWNED BUSINESS DEVELOPMENT AND LENDING PROGRAM

SCOPE OF AUDIT

In fiscal year (FY) 1987, the New York State Legislature created the Minority and Women-Owned Business Development and Lending Program (Program) to facilitate the flow of lending and investment capital into the targeted population that had difficulty accessing the mainstream financial services industry. The Program, which is administered by the Empire State Development Corporation (ESDC), is a source of funds for Minority and Women-Owned Business Enterprises (MWBE) for delivery of capital and technical assistance. The Legislature appropriated $3.5 million to the Program in fiscal years 1999-00 and 2000-01. In fiscal year 2001-02, the Legislature appropriated $2.8 million for the Program. ESDC is responsible for overseeing the Lending Program and reporting on its results.

Although the Program provides for funding through the Linked Deposit Program, the Revolving Loan Trust Fund and Community Development Financial Institutions (CDFIs), ESDC funds MWBEs primarily through credit unions and non-profit organizations classified as CDFIs. When a CDFI's application for a Program block grant is approved, ESDC executes a contract with the CDFI, draws down from the appropriations the full amount of the approved grant funds and distributes half of the approved grant funds to the CDFI. The remaining funds are kept in an ESDC bank account and are distributed to the CDFI as the project progresses. ESDC retains 10 percent of approved grant monies until the CDFI submits a final report on how funds were spent to assist MWBEs. CDFI grants must be used for specific purposes, such as loan capital or post-loan technical assistance for MWBEs. ESDC approved 52 CDFI projects in the 1999-00 and 2000-01 fiscal years.

Our audit addressed the following questions about ESDC's administration of the Program for the period April 1, 1999 through September 30, 2002:

- Is ESDC effectively administering the Program?
- Does ESDC provide funds to CDFIs in compliance with Program guidelines?

- Does ESDC monitor the uses of Program funds invested in the community?

- Has ESDC identified and quantified the benefits derived from the Program?

AUDIT OBSERVATIONS AND CONCLUSIONS

We found that ESDC does not effectively administer the Program. For example, under current practices, significant amounts of Program funds may sit idle in an ESDC bank account. Further, ESDC does not manage the award process according to ESDC guidelines or effectively monitor the CDFIs that receive Program funds for projects that should help MWBE businesses. In addition, ESDC does not determine, or report on, the Program's accomplishments in quantifiable economic terms.

The Legislature appropriated $3.5 million for Program expenditures in 1999-00 and 2000-01, but ESDC awarded only 74 percent and 29 percent, respectively, of the available funds in these years. Thus, the funds that were not awarded were not put to use to develop MWBE businesses. ESDC officials said there was a lack of eligible projects, and no demand for Linked Deposits and Revolving Loans. However, we found that ESDC does nothing to market the Program. We recommend that ESDC reassess the Program to determine how to promote it effectively among prospective MWBE clients. (See pp. 15-16)

In fiscal years 1999-00 and 2000-01, ESDC awarded most of the Program appropriations to CDFIs. ESDC has guidelines governing how CDFIs must apply for, receive and account for Program funds. Guidelines also specify the procedures ESDC should use to contract with and monitor CDFIs and to measure program outcomes. However, when we reviewed a judgmentally selected sample of 29 CDFI projects approved during 1999-00 and 2000-01 to assess ESDC's management of Program funds awarded to CDFIs, we found that CDFIs routinely start projects late (6 to 12 months or more after projects are approved), often because the CDFIs have not completed earlier projects. ESDC allows CDFIs 15 months or more to finish projects, does not terminate non-performing projects, and permits CDFIs to start new projects without executed contracts before they have submitted final reports for their prior projects. ESDC officials advised us that the CDFIs are aware that they start the new projects at their own risk. (See pp. 17-21)

We also found that CDFIs may be improperly using funds earmarked for technical assistance to pay instead for administrative costs. As a result of ESDC's lax oversight, Program funds may be used ineffectively, or subject to waste or inappropriate use. ESDC should improve its oversight of this Program, as outlined in the recommendations in this report, to help ensure the Program achieves its intended purpose. We also recommend that ESDC collect data on

Program results in measurable economic terms, and report these results as required. ESDC has not submitted to the Legislature the required biannual report for the Program since 1997. (See pp. 21-26)

COMMENTS OF ESDC OFFICIALS

A draft copy of this report was provided to ESDC officials for their review and comment. Their comments have been considered in preparing this final report, and are included as Appendix B. In addition, the State Comptroller's Notes to ESDC's response are included as Appendix C.

ESDC officials did not agree with our conclusions regarding their administration of the Program. In their opinion they properly managed the Program and have awarded funds to CDFIs upon review and approval of their application. ESDC officials disagreed with several of our recommendations. They provided reasons such as the lack of funding for hiring additional staff to carry out the level of monitoring we recommended as well as for advertising the Program. They also objected to establishing a limit on the length of time a non-performing CDFI is allowed to use funds received before they cancel a project. ESDC officials were critical of the length of time needed to complete our audit.

Our conclusion that ESDC has not properly administered the Program is supported by a number of valid observations and conclusions. For example, the amount of funds used for CDFIs decreased from about $2.6 million to $1.0 million (or 61 percent) in one year. However, ESDC officials could not demonstrate that they had taken any action to reverse this condition. In addition, they did not have information on Program results. We remind ESDC officials that considerable delay in completing the audit was due to the length of time it took them to provide the files requested for our sampled CDFIs. We continued to urge ESDC officials to take corrective action to improve administration of the Program and use the funds to help MWBEs grow.

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INTRODUCTION

Background

New York State has established a number of programs that have the potential to assist the development and expansion of Minority and Women-owned Business Enterprises (MWBEs). The Empire State Development Corporation (ESDC) administers these programs, which include the following: the Empire State Economic Development Fund program; Jobs Now; Urban and Community Development Program; Empire Zone and Empowerment Zone Programs; and the Minority and Women-Owned Business Development and Lending Program (Program). The Program, which was established in fiscal year (FY) 1987, is dedicated to providing financial and technical assistance to help strengthen and expand the capacity of small MWBEs. The Legislature created the Program to serve small MWBEs, since these businesses have traditionally had difficulty accessing funds from the mainstream financial services industry.

The Program provides funds through three sources: the Linked Deposit Program, the Revolving Loan Trust Fund, and the Community Development Financial Institutions (CDFI) program. The Linked Deposit Program is a public-private partnership that provides businesses with affordable capital based on bank loans at reduced interest rates. The bank loans are subsidized by corresponding "linked" State deposits. The Revolving Loan Trust Fund makes an initial grant to capitalize a loan pool. In the CDFI program, credit unions or non-profit organizations (also called CDFIs) serve as intermediaries in the distribution of Program funds to MWBEs that need them.

CDFIs apply to ESDC for block grants of Program funds, which are required by Program guidelines to be used for specific purposes, such as loan capital and technical assistance. The total amount of requested funds is to be based on the CDFI's projection of the amount of Program funds it will be able to use to serve MWBE clients. When the ESDC Board of Directors approves a CDFI's request for funds (a project), ESDC executes a contract with the CDFI and gives the CDFI 50 percent of the total approved funds. The CDFI then receives two increments, one for 30 percent and one for 10 percent, after the CDFI accounts for the initial monies it has already received. The

CDFI must also submit a semi-annual and final report to ESDC that attests to the project's provision of funds/assistance to the MWBE, as stated in the contract, and accounts for how the funds were spent. ESDC withholds 10 percent of the CDFI's total requested funds to ensure this final reporting takes place. It is ESDC's policy not to contract with a CDFI for a new project, or make a final disbursement (the 10 percent withheld) until the CDFI files the final report due on its prior project. In addition, ESDC's decision to award a grant to a CDFI is influenced by the CDFI's track record with prior projects.

The State Legislature appropriated $3.5 million for the Program in fiscal years 1999-00 and 2000-01. In each year, the Legislature allocated these funds as follows: up to $525,000 to Linked Deposit; up to $975,000 to the Revolving Loan Trust Fund; and up to $1 million for the CDFI program. The remaining $1 million was unallocated in both years. ESDC officials indicated that they are allowed to use these unallocated funds for any purpose related to the Program. In 1999-00 ESDC used the $1 million allocated for CDFI to fund 25 projects; however, ESDC was not able to use the Revolving Loan Trust Fund and Linked Deposit Program funds appropriated that year, as intended. Instead, ESDC used some combination of these funds and unallocated funds to provide various loans and grants, totaling $1.6 million. In the 2000-01 fiscal year, ESDC used only $1 million of the $3.5 million appropriation (the funds allocated for CDFI) to generate 27 CDFI projects, and $400,000 in funding from outside the Program i.e., State operations and aid to localities, to help pay for the services and the expenses consistent with the CDFI Program. In the 2001-02 fiscal year, the Legislature appropriated $2.8 million for the Program without making specific allocations.

ESDC established guidelines to help make sure the Program meets its objectives. ESDC assigned management of the Program to two staff: a Grants and Loans Senior Vice President and a Grants and Loans Assistant Vice President. As managers of the Program, these staff must monitor compliance with the guidelines. The Law requires ESDC to report annually to the Legislature on the results of the Program, including its impact in measurable economic terms.

Audit Scope, Objectives and Methodology

We audited the CDFI component of the ESDC Minority and Women-Owned Business Development and Lending Program for the period of April 1, 1999 to September 30, 2002. The objectives of our performance audit were to: determine whether ESDC provides CDFI grants in compliance with established procedures and guidelines; to assess whether ESDC monitors the use of the investments made in the community; and to identify and quantify the benefits achieved as a result of this Program. We also examined how ESDC administered all Program funds so that we could make sure we accounted for all funds and for CDFI program grants.

To accomplish our objectives, we interviewed ESDC management and staff responsible for administering the Program. We also reviewed a sample of CDFI projects approved during the 1999-00 and 2000-01 fiscal years. Of the 52 projects approved for Program awards to 33 CDFIs during this period, we reviewed a judgmental sample of 29 projects, with a total value of about $1.4 million, awarded to 17 CDFIs. We selected 12 CDFIs with projects in both audited fiscal years, and 5 CDFIs with projects in only one fiscal year. We also visited sampled CDFI sites to do audit tests and to make observations. We did not include any FY 2001-02 projects in our sample, since ESDC officials told us these projects were either not yet started or were in a very early stage at the time of our audit field work.

During our site visits to sampled CDFIs, we examined the extent to which ESDC monitors CDFIs to make sure they spend funds in accordance with the terms of their contracts, operate the Program in compliance with their contracts and ESDC guidelines, and report the results of Program activities, as required. We also interviewed CDFI staff and reviewed records to determine whether they could document the expenses they claimed, and were spending the funds in agreement with their ESDC contract terms and provisions. We contacted CDFIs on the ESDC mailing list to determine whether they had received the applications for funding; whether they were aware of the Program; and whether ESDC allows them adequate time for preparing and returning the applications.

We did not audit the Linked Deposit or the Revolving Loan Trust Fund programs for FY 1999-00, FY 2000-01 and FY 2001-02 because ESDC advised us that it had not approved projects for

these programs during this period. Also, we did not audit any of the other loans totaling $1,090,000, and grants totaling $489,100 that ESDC approved from FY 1999-00 appropriations.

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 operations of ESDC that are within our audit scope. Further, these standards require that we understand ESDC's internal control structure and its 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 our audit provides a reasonable basis for our findings, conclusions and recommendations. We use a risk-based approach when selecting activities for audit. This approach focuses our audit efforts on those operations that we have identified through a preliminary survey as having the greatest probability of needing improvement. Consequently, by design, we use our finite audit resources to identify where and how improvements can be made. Thus, we devote little audit effort to reviewing operations that may be relatively efficient or effective. As a result, our audit reports are prepared on an "exception basis." This report, therefore, highlights those areas needing improvement and does not address activities that may be functioning properly.

In addition to being the State Auditor, the Comptroller performs certain other constitutionally and statutorily mandated duties as the chief fiscal officer of New York State, several of which are performed by the Division of State Services. These include operating the State's accounting system; preparing the State's financial statements; and approving State contracts, refunds, and other payments. In addition, the Comptroller appoints members to certain boards, commissions and public authorities, some of whom have minority voting rights. These duties may be considered management functions for purposes of evaluating organizational independence under Generally Accepted Government Auditing Standards. In our opinion, these management functions do not affect our ability to conduct independent audits of program performance.

Response of ESDC Officials

A draft copy of this report was provided to ESDC officials for their review and comment. Their comments have been considered in preparing this final report, and are included as Appendix B. In addition, State Comptroller's Notes to ESDC's response are included as Appendix C.

ESDC officials disagreed with several of our recommendations. They provided reasons such as lack of funding for hiring additional staff to carry out the level of monitoring we recommended, as well as for advertising the program. They also objected to establishing a limit on the length of time a non-performing CDFI is allowed to use funds received before they cancel a project.

Within 90 days after final release of this report, as required by Section 170 of the Executive Law, the Chairman/Chief Executive Officer of the Empire State Development Corporation 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.

PROGRAM ADMINISTRATION

The Legislature created the Program to provide small and start-up MWBEs with financial and technical assistance they need to prosper, and might not otherwise obtain. ESDC's role is to help MWBEs access this assistance and expand their businesses. However, we found that ESDC awarded only 74 percent of the $3.5 million in Program funds available in 1999-00, and just 29 percent of the funds available in 2000-01. Thus, funds available to the Program were not used to help MWBEs. ESDC officials stated that there was a lack of eligible projects, and no demand for the Linked Deposit and Revolving Loans Programs. However, we also conclude that the primary reason all of the funds are not put to use is that ESDC does not market the Program to prospective borrowers.

Program Funds

To strengthen and expand the services and capacity of MWBEs, the Legislature appropriated $3.5 million for Program expenditures in fiscal years 1999-00 and 2000-01. However, as shown in the following table, ESDC awarded only 74 and 29 percent of these funds, respectively, in 1999-00 and 2000-01.

PROGRAM FUNDS APPROPRIATED AND AWARDED IN THE 1999-00 AND 2000-01 FISCAL YEARS				
Allocation	**FY99-00 Appropriated (Up to)**	**FY99-00 Awarded**	**FY00-01 Appropriated (Up to)**	**FY00-01 Awarded**
CDFI program (up to)	$1,000,000	$1,000,000	$1,000,000	$1,000,000
Linked Deposits (up to)	$ 525,000	$0	$ 525,000	$0
Revolving Loan Trust (up to)	$ 975,000	$0	$ 975,000	$0
Unallocated	$1,000,000	$0	$1,000,000	$0
Other loans		$1,090,000		
Other grants		$489,100		
Total Program	$3,500,000	$2,579,100	$3,500,000	$1,000,000
Additional Appropriations for CDFI Services and Administrative expenses *	$0	$0	$400,000	$400,000

*. These appropriations were made from Aid to Localities funds.

ESDC awarded about $2.6 million of the $3.5 million of the FY 1999-00 appropriation. Of this amount, ESDC awarded $1

million to CDFIs to fund 25 projects with grants that ranged from $15,000 to $100,000. Although ESDC officials did not approve any Linked Deposit or Revolving Funds projects in FY 1999-00, they did make $1.6 million in discretionary loans and grants ($1,090,000 in loans and $489,100 in grants) to individual MWBEs in this year. After subtracting all ESDC awards of any kind from the total $3.5 million appropriation, we determined that ESDC did not award about $921,000 of the Program funds it had available for fiscal year 1999-00. In the 2000-01 fiscal year, ESDC used just $1.0 million of the $3.5 million total Program appropriation, plus an additional $400,000 from Aid to Localities to fund 27 CDFI projects that ranged from $16,500 to $75,000. ESDC did not approve any Linked Deposit and Revolving Loan Trust projects in FY 2000-01, and did not award the remaining $2.5 million available from that year's appropriation.

ESDC officials said they did not use the full appropriation in those years because they were unable to identify other eligible projects, and there was no demand for Linked Deposit and Revolving Loans projects. ESDC officials stated that they do not market the Program, including its Linked Deposit and Revolving Loan Trust features, because they receive no State funds for advertising or promotion. As a result of this passive approach, funds totaling almost $1 million in fiscal year 1999-00 and about $2.5 million in fiscal year 2000-01 were not awarded to MWBE clients. ESDC should determine how to promote the Program among prospective MWBE clients to help develop and expand small MWBE businesses.

Recommendation

1. Market the Program among prospective MWBE clients so that all available funds to develop and expand MWBE businesses are used as intended by the Legislature.

   (In response to our draft report, ESDC officials agreed to strengthen their Community Network Offices outreach efforts to increase the level of MWBDL commitments.)

Note: MWBDL refers to the Minority and Women-Owned Business Development and Lending Program, called Program in this report.

CDFI PROJECTS

ESDC awarded the $2 million in funds appropriated to the CDFI Program in FY 1999-00 and FY 2000-01. The grants ESDC awarded to CDFIs are for specific purposes: Loan Capital for business loans to individual MWBE clients; Loan Loss Reserves to provide the CDFI with a cushion against possible client defaults on loans; Technology to fund the CDFI's purchase of computer hardware and software needed to serve MWBE clients; Technical Assistance, to fund the provision of post-loan technical help (financial, business management) for MWBEs; and Individual Development Accounts (IDA) funds, intended to provide qualified MWBEs with $1,000 in matching grants for future business ventures. The most commonly requested category of CDFI grant is Technical Assistance. CDFIs can use just 10 percent of grant money for administrative expenses.

When we examined ESDC's administration of CDFI grants, the one Program component ESDC has actually carried out, we concluded that ESDC does not manage the award process according to ESDC guidelines or effectively monitor the CDFIs that obtain Program funds for projects that help MWBE businesses. Specifically, we found that ESDC does not: execute project contracts promptly; monitor CDFIs' timely completion of projects; assess the utility and appropriateness of the technical assistance CDFIs provide; monitor borrowers' compliance with the terms of capital loans; or verify the reasonableness of interest rates CDFIs charge MWBEs. Further, ESDC does not know what the CDFI projects have accomplished in quantifiable economic terms, such as new businesses started or jobs created. As a result of ESDC's lax administration of the Program, funds intended to help grow small MWBEs may be spent ineffectively, and may, in fact, be subject to waste or inappropriate use.

Project Initiation and Completion

To make sure these grant funds are put to use promptly to develop and expand small MWBEs, ESDC should strongly encourage award recipients to initiate and complete funded projects within a reasonable timeframe.

Our review of a judgmentally selected sample of 29 projects approved for 17 CDFIs during the 1999-00 and 2000-01 fiscal years showed that two (12.5 percent) of the 16 FY 1999-00 projects and seven (53.85 percent) of the 13 FY 2000-01 projects in our sample were not initiated as of our review date in September 2002. As a result, State monies awarded to the CDFIs to stimulate development sit idle in ESDC's bank account. ESDC officials told us that, as of October 2002, the majority of the FY 2001-02 projects approved in March 2002 were either not yet started or were just beginning. As a result, we did not review any of the FY 2001-02 projects.

We found various reasons for the delay in starting projects. One reason is that ESDC provides grants to CDFIs that are not prepared to initiate their projects until long after the project approval date. For example, of the 16 projects approved for FY 1999-00, nine projects totaling $332,000, were estimated to start anywhere from six months to more than 12 months after the approval date. Also, ESDC guidelines require that contracts not be let for newly approved CDFI projects until the CDFI completes prior projects. As a result, delays in starting new projects often happen because CDFIs have not yet completed and reported the results of their prior projects. For example, ESDC officials said they plan to issue contracts for 15 of the 29 FY 2001-02 projects by end of December 2002, or about 9 months after the March 2002 approval date. Thus, the lag in starting new projects is creating a growing backlog of approved, but uninitiated, projects.

ESDC officials stated that the Program is prone to delays and slow uptake of funds because it is relatively new. Officials told us it is ESDC policy to allow CDFI projects to take up to 15 months. (Further, officials claim they have decreased the lag in project starts by reducing, but not eliminating, the funds awarded to a CDFI in a subsequent year when the CDFI has not yet completed an earlier project.) However, simply reducing a CDFI's funding for a subsequent year has not prevented the recurrence of significant delays in project starts.

We also found that ESDC approved new projects when CDFIs had not completed earlier approved projects or reported their results. In some cases, CDFIs approved for new projects were still due disbursements from earlier contracts because they had not filed the required final reports. For example, we found a CDFI with a FY 1999-00 project that was scheduled to start more than 12 months after the March 2000 approval. Although

this CDFI had not submitted a final report for this 1999-00 project, ESDC approved a project for this CDFI in 2000-01 for $27,700 in Technical Assistance funds. ESDC was unable to issue the 2000-01 project contract or disburse any project-related funds to this CDFI, and had given the CDFI a poor rating on its application for a 2000-01 project. Nonetheless, ESDC approved the application for new project funding for another award for $100,000 in combined Technical Assistance and Loan Loss Reserve funds in 2001-02. ESDC officials said they believe that new management at this CDFI will result in more timely completion of projects. ESDC officials told us that the CDFI needed $100,000 to assist small businesses throughout lower Manhattan since the events of September 11, 2001. However, in November 2002, ESDC had still not disbursed any of these funds because of the CDFI's failure to submit the final report for its FY 1999-00 project.

We also found that some CDFIs do not know they have grant money available for projects that are still incomplete. We found two CDFIs that were unaware of the fact that they still had grant money remaining from the FY 1999-00 funding cycle. One of these CDFIs had changed management, and the other CDFI lost track of the grant. Auditors told these officials to contact ESDC to get their projects back on track so they could receive funds due them. ESDC should communicate on a periodic basis with those CDFIs that have incomplete projects and/or undisbursed funds related to those projects.

Another factor that contributes to delays in starting and completing projects is the fact that ESDC does not terminate a project or modify its scope when it becomes apparent that the CDFI is unable to complete the project within a reasonable timeframe. For example, we found that one CDFI had delayed starting its 2000-01 project with a stated goal of issuing 35 IDA loans. Although the CDFI indicated in its semi-annual report to ESDC that it had issued just seven IDA loans because of lack of client interest, ESDC extended the project without any changes for another six months. On July 16, 2002 (more than two years after the project was approved) the CDFI official told us he had issued just seven IDA loans (he said four to six applications were pending), but planned to keep the project open until the end of 2002 – a total of 2.5 years. ESDC officials told us that they kept the project open because they did not want to terminate the new IDA program. However, it may have been better to close this project as originally contracted and provide

for continued IDA funding under a new more modest project that matched client interest in IDA loans.

We also found that ESDC allows CDFIs to delay submission of their final reports, which, in turn, delays contract issuance for new projects. ESDC requires that CDFI submit a final report on their project and its accomplishments of the project's completion. However, we found that CDFIs routinely delay submitting these reports to ESDC. Of the 29 projects in our sample, 20 were in progress, and nine were not yet started. Final reports were due from 19 of the 20 projects in progress. We found that CDFIs had submitted final reports on time for just four of these 19 projects; final reports for five projects had been submitted from 3 to 12 months late, and final reports for 10 projects were overdue but not yet submitted. Since CDFIs can receive up to 90 percent of the total project funding before submitting their final report – the prospect of obtaining the remaining 10 percent of the project money may not be enough incentive to induce compliance. Many CDFIs simply do not file the final report to account for all the expenses of a completed project.

ESDC officials said they prefer to be flexible in dealing with individual CDFIs, and are reluctant to enforce reporting compliance by terminating projects unless the CDFI's performance is unsatisfactory. Officials maintain that CDFIs are being frugal and project funds last a long time. The threat of project termination after 15 months would make the CDFIs spend Program funds with "use it or loose it" mentality.

Officials also told us that funds that are not drawn down by CDFIs remain in the ESDC bank account and earn interest. Although officials stated they use interest earned to fund program projects, they had previously said this money was used to cover ESDC operating expenses. ESDC officials reported that this interest income totaled $723,000 for the three fiscal years (FY 2000 - FY 2002), but they have not provided documentation to show how the interest was reported, and how ESDC actually used this money.

Because the Program has been in operation since 1998, ESDC has had sufficient time to develop and enforce effective guidelines for awarding CDFI projects, for tracking CDFIs' progress in initiating and completing projects in a timely way, and for obtaining CDFIs' final project reports when they are due. Without more discipline and focus in the award process, ESDC

awarding process ties up State funds in grants to CDFIs that are unable to either perform in an efficient manner or deliver their services in a timely manner. Approving CDFIs more funds than they are able to use does not help the communities, but results instead in State funds sitting idle in the ESDC bank account.

Contract Execution

ESDC should execute a project contract with a CDFI after the Board approves the CDFI's project. The contract defines all the project's objectives, states the project's expected start date, required reporting obligations and due dates. Although ESDC guidelines state that contract execution follows Board approval of a CDFI's project, we found that CDFIs worked on 14 of the 29 projects in our sample – in some instances, for seven or eight months – without having executed contracts for these projects and in one instance, a project was completed without an executed contract.

ESDC officials maintain that they allow CDFIs to start the project at their own risk as early as the application date, based on the project scope description submitted in the application. ESDC officials maintain that project implementation without an executed contract occurs when CDFIs delay filing final reports on earlier projects. It is essential for ESDC to have an executed contract with a CDFI carrying out a State-funded project so ESDC can exert control over the project's implementation and the contractor's performance. Furthermore, 14 of the 29 projects in our sample were initiated without executed contracts. We found that CDFIs had not filed either semi-annual or final reports for any of the ten projects that were started without contracts. We believe ESDC's practice of allowing CDFIs to assume the risk of starting projects without contracts also encourages noncompliance with reporting requirements. (In responding to our draft audit report ESDC officials indicated that they prefer to execute contracts prior to or as soon after initiation of projects. They also indicated that precautions are in place when this is not possible.)

Technical Assistance

CDFI grant monies can be used to provide post-loan technical assistance to qualified MWBEs in the form of qualified Technical Assistance Providers (TA Providers) and consultants, as well as supplies and training materials. The

CDFI may provide this technical assistance in the form of workshops, one-on-one sessions, or site visits to the MWBE client. Program guidelines also state that CDFIs can spend no more than 10 percent of project funds on administrative costs. However, we found that CDFIs used technical assistance funds inappropriately by using funds to support administrative services or to pay for questionable costs. Because ESDC did not adequately monitor CDFIs' use of technical assistance monies, there is increased risk that funds may have been wasted or used inappropriately, rather than spent to assist MWBE clients.

We found instances in which CDFIs used TA Provider funds to pay for administrative functions. If a function is mainly administrative or clerical, the function should be categorized as such and its costs should be classified as administrative overhead. For example, one CDFI used TA Provider funds to hire part-time clerical staff to process loans a clearly administrative function. In another instance, the CDFI used these funds to pay for a TA Provider to schedule technical assistance classes (clerical function). We conclude that some CDFIs misclassify administrative and clerical positions and used TA funds to circumvent the limit on overhead costs. (ESDC officials replied to our draft report that they do not consider these expenses as administrative because they help the CDFI carry out its work.) CDFIs can engage in these practices because ESDC does not verify that CDFIs follow program guidelines when hiring TA Providers and does not inquire about their duties. (ESDC officials replied to our draft report they do monitor the CDFIs and do not agree that funds are being used in a manner which circumvents the 10 percent cap on administrative expenses.) Although ESDC officials maintain that they must be flexible in interpreting the best use of technical assistance funds, the funds should be used as intended to provide for expert business and financial services for MWBEs, not clerical help for CDFIs.

We also found that ESDC allowed CDFIs to spend technical assistance funds for questionable purposes. For example, ESDC permitted two different CDFIs to spend between $8,500 to $9,500 for supplies and unspecified workshop materials. This amount is substantially higher than other CDFIs received for such purposes. One of these CDFIs also received $7,200 of technical assistance money to purchase computers and software for training, which is allowable under the CDFI program, but makes it even harder to justify giving the CDFI $8,500 for supplies and workshop materials. In fact, this CDFI

actually received the hardware and software as a donation and informed ESDC that it would use the $7,200 for other technical assistance purposes. The other CDFI received technical assistance funds for an additional $500 for food and $5,000 for printing, making it more difficult to justify giving $9,500 for unspecified workshop materials and supplies purposes. We believe that ESDC should limit amounts of funds that it allocates for vague purposes such as unspecified workshop materials and supplies especially when it already provided to CDFI funds for printing, computer equipment and software because such generous and unspecific allocations can lead to potential abuses of the technical assistance funds.

We also found that one CDFI received substantial technical assistance funds, even though it does not provide loans to clients, and thus had no borrowers who would seek post-loan technical assistance. This CDFI received $100,000 in FY 1999-00 – as well as $53,100 and $50,000 in FY 2000-01 and FY 2001-02, respectively. ESDC officials said this CDFI obtained the funds to provide valuable services for other CDFIs that were also federal credit unions so these credit unions could expand their business lending. However, officials at this CDFI were unable to provide any written evidence of these services. ESDC officials believe the Program appropriation language provides up to $1 million for such activities; however, the Program guidelines state that CDFI funds should be used to provide loan capital, loan loss reserve or post-loan technical assistance. Documentation should support that funds are used consistent with these purposes.

We believe that ESDC's lack of control over CDFI expenditures increases risk for abuse or inappropriate use of Program funds. Listed below are examples of ESDC's insufficient oversight of the use of technical assistance funds.

- Clients' files of just seven of the 20 projects in progress contained adequate documentation of TA Provider site visits.

- ESDC does not require that CDFIs keep attendance records at workshops conducted for clients. Just nine of the 20 projects had sign-in sheets to support client attendance at the workshops.

- ESDC's project manager visited just one of our sampled CDFIs during the term of the 29 projects we reviewed.

Although ESDC officials said they examine CDFIs' semi-annual reports to gauge project progress, we found that just 11 (55 percent) of the 20 projects underway had submitted such a report.

The CDFIs we visited stressed that MWBE entrepreneurs need technical assistance to start their businesses and to continue operating them. As a result, ESDC must increase its oversight of CDFIs' delivery of technical assistance to ensure that the funds are used to deliver the best possible services to their clients.

Loan Capital Grants

Section 6266-c of the Law (Law) restricts the use of Loan Capital funds to working capital, the purchase of equipment or inventory, or the acquisition or improvements of business property; and prohibits investment in real estate for speculative purposes and the payment of prior expenses, including debt and equity refinancing. However, we found five instances in which borrowers used Loan Capital funds for inappropriate purposes. The inappropriate use of funds occurred because ESDC requires CDFIs to provide minimal information about how the funds will be used, and then relies completely on CDFIs to monitor MWBE borrowers' compliance with the Law. As a result, some Loan Capital funds were put to uses that are highly questionable.

ESDC requires that CDFIs submit a New Loan Report form for each Capital Loan issued. Completing the form requires the CDFI to check boxes indicating the business-related purpose of the loan, such as equipment, inventory, working capital or leasehold improvements. The majority of the loans CDFIs make are for working capital. However, since this term is so broad, ESDC cannot use this classification to determine whether funds will be used for qualified purposes or to hold CDFIs or borrowers accountable for compliance with the Law's requirements.

For example, one CDFI that was unaware of the limitations on Loan Capital funds had commingled Program funds with its own funds. This CDFI found it difficult to identify all of the loans it had issued with ESDC funds. Because of record keeping problems, another CDFI was also unable to identify all the loans it had issued with ESDC funds and as a result may have issued some loans for other than qualified CDFI loans purposes.

ESDC officials attribute these problems to the CDFIs' failure to properly identify loans made with Program funds. We maintain that the above CDFIs did not enforce borrowers' compliance with the Law's requirements. Also, as previously discussed, the existing New Loan Report requires too little information about the uses of Program funds to be a useful tool for enforcing compliance. We found other instances in which CDFIs submitted New Loan Report forms that indicated its loans were issued for working capital purposes, or provided no explanation for loan purpose. This form must require CDFIs to provide more explicit information about the intended uses of loan funds. ESDC can then hold CDFIs accountable for making sure borrowers use funds for the purposes stated.

ESDC relies completely on CDFIs to oversee and to enforce borrowers' compliance with the Law and loan terms. However, CDFIs provide varying degrees of oversight of the borrowers' compliance. For example, some CDFI officials remained in close contact with borrowers throughout the mandatory post-loan technical assistance period, visiting the borrowers' businesses or reviewing the invoices and contracts to be paid with the loan's proceeds. However, other CDFIs cared only that the borrowers paid the loan installments on time. We found one CDFI with no staff assigned to visit the borrowers' businesses, and another that had no individual client folders was unable to locate all of the documentation we requested. In addition, ESDC does not require CDFIs to report on either compliant or noncompliant outcomes of loan capital grants. Thus, ESDC has little assurance that borrowers are using Loan Capital grants for purposes that comply with the Law and Program guidelines.

ESDC officials maintain they are correct in placing responsibility for enforcing loan terms on the CDFIs, but they did agree to ask the CDFIs to specify exact uses for working capital loans. One CDFI we visited already requires borrowers to describe the exact items that will be purchased (insurance, marketing services, supplies, etc.) with Loan Capital funds. We concluded that ESDC should also require CDFIs to report on borrowers' compliance with loan terms and make related documentation available for ESDC review.

Program Results

The Legislature established the Program to help grow small MWBEs. Accordingly, Section 6266-c of the Laws of 1987 requires that ESDC submit a report every two years after

September 1995 the due date of the first one. The report is an evaluation of the effectiveness of the Program prepared by an independent contractor. However, ESDC requires CDFIs to report only minimal information in semi-annual reports and statistical data in the project's final report. Further, ESDC has not submitted the required report (i.e., program effectiveness evaluation) since 1997. As a result, neither ESDC officials nor the Legislature know if the Program is achieving real economic impact and meeting its objective.

On examining CDFI final reports, we found they discuss project outcomes in terms of the number of clients receiving technical assistance and the number of workshops provided basically repeating the description of the completed project tasks instead of showing more-meaningful economic impact. For example, it would be more significant to report impact in terms of the number of new businesses started, or the percentage of decrease in loan default rates. It would also be useful to have the CDFIs report project impacts in terms of jobs created or retained.

CDFI officials point out that startup businesses are very small, and that it takes considerable time for these businesses to grow. ESDC requires CDFIs to describe project outcomes in Schedule B of the final report, but only nine CDFIs submitted final reports for the projects in our sample, and just five of these reports contained such narratives. ESDC maintains that this Program is not a job-creating program and does not require reporting in jobs term.

Further, ESDC has not prepared the reports on the Program's effectiveness, as required. The only report ESDC officials provided was the ESDC-commissioned report, *Evaluation of New York State's Technical Assistance and Financing Programs,* dated February 1997. In this report, the consultant maintained that the Program had produced an increase of 84 jobs at the cost of $18,090 per job. Since this is the only such evaluation performed, ESDC officials are not able to provide current performance information for the Program.

Based on the review of the ESDC documentation of the Program, we cannot determine what the State, or MWBEs in general, have gained from the Program. ESDC officials indicated that they recognized the need for collecting and reporting this economic impact data. They stated that, starting with the FY 2002-03 funding cycle, they would require all CDFIs

to submit an annual report, using the same indicators, that details the impact of their activities in more direct economic terms. As of July 2003, ESDC officials told us they developed the Request For Proposal (RFP) for an independent evaluation of the Program results and will issue this RFP when appropriate funding source and sufficient funds are identified. (In reply to our draft report, ESDC officials indicated that they are in the process of meeting this requirement.)

Interest Rates

Since ESDC provides CDFIs with grants for the purpose of lending money to MWBEs, it should confirm that this "free money" is being used to provide MWBEs with low-cost loans (at prime interest rates plus 3 percent or less) to stimulate their growth. However, we found that some CDFIs charge rates as high as 14.5 percent because ESDC allows CDFIs to determine the rates they charge the MWBE borrowers. ESDC officials should monitor the reasonableness of interest rates charged to make sure State funds made available to help develop MWBEs are actually accessible by these businesses.

The CDFI officials set loan interest rates in a variety of complex ways taking into account the cost of their capital, their rates of default and delinquency based on risk assumed, the collateral received and expectation of inflation. Some MWBEs are in distressed communities, and others have no collateral and no credit history. ESDC officials concede that CDFIs set the loan interest rate based on the risk involved and may charge MWBEs very high interest rates. These interest rates varied from the most common – prime rate (8.5 percent in 2000) plus 3 percent – to a high of 14.5 percent. (One CDFI was lending money at the prime rate but was considering an increase.) One CDFI official told us that the 14.5 percent rate charged MWBEs was still better than the rate local loan sharks would charge. Since regular banks would not provide loans to these businesses, CDFIs may be the only source of capital for startup MWBEs.

Although ESDC asserts that CDFIs need to base their interest rates on case-by-case basis considering many factors, they agree that MWBE borrowers are customarily charged higher rates because of the risk involved. Since the State provides the grants for this purpose, and since the CDFIs earn interest income on the loans, ESDC should make sure CDFIs make these funds available to MWBE borrowers at favorable interest

rates. The lower cost of borrowing could stimulate more growth at the MWBEs that obtain these loans.

Recommendations

2. Establish effective criteria for awarding Program grants, including a requirement that CDFIs be prepared to start a project shortly after its approval.

   (ESDC officials responded to our draft audit report that they were already doing what we recommended and added that delayed starts will be inevitable due to the State's fiscal year funding cycle and the process followed to award the Program grants.)

   Auditor's Comments: We acknowledge that all delayed starts cannot be avoided for the reasons cited by ESDC officials but, that was not the reason for the delayed starts of the projects cited in our report. As we mentioned in our report, ". . .ESDC provides grants to CDFIs that are not prepared to initiate their projects until long after the project approval date." ESDC must establish better criteria for awarding Program grants to address this problem as we recommended.

3. Enforce a policy of reducing or eliminating grants to CDFIs that performed poorly on the prior project.

   (In response to our draft audit report, ESDC officials indicated that prior performance of grantees is considered when reviewing applications for new funding.)

   Auditor's Comments: As our report indicates, new projects were approved for CDFIs that had not completed earlier approved projects or reported their results. Thus, we were not provided with evidence of such a practice by ESDC.

4. Terminate a project with no disbursement of remaining project funds unless the CDFI provides valid reasons for its failure to complete the project or submit the final report in a timely manner.

Recommendations (Cont'd)

(Responding to a draft of this report, ESDC officials said that projects were terminated for lack of a valid reason to continue, and that amount of new awards were adjusted but, they consider it counterproductive to terminate projects not completed within the anticipated timeframe.)

Auditor's Comments: During our audit, ESDC told us that they provided us with documentation of all approved projects. However, during our review of the information provided by ESDC officials we did not find any approved project that was terminated for lack of a valid reason to continue or that the new award amount was adjusted. ESDC officials did share with us their beliefs that they consider it counterproductive to terminate projects not completed within the anticipated timeframe. We recognize their position in our report, but ESDC officials should establish reasonable timeframes for project completion and close out CDFIs that do not meet these timeframes. Exceptions should be made only in the event of extraordinary circumstances, such as a CDFI's move to new premises.

5. Change a project's scope when it becomes apparent the CDFI cannot complete the project as planned without significant delay.

   (ESDC agreed with this recommendation.)

6. Communicate with CDFIs on a regular basis to inform them of the status of their projects, including award monies still available and final reports due to ESDC.

   (ESDC agreed with this recommendation.)

7. Document ESDC's use of interest income on funds that were awarded to, but not drawn down by, CDFIs.

   (ESDC agreed with this recommendation.)

8. Require CDFIs to sign project contracts after projects receive Board approval.

Recommendations (Cont'd)

(Responding to a draft of this report, ESDC officials indicated that the requirements of the previous contracts have to be completed before a new contract is executed.)

Auditor's Comments: According to ESDC procedures, projects are first approved by the Board and then a contract should be executed with the grantee. During our audit, we found that it can take as much as nine months between project approval and contract execution. As our report indicated ". . .ESDC officials said they plan to issue contracts for 15 of the 29 FY 2001-02 projects by end of December 2002, or about 9 months after the March 2002 approval date." Consequently, new projects can be underway for long periods of time without the benefit of a contract.

9. Require all CDFIs to close prior projects before starting work on the new projects.

   (ESDC officials replied to our draft report that CDFIs are required to close prior projects before receiving funds for new projects. However, CDFIs can start work on new projects at their own risk. They also added that due to the reporting requirements for prior projects and the time required for ESDC to review these reports, the CDFIs have to start work on the new projects around the same time they are closing out the prior projects.)

   Auditor's Comments: Our audit indicates that CDFIs continue projects for two or more years while also initiating new projects. This may not be in the best interest of obtaining timely program results. In addition, the time between when a final report is filed and when ESDC reviews the report is excessive. The reasons for these delays need to be addressed.

10. To make sure that TA Providers funded by Program monies have proper credentials and provide direct technical assistance to MWBEs, ESDC should:

    - require CDFIs to provide TA Providers' credentials and experience; and

Recommendations (Cont'd)

- require CDFIs to indicate the job description for their TA Providers.

(ESDC agreed with the recommendation.)

11. Establish requirements for documenting technical assistance provided, including workshop sign-in sheets and written evidence of other TA Provider services.

    (ESDC replied that it has always required documentation of technical assistance. They agreed with and have implemented the recommendation to have workshop sign-in sheets.)

12. Require CDFIs to indicate the exact purpose of technical assistance supplies and training materials, and provide Program funds for only appropriate expenses.

    (ESDC agreed with the recommendation.)

13. Limit Program funding to projects whose objectives meet Program guidelines.

    (ESDC officials responded that funding was already limited to those projects whose objectives meet the Program guidelines.)

    Auditor's Comments: We disagree. For example, as our audit report points out, TA services were provided to credit unions belonging to a National Credit Union Association. However, program funds should only be used for loans to MWBE businesses and for post-loan technical assistance to those MWBEs.

14. Visit CDFIs periodically to review supporting documentation for the technical assistance provided and related expenses.

    (ESDC officials agreed with the recommendation.)

15. Include the limitation on uses of Loan Capital money, as stated in the Law and Program guidelines, in the contracts with CDFIs and verify that CDFIs are aware of these restrictions.

Recommendations (Cont'd)

(ESDC officials agreed with the recommendation.)

16. Require that all loans specify the exact items to be purchased with loan proceeds.

    (ESDC officials agreed with the recommendation.)

17. Require CDFIs to oversee borrowers' compliance with loan terms by:

    - developing procedures for verifying compliance;
    - reporting to ESDC about borrowers' compliance; and
    - making documentation available to support reported compliance.

    (In response to our draft report, ESDC officials disagreed with our recommendation. They said that monitoring the use of the loan proceeds after loan closing was extremely difficult.)

    Auditor's Comments: Based on our findings, we believe that it is critical for ESDC to monitor the use of the loan proceeds to ascertain that borrowers are in compliance with the loan terms.

18. Visit CDFIs on a periodic basis and review loan documentation to determine the reliability of each CDFI's oversight of borrowers' compliance with loan terms.

    (ESDC officials did not address the recommendation. They replied that in addition to supporting the provision of post-loan technical assistance by CDFIs, they would continue to carefully review the documentation for this form of assistance.)

    Auditor's Comments: Our recommendation calls for periodic visits to the CDFIs. During these visits the review of loan documentation will provide ESDC with some assurance that each CDFI is monitoring the borrowers' compliance with loan terms.

Recommendations (Cont'd)

19. Require CDFIs to report project outcomes in economic terms, such as increases in business starts, decreases in default rates, and the number of jobs created/retained.

    (ESDC agreed with the recommendation.)

20. Enforce the requirement that CDFIs submit a properly completed Schedule B Project Outcomes Report at the end of each project.

    (ESDC officials did not respond to this recommendation.)

21. Prepare and submit the required evaluation of the Program's effectiveness every two years.

    (ESDC officials replied to our draft report that are in the process of meeting this requirement.)

22. Verify that the CDFIs are issuing loans made with the Loan Capital grant funds at favorable interest rates.

    (Responding to our draft report ESDC officials disagreed with our recommendation because their position is that interest rates decisions are best left to the CDFIs.)

    Auditor's Comments: Loans made with the Loan Capital grant funds at favorable interest rates may increase the demand for such loans.

MAJOR CONTRIBUTORS TO THIS REPORT

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Anita W. Laremont
Senior Vice President - Legal
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August 20, 2003

Carmen Maldonado
Audit Director
Division of State Services
State Audit Bureau
123 William Street – 21st Floor
New York, NY 10038

Dear Ms. Maldonado:

Thank you for the opportunity to respond to your office's audit of ESDC's administration of the Minority and Women-Owned Business Development and Lending Program. Attached you will find our response, to be included as an appendix to your final report. We have also included the representation letter your office requested, and regret the confusion regarding the need to provide it. As I indicated to Santo Rendon of your office previously, we do not have any record of having ever received a request for such a letter. Nevertheless, we are happy to provide it now, based upon Santo's assertion that if we provided the letter, reference to it not having been provided would be deleted from your audit report. We appreciate your office's extension of the deadline for submission of our audit response, which we requested as a result of last week's power failure.

* Note 1

Sincerely,

Anita W. Laremont

Enclosures
Audit Response, dated August 20, 2003
Representation Letter, dated August 20, 2003

Empire State Development Corporation
633 Third Avenue New York, New York 10017-6754 Tel 212 803 3750 Fax 212 803 3775

* See State Comptroller's Notes, page 61

Empire Development

Anita W. Laremont
Senior Vice President - Legal
and General Counsel

August 20, 2003

Mr. William Lichtenberg
Associate State Accounts Auditor
Office of the State Comptroller
Division of Management Audit
123 William Street, 21st Floor
New York, NY 10038

Dear Mr. Lichtenberg:

In connection with your audit of the Empire State Development Corporation ("ESDC") Minority and Women Business Development and Lending Program ("MWBDL") during the period FY 1999-00 through FY 2001-02, we confirm to you, to the best of our knowledge and belief, the following representations and assurances:

1. New York Urban Development Corporation Act Chapter 24 Section 6266-c created the Minority and Women-Owned Business Development and Lending Program ("Program") to facilitate the flow of lending and investment capital into the targeted population that had difficulty accessing the mainstream financial services industry. The Program is administered by ESDC and provides grants and loans for delivery of capital and technical assistance to qualified minority-owned businesses.

2. ESDC is responsible for issuing and approving applications for the Program grants and loans (projects), issuing project contracts, monitoring the project progress, ensuring that projects comply with the contract requirements and provide accounting for the funds received.

3. We have made available all records relating to the scope of the audit and responded completely, factually and accurately to all inquiries made by your staff to us during the audit.

4. ESDC is responsible for establishing and maintaining the internal control structure (controls) in our organization. In fulfilling this responsibility, we have made estimates and judgments to assess the expected benefits and related costs of control procedures. The objectives of the controls are to provide us with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use and disposition, that transactions are executed in accordance with management's authorization and

Empire State Development Corporation
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recorded properly in the accounting and program records, and that the programs and operations are conducted in accordance with management's policies and procedures. In establishing controls, we have considered the guidelines contained in the "Standards for Internal Controls in New York State Government" issued by the Office of the State Comptroller in December 1987.

5. There are no undisclosed:

   • Irregularities involving management or employees who have a role in the internal control structure.

   • Irregularities involving other employees that could have a significant effect on the records or operations subject to your audit.

   • Communications from regulatory agencies concerning noncompliance with, or efficiencies in, reporting or operating practices that could have a significant effect on the operations subject to your audit.

6. We have complied with all laws, rules and regulations applicable that would have a significant effect on operations subject to review in the event of noncompliance.

7. We have complied with all aspects of contractual agreements and all laws, rules and regulations applicable to ESDC operations that would have a significant effect on operations subject to your audit in the event of non-compliance.

8. We have disclosed all details concerning any pending legal action against ESDC of which we are aware and which would significantly affect results of this review.

9. There are no significant transactions that have not been recorded in the accounting records related to the subject of your audit.

10. We have disclosed to you all significant events that have occurred subsequent to the audit cutoff date of December 31, 20002 that would have an effect on the operations covered by the scope of the audit or require adjustments to or disclosure in, the financial records.

Please contact me should you have any questions or need additional information.

Sincerely yours,

Anita W. Laremont

Empire State Development

Empire State Development Corporation Response To Audit Of Minority And Women Owned Business Development And Lending Program (01-S-55)

Summary

The following constitutes ESDC's response to the Office of the State Comptroller's (OSC) report of its audit of Empire State Development's Minority and Women's Business Development and Lending (MWBDL) Program (2001-S-55) (the "Report").

In summary, ESDC has determined that the Report contains a considerable number of misinterpretations, factual errors, misunderstandings of state laws and procedures, and assertions regarding ESDC policies and practices that have no clear basis in the rules or facts pertaining to the Program. These flaws in the Report and in its ensuing recommendations have resulted in an inaccurate depiction of ESDC's administration of this program. The Legislature has determined that these programs are necessary and helpful in the provision of business opportunities for minorities and women. ESDC agrees, and endeavors to carry out its legislative mandate consistent with the purposes underlying the establishment of these programs.

* Note 2

INTRODUCTION

Background

Program Purpose

The OSC spent twenty months preparing the Report of its audit of the MWBDL Program (the "Program") and yet, in spite of ESDC's efforts, it remains confused as to the fundamental nature of the Program.

* Note 3

> ***Audit Report:***
> "The Program, which was established in fiscal year (FY) 1987, is dedicated exclusively to helping strengthen and expand the capacity, products and services of small MWBEs [minority and women-owned business enterprises]. The Legislature created the Program to serve small MWBEs since these businesses have traditionally had difficulty accessing funds from the mainstream financial services industry." (Introduction, Page 1, Paragraph 1).
>
> ***ESDC Response:***
> The purpose of the MWBDL Program and the intent of the New York State Legislature in creating it is set forth in Section 16-C of the New York State Urban Development Corporation Act (the "Act"): "There is hereby created a minority and women-owned business development and lending program for the purposes of providing financial and technical assistance to minority and women entrepreneurs."

* Note 2

* See State Comptroller's Notes, page 61

ESDC provided the above-mentioned statutory language to OSC at the beginning of the audit in November 2001. The OSC's definition of the Program purpose reveals its failure to accurately understand the Program, and its resulting inability to effectively evaluate Program policies and activities.

In addition, by speculating about the Legislature's intent, this language in the Report demonstrates the OSC's willingness to impute requirements for the Program that are not actually stated in its rules and regulations. The very first sentence of the Report's introduction is misleading in this way when it states:

Audit Report:
"New York State has established a number of programs to encourage the development and expansion of MWBEs." (Introduction, Page 1, Paragraph 1)

ESDC Response:
The above statement implies that support of MWBEs was an explicit and primary goal of the ESDC programs listed in the next sentence of the Report, which is not the case. ESDC supplied this list of programs to the OSC and described them as having the "potential" to assist MWBEs.

* Note 2

Legislative Appropriation

During the audit ESDC spent considerable time addressing the OSC's confusion over how to interpret the budget language relating to the Program (this language is attached as Appendix A). Despite this effort, the Report indicates that the OSC did not fully understand these essential documents and therefore did not rely upon them when preparing its Report.

* Note 4

Audit Report:
"The State Legislature appropriated $3.5 million for the Program in fiscal years 1999-00 and 2000-01. In each year, the Legislature allocated these funds as follows: up to $525,000 to Linked Deposit; up to $975,000 to the Revolving Loan Trust Fund; and $1 million for the CDFI Program. The remaining $1 million was unallocated in both years. ESDC officials indicated that they are allowed to use these funds for any purpose related to the Program." (Introduction, Page 2, Paragraph 2)

ESDC Response:
The Report should include the words "up to" before the words "$1 million for the CDFI Program" in the above paragraph. The last sentence of this paragraph implies that the OSC was forced to rely upon ESDC's assertions concerning the MWBDL budget and was unable to verify them independently. However, this information is readily available upon a review of the Legislature's appropriations, as set forth in the budget language provided to the OSC at the beginning of the audit.

* Note 2

Audit Report:
"Instead, ESDC used some combination of these funds and unallocated funds to provide various loans and grants, totaling $1.6 million. Information provided to us from ESDC

* See State Comptroller's Notes, page 61

did not enable us to clearly identify the sources of funds for these loans and grants." (Introduction, Page 2, Paragraph 2)

Note 2

ESDC Response:
ESDC clearly identified these projects as having been funded through the MWBDL appropriation. This issue is addressed at greater length later in the Report.

Note 5

Audit Report:
The Report's mentions "$400,000 in funding from outside the Program to help pay for CDFIs' administrative expenses." (Introduction, Page 2, Paragraph 2)

ESDC Response:
This statement is unnecessarily imprecise because the actual budget language was provided to the OSC and states that the funds were for "services and expenses" of CDFIs. The distinction is important because later in the Report the OSC expresses concern about administrative expenditures by CDFIs.

Note 2

Comments of ESDC Officials

Note 6

It is true that the OSC offered ESDC the opportunity to review and comment upon the preliminary findings of its audit. However, the Report retains a number of erroneous assumptions and inaccurate assertions that were previously addressed by ESDC.

PROGRAM ADMINISTRATION

Draw-Down of Program Funds from the OSC

The Report is again inaccurate and misleading when it describes the Program budget and ESDC's usage of Program funds. The Legislature appropriated $3.5 million for Program expenditures in both FY 1999-00 and FY 2000-01. ESDC approved projects totaling $2,579,100 in FY 1999-00 and $1 million in FY 2000-01. The remaining amounts were neither approved by ESDC nor drawn down from the OSC.

Audit Report:
"Thus, funds available to the Program sat idle in ESDC's bank accounts and were not used to help MWBEs." (Program Administration, Page 6, Paragraph 1)

ESDC Response:
ESDC does not draw down funds from its appropriation unless it has committed those funds to specific projects. Therefore, any amounts remaining from the appropriation remain in the State's coffers, which are administered by the OSC, and are available for reappropriation. The OSC is also responsible for disbursing ESDC's drawdowns upon proof of project approval, and therefore should be aware that these funds never arrive in ESDC bank accounts.

Notes 2, 7

* See State Comptroller's Notes, page 61

Program Funds

Once again, the Report is inaccurate and misleading when it discusses ESDC's use of Program funds in relation to the Legislature's budget language.

Audit Report:
In the table on page 6 and in the following paragraphs on page 7, the Report discusses Program appropriations and awards. The Report uses the term "unallocated" to describe Program funds that were not earmarked by the Legislature for specific purposes. The Report also categorizes certain ESDC awards as "Other Loans" and "Other Grants" in the table on page 6, and in a related footnote to the table it states "ESDC did not disclose the sources of funding for these loans and grants."

* Note 2

On page 7 the Report asserts that "Although ESDC officials did not approve any Linked Deposit or Revolving Funds projects in FY 1999-00, they did make $1.6 million in discretionary loans and grants ($1,090,000 in loans and $489,100 in grants) to individual MWBEs in this year. ESDC officials did not disclose to us the source – whether Linked Deposit, Revolving Trust or unallocated funds – of the $1.6 million they used to make these loans and grants." (Program Administration, pages 6 and 7)

* Note 2

ESDC Response:
These statements suggest that ESDC refused to provide this information to the OSC, which is absolutely untrue. In fact, these statements are further evidence of the OSC's ongoing confusion concerning appropriation language and the conventions used in the State budget. The Legislature does not use the term "unallocated" to describe Program funds that are not earmarked for specific purposes. The budget bill is silent with regard to such funds and they are therefore available to support the full range of MWBDL projects. Accordingly, neither does ESDC formally designate projects as "unallocated" or "discretionary" – all such projects were described accurately as general MWBDL projects on documents supplied to the OSC. These topics were discussed at length with OSC audit staff, and it is specious to state that ESDC "did not disclose" the sources of funding for these projects. In fact, as noted in the Report, ESDC informed the OSC that it had not approved Linked Deposit or Revolving Loan Trust Funds projects in FY 1999-00. It also supplied lists of CDFI projects approved in that year. Therefore, although it never questioned ESDC directly on this front, the OSC should have been able to deduce that the "Other" loans and grants approved that year came from the "unallocated" portion of the appropriation.

* Notes 4&5

* Note 2

The budget language uses the words "up to" when allocating funds for specific purposes, indicating that ESDC is not required to commit the entire amount so allocated. Instead, ESDC can respond to varying levels of demand for these funds. Any funds not used for specific purposes revert to what the OSC calls the "unallocated" category and are thus available to fund general MWBDL projects. Therefore, ESDC's commitments in FY 1999-00 did not exceed the maximum amount earmarked for any one purpose.

* See State Comptroller's Notes, page 61

Audit Report: Recommendation #1
1. Market the Program among prospective MWBE clients so that all available funds to develop and expand MWBE businesses are used as intended by the Legislature.

ESDC Response:
The CDFI Program does not rely upon marketing to generate demand because ESDC is easily able to identify and target all potential grantees by accessing the list of federally certified CDFIs located in New York State. It obtains the list of certified organizations from the U.S. Department of the Treasury and has ensured that all such organizations receive a copy of the request for proposals ("RFP") issued annually over the past six years in response to the Legislature's direction. For other programs, including the full range of MWBDL funding, ESDC relies upon its regional offices and its Economic Revitalization unit to identify projects that might benefit local employers and thus the overall economic health of the State. In addition, ESDC intends to strengthen the outreach performed by its Community Network Offices and thereby increase the level of MWBDL commitments.

* Note 8

There are a number of reasons that ESDC might be unable to utilize the entire amount appropriated for a given funding source in a given year. It is true that the Corporation receives no funding for advertising or promotion of its programs. Demand also varies from year to year depending upon the overall state of the economy, which declined precipitously beginning with the stock market crash in the spring of 2001. In addition, as previously noted, ESDC funds a variety of programs that can be used to benefit MWBEs, and some of these provide benefits that are preferable to those available under the MWBDL program. Finally, the CDFI Program achieves goals very similar to those addressed with Linked Deposit and Revolving Trust projects, and it has to a certain extent superceded those other programs as a more efficient and up-to-date method of delivering benefits to MWBEs.

CDFI Projects

The introduction to this section contains a number of statements that further reveal the OSC's incomplete understanding of the Program, of community development organizations in general, and of ESDC's policies and procedures for implementing projects of this type.

Project Initiation and Completion

Audit Report:
"ESDC should set reasonable timeframes for project completion at the time the project is approved, and penalize CDFIs that do not meet these timeframes. Exceptions should be made only in the event of extraordinary circumstances (such as a CDFI's move to a new premises)." (CDFI Projects, Page 11, Paragraph 3)

* See State Comptroller's Notes, page 62

ESDC's Response:
It is ESDC's considered opinion that penalizing grantees in the manner suggested by the Report would encourage a "use it or lose it" mentality toward the use of funds, which could result in the misuse of Program funds. This approach would therefore not be in the State's best economic development interests. ESDC *does* set reasonable timeframes for project completion at the time the project is approved, and it does monitor compliance with these timeframes. However, it does not regularly "penalize" organizations that do not meet these timeframes because CDFIs have generally displayed great care in the ways that they have utilized Program funds. ESDC uses other means to tailor levels of funding to the needs of specific CDFIs and the MWBEs that they serve.

*
Note 2

ESDC accepts applications for CDFI funding only once per year and does not consider it good policy to deny a CDFI funding for an entire year because of a delay in completing a prior project, particularly when the delay was caused by the careful stewardship of funds. Instead, if a CDFI has funding remaining under previous grants when it submits a new proposal that is also worthy of funding, the new grant amount is reduced to the amount necessary to provide funding through the new funding cycle. This approach does result in situations where an approved project is not scheduled to begin until several months after the approval date, but delays of this type are a necessary feature of the RFP process and the State's fiscal year funding cycle. The OSC is surely aware of these limitations, but it does not acknowledge them in its Report.

*
Note 9

ESDC's approach to managing CDFI projects has evolved over time, informed by experience. We believe that it strikes the right balance between service to CDFIs andMWBEs, and careful management of State funds so as to maximize their benefit. Many projects approved in the first two years of the CDFI program took longer to complete than anticipated, and this situation led to later start dates for many projects proposed in ensuing years. ESDC recognized the problem and began adjusting its award process in FY99-00, when it first began offering smaller grants to applicants that had funds remaining from previous awards. As it has gained experience with the Program and the CDFI community, ESDC has also in several cases terminated projects with serious delays. Combined, these measures have resulted in substantial reductions in the time between project approval and completion. ESDC's CDFI Program is fulfilling the Legislature's intent, the level of assistance is appropriately scaled to the need and capacity of the participating CDFIs, and there is healthy demand for CDFI program funds.

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Note 9

Audit Report:
This section of the Report contains a number of specific examples of delays in the execution of contracts and the disbursement of funds, and cases in which grantees were approved for new grants despite not having completed earlier projects.

ESDC Response:
The specific cases cited in the Report were products of some of the realities described previously, and these cases are now resolved. As stated in the preceding paragraphs of this response to the Report, ESDC has implemented a number of changes to the CDFI

* See State Comptroller's Notes, page 61 & 62

program that are designed to mitigate these issues. In addition to those measures, ESDC has stopped making grants of IDA matching funds because IDA projects often take much longer to complete than originally contemplated by grantees.

Contract Execution

The OSC's discussion of contract execution raises a number of concerns that are not warranted by the facts cited in the Report.

Audit Report:
"Without having a contract in place, ESDC officials cannot determine whether the project is progressing as intended, whether the CDFI has fulfilled all the project obligations, and whether it has claimed only qualifying expenses. ESDC officials maintain that they allow CDFI to start the project at their own risk as early as the application date, based on the project scope definition submitted in the application. ESDC officials maintain that project implementation without an executed contract is rare, and occurs when CDFIs delay filing final reports on earlier projects." (Contract Execution, Page 12, Paragraph 4)

ESDC Response:
It is quite common for grantees to initiate project activities without an executed contract. ESDC has never suggested otherwise, and the OSC Report is mistaken when it asserts that the Corporation calls the situation "rare". ESDC generally seeks to provide seamless funding to CDFIs, such that the last day of project activities under one grant is followed by the first day of project activities on the next grant. This practice enables CDFIs to maintain continuity in the programs they offer. However, it is also true that ESDC will not execute a new contract until all required reports on the previous contract have been received. Grantees are generally given a month to file a final report following the completion of project activities, and ESDC has an additional month to review and comment on the final report. This approach inevitably results in some delays between project initiation and contract execution.

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Notes 2, 10

While a contract executed in advance of project implementation allows for some modification of the project goals and timeline, ESDC allows no such modification when executing a contract after the start of the project. The grantee is held to the goals and budget it submitted with its proposal, as amended during ESDC's approval process. In addition, funds are not advanced to the grantee in these cases and payments are approved only after ESDC has reviewed the actual expenses. Therefore, only qualified expenses are reimbursed. And finally, if project goals as outlined in the proposal have not been met, ESDC can and does withhold funds if it is necessary to do so. It is the Corporation's preference to execute contracts prior to or soon after the initiation of project activities, and its efforts to calibrate funding and improve reporting have resulted in substantial improvements in this area.

* See State Comptroller's Notes, page 61 & 62

Technical Assistance

This section of the Report is inaccurate when it asserts that the CDFIs reviewed by the OSC used technical assistance ("TA") grant funds "inappropriately", and the statement that "ESDC did not monitor CDFIs' use of technical assistance monies" is patently untrue. The Report's conclusion that funds were used "inappropriately" is a result of its lack of understanding of the regulations governing the CDFI Program and of its willingness to invent requirements that are not specified in these regulations.

* Note 2

Inappropriate Expenditures

Audit Report:
"We conclude that some CDFIs misclassify administrative and clerical positions and used TA funds inappropriately to circumvent the limit on overhead costs. CDFIs can engage in these practices because ESDC does not verify that CDFIs follow program guidelines when hiring TA Providers and does not inquire about their duties." (Technical Assistance, Page 13, Paragraph 3)

ESDC Response:
The Report does not identify the "program guidelines" being ignored by ESDC. The overall goal of ESDC's CDFI Assistance Program is consistent with the Legislature's stated purpose for the MWBDL Program as a whole – "providing financial and technical assistance to minority and women entrepreneurs." It is consistent with the Legislature's appropriation of Program funds to be used "for services and expenses consistent with the Federal Community Development Financial Institutions Program," and for "program activities conducted by community development financial institutions" (CDFIs). CDFIs are required to provide technical assistance to their borrowers in order to receive and maintain their federal certification as a CDFI, which is a valuable asset for any community development organization. ESDC's funding of TA provision by CDFIs is also consistent with MWBDL regulations requiring a review of the qualifications of an *organization* providing TA to MWBEs. ESDC carefully reviews the qualifications of all grantee organizations and ensures that they have the capacity to deliver proposed technical assistance services to MWBEs.

* Note 11

Although ESDC's Request for Proposals lists "Technical Assistance Provider salary and fringe" as one possible use of TA funding, this is not a "guideline" of the Program, but merely a suggested description for a common use of funds. ESDC does not require that employees supported with TA funds be direct service providers. Instead, ESDC funds activities whose *outcome* is the direct provision of financial or technical assistance to MWBEs. For example, ESDC has determined that paying the salary of a "Coordinator" of a TA program is a valid use of TA grant funds and does not constitute an attempt to "circumvent the limit on overhead costs", as claimed in the Report. Funds granted for administrative expenses are meant to allow for some funding of the grantee's administration of the grant, as well as to pay for what are commonly referred to as "indirect" expenses, such as rent, utilities, etc. Although the CDFI Program "guidelines" do not necessarily require it, ESDC has always reviewed the qualifications of consultants

* See State Comptroller's Notes, page 61 & 62

paid with grant funds, and it will begin asking for job descriptions and qualifications of all TA staff as part of future RFP processes.

Audit Report:
"We also found that ESDC allowed CDFIs to spend technical assistance funds for questionable purposes. For example, ESDC permitted two different CDFIs to spend between $8,500 and $9,500 for supplies and unspecified workshop materials." (Technical Assistance, Page 14, Paragraph 1)

ESDC Response:
Again, expenditures of this type are allowable under all applicable guidelines for the CDFI Assistance Program. The MWBDL regulations governing TA grants envision expenditures for the provision of seminars, training programs and similar activities. CDFIs work with low and moderate-income clients in economically distressed areas and provide extensive technical service and very small loans to businesses that otherwise would not be able to obtain such loans. All CDFIs are therefore at least partially reliant upon grant funds in order to maintain their operations, including supplies and materials, and they obtain these grant funds from a variety sources in addition to ESDC. For these reasons, ESDC endeavors to allow CDFIs substantial flexibility in terms of how they budget these funds, and CDFIs have reported that they value ESDC's program in part because it provides wide support for their TA activities.

* Note 12

ESDC staff evaluates the overall budget of the organization when reviewing CDFI funding proposals, and it applies standards based on prior experience, both with the specific applicant organization and with CDFIs in general. In addition, the narrative sections of the proposals describe in detail the activities that will be funded. In the cases cited in the Report, ESDC staff used their professional judgement to evaluate the proposed expenditures and found them to be appropriate. Even after a contract is finalized, unexpected circumstances often arise, and grantees are able to request a budget modification in situations such as the one cited in the Report, where the grantee received a donation of items that it had intended to purchase with grant funds. ESDC is flexible, but not without careful scrutiny of the documentation of these expenditures to ensure that the funds are being used for appropriate purposes, as detailed below.

Audit Report:
"This CDFI's expense documentation included a $182 bill for alcoholic beverages consumed at a Christmas party for workshop participants. State funds should not be used to pay for alcoholic beverages." (Technical Assistance, Page 14, Paragraph 1)

ESDC Response:
ESDC agrees that State funds should not be used to pay for alcoholic beverages. ESDC actually identified this particular case for the OSC, and informed the OSC at that time that it had refused to consider this expense as an allowable use of Program funds. The same holds true for many of the other expenses documented for that particular grant. Unfortunately, the Report misleads the reader by failing to acknowledge ESDC's responsible handling of this case. The fact that the OSC found only one such case out of

* Note 2

* See State Comptroller's Notes, page 61 & 62

29 projects, combined with the fact that ESDC recognized the problem and refused to reimburse the inappropriate expenses, shows that ESDC does closely monitor the use of TA funds and successfully prevents their abuse.

Audit Report:
"We also found that one CDFI received substantial technical assistance funds, even though it does not provide loans to clients, and thus had no borrowers who would seek post-loan technical assistance." (Technical Assistance, Page 14, Paragraph 2)

ESDC Response:
As stated previously, ESDC's MWBDL appropriation allowed funds to be used for "program activities conducted by community development financial institutions" (CDFIs). The grantee described in this section of the Report is a federally certified CDFI that provides financial and technical assistance to other certified CDFIs. Its proposal for funding under the CDFI Assistance Program called for it to provide TA to ten New York City credit unions that are also CDFIs. This technical assistance was geared toward helping these credit unions improve and expand their business lending to MWBEs. ESDC deemed this proposal to be both worthy of and eligible for funding through the CDFI Assistance Program, and the terms of the RFP for the program allows it to make such determinations.

* Note 13

Audit Report:
"However, officials at this CDFI were unable to provide any written evidence of these services." (Technical Assistance, Page 14, Paragraph 2)

ESDC Response:
This grantee submitted substantial documentation of its activities when reporting on the use of ESDC grant funds. The documentation included a special ten-page report describing results of the projects, as well as copies of model loan documents and other resources developed to enhance the business lending programs of other CDFIs. Staff at this CDFI do not recall being unable to provide any of the information requested during the site visit by OSC audit staff.

* Note 14

Documentation of Technical Assistance Activities

Audit Report:
"Clients' files of just 7 of the 20 projects in progress contained adequate documentation of TA Provider site visits." (Technical Assistance, Page 15, Bullet 1)

ESDC Response:
The OSC does not specify what it considers to be adequate documentation of site visits, but ESDC does require grantees to provide contact information for all MWBEs that receive TA. In addition, site visits prior to the closing of a loan are standard practice in the community development lending field.

* Note 15

* See State Comptroller's Notes, page 63

Audit Report:
"ESDC does not require that CDFIs keep attendance records at workshops conducted for clients." (Technical Assistance, Page 15, Bullet 2)

ESDC Response:
Again, ESDC does require grantees to provide contact information for all MWBEs that receive TA, and it has already begun requiring submission of sign-in sheets, flyers and other additional documentation of technical assistance activities (see Appendix B: Current CDFI Assistance Program Reporting Forms).

Audit Report:
"ESDC's project manager visited just one of our sampled CDFIs during the term of the 29 projects we reviewed. Although ESDC officials said they examine CDFIs' semi-annual reports to gauge project progress, we found that just 11 (55 percent) of the 20 projects underway had submitted such a report." (Technical Assistance, Page 15, Bullet 3)

*
Note 15

ESDC Response:
ESDC requires that CDFI grantees submit semi-annual reports as a condition of additional disbursements of grant funds on open projects. As the name implies, they are due every six months, and were likely not yet due in the cases cited in the Report. With regard to site visits by ESDC staff, unfortunately the legislature does not include funding for staff when it allocates funds for the CDFI Program. The total budget of the program is relatively small in comparison with many of the other programs administered by ESDC, and the $700 million awarded to the Corporation by HUD in response to the September 11, 2001 terrorist attack stretched staff to the limit. Nonetheless, ESDC has recently devoted additional staff resources to the Program and is instituting a more regular program of site visits.

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Note 16

Loan Capital Grants

Ineligible Uses of Loan Capital

Audit Report:
"For example, one CDFI that was unaware of the limitations on Loan Capital funds had commingled Program funds with its own funds. As a result, this CDFI had issued at least five loans totaling $19,000 for unqualified purposes. This CDFI found it difficult to identify all of the loans it had issued with ESDC funds, but some of the loans we were able to review included funds for the purchase of a residence in the Dominican Republic, for personal trips abroad, and for real estate investments." (Loan Capital Grants, Page 16, Paragraph 2)

ESDC Response:
There is no evidence that ESDC funds were actually used for the unqualified purposes mentioned. The grant in question included $25,000 to be used as loan capital, and in its

* See State Comptroller's Notes, page 63

later reporting on the use of these funds the grantee unnecessarily documented 21 loans totaling $130,000. The first three loans documented were the first closed during the project period and totaled $25,000, the amount granted by ESDC. Upon subsequent review, the grantee documented that these three loans were made for legitimate purposes allowable under the terms of the grant. In fact, every loan on the list submitted, with the exception of one loan for $1,000, was made for allowable uses. This $1,000 loan was closed after the grantee had already closed $99,500 in eligible loans. Therefore, ESDC funds were not used for unqualified purposes by this grantee.

The amount of loan capital funding provided by ESDC is exceedingly small when compared to the overall loan portfolios of CDFI grantees, which are funded primarily from other sources. ESDC no longer requires grantees to maintain separate bank accounts for grant funds because staff determined that it would serve little real purpose in this program. Instead, ESDC program funds are added to the grantee's pool of available capital, and ESDC relies upon grantees to report only qualified loans in the amount necessary to document the use of grant funds. Restrictions on the use of loan capital grants as described in the Report have always been specified in the contracts between CDFI grantees and ESDC. The problem in the case cited in the Report was that the CDFI documented too many loans and included loans that exceeded ESDC's grant amount.

* Note 17

Audit Report:
"ESDC officials attribute these problems to the CDFIs' failure to properly identify loans made with Program funds. We maintain that the above CDFIs did not enforce borrowers' compliance with the Law's requirements. Also, as previously discussed, the existing New Loan Report requires too little information about the uses of Program funds to be a useful tool for enforcing compliance." (Loan Capital Grants, Page 16, Paragraph 3)

ESDC Response:
As the OSC discovered, the term "working capital" is broadly defined in the business lending field. ESDC now requires CDFI grantees to provide more specific information regarding the use of funds granted as loan capital. The CDFI Assistance Program is structured as a decentralized lending program as authorized in the UDC Act, and ESDC relies on grantees to perform due diligence reviews and to enforce loan terms. The Corporation will continue to use its funding to encourage CDFIs to pursue such monitoring as part of their normal lending and technical assistance activities. In addition, ESDC will continue to ask grantees to report on the repayment of grant-funded loans as part of the program's final reporting process.

* Note 17

Program Results

The fact that this section of the Report states that ESDC officials do not know if the Program is meeting its objectives again suggests that the OSC does not have an accurate understanding of the Program's purpose.

* See State Comptroller's Notes, page 63

Audit Report:
"ESDC does not require the CDFIs to report project impacts in terms of jobs created or retained." (Program Results, Page 17, Paragraph 4)

ESDC Response:
ESDC does not require reporting on job creation because such outcomes are not a requirement of the regulations governing the CDFI Assistance Program. The Legislature created the MWBDL Program "for the purpose of providing financial and technical assistance to minority and women entrepreneurs", and, as specified in its MWBDL appropriation, to provide funding for the "program activities of CDFIs." ESDC's CDFI Assistance Program clearly meets these objectives and meets them effectively.

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Note 2

In addition, community development professionals are divided in their opinions regarding the extent to which CDFIs can and should accept blame or credit for the economic performance of the businesses they assist. ESDC takes the position that it is not realistic or meaningful to ask CDFIs to project economic outcomes such as job creation at businesses that they have not yet encountered. Contracts with CDFIs therefore do not include goals in these terms. However, ESDC has recognized the need to collect more of this type of data at project completion, and now requires that all grantees submit an additional annual report detailing the impact of their activities more directly in economic terms.

*
Note 18

Audit Report:
"ESDC requires CDFIs to describe project outcomes in Schedule B of the final report, but only nine CDFIs submitted final reports for the projects on our sample, and just five of these reports contained such narratives." (Program Results, Page 17, Paragraph 5)

ESDC Response:
The final reports required by ESDC measure the performance of CDFIs in the terms specified by the Legislature. The OSC's Report suggests that some CDFIs had not submitted these reports, but it fails to note that the grantees had not necessarily completed their projects at the time of the OSC's review and therefore were not yet required to submit such reports. In order to be eligible to receive future funding, all CDFIs are required to submit a final report prior to the final disbursement of grant funds. These reports must include a narrative describing project outcomes, and ESDC regularly requires grantees to supply additional information in these terms before final reports are accepted as final.

*
Note 18

Audit Report:
"Further, ESDC has not prepared the required annual report on the Program's effectiveness." (Program Results, Page 18, Paragraph 2)

ESDC Response:
This report is required every two years, not annually. ESDC is in the process of meeting this requirement.

*
Note 2

* See State Comptroller's Notes, page 61 & 63

Audit Report:
"Based on the review of the ESDC documentation of the Program, we cannot determine what the State, or MWBEs in general, have gained from the Program." (Program Results, Page 18, Paragraph 3)

ESDC Response:
Again, CDFIs make "small loans and loans to start up minority- and women-owned businesses", as called for in the legislation that authorizes the MWBDL Program. The CDFIs that received grants from ESDC in FY 2001-02 made 1,102 loans to MWBEs totaling more than $12.7 million in 2001. In addition, these CDFIs provided intensive technical assistance to thousands of MWBEs. CDFIs could never have provided this assistance without grant support, and ESDC's CDFI Assistance Program is a crucial source of that support.

Interest Rates

In this section of the Report the OSC again seems to establish requirements for the Program that are not actually enumerated in its rules.

Audit Report:
"ESDC officials should monitor the reasonableness of interest rates charged to make sure State funds made available to help develop MWBEs are actually accessible by these businesses." (Interest Rates, Page 18, Paragraph 4)

ESDC Response:
CDFIs set interest rates based on a wide range of factors that vary from business to business, and ESDC has determined that it would not be appropriate for it to set maximum interest rates when it makes modest grants of loan capital. Just as called for in Section 6266-c of the Act, CDFIs make "small loans and loans to start up minority and women-owned businesses," businesses that would not otherwise be able to secure such loans. These loans are "accessible" and valuable for that reason, not because their interest rates are low. CDFIs that succeed in making loans and in getting repaid are clearly offering a product that works well for both lender and borrower. In addition, ESDC's grants of loan capital represent only a very small portion of the loan capital available to CDFIs. Moreover, the rates are comparable to bank rates for similar risk, and the income generated by lending increases the self-sufficiency of CDFIs, which is a goal that ESDC supports.

* Note 19

Recommendations

1. *Market the Program among prospective MWBE clients so that all available funds to develop and expand MWBE businesses are used as intended by the Legislature.*

* See State Comptroller's Notes, page 64

ESDC relies upon its regional offices and its Economic Revitalization unit to identify projects that might benefit local employers and thus the overall economic health of the State. In addition, ESDC intends to strengthen the outreach performed by its Community Network Offices and thereby increase the level of MWBDL commitments.

2. *Establish effective criteria for awarding Program grants, including a requirement that CDFIs be prepared to start a project shortly after its approval.*

   ESDC already employs effective criteria for awarding grants and has already taken steps to ensure that grantees are prepared to start projects shortly after their approval. However, for reasons noted in this response to the OSC's Report, delayed starts will be inevitable due to the realities of the RFP process and the State's fiscal year funding cycle

3. *Enforce a policy of reducing or eliminating grants to CDFIs that performed poorly on the prior project.*

   ESDC carefully considers the prior performance of grantees when reviewing applications for new funding, and this assessment is already a major factor affecting funding decisions.

4. *Terminate a project with no disbursement of remaining project funds unless the CDFI provides valid reasons for its failure to complete the project or submit the final report in a timely manner.*

   ESDC has terminated projects that lacked valid reasons to continue. However, ESDC does not agree with the OSC's recommendation that it penalize grantees that do not complete projects within the anticipated timeframe. Grantees in these cases often have practiced careful stewardship of their grant funds and ESDC believes that it would be counterproductive to terminate such projects. Instead, ESDC considers the amount of previous funding available when evaluating new proposals, and on this basis adjusts the amount of new awards.

5. *Change a project's scope when it becomes apparent the CDFI cannot complete the project as planned without significant delay.*

   ESDC has established policies for modifying budgets and often changes a project's scope when circumstances warrant such a change.

6. *Communicate with CDFIs on a regular basis to inform them of the status of their projects, including award monies still available and final reports due to ESDC.*

   ESDC has begun increasing the frequency of its written communications with CDFIs.

7. *Document ESDC's use of interest income on funds that were awarded to, but not drawn down by, CDFIs.*

   ESDC will document its use of these funds.

8. *Require CDFIs to sign project contracts after projects receive Board approval.*

   ESDC requires CDFI grantees to complete all of the requirements of previous contracts before a new contract is executed. This practice protects the Corporation from entering into a binding contract with a grantee that is out of compliance with previous grants.

9. *Require all CDFIs to close prior project before starting work on the new projects.*

   ESDC requires CDFIs to close prior projects before *receiving funds* for new projects. Grantees are allowed to begin work on new projects at their own risk. It is generally the case that work on new projects begins around the same time as reporting for prior projects is submitted, but there are inevitable delays because of the time required for CDFI s to prepare reports and for ESDC to review them.

10. *To make sure that TA Providers funded by Program monies have proper credentials and provide direct technical assistance to MWBES, ESDC should:*
    - *require CDFIs to provide TA Providers' credentials and experience; and*
    - *require CDFIs to indicate the job description for their TA providers.*

    It is ESDC's policy to review the credentials and job descriptions of consultants paid with grant funds, and the Corporation will begin requiring the same documentation for TA providers on the staff of CDFI grantees. This documentation will be required as part of the application for funding.

11. *Establish requirements for documenting technical assistance provided, including workshop sign-in sheets and written evidence of other TA Provider services.*

    ESDC has always required narrative descriptions of TA activities and contact information for MWBES that have received assistance. It has begun requiring the submission of workshop sign-in sheets and additional documentation (see Appendix B: Current CDFI Assistance Program Reporting Forms).

12. *Require CDFIs to indicate the exact purpose of technical assistance supplies and training materials and provide Program funds for only appropriate expenses.*

    ESDC carefully monitors the use of Program and only provides funds for appropriate expenses. It will include more detail in contract budgets concerning expenditures on supplies and training materials whenever it is practical to do so.

13. *Limit Program funding to projects whose objectives meet Program guidelines.*

    ESDC's funding is already limited to projects whose objectives meet Program guidelines.

14. *Visit CDFIs periodically to review supporting documentation for the technical assistance provided and related expenses.*

    ESDC already requires CDFIs to submit substantial documentation when reporting. The Corporation will increase its visits to CDFIs as resources allow.

15. *Include the limitation on uses of Loan Capital money, as stated in the Law and Program guidelines, in the contracts with CDFIs and verify that CDFIs are aware of these restrictions.*

    These limitations have always been set forth in the contracts for the program. ESDC has also modified the contract reporting forms to ensure that CDFIs are aware of these restrictions (See Appendix B: Current CDFI Assistance Program Reporting Forms).

16. *Require that all loans specify the exact items to be purchased with loan proceeds.*

    ESDC has already modified the contract reporting forms to obtain this information.

17. *Require CDFIs to oversee borrowers' compliance with loan terms by:*

    - *Developing procedures for verifying compliance;*
    - *Reporting to ESDC about borrowers' compliance; and*
    - *Making documentation available to support reported compliance.*

    CDFIs already document repayment rates and loan policies and procedures when applying for funds. They also report on loan repayment rates as part of the final report for grants. Applicants also submit audited financial statements showing that they have been independently audited. Monitoring borrowers' use of loan proceeds after loan closing is extremely difficult. ESDC relies upon CDFIs to conduct monitoring of this type, and evaluates the capacity of CDFIs to perform this monitoring when making funding decisions.

18. *Visit CDFIs on a periodic basis and review loan documentation to determine the reliability of each CDFIs oversight of compliance with loan terms.*

    ESDC will continue to use its funding to support the provision of post-loan technical assistance by CDFIs, and will continue to carefully review the documentation of this form of assistance.

19. *Require CDFIs to report project outcomes in economic terms such as increases in business starts, decreases in default rates, and the number of jobs created/retained.*

    ESDC now requires submittal of an annual report data of this type, including the number of loans made to startups, and changes in delinquency rates. ESDC already collects data on the number of employees at businesses assisted, although it does not necessarily consider these jobs to be "created" or "retained" (See Appendix B: Current CDFI Assistance Program Reporting Forms).

20. *Prepare and submit the required evaluation of the of the Program's effectiveness on an annual basis.*

    ESDC is required to submit this report every two years and is in the process of meeting this requirement.

21. *Verify that the CDFIs are issuing loans made with the Loan Capital grant funds at favorable interest rates.*

    For reasons cited in this response to the OSC's Report, ESDC does not believe that it is an appropriate policy to specify the interest rates at which these funds are loaned. The value of these loans is in the fact that assistance is provided to businesses that would otherwise not be able to secure financing. ESDC believes that interest rates decisions are best left to the CDFIs.

Empire State Development Corporation Response To Audit of Minority And Women Owned Business Development And Lending Program (01-S-55)

Appendix A:
Legislative Appropriations and Budget Language for the MWBDL and CDFI Assistance Programs

1. FY 1999-00 MWBDL Appropriation and Budget Language
2. FY 2000-01 MWBDL and Aid to Localities CDFI Appropriations and Budget Language

OK

453

07904-14-9

NEW YORK STATE URBAN DEVELOPMENT CORPORATION

STATE OPERATIONS AND AID TO LOCALITIES 1999-2000

For payment according to the following schedule:

ECONOMIC DEVELOPMENT PROGRAM 156,200,000

General Fund / Aid to Localities
Local Assistance Account - 001

For services and expenses of the delphi harrison thermal systems project 16,000,000
For services and expenses of the jobs now program 45,000,000
For services and expenses of the empire state economic development fund 40,000,000
For services and expenses of the urban and community development program in economically distressed areas 3,500,000
For services and expenses of the minority

454

07904-14-9

NEW YORK STATE URBAN DEVELOPMENT CORPORATION

STATE OPERATIONS AND AID TO LOCALITIES 1999-2000

and women-owned business development and lending program 3,500,000

08/02/99 91 14224-02-9

(b) minority- and women-owned business development and lending program, (i) for services and expenses consistent with the Federal Community Development Financial Institutions Program (12 U.S.C. 4701 et seq.), up to $1,000,000 shall be used for program activities conducted

08/02/99 92 14224-02-9

by community development financial institutions in economically distressed and highly distressed areas; (ii) up to $525,000 shall be used to make linked deposits of funds into federally and state chartered credit unions in New York state to make small loans to minority- and women-owned businesses; and (iii) up to $975,000 shall be used to capitalize and recapitalize revolving loan trust fund accounts administered by locally and community based entities.

2. FY 2000-01 MWBDL and Aid to Localities CDFI Appropriations and Budget Language

NEW YORK STATE URBAN DEVELOPMENT CORPORATION

STATE OPERATIONS AND AID TO LOCALITIES 2000-01

18 ECONOMIC DEVELOPMENT PROGRAM 142,833,000
19 ----------

20 General Fund / Aid to Localities
21 Local Assistance Account - 001

22 For services and expenses of the jobs now
23 program 42,000,000
24 For services and expenses of the empire
25 state economic development fund 37,000,000
26 For services and expenses of the urban and
27 community development program in econom-
28 ically distressed areas 3,500,000
29 For services and expenses of the minority
30 and women-owned business development and
31 lending program 3,500,000
32 For services and expenses of a community
33 designated as an empowerment zone pursuant

NEW YORK STATE URBAN DEVELOPMENT CORPORATION

STATE OPERATIONS AND AID TO LOCALITIES 2000-01

1 president of the senate and the speaker of
2 the assembly 19,000,000
3 For services and expenses of American Axle-
4 Tonawanda Forge 1,000,000
5 For services and expenses of the Centers for
6 Remanufacturing 1,000,000
7 For services and expenses of Community
8 Development Financial Institutions 400,000

1 the neighborhood and community partnership program; and (iii) up to
2 $1,420,000 shall be used for program activities in economically
3 distressed and highly distressed communities, including providing tech-
4 nical and educational assistance in the area of information technology;
5 (b) minority- and women-owned business development and lending
6 program, (i) for services and expenses consistent with the Federal
7 Community Development Financial Institutions Program (12 U.S.C. 4701 et
8 seq.), up to $1,000,000 shall be used for program activities conducted
9 by community development financial institutions in economically
10 distressed and highly distressed areas; (ii) up to $525,000 shall be
11 used to make linked deposits of funds into federal and state chartered
12 credit unions in New York state to make small loans to minority- and
13 women-owned businesses; and (iii) up to $975,000 shall be used to capi-
14 talize and recapitalize revolving loan trust fund accounts administered
15 by locally and community based entities.

Empire State Development Corporation Response To Audit Of Minority And Women Owned Business Development And Lending Program (01-S-55)

Appendix B: CDFI Assistance Program Reporting Forms

1. EXHIBIT B Final Report
2. EXHIBIT B-1 Annual Report
3. EXHIBIT G-3 Technical Assistance and Lending Report Forms

EXHIBIT B: Report

«Project_Name», Project #«Project_Number»

This Final Report shall first be submitted in draft form for comment by ESDC. The last disbursement of Grant funds will not be made until the Final Report, incorporating ESDC's comments, is received by ESDC.

Date of report:_____ Amount of Grant: «Total_Grant_Recommend»

Project start date: _____ Project completion date: _____

I. On attached pages, provide the following information regarding the results of the Project:

A. Describe in detail the outcomes and benefits of the Project for M/WBEs, and for the overall economic development of the community served by «Orgn_Acronym». Describe any changes to delinquency and default rates that occurred during the project period, and provide any available quantitative data that supports this narrative description of benefits.

B. Describe any challenges or unexpected events that arose in implementing the Project.

II. Provide the following data:

Total number of loans made to M/WBEs during the project period	
Total principal amount of loans made to M/WBEs during the project period	
Total employment at these M/WBE borrowers (FTEs, including principals)	
Total number of M/WBEs who received one-on-one technical assistance during the project period	
Total employment at M/WBEs receiving one-on-one technical assistance (FTEs, including principals)	

III. Submit a current loans receivable report and identify M/WBE borrowers. Identify any loans funded in part or in whole with Grant funds, or with funds leveraged using loan loss reserve Grant funds, and indicate total employment at such businesses (FTEs, including principals).

IV. Loan Portfolio Performance

A. Delinquency Ratio (the ratio of the total principal outstanding for business loans with payments 31 days or more past due, divided by the total amount of business loan principal outstanding)

1. On Project Start Date: Ratio_____% Date (per Exhibit A)_____
2. On Date of this Report: Ratio_____% Date (as above)_____

B. The total number and aggregate amount of business loans charged off during the project period: 1. Number of Loans _____ 2. Principal charged-off $_____

C. The Loan Loss Reserve Ratio (total business loan loss reserves divided by total business loan principal outstanding).

1. On Project Start Date: Ratio_____% Date (per Exhibit A)_____
2. On Date of this Report: Ratio_____% Date (as above)_____

V. (This section of the report may be submitted under separate cover to: VP Loans & Grants, ESDC, 633 Third Avenue NY, NY 10017)
We would appreciate feedback regarding this ESDC program. Please comment on any interactions you had with ESDC before applying for funds, on the application and project approval process, on the payment reimbursement process, or on any other interactions with ESDC related to the project, and whether you would use this program again or recommend it to other organizations/businesses.

Exhibit B-1: Annual Report
ESDC CDFI ASSISTANCE PROGRAM

Section 1. General Information

Complete each section of this report and submit by OCTOBER 31, 2003.

ESD Project Number: Q968 **Grant Amount: $30,000**

Legal Name of Organization (include d/b/a):

Street (not P.O. Box): City: State: County:

Zip: Phone: Ext.: Fax: Website:

Executive Director/President:

Contact name/title/telephone number/email address for this grant:

Contact name/title/telephone number for small business referrals:

Form of Organization (i.e. Federal Credit Union, Micro-Loan Fund):

Expiration Date of CDFI certification from the United States Department of the Treasury:

Date of most recent Fiscal Year End (mm/dd/yy):_____Year of incorporation/charter:_____

Total # Employees (FTE): _____ (Full-time: _____ Part-time: _____)

Mission Statement:

Section 2. Staffing

A. Total # of full-time employees or equivalents dedicated to lending? _____
(Includes the following: Portfolio Management, Loan/Investment Underwriting and Outreach, and Loan/Investment Administration)

B. Total # of full-time employees or equivalents dedicated to Technical Assistance and Training? _____
(Training and TA activities may be performed by TA staff, a loan officer, or other staff members)

C. Total # full-time employees or equivalents for Administration and other? _____
(Includes any activities not covered in other categories, such as finance, human resources, fundraising, policy, and administration).)

D. Provide contact name and phone number for key staff:

Business lending staff contact information

Name: _____ E-Mail: _____

Phone: _____ Fax: _____

Technical assistance/training staff contact information

Name: _____ E-Mail: _____

Phone: _____ Fax: _____

Section 3. Financial Position

Attach balance sheet and income statements for the most recently-completed fiscal year, AND as of September 30 of this year. Income statement for current year should show progress against budget.

Balance Sheet Information as of September 30 of this year:

Total Assets as of September 30 $_____

Loans Receivable as of September 30 $_____

Loan Loss Reserve as of September 30 $_____ As % of Loans Receivable:_____

(Loan Loss Reserves are funds set aside in the form of cash reserves or through accounting-based accrual reserves that serve as a cushion to protect an organization against potential future losses. The Loan Loss Reserve typically shows up as a contra-asset on the balance sheet. It is not the expense listed on the income/expense statement.)

Total Liabilities as of September 30 $_____

Total Equity/Net Assets as of Sept. 30 $_____

Income Statement Information for most recently-completed fiscal year:

Total Operating Revenues for most recent fiscal year $_____

(Includes unrestricted operating grants and donations and/or temporarily restricted grants released from restriction during latest fiscal year. It does NOT include equity grants for capital, temporarily restricted grants, which are intended for future operating periods, or grants that will be passed through to other organizations.)

Total Operating Expenses for most recent fiscal year $_____ *(Excludes pass-through grants.)*

Net Income (Loss) for most recent fiscal year $_____

Loan Loss Expense for most recent fiscal year $_____

Capital Available for Financing as of September 30 of this year:

Total Borrowed Capital, Equity and Equity Equivalents available for lending as of September 30: $ _____

Total Committed Capital as of September 30 $_____ (Attach a list of sources and amounts committed.)

(Committed Capital: Funds committed to your organization by an outside source that are available for lending but have not yet been drawn down. Such undrawn funds can consist of both debt and equity but excludes lines-of-credit.)

Section 4 Business Loan Portfolio Performance and Activity

A. Business Lending status:

Total # Business Loans Outstanding as of September 30 of this year: _____

Total Amount of Business Loans Outstanding as of September 30 of this year $_____

Total # Business Loans Disbursed during most recent fiscal year: _____

Total Amount of Business Loans Disbursed during most recent fiscal year: $_____

Total # Business Loans Disbursed Jan. 1 – Sept. 30, 2003: _____

Total Amount of Loans Disbursed Jan. 1 – Sept. 30, 2003: $_____

Total # Business Loans current in repayment (30 days or less) as of September 30: _____

Total Principal Amount of Business Loans current in repayment as of September 30: $_____

Total # Loans Overdue (31-60 days): _____ Total Principal Amount: $_____

(61-90 days): _____ Total Principal Amount: $_____

(over 91 days): _____ Total Principal Amount: $_____

Delinquency Ratio as of September 30: _____% *(Total Principal overdue divided by total outstanding.)*

Total Number of Business Loans Charged off in most recent fiscal year: _____ Amount Charged Off: $_____

Net Loan Loss Ratio in most recent fiscal year: _____%

(Net charge-offs of business loans during the year, divided by the total amount of business loan principal outstanding at year-end)

B. Business Lending to Minority and Women Owned Businesses and Entrepreneurs (M/WBEs)

Total # M/WBE Loans outstanding as of September 30 of this year: _____

Total Principal Amount M/WBE Loans outstanding as of September 30 of this year: $_____

Total # M/WBE Loan Applications Received during most recent fiscal year: _____

Total # M/WBE Loans Approved during most recent fiscal year: _____

Total # M/WBE Loans Closed during most recent fiscal year: _____

Total Principal Amount M/WBE loans closed during most recent fiscal year: $_____

Total Employment at M/WBE borrowers during most recent fiscal year (FTE): _____

Total # M/WBE Loan Applications Received Jan. 1 thru Sept. 30, 2003: _____

Total # M/WBE Loans Approved Jan. 1 thru Sept. 30, 2003: _____

Total # M/WBE Loans Closed Jan. 1 thru Sept. 30, 2003: _____

Total Principal Amount M/WBE loans closed Jan. 1 thru Sept. 30, 2003: $_____

Average Loan Amount M/WBE loans closed Jan. 1 thru Sept. 30, 2003: $_____

Average Interest Rate and Term, M/WBE loans closed Jan. 1 thru Sept. 30, 2003 _____% _____months

Total Employment at M/WBEs for loans closed Jan. 1 thru Sept. 30, 2003 (FTE): _____

Percent of these M/WBE borrowers that were startups (in operation for one year or less): _____%

C. Other Lending

Total # Housing Loans Approved most recent fiscal year: _____ Total Principal Amount: $_____

Total # Consumer/Auto Loans Approved most recent fiscal year: _____ Total Principal Amount: $_____

Total # All Other Loans approved most recent fiscal year: _____ Total Principal Amount: $_____

Section 5. Technical Assistance Performance and Activity

A. One-on-One Technical Assistance <u>delivered January 1 through September 30, 2003</u>:

Total # Businesses: _____ Pre-loan: _____ Post-loan:_____

Total # M/WBEs: _____ Pre-loan: _____ Post-loan: _____ Employment at these M/WBEs (FTE):_____

B. Workshops and Seminars <u>delivered January 1 through September 30, 2003</u>:

Total # Workshops and Seminars: _____

Total # Attendees: _____ Total # M/WBEs Attendees: _____

C. Individual Development Accounts

Total # Business IDA Holders as of September 30 of this year: _____

Total Amount ($ Value) of IDAs as of September 30 of this year: $_____

(When calculating the amount DO NOT INCLUDE THE MATCH. The total amount of capital held by participants in IDAs opened by your organization's IDA program.)

Section 6. Case Study/Testimonials

A. Attach at least one and no more than two letters/testimonials) from businesses served by the organization's business lending or technical assistance program during the period January 1 through September 30, 2003.

B. Attach a profile of a minority or woman-owned business served by your organization during the period January 1 through September 30, 2003 through a program funded with this CDFI 6 grant. Provide a description of the business, its location, number of employees, the type of assistance provided, and the benefits of that assistance. Please also provide a biographical summary of the business owner(s). Limit to no more than two pages.

C. Optional: Attach additional narrative description of the benefits provided by your organization to M/WBEs and the organization's community as a whole.

EXHIBIT G-3: Report Forms (Page 1 of 3)

ESDC CDFI ASSISTANCE PROGRAM

Technical Assistance and Lending Report

This report should be used by «Orgn_Acronym» to report how ESDC grant proceeds were used to provide financial and technical assistance directly to MWBEs and minority or women entrepreneurs.

Date of Report: _____ Project Number: «Project_Number»

Organization: «Orgn_Name_Client»

Covering the Period from _____ through _____.

1) Below are the technical assistance and lending goals set forth in Exhibit A of this Agreement. In the column on the right of the table indicate progress toward achieving these goals:

Projected	**Actual (cumulative for project to date)**

2) **On an attached page describe in detail the steps taken during this reporting period to achieve these goals and the types of technical assistance provided.** If grant proceeds were used to fund workshops, seminars or similar events open to the general public, include a description of specific actions taken to encourage the participation of MWBEs and women and minority entrepreneurs.

3) Attach copies of sign-in sheets for technical assistance activities, and other documentation of TA activities such as flyers, advertising and agendas. Attach additional pages as necessary.

4) Attach a list of the business names, contact names, telephone numbers and total employment information (FTEs, including principals) for MWBEs and minority and woman entrepreneurs that received technical assistance during the reporting period. Indicate which of these businesses is a startup (in business for one year or less).

5) **Exception Report:** Please note that all modifications to the budget as set forth in Exhibit D to this Agreement must be approved in advance by ESDC. To the extent that grant funds budgeted for the provision of technical assistance were used for purposes other than the provision of pre-loan, post-loan and/or IDA technical assistance, attach a page to this report describing the specific uses of these funds, the amounts and reasons for the expenditures, the number of MWBEs and minority and women entrepreneurs assisted, total employment at these businesses, the nature of the business activities being pursued by beneficiaries, and the specific outcomes of the activities funded.

EXHIBIT G-3 Report Forms (Page 2 of 3)

ESDC CDFI ASSISTANCE PROGRAM

New Loan Report

This report should be used by the organization to report each new loan funded in part or in whole with ESDC grant proceeds. Rules pertaining to the use of funds for loan capital and loan loss reserve are set forth in Section 7r on Page 6 of this Agreement.

Attach pages from the promissory note for this loan showing the designated use of loan proceeds, the interest rate and other terms, the business address, and borrower signatures.

Date of Closing:_____ Project Number: «Project_Number»

Lender: «Orgn_Name_Client» -- «Project_Name»

Name of Business (Borrower): _____

Ownership: Name: _____Ownership %: _____%

Name: _____Ownership %: _____%

>51% Minority Ownership (if applicable): Yes ❒ No ❒
Specify Minority Group Member (see Exhibit H for clarification) _____

>51% Female Ownership (if applicable): Yes ❒ No ❒

Address of Business:_____

_____Telephone Number: (___)_____

Description of Business*: _____

* Note: ESDC grant funds may not be loaned to: 1) educational institutions, except licensed child care facilities; 2) hospitals or residential health care facilities; or 3) overnight lodging facilities.

Total Employment at Business (FTEs, including principals): _____

Is the business a startup (in business for one year or less at time of closing?) Yes ❒ No ❒

Proposed Sources and Uses* of Loan Proceeds (describe specific uses*):

Use of Funds*	Amount	Source of Funds	Amount
		ESDC	
		«Orgn_Acronym»	
		Other	
TOTAL	$	TOTAL	$

*Note: ESDC grant proceeds may not be used for: 1) refinancing, retiring or liquidating existing debt or equity; 2) residential construction projects; 3) payment of any tax arrearage[s]; 4) payment of any employee benefit arrearage[s]; and 5) purchase or rehabilitation of real property for speculative purposes.

EXHIBIT G-3: Report Forms (Page 3 of 3)

ESDCCDFI ASSISTANCE PROGRAM

Loan Loss Reserve Report

This report should be used to report loans for which ESDC grant funds have been placed in the organization's loan loss reserve, or loans that have been charged off and ESDC grant funds have been applied against the resultant loss. Rules pertaining to the use of funds for loan capital and loan loss reserve are set forth in Section 7r on Page 6 of this Agreement.

Attach copies of documentation to this form for each loan, including relevant pages from the promissory note, correspondence related to delinquency, and documentation of charge-off.

Date: _____ Project Number: Q968

Organization: Commercial and Industrial Capital Corporation - CICC CDFI 6

Loan Information: Loan ID Number: _____

Name of Business: _____

Description of Business: _____

* Note: ESDC grant funds may not be used to benefit: 1) educational institutions, except licensed child care facilities; 2) hospitals or residential health care facilities; or 3) overnight lodging facilities.

Is business >51% minority-owned? Yes ☐ No ☐ (if yes, specify minority group: _____)
Is business >51% women-owned? Yes ☐ No ☐

Total employment (FTEs) at the business (indicate if this figure is an estimate): _____

Initial amount of loan: _____ Total amount of principal outstanding: _____

Original business purpose* of loan (be specific): _____

*Note: ESDC loan loss reserve funds may not be used in connection with loans for: 1) refinancing, retiring or liquidating existing debt or equity; 2) residential construction projects; 3) payment of any tax arrearage[s]; 4) payment of any employee benefit arrearage[s]; and 5) purchase or rehabilitation of real property for speculative purposes.

Total amount past due: _____ Number of days delinquent: _____

Amount of ESDC grant proceeds placed in reserve for this loan: _____

Percentage of loan that is secured and description of security/collateral: _____

List any and all responsible parties for the debt obligation: _____

If this loan has been charged-off, complete the following:

Amount of ESDC grant proceeds used to cover charge off of loan (net after amount recovered following foreclosure): $_____

Describe collection and loss recovery methods employed and results: _____

_____

State Comptroller's Notes

1. The request for a representation letter was first faxed to ESDC officials on January 21, 2003. On July 24, 2003 we again faxed the request because ESDC officials advised us that the first request was not received. The signed representation letter is now included in the ESDC response to the audit. Accordingly, we have revised our report to reflect its receipt.

2. Where appropriate, we have revised this final audit report to reflect information provided by ESDC officials in their response to our draft report.

3. ESDC officials contributed to the delay in the audit process by taking considerable time to provide project files for sampled CDFIs. In fact, ESDC officials previously advised us that delays resulted when they reviewed the files to make sure they were complete before providing them to the auditors. They also advised us that the employee handling our information request had other work that also had to be completed. Their comments also presume that this was the only report the audit team was assigned to, however, this was not the case.

4. We disagree with ESDC officials. Considerable time and effort was needed for our auditors to obtain clear answers from ESDC officials about why Program funds were not expended and whether any projects pertained to the Revolving Trust or Linked Deposit Programs.

5. Despite repeated requests that ESDC officials provide a breakdown of the use of appropriated MWBDL funds by program (Revolving Loan Trust Fund, CDFI program, and Linked Deposit), the information was not provided in a timely manner. Officials did not inform us until the end of audit fieldwork that there were no Revolving Loan Trust Fund or Linked Deposit projects funded for our audit period. At that time, ESDC officials informed us that in addition to funding CDFI projects, they issued another $1.6 million in grants and loans. We classified these as "other loans and grants" in the absence of any information from ESDC officials.

6. The draft audit report does reflect information in ESDC's response to the preliminary audit findings to the extent that such responses warranted corrections to our findings.

7. The report was revised to distinguish the funds that ESDC did not award to CDFIs from the funds that were awarded by ESDC but were unused by the CDFIs. The former funds are discussed in the report section entitled Program Administration and the latter funds are discussed in the report section entitled CDFI Projects.

8. We acknowledge ESDC's reliance on its regional offices and its Economic Revitalization Unit to identify projects eligible for MWBDL Program funds. We also take note that ESDC indicates it will strengthen its outreach efforts through Community Network Offices. However, if the Revolving Loan Trust Fund and Linked Deposit projects are being superceded by the CDFI projects, then ESDC officials need to evaluate how to redirect their efforts so that maximum use is made of available appropriated funds.

9. ESDC officials identified to us that projects should take no longer than 15 months and contracts for projects should not be approved until final reports on prior projects are completed. Accordingly, standards for timelines have been set by ESDC. Our recommendation number 4 is consistent with these standards. Allowing CDFIs to continue projects in some cases for two or more years while also being annually funded for new projects may not be the best way to ensure timely and effective results from Program funds.

   The majority of the CDFIs we visited in late summer of 2002 were working on their FY 1999-00 projects but many of these CDFIs received funding in FY 2000-01 and FY 2001-02 funding cycles. We agree that certain delays are inherent in the State's budget and RFP approval process.

10. ESDC officials explain that some delay in executing new project contracts happens as grantees are given one month to file final reports on completed projects and ESDC allows its staff an additional month to review the final report. They also cite that safeguards are in place for those situations where projects commence without approved contracts. The delays we observed between the completion of a project and the ESDC review of a final report for the completed project were longer than the timeframes indicated by ESDC. We do not agree with ESDC's assertion that the project description in the CDFI application can be used in lieu of a contract. It is good business practice to have a contract in place when work commences, especially if a legal dispute should occur. ESDC as a government agency should adhere to this practice.

11. Our reference is to ESDC's own guidelines for the MWBDL program that defines the types of services that qualify for Technical Services. We acknowledge that ESDC recognizes the need for monitoring CDFI expenditures of funds for budgeted purposes and will require CDFIs to submit TA job descriptions and the qualifications of TA Providers as part of future RFP processes. However, the MWBDL Program defines a TA Provider as a person possessing expertise in the financial, legal, accounting or business areas able to deliver technical assistance to MWBEs in the Program. In this regard, ESDC needs to ensure that technical assistance is not really an administrative expense properly part of CDFI overhead costs.

12. ESDC officials believe they are allowed to permit CDFIs "substantial flexibility in terms of how they budget these funds." As we indicated in our draft audit report,

certain expenditures we examined were vaguely defined and, therefore, questionable.

13. ESDC guidelines specify that CDFI program funds are to be used for loans to MWBEs and post-loan technical assistance to these MWBEs. Based on ESDC guidelines, we questioned when a CDFI received funds but did not make loans to MWBEs or provide post-loan assistance to any borrower of such funds. In addition, CDFI officials receiving these technical assistance funds told us that their meetings with credit union officials are not documented and there are no sign-in sheets for attendees. The CDFI officials maintain that during these meetings they provide credit union managers with technical assistance for complex loans or construction, etc.

14. At the time of our audit fieldwork, this contractor/grantee did not have any documentation to support its activities on the use of ESDC funds. Our work papers show that this contractor did not have a final signed contract because it had not completed all of the reports for the closeout of prior projects. Therefore, any report on its activities was filed after the completion of our fieldwork. We also cannot explain why they do not recall that information requested was not provided to the auditors.

15. ESDC officials point out that they require CDFIs to provide contact information about MWBEs that receive technical assistance. However, we looked for documentation such as the date of the site visit, the name of the person that made the visit and a brief description of the technical assistance provided or observations made during the visit. This information was not always available. Similarly, we maintain that CDFIs need to keep attendance records for TA sessions provided as part of projects. We are pleased that ESDC has started to require sign-in sheets, flyers and other documentation to support technical assistance delivered for projects.

16. We are pleased that ESDC is in the process of initiating a more regular program of site visits. We found that semi-annual reports were submitted to ESDC for review for just 11 (55 percent) of 20 projects. Based on information in project files, we maintain that the semi-annual reports were due.

17. ESDC officials maintain that there was no misuse of its funds. They explain that in reporting the use of the funds in question, the grantee unnecessarily documented 21 loans totaling $130,000. They further maintain that the first three loans documented pertained to the ESDC funds and, upon subsequent review, these loans were for legitimate purposes. Officials conclude that the problem in the case cited in the audit report was that the CDFI documented too many loans and included loans that exceeded the CDFI's grant amount. Our findings and conclusions are based on the records that were provided at the time of the audit. We are pleased that ESDC now requires grantees to provide more specific information regarding the use of funds granted as loan capital.

18. We are pleased that ESDC requires that all grantees submit an annual report detailing the impact of their activities more directly in economic terms. ESDC officials suggest that for some of the CDFIs we cited as failing to submit a final report, including a narrative of project outcomes, the report was not due. Based on information in project files, we maintain reports were due.

19. ESDC officials maintain it would not be appropriate for ESDC to set interest rates for CDFIs for the loans made with the program funds. They believe that CDFIs should be allowed to charge MWBEs interest rates similar to the rates banks are charging to clients with similar risk. Furthermore, the officials believe that interest earned on the loan helps the CDFIs to survive. However, in our view, MWBEs would benefit further if they were able to obtain low interest loans from the program. We also see charging a lower interest rate as an opportunity to increase demand for the CDFI loan capital grants that could result in using more of the funds appropriated for direct services to MWBEs.