



SAFE-BIDCO

At Risk of Insolvency, It Needs Increased Oversight if It Is to Receive State Funding and Continue to Help Small Businesses in California Gain Financing

Report 2016-133

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April 27, 2017

2016-133

The Governor of California
President pro Tempore of the Senate
Speaker of the Assembly
State Capitol
Sacramento, California 95814

Dear Governor and Legislative Leaders:

As requested by the Joint Legislative Audit Committee, the California State Auditor presents this audit report concerning the operations and financial condition of the State Assistance Fund for Enterprise, Business and Industrial Development Corporation (SAFE-BIDCO). SAFE-BIDCO, located in Santa Rosa, operates a variety of loan programs to assist small businesses in California obtain financing.

This report concludes that because of its declining financial position, SAFE-BIDCO could become insolvent as soon as June 2018. SAFE-BIDCO's expenses have exceeded revenue in each of the last five fiscal years, and it has been unsuccessful in obtaining sufficient additional capital. Although SAFE-BIDCO is a nonprofit, it has not attempted to obtain capital from fundraising such as donations and sponsorships, and has been unsuccessful in obtaining additional funds from the State.

Despite its declining financial position, SAFE-BIDCO has imprudently spent its limited funds on questionable items such as continuing with a business development contractor that did not meet his performance milestones for several years. Additionally, during fiscal years 2011–12 through 2015–16, SAFE-BIDCO's chief executive officer made 16 out-of-state trips and one international trip to Ireland. These expenses are particularly troubling as SAFE-BIDCO's mission is to act as a catalyst for economic development in California.

Finally, a lack of oversight and insufficient tracking of its performance obscured the issues now facing SAFE-BIDCO. Existing oversight by the State is limited to an annual examination by the Department of Business Oversight, and these examinations are confidential. SAFE-BIDCO's board has been hampered because of the voluminous and inconsistent reports provided to it and a lack of information for use in tracking its loan program performance.

As a result of these issues, we are reluctant to recommend that the State appropriate funding without increased direct oversight to ensure adequate reporting and controlled expenses. We believe direct oversight could occur by establishing SAFE-BIDCO as a program within the State Treasurer's Office.

Respectfully submitted,



ELAINE M. HOWLE, CPA
State Auditor

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Summary

Results in Brief

The State Assistance Fund for Enterprise, Business and Industrial Development Corporation (SAFE-BIDCO) has spent more than it has earned over the past decade and needs additional capital if it is to continue its mission of helping to provide financing to California's small businesses. Initially funded by an appropriation and a loan from the State in 1981, SAFE-BIDCO, which is a nonprofit organization overseen by a governing board, has over the years operated eight programs designed to help small businesses obtain financing in the form of direct loans and loan guarantees. SAFE-BIDCO estimates that it has helped create more than 13,000 jobs during that time.

However, because of its declining financial condition, SAFE-BIDCO in recent years has had limited funds to make loans. We estimate that SAFE-BIDCO could become insolvent as soon as June 2018, so it needs additional capital if it is to continue its operations. According to its chief executive officer (CEO), SAFE-BIDCO's declining financial position is primarily the result of historically low interest rates and the low amount of available capital it has to make loans, and this situation has limited the revenue SAFE-BIDCO can earn through lending. However, our review has identified other factors, such as insufficient efforts to obtain additional capital and questionable expenses, that have negatively affected SAFE-BIDCO's financial condition.

SAFE-BIDCO's management of its operations raises concerns about whether the State should appropriate any funding to it without increasing the State's direct oversight of SAFE-BIDCO's expenses and performance. SAFE-BIDCO has not taken sufficient steps to raise additional capital on its own to address its financial condition. Although it has borrowed funds to make loans, obtained grants, and sold some of its loans to raise capital, these efforts have not generated sufficient funds to address its declining net assets. Also, even though SAFE-BIDCO is a nonprofit, it has not attempted to obtain capital from donations, which similar organizations providing comparable lending services and assistance to small business indicated to us they had obtained to support their programs. Further, SAFE-BIDCO has been unsuccessful in obtaining additional funds from the State.

Despite its declining financial position, SAFE-BIDCO has imprudently spent its limited funds on questionable items, such as continuing its contract with a business development contractor who did not meet his performance goals in each of the last

Audit Highlights . . .

Our review concerning the financial condition and operations of the State Assistance Fund for Enterprise, Business and Industrial Development Corporation (SAFE-BIDCO) revealed the following:

- » *In the past five years, SAFE-BIDCO has spent more than it has earned, and its net assets have declined from \$3.7 million to \$1.3 million.*
- » *SAFE-BIDCO needs additional capital to make loans to continue its operations; otherwise it could become insolvent as soon as June 2018.*
 - *Although SAFE-BIDCO is a nonprofit, unlike similar entities it has not attempted to obtain capital from fundraising activities, and it has been unsuccessful in obtaining additional funding from the State.*
- » *Despite its declining financial position, SAFE-BIDCO has imprudently spent its limited funds on questionable activities.*
 - *It continued to use a business development contractor even though he did not achieve his performance goals, and it continued with this contract without a competitive bidding process.*
 - *The chief executive officer made 16 out-of-state trips and a trip to Ireland.*
- » *A lack of oversight and insufficient tracking of performance obscured the issues now facing SAFE-BIDCO.*

four fiscal years. SAFE-BIDCO has continued with this contract without seeking competitive bids for these services to ensure that it is receiving the best value for its limited funds.

The CEO also spent a substantial portion of SAFE-BIDCO's travel expenses on out-of-state travel and a trip to Ireland. The CEO stated that given SAFE-BIDCO's inability to secure state funding, she has traveled to research federal programs that might once again be possibilities for funding. Specifically, she stated that her travel resulted in an increase in grant funding from the U.S. Department of Agriculture (USDA). However, we noted that SAFE-BIDCO has worked with the USDA for more than 10 years. Further, the trip to Ireland involved a conference sponsored by an Internet marketing business owned by a then-board member of SAFE-BIDCO. In addition, the CEO attended two other conferences in Washington, D.C., held by the same business, giving the appearance that the board member personally benefited from his position on SAFE-BIDCO's board. The total cost to attend these three conferences was \$10,000 plus travel expenses. These expenses for out-of-state travel are particularly troubling because SAFE-BIDCO's mission is to act as a catalyst for economic development in California by providing access to alternative loan programs for small businesses.

A lack of oversight and insufficient tracking of performance obscured the issues now facing SAFE-BIDCO. Existing oversight by the State is limited to an annual examination by the Department of Business Oversight (Business Oversight), which focuses on determining the soundness of SAFE-BIDCO's lending. Although we reviewed the reports from the annual examinations since 2011, state law prevents us from disclosing the content of the reports without Business Oversight's release of the reports. We requested that Business Oversight release the reports, which we believe is allowed under a reasonable interpretation of the law, but it declined to do so. SAFE-BIDCO's board is the body primarily responsible for overseeing its operations. However, it has been hampered by the voluminous and inconsistent reports provided to it by SAFE-BIDCO's staff and by a lack of information on program performance. SAFE-BIDCO typically reports either the total dollar value of loans it hopes to make or the revenue it hopes to generate from loan programs. Unfortunately, it has not made the critical link between the dollar value of loans it needs to make to meet its revenue goals. Therefore, board members have not received sufficient information to determine whether the goals established are adequate.

Although it is clear that SAFE-BIDCO needs capital to continue its mission to assist small businesses, we are reluctant to recommend that the State appropriate funding without increased direct

oversight of SAFE-BIDCO to ensure adequate reporting and controlled expenses. We believe direct oversight could occur by the Legislature's establishing SAFE-BIDCO as a program within the State Treasurer's Office (Treasurer's Office).

Selected Recommendations

To ensure that SAFE-BIDCO's operations are subject to appropriate oversight and to fulfill its mission of providing financing to small businesses, the Legislature should establish SAFE-BIDCO as a program within the Treasurer's Office.

To obtain needed capital, SAFE-BIDCO should raise funds by seeking donations.

To obtain the best value for its limited funds, SAFE-BIDCO should by October 2017 establish a policy and related procedures requiring that it seek competitive bids for significant contracted services. The policy should establish a dollar threshold for what services SAFE-BIDCO considers significant.

To ensure that it spends its funds furthering its mission of helping California small businesses, SAFE-BIDCO should decrease its travel expenses by adopting a travel budget in consideration of its expenses and mission and limiting out-of-state travel.

To ensure that decision makers—such as the board of directors, Legislature, and other stakeholders—have sufficient information to assess its performance, SAFE-BIDCO should by October 2017 create one central report for its board that includes revenue goals and actual performance for each program it operates.

Agency Comments

SAFE-BIDCO indicated that it is taking steps to implement our recommendations and would not be opposed to placing its programs within a state agency if it would allow its programs to continue. However, it states that it is difficult to compare it to other entities and notes that the out-of-state travel we discuss was to research and develop additional funding sources and programs.

To review the agency response and our comments to the response, please see pages 43 through 51.

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Introduction

Background

The Legislature authorized the creation of the State Assistance Fund for Enterprise, Business and Industrial Development Corporation (SAFE-BIDCO) in 1981 to provide financing assistance to small business through loans for the manufacture or purchase of alternative energy equipment. In 1990 the Legislature amended SAFE-BIDCO's statutory purpose, expanding it to make more financial assistance available to the State's small businesses, with a goal of increasing the competitiveness of California's small businesses and of creating jobs. The Legislature originally provided SAFE-BIDCO with a \$750,000 appropriation and a loan of up to \$2.5 million, but the State has not provided additional funding. Since 1981, SAFE-BIDCO has operated using these resources as well as resources provided by federal and state programs.

Loan Programs

To fulfill its mission, SAFE-BIDCO operates eight programs to provide loans for small businesses or to guarantee loans made to small businesses. Figure 1 beginning on page 6 shows the eight loan programs that SAFE-BIDCO operates. According to a research report published by the U.S. Small Business Administration (SBA), the major constraint limiting the growth and expansion of small businesses is inadequate capital. SAFE-BIDCO works to provide this needed capital by either making a loan to a small business itself or by guaranteeing a loan from a traditional bank, thereby reducing the bank's risk.

When it guarantees a loan, SAFE-BIDCO does not loan funds directly to a borrower; instead, as a participant in the California Small Business Loan Guarantee Program, it guarantees that the State will repay the lender a portion of the principal and interest on the loan if the borrower defaults. For example, for one loan guarantee we reviewed, a lender wanted to make a loan of \$515,000 to a small business. To address its risk, the lender sought a guarantee from SAFE-BIDCO, which approved a guarantee of 80 percent of the loan—\$412,000. If the borrower subsequently failed to pay the lender, the State would pay the lender up to the \$412,000 it guaranteed plus interest, and the lender would be at risk only for the remaining \$103,000.

Figure 1
SAFE-BIDCO's Loan Programs Assist Small Businesses in California



Sources: Loan program summary information from SAFE-BIDCO's website, the Native American Loan Program work plan application, Energy Efficiency Loan Program administrative practices, SAFE-BIDCO's audited financial statements, the RUST Program contract, and the *Financial Development Corporation Policy Manual*.

Note: In addition to the programs described in the figure, SAFE-BIDCO performed such services as loan underwriting and loan fund development under contract with third-party entities, including the city of Berkeley and the California Public Utilities Commission, during fiscal years 2011–12 through 2015–16.

* The full name of the RUST Program is the Replacing, Removing, or Upgrading Underground Storage Tanks Program.

† SAFE-BIDCO did not make any loans under this program during the five-year period we audited.



SMALL BUSINESS ADMINISTRATION (SBA) LOANS

SAFE-BIDCO makes loans of up to \$750,000 to qualifying small businesses that meet SBA eligibility standards. The loans can have maximum terms of seven, 10, or 25 years, depending on the type of project, and have an interest rate set at a fixed percentage above the prime interest rate.

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ENERGY EFFICIENCY LOAN PROGRAM

SAFE-BIDCO makes loans of up to \$450,000 to small businesses, qualifying landlords, and nonprofit organizations for a maximum term of 15 years. These loans are for projects that reduce energy use by up to 15 percent, manage load, or retrofit equipment.

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MICROLOANS

SAFE-BIDCO makes loans of up to \$25,000 to qualifying small businesses for projects including start-up costs, costs of expanding operations, or acquisition of existing enterprises. Loan terms range from three to six years, depending on the size and purpose of the loan.

7



AGRICULTURAL LOANS[†]

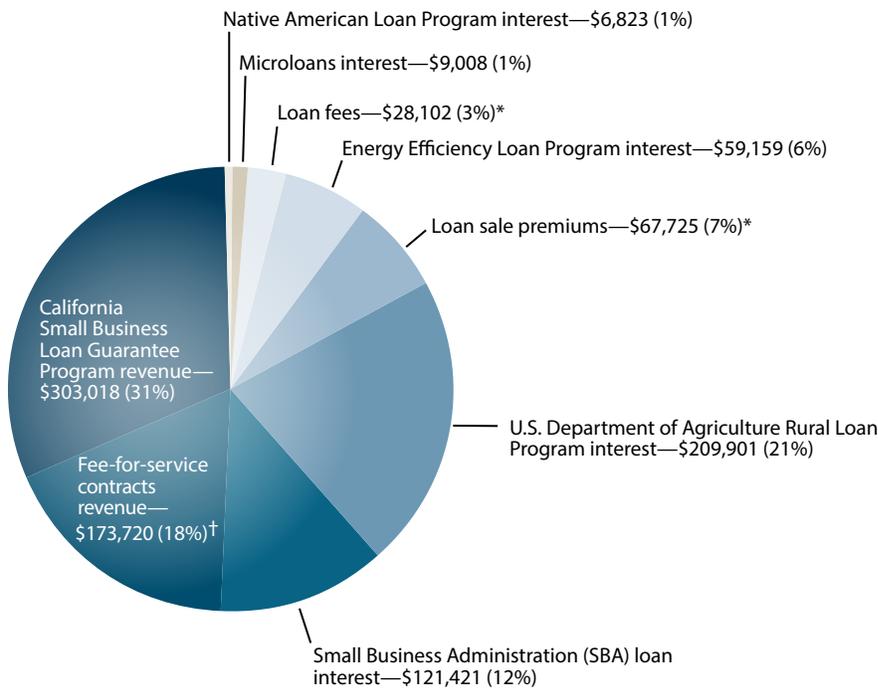
SAFE-BIDCO makes loans of between \$10,000 and \$500,000 to owners and operators of family farms who can use these loans for equipment acquisition, crop production, harvest costs, farm improvements, operational costs, and farm ownership. Loan terms can range up to 40 years, depending on the purpose of the loan.

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SAFE-BIDCO supports itself primarily through fees, contract revenue, and interest generated from these lending programs. For example, for loans it makes under the SBA loan program, SAFE-BIDCO earns interest on the outstanding loan amounts and may charge a loan packaging fee for assisting a small business applicant with completing the application and other documents related to the application. These fees ranged from \$1,000 to \$1,575 for the loans we examined during the five-year period that we reviewed. Figure 2 presents the average annual revenue these loan and loan guarantee programs generated for SAFE-BIDCO during our audit period.

Figure 2
SAFE-BIDCO's Small Business Loan Guarantee Program Is Its Largest Revenue Source



Source: California State Auditor's analysis of SAFE-BIDCO's Budget vs. Actual reports for fiscal years 2011–12 through 2015–16.

Notes: *Revenue* is based on a five-year average for fiscal years 2011–12 through 2015–16. SAFE-BIDCO earns additional revenue from activities unrelated to its lending programs such as administrative fees and interest income that are not included in the figure. Over the past five fiscal years, this revenue has averaged roughly \$107,000.

Interest income from SAFE-BIDCO's Agricultural Loans Program is not included in the figure because this income averaged less than \$100 per year.

* SAFE-BIDCO does not report separately loan fees and loan sale premiums for its different loan programs.

† Fee-for-service contracts revenue includes revenue from the Replacing, Removing, or Upgrading Underground Storage Tanks Program, among others.

One of SAFE-BIDCO's goals is to create jobs in California, which it accomplishes by financing small businesses that create jobs. SAFE-BIDCO estimates that it has helped create more than 13,000 jobs since it was founded in 1981. This number is in line

with estimates developed by the SBA of roughly one job created per \$14,400 in small-business financing. According to that calculation, SAFE-BIDCO would have helped to create about 2,992 jobs with the loans and loan guarantees it made from July 2011 to June 2016.

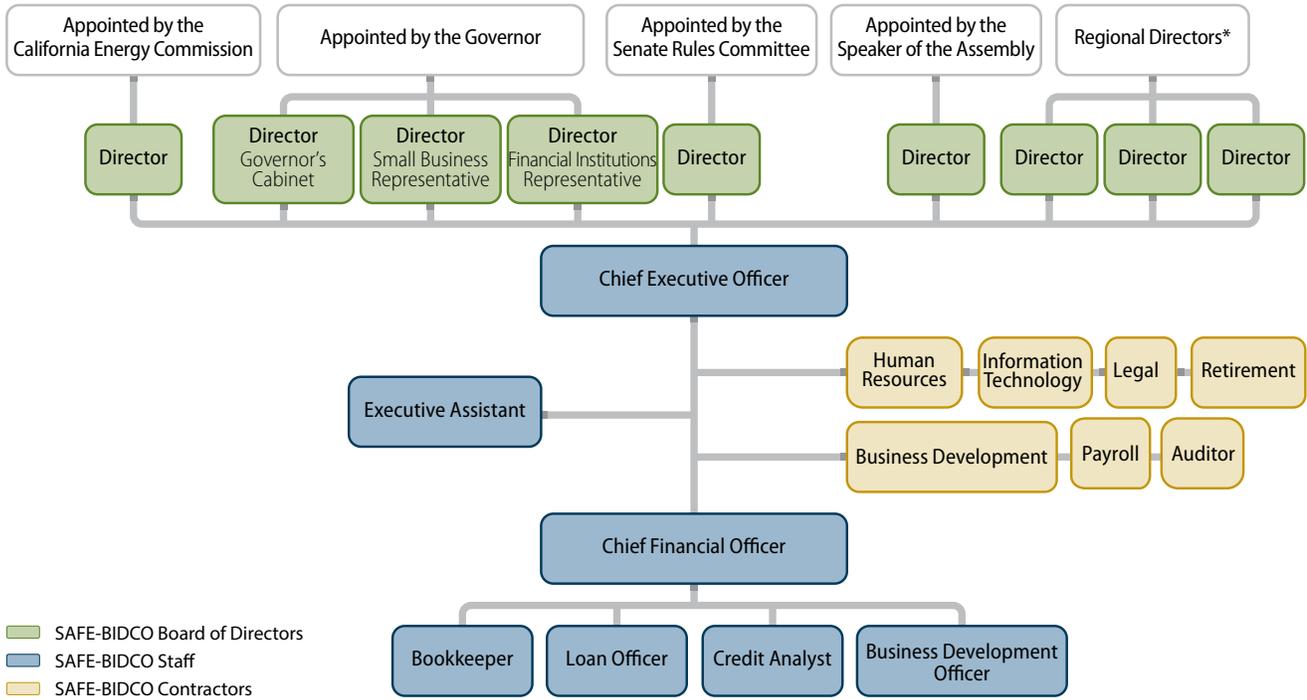
Organizational Structure

Located in Santa Rosa, SAFE-BIDCO is a nonprofit organization governed by nine board members, three of whom are appointed by the Governor and two by the Legislature. The Governor's three appointees must include one from the Governor's Cabinet or his or her designee, one from California's small business community, and one who is an officer or employee of a financial institution. The Legislature's two appointees include one chosen by the Legislature's Senate Rules Committee and one chosen by the Speaker of the California State Assembly. A commissioner for the California Energy Commission also sits on SAFE-BIDCO's board. These six appointed members select the remaining three members, who represent local businesses in the region served by SAFE-BIDCO. State law requires SAFE-BIDCO to have three regional members because it is a small business financial development corporation.

The board generally meets quarterly to review SAFE-BIDCO's management and finances, but it does not approve loans. State law requires the board to establish a loan committee whose members are appointed by and serve at the pleasure of the board. Further, state law requires the loan committee to approve or disapprove loan applications in accordance with procedures and criteria adopted by the board. The board establishes and appoints a loan committee—which currently includes local bankers, an individual from a state agency, and an individual from a local community college—whose responsibility is to review and approve loans.

As of February 2017, SAFE-BIDCO had seven staff members, including its chief executive officer (CEO), who assist in operating its loan programs by performing a variety of tasks, including reviewing potential loans and loan guarantees and managing approved loans. SAFE-BIDCO's CEO has served in her position since 2000. SAFE-BIDCO also uses contractors for its administrative functions, including human resources, retirement planning, information technology, legal, payroll, business development, and auditing services. Figure 3 on the following page shows SAFE-BIDCO's organizational structure.

Figure 3
SAFE-BIDCO's Organizational Structure
As of February 2017



Sources: Financial Code sections 32320, 32321, and 32352.5; agreements between SAFE-BIDCO and its contractors; SAFE-BIDCO's website; and SAFE-BIDCO's organizational chart.

* Regional directors are residents of the region served by SAFE-BIDCO and are appointed by the other six directors.

Audit Results

The State Assistance Fund for Enterprise, Business and Industrial Development Corporation (SAFE-BIDCO) has spent more than it has earned in each of the past five fiscal years, and its net assets have declined from \$3.7 million to \$1.3 million over the five-year period. As a result of its continual overspending and declining net assets, SAFE-BIDCO could become insolvent as soon as June 2018, leaving it unable to continue to operate and to help California's small businesses to obtain financing and create jobs. Because of its declining net assets, SAFE-BIDCO has made fewer loans in recent years, and it needs additional capital to make loans so that it can generate enough revenue to cover its expenses. However, despite the decline in its net assets, SAFE-BIDCO has been unsuccessful in obtaining sufficient additional capital. SAFE-BIDCO also used its limited resources to make questionable spending decisions regarding some of its contractors, out-of-state travel, and, in one instance, international travel.

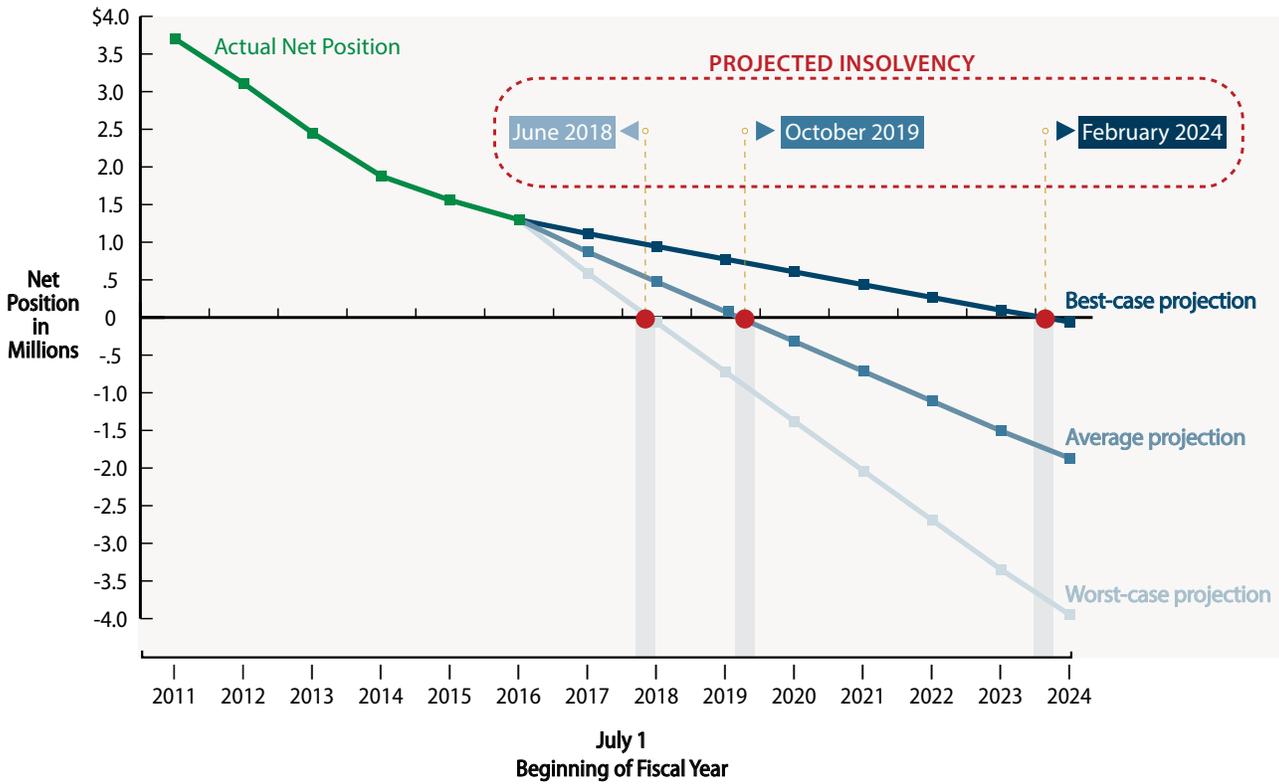
SAFE-BIDCO Could Be Insolvent as Early as June 2018

SAFE-BIDCO's expenses were greater than its revenue in each of the last five fiscal years and in nine of the last 10 fiscal years. Except in the case of fiscal year 2007–08, SAFE-BIDCO's expenses were between \$170,000 and \$656,000 more than its revenue in each of the last 10 years. The one time in the last 10 years when its revenue exceeded expenses occurred because SAFE-BIDCO received forgiveness of an obligation from the U.S. Department of Energy (Energy). According to its audited financial statements, SAFE-BIDCO contracted with the State to manage the \$2.75 million federal Energy Efficiency Improvements Loan Fund in 1987 for the purpose of providing direct loan assistance to small businesses for the installation of projects to improve energy efficiency. In 2008 Energy determined that the program funds were fully expended and released all claim to the \$2.75 million. Without the forgiveness of that outstanding obligation, SAFE-BIDCO would have spent more than it earned in that year as well.

Because SAFE-BIDCO's expenses have exceeded revenue in each of the last five fiscal years, its net assets—the difference between its total assets and total liabilities—have declined from \$3.7 million on July 1, 2011, to \$1.3 million on June 30, 2016. If SAFE-BIDCO continues this pattern of spending more than it earns, it will become insolvent, leaving it unable to continue to operate. Using SAFE-BIDCO's history of expenses and revenue for

fiscal years 2011–12 through 2015–16, we project that in the worst case, SAFE-BIDCO could become insolvent as soon as June 2018, as shown in Figure 4.

Figure 4
SAFE-BIDCO Could Be Insolvent as Soon as June 2018
(Dollars in Millions)



Source: California State Auditor’s analysis of audited financial statements for SAFE-BIDCO for fiscal years 2011–12 through 2015–16.

Notes: *Insolvency* is defined as a situation when assets in excess of liabilities decline below \$0.

Average projection is based on the average change in net assets for fiscal years 2011–12 through 2015–16 (\$396,000) projected at a constant rate.

Best-case projection is based on smallest annual decline in net assets for fiscal years 2011–12 through 2015–16 (\$170,000) projected at a constant rate.

Worst-case projection is based on largest annual decline in net assets for fiscal years 2011–12 through 2015–16 (\$656,000) projected at a constant rate.

As a result of its declining net assets, SAFE-BIDCO has made fewer loans in recent years, hampering its ability to generate sufficient revenue to cover its expenses. When SAFE-BIDCO acts as a lender, it can generate revenue through fees it charges borrowers and through interest on the outstanding loan balances. For some of its loan programs, a portion of each loan SAFE-BIDCO makes is guaranteed by the U.S. Small Business Administration (SBA). SAFE-BIDCO not only earns interest on the outstanding balance of the loan, but it also can sell at a premium the portion of the loan guaranteed by the federal government because the SBA will purchase that portion if the borrower defaults on the loan.

As shown in Table 1, the number of loans SAFE-BIDCO made in fiscal years 2011–12 through 2015–16 was 54, but it made only 12 of those since July 2014. As SAFE-BIDCO makes fewer loans, it provides less assistance to help create jobs.

Table 1
SAFE-BIDCO’s Total Number of Loans Made Annually Has Declined,
While Its Number of Loan Guarantees Has Generally Increased
Fiscal Years 2011–12 Through 2015–16
(Dollars in Thousands)

| FISCAL YEAR | LOANS | | LOAN GUARANTEES | |
|---------------|----------------|-----------------|-----------------|---------------------------|
| | DOLLAR VALUE | NUMBER OF LOANS | DOLLAR VALUE | NUMBER OF LOAN GUARANTEES |
| 2011–12 | \$2,970 | 18 | \$4,507 | 17 |
| 2012–13 | 2,012 | 16 | 4,158 | 18 |
| 2013–14 | 755 | 8 | 5,927 | 20 |
| 2014–15 | 775 | 9 | 10,448 | 25 |
| 2015–16 | 525 | 3 | 11,182 | 22 |
| Totals | \$7,037 | 54 | \$36,222 | 102 |

Sources: SAFE-BIDCO’s loan and loan guarantee files.

The revenue SAFE-BIDCO generated from its loans declined from \$517,000 in fiscal year 2011–12 to \$261,000 in fiscal year 2015–16. We discussed SAFE-BIDCO’s declining net assets with its chief executive officer (CEO), and she indicated that the primary causes for the decrease included the low-interest-rate environment and the low amount of capital available to make loans. Because of declining loan revenue, it is likely that SAFE-BIDCO will continue to make fewer loans than it did previously, creating a downward spiral of fewer loans and loan revenue, pushing SAFE-BIDCO closer to insolvency.

SAFE-BIDCO earns less per dollar for operating fee-for-service programs than it does for loan programs. Under its fee-for-service programs, SAFE-BIDCO receives a fee for services it provides, such as reviewing loan guarantees on loans made by financial institutions, underwriting loans, or servicing loans for third parties. The fees it earns are either flat fees or percentages of the loan guarantee amounts. For example, when SAFE-BIDCO approves a loan guarantee for the California Small Business Loan Guarantee Program, it earns a one-time fee of 2.5 percent of the guaranteed loan amount. In comparison, when it makes a loan, SAFE-BIDCO generally earns annual interest of 1 percent to 6.5 percent plus a variable prime interest rate on the outstanding loan balance. As a result, a loan made by SAFE-BIDCO typically

SAFE-BIDCO needs additional capital so that it can make loans and generate enough revenue to prevent further declines in its net assets.

generates much more revenue than a loan guarantee. For example, if SAFE-BIDCO reviewed and approved a \$250,000 loan guarantee, it would receive a fee of \$6,250. However, if it loaned \$250,000 for 10 years at 6 percent annual interest, it would earn \$15,000 in interest the first year as well as interest in each additional year of the loan, a total amount much more than the one-time fee it would receive for a similar loan guarantee. SAFE-BIDCO could generate substantially more revenue if it could make loans instead of relying on fee-for-service programs.

SAFE-BIDCO needs additional capital so that it can make loans and generate enough revenue to prevent further declines in its net assets. For fiscal year 2015–16, SAFE-BIDCO’s total revenue was \$908,000, while its expenses for the year totaled \$1.17 million. The largest portion of its expenses was for personnel and contracted professional services. Using the average annual decline in net assets over the past five fiscal years, we estimated that SAFE-BIDCO will need to generate an additional \$396,000 in revenue annually—with no increase in expenses—to prevent further declines in its net assets. We estimated that to produce this amount of revenue, SAFE-BIDCO needs to make additional loans each year of \$5.3 million. This estimate is based on the revenue SAFE-BIDCO could expect to generate from fees, loan sale premiums, and interest income. Our estimate includes the revenue and fees that SAFE-BIDCO could collect if it loaned funds at a 6.25 percent interest rate. For example, at \$250,000 per loan, SAFE-BIDCO would need to make 21 additional loans each year. This amount of lending would represent a significant increase in its loan activities, as SAFE-BIDCO made only three loans totaling \$525,000 in fiscal year 2015–16. However, if SAFE-BIDCO were to obtain, review, and manage 21 additional loans, it would likely incur additional staffing expenses caused by the increased workload and thus would need additional revenue above the \$396,000 we calculated to cover those increased expenses.

In fact, SAFE-BIDCO recently requested a significant amount of additional funding. At a December 2016 public meeting of the executive subcommittee, SAFE-BIDCO staff reported they had submitted a budget change proposal to the State requesting \$15.5 million—\$15 million to use to make loans and \$500,000 for additional staff. When we asked SAFE-BIDCO’s CEO whether it was a realistic assumption that SAFE-BIDCO could loan \$15 million in one year, she stated that it could be accomplished by making larger loans of up to \$750,000. She also stated that SAFE-BIDCO turns away prospective borrowers daily because of the potential borrowers’ requested loan amounts and business locations. However, \$15 million in loans in a single year would be a significant increase in SAFE-BIDCO’s loan activity, and it would considerably exceed its loan activity in any one year over the past 10 years.

Specifically, in fiscal year 2011–12, which was the fiscal year with the greatest loan activity during the past 10 years, SAFE-BIDCO made 18 loans totaling just \$3 million.

In addition to its operating expenses, SAFE-BIDCO provides other postemployment benefits (OPEB) to its retirees and to its current employees once they retire. Specifically, SAFE-BIDCO's OPEB costs include postemployment health care benefits to all employees who retire from the organization on or after reaching age 65 with at least five years of service. According to its audited financial statements, SAFE-BIDCO pays the full amount of the monthly medical premium for the lifetime of each retired employee and dependent spouse. However, SAFE-BIDCO has not set aside any funds for its future OPEB obligation. Its net OPEB obligation—\$650,000 as of June 30, 2016—has increased by 179 percent since June 30, 2011, and its net assets as of June 30, 2016, were \$1.3 million. Setting aside \$650,000 for the OPEB liability would significantly limit SAFE-BIDCO's ability to continue to operate. Without generating additional revenue through its loan activities, SAFE-BIDCO is unlikely to be able to fulfill its OPEB obligation to its employees and retirees.

SAFE-BIDCO Has Been Unsuccessful in Obtaining Sufficient Additional Capital

Although SAFE-BIDCO's net assets have been declining for years, it has not taken sufficient steps to obtain additional capital to address the decline, allowing its net assets to continue to dwindle and pushing it closer to insolvency. It has borrowed funds to make loans, obtained grants, and sold some of its loans to raise capital. However, these efforts have not generated sufficient funds to address its decreasing net assets. Further, SAFE-BIDCO has not attempted to obtain capital from donations or sponsorships, nor has it attempted to obtain funds to support its operations through fundraising activities—such as selling tickets for special events.

SAFE-BIDCO has made some efforts to obtain other sources of funding, but the funds generated were not sufficient to prevent declines in SAFE-BIDCO's net assets. According to its audited financial statements, in December 2010, SAFE-BIDCO entered into a \$1 million promissory note with a development corporation to obtain funds to finance the guaranteed portions of the SBA loans it made. It repaid that promissory note in fiscal year 2015–16. Additionally, between 1996 and 2010, SAFE-BIDCO received five loans from the U.S. Department of Agriculture (USDA) Rural Development totaling \$2.75 million to make loans to businesses located in designated counties. It also received a \$500,000 grant

Without generating additional revenue through its loan activities, SAFE-BIDCO is unlikely to be able to fulfill its OPEB obligation to its employees and retirees.

in fiscal year 2015–16 for its Native American Loan Program. However, these funds alone have been insufficient to resolve SAFE-BIDCO's financial concerns.

SAFE-BIDCO has also raised capital by selling loans it makes, but it now has very few loans that it can sell. When SAFE-BIDCO acts as a lender, it can typically sell the guaranteed portions of its loans to third parties because the guaranteed portions have reduced risk for the purchasers. However, SAFE-BIDCO has made few loans guaranteed by other entities in recent years. For fiscal years 2011–12 through 2015–16, SAFE-BIDCO sold loans and received more than \$4 million in total revenue, or a little over \$801,000 per year, but as of June 30, 2016, it held \$2.8 million in loans. SAFE-BIDCO's CEO stated that it has been unable to sell the remainder of its \$2.8 million in loans—\$1.1 million made through the USDA Rural Loan Program—because its loan agreement with the USDA requires SAFE-BIDCO to hold the loans as collateral for the loans the USDA made to SAFE-BIDCO. The remaining \$1.7 million was unguaranteed. SAFE-BIDCO has attempted to sell unguaranteed loans made under its Energy Efficiency Loan Program, which total \$899,000, but it has been unsuccessful. Reasons given by third parties for declining to purchase the loans include that the loans are unguaranteed, no updated financial information is available, and the third parties are not interested in these types of loans.

Despite its status as a nonprofit, SAFE-BIDCO has not sought donations and raised funds to help meet its need for additional capital.

Despite its status as a 501(c)(3) nonprofit, SAFE-BIDCO has not engaged in fundraising activities, such as seeking donations and sponsorships or selling tickets for special events, to help meet its need for additional capital.¹ In explaining that SAFE-BIDCO has not attempted to obtain donations, its CEO told us that she knows of no state-affiliated organization that solicits funds. She further explained that special events can be very expensive to organize and stage. Nevertheless, given its status as a nonprofit, SAFE-BIDCO can seek donations and raise funds. A senior loan officer at California Capital Financial Development Corporation (California Capital), a Sacramento-based nonprofit, told us that it receives federal and state revenue for operating the SBA loan program and the California Small Business Loan Guarantee Program. These are some of the same programs SAFE-BIDCO operates. However, unlike SAFE-BIDCO, California Capital does seek donations and sponsorships. A program director at California Capital stated that it is supported in part through funding from foundations and financial institutions that provide donations in the form of grants and sponsorships. She stated that grant funding can specify

¹ Organizations described in section 501(c)(3) of the Internal Revenue Code are commonly referred to as *charitable organizations* and are eligible to receive tax-deductible contributions.

a purpose, such as helping fund capacity building services for small businesses. She explained that these services provide small business owners with training, counseling, workshops, and other resources that businesses need to become more successful and self-sustaining. Further, she stated that California Capital receives sponsorship funding when a donor wants to give funds for a particular program or event. According to the vice president of Valley Small Business Development Corporation, a Fresno-based nonprofit, it obtained \$1.2 million in technical assistance grants since 2011 from banks and other financial institutions for such services as providing no-cost individualized business counseling focusing on loan readiness and financial troubleshooting. The business services director for the Napa-Sonoma Small Business Development Centers, a nonprofit that provides business counseling services to small businesses in the same geographic region as SAFE-BIDCO and that receives funding from some of the same entities, such as the SBA, noted that it operates workshops for small businesses that are partially funded by participant fees or bank sponsorships. She also noted that it holds the workshops in a variety of places, including local chambers of commerce, which donate space for the events. Because SAFE-BIDCO is not engaging in fundraising efforts such as soliciting donations as similar organizations do, it is missing out on potential sources of additional capital.

Finally, SAFE-BIDCO has been unsuccessful in obtaining funding from the State. As discussed earlier, SAFE-BIDCO noted at its December 2016 public executive committee meeting that it had submitted a budget change proposal to the State requesting \$15.5 million. According to the CEO, she had made multiple efforts to obtain financing in past years by reaching out to legislators, legislative staff, members of the board, the Department of Business Oversight, and Department of Finance (Finance) staff. She also stated that her first efforts started in 2000 and consisted of in-person meetings and telephone conversations. However, only after she spoke in 2016 with a program budget manager at Finance, who directed her to submit a budget change proposal directly to Finance, did SAFE-BIDCO formally request additional funding from the State.

The CEO told us about SAFE-BIDCO's plan to borrow funds from a private organization based in San Jose that intends to raise money under the federal EB-5 Immigrant Investor Program (EB-5 Program), which allows foreign nationals to obtain residence status in the United States in exchange for investments in the United States that create jobs. Under the proposed plan structure, the private organization would employ brokers to seek foreign nationals wishing to make investments in exchange for residence status. Once a broker obtains a foreign investment that is approved by the federal government, the private organization would lend the

SAFE-BIDCO plans to borrow funds from a private organization that intends to raise money under a federal program that allows foreign nationals to obtain residence status in exchange for investments that create jobs.

funds to SAFE-BIDCO at a 3 percent interest rate. SAFE-BIDCO would be able to use the funds it borrows as needed to make loans. According to the CEO, as of the end of January 2017, the proposed structure of the plan had not yet been approved by the federal government. She also stated that she does not know when the federal government might approve the plan. However, the EB-5 Program is scheduled to expire on April 28, 2017. Although the program has been reauthorized regularly since 1990, a bill was introduced in January 2017 in the U.S. Senate that would end the EB-5 Program. A statement by a senator cosponsoring this legislation noted some specific examples of fraud occurring under the program and indicated that the program has been rife with national security weaknesses. Therefore, it is unclear whether this federal program will continue. Additionally, because the federal government has not approved the formal plan to obtain funds through the EB-5 Program and because SAFE-BIDCO's access to such funds has no formalized timeline, it is premature and imprudent for SAFE-BIDCO to rely on this funding for its future operations.

SAFE-BIDCO Made Questionable Spending Decisions About Contractors and Out-of-State Travel

SAFE-BIDCO did not significantly reduce its expenses over the past five years, even though it brought in less revenue over this period than it had generated previously.

SAFE-BIDCO did not significantly reduce its expenses over the past five years, even though it brought in less revenue over this period than it had generated previously. SAFE-BIDCO's annual revenue declined by about \$300,000, from \$1.2 million in fiscal year 2011–12 to \$908,000 in fiscal year 2015–16. In contrast, it reduced its expenses by only about \$200,000, from roughly \$1.4 million in fiscal year 2011–12 to roughly \$1.2 million in fiscal year 2015–16. Given SAFE-BIDCO's declining net assets, we expected that it would attempt to reduce its expenses to bring them in line with its revenue, but it has not done so. Instead, it has imprudently spent its limited funds on questionable activities.

As shown in Figure 3 on page 10, SAFE-BIDCO has a small staff of seven employees, and it uses contractors for many of its services. However, we question the prudence of using its limited resources for two of its contractors. Specifically, the primary responsibility of SAFE-BIDCO's business development contractor is to develop leads for the California Small Business Loan Guarantee Program. SAFE-BIDCO began contracting with him in February 2011 and has renewed his services for each fiscal year since then. For fiscal years 2011–12 through 2015–16, we estimated the business development contractor generated \$586,000 in fees and interest income, or \$117,000 per year, on average. However, SAFE-BIDCO paid the contractor \$471,000 over those five years, or \$94,000 per year. Thus, the contractor generated only \$115,000 in revenue

in excess of the amount SAFE-BIDCO paid him for the five-year period, or about \$23,000 per year. This low return on investment is problematic given SAFE-BIDCO's declining assets.

When we discussed with the CEO our cost-benefit analysis of the business development contractor, she stated that the contractor does more work than implied by the amount of loans generated because many loans do not come to fruition. She also stated that the contractor is good at what he does because he knows a lot about credit and that he can review the credit of borrowers and know whether to continue with the borrowers. She indicated that he was more efficient in this area than were previous business development contractors. However, the business development contractor did not meet the performance milestones specified in his contracts for fiscal years 2012–13 through 2015–16. His contract for fiscal years 2012–13 through 2014–15 identifies that he was to produce \$30 million in loan guarantee packages and \$2.5 million in other loans, and he was to conduct 16 speaking engagements or bank presentations annually. For fiscal year 2015–16, SAFE-BIDCO amended the contractor's performance milestones to focus on his generating \$300,000 in income from loan guarantee fees.

SAFE-BIDCO continued to use this business development contractor, even though he did not achieve the goals for the loans and loan guarantees in any of the fiscal years we reviewed, only reaching a maximum of \$395,000 in loans in fiscal year 2012–13 and nearly \$12 million in loan guarantees in fiscal year 2013–14. Additionally, in fiscal year 2015–16, he did not meet his milestones, generating only 44 percent of the goal, or \$133,000 in fee income.

Given SAFE-BIDCO's financial position, we expected that SAFE-BIDCO would closely track the business development contractor and compare his performance to the milestones in his contract because he is SAFE-BIDCO's key individual responsible for developing business under the Small Business Loan Guarantee Program. We expected that when the contractor did not meet these milestones, SAFE-BIDCO would open a search for a contractor who could provide better performance to meet SAFE-BIDCO's business development needs. However, SAFE-BIDCO did not do so. The CEO stated that since hiring the contractor, loan fees from banks have steadily increased, and loan guarantees have increased somewhat. However, the CEO also noted that the guarantee fees charged to banks have increased from 1 percent to 2.5 percent. This change in guarantee fees could also explain, in part, the rise in total fees collected. Because the contractor did not meet performance goals consistently and because SAFE-BIDCO did not seek competitive bids for his services, we question whether SAFE-BIDCO has received the best value for its money.

SAFE-BIDCO continued to use a business development contractor even though he did not achieve the goals for the loans and loan guarantees in any of the fiscal years we reviewed.

Consultant's Scope of Work

1. Provide research, analysis, and recommendations related to SAFE-BIDCO's business development objectives and the possible expansion of its funding and mission to include the authority and financial resources to enable it to provide small business financing assistance for water conservation and greenhouse gas emission reduction projects.
2. Advise and consult with SAFE-BIDCO in identifying and prioritizing meetings and discussions with appropriate state officials and other interested parties about its business development objectives and expanded mission and funding.
3. Assist SAFE-BIDCO, upon request, in scheduling meetings with appropriate officials in state government.
4. Meet periodically with SAFE-BIDCO management and the board of directors to report on progress and actions undertaken to meet its business development objectives.
5. Provide as needed the lobbying services approved or authorized by the board.

Source: SAFE-BIDCO's contract with the consultant.

The second consultant whose hiring we question was contracted in fiscal year 2015–16 to help SAFE-BIDCO carry out tasks related to its educational and marketing goals and objectives. The consultant's scope of work specified the activities outlined in the text box. Under the agreement, SAFE-BIDCO paid the consultant \$6,000 per month for 10 months, or \$60,000. We noted that SAFE-BIDCO did not seek competitive bids for his services. Additionally, given SAFE-BIDCO's financial condition and the fact that five of its nine board members are appointed by the Governor or Legislature, we expected that SAFE-BIDCO board members would contact state officials directly regarding funding rather than hire a consultant to perform this work.

According to the board meeting minutes for September 2015, the board and the consultant discussed the potential for expanding the scope of SAFE-BIDCO and the possibility of accessing other funding sources. Additionally, they discussed potential opportunities related to the Clean Energy and Pollution Reduction Act of 2015, which established requirements to increase procurement of electricity from renewable sources and to double the energy efficiency savings in electricity and natural gas end uses. In a later meeting in March 2016, the consultant

reported that he introduced SAFE-BIDCO to legislators whom he thought might be able to assist SAFE-BIDCO in acknowledging the use of SAFE-BIDCO as the instrument to provide financing to disadvantaged communities for water conservation and energy efficiency projects. In May 2016, in the consultant's summary report of activities, he recommended that SAFE-BIDCO develop a budget change proposal to request state funding and to ensure that SAFE-BIDCO submits the proposal on time. His second recommendation was for SAFE-BIDCO to develop a strategic plan. The analysis in the summary report of activities also states that the board might wish to consider inviting the California State Auditor to meet with members to discuss the questions that SAFE-BIDCO should be prepared to answer from Finance and legislative staff regarding its operations and business model. We began this audit following the Joint Legislative Audit Committee's approval in August 2016. Although the recommendations from the consultant might have been helpful for SAFE-BIDCO, we question why SAFE-BIDCO, which has two legislative and three Governor's appointees on its board, needed to spend \$60,000 of its limited resources to obtain such advice.

SAFE-BIDCO's mission is to act as a catalyst for economic development in California by serving as a nontraditional financing source providing access to alternative loan programs for small businesses that are in

markets currently underserved by traditional lending institutions. However, SAFE-BIDCO spent a portion of its dwindling assets on questionable travel, including out-of-state travel and one international trip. For fiscal years 2011–12 through 2015–16, SAFE-BIDCO's average annual travel expenses totaled more than \$28,000, with a high of nearly \$36,000 in fiscal year 2012–13. The CEO's travel expenses included costs for her attendance at conferences and meetings. When we asked the CEO how she has chosen which conferences to attend, she stated that given SAFE-BIDCO's inability to secure state funding, she has been researching opportunities with federal programs. She also said that SAFE-BIDCO benefits from her networking during out-of-state travel. Specifically, she believes that her travel has resulted in referrals to some of its loan programs and an increase in USDA grant funding for SAFE-BIDCO's Native American Loan Program, USDA Rural Loan Program, and USDA Rural Microentrepreneur Assistance Program. However, we noted that SAFE-BIDCO has received funding and worked with the USDA for more than 10 years.

Further, SAFE-BIDCO increased its travel budget in three of the five fiscal years we reviewed, and SAFE-BIDCO also exceeded its budget for travel expenses in three of these five fiscal years. This might have occurred because, according to the CEO, she does not consider the budget when making travel plans. Instead, she chooses conferences to attend based on SAFE-BIDCO's current projects, the legislators or speakers in attendance, the presentations about program updates or changes, and the presentations from organizations with similar structures. The CEO stated that she finds it helpful to hear what others have done and to attend trainings on different operating procedures. Regardless, while exercising her discretionary authority over which conferences to attend and how to manage SAFE-BIDCO's travel budget, the CEO has a fiduciary duty to protect SAFE-BIDCO's assets.

During fiscal years 2011–12 through 2015–16, the CEO made 16 out-of-state trips, more than half of which were to Washington, D.C. She also made one international trip to Ireland. The expenses for these trips totaled more than \$43,000. Figure 5 on the following page displays the numerous out-of-state trips made by the CEO and paid for by SAFE-BIDCO. Given SAFE-BIDCO's mission—to act as a catalyst for economic development in California—and the fact that almost half of SAFE-BIDCO's programs focus on counties in Northern California, we question the prudence of the CEO's quantity of out-of-state travel.

The CEO took a trip to Dublin, Ireland, to attend a conference in June 2013. The expense logs for the trip show that SAFE-BIDCO paid \$5,900 for the conference fee, travel, lodging, and other related expenses. According to the description in SAFE-BIDCO's expense log, the purpose of the trip was for marketing and meetings related to the EB-5 Program. As explained earlier, the EB-5 Program

During the past five years, the CEO made 16 out-of-state trips, more than half of which were to Washington, D.C., and one international trip to Ireland, all of which totaled more than \$43,000.

allows foreign nationals to obtain residence status in the United States in exchange for investments that create jobs. Other expense logs and documentation for this trip show that the CEO attended a one-day conference on the subject of the development of a small island in the northwest corner of Europe, from its origins to its leading role in business, digital, and social media. When we asked the CEO about this trip, she stated that a board member at the time had asked her to support his business activity by attending the conference in Ireland held by an Internet marketing organization he owns. The former board member told us that he did not recall the exact conversation but that he saw SAFE-BIDCO's attendance as a valid opportunity for it to expand its footprint, because its digital marketing was lacking. Although the CEO stated that the board member asked her to attend, she also said that the trip gave her an opportunity to collect information on the EB-5 Program. However, the description for the conference does not include any reference to the EB-5 Program, and the conference was not related to small businesses in California. We, therefore, question the prudence of the CEO's trip to Ireland. Although the trip's total cost may be small in comparison to SAFE-BIDCO's overall budget for the year in which the trip occurred, this kind of spending raises questions about SAFE-BIDCO's efforts to do all it can to reduce its expenses.

Figure 5
SAFE-BIDCO's Chief Executive Officer Made 17 Trips to Destinations Outside of California During Fiscal Years 2011–12 Through 2015–16



Source: SAFE-BIDCO's expense reports for fiscal years 2011–12 through 2015–16.

 = One trip.

Further, the CEO attended a total of three conferences organized by the former board member's Internet marketing organization, giving the appearance that the board member personally benefited from his position on SAFE-BIDCO's board of directors. During the time this individual was a board member, SAFE-BIDCO made payments to his Internet marketing organization of \$10,000 for the CEO to attend these three conferences, including \$3,000 for the one in Ireland and \$7,000 for two other conferences in Washington D.C. Additional travel-related expenses for these three trips and for two conferences in Las Vegas totaled more than \$7,100. Board members and SAFE-BIDCO's CEO are fiduciaries of SAFE-BIDCO when participating in the management of the corporation or when exercising discretionary authority. By having SAFE-BIDCO pay for these conferences that provided questionable benefit to SAFE-BIDCO and that personally benefited a sitting board member, the board member and the CEO violated their fiduciary duties and directed funds to the board member's business that could have gone toward aiding small businesses in California.

In addition, we reviewed the board member's statement of economic interests to determine whether he disclosed his financial interests in the Internet marketing organization to which SAFE-BIDCO made payments. Although SAFE-BIDCO's conflict-of-interest code requires its board members to disclose financial interests in compliance with the Political Reform Act of 1974 by filing statements of economic interests annually and within 30 days of assuming or leaving office, this board member failed to disclose in any of his required statements any reportable economic interests. Although the board member stated that he recalls asking the Fair Political Practices Commission how to deal with SAFE-BIDCO's involvement in attending events for his business, he did not correctly disclose his financial interests. He also noted that he did not vote on the CEO's attending these events, nor did he make such a decision. Our review of SAFE-BIDCO's board meeting minutes did not reveal any instances in which the board voted to approve the CEO's attendance at the board member's conferences. Nevertheless, by failing to disclose the information, the board member did not comply with state law designed to ensure the disclosure of potential conflicts of interests.

A Lack of Oversight and Insufficient Tracking of Program Performance Obscured the Issues Now Facing SAFE-BIDCO

SAFE-BIDCO receives oversight at the state level by the Department of Business Oversight (Business Oversight). Although we were able to obtain and review Business Oversight's annual examination reports of SAFE-BIDCO since 2011, state law prevents us from disclosing the content of the reports

A board member failed to disclose his financial interests in the Internet marketing organization to which SAFE-BIDCO made payments.

without Business Oversight's release of those reports. We requested that Business Oversight release the reports, but it declined to do so. Its board of directors also directly oversees SAFE-BIDCO. However, board oversight has been hampered by limited participation by the board in its subcommittees and ineffective reports prepared by SAFE-BIDCO.

State law specifies that Business Oversight is responsible for performing annual examinations of the entities it licenses to provide lending services, including SAFE-BIDCO. According to an overview of its examination process, the purpose of Business Oversight's periodic examinations is to determine the condition of a licensee—such as SAFE-BIDCO—and to require management to take steps to correct weaknesses or unsafe and unsound conditions. Business Oversight's reviews gather information about a licensee's current asset condition, ability to meet the demands of creditors, adequacy of capital structure, earnings performance and future prospects, level of competency of management, and the extent of compliance with applicable laws and regulations. The function of the examinations is also to identify weaknesses in safeguards and internal routines, and controls and to obtain a commitment from management to correct any noted deficiencies. Business Oversight's examiners evaluate specific areas of a licensee, including its capital adequacy, asset quality, management, earnings, and liquidity and funds management. Based on evaluations of these areas, the examiner determines the overall condition of the licensee and provides an overall rating of *strong*, *satisfactory*, *less than satisfactory*, or *unsatisfactory*.

Business Oversight conducted annual examinations of SAFE-BIDCO for fiscal years 2011–12 through 2015–16. However, state law specifies that examinations prepared by Business Oversight are confidential. We believe a reasonable interpretation of the law allows Business Oversight to publish its reports if it so chooses, making the report available to the public. We asked Business Oversight whether it would publish its reports on SAFE-BIDCO so that we could better describe Business Oversight's efforts to provide oversight to SAFE-BIDCO. Business Oversight declined to do so.

To better describe Business Oversight's efforts to provide oversight to SAFE-BIDCO, we asked Business Oversight to publish its reports on SAFE-BIDCO, but it declined to do so.

Annual financial audits provide another form of oversight. SAFE-BIDCO obtains annual audits of its financial statements from an independent public accounting firm that furnishes verified financial information to its management. We reviewed these audit reports for the past five fiscal years, and we noted that the independent auditor had concluded in each report that the financial statements were fairly and appropriately presented. The independent auditor did not report any findings relating to reviews of SAFE-BIDCO's compliance with federal programs.

Moreover, the independent auditor did not include a *going concern disclosure* in its opinions for the last five years. Under generally accepted accounting principles, an auditor includes a going concern disclosure when it has substantial doubt regarding an entity's ability to continue as a going concern when conditions and events, considered in the aggregate, indicate the probability that the entity will be unable to meet its obligations as they become due within one year after the date that the financial statements are issued. Even our worst-case projection estimated that SAFE-BIDCO could continue operations for at least 12 months from its June 30, 2016, financial audit. Thus, despite its declining financial position, SAFE-BIDCO has not met the criteria to warrant a going concern disclosure. However, SAFE-BIDCO's financial statements still provide the statements' users and reviewers, including board members and such oversight agencies as Business Oversight, with information about SAFE-BIDCO's financial condition. Reviewers of SAFE-BIDCO's financial statements can clearly see the organization's declining financial position and can use the information for their decision making.

SAFE-BIDCO's nine-member board is the body that is primarily responsible for overseeing the organization's operations. However, the board is hampered by its members' limited involvement in its subcommittees and the lengthy, duplicative reports that staff members prepare and provide to the board. In our review of the board's meeting minutes, we noted that the board uses the work of three subcommittees—the executive, audit, and investment subcommittees—to inform its decision making. Subcommittees can be useful in helping a board address its responsibilities, but only four of SAFE-BIDCO's nine board members—the three regional board members and one of the six appointed members—sit on these subcommittees. Except in the case of the executive subcommittee, whose membership is defined in SAFE-BIDCO's bylaws, board members volunteer to serve on these subcommittees. Figure 6 on the following page shows the current subcommittee makeup. In fiscal year 2015–16, the full board met quarterly to conduct board business and hear updates and recommendations regarding subcommittee activities. The subcommittee meetings included important discussions regarding SAFE-BIDCO's financial condition and future plans. Typically, the executive subcommittee reviews the agenda and acts on matters specifically referred to it by the board. The audit subcommittee reviews annual independent audits, internal financial statements, records, and procedures to ensure prudent and sound financial management. The investment subcommittee provides direction to investment staff regarding portfolio diversification, economic outlook, and overall risk management. Because generally only one of the appointed members of the board participates actively in these subcommittees, the board is missing an opportunity to provide SAFE-BIDCO with

The board is hampered by its members' limited involvement in its subcommittees and the lengthy, duplicative reports that staff members prepare for the board's review.

the full range of its members' experience and expertise, and only a few of the board members are heavily involved in the guidance of the organization.

Figure 6
Only Four of Nine SAFE-BIDCO Board Members Serve on Board Subcommittees



Sources: SAFE-BIDCO's bylaws and meeting minutes for its executive, audit, and investment subcommittees.

SAFE-BIDCO Should Consolidate and Streamline Its Reports to the Board

The primary methods SAFE-BIDCO uses to report to its board are memos, reports, and other information prepared by staff and compiled into board packets provided to the board members in advance of each quarterly board meeting. However, information provided in the packets should be better structured to provide critical information to board members. SAFE-BIDCO's board packets contain information including the current meeting's agenda, committee and board meeting minutes from the previous meeting, a compilation of memos to the board, and numerous financial reports. SAFE-BIDCO has changed the types of financial reports over the years, but the packets have consistently included a summary from its chief financial officer, the most recent financial statements, investment reports, budget-to-actual summary and comparative operating data, loan loss reserve evaluations, fee-for-service reports, and loans in process. According to the CEO, when board members request new information, SAFE-BIDCO develops a new report, and it continues to include the report in the board packet unless told otherwise by the board. As a result, the board packets have become voluminous, and the packets' comprehensive nature has sometimes limited the usefulness of information provided. In fact, board packets for fiscal year 2015–16 averaged more than 90 pages.

Although providing extensive information may be useful, board members do not always have sufficient time to review their packets before board meetings. When we discussed board members'

sometimes receiving their packets within 24 hours of the meeting, the CEO explained that the shortage of staff—including the loss of the board secretary in November 2014—has challenged SAFE-BIDCO’s ability to meet routine daily deadlines. She stated that managing day-to-day activities with novice administrative staff is a challenge and has translated into delays. She acknowledged that the board members had received their materials later than usual during the past year. Given the size of the packet and the short time for review, the ability of a board member to provide meaningful oversight at a quarterly meeting is limited. Consolidating duplicative information and reducing the size of the packets could also help ease the burden on staff who prepare the packets.

Further, the reports SAFE-BIDCO provides its board members have not consistently tracked or compiled relevant data related to its goals, thus limiting the board’s ability to assess SAFE-BIDCO’s performance. Although SAFE-BIDCO has established various goals, the organization’s reports do not explain how these goals are related. For example, SAFE-BIDCO’s fiscal year 2014–15 budget listed a revenue goal of generating \$66,000 in premiums for selling SBA loans. Another report listed a goal of making \$839,000 in SBA loans in fiscal year 2014–15. However, the reports fail to explain whether making \$839,000 in SBA loans would help achieve SAFE-BIDCO’s revenue goal of generating \$66,000 in premiums from selling SBA loans. Without clearly explaining the relationships among various goals, SAFE-BIDCO cannot assure the board members and other stakeholders that its goals are appropriate.

Although SAFE-BIDCO prepares multiple types of goal reports for its board, it could better demonstrate that it is allocating its resources effectively and eliminating redundant information by compiling a single unified report containing goals and production for all of its programs. As shown in Table 2 on the following page, SAFE-BIDCO provides to its board four separate reports containing program performance information, but it does not assemble a single unified report tracking all individual loan program and fee-for-service production and goals. SAFE-BIDCO’s CEO stated that individual program goal and performance tracking is already contained in a report prepared for the board. However, as we discuss above, the reports SAFE-BIDCO provided do not contain the relevant details connecting the goals, limiting the ability of the board to assess SAFE-BIDCO’s performance.

SAFE-BIDCO’s CEO explained that the board’s preference for specific levels of detail in the reports has changed over time. For example, according to the CEO, SAFE-BIDCO staff created a new report when the board requested information regarding the production activity for SAFE-BIDCO’s two programs that produce the highest income. However, the information in that report,

The reports SAFE-BIDCO provides its board members have not consistently tracked or compiled relevant data related to its goals, thus limiting the board’s ability to assess SAFE-BIDCO’s performance.

provided as a memo in the board of directors' packages, contains duplicate information that is already included in other reports the board has continued to receive. For example, a loan volume goal included in SAFE-BIDCO's loan report was also included in the new report. Additionally, the new report lists a goal for loan sale premiums that SAFE-BIDCO's budget also includes. SAFE-BIDCO should not limit itself to providing just what the board requests and should consider how to most effectively present the information. By preparing a single report containing goals and production for its programs, SAFE-BIDCO can avoid redundant information and better demonstrate to its board that it is allocating its limited resources effectively among the programs and services it provides to its clients. A consistent, consolidated report could also help SAFE-BIDCO readily provide information on its successes in its efforts to obtain additional sources of capital.

Table 2
SAFE-BIDCO Has Presented Multiple Reports to Its Board of Directors, but the Reports Have Failed to Track Its Performance Clearly
Fiscal Years 2011–12 Through 2015–16

| REPORTS BY SAFE-BIDCO | PERFORMANCE GOALS THAT SAFE-BIDCO'S REPORTS TRACK | | | | | |
|---|--|---|---|---|---|---|
| | GOALS FOR INDIVIDUAL LOAN PROGRAMS | | | | GOALS FOR SAFE-BIDCO AS AN ORGANIZATION | |
| | GOAL FOR LOAN VOLUME COMPARED TO ACTUAL LOAN VOLUME* | GOAL FOR LOAN PROGRAM REVENUE COMPARED TO ACTUAL REVENUE* | LOAN VOLUME NEEDED TO REACH REVENUE GOALS | GOAL FOR LOAN GUARANTEE FEES COMPARED TO ACTUAL LOAN GUARANTEE FEES | GOAL FOR LOAN VOLUME COMPARED TO ACTUAL LOAN VOLUME | GOAL FOR FEE-FOR-SERVICE REVENUE COMPARED TO ACTUAL REVENUE |
| SAFE-BIDCO budget | ✗ | ✓ | ✗ | ✓ | ✗ | ✓ |
| Direct Pipeline Summary report [†] | ✓ | ✗ | ✗ | ✗ | ✓ | ✗ |
| Goal Comparison report [‡] | ✗ | ✗ | ✗ | ✓ | ✓ | ✗ |
| Guarantees Booked report [§] | ✗ | ✗ | ✗ | ✗ | ✗ | ✗ |

Source: SAFE-BIDCO reports presented in agenda packets to its board of directors.

✓ = Yes

✗ = No

* *Loan volume* refers to the total dollar value of loans that SAFE-BIDCO actually made. For example, if SAFE-BIDCO made 10 loans totaling \$10 million, the loan volume would be \$10 million. *Loan program revenue* refers to the amount of revenue earned by SAFE-BIDCO on the loans it made.

† The Direct Pipeline Summary report presents the number of potential loans, loans in process, and actual loans made for the fiscal year. This report also presents the loan volume goal by program.

‡ SAFE-BIDCO began preparing this report in fiscal year 2014–15. Although this report does not list all individual loan programs, it does have a separate goal category for its Native American Loan Program.

§ The Guarantees Booked report presents the actual loan guarantee volume, but it does not compare this amount to any goals.

SAFE-BIDCO also has established qualitative goals in its strategic plan, but it does not report on how well it is meeting most of them to the board. For example, none of SAFE-BIDCO's reports assess how well it is achieving the goals of advocating for small business finance, providing high-quality customer service, and implementing lending programs valued by lenders and clients.

Adding a Supervisory Review of Its Loan Files Would Help Ensure That SAFE-BIDCO Is Complying With Loan Program Requirements

SAFE-BIDCO lacks policies and procedures for supervisory review of loan files. Establishing such policies and procedures would help it ensure that reports to the board are accurate and that SAFE-BIDCO is lending funds or guaranteeing loans according to the loan programs' requirements. We reviewed the loan files for a selection of loans and loan guarantees processed by SAFE-BIDCO's staff to determine whether they complied with selected program requirements. Specifically, we reviewed two loans or loan guarantees for each of the seven programs that SAFE-BIDCO operated during fiscal years 2011–12 through 2015–16. SAFE-BIDCO did not make any loans under its Agricultural Loan Program during this period. As shown in Table 1 on page 13, SAFE-BIDCO made 54 loans and 102 loan guarantees during those five fiscal years.

We identified three errors in the 14 files reviewed, but these errors could have been prevented if SAFE-BIDCO had established a consistent review process for its loan files. For one of the two loan guarantees we reviewed under the California Small Business Loan Guarantee Program, SAFE-BIDCO promised in April 2014 a 10-year guarantee, yet the program's maximum allowable duration for a guarantee is seven years. As a result, SAFE-BIDCO could be liable to pay the guaranteed amount of the loan if the borrower defaults on the loan after seven years. After we brought this matter to SAFE-BIDCO's attention, it contacted the bank that made the loan to inform it of the error.

We also noted one error in two of the loan files we reviewed for the Replacing, Removing, or Upgrading Underground Storage Tanks (RUST) Program. Specifically, under its contract with the State Water Resources Control Board (State Water Board), SAFE-BIDCO packages loans and submits them to the State Water Board for funding consideration. According to its contract, SAFE-BIDCO is paid a loan packaging fee of \$1,000 and receives 1 percent of the funded loan amount, but it is prohibited from charging other fees or interest. Nevertheless, in November 2013, SAFE-BIDCO charged an application fee of \$275 for one of the two RUST loan files we reviewed. SAFE-BIDCO's CEO agreed that SAFE-BIDCO should not have charged the fee, and she did not know why it had done so.

For one of the two Native American Loan Program loans we reviewed, we found no evidence in SAFE-BIDCO's loan file demonstrating that before issuing the loan in April 2013, SAFE-BIDCO had verified that the borrower met the tribal member requirements specified in its program plan criteria. Because this program is intended to benefit tribal members who might have more difficulty than others in obtaining capital from traditional

We identified three errors in the 14 loan files reviewed, but these errors could have been prevented if SAFE-BIDCO had established a consistent review process for its files.

lenders, SAFE-BIDCO's program eligibility requirements state that businesses must be at least 51 percent Native American-owned. After we brought this issue to SAFE-BIDCO's attention, it obtained evidence that the primary borrower was a tribal member.

Because of the errors we noted, we asked SAFE-BIDCO's CEO whether SAFE-BIDCO has a policy or practice that every loan file receive a review by a second employee. She said that SAFE-BIDCO's general practice is for the senior credit officer to review each loan file. However, she noted that SAFE-BIDCO has no formal review documented by signatures. We discussed with the CEO whether creating a formal supervisory review process would be a good idea to ensure that SAFE-BIDCO's loan files comply with program requirements. She stated that she believes such a practice is unnecessary given her staff's experience in processing loans. She also indicated that large loans must be reviewed and approved by the loan committee. Additionally, she noted that outside entities already review some of the loans. For example, the California Infrastructure and Economic Development Bank, also known as IBank, reviews loan guarantees made by SAFE-BIDCO under the California Small Business Loan Guarantee Program. However, because not all programs SAFE-BIDCO operates undergo an external review, and because not all loans are reviewed by the loan committee, it is important that SAFE-BIDCO establish a supervisory review process to ensure compliance with requirements. SAFE-BIDCO's CEO indicated that establishing a supervisory review process for its programs would not be practical given its limited staffing. However, SAFE-BIDCO's loan volume for fiscal year 2015–16 consisted of three loans and 22 guarantees, or roughly two loans or guarantees per month. Because of the low number of approved loans and loan guarantees, it should not be onerous for SAFE-BIDCO to conduct a supervisory review of all loans and loan guarantees it approves. By establishing a documented supervisory review process, SAFE-BIDCO could help ensure that it has gathered sufficient documentation to demonstrate that the loans and guarantees it makes are consistent with individual program requirements.

Restructuring SAFE-BIDCO Could Address Operational Concerns and Allow It to Continue Serving Small Businesses

To continue to operate its programs to provide financing assistance to California's small businesses, SAFE-BIDCO needs additional capital. However, as discussed earlier, we are concerned with several aspects of its operations. Therefore, we are reluctant to recommend that the Legislature appropriate funding to SAFE-BIDCO as it is currently structured. Despite the continuous decline of available capital to make loans, SAFE-BIDCO has spent more than it has earned in each of the last five fiscal

years, has made questionable spending choices, and has been unsuccessful in obtaining sufficient additional capital. In its current form, SAFE-BIDCO has limited state oversight through annual examinations of its lending services, and its board is hampered by the limited number of board members who actively participate in its subcommittees and by the voluminous and sometimes duplicative information reported in the board packets. Therefore, if the State appropriates funding, SAFE-BIDCO should undergo organizational changes to address these concerns and to maximize the use of any funding received. Table 3 outlines several options that the Legislature could pursue to address our concerns.

Table 3
Benefits and Costs to the State of Legislative Options to Restructure SAFE-BIDCO

| LEGISLATIVE OPTION | BENEFITS | COSTS |
|--|---|---|
| Establish SAFE-BIDCO as a program within an existing state department. <i>The State takes over SAFE-BIDCO's operations.</i> | <ul style="list-style-type: none"> The State continues SAFE-BIDCO's mission to provide financial assistance to California's small businesses through access to various alternative loan programs. The designated state department has direct oversight and control of SAFE-BIDCO's operations. SAFE-BIDCO's operations are subject to state requirements for competitive bidding of contracts. | <ul style="list-style-type: none"> The designated state department would need annual funding to support its operations and the lending programs taken over by the State. The State might need to take on SAFE BIDCO's existing obligations. |
| Appropriate funding to SAFE-BIDCO and require direct reporting to the Legislature on its performance. <i>SAFE-BIDCO receives an appropriation. The Legislature requires SAFE-BIDCO to report annually on its performance.</i> | <ul style="list-style-type: none"> SAFE-BIDCO continues its mission to provide financial assistance to California's small businesses through access to alternative loan programs. SAFE-BIDCO receives increased oversight through its direct reporting to the Legislature. | <ul style="list-style-type: none"> The State appropriates funding to SAFE-BIDCO to make loans to small businesses. The State would have limited assurance that its investment would be used efficiently to benefit small businesses. SAFE-BIDCO's reporting on its performance annually would not prevent day-to-day management concerns similar to those identified in our audit, including imprudent spending on travel and contractors. |
| Take no action. <i>The Legislature leaves SAFE-BIDCO as is.</i> | The State receives no additional benefits. | SAFE-BIDCO might eventually become unable to continue its mission to assist small businesses with financing. |
| Dissolve SAFE-BIDCO. <i>The Legislature enacts legislation to dissolve SAFE-BIDCO.</i> | The State receives no additional benefits. | <ul style="list-style-type: none"> The State is likely to incur costs to wind down SAFE-BIDCO, such as those related to transferring loans and loan programs to other entities. Dissolving SAFE-BIDCO would terminate health benefits for current employees and retirees. |

Sources: California State Auditor's analyses of SAFE-BIDCO's operations and of relevant laws and regulations.

Of these options, the one that would best address our concerns would be for the Legislature to establish SAFE-BIDCO as a program within an existing state department that already performs similar activities. Doing so would enable the State to continue to support financial assistance for small businesses and to have direct oversight of and control over SAFE-BIDCO's operations. Instead of a board of directors that manages SAFE-BIDCO's activities, the chosen state department would manage SAFE-BIDCO's programs, control the tracking of program performance, and ensure that adequate information is reported. State employees seeking contracted services for SAFE-BIDCO's programs would be subject to such state contracting policies as competitive bidding. As a result, this transfer should help control costs and increase oversight.

If it moves SAFE-BIDCO under a state department, the Legislature should not transfer all of SAFE-BIDCO's functions. Of its eight programs, only two—the Energy Efficiency Loan Program and the Native American Loan Program—are exclusive to SAFE-BIDCO and could provide a unique benefit if continued. Each of these two programs is designed to aid a specified community and could be implemented statewide. As for the other six programs, SAFE-BIDCO's Rural Loan Program is funded through a low-interest federal loan from the USDA and could be transferred to either the chosen state department or to a nonprofit organization. In addition to SAFE-BIDCO, other local organizations operate the California Small Business Loan Guarantee Program and RUST Program for the State and so it would be unnecessary for a state entity to operate them. A state department contracts with 11 organizations located throughout the State to review RUST Program loan applications. Another state department contracts with nine organizations throughout the State to operate the California Small Business Loan Guarantee Program. SAFE-BIDCO's remaining three programs—SBA loans, microloans, and agricultural loans—are offered by many other entities. SBA has identified more than 20 other participating lenders in Northern California alone as preferred participating lenders for SBA loans to start-up businesses as well as seven organizations that specifically provide microloans. The USDA Farm Service Agency lists nearly 60 organizations in California that provide the same federally backed agricultural loans that SAFE-BIDCO offers. Therefore, small businesses could seek assistance with loans from other, similar entities if SAFE-BIDCO no longer operates these programs.

We identified the State Treasurer's Office as the best fit to take on SAFE-BIDCO's role because it currently provides some similar lending assistance services.

We reviewed several state departments as possible options to house SAFE-BIDCO's operations and identified the State Treasurer's Office (Treasurer's Office) as the best fit to take on SAFE-BIDCO's role because it currently provides some similar lending assistance services. In particular, the California Pollution Control Financing Authority (CPCFA), chaired by the State Treasurer,

manages the California Capital Access Program (CalCAP), which assists small businesses in obtaining financing from lenders by insuring loans made to small businesses enrolled in this program. Although CalCAP does not offer direct loans, the Treasurer's Office operates other programs that provide direct lending. The executive director of CPCFA stated that the Treasurer's Office is committed to ensuring that small businesses in California have access to capital and to support high-quality, sound lending practices. She told us that the Treasurer's Office believes that a review of state agencies, existing lenders, organizations, and networks would identify an agency or entity capable of taking on SAFE-BIDCO's programs. Further, she stated that the Treasurer's Office would be willing to administer those programs if no existing agency or organization can readily do so, if adequate capital and administrative funding and resources are provided. Notwithstanding its belief that a review would find another agency or entity capable of taking on SAFE-BIDCO's programs, we identified the Treasurer's Office as the best fit to take on SAFE-BIDCO's role. Finally, reporting on the success of SAFE-BIDCO's programs is critical for the Legislature to make decisions regarding this nonprofit organization. Thus, SAFE-BIDCO should report to the Legislature even if it does not become part of a state department.

Recommendations

Legislature

To ensure that SAFE-BIDCO's operations are subject to appropriate oversight and to fulfill its mission of providing financing to small businesses, the Legislature should establish SAFE-BIDCO as a program within the Treasurer's Office.

To track SAFE-BIDCO's performance in fulfilling its mission to provide assistance to California small businesses, the Legislature should require SAFE-BIDCO to report to the Legislature annually on its revenue and expenses and the success of its programs.

SAFE-BIDCO

If it is not established as a program within a state entity, SAFE-BIDCO should do the following:

- To ensure that it has sufficient funding to fulfill its OPEB obligations to its employees and retirees, SAFE-BIDCO should by April 2018 research options to address its obligations, such as setting aside funds dedicated to its OPEB liabilities and take appropriate action based on the research performed.
- To obtain needed capital, SAFE-BIDCO should take steps to raise funds by seeking donations.
- To receive the full range of experience and expertise of its board members, SAFE-BIDCO should by October 2017 take steps to increase participation on its subcommittees by its board members, such as by assigning board members to subcommittees.

Regardless of whether the Legislature establishes SAFE-BIDCO as a program within a state entity, it should do the following:

- To obtain the best value for its limited funds, SAFE-BIDCO should by October 2017 establish a policy and related procedures requiring that it seek competitive bids for significant contracted services. The policy should establish a dollar threshold for what services SAFE-BIDCO considers significant.
- To ensure that it spends its funds furthering its mission of helping California small businesses, SAFE-BIDCO should decrease its travel expenses by adopting a travel budget in consideration of its expenses and mission and limiting out-of-state travel.
- To ensure that decision makers, such as the board of directors, Legislature, and other stakeholders have sufficient information to assess its performance, SAFE-BIDCO should by October 2017 create one central report that includes revenue goals and actual performance for each program it operates.
- To ensure that its loans comply with the requirements of its programs, SAFE-BIDCO should by October 2017 establish policies and procedures for a supervisorial review process of its loan files.

Other Areas We Reviewed

To address the audit objectives that the Joint Legislative Audit Committee approved, we reviewed the subject areas shown in Table 4. In the table, we indicate the results of our review and any associated recommendations we made that are not discussed in other sections of this report.

Table 4
Other Areas Reviewed as Part of This Audit

| SAFE-BIDCO's Access to California Public Employees' Retirement System (CalPERS) Benefits |
|--|
| <ul style="list-style-type: none"> • The Joint Legislative Audit Committee directed us to determine whether SAFE-BIDCO employees are considered to be state employees for the purposes of health and retirement benefits through CalPERS. • SAFE-BIDCO received approval to obtain health benefit coverage for its employees through CalPERS beginning in June 1989. In December 2015, SAFE-BIDCO requested to participate in the CalPERS retirement plan. CalPERS denied the request in March 2016, stating that SAFE-BIDCO had not demonstrated its eligibility to participate. In April 2016 SAFE-BIDCO appealed the decision. As of March 2017, the appeal is still pending. • With limited exceptions, state employees become members of CalPERS upon being hired. SAFE-BIDCO staff are not state employees for the purposes of CalPERS because their salaries do not come directly from the state treasury, among other reasons. However, state law allows certain other public agencies to contract with CalPERS for health and retirement benefit coverage and specifically lists SAFE-BIDCO as a potential contracting agency. To qualify as a <i>public agency</i> for participation in the CalPERS retirement system, state law requires SAFE-BIDCO to obtain a written advisory opinion from the U.S. Department of Labor (Labor) stating that SAFE-BIDCO is an agency or a political subdivision of the State and its participation would not adversely affect CalPERS as a "governmental plan" under federal law. SAFE-BIDCO provided a copy of its request for an advisory opinion to Labor dated June 2004 and a copy of Labor's response dated September 2008, which states that Labor was not issuing any opinions pending new guidance expected from the U.S. Internal Revenue Service (IRS). The response letter also states that SAFE-BIDCO is encouraged to resubmit its request if it has questions after the final guidance is issued. However, as of February 2017, the IRS had not issued the expected final guidance. Partly because SAFE-BIDCO had not obtained the required advisory opinion from Labor, CalPERS denied SAFE-BIDCO's participation in the CalPERS retirement plan. |
| Money at California Infrastructure and Economic Development Bank (IBank) |
| <ul style="list-style-type: none"> • According to correspondence between SAFE-BIDCO and the IBank, SAFE-BIDCO contributed \$750,000 to the State to participate in the California Small Business Loan Guarantee Program in 1990. In late May 2015, SAFE-BIDCO asked that these funds be returned to it. At the time SAFE-BIDCO requested the return of the funds, they were held in a segregated account by IBank. SAFE-BIDCO told IBank that the funds it contributed were intended to be invested and, along with future account interest, used as a loan loss reserve to cover SAFE-BIDCO's losses on loan guarantees it made. According to IBank's fiscal year 2012–13 annual report, the State received approval for \$84.2 million in federal funding for use by the California Small Business Loan Guarantee Program, and began making guarantees with this funding in February 2011. In a July 2015 letter to IBank, SAFE-BIDCO's chief executive officer (CEO) requested return of the funds, stating that the funds were no longer needed for their intended purpose. |

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- In July 2015, IBank's executive director responded to SAFE-BIDCO, stating that IBank does not have statutory authority to return the funds but would keep the funds separate until December 31, 2015, while SAFE-BIDCO explored other avenues to provide the necessary authority for IBank to make the transfer. In mid-December 2015, the executive director of IBank again informed SAFE-BIDCO that it did not have the statutory authority to return the funds and extended the period it would hold the funds separately until July 1, 2016. In late July 2016, IBank notified SAFE-BIDCO that it was exercising its right to combine the trust accounts of SAFE-BIDCO under the California Small Business Loan Guarantee Program account.
- According to SAFE-BIDCO's CEO, she attempted to obtain legislation to authorize the release of funds to SAFE-BIDCO, but the staff of the legislator she was working with indicated to her that they needed approval from the Department of Finance (Finance) to move forward with a bill. She stated that Finance staff indicated to her that this matter had nothing to do with them. Ultimately, the CEO was not able to obtain legislative resolution of the issue.
- If money from the state treasury is issued to return the funds to SAFE-BIDCO, the Legislature would first need to pass legislation to allocate the funds. However, whether the Legislature should consider legislation to transfer these funds to SAFE-BIDCO depends on how the Legislature chooses to restructure SAFE-BIDCO. If the Legislature implements our recommendation to establish SAFE-BIDCO within the State Treasurer's Office (Treasurer's Office), a transfer of funds would be moot because SAFE-BIDCO would be part of the State. Additionally, if SAFE-BIDCO is dissolved, the issue would be moot. However, if the Legislature chooses to appropriate funding and require additional oversight of SAFE-BIDCO but does not make SAFE-BIDCO a part of the Treasurer's Office, return of the \$750,000 may be warranted.

State Law Limiting Programs

- We identified an instance in which state law had limited SAFE-BIDCO's ability to operate one program. SAFE-BIDCO provided to us a letter that it received in August 2012 stating that SAFE-BIDCO was not selected for participation in an intermediary lending pilot program run by the U.S. Small Business Administration (SBA). The letter from the SBA stated that SAFE-BIDCO was not eligible for the program because its board of directors is controlled by a government entity. State law requires the Governor and the Legislature to appoint the majority of SAFE-BIDCO's board.
- However, SAFE-BIDCO does not have sufficient resources to fully operate the programs it currently has, including one managed by the SBA. Therefore, being prevented from operating one program did not meaningfully limit SAFE-BIDCO's ability to operate other programs to benefit small businesses.

SAFE-BIDCO's Loan Committee

- State law requires a loan committee of a financial development corporation, of which SAFE-BIDCO is one, to emphasize consideration of applications that will increase employment of disadvantaged, disabled, or unemployed persons or increase employment of youth residing in areas of high youth unemployment and delinquency.
- SAFE-BIDCO established a financing assistance policy, which is intended to govern loans made using funds it borrowed or its own funds and to guide its loan committee members in their decisions. However, the policy does not include a requirement to emphasize applications that would benefit certain groups. According to its loan officer, SAFE-BIDCO tries to assist every loan applicant, and it does not prioritize the groups emphasized in the statutory requirements.

- SAFE-BIDCO does not include the financing assistance policy in the loan committee orientation packet given to new loan committee members, despite the fact that its bylaws require the loan committee to review applications and make decisions in accordance with the financing assistance policy. Instead, according to SAFE-BIDCO's loan officer, he presents the loan application to the loan committee and answers any committee members' questions or concerns before the committee votes to approve or disapprove the application. By not providing its financing assistance policy to loan committee members, SAFE-BIDCO cannot ensure that the members are aware of and follow the policy and that loan applications are reviewed, approved, or disapproved in a standardized, fair, and consistently applied manner.

Recommendations

- *To ensure consistency of its reviews and approvals of loan applications, SAFE-BIDCO should establish a process to provide all loan committee members with its financing assistance policy.*
- *To make certain that loan committee members are aware of statutory requirements, SAFE-BIDCO should revise its financing assistance policy to ensure that it contains all required language, including emphasizing consideration of applications that will increase employment of disadvantaged, disabled, or unemployed persons or increase employment of youth residing in areas of high youth unemployment and delinquency.*

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Scope and Methodology

The Joint Legislative Audit Committee (Audit Committee) directed the California State Auditor to review SAFE-BIDCO's management and operations. Specifically, it directed us to review SAFE-BIDCO's financial condition and solvency, its efforts to obtain additional capital, how it operated its programs, and its oversight by state entities and SAFE-BIDCO's board. Table 5 lists the objectives that the Audit Committee approved and the methods used to address those objectives.

Table 5
Audit Objectives and the Methods Used to Address Them

| | AUDIT OBJECTIVE | METHOD |
|---|---|---|
| 1 | Review and evaluate the laws, rules, and regulations significant to the audit objectives. | Reviewed relevant laws, regulations, and other background materials applicable to SAFE-BIDCO. |
| 2 | Determine what state entities are responsible for overseeing SAFE-BIDCO, those entities' oversight responsibilities, and whether those entities have conducted that oversight appropriately. | <ul style="list-style-type: none"> • Reviewed applicable state law to determine the entities responsible for state oversight. • Identified the Department of Business Oversight (Business Oversight) as the only state entity that provides oversight of SAFE-BIDCO. • Reviewed examination reports completed by Business Oversight. |
| 3 | Determine whether SAFE-BIDCO monitors its own progress toward achieving its mission and whether it reports on that progress. To the extent possible, identify and review the services and programs that SAFE-BIDCO has provided since 1981 and determine the number of businesses served, jobs created, and the amount of capital provided by SAFE-BIDCO. | <ul style="list-style-type: none"> • Reviewed the materials SAFE-BIDCO provides to its board of directors to report on goals and any other documents in which SAFE-BIDCO tracked its progress. • Determined that SAFE-BIDCO did not consistently track the number of businesses served, jobs created, or capital provided since 1981. • Documented every loan and loan guarantee made by SAFE-BIDCO for fiscal years 2011–12 through 2015–16 so that we could obtain a reasonable estimate of the businesses served and capital provided. • Compared the estimate SAFE-BIDCO used for the number of jobs created to the measure used by the U.S. Small Business Administration to determine reasonableness. |
| 4 | For the last five years, determine whether the programs and services SAFE-BIDCO offered were and are consistent with its authority under state law. Assess whether state law has limited the number of programs or services that SAFE-BIDCO has been able to provide. For each program SAFE-BIDCO currently offers, determine whether the program operates as intended and whether it is meeting any specified goals or objectives. | <ul style="list-style-type: none"> • Documented the programs and services offered by SAFE-BIDCO over the last five fiscal years and tested 14 individual items (two for each of the seven programs that SAFE-BIDCO has operated in the last five fiscal years) to ensure that SAFE-BIDCO followed applicable laws and program rules. • Reviewed state law and interviewed SAFE-BIDCO staff to identify any possible limitations in the programs or services offered by SAFE-BIDCO. • Reviewed the materials SAFE-BIDCO provides to its board to report on program goals and other documents in which SAFE-BIDCO tracked the progress of its programs. |

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| AUDIT OBJECTIVE | METHOD |
|---|--|
| <p>5 Evaluate the distribution of duties at SAFE-BIDCO between the staff it employs and any contracted firms it may use. Describe the basic responsibilities that staff members and contractors are assigned. Determine whether SAFE-BIDCO employees are considered to be state employees for the purposes of health and retirement benefits through the California Public Employees' Retirement System (CalPERS).</p> | <ul style="list-style-type: none"> • Interviewed staff and reviewed contracts to determine the distribution of duties among SAFE-BIDCO staff and contractors. • Reviewed contracted services to determine reasonableness. • Reviewed state law and SAFE-BIDCO's correspondence with CalPERS to determine whether SAFE-BIDCO staff are state employees for the purposes of health and retirement benefits for CalPERS. |
| <p>6 To the extent possible, assess SAFE-BIDCO's current financial condition and solvency. At a minimum, consider the financial audits of SAFE-BIDCO over the past five years, the funding SAFE-BIDCO currently has access to, and the funding it uses to operate. Determine whether any improvements should be made to the scope of SAFE-BIDCO's financial audits.</p> | <ul style="list-style-type: none"> • Reviewed audited financial statements and internal financial reports for fiscal years 2011–12 through 2015–16 to assess SAFE-BIDCO's financial condition and solvency. • Identified SAFE-BIDCO's current assets and funding sources. • Did not identify any improvements that should be made to the scope of SAFE-BIDCO's financial audits. |
| <p>7 Determine how SAFE-BIDCO can request additional funding for capitalization and whether it has done so in the last five years.</p> | <ul style="list-style-type: none"> • Documented SAFE-BIDCO's attempts to obtain additional funding for capitalization for fiscal years 2011–12 through 2015–16. • Estimated the amount of capital SAFE-BIDCO would need to address its declining net assets. • Reviewed SAFE-BIDCO's use of its existing funding sources. Specifically, we reviewed its use of federal funding available to it and its efforts to sell its existing loan portfolio. |
| <p>8 To the extent possible, review and evaluate SAFE-BIDCO's governance and financial oversight structure. At a minimum, determine the extent to which the following are true:</p> <p>a. The SAFE-BIDCO board of directors is informed about key financial and operational issues.</p> <p>b. SAFE-BIDCO has effective and appropriate financial and governance controls.</p> <p>c. SAFE-BIDCO's management practices are aligned with best practices for organizations of similar size and nature.</p> | <ul style="list-style-type: none"> • Reviewed board meeting minutes and the board packets for fiscal years 2011–12 through 2015–16. • Interviewed six of the nine current board members to obtain their perspective on issues facing SAFE-BIDCO. At the time of our interviews, one seat was vacant, one member had recently joined the board and so would not have knowledge of its workings, and one member was unavailable. <p>Reviewed SAFE-BIDCO's internal controls and compared them to best practices identified in objective 8(c) and to the California Attorney General's <i>Guide to Charities</i>, which provides best practices for nonprofits.</p> <ul style="list-style-type: none"> • Identified organizations comparable to SAFE-BIDCO. • Given SAFE-BIDCO's declining financial position, focused our review of best practices of comparable organizations to identify efforts of these organizations to seek funding. |
| <p>9 Review and assess any other issues that are significant to the audit.</p> | <ul style="list-style-type: none"> • Reviewed claims made by SAFE-BIDCO that it is owed \$750,000 that it had previously contributed to a state pool for participation in the California Small Business Loan Guarantee Program. • Reviewed extensive out-of-state travel made by the chief executive officer. |

Sources: California State Auditor's analysis of Joint Legislative Audit Committee audit request number 2016-133 and information and documentation identified in the table column titled *Method*.

Assessment of Data Reliability

In performing the audit, we obtained SAFE-BIDCO's general ledgers for fiscal years 2011–12 through 2015–16. The U.S. Government Accountability Office, whose standards we are statutorily required to follow, requires us to assess the sufficiency and appropriateness of the computer-processed information that we use to support our findings, conclusions, or recommendations. Specifically, we used the general ledger to determine the amount SAFE-BIDCO paid to two contractors. To gain some assurance of the completeness of SAFE-BIDCO's general ledger data, we compared the account balances in SAFE-BIDCO's fiscal year 2015–16 general ledger to its fiscal year 2015–16 audited financial statements and found that the data were consistent with reported financial information. However, we did not conduct full accuracy or completeness testing on these data because this level of review was cost-prohibitive. Thus, we determined that SAFE-BIDCO's general ledger data were of undetermined reliability for the purposes of this audit. Although this determination may affect the precision of the numbers we present, there is sufficient evidence in total to support our audit findings, conclusions, and recommendations.

We conducted this audit under the authority vested in the California State Auditor by Section 8543 et seq. of the California Government Code and according to generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives specified in the Scope and Methodology section of the report. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Respectfully submitted,



ELAINE M. HOWLE, CPA
State Auditor

Date: April 27, 2017

Staff: Tammy Lozano, CPA, CGFM, Audit Principal
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For questions regarding the contents of this report, please contact Margarita Fernández, Chief of Public Affairs, at 916.445.0255.

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April 2017

*Small Business Loans*

April 6, 2017

Elaine Howle, CPA *
 California State Auditor
 621 Capitol Mall, Suite 1200
 Sacramento, CA 95814

Dear Ms Howle:

Thank you for the opportunity to respond to the California State Auditors report of State Assistance Fund for Enterprise, Business and Industrial Development Corporation (SAFE-BIDCO). The final report will be shared with the SAFE-BIDCO Board of Directors. We would like to note that although the board did ask to review the draft, the five day response time and confidentiality requirements did not allow time for the board to review the report and provide any input as a board. The draft was also reviewed by SAFE-BIDCO Board Chairman Glen Stanley. ①

We appreciate the time and effort made by the Auditor's Staff to review and analyze SAFE-BIDCO and its structure. Although we do not agree with some of the observations made by the audit team we truly appreciate the time and thought that went into the data collection and analysis. It is difficult to compare SAFE-BIDCO to other entities as we are the last remaining BIDCO in the State. The other entities that we were compared with in the report are unregulated lenders, whereas SAFE-BIDCO is regulated by the Department of Business Oversight (DBO) and annually examined. ②

The SAFE-BIDCO board finds SAFE-BIDCO has been a well-kept secret for all too long. What other program within the State can boast of leveraging a \$2.5 million loan and a \$750,000 appropriation into over \$200 million small business loans and guarantees, without requesting any additional funding from the State, and while fully supporting its operations independently from the State for over 35 years. In order to continue the mission and mandate it has become necessary for SAFE-BIDCO to seek an increase to its line of credit from the State. This review was initiated by SAFE-BIDCO's request to increase its line of credit from \$2.5 it from \$15 million. ③ ④

We have no problem with any of the recommendations in the report, attached are our responses to the draft recommendations broken out by recommendation.

Again, than you for the opportunity to review and respond to the raft report. If you have any questions, please do not hesitate to contact me at 707-577-8621.

Sincerely,

Mary Jo Dutra
 President/CEO

STATE ASSISTANCE FUND FOR ENTERPRISE, BUSINESS AND INDUSTRIAL DEVELOPMENT CORPORATION

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* California State Auditor's comments begin on page 49.

SAFE-BIDCO - Management's Response

Recommendations:

Legislature

To ensure that SAFE-BIDCO's operations are subject to appropriate oversight and fulfill its mission of providing financing to small businesses, the Legislature should establish SAFE-BIDCO as a program within the State Treasurer's Office.

To track SAFE-BIDCO's performance in fulfilling its mission to provide assistance to California small businesses, the Legislature should require SAFE-BIDCO to report to the Legislature annually on its revenue and expenses and the success of its programs.

Response:

SAFE-BIDCO is not opposed to placing the program within an agency such the State Treasurer's Office. The Legislature created the corporation as a non-profit public benefit entity. If placing the corporation within another agency will allow SAFE-BIDCO's much needed programs to continue with access to needed capital we are in favor of the suggestion.

SAFE-BIDCO is not opposed to reporting annually to the State Legislature. From 1981 – 1990 the corporation did report directly to the Legislature; in 1990 the reporting was transferred to the Office of Small Business within the Department of Commerce and in 2000 that office decided it only wanted information from SAFE-BIDCO on its State Loan Guarantee Program activity. We are examined annually by the Department of Business Oversight (DBO), and as a component unit of government our annual Audited Financials have been submitted to the State Controller since 2012.

Recommendation:

SAFE-BIDCO

If it is not established as a program within a state entity, SAFE-BIDCO should do the following:

- To ensure that it has sufficient funding to fulfill its OPEB obligations to its employees and retirees, SAFE-BIDCO should by April 2018, research options to address its obligation, such as setting aside funds dedicated to its OPEB liabilities, and take appropriate action base on the research performed.
- To ensure that it obtains needed capital, SAFE-BIDCO should take steps to raise funds by seeking donations.

- To ensure it received the full range of experience and expertise of its board members, SAFE-BIDCO should by October 2017, take steps to increase participation on its subcommittees by its board members.

Response:

- This is in process. SAFE-BIDCO self-funds its ongoing public employees (OPEB) obligation. SAFE-BIDCO applied to CalPERS to place our funding contribution within the CalPERS California Employers Retiree Benefit Trust (CERT) to be used to pay CalPERS (SAFE-BIDCO's medical insurance provider) for future retiree medical benefits. CalPERS has decided we are not "an agency or instrumentality of the State ..." and therefore unable to use CERT. SAFE-BIDCO is investigating the legal expense of establishing a private trust for its 6 employees and 4 retirees to pay CalPERS for its ongoing retiree's medical insurance expense.
- This is in process. SAFE-BIDCO has and plans to continue to pursue outside funding sources. SAFE-BIDCO has been unsuccessful in securing an increase to its existing line of credit with the State therefore we have met with numerous federal agencies, through conferences and face to face meetings. As a result we recently completed negotiations for the assumption and transfer of a \$2 million USDA, IRP revolving loan fund and portfolio from a corporation that is dissolving. ⑤

As noted in the Auditor's report we are in negotiations to obtain funding through the EB-5 Program. The report notes that a bill was introduced in the U.S. Senate to do away with the program; however it does not tell you another bill has also been introduced to reauthorize the program (S.727). ⑥

SAFE-BIDCO hosted a Green Entrepreneur fund raising program in the early 2000's. After four years of unprofitable returns the board decided to terminate the event. We have talked about reintroducing the program in the next year as the initial timing may not have been optimal for interest in "Green" Entrepreneur programs. The experience did teach us that donations (auction items, ticket sales and sponsorships) were not a good vehicle for funding resources for SAFE-BIDCO due to the quasi-governmental nature of the corporation's origins. ⑦

- Board member participation is welcome and encouraged. The SAFE-BIDCO board is comprised of 9 directors (currently there is one vacancy). Of the 8 current directors, 5 volunteer for one or more board committees. Committee assignments are a standing item on the board agenda. The chairman asks for volunteers for committee participation. We will suggest to the board that committee assignments be directed by the board chairman and not filled on a volunteer basis. ⑧

Recommendation:

Regardless of whether SAFE-BIDCO is established as a program within a state entity, it should do the following:

- To ensure it obtains the best value for its limited funds, SAFE-BIDCO should by October 2017, establish a policy and related procedures to require it to seek competitive bids for significant

contracted services. The policy should establish a dollar threshold for what services SAFE-BIDCO considers significant.

- To ensure that its funds are spent furthering its mission of helping California small businesses, SAFE-BIDCO should decrease its travel expenses by adopting a travel budget in consideration of its expenses and mission and limiting out-of-state- travel.
- To ensure that decision makers, such as the board of directors, Legislature and other stakeholders, have sufficient information to assess its performances, SAFE-BIDCO should by October 2017, create one central report that includes revenue goals and actual performance for each program it operates.
- To ensure that its loans comply with the requirements of its programs. SAFE-BIDCO should by October 2017, establish policies and procedures for a supervisory review process of its loan files.

Response:

- ⑨ ● There is no problem with establishing a competitive bid process for contracted services and establishing a dollar threshold for said services, as long as it does not contradict our enabling legislation. Finance Code section 32350 of the "State Assistance Fund for Enterprise Act of 1989" states that "The Corporation may appoint such agents and employees as it requires, and determine their qualifications, duties, terms of employment , and compensation. "
- ⑩ The report takes exception to the hiring of two consultants without going through a competitive bid process. A consultant hired in 2011 to do business development for the State Loan Guarantee Program portion of our operation. As a result, the program has demonstrated a steady increase in loan production and guarantees (16 guarantees with a guarantee amount of \$4,639,000 in FY11/12, 21 guarantees with a guarantee amount of \$5,138,400 in FY12/13, 24 guarantees with a guarantee amount of \$7,105,598 in FY13/14, 26 guarantees with a guarantee amount of \$10,906,048 in FY14/15 and 24 guarantees with a guarantee amount of \$11,689,751). A second consultant, familiar with the corporation, having been involved with its creation back in the 1980's was hired to work with state legislators and staff on behalf of SAFE-BIDCO as the board members had been unsuccessful in making inroads with their appointing authorities.
- ⑪ ● Annual travel budget will be more comprehensive in detail and scope as well as reported on during the quarterly budget review. All travel reviewed and included in this report was for the research and development of additional funding sources and programs.
- ⑫ ● We will create a consolidated report that includes revenue goals and actual performance for each loan program. We have had similar reports in the past.
- ⑬ ● We will add a sign off sheet for the staff involved in the organization and review of the files. We have never had any complaints from any of our reviewing agencies on our loan files; quite the opposite in fact, our files are always praised for their organization and ease of accessing information. Files are compiled after loan review and approval.

Other areas reviewed and recommendations:

We were disappointed in the lack of recommendations on some of the issues requested; however we understand the complexity of the questions. ⑭

Access to CalPERS retirement benefits - we are not asking the state to pay for these benefits we are asking to place the funds we have already set aside into the system for the benefit of our employees. It is less costly to have the State manage these funds than to hire outside sources to manage them for such a small staff.

Money at California Infrastructure and Economic Development Bank - Thank you for acknowledging that the \$750,000 taken by IBank should be returned to SAFE-BIDCO, if the Legislature choses to appropriate funding and not make SAFE-BIDCO part of the State Treasurer' office. ⑮

State Law Limiting Programs - In addition to the information provided to you regarding the SBA pilot program we provided you the same information from the U.S. Treasury regarding the Community Development Financial Institutions Fund (CDFI), where they too said SAFE-BIDCO was not eligible for the program because its board is controlled by a government entity. ⑯

SAFE-BIDCO Loan Committee

Recommendation:

- To ensure consistency of its reviews and approvals of loan applications, SAFE-BIDCO should establish a process to provide all loan committee members with its financing assistance policy.
- To ensure loan committee members are aware of statutory requirements, SAFE-BIDCO should revise its financing assistance policy to ensure that it contains all required language, including emphasizing consideration of applications that will increase employment of disadvantaged, disabled, or unemployed persons or increase employment of youth residing in areas of high youth unemployment and delinquency.

Response:

- We will provide the loan committee with copies of the financing assistance policy. We are planning a loan committee tutorial/workshop before the end of the year and can distribute the policy at that time.
- We will review and update the policy for adoption by the board and distribution to the loan committee.

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Comments

CALIFORNIA STATE AUDITOR'S COMMENTS ON THE RESPONSE FROM SAFE-BIDCO

To provide clarity and perspective, we are commenting on the response to our audit from SAFE-BIDCO. The numbers below correspond to the numbers we placed in the margin of SAFE-BIDCO's response.

SAFE-BIDCO's statement that the five-day response period and confidentiality requirements did not allow time for the board to review the report and provide any input as a board is misleading. We informed SAFE-BIDCO in September 2016 at our opening conference of the legal process that can be used for the full board to meet in closed session to review the draft report. We also reminded SAFE-BIDCO of this process again in early March 2017 at the closing conference.

①

SAFE-BIDCO's statement regarding comparing it to other entities is misleading. We compare SAFE-BIDCO to other nonprofits in their efforts to obtain funding through donations and fundraising. SAFE-BIDCO's regulation as a lender has no bearing on this comparison.

②

As we acknowledge on page 5, SAFE-BIDCO received initial funding of \$750,000 and a loan of up to \$2.5 million from the State. However, as for SAFE-BIDCO's claim of fully supporting its operations for over 35 years, as we state on pages 11 and 12, it has spent more than it has earned for nine of the last 10 years and, because of its continual overspending, it could become insolvent as soon as June 2018. As a result, it has requested funding from the State, as we describe on page 14.

③

SAFE-BIDCO is mistaken. This audit was initiated at the direction of the Joint Legislative Audit Committee at its hearing in August 2016.

④

SAFE-BIDCO indicated to us that it would brief its board on this \$2 million in potential new funding at its March 2017 board meeting, well after the completion of our audit fieldwork. Although we are encouraged that SAFE-BIDCO appears to have secured additional funding, \$2 million falls far short of the \$5.3 million in additional loans we indicate on page 14 that it needs to make annually just to prevent a further decline in its financial position. Further, as we note on page 16, its agreement with the U.S. Department of Agriculture (USDA) requires SAFE-BIDCO to hold loans made through the USDA Rural Loan Program as collateral for the loans made to SAFE-BIDCO. Thus, these loans originating from the USDA Rural Loan Program's financing earn interest but cannot be sold, limiting the usefulness of the funding to address SAFE-BIDCO's financial problems.

⑤

- ⑥ The new information provided by SAFE-BIDCO does not change our conclusion on page 18 that it is premature and imprudent for SAFE-BIDCO to rely on this funding for its future operations. The U.S. Senate bill to reauthorize the EB-5 Immigrant Investor Program (EB-5 Program) that SAFE-BIDCO mentions was introduced on March 27, 2017, only three days before we sent the draft report to SAFE-BIDCO for its review and response and, to our knowledge, has yet to pass. As a result, this does not change the fact that, as we state on that same page, the EB-5 Program is scheduled to expire on April 28, 2017, and a bill was introduced in January 2017 in the U.S. Senate to end the program. Further, the federal government has not approved the formal plan to raise money under the EB-5 Program, and SAFE-BIDCO has no formalized timeline to access such funding.
- ⑦ SAFE-BIDCO should not let one method of attempting to obtain donations deter it from seeking future funding. As we discuss on pages 16 and 17, other nonprofit organizations we spoke to obtained funding from donors and sponsorships. By not engaging in these efforts, SAFE-BIDCO is missing out on potential sources of additional capital. To obtain donations and sponsorships, SAFE-BIDCO should work to educate potential donors on the work it does and demonstrate why it is worthy of sponsorship or donations.
- ⑧ Although SAFE-BIDCO states that five board members volunteer for one or more board subcommittees, our review of SAFE-BIDCO's meeting minutes indicate that only four board members participate, as we state on page 25.
- ⑨ We find it odd that SAFE-BIDCO qualifies its willingness to engage in competitive bidding by stating "as long as it does not contradict its enabling legislation." The legislation it refers to gives SAFE-BIDCO wide latitude to operate, as SAFE-BIDCO itself notes. We do not see that conducting competitive bidding would in any way conflict with or contradict its enabling legislation.
- ⑩ Despite SAFE-BIDCO's indication that its State Loan Guarantee Program (we refer to this program as the California Small Business Loan Guarantee Program in the report) has had a steady increase in loan production and guarantees as a result of its business development contractor, as we state on page 19 the business development contractor did not meet the performance milestones specified in his contracts for fiscal years 2012–13 through 2015–16, yet SAFE-BIDCO continued to use this contractor. Additionally, as we also state on the same page, because the contractor did not meet performance goals consistently and because SAFE-BIDCO did not seek competitive bids for his services, we question whether SAFE-BIDCO has received the best value for its money. Similarly, SAFE-BIDCO states that the second consultant was hired to work with state legislators and staff on behalf of SAFE-BIDCO as the board members had been unsuccessful in

making inroads with their appointing authorities. However, as we state on page 20, although the recommendations from the consultant to develop a budget change proposal to request state funding and to develop a strategic plan may have been helpful, we question why SAFE-BIDCO, which has two legislative and three Governor's appointees on its board, needed to spend \$60,000 of its limited resources to obtain such advice.

The number of loan guarantees we present in Table 1 on page 13 are based on our review of SAFE-BIDCO's loan files. In total, we identified 102 guarantees totaling \$36.2 million for fiscal years 2011–12 through 2015–16. The amounts presented by SAFE-BIDCO are slightly higher, 111 guarantees totaling \$39.5 million. It is not clear to us how SAFE-BIDCO arrived at the numbers in its response.

We disagree with SAFE-BIDCO's statement that all travel reviewed and included in our report was for the research and development of additional funding sources and programs. As we state on page 21, given its mission to act as a catalyst for economic development in California and the fact that almost half of SAFE-BIDCO's programs focus on counties in Northern California, we question the prudence of the quantity of its out-of-state travel.

SAFE-BIDCO states that it has always been praised for the organization of its loan files and the ease of accessing information. Although that may be true, organization and ease of access have nothing to do with the accuracy of SAFE-BIDCO's files. As we state on page 29, we identified three errors in the 14 loan files reviewed and these errors could have been prevented if SAFE-BIDCO had established a consistent review process for its loan files.

Although SAFE-BIDCO states that it is disappointed in the lack of recommendations on some of the issues requested, we fully reviewed the issues we were asked to review by the Joint Legislative Audit Committee and believe our recommendations are appropriate.

SAFE-BIDCO is mistaken. Our report does not state that the \$750,000 taken by the California Infrastructure and Economic Development Bank should be returned to SAFE-BIDCO. We state on page 36 that if the Legislature chooses to appropriate funding and require additional oversight of SAFE-BIDCO but does not make SAFE-BIDCO part of the State Treasurer's Office, return of the funds may be warranted.

The audit request asked us to assess whether state law has limited the number of programs or services that SAFE-BIDCO has been able to provide. Although SAFE-BIDCO did provide a letter to us indicating that its application to become a Community Development Financial Institution was denied in November 2002 because of the composition of its board, this was not a program but a designation and would not immediately result in funding.

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