



Commonwealth of Massachusetts
Office of the State Auditor
Suzanne M. Bump

Making government work better

Issued Audit Report – June 26, 2019

Massachusetts Growth Capital Corporation

For the period July 1, 2016 through June 30, 2018





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Making government work better

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Mr. Lawrence D. Andrews, President and Chief Executive Officer
Massachusetts Growth Capital Corporation
529 Main Street, Suite 201
Charlestown, MA 02129

Dear Mr. Andrews:

I am pleased to provide this performance audit of Massachusetts Growth Capital Corporation. This report details the audit objectives, scope, methodology, findings, and recommendations for the audit period, July 1, 2016 through June 30, 2018. My audit staff discussed the contents of this report with management of the agency, whose comments are reflected in this report.

I would also like to express my appreciation to Massachusetts Growth Capital Corporation for the cooperation and assistance provided to my staff during the audit.

Sincerely,

A handwritten signature in blue ink, appearing to read "SMB", written over a light blue circular watermark.

Suzanne M. Bump
Auditor of the Commonwealth
cc: Michael Kennealy, Chair of the Board of Directors

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LIST OF ABBREVIATIONS

EOHED	Executive Office of Housing and Economic Development
GPOA	Grant Performance and Outcome Analysis
HLSS	Historical Loan Summary Spreadsheet
MGCC	Massachusetts Growth Capital Corporation
OPMO	Office of Performance Management and Oversight

EXECUTIVE SUMMARY

In accordance with Section 12 of Chapter 11 of the Massachusetts General Laws, the Office of the State Auditor has conducted a performance audit of Massachusetts Growth Capital Corporation (MGCC) for the period July 1, 2016 through June 30, 2018. In this performance audit, we examined MGCC's administration of its small business financing and diversity program.

Below is a summary of our findings and recommendations, with links to each page listed.

Finding 1 Page 9	Some of the performance and outcome information that MGCC reported was inaccurate.
Recommendation Page 10	MGCC should develop written policies and procedures as well as monitoring controls to ensure that its performance and outcome data are accurate.
Finding 2 Page 11	MGCC's system of internal controls needs improvement.
Recommendations Page 12	<ol style="list-style-type: none">1. MGCC should perform an annual entity-wide risk assessment and then develop and document controls (i.e., policies and procedures) to mitigate identified risks.2. MGCC should develop a business continuity plan and annually test its disaster recovery plan.

OVERVIEW OF AUDITED ENTITY

Massachusetts Growth Capital Corporation (MGCC) was established on October 1, 2010, under Chapter 40W of the Massachusetts General Laws, as an independent quasi-public agency formed by the combination of two preexisting entities: the Massachusetts Community Development Finance Corporation and the Economic Stabilization Trust. Both preexisting entities were quasi-public financing agencies devoted to making nontraditional¹ business loans to foster economic growth in the Commonwealth. MGCC has a similar purpose and is a resource for small businesses seeking growth capital.

According to its website, MGCC's mission is as follows:

Empowering Small Business through financing and managerial assistance to create economic opportunities for all. MGCC provides and supports inclusive business resources to organizations across the Commonwealth.

To accomplish its mission, MGCC works with local banks and lending institutions, community development corporations, and other nonprofit organizations to finance projects that will produce jobs in economically distressed communities throughout the Commonwealth. It also provides loans to organizations that for various reasons cannot obtain financing from traditional sources. Finally, MGCC manages a competitive grant program for community development organizations that provide training and technical assistance to small businesses, including small contractors. MGCC uses its capitalization fund to service the debt it incurs to finance its loans. According to MGCC's audited financial statements, it receives an annual appropriation from the Commonwealth to fund its grants; the combined total appropriation for fiscal years 2017 and 2018 was \$1,750,000.

MGCC is governed by a 12-member board that is chaired by the Secretary of Housing and Economic Development and has a designated seat for the Secretary of Administration and Finance or their designee. The other 10 board members are appointed by the Governor. The board meets five or six times a year to vote on debt financings, loan portfolio reviews, approval of grants, and fiscal decisions and is governed by the organization's enabling legislation.

MGCC is located at 529 Main Street in Charlestown. According to its organizational chart, as of June 30, 2018, MGCC had 14 full-time employees. Staff members are responsible for underwriting proposed

1. Nontraditional loans are loans with characteristics that may result in higher risk than typical loan products.

loans, administering the grant program, marketing the loan and grant programs, handling credit and collections, and performing accounting activities. During fiscal years 2017 and 2018, MGCC's financial position, revenue, and expenses, as reported by its independent accounting firm, included the following selected data.

MGCC's Assets and Liabilities

	Fiscal Year 2017	Fiscal Year 2018
Total Assets	\$ 51,072,985	\$ 49,460,251
Total Liabilities	1,545,876	1,249,705
Total Net Position	<u>\$ 49,527,109</u>	<u>\$ 48,210,546</u>

The "Total Assets" category includes loans receivable of \$24,572,664 and \$22,467,781, net of allowances for uncollectible loan amounts of \$2,742,589 and \$3,778,835, respectively, for fiscal years 2017 and 2018.

Revenue and expenses during fiscal years 2017 and 2018 were as follows.

MGCC Revenue and Expenses

	Fiscal Year 2017	Fiscal Year 2018
Operating Revenue	\$ 2,830,440	\$ 2,800,900
Operating Expenses	(2,845,187)	(2,921,424)
Net Loan Loss (Provision) and Recovery	(863,936)	(1,182,233)
Non-Operating Revenue	4,294,464	3,975,000
Non-Operating Expenses	(4,287,045)	(3,988,806)
Change in Net Position	<u>\$ (871,264)</u>	<u>\$ (1,316,563)</u>

The table below summarizes the number and total value of the loans and grants MGCC awarded during the audit period, according to MGCC's audited financial statements and internal records.

MGCC Financial Awards

Type of Award	Number of Awards		Amount Awarded	
	July 1, 2016–June 30, 2018		July 1, 2016–June 30, 2018	
Small Business Loans	57		\$ 19,983,200	
Technical Assistance Grants*	81		1,825,851	
Total	<u>138</u>		<u>\$ 21,809,051</u>	

* Technical assistance grants awarded during the audit period included 19 grants, totaling \$140,851, that were not included in the audit testing because they were not part of the annual grant award process and were considered to be outside MGCC's grant program.

The loan portfolio as of June 30, 2017 and June 30, 2018 contained 163 and 119 loans outstanding, respectively. As of June 30, 2018, outstanding loan balances ranged from \$248 to \$1,000,000, with an average outstanding loan amount of approximately \$232,000.

Grant expenses of \$4,287,045 and \$3,988,806 for fiscal years 2017 and 2018, respectively, included \$3,225,000 (in each year) of funds received from the Commonwealth that MGCC transferred to MassVentures, a quasi-public venture capital agency, for the Small Business Innovation Research Matching Grants Program. The funds provided to MassVentures were not included in the scope of our audit.

AUDIT OBJECTIVES, SCOPE, AND METHODOLOGY

In accordance with Section 12 of Chapter 11 of the Massachusetts General Laws, the Office of the State Auditor has conducted a performance audit of certain activities of Massachusetts Growth Capital Corporation (MGCC) for the period July 1, 2016 through June 30, 2018.

We conducted this performance audit in accordance with 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. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Below is our audit objective, indicating each question we intended our audit to answer; the conclusion we reached regarding each question; and, if applicable, where each is discussed in the audit findings.

Objective	Conclusion
1. Did MGCC administer its small business financing and diversity program in accordance with its enabling legislation, Chapter 40W of the General Laws? Specifically, did MGCC do the following?	
a. administer its small business loan program in accordance with Chapter 40W of the General Laws	Yes
b. administer its technical assistance grant program in accordance with Chapter 40W of the General Laws	Yes
c. accurately summarize performance and outcome data and prepare accurate reports of the services it provided	No; see Finding <u>1</u>

To achieve our objective, we gained an understanding of the internal control environment by reviewing MGCC's internal control plan and applicable laws, regulations, and agency policies and procedures, as well as conducting interviews with MGCC management. We tested the design and effectiveness of controls we determined to be relevant to our audit objective regarding the awarding of loans and grants (see Finding 2). We also performed the following procedures.

Loan Financing

To determine whether MGCC had complied with its loan policy and Chapter 40W of the General Laws, we inspected loan files for a judgmentally selected sample of 15 loans (8 loans for fiscal year 2017 and 7 for fiscal year 2018) from the population of 57. We determined the following:

- whether the borrowers' expected use of funds was allowable
- whether the underwriting process included a review of the borrowers' financial strength
- whether the loan terms (including loan amount, interest rate, and length) in the loan files matched the information in the executed loan agreements

Grant Awards

To determine whether MGCC administered the demographic and diversity aspects of the grant program in accordance with its policies and procedures, we selected a judgmental sample of 12 grants (6 from fiscal year 2017 and 6 from fiscal year 2018) from the population of 62 awarded by MGCC during the audit period. We reviewed each grant file and determined the following:

- whether the grant files contained a completed grant checklist submitted by the applicant
- whether the grant files included an evaluation and scoring sheet prepared by the grant review committee²
- whether the grant recipient reporting requirements were met (with the recipient submitting both a six-month interim report and a year-end activity report)

Performance and Outcome Reporting

To determine whether MGCC accurately measured and reported the achievement of its annual goals and objectives that are required to be reported to the Executive Office of Housing and Economic Development (EOHED), we verified the completeness and accuracy of MGCC's performance and outcome reporting. To perform our audit tests, we compared MGCC's Historical Loan Summary Spreadsheet³ (HLSS) as of the end of fiscal year 2018, its Grant Performance and Outcome Analysis⁴

2. This external review group, which comprises 14 members with community development expertise, is responsible for the independent review, evaluation, and scoring of grant applications.

3. This is a cumulative list of loans approved since MGCC's inception on October 1, 2010 that is maintained by management in an Excel spreadsheet.

4. This is an annual summary of all funded grants that includes performance and outcome statistics provided to MGCC by the grant recipients in their year-end activity reports. It is maintained by management in an Excel spreadsheet.

(GPOA) for fiscal years 2017 and 2018, and the Office of Performance Management and Oversight⁵ (OPMO) annual reports filed with EOHEd for fiscal years 2017 and 2018 to the supporting loan and grant files.

We tested whether MGCC had achieved its annual goals and had compiled, summarized, and reported the information completely and accurately. Specifically, we determined whether MGCC had done the following:

- increased the dollar amount of loans from the previous year
- sustained or increased the percentage of loans made to small businesses located in gateway cities⁶ and underserved communities
- sustained or increased the percentage of loans made to minority-owned small businesses
- sustained or increased the percentage of loans made to woman-owned small businesses
- tracked progress made in the small business technical assistance grant program, as follows:
 - the number of businesses served by grant recipients
 - the number of jobs created and saved by grant recipients
 - the percentage of woman-owned businesses served by grant recipients
 - the percentage of minority-owned businesses served by grant recipients
 - the percentage of businesses located in low-to-moderate-income communities served by grant recipients

Data Reliability

To determine the reliability of data on MGCC's spreadsheets of annually awarded small business loans and technical assistance grants, we interviewed management personnel who were responsible for the source data. Regarding the awarded small business loans for our audit period, we verified the accuracy of the HLSS by tracing loan awardee names, loan amounts, interest rates, and terms from a nonstatistical random sample of 15 of the 57 executed loan agreements to the supporting loan files, and we reconciled the dollar value of these loans to the general ledger and audited financial statements. For

5. According to its website, "The Office of Performance Management and Oversight measures the performance of all public and quasi-public entities engaged in economic development."

6. According to Section 3A of Chapter 23A of the General Laws, a gateway city is "a municipality with a population greater than 35,000 and less than 250,000, a median household income below the commonwealth's average and a rate of educational attainment of a bachelor's degree or above that is below the commonwealth's average."

the technical assistance grants awarded during our audit period, we verified the accuracy of the GPOA by tracing the grant awardee names and dollar amounts from a nonstatistical random sample of 12 of the 62 grant awards to the supporting grant files, and we reconciled the dollar amount of these grants to the general ledger and audited financial statements. We determined that the data were sufficiently reliable for the purposes of our audit report.

For our audit period, we verified MGCC's performance and outcome spreadsheets by using the same sample selections used for our loan and grant substantive testing (a sample of 15 loans and 12 grants) to determine whether MGCC compiled, summarized, and reported the information completely and accurately. We verified that the loans tested were listed on the HLSS by comparing the data in the HLSS to the loan files. We determined whether the numbers of jobs created and saved, as well as demographic information such as borrower race, gender, and veteran status, were accurately reported by tracing the data from the annual GPOA to grant recipients' year-end activity reports. We determined whether the statistical data on the HLSS agreed to the outcome data on the MGCC website and in the OPMO annual reports. Also, we verified that the grants tested were included on the GPOA with accurate dollar amounts and that the grant application process was completed within guidelines. Lastly, we tested whether the statistical data on the GPOA agreed to the outcome data on the MGCC website, in MGCC's marketing materials, and in the OPMO annual reports. We determined that the data were sufficiently reliable for the purposes of our audit report.

We used nonstatistical sampling to help us achieve our audit objectives and therefore did not project our results to the various populations.

DETAILED AUDIT FINDINGS WITH AUDITEE'S RESPONSE

1. Some of the performance and outcome information that Massachusetts Growth Capital Corporation reported was inaccurate.

Certain performance and outcome information that Massachusetts Growth Capital Corporation (MGCC) is required to report to the Executive Office of Housing and Economic Development (EOHED), as well as information in MGCC publications and in information the agency reports on its public website, was inaccurate. Specifically, we found the following:

- MGCC overstated the number of "jobs created and saved" on its website by 2,978. Our audit test indicated that 19,204 jobs had been created and saved from the agency's inception through June 30, 2018, but the MGCC website stated that 22,182 jobs had been created and saved.
- During fiscal year 2018, MGCC stated on its website that the number of companies that either received a loan or were awarded a grant totaled 8,889 from the programs' inception through June 30, 2017; however, our audit test found the correct figure to be 7,413, indicating an overstatement by MGCC of 1,476 companies.
- In the annual report MGCC filed with EOHED for fiscal year 2018, MGCC understated the number of "jobs created and saved" for the grant program by 700. The annual report filed with EOHED listed the number of jobs created and saved as 2,257; however, our audit test revealed that 2,957 jobs were created and saved.
- MGCC reported inaccurate dollar amounts in the grant program's marketing brochures for "loans facilitated"⁷ during fiscal years 2017 and 2018. For fiscal year 2017, MGCC's marketing brochure indicated that it had facilitated \$27,257,602 in loans; however, our audit test revealed that it had facilitated \$27,058,602 in loans, indicating an overstatement of \$199,000 in MGCC's brochure. For fiscal year 2018, MGCC's brochure reported \$32,850,132 in facilitated loans; however, our audit test revealed that \$32,901,132 in loans had been facilitated, indicating an understatement of \$51,000 in MGCC's brochure.

By not ensuring that the information it disclosed about these activities was accurate, MGCC did not allow those who accessed the information to accurately assess the organization's performance. Presenting inaccurate data may also harm the organization's credibility, which could discourage some people from using its services.

7. "Loans facilitated" represents the value of loans obtained by small businesses that received assistance from the grant recipients, such as community development corporations and other nonprofit organizations.

Authoritative Guidance

Standards for Internal Control in the Federal Government, issued by the US Government Accountability Office and dated September 2014, contains 17 principles that must be present in an effective system of internal control. Subsection 13.05 of the section titled "Principle 13—Use Quality Information" states,

Management processes the obtained data into quality information that supports the internal control system. This involves processing data into information and then evaluating the processed information so that it is quality information. Quality information meets the identified information requirements when relevant data from reliable sources are used. Quality information is . . . accurate . . . and provided on a timely basis.

Although MGCC is not required to adhere to this standard, the Office of the State Auditor believes that it represents a best practice that MGCC should follow.

Reasons for Issue

MGCC did not have a validation or review process in place to verify the quality of the information before it was publicly disclosed. Further, MGCC lacked written policies and procedures to provide guidance for the administration of the performance and outcome data. According to MGCC management, having written procedures for gathering and reporting performance and outcome information was not considered a priority because of limited staffing.

Recommendation

MGCC should develop written policies and procedures as well as monitoring controls to ensure that its performance and outcome data are accurate.

Auditee's Response

We agree that there were inadvertent inaccuracies that were primarily reported in MGCC marketing materials. To this end we have established a policy that all historical numbers associated with our lending and grant programs will be checked by our controller prior to being published or used.

Auditor's Reply

The integrity of performance and outcome data is critical to evaluating the success of MGCC's lending programs. We believe that the steps initiated by MGCC management to address our concerns will enhance the accuracy of the information MGCC reports on its website and in its marketing brochures.

2. MGCC's system of internal controls needed improvement.

We found problems with the system of internal controls MGCC had established over its operations. Specifically, although MGCC had a risk management plan that documented the results of its risk assessment, the plan had not been updated since June 2015. Further, MGCC had not considered any additional risks or the internal controls that should be used to mitigate them since June 2015. Without an updated and adequately documented system of internal controls, including an entity-wide risk assessment, MGCC management cannot measure, prioritize, and manage risks that are relevant to achieving its mission.

In addition, MGCC has not developed a business continuity plan or tested its disaster recovery plan. This may cause its critical operations to be disrupted if a loss of data or systems occurs.

Authoritative Guidance

MGCC's risk management plan, which documents the results of the organization's risk assessment, indicates that "the Plan will be reviewed and updated at least annually."

In addition, the Executive Office of Technology Services and Security's "Enterprise Information Security Policy," dated January 10, 2017, requires agencies to do the following:

*Protect mission-critical **information assets**, processes and facilities from the effects of major failures or disasters by developing and implementing a business continuity strategy that is consistent with organizational objectives and priorities. Back up critical data, such as confidential information, and strive to prevent disasters and implement timely recovery from disasters as well as continue critical organizational functions during a disaster or major disruption while maintaining the confidentiality of classified information.*

Although MGCC is not specifically required to follow this policy, it represents a best practice that should be followed by all Commonwealth governmental agencies, as well as quasi-public agencies such as MGCC.

Reasons for Issue

According to MGCC senior management, the organization's risk profile has not changed significantly since the initial risk assessment was completed, and therefore MGCC has not needed to update the plan. MGCC management said that the agency relied on an external service provider for all of its information technology services and was satisfied that the service provider's procedures for backups

and system restoration were appropriate and adequate. However, during our conversation with this service provider, we found that these procedures did not include business continuity and disaster recovery plans.

Recommendations

1. MGCC should perform an annual entity-wide risk assessment and then develop and document controls (i.e., policies and procedures) to mitigate identified risks.
2. MGCC should develop a business continuity plan and annually test its disaster recovery plan.

Auditee's Response

We feel that the critical internal controls of accounting and cash management, loan risk and grant management are well documented, strong and independently audited with no exceptions or findings. We agree that the risk management plan needs to be reviewed annually and a disaster recovery plan needs to be established.

To this end we are formalizing a disaster recovery plan, which will be presented to our Board for ratification. The risk management plan will be reviewed and updated this summer. Both of these will be added to our compliance duties which get reported quarterly to our Audit Committee and subsequently to the Board.

Auditor's Reply

We believe the actions outlined by MGCC management to address our concerns regarding the risk management and disaster recovery plans will strengthen the agency's internal controls.