Audit Report Highlights

Economic Development Loan **February 2024**

DoD Annual Budget[1] = $13.4 million **County Annual Budget[2] = $1.4 billion**

Why DIA Did This Audit

The purpose of this audit was to assess the Department of Development's (DoD's) effectiveness and adequacy of policy, procedures, and controls in mitigating the risk of servicing the County's development loan portfolio including collection of payments. The audit was approved as part of the 2023 Audit Plan. The Economic Development Loan portfolio posed an area of higher risk due to significant deficiencies identified in past audits. This audit included processes in place during the period of January 1, 2020 through December 31, 2022. The following loan servicing activities were considered in the assessment:

- Origination and Disbursements
  - Credit Initiation and Investigation
  - Risk Analysis
  - Management and Committee Oversight
- Accounting
  - Recording and Reconciliation
  - Financial Reporting
- Credit Monitoring and Collections
  - Analyzing Periodic Financial Statements
  - Billing and Collections
  - Reviewing Aging Reports
- Compliance Monitoring
  - Compliance with Lending Regulations and Institution Policies
- Portfolio Risk Management
  - Analyzing for concentrations of risk
  - Setting appropriate risk tolerance
- Internal Loan Review
  - Assessing quality of policies and lending practices
- IT General Controls

What DIA Found

While DoD does have policies and controls in place to mitigate the risk of servicing its loans, enhancements to policies and controls are needed. DIA noted issues relative to the following areas:

- Financial Due Diligence Review
- Credit Checks
- Loan and Portfolio Risk Analysis
- Committee Oversight and Meetings
- Compliance Monitoring
- Accounting / Financial Reporting
- Job Growth and Diversity Reporting
- Outdated or Inaccurate Policies
- IT General Controls

Recommendations have been rated by priority: High, Moderate, Low, or Business Process Improvement.
The report contains 28 recommendations:

*15 **High** – 30 days to complete*
*1 **Moderate** – 90 days to complete*
*6 **Low** – 180 days to complete*
*6 **Process Improvements-** No action required*

[1] *DoD's 2022 adopted budget taken from the Office of Budget Management's 2022-2023 Departmental Budget Summary.*
[2] *The County Annual Budget includes operating appropriations from all County funds.*

Audit Report Highlights

Economic Development Loan — February 2024

Background

DoD's mission is to improve Cuyahoga County's global competitiveness through economic growth to ensure the region is economically competitive, businesses are growing and profitable, and the community is vibrant, dynamic, and diverse. In support of these efforts, DoD provides gap financing in the form of economic development loans to support business expansion and attraction that are critical sources of job creation and investment in Cuyahoga County.

DIA commends DoD for its cooperation and for being proactive in implementing process improvements for the servicing of its economic development loan portfolio.

What DIA Recommended

DIA provided DoD management with recommendations for improving internal controls. Based on DoD's responses, we believe corrective action will be taken to mitigate the risks identified. Management responses follow each recommendation in the report. DIA recommended DoD implement the following:

- Risk-rating process to score new loans and a formal loan portfolio risk analysis process to monitor risk exposures.
- Formal loan collectability and write-off review policy to ensure the timeliness of collections activities and financial reporting accuracy.
- Monthly reconciliation of loan disbursements and receipts between Portfol and Lawson.
- Update DoD policy to ensure the following:
  - Credit check reports are obtained and reviewed consistently.
  - Adequate loan committee oversight is achieved for loans.
  - Borrowers provide evidentiary support for job creation and retention.
  - Appropriate financial statements are obtained for underwriting and loan servicing to ensure a verified view of a borrower's financial health and performance.
  - The County's conflict of interest process is adhered to.
  - Loan workouts are consistently supported by documented evidence of a borrower's inability to adhere to payment terms.
  - Prevailing wage compliance payroll review is appropriate and supported by documentation for verification of review.
  - Quarterly performance reporting of job creation and diversity data to County Executive leadership is appropriate.
- Implement additional IT controls, including a system access policy to achieve least privilege access, stronger password requirements, and policy requirement as to an expected timeframe for user deactivation.

Internal Audit would like to express our appreciation for the cooperation and assistance received from DoD during this audit. The strides made help improve the County's efficiency and accountability.

Internal Audit Report

Economic Development Loan
January 1, 2020 - December 31, 2022

Director of Internal Auditing: Monica Houston, CPA, CGMA, CFE, CIDA

Audit Manager: Joshua Ault, CIA

Sr. Internal Auditor: Tom Schneider, CPA

Staff Auditor:
Joseph Balbier
Dawn Meredith

Release Date: 06/11/2024

INTERNAL AUDIT REPORT
Economic Development Loan
Cover Letter

February 26, 2024

To: Director of Department of Development, Paul Herdeg, and current management of Department of Development.

The Department of Internal Auditing (DIA) has conducted an audit of the Economic Development Loan Portfolio for processes in place during the period of January 1, 2020 – December 31, 2022. Our main objective was to assess the effectiveness and adequacy of policy, procedures, and controls in mitigating the risk of servicing the County's development loan portfolio including collection of payments.

To accomplish our objectives DIA relied on authoritative guidance to determine lending best practices that mitigate risk, providing a basis for assessing the adequacy of DoD's policies, procedures, and controls. DIA made its assessments by conducting interviews with management and staff regarding processes, reviewing the Department of Development's (DoD) policy and procedures, and obtaining various documentation from staff. In addition, where best practices were observed, DIA performed audit procedures to determine effectiveness.

Our audit procedures disclosed internal control weaknesses or areas of potential process improvement relative to board oversight, loan underwriting and monitoring, risk analysis, job creation and diversity monitoring, prevailing wage compliance monitoring, disbursements and receipts reconciliations, financial reporting, and IT controls. This report provides the details of our findings. We are confident corrective action has been or will be taken to mitigate the risks identified in this audit report.

We conducted this audit in accordance with the International Standards for the Professional Practice of Internal Auditing. 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.

Because of the inherent limitations of internal controls, errors or irregularities may occur and not be detected. Also, the projection of any current evaluation of the internal control structure to future periods is subject to the risk that procedures may become inadequate due to changes in conditions, or that the degree of compliance with the procedures may weaken.

DIA would like to express our appreciation to DoD staff and management that assisted throughout the process for their courtesy and cooperation during this audit. A draft report was provided to DoD management for review. Management responses are included within the audit report.

Respectfully,

Monica Houston, CPA, CGMA, CFE, CIDA
Director of Internal Auditing

Cc: Cuyahoga County Council
Erik Janas, Chief of Staff
Debbie Berry, Deputy Chief of Staff Integrated Development
Richard D. Manoloff, Law Director
Michael C. O'Malley, Cuyahoga County Prosecutor

Contents

Glossary

Loan portfolio	A collection of loans issued by a lending institution. The DoD loan portfolio is comprised of loans issued to local businesses for the goal of fostering economic development and job growth in Cuyahoga County. The loan portfolio is one of several economic development initiatives within the County's $100 million Economic Development Fund.
Credit monitoring	A process to assess a borrower's ability to repay a loan based on the borrower's credit information. Credit monitoring involves the borrower completing a credit application, which the lender reviews and compares with a credit report obtained from an external credit bureau.
Annual Comprehensive Financial Report (ACFR)	A set of audited financial statements for a state, municipality or other governmental entity that comply with accounting requirements. DoD reports its annual loan activity and balances to the County's Fiscal Office within a "ACFR Master Disaggregated Data Deliverable" report, which the Fiscal Office uses to report DoD's loan balances within the County's ACFR.
Loan Portfolio Management Team (LPMT)	DoD employees whose duties include monitoring loan closing, billing, servicing, compliance monitoring, and reporting processes.
Economic Development Loan Policies and Procedures Manual	Effective April 1, 2019, the policies and procedures which provide the guidelines in which DoD employees administer the economic development loans and projects.
Portfol	Fully integrated, multi-user portfolio management software used by DoD to manage the administration and accounting for its economic development loans and projects.
Brownfield remediation loans	County loans relating to the remediation of brownfield sites for economic development activity. Brownfield refers to real property, the expansion, redevelopment, or reuse of which may be complicated by a contaminant.

Default

Events that constitute a default are enumerated in a loan agreement and include when the borrower misses a payment or is prevented from performing material contractual obligations, such as job creation covenants. After a default event, the County may agree with the borrower to a loan workout where the original loan obligations are modified to permit a continuation of loan repayments. Alternatively, collection activities may commence where a collection agent pursues collection efforts on behalf of the County.

LCP Tracker

Advanced labor compliance software for certified payroll reporting, construction site compliance management, and workforce reporting. DoD's loans with prevailing wage requirements must use the LCP Tracker to review payroll information for compliance with prevailing wage.

Origination and Underwriting

Origination is the process by which lenders assess and approve borrower loan applications. A component of origination, underwriting, is the in-depth review of financial statements and credit reports by which the lender decides whether an applicant is creditworthy and should receive a loan. During underwriting, the lender performs a risk analysis through use of financial ratios and scoring metrics.

Cuyahoga County Community Improvement Corporation (CCCIC)

Established by County Resolution #237321 on July 29, 1982, the CCCIC serves as Cuyahoga County's review agent for industrial revenue bond financing and economic development lending activity. The CCCIC consists of both County Class and Private Class trustees who are tasked with reviewing DoD's loan presentations and recommending loans for approval by the County Board of Control or Council.

ClearPoint

The County's performance monitoring system used by County departments and agencies to report performance related metrics to County executive leadership on a quarterly basis. DoD's established metrics as they relate to its economic development loans are job creation and retention and diversity.

Report Details

Purpose

The purpose of this audit was to conduct a comprehensive assessment of DoD's servicing of the County's economic development loan portfolio.

The Audit Committee approved DIA's 2023 Audit Plan to include an audit of the County's economic development loan portfolio. The economic development loan portfolio was identified as an area of higher risk due to significant deficiencies previously identified by the Ohio Auditor of State in the County's financial audits from 2016 to 2019 and County Inspector General's investigations dating from 2012 through 2021.

The audit included review and evaluation of procedures, practices and controls as deemed necessary.

Audit Objectives

The objective of this audit was to assess the effectiveness and adequacy of policy, procedures, and controls in mitigating the risk of servicing the County's development loan portfolio including collection of payments.

Scope

To accomplish our objectives, we focused on the testing of controls for processes including loan origination, risk analysis, credit monitoring, governance and oversight, disbursement, collections, and IT controls. We considered performance in past audits and primarily focused on 2022 loan activity and DoD's contemporary processes. However, because the typical lifecycle of DoD's loans are five to seven years, a review of loan activity from earlier dates was sometimes necessary.

Methodology

DIA made inquiries with management and staff to gain a general understanding of DoD policies, processes, and controls relative to economic development loans. Further, DIA performed research of best practices from the finance, lending, and economic development sectors and assessed whether they were adequately addressed in DoD's processes. To the extent that processes or controls were identified, DIA performed testing to ensure they were operating effectively.

Audit Procedures

Although every audit conducted by the DIA is unique, the audit process for most engagements consists of the following three phases:

- Planning
- Fieldwork
- Reporting

The planning phase of an engagement entails gathering sufficient understanding of the area being audited to identify and reduce key audit risks to an appropriate level. The DIA must document and develop a plan for each audit engagement, including the engagement's objectives, scope, timing, and resource allocation.

The fieldwork phase of an engagement entails executing the audit steps. This usually includes testing, reviewing, and analyzing data along with interviewing the appropriate personnel. Each audit has unique aspects and therefore the audit fieldwork and analysis performed on each audit segment should be customized for that assignment. See Methodology for a summary of fieldwork performed.

The DIA prepares written reports to communicate the results of each engagement. The format and nature of the report can vary depending on user needs and the type of engagement. Additionally, the DIA requires all engagements to receive an appropriate level of supervisory review and quality control as required by professional standards. At the time of report release, DIA resources required to complete the audit were as follows:

Stages		**Actual Hours**
Planning		227.99
Fieldwork		323.00
Reporting:		259.16
Review	86.08	
Draft Report	173.08	
	Totals	**810.15**

Background

DoD's mission is to improve Cuyahoga County's global competitiveness through economic growth to ensure the region is economically competitive, businesses are growing and profitable, and the community is vibrant, dynamic, and diverse. In support of these efforts, DoD provides gap financing in the form of economic development loans to support business expansion and attraction that are critical sources of job creation and investment in Cuyahoga County.

DoD's loan officers are tasked to underwrite loan requests and present recommendations to DoD's Director, the County's loan review committee, and County Council and/or Board of Control for approval. Upon approval, loan officers coordinate with borrowers and legal counsel to negotiate and issue loan agreements and contracts.

DoD's Loan Portfolio Manager and staff are tasked to monitor loan repayments and job creation, among other loan servicing, compliance, and reporting duties. During 2022, DoD collected $5,408,397.61 in loan repayments and its borrowers have committed to creating 259 new jobs in Cuyahoga County as of 3rd quarter.

DoD has issued an average of 11 loans per year. As of 12/31/2022, DoD's portfolio consisted of 204 active loans with a balance of $76,830,328.86. Of the 204 active loans, 160 will be repaid and 44 are forgivable if job creation requirements are met.

Commendable Practices

DIA commends DoD for their dedication to public service by partnering with local businesses to foster job growth in Cuyahoga County. DoD's team is committed to upholding underwriting standards and quality in servicing its loan portfolio. DIA acknowledges that DoD has committed to continuous improvement through the implementation of recommendations from past reviews by the Inspector General and Office of Innovation. DIA identified the following commendable practices during its testing:

- DoD's billing practices are consistently followed by the Loan Portfolio Management Team and are effective in ensuring timely and accurate billing. The team's use of the Portfol system adds efficiency to the process through automated invoice generation and email notices to borrowers.

- Throughout 2022, DoD timely performed activities that resulted in the complete and accurate depositing and accounting of loan payment collections. The Loan Portfolio Management Team's coordination with the Business Services team ensures that check payments in the mail are received, deposited, and posted in both Portfol and the County's accounting system, Lawson, in a timely manner.

- The Loan Portfolio Management Team implemented an effective "Loan Management Reporting System" to monitor all reporting deadlines. Additionally, the team's use of the Portfol system adds efficiency to the process through automated alerts of reports coming due. DIA's testing revealed that these processes enabled the team to ensure compliance is met with reporting requirements.

- DoD management provides adequate oversight and guidance to the Loan Portfolio Management Team through the holding of regular meetings where loan activity reports are discussed. This enables DoD management to ensure the loan portfolio is effectively managed and any risks appropriately mitigated.

- During the audit, DoD affirmed that it had implemented credit checks into its underwriting process and initiated monthly reconciliations of loan disbursements and receipts. Further, DoD has been actively engaging in revising its policies and procedures and completing the development of an updated risk rating tool to formally incorporate into its underwriting process.

Priority Level Criteria for Recommendations

High **(P1)**	**Highest-Ranking Officer's immediate attention** is required. Corrective action is strongly recommended (<u>30 days</u>).
	• Financially material loss or potential loss • Lack of or failure of internal controls requiring considerable time and resources to correct • Non-compliance with laws, regulations, and policies resulting in significant loss of funds, fines, or restrictions • Significantly negative effect on the County's reputation or public perception
	Senior Management's attention is required. Corrective action is recommended (<u>90 days</u>).
	• Financial loss or potential loss • Internal controls exist but they are not effective, or they are not consistently applied • Non-compliance with laws, regulations, and policies resulting in loss of funds, fines, or restrictions • Negative effect on the County's reputation or public perception
Low **(P3)**	**Management's attention** is required. Corrective action is recommended (<u>180 days</u>).
	• Financial loss or potential loss is minimal • Internal controls exist, but could be improved • Non-compliance with laws, regulations, and policies is a minimal risk • No effect on the County's reputation or public perception
Business Process Improvement **(P4)**	**Management or supervisory attention** recommended but not required
	• Process improvement recommendation • Financial loss or potential loss is minimal or not applicable • Non-compliance with laws, regulations, and policies is a minimal risk or not applicable • No effect on County's reputation or public perception

In an effort to assist the auditee in making the best use of their resources, we have prioritized the recommendations according to the table above.

Findings and Recommendations

Governance

FINDING Conflict of Interest Policy Needs Updating

The Department of Development's (DoD) Conflict-of-Interest policy in its Economic Development Loan Policies manual is not adhered to and appears to be outdated.

DoD's Economic Development Loan Policies manual includes a Conflict-of-Interest policy which requires all County employees involved in a borrower evaluation or loan approval to complete the Nepotism and Conflict-of-Interest Statement (or such applicable successor form) found on the County Inspector General's website and self-certify that they have no conflict of interest on the project being considered. The Policy is not limited to DoD staff and specifically includes references to executive staff, council members, and staff.

During testing, DIA noted DoD files did not include the requisite Nepotism and Conflict-of-Interest Statements. Upon inquiry, DoD advised their Conflict-of-Interest policy was not operationalized. Although the DoD Conflict-of-Interest policy is not adhered to, all Executive Agency employees (including DoD) are required to complete the Inspector General County ethics training annually. They must also acknowledge their awareness of the County Code Conflict-of-Interest reporting requirements which limits reporting of conflicts of interest to situations when a potential conflict is identified.

Regularly reviewing policies and procedures keeps an organization up to date with the latest regulations and technology, as well as consistent with industry best practices. Conflict-of-interest disclosures are also a best practice to ensure impartiality and transparency in any process.

The County has a Conflict-of-Interest Policy as set forth in Cuyahoga County Code Section 403.04 which states:

A. Whenever a matter involving the exercise of discretion comes before an elected official, employee, or board member, either individually or as a member of a body, and the individual knows or has reason to know the disposition of the matter could result in a direct financial or material benefit to himself or herself, a relative, business associate, or any private organization in which he or she has an interest, the individual shall disclose the nature of the interest to the public in an open meeting or in writing to the Inspector

General, and shall recuse themselves as required by paragraph (C) and the Ohio Revised Code.

B. The disclosure required in paragraph (A) shall be made when the matter requiring disclosure first comes before the individual or when the individual first acquires knowledge of the interest requiring disclosure.

C. No elected official, employee, or board member may participate in any decision or take any official action with respect to any matter involving the exercise of discretion, including discussing the matter and voting on it, when he or she knows or has reason to know that the action could confer a direct financial or material benefit on himself or herself, a relative, or any private organization in which he or she has an interest.

County Code Section 403.05(C) Nepotism states that no public official, employee or board member shall secure any public contract in which the individual, a member of the individual's family, or any of the individual's business associates has an interest in violation of Ohio Revised Code Section 2921.42.

The County's Inspector General provides a Nepotism and Conflict of Interest Statement Form on its webpage for individuals to submit in writing to the Inspector General any matters requiring disclosure under County Code Section 403.04 or 403.05. As the County's Chief Ethics Officer, the Inspector General conducts annual training on the County Code requirements. Employees are required to acknowledge receipt understanding of said ethics training.

DoD policies have not been updated since 2019. They have not enforced its Conflict-of-Interest policy as it would be unrealistic to expect all employees (including departments outside DoD and Council members) outside DoD to complete a form for every loan given. Additionally, County Code and Ethics policies already address conflict of interests.

Risk to the County if Not Corrected

Outdated policies can leave an organization at risk, including failure to comply with new laws and regulations. They may also result in inconsistent practices.

Recommendations

1. (P3) DoD should revise its Conflict-of-Interest policy to be consistent with current practices which is to conform with County Code Section 403.04 and 403.05 by disclosing potential conflicts of interest to the Inspector General and, if involved, recuse themselves from the matter.

Management's Response:

Agrees – DoD will revise its Conflict-of-Interest Policy to be in line with the Agency of Inspector General's policy and also update the manuals to reflect that DoD staff shall assert whether a conflict of interest exists for each project they are working on based on the best practice and consult with the Law Department.

Target Date for Completion: Upon updating of the ED Loan Policies and Procedures Manuals by July 31, 2024

2. (P4) DoD should consider adopting within its Conflict-of-Interest policy a requirement for any DoD employees involved in borrower evaluation and loan approval to fill out a Project Independence Statement form for every project. This form would enable individuals either to assert they have no conflicts of interest or disclose any potential conflicts known to them, necessitating recusal if required.

Management's Response: Same as response to #1.

Target Date for Completion: Same as response to #1.

FINDING Formal Loan Portfolio Risk Analysis

The Department of Development (DoD) lacks appropriate loan risk analysis for its economic development loan portfolio.

DoD's Economic Development Loan Polices (Policy Manual) requirement to perform risk-rating during underwriting is not enforced. Also, DoD does not evaluate the broader portfolio's vulnerability to unforeseen loan losses resulting from a concentration of loans extended to borrowers with elevated credit or industry-related risks.

At the end of 2022, 158 loans totaling $87,683,264 were in active repayment status with unpaid balances of $66,071,757. Of those 158 loans, 101 (64%) were 120+ days past due as per the table below. DIA noted, of these 101 loans, 85 originated from two programs focusing on startups for new technology and product development. These programs were high risk and are no longer offered by DoD. If excluded, the delinquency rate would be reduced to 16 of 158 loans (10%) in active repayment status.

Unpaid loan balance	$12,027,082
Accrued interest and/or penalties	$ 4,561,717
Total Past Due over 120 days	**$16,588,799**

It should be noted that 72 of the 101 loans (71%) had starting balances of less than $100,000 and comprise only $3,558,454 of the $16,588,799 (21%) of the total past due. There was a previous attempt by management to write off many of these loans (primarily from the two programs previously referenced); however, the Office of Inspector General opined that DoD could not do so without formal approval from County Council. A difference of legal opinion ensued which left the write-off of the loans in limbo. See Financial Reporting Accuracy Finding for additional details on implementation of the collectability and write-off policy.

This indicates a notable level of credit risk. A risk analysis could provide valuable insights to better guide DoD management in reevaluating its lending strategies and effectively managing concentrated risk levels.

The DoD is charged with ensuring the effective management of its loan portfolio. This responsibility makes the continuous process of identifying and mitigating risk a vital component for achieving success.

The DoD Policy Manual includes several best practices to ensure due diligence including the use of a risk-rating tool when evaluating individual loan applications for creditworthiness. The Policy Manual states in part "All loans will be evaluated and ranked using a risk-rating tool…"

Risk-rating systems/models are an industry best practice for loan portfolio management. Risk rating involves the categorization of individual credit facilities based on credit analysis and local market conditions utilizing a series of graduating categories based on risk. It is primarily used for:

- Underwriting of new loans including loan pricing (the interest rate for granting a loan) determination.
- Predicting changes in portfolio quality and the subsequent financial impact.
- Regulating the commercial portfolio exposure to acceptable levels of risk as established in board policy.

Risk rating can allow for earlier response to potential deteriorating trends and a wider choice of corrective actions to decrease exposure of unexpected loan losses. Risk ratings should be conducted at the time of application for all new or increased loan facilities, as part of the annual review process, and in situations where new information is presented that may materially affect the credit risk of the loan.

Industry analysis has also become an important component of portfolio management practices at many financial institutions. The key to analyzing industry risk at the portfolio level is having a clear and comprehensive approach that articulates industry risk in a way that all areas of the organization affected by industry analysis can understand and use. Isolating and managing industry risk in a commercial loan portfolio may be one key in weathering the next downturn.

DoD has not enforced their policy to use a risk-rating tool to the one outlined in its Policy Manual. The underwriting division's process for assessing risk does include an analysis of a borrower's financial and management capacity, collateral, and owner equity; however, it does not compute an overall score to differentiate the quality of the loans. Additionally, DoD lacked a policy requiring a formal industry analysis.

Risk to the County if Not Corrected

A lack of an underwriting and loan portfolio risk analysis results in failures to understand the risk exposures and can lead to financial loss from an increased rate of default or uncollectible loans. This could also negatively affect the County's reputation or public perception.

Recommendations

1. (P1) DoD management should enforce the expectation of the underwriting division to score new loans using a risk-rating tool similar to the one outlined in DoD's Policy Manual and to classify borrowers by industry using a classification system, such as the North American Industry Classification System (NAICS).

Management's Response:

Agrees – DoD agrees that a risk rating tool would add significant value to the evaluation of new loans presented. DoD is already in the process of exploring empirical risk assessment model rating methodologies best suited to the lending mission of the County, per the Charter. Once established, the objective is to tie the adopted system into either/both loan software platforms (Portfol and future software of Salesforce.) Outreach to several subject matter experts and practitioners has already begun to assist in the development of the Risk Rating system.

Target Date for Completion: Due to the efforts required to identify and tailor a risk rating system specific to County lending mission, DoD will need more than the recommended thirty (30) days as once a method is identified, integration into current and future technologies will add to the date of implementation. July 31, 2024 – to have risk rating in place and incorporated into updated ED Loan Policies and Procedures

2. (P1) DoD should implement a formal loan portfolio risk analysis process to assist in governance of the loan portfolio management. This will require assessing whether the current technologies in place can conduct loan portfolio risk analysis effectively and efficiently, or if the adoption of new technologies is necessary.

Management's Response: Same as response to #1.

Target Date for Completion: Same as response to #1.

FINDING Loan Committee Oversight

The Department of Development's (DoD) current policy does not require loan committee review of all loans.

DIA's testing of a sample of 5 out of the 43 loans originated and disbursed from 2020 through 2023 identified 3 loans not reviewed (60%) by the loan review committee, Cuyahoga County Community Improvement Corporation (CCCIC). The three loan types included:

- Non-Profit Forgivable Loan.
- Large-Scale Economic Development Leverage Grant.
- Brownfield Match Forgivable Loan.

Establishing policies with clear expectations ensures a uniform alignment of employee conduct with management's expectations and ensures compliance with any legislative requirements.

County Resolution 710325 authorizes the CCCIC to act as the Loan Review Committee for the DoD Economic Development Program.

According to paragraph 8.13 of the AICPA Audit and Accounting Guide for Depository and Lending Institutions (DEP), internal loan review functions are essential for assessing the quality of the loan portfolio and lending process:

> To be fully effective, the internal loan review function should be independent of origination, disbursement, servicing, accounting, monitoring, and collection functions. Objectives of internal loan reviews include:
>
> - Monitor compliance with established lending policies.
> - Assess whether the payments due on the loan are likely to be received in accordance with the loan terms.
> - Identify weaknesses in the lending process or the lending officers' skills in originating, monitoring, and collecting loans.

County Resolution 710325 does not specify which loan types are subject to or exempt from CCCIC review.

Prior to a 2019 policy change, DoD's policy required all loans, subordination requests, material changes to the terms and conditions of a current loan including without limitation assignments, releases, workout strategies or revised payment plans, to be presented and evaluated by the CCCIC. However, effective in April 2019, DoD's policy changed to allow for exceptions to CCCIC review. The language is ambiguous and states:

> With few exceptions (e.g., loans for brownfield clean-up projects), loan financing proposals are submitted by DoD staff to the CCCIC Board of Trustees in the form of a loan "Write-up".

DoD advised the reason for the current policy and the 3 loans being an exception to CCCIC submittal is that all three loan types do not require the traditional underwriting provided by the CCCIC. Instead, the Executive administration, BOC, and County Council assume the role of review and approval of providing such loans.

Risk to the County if Not Corrected

The absence of review by an independent body to ensure the efficacy of projects and a borrower's capacity to meet loan conditions, both financial and nonfinancial, can lead to adverse business consequences. Without appropriate oversight, there is a heightened risk that the County's economic development goals will not be met.

Recommendations

1. (P1) DoD should update its policies and process to clearly identify which loan types must receive CCCIC recommendation/approval prior to County Council or Board of Control submittal.

Management's Response:

Agrees – DoD feels that the language in the current Policies and Procedures Manual should be updated to better articulate what items are taken to CCCIC for review despite the fact that County Resolution 710325 does not specify which loan types are subject to or exempt from CCCIC review.

Target Date for Completion: DoD agrees to update the language in the Policies and Procedures Manuals by the July 31, 2024 date for which the updated manuals will be finalized.

FINDING Loan Committee Meetings Accessibility and Transparency

The meetings held by the Cuyahoga County Community Improvement Corporation (CCCIC) may not comply with County Code.

As defined in County Codes 105 and 106, the CCCIC appears to meet the definition of a "public body" and/or "public office". During the audit, DIA noted the CCCIC does not:

- Provide time during meetings for public comment related to or unrelated to the agenda.

- Post meeting minutes to the public on the County's webpage. It should be noted, DoD does maintain copies of the minutes within its filings related to the loans that are discussed and reviewed at the CCCIC meetings.

County Resolution 710325 authorizes the CCCIC to act as the Loan Review Committee for the DoD's economic loan program. The Board of Trustees consists of 11 members, all of which are appointed by the County Executive and confirmed by the County Council.

Per County Code Chapter 105 (Open Meetings), legislated under County Council Ordinance No. O2011-0013:

- Section 105.01 defines a "public body" as only those entities of Cuyahoga County government listed in Article 12, Section 5 of the Cuyahoga County Charter.

- Section 105.03 requires any meeting of a public body include time at the beginning of the meeting for public comment related to the agenda for that day's meeting. Every such meeting shall also include time for public comment related to that meeting's purposes but not related to that day's agenda.

Per County Code Chapter 106 (Public Records), legislated under County Council Ordinance No. O2013-0002:

- Section 106.02B defines "public office" which includes all Boards, Commissions, and Advisory Councils to which the County Executive and/or the County Council appoints at least a majority of its members, or any similar body created by the Cuyahoga County Charter, the County Council, and/or the County Executive.

- Section 106.04, Part J requires the County to maintain a readily accessible website. The County Executive and the Clerk of County Council are required to ensure the website is regularly updated to provide current information, including the notice, agenda, minutes, and reports of all public meetings conducted by offices within the scope of Chapter 106 of the Cuyahoga County Code.

DoD management indicated they were not previously made aware that the CCCIC may be subject to the County's Public Meetings Policy and Public Records Policy as reflected in County Code 105 and 106.

Risk to the County if Not Corrected

Failure of a public body to conduct meetings openly could result in non-compliance of County Code. Additionally, it increases the risk of eroded public trust and accountability thus impeding DoD's effectiveness in fostering job creation and retention in the County.

Recommendations

1. (P1) DoD management should consult with the Law Department to determine if the CCCIC is subject to the County's Public Meeting and Public Record policies as reflected in County Code. If so, appropriate action should be taken to ensure that the assigned CCCIC secretary:

a. Includes agenda items to allow for public comment both related and unrelated to the agenda, and
b. Posts CCCIC meeting minutes to the County's webpage in a timely manner.

Management's Response:

After consultation with an Assistant Law Director, it was determined the CCCIC is not a public body per Section 105.01 of the Code which refers back to the County Charter. Based on Law's interpretation, CCCIC is not a public body but rather a 501(c)3 advisory committee, and not an entity vested with authorization to approve.

For the purpose of transparency, going forward CCCIC meetings will, as a policy, follow Ohio's and the County's open meetings requirements, including: i) adding an opportunity for public comment on meeting agendas, and ii) requiring a majority vote of all members present to close the meeting (i.e., executive session) during consideration of any confidential information. No recommendation by CCCIC will be finalized in executive session.

Target Date for Completion: Beginning at the April 2024 CCCIC meeting, the CCCIC Board will have the necessary instruction on the motion described above and the requirement to do so will be incorporated into the policies and procedures by July 31, 2024

FINDING Financial Reporting Accuracy

The accuracy of the loans receivable balance and bad-debt expense in the County's annual financial statements is not ensured.

In its testing, DIA determined the following financial reporting discrepancies:

- A loan with a $121,044.99 balance was inaccurately classified as "Loans Receivable" in the County's 2022 financial statements. The loan should have been reclassified as

"Allowances for Uncollectible" with a corresponding charge to bad-debt expense in 2012 when the County received a settlement payment from the borrower's bankruptcy case. This led to DoD's release of the lien on collateral, rendering the loan a probable loss. DIA alerted DoD to the situation on 9/19/23, prompting DoD to request assistance from its legal counsel to assess the loan's collectability and write-off status from a legal perspective.

- A loan initially disbursed in 2009 with a $500,000 balance was missing from the County's 2022 financial statements. DoD is currently in the process of verifying whether the borrower met the requirements for loan forgiveness under the terms of the loan agreement.

- Four unreconciled loans totaling $2,700,000. The loans reflect a $0 balance on the County's 2022 financial statements; however, are noted within DoD's loan portfolio software as "insufficient documentation" to determine their actual balance. Based on the available information, these loans were disbursed during 2008 and 2009. DoD is currently in the process of obtaining sufficient documentation to discern whether the loans have balances and/or an update to the financial statements is necessary.

- See Formal Loan Portfolio Risk Analysis finding for information on loan delinquencies.

Ohio Administrative Code Section 117-2-03(B) requires reporting of the County's annual financial statements using generally accepted accounting principles (GAAP). U.S. GAAP standards provides the following guidance relative to determining loan collectability, per Accounting Standards Codification Topic 310 Receivables, 35 Subsequent Measurement, General, Impairment of Loans and Receivables:

- It is usually difficult, even with hindsight, to identify any single event that made a particular loan uncollectible. However, the concept in GAAP is that impairment of receivables shall be recognized when, based on all available information, it is probable that a loss has been incurred based on past events and conditions existing at the date of the financial statements.

- Measuring impairment of a loan requires judgment and estimates, and the eventual outcomes may differ from those estimates. Creditors shall have latitude to develop measurement methods that are practical in their circumstances.

- The creditor may choose a measurement method on a loan-by-loan basis. A creditor shall consider estimated costs to sell, on a discounted basis, in the measure of impairment if those costs are expected to reduce the cash flows available to repay or otherwise satisfy the loan. If the present value of expected future cash flows (or,

> alternatively, the observable market price of the loan or the fair value of the collateral) is less than the recorded investment in the loan (including accrued interest, net deferred loan fees or costs, and unamortized premium or discount), a creditor shall recognize an impairment by creating a valuation allowance with a corresponding charge to bad-debt expense or by adjusting an existing valuation allowance for the impaired loan with a corresponding charge or credit to bad-debt expense.

DoD is charged with maintaining accurate records and accounting for its loans to ensure its appropriate servicing of loans, including collections. Accordingly, the County's Fiscal Office requests DoD provide a listing of all its loan activity and balances as of the end of the year (referred to as the "ACFR Master Disaggregated Data Deliverable" report). Included in the listing is a notes column for DoD to indicate which loans it has determined as uncollectable. In the past, DoD has relied on the assessments by third party collection agencies for its determinations as documented within their Economic Development procedures manual. This manual states in part:

> The Collection Agent will use best practices common in the industry to assess the Borrower's ability to pay in order to make a recommendation to the DoD as to whether and how collection efforts should be pursued. Based on such assessment, the Collection Agent may, without limitation, recommend:
>
> - Restructuring the Loan or the Borrower and County enter into a repayment plan, or
> - Pursuing the amounts owed through all available and appropriate legal action, or
> - The Loan be written off ("Collection Recommendation").
>
> Any Collection Recommendation must be fully reviewed by the Loan Portfolio Manager (LPM) with the Director and Deputy Director, and such other County agencies as the Director or Deputy Director deems appropriate, prior to being forwarded to the County Executive. Under Section 109.01 of the County Code, the County Executive has the authority to settle all such claims that do not require expenditure of an amount in excess of $100,000.00.

Per Section 109.01(C) of the County Code, any claims in excess of $100,000 shall require prior approval of County Council.

DoD's documented loan collectability and write-off review process is not utilized. DoD no longer refers loans to third party collection agencies and DoD has not subsequently implemented a collectability and write-off review process with criteria for determining loans that are uncollectable.

Risk to the County if Not Corrected

A lack of formal process to assess and monitor loans for collectability could result in inaccurate financial statements. Material misstatements can mislead stakeholders, including taxpayers, creditors, and bondholders, who rely on accurate financial information to make informed decisions. Additionally, non-compliance with accounting standards, such as those outlined in GAAP, can result in regulatory and legal issues, potentially damaging the county's reputation and subjecting it to penalties or sanctions.

Recommendations

1. (P1) DoD should implement a formal loan collectability and write-off review policy and processes. The Economic Development procedures manual should be updated as necessary including appropriate collection activities and criteria for identifying loans as uncollectable. Additionally, DoD should consider including within the policy and procedures requirements to:

a. Obtain an opinion from its legal counsel to ensure that all available collection activities within the contractual terms of the loan agreement and the boundaries of the law were pursued. If it is found that certain collection activities are still viable, then they should be pursued.
b. Complete a loan collectability and write-off review form for the loan portfolio management employees to complete. The DoD Deputy Director and DoD Director should review the form and sign off to approve any collections activities or write-offs.
c. Comply with Section 109.01 of the County Code, loans with balances up to $100,000 determined as uncollectible should be forwarded as a write-off recommendation to the County Executive for approval and over $100,000 forwarded to County Council for approval.
d. Report write-offs to the County's Fiscal Office annually in the "ACFR Master Disaggregated Data Deliverable" report.

Management's Response:

Agrees – DoD agrees with all of the recommendations made by DIA to follow the code as it is opined by the Law Department. DoD will work diligently to engage all of the inter-county agencies referenced to develop and formalize a comprehensive policy and procedure to better adjudicate bad loans on the aging report pursuant to county code as it is opined by the Law Department.

Target Date for Completion: DoD will have the formal policy and procedure established and incorporated into the updated Loan Policies and Procedures Manuals by July 31, 2024. As for the recommendation made in #3, this will take more time due to the capacity of the current Loan Portfolio Management team due to it consisting of two

individuals and the amount of work required to review all of the legacy delinquent loans. Estimated timeframe to this specific recommendation would be March 31, 2025.

2. (P1) DoD should request the Fiscal Office review the policy to ensure it will facilitate accurate financial reporting in conformity with GAAP.

Management's Response: Same as response to #1.

Target Date for Completion: Same as response to #1.

3. (P1) Following its adopted collectability and write-off review policy and procedures, DoD should review all its delinquent loans to identify any additional loans meeting the write-off criteria or where further collection activities can be pursued. Going forward, a review should be performed annually.

Management's Response: Same as response to #1.

Target Date for Completion: Same as response to #1.

4. (P1) DoD should continue to pursue collections or write-off for the $121,044.99 loan balance depending on the opinion from its legal counsel.

Management's Response: Same as response to #1.

Target Date for Completion: Same as response to #1.

5. (P1) DoD should report the $500,000 loan balance to the Fiscal Office for reporting in the next ACFR, provided terms for loan forgiveness have not been confirmed.

Management's Response: Same as response to #1.

Target Date for Completion: Same as response to #1.

6. (P1) DoD should continue its efforts to locate sufficient documentation to discern the balances for the four loans totaling $2,700,000. Once determinations have been made, DoD should report the necessary changes to the Fiscal Office for reporting in the next ACFR.

Management's Response: Same as response to #1.

Target Date for Completion: Same as response to #1.

FINDING Job Growth and Diversity Reporting

The Department of Development's (DoD) job performance reporting to Executive level leadership could be enhanced with use of actual performance data.

Based on DIA's observations of DoD's current practices, actual jobs created and diversity data for DoD's economic development loan monitoring is not included in the quarterly performance reports to Executive leadership. Instead, performance reports are based on the number of jobs projected to be created and retained for the quarter as reflected within the original loan agreements.

Job growth and diversity in the County are indicators of compliance and mission success for DoD's economic development loans. As such, accurately reporting the department's actual performance figures to County Executive leadership through the countywide performance monitoring system, ClearPoint, is a best practice.

DoD's Policy Manual requires job creation and/or retention to be tracked in accordance with the job-retention and/or creation provisions of the loan or grant agreement. Actual jobs created and diversity data is obtained and maintained within DoD's loan portfolio management software, Portfol, and is reported monthly for internal loan compliance monitoring.

DoD management is also required to submit quarterly data to the Innovation Department's countywide performance monitoring system, ClearPoint. This acts as a lens for the County Executive leadership to monitor overall performance with the County's strategic plan.

The DoD Policy Manual does not establish criteria and methodology for the quarterly reporting of job creation and diversity data for DoD's economic development loans.

Risk to the County if Not Corrected

A clear policy over the job reporting process increases transparency and increases accuracy of performance data. Use of actual jobs created and diversity data within reporting could also enhance County management's ability to make informed decisions relative to future investments.

Recommendations

1. *(P4) DoD should consider revising its policy by defining management's expectations for the criteria and methodology for the quarterly reporting of job creation and diversity data for DoD's economic development loans.*

Management's Response:

Common practice in the Economic Development lending industry is to use the number of jobs a loan/grant recipient promises to create WHEN IT IS approved by the authorizing body. Additionally, the date that has been requested is based on the approval date. The actual data is still collected and housed in Portfol so that Loan Portfolio Management Team (LPMT) can track for compliance as Job Creation/Retention is a key covenant and also important to have so that data can be reviewed to identify how our lending programs (direct lending from DoD) impact not only the new to County jobs being created, but who and type of people are receiving employment based on the County's involvement. Beginning with reports due in 2024 for periods ending up to 12/31/2023 that are the FINAL reports due, LPMT will draft a memorandum to DoD leadership informing them of the status of the final job creation data along with the documentation received for their own respective review. This minor action will be updated into our respective manuals.

Target Date for Completion: July 31, 2024 is when the manuals will be updated and the memorandum for final reporting will be incorporated into the manuals.

2. (P4) DoD management should consider submitting actual data to County Executive leadership performance reporting within ClearPoint. This could enhance management's ability to verify compliance is met and performance effectively monitored for loans with job growth and diversity requirements.

Management's Response: Same as response to #1.

Target Date for Completion: Same as response to #1.

Operations

FINDING Financial Due Diligence Review

The Department of Development's (DOD) loan underwriting policies do not ensure the consistent provision of reliable financial information as a part of the due diligence.

In its testing of five DoD loans originated between 2020-2022, DIA identified one loan for a real estate acquisition where DoD obtained a personal financial statement from the borrower during underwriting that was self-prepared and lacked adequate evidentiary support to verify the borrower's financial history.

Obtaining and analyzing a prospective borrower's financial well being is an integral part of the underwriting process. The provision of externally prepared financial statements and tax returns is considered a best practice because it allows loan decisions to be made on the basis of comprehensive and credible financial information.

CPA-prepared financial statements and tax returns are the most desirable as they are independently and objectively prepared by competent professionals. This ensures a higher level of reliability and accuracy providing clear and detailed insight into the company's financial performance, revealing patterns, trends, and potential risks. They serve as a trustworthy source for evaluating the borrower's ability to generate revenue, manage expenses, and service existing debts, which are relevant factors in determining creditworthiness and assessing the potential risks associated with lending. This practice not only enhances the lender's confidence in the borrower but also aids in making well-informed lending decisions based on a more reliable and transparent financial picture.

Further, obtaining financial statements is a necessary step in assigning credit risk scores for borrowers during underwriting.

DIA noted that the practice for underwriting various project loan types (i.e. real estate acquisitions) is not differentiated in DoD's Policy Manual.

Risk to the County if Not Corrected

The absence of historic financial statements and tax returns hampers DoD's ability to perform risk ratings to assess the borrower's financial stability and performance during underwriting and servicing of the loan. This increases the risk of extending loans to potentially unqualified or risky applicants jeopardizing the program's success.

Recommendations

1. *(P3) DoD should revise its policy over the loan underwriting processes to differentiate any financial documentation requirements between the various types of projects engaged.*

In general, the policy should be written in a way that ensures the expectations of management are clear and promotes a consistent level of underwriting across all loans.

Management's Response:

DoD AGREES that revisions to its ED Loan Policy and Procedure Manuals UW processes as described in the recommendation would add value as it will guide existing and future DoD staff. Additionally, this will provide DoD management with greater ability to hold origination team accountable.

Target Date for Completion: July 31, 2024

2. (P3) Although DoD's past practice of underwriting for real estate acquisitions has been proforma analysis of the property to be acquired, DoD should institute a requirement to obtain evidentiary support of the borrower's overall financial history for all loans, such as externally prepared financial statements and tax returns. This would provide a comprehensive and verified view of the borrower's financial health and performance.

Management's Response:

Similar to the previous recommendation, DoD will address the required documentation for each project type/loan program. That said, a majority of real estate financing transactions by the County as well as other private and public lending institutions involves the creation of new entities (e.g. LLC, LP, Inc,) to serve as Real Estate Holding entity based on a specific project. As such, there is not any financial history or tax returns due to the entity being newly formed. In the event that the Real Estate Holding Company is set up for a project and the end user is affiliated with the holding company, DoD would require evidentiary support from the end user in the desired form of the County along with tax returns for previous period. In an instance like this, the end user would most likely be required to serve as a Guarantor on the loan and therefore this information would already have been obtained or required to assess the strength of the pledged guaranty.

Target Date for Completion: Same as response to #1.

FINDING Credit Checks and Monitoring

The Department of Development (DoD) lacks a formal credit check and credit monitoring process in the underwriting and servicing of its economic development loans.

Although the DoD adheres to several best practices relative to assessing the borrower's creditworthiness, they do not consistently obtain personal or business credit reports to analyze a borrower's full credit history. DIA tested a sample of 5 out of the 43 loans originated and disbursed from 2020 through 2022 and noted credit reports were not obtained. Similarly, DoD did not utilize credit monitoring services to periodically review a borrower's credit for potential red flags throughout the life of the loan.

The DoD is charged with ensuring the effective underwriting and servicing of loans. Credit checks and credit monitoring are best practices of loan underwriting and servicing to ensure the creditworthiness of borrowers. Further, obtaining external credit scores is a relevant factor in assigning credit risk scores to individual loan applications.

Credit reports allow lenders to better assess credit risks and borrowers to potentially negotiate more favorable terms on credit applications. Lenders can therefore make better-informed lending decisions including avoiding loans with high-risk applicants and rewarding good payment behavior with better terms and conditions.

DoD does not require credit check and credit monitoring in its underwriting and servicing of its economic development loans within their Policy Manual.

Risk to the County if Not Corrected

Without access to comprehensive credit information, DoD may face heightened risks of lending to individuals or businesses with undisclosed financial challenges, leading to a higher likelihood of loan defaults and losses. Inadequate credit checks can also result in suboptimal lending decisions including extending credit to high-risk borrowers who may not be able to meet their obligations. Overall, the absence of credit check reports can negatively impact DoD's economic development fund budget, risk analysis, and reputation.

Recommendations

1. *(P1) DoD should establish a well-defined protocol for obtaining and reviewing credit check reports, applicable to both individual and business borrowers during the loan origination and continuous monitoring phases. Written consent should be obtained and credit check reports securely stored. DoD should integrate credit check reports into its overarching risk rating and lending decision-making processes.*

   Management's Response:

   Agrees – DoD has an account with Transunion and has implemented the requirement for any individual who is either a Guarantor or Coborrower. Loan officers are required to make formal request to Loan Portfolio Manager to run a Credit Report through the Transunion program upon the execution of a Term Sheet where a Guarantor and/or Coborrower are required. DoD does not issue loans solely to individuals but rather businesses and/or real estate holding corporations. The current application for an economic development loan contains the following language as well, "The County may also check the personal credit history of the principal owner(s) and/or key individuals." DoD will be updating the loan application with the assistance of the Department of Law

to ensure the language reflects that an individual is providing written consent to perform a credit check if said individual is either a Guarantor or Coborrower. DoD is in the process of researching the use of Dun & Bradstreet to identify if utilizing this service would add value based on the lending provided by DoD. DoD will also consult with Department of Law on any requirements or best practices for the safe storage of credit reports and the documentation provided in order for the report to be generated.

Target Date for Completion: Corrective action already taken shall be incorporated into updated Policies and Procedures to be updated by July 31, 2024

FINDING Prevailing Wage Compliance Documentation

The Department of Development (DoD) does not maintain evidence of prevailing wage compliance.

DoD obtains and verifies use of prevailing wage data utilizing a certified payroll reporting software (LCP Tracker). Access to the LCP Tracker is limited within DoD and payroll reporting is not extracted from the system. Rather, the supporting documentation remains in the LCP Tracker system and the DoD employee emails the Loan Portfolio Manager self-attesting completion.

Prevailing Wage laws (Davis-Bacon) require contractors who work on certain public projects to pay construction workers the region's standards for hourly wages, benefits, and overtime, as calculated by the U.S. Department of Labor and Ohio Department of Commerce. These market wages are established by local standards and competitive practices. Section 501.15 of the County Code requires County project contractors to pay the prevailing wage rate where possible. DoD also includes prevailing wage compliance requirements within its loan agreements when applicable, such as a construction or rehabilitation project.

To ensure compliance with any legislative or contract prevailing wage requirements, actual wages paid should be verified against prevailing wages prior to reimbursement of labor related project expenditures. Confirmation and support documentation of such verification should be maintained within project records as a best business practice.

DoD lacks any formal policies and procedures relative to ensuring prevailing wage compliance. While the current DoD employee tasked with compliance review appears knowledgeable and competent with the state and federal laws governing prevailing wage and the process to assess payroll support for compliance, there is not an expectation through policy for the DoD employees' work to be verified for completion by the Loan Portfolio Manager through obtainment of support and the verification to be documented.

Risk to the County if Not Corrected

The absence of a policy or procedure requirement to retain sufficient documentation supporting compliance with prevailing wages could result in a failure to detect unfair compensation practices or potential labor violations. Vendors may underpay workers or fail to provide the mandated benefits. Any of which could tarnish the County's reputation as a socially responsible and ethical organization.

Recommendations

1. *(P3) DoD should update their Policy and Procedure Manuals to:*
   a. *Document the process of validating prevailing wage compliance prior to disbursement on applicable loans (e.g. construction or rehabilitation).*
   b. *Require the DoD employee tasked with prevailing wage compliance reviews extract and maintain prevailing wage reports within DoD files.*

Management's Response:

Agrees – Tracking the document and validation process will be done utilizing the loan portfolio software via a Note and Tickler evidencing the review and approval by the DoD representative assigned to this role. DoD has a contract with LCP Tracker that stores the information for each project we enter.

DoD is required at minimum to retain them for 3 years but have had no issue going back further. The reports are saved in PDF format under each project once accepted and approved in the Tracker System.

Target Date for Completion: Immediate implementation as of 4/1/2024 with it being incorporated into the manuals by July 31, 2024.

FINDING Loan Disbursements and Receipts Reconciliation

The Department of Development (DOD) lacks a monthly reconciliation process for its loan disbursements and receipts.

There is a not a process in which an employee independent of the loan servicing functions ensures the completeness and accuracy of monthly loan disbursements and receipts entered in DoD's system of record (Portfol) and posted in the County's financial system (Lawson).

DoD's Loan Procedures (adopted effective April 1, 2019) include performance of hard closing accounts monthly. "Hard close" refers to the closing of each accounting month in Portfol whereby all loan disbursements and receipts, and any adjustments, must be entered in Portfol before the end of the grace period. The hard close function prevents any further changes to individual loan balances as of the month end, thus ensuring accurate loan activity and monthly aging reports. Following a monthly close, the “Drawdowns Report” and “Receipts Report” in Portfol serve as the official accounting record for loan disbursements and receipts, respectively. These reports could be used to reconcile with Lawson’s general ledger reports.

Monthly reconciliations by a person independent of the loan servicing functions is a business best practice. It plays a critical role in maintaining financial transparency and accuracy. By reconciling DoD’s loan portfolio software with the County’s general ledger, discrepancies and errors can be promptly identified and rectified. This process ensures that the County’s financial records are up-to-date and reliable, which is vital for audit readiness and overall financial accountability. It also helps in preventing financial irregularities, fraud, and operational inefficiencies.

DoD management was unaware that monthly reconciliations were not being performed. DoD’s policies and procedures do not include all fiscal roles within the Business Services division. However, it should be noted that their current fiscal roles were documented in workflows and tracking spreadsheets.

Risk to the County if Not Corrected

A lack of monthly reconciliations can lead to accounting errors, misappropriation of assets, and/or inaccurate account balances going undetected by management. The absence of policies and procedures for the Business Services division could result in performance that does not align with the overall goals for the department.

Recommendations

1. *(P1) DoD should implement monthly reconciliations of loan disbursements and receipts between Portfol and Lawson that is documented and retained for verification by DoD management. As some loan service activity is handled in trust bank accounts, the person assigned to the reconciliation process should also reconcile the loan activity to the separate trust bank statements as well.*

   Management’s Response:

   Agrees – DoD agrees with the recommendations for the implementation of monthly reconciliations and incorporating fiscal roles of Business Services into ED Loan Policies and Procedures. Reconciliation will occur on a monthly basis and the reports from Portfol will be generated by an individual member of the Business Services team after Loan Portfolio Management Team performs the Hard Close of Accounting Month. Said individual will also obtain the Trust Statement from the proper drive and send that, along with the Portfol generated reports to another member of the Business Services team for the actual reconciliation of receipts and drawdowns by accounting month. This has already been incorporated into Business Services Fiscal Policies and Procedures.

Target Date for Completion: Corrective action already taken. Implementation commenced with the accounting month of January 2024. Policies and procedures will be updated to reflect corrective actions already in place by July 31, 2024

2. (P4) DoD should consider incorporating the fiscal roles of the Business Services division into DoD's policies and procedures.

Management's Response: Same as response to #1.

Target Date for Completion: Will be added to the updated DoD Loan policies and procedures by July 31, 2024

FINDING Effective Loan Monitoring Not Ensured

Effective loan monitoring is not ensured.

DIA noted the following in its testing of a sample of 15 active loans in 2022:

- DoD did not perform monitoring reviews of 2021 financial statements for eight of the loans during 2022 or 2023. The terms of these loans only require the borrower to make financial statements (audited or independent certified public accountant prepared) available for inspection and review by the County during normal business hours at the address of the borrower upon written notice from the County.

- Two borrowers did not provide DoD with their most recent Federal income tax return during 2022 or 2023. The terms of these loans require the borrower to deliver annually to DoD internally prepared financial statements and its federal income tax returns for the fiscal year last ending. It should be noted that internally prepared financial statements were provided; however, the accuracy of said financial statements cannot be validated without the corresponding income tax returns.

One of the key challenges of commercial loans is ensuring that the borrower remains financially healthy and capable of meeting their obligations under the loan agreement. While DoD conducts an assessment on perspective borrowers before approving loans, financial circumstances can change over time, presenting risks to both the borrower and DoD as the lender.

Effective continued loan monitoring is a best practice to mitigate the risks of commercial lending. This involves ongoing assessment of the borrower's financial health and their ability to meet obligations under the loan agreement. Regular monitoring enables lenders to detect early warning signs of financial distress and manage risks effectively.

DoD's Policy Manual requires the Loan Portfolio Manager (LPM) to monitor loans with respect to submission of financial statements and other covenants/milestones. DoD uses the Portfol loan software to monitor the due dates for financial statements and tax returns and completion of reviews. DoD often includes terms within loan agreements requiring borrowers to either furnish information such as financial statements and/or tax returns. The requirements may vary based upon the loan type or negotiations with the borrower; however, most require borrowers to submit such documentation annually or upon request of the DoD.

For the two loans lacking a most recent federal income tax return, DoD only requested financial statements in their requests to the borrowers. Contract terms for all eight loans lacking a financial review allow the borrower to limit DoD access while on-site of the borrower premises. DoD cited the COVID-19 pandemic and limited staff resources as a reason for the inability to conduct on-site visits during 2022 or 2023. Staffing to conduct such reviews is limited to two people.

Although the DoD Policy Manual includes a requirement to monitor the submission of financial statements, it lacks a requirement to ensure review of said submitted financial statements and/or tax returns occurs.

Risk to the County if Not Corrected

Lack of appropriate loan monitoring could result in missed warning signs of financial distress leading to delayed reactions and limited options when dealing with a potential borrower default. A heightened risk of loan default could compromise DoD's ability to maintain a stable and sustainable loan portfolio.

Recommendations

1. (P3) DoD should update their Policy and Procedure Manuals to include a requirement that appropriate loan monitoring over financial statements and/or tax returns occur on all loans on an annual basis.

Management's Response:

Agrees – Action will commence beginning with the outreach for 2023 financials which are set to occur after the April 15, 2024, tax filing deadline. Manuals will be updated to reflect the first two recommendations by July 31, 2024 and implemented upon review of the entire situation and examination of the rights to enforce compliance via default via consultation with Law Department.

Target Date for Completion: See above.

2. (P3) DoD should document their loan monitoring, as support that such reviews have occurred, on any loan which allow borrowers to restrict access of financial statements *and/or tax returns to on-site of the borrower's premises. For example, support could include the written request and correspondence with the borrower relative to the onsite visit, notes from DoD relative to the date and time of the onsite visit, and results of the review. In cases where there is a need to discuss restructuring loan terms due to financial distress identified in the financials, the notes should be sufficiently detailed for DoD management to make informed decisions.*

Management's Response: Same as response to #1.

Target Date for Completion: Same as response to #1.

3. (P4) DoD should consider consulting with the Law Department to determine if a standard requirement allowing the right to request a borrower's financial statements and/or tax returns without the restriction of on-site visitation can be implemented in all future loan agreements/contracts.

Management's Response: Same as response to #1.

Target Date for Completion: Same as response to #1.

FINDING Evidentiary Support for Job Creation

The Department of Development (DOD) does not require evidentiary support to validate job creation and retention goals are being achieved.

Borrowers self-attest to the number of jobs created and retained including certifying the accuracy and truthfulness of the information provided. Although DoD policy and the borrower self-attestation form support that the information provided is subject to verification by the County, DIA noted that DoD had not performed such a verification. DoD confirmed validating the accuracy of job reporting is not a regular practice.

Job creation and retention in the County are the indicator of mission success for the type of economic development loans that DoD provides. As such, obtaining evidentiary support for job creation and retention is critical to ensure the program's success. Much like DoD's existing policy to obtain support of project costs prior to loan disbursement, a similar policy to verify job creation and retention through evidentiary support prior to providing loan satisfaction or loan forgiveness is a best practice.

DIA performed research and inquiry with other Departments of Development within the State and noted obtaining standard payroll records (e.g. IRS forms W-3 and W-2) to verify self-reported employment numbers is a standard industry practice.

As the loan servicing team consists of only two employees, DoD lacks sufficient resources to implement consistent review of evidentiary support for every loan agreement with job creation and retention requirements. Additionally, not all DoD loan agreements include a requirement to provide such evidentiary support from the borrower even if requested.

Risk to the County if Not Corrected

Failure to ensure the accuracy of a borrower's self-reported job creation and retention figures with evidentiary support could result in inaccurate or falsified job figures misrepresenting the program's success, thus hindering the program's goals. This could also erode trust among stakeholders, discourage future investments, and limit the program's ability to generate actual economic growth.

Recommendations

1. (P2) DoD should implement periodic reviews of evidentiary support to verify job creation and job retention goals have been achieved. This may be achieved either internally with limited resources or through agreed-upon procedures with an external assurance provider if verification was performed methodically on a sample basis. DIA could also be engaged to perform periodic reviews or advise on the development of testing criteria if DoD decides to perform the review internally.

Management's Response:

DoD Agrees to update the ED Loan Policies and Procedures Manuals to implement periodic reviews of evidentiary support pursuant to the rights of the County established in a given executed Loan Agreement. DoD will achieve this internally on a sample basis for loans still within the job creation and/or job retention period of the project. DoD may also engage DIA to discuss and seek advice on the development of testing criteria.

Target Date for Completion:

To be updated in ED Loan Policies and Procedures by July 31, 2024. Implementation of the periodic review of employment data will commence by year end based on the final update to the respective manuals.

FINDING Loan Workout Policy Evidence Requirement

The Department of Development (DoD) could better ensure effective loan workout decisions with a requirement of evidence-based support.

Currently, evidence-based support is not required for every workout agreement. During testing, DIA identified 1 out of 3 loan workouts in 2022 that did not include evidence-based support (e.g. Current financial statements or tax returns).

A workout agreement is a contract mutually agreed to between a lender and borrower to renegotiate the terms on a loan that is in default. Often, a workout agreement includes provisions to waive existing defaults and/or restructuring of the loan's terms and covenants.

DoD's Policy and Procedure Manuals address loan workouts. Any borrower request to obtain a workout agreement is submitted to the Loan Portfolio Manager (LPM). The LPM, in consultation with others within DoD, conducts a review prior to preparing a memorandum to the Director outlining the nature of the request and a recommendation as to how DoD should proceed (e.g. Proceed with the request, propose an alternative to the request, or refer the loan for collection). Upon approval by the Director, the LPM and an Assistant Director of Law take steps as necessary and appropriate to implement the approved loan restructuring.

DoD's Policy Manual requires that approval of any negotiated workout agreement or settlement including any reduction or forgiveness of any principal, interest, or fees, be approved by the County Executive or County Executive's authorized designee. Section 501.03(B) of the County Code allows the County Executive to perform any of the functions that he or she may perform under Chapter 501 through his or her duly authorized designees. Executive Order No. EO2023-0003 authorizes the Director of Development to act as the County Executive's designee related to economic and business development transactions approved by the appropriate county contracting approval authority.

Although DoD's Procedure Manual encourages taking an evidence-based approach, it gives the Loan Portfolio Manager sole discretion to decide what additional information or support documentation from the borrower is necessary.

Process Improvement Opportunity

A policy requiring an evidence-based approach for loan workouts will ensure decision-making is informed and unbiased. This can result in reduced financial losses for the County.

Recommendations

1. *(P4) DoD should consider revising its policy to require all loan workouts be consistently supported by documented evidence of a borrower's inability to adhere to the payment terms of the loan.*

Management's Response:

DoD lending mission is to support the economic growth and viability of businesses located in Cuyahoga County. Evidence based documentation is always considered and reviewed when evaluating for a decision. Other instances where a decision is made is based on several factors, including but not limited to:

- ***County's rights pursuant to agreements entered into by and between participating lenders in any given deal (e.g. Subordination Agreement, Intercreditor Agreement, etc...). These documents articulate the rights of Senior and Subordinate lenders and in all cases, the County is a subordinate lender.***

- ***Positive working relationship between Borrower and DoD that have been constant and consistent throughout the life of the loan. Several Borrowers demonstrate strong interest in maintaining current status on the County loan and in certain circumstances, this involves a modification that allows the Borrower to achieve that goal.***

The language as it relates to the Loan Portfolio Manager having sole discretion will be updated to reflect the discretion subject to DoD leadership based on the recommendation of the Loan Portfolio Management Team.

Target Date for Completion:

This corrective action will be updated into the policies and procedures by July 31, 2024.

FINDING Loan Software Lacks Sufficient IT Controls

The Department of Development's (DoD) lacks general information technology (IT) controls necessary to protect data and application controls necessary to protect transactions within the loan system.

DIA performed limited observations of IT controls of DoD's loan system (Portfol) and noted the following:

- The system does not promote the use of strong passwords: It does not require complex password parameters (alphanumeric mixed case). The only criterion is a minimum length of 8 characters.

- The system does not provide segregation of duties as it does not support an approval function: Porfol does not require system approval to prevent unauthorized recordation and modification of loans. As a compensating control, DoD policies require the DoD Director and Deputy Director sign and approve loan documents. Although the system has an audit log feature to display recordation and modification entries, DoD management does not utilize this feature to verify recordation and modification entries are supported by signed and approved loan documents.

- The department lacks a system access policy that ensures access rights for users, accounts, and computing processes is restricted to only those resources absolutely required to perform legitimate functions (least privilege access).- DIA noted that the DoD Director's and Deputy Director's levels of access in the system were not commensurate with their roles as reviewers. Each was granted access with the ability to enter, modify, and delete loan information and lending activity.

- Access termination may not be timely: Although DoD's procedure manual discusses user access management, it does not specify a time requirement for access termination. DIA noted the system access for an employee who was terminated recently was not deactivated promptly. The employee's last day was 10/31/2023; however, the deactivation of access did not occur until 11/30/2023. A memo dated 11/29/2023, signed by the Deputy Director, authorized the deactivation.

Best practice IT controls per the National Institute of Standards and Technology (NIST) include:

- Passwords should have minimum lengths of at least 8 characters and contain both numeric and alphabetic characters with mixed-case. [NIST Special Publication 800-63B Digital Identify Guidelines]

- User access should be commensurate with job functions and promote the principle of least privilege (PoLP) and segregation of duties. PoLP is a security concept advocating for users and systems to be granted the minimum necessary access or permissions to fulfill their designated tasks. Segregation of duties involves separating functions within a system, such as data entry and approval. [NIST Special Publication 800-171 Revision 2: Protecting Controlled Unclassified Information in Nonfederal Systems and Organizations]

- Effective administration of users' computer access is essential to maintaining system security. User account management focuses on identification, authentication, and access authorizations. This is augmented by the process of auditing and otherwise periodically verifying the legitimacy of current accounts and access authorizations. Finally, there are considerations involved in the timely modification or removal of access and associated issues for employees who are reassigned, promoted, or terminated, or who retire. [Special Publication 800-12: An Introduction to Computer Security - The NIST Handbook]

DoD was not previously made aware of the NIST best practices of system controls including complex password requirements, user access assignments commensurate with job functions, system-based segregation of duties, and timely termination of user access.

Risk to the County if Not Corrected

Lack of sufficient IT controls could result in:

- Compromised passwords and unauthorized access,
- Exposure of sensitive customer data and financial information resulting in reputational damage and potential legal consequences.
- Increased risk of unauthorized activity, inaccurate information, or fraud.

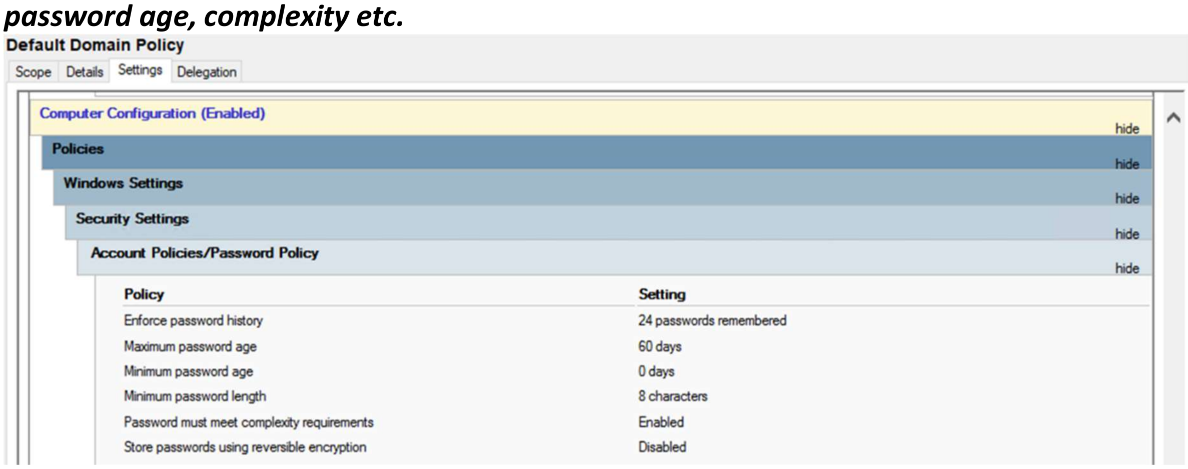
Recommendations

1. *(P1) DoD should consult with their system provider to determine if Portfol can be re-configured to require complex passwords, including both numeric and alphabetic characters with mixed-case.*

Management's Response:
Agrees – DoD agrees with recommendations #1 and #3. Recommendation 2 is already in place.

Per the email with Dept of IT:

I've confirmed that access to the SQL data is limited to an Active Directory group, AD-CUYAHOGA\ALL-DOD-PORTFOL. Users must be in that group and authenticate against AD to access the data. At that point, the normal AD password policy is controlling password age, complexity etc.



Based on this information, only the back-end database is controlled using the requirements of the Active Directory.

Target Date for Completion:

Incorporation of deactivation timeline and procedure will be added to updated ED Loan Policies and Procedures Manuals by July 31, 2024. An updated policy and procedure will also be written for Portfol user access requiring that passwords meet certain complexity requirements (essentially mirror Active Directory requirements).

This will be an automated function of the Salesforce system once it is in place (anticipated commencement of Salesforce is Q1 2025). While Portfol is in use by DoD, the Loan Portfolio Manager will engage all users every sixty days and reset all passwords and remind all users of the password length and complexity requirements when creating a new password commencing April 1, 2024.

2. (P1) DoD should implement a system access policy to restrict access rights for users, accounts, and computing processes to only those resources absolutely required to perform legitimate functions (least privilege access).

Management's Response: Same as response to #1.

Target Date for Completion: Same as response to #1.

3. (P1) DoD should update their policy to outline the expected timeframe for deactivating access of former employees in the Portfol system.

Management's Response: Same as response to #1.

Target Date for Completion: Same as response to #1.