



U.S. Department of Agriculture  
Office of Inspector General  
Western Region  
Audit Report

REVIEW OF CALIFORNIA COASTAL  
RURAL DEVELOPMENT CORPORATION  
SALINAS, CALIFORNIA



Report No.  
85099-1-SF  
December 2000



UNITED STATES DEPARTMENT OF AGRICULTURE

OFFICE OF INSPECTOR GENERAL

Western Region - Audit

75 Hawthorne Street, Suite 200

San Francisco, California 94105

TEL: 415-744-2851 FAX: 415-744-2871



DATE: December 28, 2000

REPLY TO

ATTN OF: 85099-1-SF

SUBJECT: Review of California Coastal Rural Development Corporation

TO: Celeste Cantú  
State Director  
California State Office  
Rural Development

This report presents the results of our audit of California Coastal Rural Development Corporation (Cal Coastal). The audit was conducted to evaluate a number of charges made by a complainant about alleged financial problems at Cal Coastal. All recipients of this report should be aware that this report supersedes our earlier release dated August 10, 2000. We reopened the audit at the request of Cal Coastal and Rural Development (RD) to consider additional information. Based on our expanded review of the additional information, we reached conclusions that were materially different from those in our original release.

The initial report contained findings and recommendations relating to Cal Coastal, its certified public accounting (CPA) firm, and RD. Our subsequent review has answered all of our original concerns, and we have concluded that we have no material findings regarding the operations of Cal Coastal and no evidence to support the complaint concerning Cal Coastal's ability to continue as a going concern. Regarding the CPA firm, we had raised some questions about its audit report of Cal Coastal for fiscal year (FY) 1998 and referred the issues to the American Institute of Certified Public Accountants and the California Board of Accountancy. In our subsequent work, we worked with the CPA firm in reviewing issues raised by the complainant and relied on the work of the CPA firm. Nothing came to our attention that would cause us to believe that RD and Cal Coastal should not continue to rely on the work of this CPA firm.

The complainant made a number of allegations of financial irregularities at Cal Coastal and concluded that these irregularities were material enough to impact Cal Coastal's ability to continue as a going concern. This audit was performed to investigate the complainant's allegations.

**AUDIT REPORT**

As stated, we found nothing during our subsequent review that impacted Cal Coastal's ability to continue as a going concern. We did find one minor condition related to the accounting of RD Intermediary Relending Program (IRP) funds. Cal Coastal officials were in the process of properly accounting for the IRP funds at the time of our audit.

The audit was conducted in accordance with generally accepted government auditing standards. The additional work performed was conducted in accordance with SAS 1 section 561, Subsequent Discovery of Facts Existing at the Date of the Auditor's Report.

## **BACKGROUND**

Cal Coastal is a nonprofit financial development corporation serving the financial needs of small businesses and farmers located primarily in the mid-coastal region of California, including Monterey, San Luis Obispo, Ventura, Santa Barbara, Santa Cruz, San Benito, and Southern Santa Clara counties. It operates primarily five loan programs funded by the State of California and various Federal agencies and financial institutions. Loans made under two of the programs are 90 percent guaranteed by the U.S. Department of Agriculture's Farm Service Agency or RD.

Cal Coastal's primary source of revenue from administering these loan programs is from interest earned on the loans and from loan origination and guarantee fees it receives when making the loans. Cal Coastal also has an administrative support agreement with the State of California Trade and Commerce Agency to support its core operating activities.

## **SCOPE AND METHODOLOGY**

Our review covered Cal Coastal's FY's 1997 and 1998, when the alleged irregularities occurred per the complainant, through FY 2000. Subsequent audit work was conducted during October 2000 at Cal Coastal in Salinas, California.

The following procedures were performed:

- We reviewed Cal Coastal's FY 1998 through 2000 financial statements in order to assess Cal Coastal's overall financial health (i.e., its ability to continue as a going concern.) We also interviewed staff from the CPA firm that audited Cal Coastal's FY 1998 through 2000 financial statements and reviewed their work papers on internal controls as well as their confirmations with third parties used to verify the loan and cash account balances reported in the financial statements.
- We reviewed the Trust Principal and Interest Reports for FY's 1998 and 1999 to follow up on the complainant's allegation that Cal Coastal was unable to meet its loan repayment obligations as of June 30, 1998, to the State Loan Guarantee Trust Fund administered by the State of California Trade and Commerce Agency and to assess whether Cal Coastal's repayments to the State Loan Guarantee Trust Fund were made timely in accordance with applicable laws and regulations.
- We reviewed Cal Coastal's current administrative support agreement with the State of California Trade and Commerce Agency and assessed whether it was timely

renewed and adequate to ensure Cal Coastal's ability to continue as a going concern.

- We verified to available records that Cal Coastal adequately funded all of its loan loss reserve accounts during FY's 1999 and 2000 based on program requirements.
- We verified to available records that Cal Coastal was current on all of its loan program accounts at the end of each of the prior 3 fiscal years (i.e., FY's 1998 through 2000.)
- We reviewed Cal Coastal's line-of-credit agreement with a local bank as well as assessed Cal Coastal's need for the line of credit and the timeliness at which it was repaid.
- We reviewed Cal Coastal's Cost Allocation Plans for FY's 1998 through 2000 and assessed whether the expenditures allocated to the various programs administered by Cal Coastal were allowable under Office of Management and Budget Circular A-122 and that the percentage of total cost allocated to each program appeared reasonable and was supported by a time study.
- We reviewed available records to determine whether Cal Coastal had properly funded its employees' Simplified Employee Pension Plan – Individual Retirement Account during FY's 1997 and 1998.

## **FINDINGS**

We found nothing to support the complainant's allegations about Cal Coastal's ability to continue as a going concern. We did find one minor condition related to the accounting of IRP funds. Our audit found that Cal Coastal did not properly account for the \$30,000 it received in FY's 1998 and 1999 from contracts belonging to the IRP program. The contract revenue was improperly deposited into its Corporate Fund. Cal Coastal's Chief Financial Officer (CFO) agreed that the contract revenue should have been deposited into the IRP revolving fund and stated that the error was inadvertent. Due to the error, available funds in the IRP revolving fund for relending were understated by at least \$30,000.

Section 4274.332(b) of Subpart D of RD Instruction 4274, dated February 6, 1998, states that "the receivables created by making loans to ultimate recipients, the intermediary's security interest in collateral pledged by ultimate recipients, collections on the receivables, interest, fees, and any other income or assets derived from the operation of the IRP revolving fund are a part of the IRP revolving fund."

According to Cal Coastal's CFO, Cal Coastal has contracts with the cities of Monterey and Santa Cruz among others to assist Cal Coastal in implementing their microloan programs. These are jurisdictional programs, which provide for loans (ranging from \$5,000 to \$25,000), loan guarantees, and technical assistance to certain low and moderate-income small businesses within designated areas. In helping these cities implement their microloan programs, Cal Coastal is responsible for client selection (including review by

the Cal Coastal Loan Committee and approval by the Cal Coastal Board of Directors), as well as loan documentation, disbursement, and collection. Cal Coastal is compensated for the services it provides. Cal Coastal made a total of nine microloans under the IRP program. The first loans were made on June 27, 1996, and the last loan was made on May 19, 1997. Six of the nine loans have already been paid off.

In a letter dated January 27, 1999, the complainant alleged that during FY 1998 Cal Coastal had improperly deposited \$47,262 in IRP jurisdictional contract revenues in its Corporate Fund. The complainant discovered the discrepancy while reviewing Cal Coastal's cost allocation formulas. The complainant had noted that while costs for operating the microloan program under the jurisdictional contracts were charged to the IRP program, the revenue or fees generated from such charges were deposited to the Corporate Fund.

We followed up with Cal Coastal's CFO on the allegation and determined that in FY's 1998 and 1999, Cal Coastal had indeed received IRP jurisdictional contract revenue that was deposited into the Corporate Fund. However, the amount in question totaled only \$30,000 (\$20,000 received in FY 1998 from the City of Monterey and \$10,000 received in FY 1999 from the City of Santa Cruz), not the \$47,262 alleged by the complainant.

The CFO acknowledged in a memo dated October 20, 2000, that a review of the accounting records revealed that the payments from the two cities were inadvertently credited to the "Other Jurisdictional Income Account" within the Corporate Fund and that these payments should have been credited to the IRP program. In the memo, the CFO also indicated the proposed adjusting journal entries that would be made in order to correct the error. The CFO further noted that there would be no effect on Cal Coastal's FY 2000 operating income or consolidated net worth since these entries simply represented a transfer of retained earnings (fund balances) between the Corporate Fund and the IRP program for the prior year transactions.

In addition to the \$30,000 received in FY's 1998 and 1999, we determined that Cal Coastal might have also received an additional \$60,000 in IRP jurisdictional contract revenue in FY 1997. However, we were unable to verify both the amount received and whether it had been properly accounted for, since this was not easily determinable from the accounting records. According to the CFO, some of the accounting records for FY 1997 were incomplete due to staff turnover. As a result, the CFO stated that he would need additional time to sort through all of FY 1997's accounting records to verify both the amount of IRP jurisdictional contract revenue received during FY 1997 and whether it had been properly accounted for.

### **Recommendation No. 1:**

Confirm with Cal Coastal that the proposed adjusting journal entries indicated in the October 20, 2000, memo have been made and that the \$30,000 in IRP jurisdictional contract revenue received in FY's 1998 and 1999 has been properly accounted for.

**RD Response:**

In its written response to the draft report, dated December 19, 2000, RD stated that it would work with the California Coastal Rural Development Corporation to comply with the recommendation by January 31, 2001.

**OIG Position:**

We accept RD's management decision on this recommendation.

**Recommendation No. 2:**

Ensure that Cal Coastal determines the amount of IRP jurisdictional contract revenue it received during FY 1997 (estimated at \$60,000 per our audit) and that appropriate adjustments are made to correct any errors.

**RD Response:**

In its written response to the draft report, dated December 19, 2000, RD stated that it would work with the California Coastal Rural Development Corporation to comply with the recommendation by January 31, 2001.

**OIG Position:**

We accept RD's management decision on this recommendation.

**CONCLUSION**

Based on RD's response to our report, we have reached management decision on the recommendations in this audit. RD's response is shown in Exhibit B, and Cal Coastal's response is shown in Exhibit C.

RD needs to provide the USDA Office of the Chief Financial Officer with the final action correspondence related to this audit. Please note that Departmental Regulation 1720-1 requires final action to be taken within 1 year of each management decision.

We appreciate the cooperation and assistance the Cal Coastal and RD staffs provided to our auditors during the audit.

/s/

SAM W CURRIE  
Regional Inspector General  
for Audit

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**EXHIBIT A – SUMMARY OF MONETARY RESULTS**

<b>RECOMMENDATION NUMBER</b>	<b>DESCRIPTION</b>	<b>AMOUNT</b>	<b>CATEGORY</b>
1	Jurisdictional contract revenue received in FY's 1998 and 1999 belonging to IRP not properly accounted for	\$30,000	FTBPTBU <sup>1</sup> - Improper Accounting
2	Jurisdictional contract revenue received in FY 1997 belonging to IRP that might not have been properly accounted for	\$60,000 (estimated)	FTBPTBU - Improper Accounting
<b>TOTAL</b>		\$90,000 (estimated)	

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<sup>1</sup> Funds To Be Put To Better Use

## EXHIBIT B – RURAL DEVELOPMENT RESPONSE



**Rural  
Development**  
Celeste Cantú, State Director  
Business . Housing . Utilities

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State Director  
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December 19, 2000

Mr. Sam Curry  
Office of Inspector General  
United States Department of Agriculture  
75 Hawthorne Street, Suite 200  
San Francisco, CA 94105

Subject: Review of California Coastal Rural Development Corporation  
Audit #85099-1

Dear Mr. Curry:

USDA Rural Development has reviewed the findings and the recommendations of the subject audit and we concur with them.

We will work with the California Coastal Rural Development Corporation to comply with the recommendations by January 31, 2001.

If you have any questions or need clarification, please contact Chuck Clendenin, Business and Cooperative Program Director, at 530-792-5825.

Sincerely,

A handwritten signature in black ink, appearing to read "Celeste Cantu", written over the typed name.

CELESTE CANTU  
State Director

C: California Coastal Rural Development Corporation  
Rita Medina, USDA Rural Development, Davis

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Secretary of Agriculture, Washington, D.C. 20250

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## EXHIBIT C – CALIFORNIA COASTAL RURAL DEVELOPMENT CORPORATION RESPONSE



Rural Development Corporation

December 14, 2000

Mr. Sam Currie  
Regional Inspector General for Audit  
U. S. Department of Agriculture  
Office of the Inspector General  
75 Hawthorne Street, Suite 200  
San Francisco, CA 94105

Dear Mr. Currie:

We have reviewed your draft report of December 12, 2000 (which supercedes the original report dated August 10, 2000 ). In general, we are in substantial agreement with the overall findings and conclusions, but believe the following issues need to be addressed:

#### Trust Principal and Interest Reports

The complainant's allegations were predicated upon outdated State regulations pertaining to the timing of principal and interest payments. You verified that our operations have been in compliance with State regulations in effect since February, 1994.

#### Loan Loss Reserves

You were able to verify to available records that we were in compliance with the cash loan loss reserves required by the various funding agencies including the NADBANK-CAIP program. You were able to verify that a reasonable standard was used for determining the adequacy of our allowance for loan losses. These are in addition to any cash reserves required to be maintained.

We applaud the supportive comments in the second paragraph of the report concerning our current CPA firm. However, the last sentence of this paragraph appears to be out of context and infers an unsettled and negative connotation. We suggest that this sentence be removed from the final draft.

All of us at Cal Coastal appreciate the very professional and prompt manner exhibited by your field staff in conducting the additional work. They should be complimented on their tenaciousness in handling this unfortunate situation.

Sincerely yours,

Herb Aarons  
President