

AUDIT OF
COLORADO DISTRICT OFFICE 7(a) LOANS
DENVER, COLORADO
AUDIT REPORT NO. 9-05
February 24, 1999



US SMALL BUSINESS ADMINISTRATION
OFFICE OF INSPECTOR GENERAL
Washington, DC 20416

AUDIT
REPORT

Issue Date: February 24, 1999

Number: 9-05

To: Patricia Barela Rivera, District Director
Colorado District Office

Charles E. Shepperson, Assistant Administrator
for Financial Program Operations

From: 
Peter L. McClintock, Assistant Inspector General
for Auditing

Subject: Audit of Colorado District Office 7(a) Loans

Attached is a copy of the subject report. The report contains two findings with seven recommendations for the Colorado District Office Director and the Assistant Administrator for Financial Program Operations.

The recommendations in this report are subject to review and implementation of corrective action by your office in accordance with existing Agency procedures for audit follow-up. Please provide your management response within 30 days from the date of this report, using the attached SBA Forms 1824, Recommendation Action Sheet.

Any questions or discussion of the issues contained in the report should be directed to Garry Duncan at (202)-205-7732.

Attachment

**AUDIT OF 7 (a) LOAN PROCESSING
COLORADO DISTRICT OFFICE
DENVER, COLORADO**

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SUMMARY

The audit was part of a nationwide review to determine whether 7(a) loans were processed, disbursed, and used in accordance with Small Business Administration requirements. The Colorado District Office was assigned 857 loans valued at \$274.3 million from March 1, 1996, to June 30, 1997. The sample loans, made to small business concerns within the state of Colorado, were processed by the District Office and the Preferred Lender Program Loan Processing Center. We selected a random sample of 30 loans valued at \$11.1 million for review.

SBA procedures for lenders and SBA loan officers are intended to reduce risks and assure that only eligible loans are guaranteed. Failure to follow these procedures increases the chance that ineligible or risky loans will be approved. We reviewed lenders' compliance with 22 such procedures. We determined that lenders did not follow at least 1 of the 22 SBA procedures for 12 of the 30 loans reviewed.

The noncompliance with procedures consisted of the following:

- The borrower of a * loan did not provide adequate support that the business could repay the loan.
- Lenders for two loans totaling \$491,000 did not properly evaluate borrower creditworthiness.
- Proceeds from a * loan and part of the proceeds from a * loan were for ineligible purposes.
- Cash injections totaling \$27,730 were not verified prior to disbursement of three loans valued at \$697,000.
- Part of the disbursement of a * loan exceeded the amount authorized for working capital.
- Business financial information was not verified with the Internal Revenue Service for a loan valued at *.
- Settlement sheets for four loans either were not completed or signed in blank.
- The lender of a * loan did not verify use of proceeds.
- Joint payee checks were not used to disburse proceeds for a * loan.
- The lender for one loan did not disclose a character issue to SBA.

The report contains recommendations to the District Director and the Assistant Administrator for Financial Program Operations to rescind loan guarantees when appropriate and to take corrective actions to prevent reoccurrence of the problems.

As of September 15, 1998, 24 of the 30 sampled loans were current, 4 were canceled, 1 was in liquidation, and 1 was undisbursed. Lender responses regarding the loans indicated the deficiencies were generally due to loan officers choosing to ignore SBA policy and unintentional loan officer errors.

The findings in this report are the conclusions of the OIG's Auditing Division based on testing of the auditee's operations. The findings and recommendations are subject to review, management decision, and corrective action by your office in accordance with existing Agency procedures for follow-up and resolution.

INTRODUCTION

A. BACKGROUND

Audits of the Small Business Administration (SBA) LowDoc Loan Program (a subsection of the 7(a) Loan Program) in 1996 and 1997 showed that lenders and SBA district offices were not always processing loans in compliance with existing policies and procedures. At the request of SBA's Office of Financial Assistance, we initiated an audit of the 7(a) Loan Program to determine if a similar level of non-compliance exists. Our evaluation will be presented in a summary report combining the results of eight individual audits. This report presents the audit results for one site.

Section 7(a) of the Small Business Act of 1958, as amended, authorizes SBA to provide financial assistance to small businesses. SBA provides this financial assistance primarily by guaranteeing loans made by participating lenders to small businesses. To obtain the SBA guarantee, a lender must have continuing ability to evaluate, close, service, and liquidate loans in accordance with SBA requirements. A Loan Guaranty Agreement between SBA and the lender requires the lender to abide by SBA regulations and procedures and allows the lender to request SBA purchase of defaulted loans.

Generally, SBA regulations and procedures require both the lender and SBA to review the borrower's eligibility, repayment ability, management qualifications, character, creditworthiness, and adequacy of collateral for loans submitted under regular procedures. The most active and expert lenders qualify for SBA's Certified Lender Program (CLP) and Preferred Lender Program (PLP), respectively. Under CLP procedures, SBA utilizes the credit presentation of the lender and makes a credit and eligibility determination. Under PLP procedures, the Sacramento PLP Loan Processing Center reviews loan applications solely for eligibility.

B. AUDIT OBJECTIVE AND SCOPE

The audit objective was to determine whether 7(a) loans (excluding special programs with modified requirements such as LowDoc) were processed and proceeds disbursed and used in accordance with SBA requirements. The audit was based on a statistical sample of 30 loans (see Appendix A) valued at \$11.1 million out of a population of 857 loans totaling \$274.3 million made to small businesses in the state of Colorado and assigned to the Colorado District Office between March 1, 1996, and June 30, 1997.

The auditors reviewed compliance with 22 procedures established by SBA to reduce risks associated with loan making and to assure that only eligible loans are guaranteed (see Appendix B). To make these determinations, the auditors reviewed lender and SBA file documentation for each loan in the sample; interviewed borrower, lender, and SBA district office personnel; and visited businesses to review records. Fieldwork was performed from May through August 1998. The audit was conducted in accordance with Government Auditing Standards.

RESULTS OF AUDIT

FINDING 1 SBA 7(a) Guaranteed Loans were not always Processed, Disbursed, and Proceeds Used in Accordance with SBA Requirements

SBA procedures for lenders and SBA loan officers are intended to reduce risks and assure that only eligible loans are approved. The chance that risky or ineligible loans will be approved is increased when these procedures are not followed. In our sample, at least 1 processing or disbursing deficiency was identified for 12 of the 30 loans reviewed. Noncompliance with established procedures resulted in SBA inappropriately providing \$130,000 in guarantees for 2 loans (*sample numbers 14 and 18*). Also, loan proceeds totaling \$2.4 million were used for an ineligible purpose (*sample numbers 22 and 23*), equity injections totaling \$27,730 were not made (*sample numbers 7, 25, and 28*), and \$12,669 of working capital disbursements were not approved by SBA (*sample number 11*). In following up on deficiencies for the remaining 4 loans (*sample numbers 4, 9, 15, and 21*), the auditors found no actual adverse effect.

Borrower lacked repayment ability

One borrower, who received a $\$100,000$ loan (*sample number 14*), lacked repayment ability. The loan was approved in $\$100,000$ to purchase business machinery and equipment. This loan and a companion SBA working capital loan for $\$100,000$ were made simultaneously. The borrower reported sales of \$11,700, \$20,200, and \$26,100 from 1994 through 1996. For each of those years, cash flow and net income were negative. The borrower, however, projected sales of \$522,200 and \$1,200,000 for 1997 and 1998, respectively. These projections represented a 1,900 and 4,497 percent increase over 1996 sales. Support for the significant projection of increased sales included three invoices and a draft contract to the same customer. Consideration was not given, however, to the effect on the borrower's repayment ability if the contract was not executed. The risk of failure increases significantly when relying upon one customer for success. The lender stated that the loan failed because the borrower was unable to attain projected sales. As of September 15, 1998, the loan was in liquidation.

Evaluation of creditworthiness

Lenders for two loans totaling \$491,000 did not adequately evaluate creditworthiness of the borrowers or inform SBA of credit issues that could have affected loan approval. Title 13 Code of Federal Regulations (CFR) Section 120.150 states that applicants must be creditworthy, including character, reputation, and credit history. The borrower, its associates, affiliated businesses, and guarantors are evaluated for creditworthiness.

A loan for $\$100,000$ (*sample number 18*) was approved $\$100,000$ for leasehold improvements, machinery, working capital, and debt repayment. The borrower's credit report showed four Federal tax liens which had been released, one which had not been released, a state tax lien, a bankruptcy, a charged off account, several late payments, and a suspension of its business charter. The lender provided proof that the state tax lien was paid and provided documentation explaining the bankruptcy and liens. We requested evidence that the bankruptcy had been discharged and that the Federal tax lien had been released, but the lender could not

provide the evidence. Repeated failure to pay taxes and suspension of a business charter indicate a less than creditworthy character. The loan was current as of September 15, 1998.

The lender of a [redacted] loan (*sample number 19*) for construction of a car wash, purchase of equipment and inventory, and working capital did not obtain sufficient evidence that the borrower was creditworthy. The lender did not obtain a credit report of the borrower's affiliated businesses. Instead, a letter from one bank stating that the borrower was a good credit risk was used. The lender's credit analysis stated that the borrower's other businesses could be relied upon for repayment of the loan if the car wash could not generate sufficient funds to make the loan payments. Without reviewing the credit history of the borrower's other businesses, the lender had no basis for this assertion. The loan was current as of September 15, 1998.

Loan proceeds were used for an ineligible purpose

A [redacted] PLP loan (*sample number 23*), approved in [redacted], should have been processed using regular 7(a) procedures. The proceeds were to be used to liquidate a construction loan the PLP lender had previously made to the borrower. When loan proceeds are to be used to reduce the lender's risk, SBA regulations prohibit approval under PLP procedures. Section 120.452 of the CFR states that a lender may not make a PLP loan that reduces its existing credit exposure for any borrower. In addition, Section 120.140 requires a lender to process the loan under regular procedures and to provide a full explanation to SBA that the loan will repay or refinance debt owed to the lender and would reduce the lender's exposure to a loss. Section 120.140 also prohibits a lender from engaging in transactions which could result in a real or apparent conflict of interest. When funding became available from another Federal Government agency, the lender canceled the loan.

Part of the proceeds of a [redacted] loan (*sample number 22*) were used for an ineligible purpose. The borrower contracted with her parents to research, develop, and subcontract construction of an assisted care facility. She agreed to pay her parents 60 percent of the difference between the construction costs and the appraised value of the facility. Additionally, the borrower agreed to pay the parents' living expenses during the construction and for one year after the completion of the project. In May 1996, the parents agreed to accept \$490,000, of which \$390,000 was paid from the loan proceeds. The remaining \$100,000 was subordinated to the SBA debt and placed on stand-by with interest of 10 percent.

The lender did not inform SBA that the basis of the payments to the parents failed to conform with ordinary compensation for the services rendered. The compensation was not ordinary because it was based on a subjective value such as an appraisal rather than actual costs that could be documented. The approving SBA loan officer stated that she would not have approved the loan if she had known the payment to the parents was on a percentage of equity basis rather than actual costs incurred. Additionally, another SBA loan officer stated that he did not consider percentage of equity as ordinary compensation for services rendered.

Section 120.130 of the CFR states that SBA will not authorize, nor may a borrower use, loan proceeds for payments, distributions, or loans to associates of the applicant (except for ordinary compensation for services rendered). The SBA guarantee of [redacted] should be reduced by the \$390,000 paid to the parents of the borrower. As of September 15, 1998, the loan was current.

Equity injections were not verified

Lenders did not ensure that all required equity injections were made for three loans totaling \$697,000. By not complying with the loan requirements, lenders increased the risk that borrowers may not remain committed to the business or the business may not have sufficient cash flow to sustain operations. Required equity injections, totaling \$27,730, could not be verified.

A loan for [redacted] (sample number 7) for the purchase of an existing business was approved in [redacted]. The loan agreement required the borrower to make an equity injection of at least \$75,000 prior to the first disbursement. The lender's loan file contained evidence that \$70,228 was injected prior to disbursement of the loan proceeds. The remaining injection of \$4,772 should be made. As of September 15, 1998, the loan was current.

A loan (sample number 25) was approved in [redacted] to repay a \$380,000 note. The loan agreement required the lender to have evidence that the borrower injected at least \$139,200 into the business. The lender did not verify that the borrower had injected the entire amount. The lender obtained a check issued by the borrower to the business for \$100,000, a promissory note for \$20,000 (as required by the loan authorization) and several checks totaling \$19,276. These checks, however, were drawn on the business checking account to pay vendors and were not an equity injection by the borrower into the business. The borrower admitted that he injected only \$120,000. The borrower should inject the remaining equity of \$19,200. As of September 15, 1998, the loan was current.

A [redacted] loan (sample number 28) was approved in [redacted] to purchase land and a building. The loan agreement required the borrower to make an equity injection of \$3,758 to pay the SBA guarantee fee. The guarantee fee was paid by a third party, who accepted a promissory note from the borrower. The lender could not provide evidence that the promissory note had been paid. Thus, there was no evidence that the borrower had injected the funds as required by the loan agreement. The remaining equity injection of \$3,758 should be made. As of September 15, 1998, the loan was current.

Disbursements not made per the loan agreement

A loan for [redacted] (sample number 11) was approved in [redacted] for debt repayment, equipment, and working capital. The loan agreement allowed \$7,550 for working capital, but the lender disbursed \$20,219 for this purpose. According to the lender, this occurred because the debt repayment and equipment costs were less than originally estimated. The lender should have requested approval from SBA to modify the loan agreement to allow for an increase in working capital. The loan was current as of September 15, 1998.

Financial information was not verified prior to disbursement

A loan for [redacted] (sample number 19) was approved for construction of a car wash and the purchase of business equipment, inventory, and working capital in [redacted]. As required, the lender requested Internal Revenue Service (IRS) verification of the tax returns for

1994 and 1995. The lender, however, could not provide proof that the verifications were received from the IRS. After our review of the loan files, the lender obtained an IRS verification of the 1994 and 1995 tax returns. The borrower-furnished financial information agreed with the IRS verification. As of September 15, 1998, the loan was current.

Settlement sheet deficiencies

The settlement sheets (SBA Form 1050) for four loans totaling \$376,800 were not prepared properly. The settlement sheet states that it must be signed and returned to the SBA immediately after each disbursement. The sheets for three loans (*sample numbers 4, 11, and 14*) were signed by the borrower prior to disbursement. One settlement sheet was signed before disbursement because the borrower was in a remote location and it was difficult to obtain signatures. For another loan (*sample number 7*), the settlement sheet was not prepared. The lender could not provide a reason for the omission. By not complying with the requirement to properly prepare settlement sheets, the lender violated a control established to ensure proper disbursement and use of loan proceeds. These deficiencies, however, were not serious enough to invalidate the loan guarantees. As of September 15, 1998, three of the loans were current, with the fourth in liquidation.

Use of proceeds not verified

A loan for [redacted] (*sample number 15*) was approved in [redacted] for working capital. The loan agreement required that disbursements for working capital be accounted for by receipts, invoices, or other evidence satisfactory to the lender. The loan file did not contain any documentation supporting the use of proceeds. The lender could not explain why there was no support for the use of proceeds in the file. A visit to the borrower disclosed that the proceeds were used properly. The loan was current as of September 15, 1998.

Required joint payee checks were not used

Joint payee checks were not used to disburse a loan (*sample number 18*) for [redacted]. Disbursements of \$56,591 of loan proceeds designated as other than working capital were made payable to the borrower. SOP 70 50 2, paragraph 3.F(1) and SBA Form 1050 require that lenders use joint payee checks to disburse loan proceeds when disbursements were for other than working capital. By not complying with this requirement, the lender increased the risk that the loan proceeds could be improperly used. A review of the use of the loan proceeds disclosed they were properly used. As of September 15, 1998, the loan was current.

Character issue not disclosed to SBA

A loan for [redacted] (*sample number 21*) was approved in [redacted] for construction, purchase of machinery and equipment, working capital, and debt refinancing. The initial loan request in May 1996 was denied due to concerns about sufficient cash flow to repay the loan and working capital. In July 1996, the lender requested SBA to reconsider loan approval. About a month earlier, however, the lender learned from the IRS that the tax returns of a co-borrower, submitted with the application, had never been filed with the IRS. In the letter requesting reconsideration, the lender did not disclose this questionable character issue to SBA. Section

120.150 states that a borrower must have good character. SBA loan officers stated that they would not approve a loan in which a co-borrower was three years delinquent in filing income tax returns. The lender canceled the loan in February 1997 when the applicant did not provide requested information.

Relationship of loan deficiencies to SBA oversight

The majority of loans with deficiencies were originated when SBA had limited or no oversight of lenders' loan processing and disbursing. For certain loan processing and disbursing actions, an SBA district office would normally be unaware of how and when the actions were done because no documentation of the actions was required to be submitted to SBA. These actions include, but are not limited to, equity injections, IRS verifications, and use of loan proceeds. District offices are unaware of most actions for loans processed under PLP procedures.

Of the 18 deficiencies identified, 16 were processing or disbursing actions not normally reviewed by or reported to SBA under existing procedures. As a result, the deficiencies generally would not be identified by SBA under existing procedures until after the loan defaulted and the lender requested the guarantee be honored. The remaining two deficiencies should have been identified during the SBA loan officer's review.

Reasons for lender deficiencies

As mentioned above, we determined that lenders were responsible for all the deficiencies identified. Lenders were interviewed to find out why the deficiencies occurred and provided the following reasons:

Loan officers chose to use other than SBA policy	9 deficiencies
Loan officers made an unintentional error	7 deficiencies
Loan officers disagreed	2 deficiencies

These issues will be further addressed in a summary audit report on the 7(a) Loan Program because actions to minimize SBA's risk must be implemented Agency-wide.

Recommendations

We recommend that the Colorado District Office Director take the following actions:

- 1.A. Require the remaining equity injection for sample number 7 be made or notify the lender that SBA may deny liability in whole or part if requested to purchase the guarantee.
- 1.B. Require SBA loan officers to thoroughly review repayment ability and creditworthiness for regular 7(a) loans.

- 1.C. Reduce the loan guarantee for sample number 22 by the \$390,000 paid to an associate of the borrower.
- 1.D. Re-emphasize to lenders their responsibility to comply with SBA loan requirements, to ensure
- loans are for eligible purposes,
 - loan proceeds are used for authorized purposes,
 - SBA approval is obtained for loan agreement modifications,
 - required cash and equity injections are made and properly documented,
 - financial data are verified with the IRS prior to disbursement of loan proceeds,
 - borrowers are creditworthy and eligible for loans,
 - borrowers have evidence of repayment ability,
 - joint payee checks are used, and
 - compensation agreements are completed and sent to SBA.

We recommend that the Assistant Administrator for Financial Program Operations direct the servicing center to take the following action:

- 1.E. Require the remaining equity injections for sample numbers 25 and 28 be made or notify the lenders that SBA may deny liability in whole or part if requested to purchase the guarantees.

Management Response

The District Director agreed with our recommendations and stated that: (i) the borrower for sample number 7 will be required to make the remaining equity injection; (ii) additional loan officer training will stress the importance of solid documentation in the file prior to making a loan decision; (iii) guarantee reduction will be requested for sample number 22 after the loan file is reviewed; and (iv) lender responsibilities will be emphasized in training seminars.

The Assistant Administrator for Financial Program Operations agreed with the recommendation and stated that the Colorado District Office will be requested to verify that the remaining equity injections were made. If not made, the District Office will be requested to review the loan documentation and make a recommendation to deny liability, in whole or part, should purchase be requested.

Evaluation of Management's Response

The planned actions are responsive to our recommendations.

FINDING 2 A Loan was not Disbursed within the Required Timeframe

A loan for [REDACTED] (sample number 3) was not disbursed within the time limits specified in the loan agreement. The loan was approved in [REDACTED] for construction of a building, construction loan interest, closing costs, and debt repayment. The loan agreement required the first disbursement be made not later than 12 months from the approval date, unless such time is extended by prior written consent of SBA. The lender had not requested an extension of the disbursement date. The primary reasons for the delay in disbursement of funds were the inability of the borrower to obtain a permit for a parking lot, problems leasing equipment, and design changes. The lender stated that it would obtain updated financial statements prior to disbursing the loan. The loan had not been disbursed as of September 15, 1998.

Each loan applicant provides financial and background data to indicate their credit-worthiness and repayment ability. Lenders supplement this information with credit reports and tax information from the IRS. This information is used as the basis for loan approval; therefore, it should be accurate and timely. SOP 50 10 3 requires personal financial information be provided within 90 days of the application date. Also, an interim business financial statement for the current period should be prepared when the year-end business financial statement is not within 90 days of the application date.

By not identifying and canceling the loan, SBA risked disbursement of loan proceeds based on outdated credit and financial information. In addition, guarantee authority that could have been applied to other loans remained obligated unnecessarily.

Recommendations

We recommend that the Assistant Administrator for Financial Program Operations direct the PLP Loan Processing Center to take the following actions:

- 2.A. Require the lender to either request an extension of time to disburse loan proceeds or cancel the loan. If an extension is requested, require the lender to obtain updated financial information prior to disbursement.
- 2.B. Inform all lenders of the requirement to either request an extension of the disbursement period or request cancellation of the loan guarantee when disbursements are not made within the specified time limit.

Management Response

The Assistant Administrator agreed with the recommendations and stated that the PLP Loan Processing Center will be requested to advise the lender of the need to extend the disbursement period or cancel the loan. The PLP Loan Processing Center will also be requested to remind all lenders of the need to extend disbursement periods or cancel loans when disbursements have not been made within disbursement periods.

Evaluation of Management Response

The planned actions are responsive to our recommendations.

Other Matters

Borrower Misrepresentations

The auditors requested criminal history reviews for the principals identified as a borrower of each loan. The results of the criminal history checks showed that 4 borrowers (*sample numbers 7, 13, 15 and 24*) did not state that they had a criminal history, when in fact they did. Their histories, however, did not contain offenses that were serious enough to preclude financial assistance from SBA.

Appendix A

Schedule of Loans Reviewed and Their Status as of September 15, 1998

SAMPLE NUMBER	DATE	AMOUNT	STATUS	TYPE
1	7	75	Current	CLP
2	7	80	Current	PLP
3		63.8	Undisbursed	PLP
4		80	Current	PLP
5		75	Current	REGULAR
6		80	Current	PLP
7		75	Current	CLP
8		75	Current	CLP
9		75	Current	REGULAR
10		N/A	-----	---
11		75	Current	CLP
12		75	Current	PLP
13		75	Canceled	REGULAR
14		75	Liquidation	REGULAR
15		80	Current	PLP
16		75	Canceled	CLP
17		75	Current	REGULAR
18		80	Current	REGULAR
19		75	Current	REGULAR
20		75	Current	CLP
21		75	Current	REGULAR
22		67.3	Canceled	CLP
23		37.5	Canceled	CLP
24		75	Current	PLP
25		75	Current	PLP
26		75	Current	PLP
27		75	Current	PLP
28		75	Current	PLP
29		75	Current	PLP
30		75	Current	PLP
31		75	Current	CLP

Ex. 4

Ex. 4

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Schedule of Procedures Reviewed and the Related Loans with Discrepancies

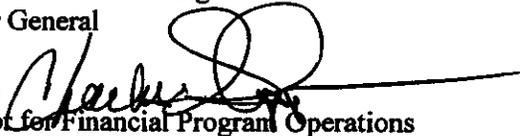
Procedures Reviewed	Loans with Discrepancies
1) Inadequate evidence of repayment ability	E *
2) No repayment ability calculation documented	E *
3) Lack of character/creditworthiness (including lack of credit reports)	E *
4) Conflict of interest	E *
5) Alternative sources of funds availability	E *
6) Size standards	E *
7) Ineligible loan purpose or ineligible use of proceeds	E *
8) Unallowed business type	E *
9) IRS verification not done	E *
10) IRS verification done after disbursement of loan	E *
11) False/inaccurate financial information provided	E *
12) 1050 Settlement sheet signed in blank	E *
13) 1050 Settlement sheet not prepared	E *
14) Disbursements not made per loan authorization requirements	E *
15) Joint payee checks not used	E *
16) Use of proceeds not verified or not used in accordance with the loan agreement	E *
17) Required equity injections not verified	E *
18) Adverse change not reported	E *
19) All available and needed collateral not used	E *
20) Disbursements not per the required time frame	E *
21) Required standby agreement not obtained	E *
22) Unallowable fees charged borrowers	E *



U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

DATE: February 10, 1999

TO: Peter L. McClintock
 Assistant Inspector General for Auditing
 Office of the Inspector General

FROM: Charles E. Shepperson 
 Assistant Administrator for Financial Program Operations
 Office of Financial Assistance

SUBJECT: Final Action Status – O.I.G. Report on Colorado District Office 7(a) Loans
 Audit Report No. 9-XX, December 1998

CC: Jerry P. Garner, Director , HQ-Field Liaison Division
 Richard A. Taylor, Director, Preferred Lender Program Loan Processing Center
 Raymond B. Snyder, Chief, Administrative Branch

We have reviewed your Audit report on 7(a) guaranteed loans and have the following comments on your recommendation:

Recommendation 1. E. Request the lender to release SBA from the loan guarantee for sample 23.

Response: We concur. The Colorado District Office will be requested to verify that "Sample 23" was canceled. If not cancelled, the District Office will be requested to review the loan documentation and then make a recommendation of whether the lender should release the SBA.

Target Dates: 3/31/99 Colorado District Office completes review of case.
 5/31/99 Headquarters completes review and recommends lender actions, if necessary.

Recommendation 1. F. Require the remaining equity injections for sample numbers 25 and 28 be made or notify lenders that SBA may deny liability in whole or part if requested to purchase the guarantees.

Response: We concur. The Colorado District Office will be requested to verify that the remaining equity injections were made. If not made, the District Office will be requested to review the loan documentation and make a recommendation whether the SBA should deny liability, in whole or part, should purchase be requested. Lender will be notified by District if repair or denial action is taken.

Target Dates: 3/31/99 Colorado District Office completes review of case.
 5/31/99 Headquarters completes review and recommends Lender actions.

Memo to Mr. McClintock
Re: Final Action Status – O.I.G. Report on Colorado District Office 7(a) Loans
Audit Report No. 9-XX, December 1998
February 10, 1999 – page 2

Recommendation 2. A. **Require the lender to either request an extension of time to disburse loan proceeds or cancel the loan. If an extension is requested, require the lender to obtain updated financial information prior to disbursement**

Response: We concur. The PLP Loan Processing Center will be requested to advise the lender of the need to extend the disbursement period or cancel the loan in question.

Target Date: 3/31/99 The PLP Loan Processing Center advises lender of the need to extend the disbursement period or cancel the loan in question.

Recommendation 2. B. **Inform all lenders of the requirement to either request an extension of the disbursement period or request cancellation of the loan guarantee when disbursements are not made within the specified time limit.**

Response: We concur. The PLP Loan Processing Center will be requested to remind all lenders of the need to extend disbursement periods or cancel loans when disbursements have not been made within disbursement periods.

Target Dates: 3/31/99 The PLP Loan Processing Center will send a letter to all PLP Lenders and remind them of the need to extend disbursement periods or cancel loans when disbursements have not been made within disbursement periods.



U.S. SMALL BUSINESS ADMINISTRATION
721-19TH STREET, SUITE 426
DENVER, CO 80202-2517

SERVING THE STATE OF COLORADO

Date: February 9, 1999
To: Peter L. McClintock, Assistant Inspector General
CC: Marvin Houle
CC: Garry Duncan
Thru: Patricia Barela Rivera, District Director *PR*
Thru: Steven Muhlhauser, ADD/ED *SM*
From: Ted R. Nelson, Chief, Finance Division *TN*
Subj: Audit of Colorado District Office 7(a) loans

This is in reference to your memo of December 21, 1998 to which you attached a draft of the report on the audit of our 7(a) loans last year. In reviewing the draft report we do agree with the report noting that two of the deficiencies should have been identified during processing at the District Office level. The other 16 deficiencies were at the lender level and actions not normally reviewed or reported to SBA District Office.

You have made the following recommendations and we are identifying the action we are taking based on your recommendation.

1.A. Require the remaining equity injection for sample number 7 be made or notify the lender that SBA may deny liability in whole or part if requested to purchase the guarantee.

District Office action: This is loan number *□* * *□*
is the lender, the lender is being contacted to make arrangements with the business principals to inject the additional \$4,772 that is needed on the equity injection.

1.B Require loan officers to thoroughly review all aspects of the loan application, specifically repayment ability and creditworthiness.

District Office action: This recommendation refers to two loans, *□* * *□*
↳ The processing loan officer is no longer with the Colorado District Office. Additional training with the loan officers presently in the District Office has stressed the importance of solid documentation in file prior to making a decision. In both of these cases it appears that the loan officer made a decision without all the facts available. In any event, corrective training is now in place.

1.C. Reduce the loan guarantee for sample number 22 by \$390,000 paid to an associate of the borrower.

District Office action. This refers to loan number *□* * *□*

↳ Prior to requesting reduction in the guarantee amount, we will need the

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Memo to P. McClintock
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file returned to be in a position to answer any questions the lender may have regarding this transaction. Presently the file is in Texas. We do not disagree with the findings identified in the audit.

1.D. Re-emphasize to lenders their responsibility to comply with SBA loan requirements to ensure:

- Loans are for eligible purposes
- Loan proceeds are used for authorized purposes
- SBA approval is obtained for loan agreement modifications
- Required cash and equity injections are made and properly documented
- Financial data is verified with the IRS prior to disbursement of loan proceeds
- Borrowers are credit worthy and eligible for loans
- Borrowers have evidence of repayment ability
- Joint payee checks are used
- Compensation agreements are completed and sent to SBA

District Office action. These issues are being emphasized in our lender training seminars and in the loan officer training to keep lenders informed of their obligations.

1.E. and 1.F are issues addressed to the servicing centers regarding PLP loans.

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