Performance Audit

Significant Opportunities Exist to Improve the Management of the 7(a) Loan Guaranty Approval Process

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TO: JOHN A MILLER,
DIRECTOR, OFFICE OF FINANCIAL PROGRAM OPERATIONS AND OFFICE OF PORTFOLIO MANAGEMENT

SUBJECT: AUDIT OF SBA'S 7(A) LOAN GUARANTY APPROVAL PROCESS

This report presents the results of our audit of the Small Business Administration's 7(a) loan guaranty approval process. Our objective was to determine the extent to which the Small Business Administration (SBA) was managing the 7(a) loan approval process to mitigate its risk of loss.

We conducted this audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

We appreciate the courtesies and cooperation of the SBA extended to the staff during this audit. Please direct any questions to me at (202) 205-7100 or Andrea Rambow, Acting Director, Credit Programs Group at (202) 205-4428.

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/s/
Robert A. Westbrooks
Deputy Inspector General

Executive Summary

Significant Opportunities Exist to Improve The Management of SBA's 7(a) Loan Guaranty Approval Process

Report Number 14-13

What the OIG Audited

This report presents the results of our audit of the SBA's 7(a) loan guaranty approval process. Our objective was to determine the extent to which the SBA was managing the 7(a) loan approval process to mitigate its risk of loss. We reviewed SBA regulations, policies and procedures, Government Accountability Office (GAO) standards[1] and Office of Management and Budget (OMB) guidance.[2] In addition, we reviewed SBA Strategic Plans and analyzed historical loan portfolio and resource data related to the 7(a) loan guaranty approval process.

We selected and reviewed 70 loans approved by the SBA's Loan Guaranty Processing Center (LGPC) during the period of April 1, 2011, to April 30, 2013. The approved amount for these loans totaled $58 million. We reviewed the 13 SBA loan files to assess compliance with SBA's regulations and procedures. Additionally, we performed a limited review of data in SBA's Loan Accounting System for the other 57 loans. These 57 loans were transferred to liquidation within 18 months of disbursement.

We also conducted a survey of internal controls using a random sample of 34 representatives from the Office of Capital Access (OCA) and the LGPC. Furthermore, we conducted a site visit at the LGPC located in Citrus Heights, CA, and interviewed multiple LGPC managers and loan specialists.

What the OIG Found

We determined that significant opportunities exist to improve the management of the 7(a) loan guaranty approval process to mitigate the SBA's risk of loss. Specifically, we found that LGPC management emphasized quantity over quality for 7(a) loan reviews, which was not in accordance with the strategic mission of the LGPC. Additionally, we determined that LGPC loan specialists were not provided adequate guidance and training to conduct their 7(a) loan review activities. We further identified that a decrease in the number of staff assigned to loan reviews, increase in loan size and complexity, additional LGPC responsibilities, and inadequate supervision also contributed to inappropriate loan decisions.

Based on our small judgmental sample of 13 loans approved for $13 million, we identified that 11 loans approved for $11.3 million had material underwriting deficiencies. Additionally, 6 of the 11 loans defaulted and the SBA purchased the guaranties for $4.8 million, resulting in unnecessary losses. Based on the limited reviews of 57 other loans, we found evidence indicating that 8 of these loans totaling $5.6 million should not have been approved due to repayment ability and eligibility deficiencies. Finally, we identified suspicious activity in five of the loans we reviewed.

OIG Recommendations

We recommended that the Director of the Office of Financial Program Operations revise management reports to measure quality against established targets and promote compliance with SBA requirements, ensure that quality goals are regularly communicated to LGPC staff, develop and issue appropriate guidance to loan specialists, develop and implement a staff training plan, and allocate LGPC resources to ensure risk is mitigated and quality is emphasized in accordance with the LGPC Strategic Plan. If implemented, these changes will result in significant savings for the SBA. Based on the small judgmental sample of loans reviewed in this audit alone, the identified funds to be put to better use over the next two years is at least $4.8 million.

Management Response and Actions Taken

The SBA agreed with each recommendation. During the course of the audit, the SBA (1) began tracking the results of the LGPC quality control reviews and proposed a plan to share the results with staff, (2) required lenders to submit loan applications in an organized and streamlined manner, and (3) revised its loan officer report to address complex transactions. Finally, the SBA created a temporary risk-based approach to streamline the review of 7(a) loan applications.

[1] GAO Publication AIMD-00-21.3.1, *Standards for Internal Control in the Federal Government*, November 1999.

[2] OMB Circular A-123, *Management's Responsibility for Internal Control*, December 21, 2004.

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Introduction

This report presents the results of our audit of the Small Business Administration's 7(a) loan guaranty approval process. Our objective was to determine the extent to which the Small Business Administration (SBA) was managing the 7(a) loan approval process to mitigate its risk of loss. To answer our objective, we reviewed SBA rules, regulations, policies, and procedures relevant to our audit. We also reviewed Government Accountability Office (GAO) standards[3] and Office of Management and Budget (OMB) guidance.[4] In addition, we reviewed SBA's Fiscal Year (FY) 2011- 2016 Strategic Plan (SBA Strategic Plan) and the FY 2012-2013 *OFPO/Standard 7(a) Loan LGPC (LGPC) Strategic Plan* (LGPC Strategic Plan). We also obtained and analyzed historical loan portfolio and resource data related to the 7(a) loan guaranty approval process.

We selected and reviewed 70 loans approved by the Loan Guaranty Processing Center (LGPC) during the period of April 1, 2011, to April 30, 2013. The approved amounts for these loans totaled $58 million. All 70 sampled loans were selected from a universe of 7,489 loans totaling $6.2 billion. Using an Office of Inspector General (OIG) review methodology—that we prepared based on applicable SBA regulations and Standard Operating Procedures (SOP)—we reviewed 13 SBA loan files to assess compliance with SBA's regulations and procedures. A limited review of the other 57 sampled loans included an examination of the information in SBA's Loan Accounting System to identify instances where origination deficiencies contributed to loan defaults. These 57 loans were transferred to liquidation within 18 months of loan disbursement.

In addition, we conducted a survey of internal controls using a random sample of 34 representatives from the Office of Capital Access (OCA) and the LGPC. Furthermore, we performed a site visit at the LGPC located in Citrus Heights, CA, and interviewed the LGPC managers and 15 loan specialists responsible for LGPC loan approval activities. We also interviewed one information technology specialist and the LGPC's quality control specialist. Finally, we interviewed representatives of lenders that submitted loans to the LGPC for approval. See Appendix I for the full details of our methodology. See Appendices II and III for lists of sampled loans.

We conducted fieldwork between June 2013 and March 2014. We conducted this audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

Background

The Small Business Administration

The SBA is authorized under Section 7(a) of the Small Business Act[5] to provide financial assistance to small businesses in the form of government-guaranteed loans. These loans are made by participating lenders under an agreement with the SBA to originate, service, and liquidate loans in accordance with SBA's rules, regulations, policies, and procedures. Some 7(a) loans are made by lenders using delegated

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[3] GAO Publication AIMD-00-21.3.1, *Standards for Internal Control in the Federal Government*, November 1999.
[4] OMB Circular A-123, *Management's Responsibility for Internal Control*, December 21, 2004.
[5] Title 15 U.S. Code Section 636(a).

authority, which undergo very limited review by the SBA prior to loan disbursement. Others are subject to more extensive underwriting and eligibility review and approval by the SBA before the loan is disbursed. This audit focuses on the underwriting, eligibility reviews and approval process at the LGPC for loans that are not made under delegated authority.

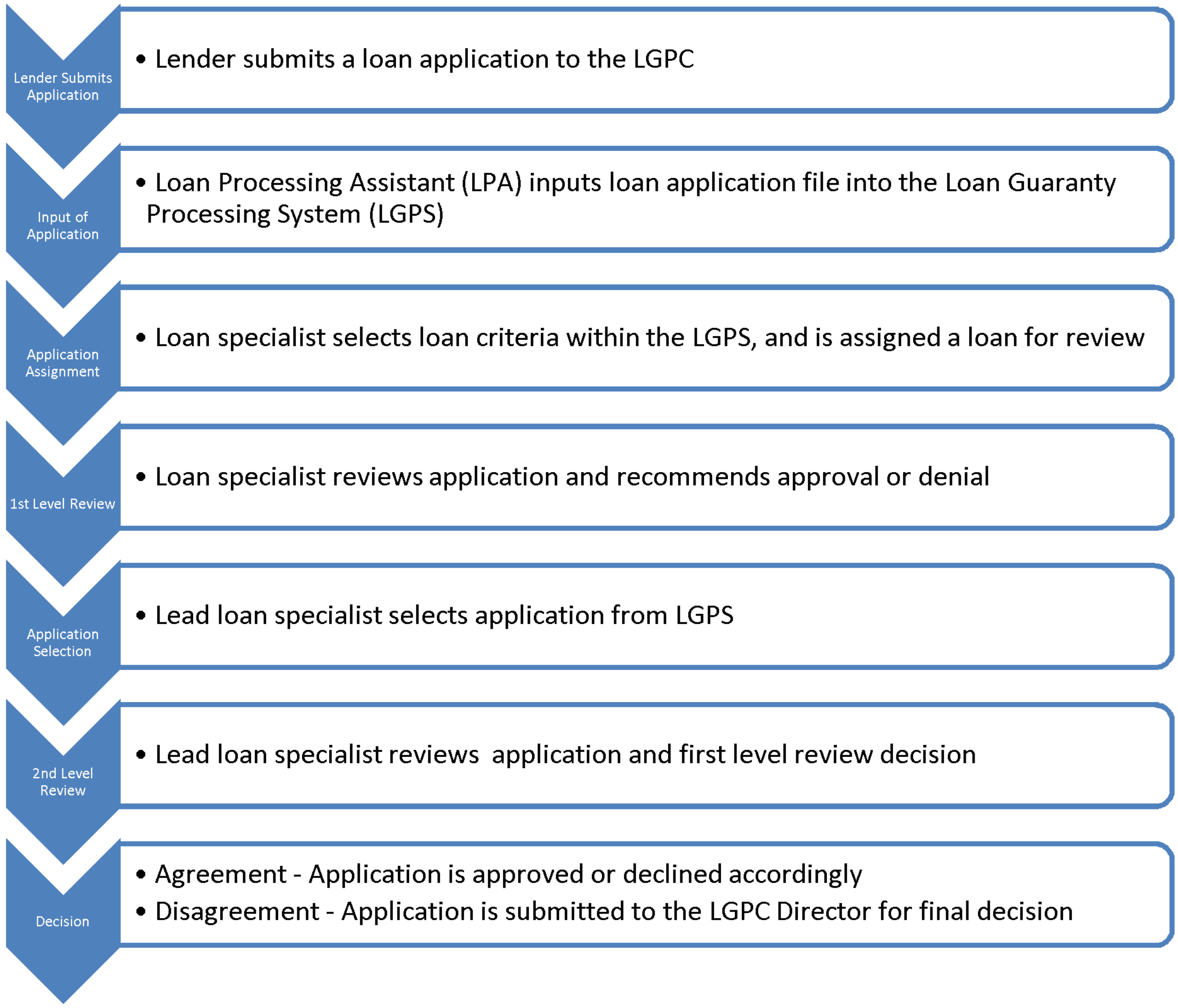
The SBA's Loan Guaranty Processing Center

The SBA, in order to centralize and promote consistency in SBA loan program operations, established the LGPC in December 2006. Prior to the LGPC's establishment, SBA field offices located throughout the United States had responsibility for reviewing 7(a) loan applications. The Office of Financial Program Operations (OFPO), which operates under the OCA, has authority over the LGPC. The LGPC, located in Citrus Heights, CA, and Hazard, KY, is responsible for approving and declining 7(a) loan guaranty applications submitted to the SBA for review. These two locations are connected electronically, function as one process, and are managed by the same Director.

The LGPC loan specialists determine borrower eligibility and credit risk, in accordance with SBA's requirements, based on information submitted by lenders. As a result, if an SBA-approved loan is ineligible or defaults because of poor underwriting decisions, the SBA may not have recourse against the lender to deny its guaranty as it does for loans approved by lenders using their delegated authority.

The LGPC has a two level review process to ensure loans are approved in accordance with SBA requirements. The LGPC loan specialists evaluate whether loan applications should be approved or denied with the final decisions being made by the lead loan specialists (leads). The leads may provide feedback and guidance to the loan specialists during the review of their loan decisions. However, if there is a disagreement between the loan specialist and a lead, the loan application is submitted to the LGPC Director, or his designee, for review and final decision. Figure 1 describes this process.

Figure 1 Basic LGPC 7(a) Loan Guaranty Review Process



Source: LGPC internal process documentation and interviews

During the loan application review, a loan specialist may contact the lender to obtain additional information or clarification. If no response is received from the lender, the loan specialist will issue one or more letters to the lender to obtain the additional information or clarification, referred to as screen-out letters. The loan application may be withdrawn by the LGPC if the lender does not respond to a screen-out letter or withdrawn voluntarily by the lender. Furthermore, in the case of a decline decision, a lender may submit the loan application for reconsideration within six-months of the decline date. Loan applications submitted for reconsideration are reviewed by different loan specialists than those who originally declined the application. If the loan application is declined a second time by the LGPC, another reconsideration may be submitted to the Director of the Office of Financial Assistance, whose decision is final.

LGPC's Quality Control Program

In 2010, the SBA established a Quality Control Program, which operates under the OFPO, to assess quality for all of its loan operation centers. The quality control program was designed to ensure that loan centers accurately and consistently apply statutory, regulatory, and procedural loan program requirements. The goals of the program are to improve services provided by the loan operation centers and reduce waste, fraud, and abuse. The LGPC quality control specialist is located at the LGPC's Citrus Heights, CA, office, but is managed by the quality control manager located at SBA headquarters in Washington, D.C. According to the LGPC quality control program guide, loans approved by the LGPC are reviewed on a monthly basis to ensure that borrowers demonstrate the ability to repay debt, are eligible, and have acceptable credit, among other criteria. It also ensures that decisions by processing staff reflect the appropriate SBA regulations and guidelines for the program under which the loan was submitted. On a monthly basis, loans approved by the LGPC are randomly selected for review. The quality control specialist conducts a review of the loan file and shares the results with the individual loan specialists who reviewed the loan.

The American Recovery and Reinvestment Act and Small Business Jobs Act

The American Recovery and Reinvestment Act of 2009[6] (Recovery Act) provided the SBA with $730 million to expand the SBA's lending and investment programs and create new programs to stimulate lending to small businesses. Of the $730 million received, $375 million was authorized for the SBA to (1) eliminate or reduce fees charged to lenders and borrowers for 7(a) and 504 loans, and (2) increase its maximum loan guaranty to 90 percent for eligible loans.[7] Pursuant to this authorization, the SBA eliminated guaranty fees charged to borrowers and increased the maximum loan guaranty percentage, but did not reduce or eliminate the ongoing yearly servicing fee charged to lenders. The SBA eliminated the borrower guaranty fees for loans approved on or after February 17, 2009, and increased the guaranty percentage for eligible 7(a) loans approved on or after March 16, 2009.

While these Recovery Act provisions were available until September 30, 2010, the funding provided by the Act was only sufficient to allow the SBA to eliminate the borrower fees and provide increased guaranties through November 2009. The President signed the Department of Defense Appropriations Act on December 19, 2009, which provided an additional $125 million for fee eliminations and increased guaranties until February 28, 2010. In addition, the Small Business Jobs Act of 2010[8] (Jobs Act) provided increased guaranties until December 31, 2010. The Jobs Act also increased the maximum 7(a) loan amount from $2 million to $5 million, which increased the maximum SBA guaranteed amount to $3.75 million.[9]

In order to address the increase in loan applications submitted to the LGPC as a result of these Acts, the LGPC was required to ramp up the number of staff using temporary employees and employees redirected from the SBA Office of Disaster Assistance.

Trends in 7(a) Loan Approval Activity

As a result of the Recovery Act and the Jobs Act, 7(a) loans submitted to the LGPC for approval have increased in both size and volume. Specifically, from Fiscal Year (FY) 2007 to FY 2008 (prior to the Recovery Act), the LGPC annually approved an average of 4,119 loans for $1.9 billion,[10] averaging

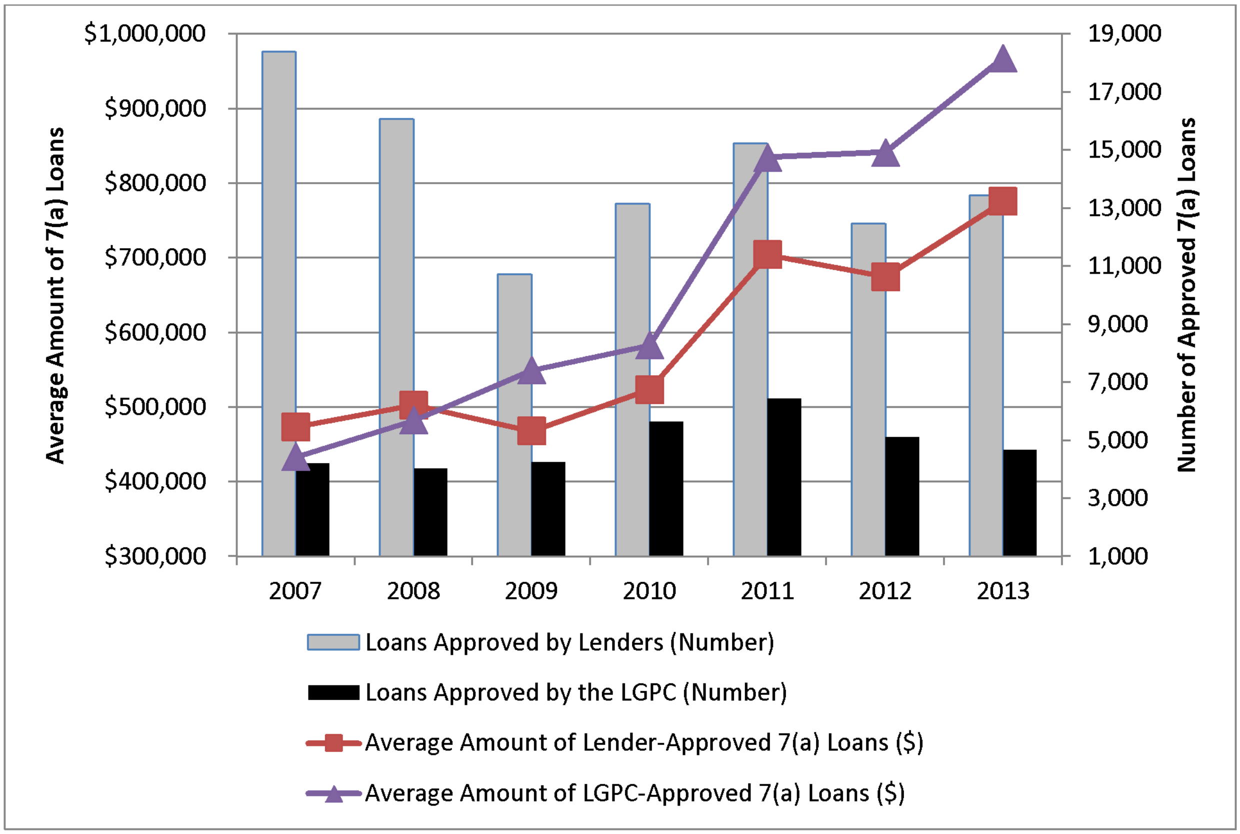
[6] Public Law 111-5, *American Recovery and Reinvestment Act of 2009*, February 17, 2009.
[7] The maximum guaranty for SBAExpress loans remained at 50 percent.
[8] Public Law 111-240, *Small Business Jobs Act of 2010*, September 27, 2010.
[9] For loans approved from September 27, 2010 through December 31, 2010, the maximum SBA guaranteed amount was $4,500,000 because of the temporary 90 percent SBA guaranty on eligible 7(a) loans established under the Recovery Act.
[10] The numbers presented in this paragraph include Regular 7(a), CAPline, Export Working Capital, International Trade, and LowDoc loans for comparison purposes with Preferred Lender Program (PLP) loan approvals.

$458,044 per approval. From FY 2009 to FY 2010 (during the Recovery Act), the LGPC annually approved an average of 4,956 loans for $2.8 billion, averaging $569,097 per approval. In FY 2012 alone, approximately 5,124 loans were approved for $4.3 billion by the LGPC, resulting in an average approval amount of $841,688.

In comparison, approximately 12,471 loans were approved by delegated lenders in FY 2012 for $8.4 billion, resulting in an average approval of $675,108, or 25 percent less than the average LGPC-approved amount.

In FY 2013, the LGPC approved 4,677 loans for $4.5 billion, averaging $968,255 per approval. Figure 2 below shows the recent disparity in the average loan approval amounts for LGPC-approved loans vs. loans approved by delegated lenders for similar types of loans.

Figure 2 LGPC-Approved Loans vs. Loans Approved by Delegated Lenders Under PLP Authority (per FY)



Source: SBA Loan Accounting System
*This data only includes Regular 7(a), CAPline, Export Working Capital, International Trade, and LowDoc loans for comparison purposes with Preferred Lender Program (PLP) loan approvals for comparison purposes.
*The SBA district offices approved a portion of the loans in FY 2007 as the LGPC began operations in December 2006.

Trends in 7(a) Loan Defaults and Guaranty Payments

The default rate of 6.5 percent for SBA-approved loans[11] made between FY 2009 and FY 2012 was slightly higher than the default rate of 5.3 percent for lender-approved loans made during that same time period. In addition, the rate of early-default[12] on SBA-approved loans (2.5 percent) was slightly higher than that of lender-approved loans (1.7 percent). An early default can be an indication of material loan origination deficiencies. Therefore, the early default statistics provided above indicate there may be a higher number of origination deficiencies on SBA-approved loans. We recognize that loans submitted to the LGPC include more complex and higher risk transactions, including the refinance of same institution debt and change of ownership transactions involving significant intangible assets.

As the average amount of SBA-approved 7(a) loans has increased, there is a risk that the average guaranty payment amount will also increase. The average guaranty payment on SBA-approved 7(a) loans that defaulted early was 41 percent higher than that of lender-approved loans. Specifically, as of April 30, 2013, for loans approved between FY 2009 and FY 2012, the SBA made guaranty payments of $116 million on 274 SBA-approved 7(a) loans that defaulted early, resulting in an average purchase amount of $423,358. In comparison, the SBA made guaranty payments of only $131 million on 437 lender-approved 7(a) loans that defaulted early, resulting in an average purchase amount of $299,771.

Furthermore, previous OIG audits[13] have identified issues with SBA's repayment ability analysis and eligibility determinations on loans approved by the LGPC. Finally, the SBA's FY 2012 improper payment rate for the 7(a) loan guaranty approvals activity was 1.8 percent, or $233.2 million. However, in FY 2013 the estimated amount of improper payments for this activity increased to 4.6 percent, or $510.9 million.

Recent SBA Improvements

It is important to note that during the period of our audit, the SBA took steps to improve the 7(a) loan guaranty approval process. In April 2013, LGPC management began tracking the results of the quality control reviews conducted at the LGPC. Prior to April 2013, the quality control review results were only being tracked by the quality control team. In April 2013, management also proposed a plan to formally notify all LGPC staff of the quality control review results rather than having the quality control specialist provide the results to only the loan specialists who made the errors. Effective March 2014, the SBA required lenders to submit loan applications in an organized and streamlined manner using an SBA developed 10-tab system. Upon receipt of loan applications, the LGPC will determine the completeness of the application packages. If incomplete, the LGPC will direct lenders to their local SBA District Office for assistance in preparing complete loan application packages. Further, based on feedback we provided during our audit, management revised the loan officer report to include additional loan compliance questions for complex transactions. Finally, the SBA created a temporary risk-based approach to streamline the review of small 7(a) loan applications ($350,000 and under) in response to the backlog of loan applications caused by the Federal government shutdown in October 2013 and limited resources. As a result, more staff was allocated for the review of higher dollar loans.

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[11] The numbers presented in this section for default and payment statistics include Regular 7(a), CAPline, Export Working Capital, International Trade, and LowDoc loans for comparison purposes with Preferred Lender Program (PLP) loan approvals.

[12] SOP 50 57, *Loan Liquidation*, defines early-defaulted loans as those loans that default within 18 months of initial disbursement of the proceeds from an SBA loan. If the final disbursement occurs more than six months after initial disbursement, the 18-month period begins from the date of the final disbursement.

[13] See Appendix I Scope and Methodology for the list of OIG reports.

Nature of Limited or Omitted Information

We identified five loans with indications of suspicious activity, the details of which have not been included in this report. These loans were referred to the OIG Investigations Division for further review.

Review of Internal Controls

The SBA's internal control systems SOP[14] provides guidance on the implementation and maintenance of effective systems of internal control as required by OMB Circular A-123. According to OMB, effective systems of internal control improve the accountability and effectiveness of Federal programs and operations by establishing, assessing, correcting, and reporting on internal controls.

To assess internal controls related to our audit objective, we evaluated the environment in which the LGPC functioned and reviewed the activities and processes used to execute its 7(a) loan guaranty approval process. We also conducted a survey of internal controls using a random sample of representatives from the OCA and the LGPC. It is important to note that internal controls at the LGPC are part of the overall internal control structure of the SBA. The SBA has performed assessments of internal controls in accordance with OMB Circular A-123. Nevertheless, we found weaknesses in the management of the LGPC's 7(a) loan guaranty approval process as presented below.

Results

Significant opportunities exist to improve the management of the 7(a) loan guaranty approval process to mitigate the SBA's risk of loss. Specifically, we found that LGPC management emphasized quantity over quality for 7(a) loan reviews, which was not in accordance with the strategic mission of the LGPC. Additionally, we determined that LGPC loan specialists were not provided adequate guidance and training to conduct their 7(a) loan review activities. As a result, SBA management did not ensure that 7(a) loans to assist small businesses were always approved in accordance with regulations and procedures. Specifically, based on a small judgmental sample of 13 loans approved for $13 million, we identified that 11 loans approved for $11.3 million had material underwriting deficiencies. Additionally, 6 of the 11 loans defaulted and the SBA purchased the guaranties for $4.8 million, resulting in unnecessary losses. Further, we conducted limited reviews[15] of another 57 SBA-approved 7(a) loans that were transferred to liquidation and defaulted early. We found evidence indicating that eight of these loans totaling $5.6 million should not have been approved due to repayment ability and eligibility deficiencies.[16] We further identified that a decrease in the number of staff assigned to loan reviews, increase in loan size and complexity, additional LGPC responsibilities, and inadequate supervision also contributed to inappropriate loan decisions. Finally, we identified suspicious activity in five of the loans we reviewed.

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[14] SOP 00 02, *Internal Control Systems*.

[15] This limited review included an examination of the information in SBA's Loan Accounting System to identify instances where origination deficiencies contributed to loan defaults.

[16] See Appendices II and III for complete lists of these loans.

Finding 1: Greater Emphasis on Quality is Needed to Improve LGPC Loan Decisions

We found that LGPC management emphasized the quantity over quality of 7(a) loan reviews. We determined that the LGPC production and efficiency reports measured the quantity and timeliness of loan reviews, but did not include measures for the quality of the loan reviews. Additionally, we found that the LGPC Strategic Plan, which included quality performance initiatives and targets, was not communicated to LGPC loan specialists. As a result, the loan specialists believed LGPC management was focused on the quantity of loan decisions without consideration for the quality of those decisions.

LGPC Production and Efficiency Reports Did Not Measure Quality

In order to measure and communicate loan specialist compliance with LGPC production standards, management developed performance reports in 2008, which were issued to staff on a bi-weekly and quarterly basis. The production reports included different standards for different types of loans[17] and decisions, and tracked the number of weighted decisions made per day by each loan specialist. In addition, LGPC management established loan specialists' performance ratings—excellent, very good, good, fair, poor—based on the number of weighted decisions made per day, and included these ratings in the production reports. In order to assess the efficiency of the LGPC, management also created a report to regularly track applications received, loan decisions made, work in process, loan processing turnaround time, and effective staffing levels.

While these reports provided a reasonable assessment of the productivity and timeliness of the LGPC, they did not measure or communicate the quality of the loan reviews conducted by loan specialists. Specifically, the reports did not measure whether or not the loan decisions complied with SBA's regulations and procedures. Additionally, the reports did not include adjustments to performance standards to account for the increased complexity in reviewing large dollar loans even though LGPC management acknowledged a direct correlation between a loan's size and its complexity. Further, we also determined that loan specialists did not receive performance credit for loan screen-outs.

After the OIG raised questions about the production reports during the audit, notes were added to the production report stating, "Quality, complexity and other factors are also considered" and "Production standards may be adjusted quarterly, based on workload, etc." During our audit, however, we did not find evidence that quality and increased complexity of larger loans impacted the production report or production standards in any way. Rather, management stated they did not quantitatively measure the quality of loan decisions and simply relied on subjective feedback from lenders, leads, and loan modification information to provide performance evaluations to staff. Of the 15 loan specialists and leads we interviewed, 14 indicated that historically management emphasized their production over the quality of their loan decisions. Further, 9 of the 15 LGPC staff we interviewed stated the quality of loan decisions only became a focus of management shortly before the auditors' site visit to the LGPC in June 2013. The following comments demonstrate the loan specialists' understanding of management's philosophy and tone at the LGPC prior to our audit:

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[17] CAPLine and Dealer Floor Plan loans received a weight of 150 percent due to their complexity. Small/Rural Lender Advantage, Small Loan Advantage, and Community Advantage loans received a weight of 50% due to their smaller loan size of $350,000 or less.

Management is only concerned about production and could care less about quality.

Some people at the LGPC work the system. The production reports show that the same people are always at the top and I don't understand how they can produce that much and do quality work.

The only thing that counts is production. Loan officers are pushed so hard for production that I am tempted to forget about quality.

If a loan specialist is at the top of the production report then it means they are doing a very good job.

In April 2013, LGPC management began tracking the results of the quality control reviews conducted at the LGPC. Prior to April 2013, the quality control review results were only being tracked by the quality control team. In April 2013, management also proposed a plan to formally notify all LGPC staff of the quality control review results rather than having the quality control specialist provide the results to only the loan specialists who made the errors. During our audit, LGPC management stated they were trying to revise the production and efficiency reports to address the complexity of loans. Nevertheless, as of March 2014, management had not begun sharing the quality control review reports with LGPC staff and had not revised the production and efficiency reports to address loan complexity. Furthermore, based on the results of a recent OIG evaluation[18] of quality control activities at the loan centers, we are concerned that the quality control review activities at the LGPC may not be sufficient to improve the quality of the LGPC's loan reviews. Specifically, the evaluation identified that not all quality control reviews were completed as required by the quality control guide for the LGPC. Additionally, the report noted that aside from the IPERA reviews conducted as part of the quality control program, there were no quality control reviews of LGPC loans approved for less than $1.5 million. Specifically, the LGPC quality control review guide states that reviews are limited to three percent of the loans approved for greater than $1.5 million. This equates to less than one percent of the loans and approximately 1.6 percent of the dollars approved by the LGPC during FY 2013. As the average amount of loans approved by the LGPC during FY 2013 was approximately $750,000,[19] the quality control program may not be sufficient to assess the quality of loan decisions made for the majority of the loans approved by the LGPC.

Quality Performance Initiatives and Targets Were Included in the LGPC Strategic Plan, but Were Not Communicated to Staff

The mission of the OCA states, in part, that it "balances the need to make capital available to small businesses with the importance of providing appropriate monitoring and oversight to protect taxpayer dollars and ensure its programs remain strong." The OFPO, in coordination with LGPC management, developed a strategic plan for the LGPC that aligned with the overall SBA Strategic Plan and OCA mission. However, our audit found that the LGPC Strategic Plan, which included quality performance initiatives, was not provided or communicated to LGPC loan specialists. The LGPC Strategic Plan stated its mission was to lead the financial services industry in quality products and services to its partners and customers, and to protect the integrity of SBA programs. The strategic plan initiatives included clarifying quality product definitions and expectations as well as refining the quality program through improved

[18] OIG Report 14-08, *Improvement is Needed to Ensure Effective Quality Control at Loan Operation Centers*, January 17, 2014.

[19] This estimate considers all loans submitted to the LGPC during FY 2013.

guidance, tool development, and a feedback mechanism for process improvement. Further, the strategic plan established an objective to improve the quality of LGPC products that was to be measured by the percentage of findings identified in quality control reviews. The LGPC defined success against this objective as having material findings on 10 percent or less of the LGPC products reviewed (i.e., loans).

We first inquired in January 2013 whether the LGPC Strategic Plan had been provided to LGPC staff. Management at the LGPC informed us that it had not been provided, but that LGPC staff understood that the goal of the LGPC was loan production. Further, during our site visit at the LGPC in June 2013, we confirmed with LGPC management and staff that the LGPC Strategic Plan had still not been distributed. Because the LGPC Strategic Plan was not distributed, LGPC staff was not informed of the quality performance initiatives established by OFPO and LGPC management. As we previously noted, 14 of the 15 LGPC loan specialists and leads we interviewed indicated that management historically emphasized production over the quality of loan decisions. Most of the LGPC staff we spoke to stated the quality of loan decisions only became a focus of management shortly before the auditors' site visit to the LGPC in June 2013. Proper communication of the organizational mission, goals, and objectives is necessary to ensure desired outcomes are achieved and the integrity of the 7(a) program is maintained.

Federal guidance describes the importance of measuring quality, developing a strategic plan and communicating a proper tone in an organization. While this guidance applies to the overall SBA strategic plan and management, these are good practices to implement at the program level (i.e., LGPC) to ensure the integrity of the 7(a) program and to protect taxpayer dollars.

According to the General Accounting Office's (GAO) *Standards for Internal Control in the Federal Government*, control activities must be established within all Federal agencies to monitor performance. This may include comparisons and assessments of different sets of data to analyze relationships in the data so appropriate actions can be taken. Controls should also be aimed at validating the propriety and integrity of both organizational and individual performance measures and indicators. Furthermore, performance evaluation and feedback, supplemented by an effective reward system, should be designed to help employees understand the connection between their performance and the organization's success. The standards further stipulate that internal control monitoring should assess the quality of performance over time and ensure that the findings of audits and other reviews are promptly resolved.

A strategic plan is a valuable tool for communicating to agency managers, employees, and other stakeholders a vision for the future.[20] According to OMB Circular A-11, it should be used to align resources and guide decision-making to accomplish established priorities and improve outcomes. The Strategic Plan should support planning across organizational operating units and describe how agency components are working toward common results. According to OMB Circular A-11, an agency formulates its Strategic Plan with input from Congress, OMB, the public and the agency's personnel, partners, and stakeholders and should make the plan easily accessible to all. To ensure transparency of performance information that increases accountability, results, and cost-effectiveness, OMB suggests that program managers regularly communicate actionable performance metrics and analyses to those in the field.

Furthermore, in guidance provided in OMB Circular A-123, *Management's Responsibility for Internal Control*, the control environment is the organizational structure and culture created by management

[20] OMB Circular A-11, *Preparation, Submission, and Execution of the Budget,* July 26, 2013.

and employees to sustain organizational support for effective internal control. Further, the guidance states that management's philosophy and operational style will set the tone within the organization.

Finding 2: Improved Guidance and Training Needed at the LGPC

The LGPC staff did not receive adequate guidance and training to support their loan review activities. Specifically, we found that LGPC management issued guidance that conflicted with SOP 50 10 5, *Lender and Development Company Loan Programs*. Further, we found that loan specialists did not have a desk manual to assist them with their loan reviews. We also determined that LGPC management did not formally document loan screen-out procedures and disseminated the procedures to loan specialists through email. Finally, we learned that management did not comply with the requirements to develop a formal training plan and track training provided to LGPC staff.

The LGPC Did Not Issue Appropriate Guidance to Mitigate the SBA's Risk of Loss

The SOP[21] states that for loans submitted to the LGPC, the SBA approves the loan for both credit and eligibility. In May 2011, during an ongoing effort to reduce loan screen-outs, LGPC management, via email, directed LGPC loan specialists to cease requesting certain eligibility documents from lenders. For example, the email stated that lenders were not required to submit the original note for a loan that was being refinanced with SBA loan proceeds. In addition, for credit card debt refinancing, LGPC staff were advised that they were not required to review documentation demonstrating the business-related purpose for the credit card debt. We determined that this internal guidance conflicted with the SOP and eliminated critical documents necessary for LGPC loan specialists to make informed loan eligibility decisions and mitigate the SBA's risk of loss.

In the case of general debt refinancing, the SOP states that the lender's loan file must include (1) a written analysis including why the debt was incurred, and if it was current and on reasonable terms, and (2) any supporting documentation. To verify whether the debt being refinanced was eligible and on reasonable terms, it would be necessary for LGPC staff to review the original note associated with the debt.

Furthermore, according to the same SOP, if credit card debt being refinanced was issued to an individual personally, the lender must confirm which of the credit card obligations were used for business-related purposes. Lenders must document the specific business purpose of the credit card debt and the borrower must certify that the loan proceeds are being used only for business-related debt. Documentation required for refinancing credit card debt includes a copy of the credit card statements and individual receipts for any business expenses in excess of $100.

We were informed by LGPC management that the documents were no longer required because of staffing issues at the LGPC and in an effort to reduce the amount of information requested from lenders. According to LGPC management, the lender is required to obtain the original note and submit it with its request for guaranty purchase. However, only a fraction of the loans approved by the LGPC default and are submitted for purchase. As stated above, for loans submitted to the LGPC, the SBA approves the loan for both credit and eligibility. Therefore, this control is not effective to prevent ineligible loans from being made. Further, we confirmed with management at the National Guaranty Purchase Center

[21] SOP 50 10 5, Lender and Development Company Loan Programs (Versions C, D, & E effective 10/01/2010, 10/01/2011, and 06/01/2012, respectively).

(NGPC)—the center responsible for reviewing guaranty purchase requests—that the NGPC does not review these documents during its purchase review and relies on the original eligibility determinations by the LGPC.

To illustrate our concerns, we identified one loan approved by the LGPC that refinanced debt originally provided by four separate institutions totaling $403,450. We determined that the LGPC did not obtain the original notes associated with these debts to verify the cost savings and cash flow improvement presented by the lender as required. As a result, there is no assurance this loan was eligible for SBA financing. This loan defaulted early and was purchased by the SBA.

We also identified that unlike another major SBA processing center, the LGPC did not have a desk manual to assist loan specialists with their loan reviews. Loan specialists we interviewed at the LGPC stated that they used the SOPs, Code of Federal Regulations,[22] an LGPC developed loan officer report, and feedback from co-workers and management to guide their loan reviews. However, multiple loan specialists noted inconsistencies in both the interpretation and application of the SBA requirements amongst LGPC staff. In an effort to provide improved guidance, the LGPC Strategic Plan included an initiative to develop a desk manual. However, during our site visit in June 2013, management stated that a desk manual had not yet been developed. In comparison, the NGPC developed and issued a manual in 2007 for its loan specialists. The NGPC manual includes a systematic approach for how loan specialists should conduct their loan review activities and references the applicable SBA requirements to be used.

Moreover, our audit found that formal procedures were not documented at the LGPC for the loan screen-out process, which led to ambiguity and inconsistency in how loan screen outs were processed and addressed. We determined that the process for screening out loans and issuing screen-out letters to lenders was provided to LGPC staff through a series of emails between October 2010 and May 2012. To evaluate whether the informal screen-out process was being appropriately followed, we reviewed the emails from LGPC management and SBA loan files that received screen-outs. We found that screen-outs were not always properly documented and resolved. For example, a loan specialist screened-out an application because documentation was missing to verify that a seller note had been paid, as required, by the borrower. The loan was approved demonstrating the screen-out issues had been resolved. Nevertheless, the documentation submitted in response to this screen-out showed that the seller's note was delinquent. Based on these findings, the LGPC management should develop and formerly document a process for issuing and reviewing loan screen-outs to eliminate ambiguity and ensure all screen-out issues are addressed prior to final decision.

Federal guidance states that internal controls are necessary to ensure the integrity of programs. According to OMB Circular A-123, effective organization, policies, and procedures, commonly referred to as internal control, are tools to help program and financial managers achieve results and safeguard the integrity of their programs. Further, the circular states that while the procedures may vary from agency to agency; management should have a clear, organized strategy with well-defined documentation processes. These processes contain an audit trail, verifiable results, and specify document retention periods so that someone not connected with the procedures can understand the assessment process.

Furthermore, the GAO *Standards for Internal Control in the Federal Government* state that internal control serves as the first line of defense in safeguarding assets and preventing and detecting errors and

[22] Code of Federal Regulations, Title 13-Business Credit and Assistance.

fraud. It also states that internal control should provide reasonable assurance that the objectives of the agency are being achieved in the following categories:

- Effectiveness and efficiency of operations including the use of the entity's resources,
- Reliability of financial reporting, including reports on budget execution, financial statements, and other reports for internal and external use, and
- Compliance with applicable laws and regulations.

Finally, these standards also state that information should be recorded and communicated to management and others within the entity that need it, in a form, and within a time frame that enables them to carry out their internal control and other responsibilities.

LGPC Staff Training Needs Were Not Met

We determined that LGPC management did not develop a formal training plan for staff as required and did not regularly track training that was provided. On January 31, 2013, we requested a list of training received by LGPC staff during 2012. In response, LGPC management stated that training was not tracked in the manner of our request and would need to be reconstructed. On March 22, 2013, LGPC management provided a list of trainings provided during 2012; however, the list was incomplete and did not specify which LGPC location received the training. Examples of the training provided during 2012 according to the list included emails from management discussing SBA requirements, SBA system training, and required Agency-wide trainings (i.e. Computer Security Awareness Training). We believe this is an indication that, in general, training was not designed to meet the specific needs of the loan specialists.

Based on our interviews with LGPC loan specialists and management, we determined that the loan specialists' training needs were not being satisfied. Specifically, 11 of the 13 loan specialists we spoke to about their training believed that formal training had not been regularly provided at the LGPC. Further, loan specialists expressed concern that the two LGPC locations did not receive the same training. During our site visit to the LGPC in June 2013, many of the loan specialists we interviewed noted that the last comprehensive training they received, which covered lending practices for commercial loans to small businesses, began in 2011 and was completed in February 2012. Additionally, four loan specialists noted that they did not find this training useful as it included a commercial lending curriculum not related to their loan review activities at the SBA. We noted that 10 of the 13 loan specialists we spoke to stated that there was a need for additional training. Specifically, loan specialists noted that additional training was needed on cash flow analysis and the SOPs.

Further, we determined that regular meetings held by LGPC management with staff, which focused on SBA's rules and regulations, discontinued during FY 2012 and were replaced with email communications. According to LGPC management and loan specialists, these regular meetings discontinued due to increased demand on the Center. However, multiple loan specialists noted the importance of these meetings in performing their loan review functions and communicating issues to LGPC management.

According to GAO *Standards for Internal Control in the Federal Government*, management needs to identify the appropriate knowledge and skills for various jobs and provide training, as well as candid and constructive counseling, and performance appraisals. Further, management should ensure that skill needs are continually assessed and that the organization is able to obtain a workforce that has the required skills that match those necessary to achieve organizational goals. Training should be aimed at developing and retaining employee skill levels to meet changing organizational needs. Finally, good human capital policies and practices are another critical environmental factor and include training.

Moreover, the LGPC Strategic Plan included the following training goals, objectives, and initiatives:

Table 1 LGPC FY 2012-2013 Strategic Plan

Goals (Overall or Performance)	Objectives	Initiatives
Fully Engaged and Trained Employees	Develop and assess training needs for individual LGPC positions	Consistently implement and monitor the management of individual training needs
Employee Satisfaction (Performance)	(1) Develop training calendar for 2013 based on Employee/Supervisor needs assessment and the new Talent Management Process. (2) Track LGPC Staff Training	FY 2013 Staff Training

Source: LGPC FY 2012-2013 Strategic Plan

The position description for the LGPC Director also required the development of a comprehensive training program for Center staff. While LGPC management stated that planned training existed for different employee positions, a formalized training plan had not been developed. It is important to note that the LGPC staff training plan was a special project and was in the process of being developed during FY 2013. Finally, LGPC management explained it was challenging to formalize standard training around complex aspects of SBA rules and regulations that required experience in reviewing loan applications.

Finding 3: Staffing Levels, Loan Complexity and Inadequate Supervision Contributed to Inappropriate Loan Decisions and Loss to the SBA

As previously discussed in this report, the LGPC was focused on production and did not provide sufficient guidance and training to LGPC staff. We believe this contributed to the approval of loans that did not comply with SBA's regulations and procedures. Further, we identified that a decrease in the number of staff assigned to loan reviews, additional center responsibilities, and inadequate supervision also contributed to inappropriate loan decisions.

Staffing Levels Decreased While Loan Review Complexity Increased

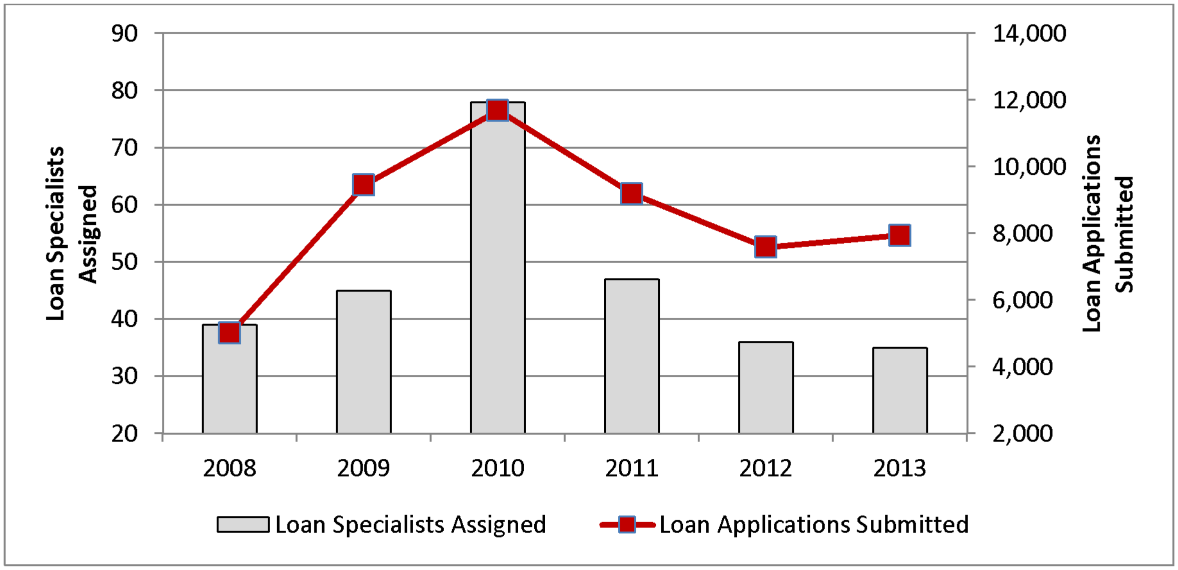
The average amount of Regular 7(a) loans approved by the LGPC increased from $583,469 in FY 2010 to $968,255[23] in FY 2013, an increase of 66 percent. Management acknowledged that there is a direct correlation between the size of a loan and its complexity. One manager stated that the loan applications submitted to the LGPC have been larger, more complicated, and included a significant amount of affiliated businesses. Management and loan specialists also stated that the quality of loan packages submitted to the LGPC had declined, further contributing to the complexity of loan reviews. Management estimated that it takes twice as long to review a larger, more complex loan.

[23] This figure only includes Regular 7(a), CAPline, Export Working Capital, International Trade, and LowDoc loans.

Generally, the number of staff assigned to review loans has correlated to the number of applications received by the LGPC (see Figure 3). Therefore, as the number of applications has declined since 2010, so has the number of staff conducting loan reviews. During this same period, however, the average requested amount per loan also increased by $321,371, or 77 percent.

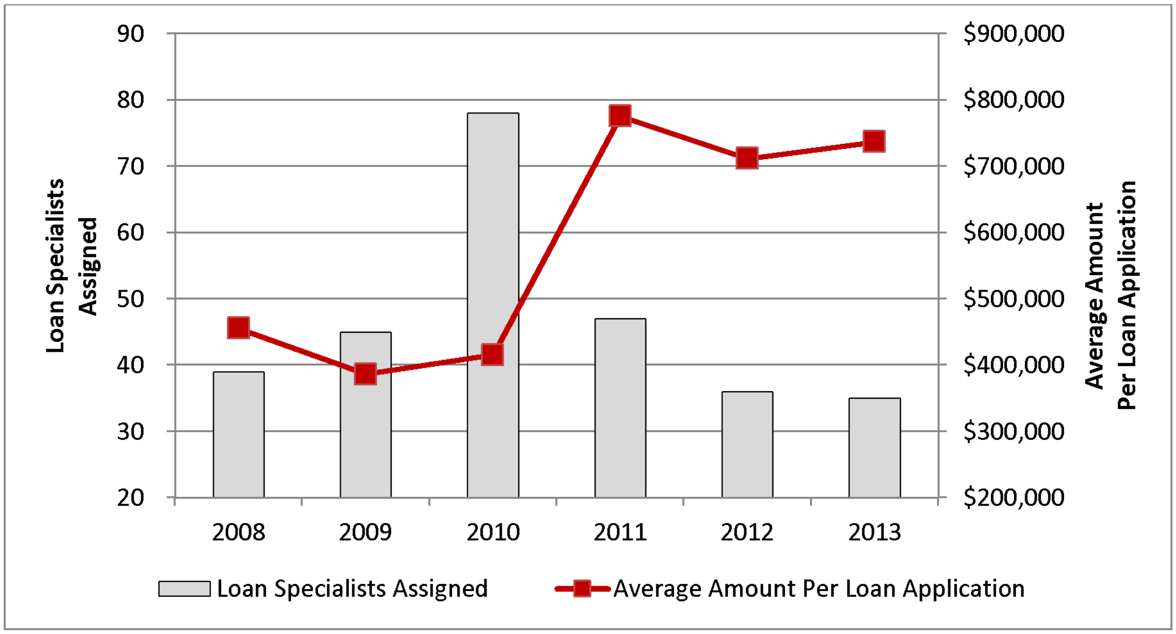
Given management's acknowledgment of the direct correlation between the size of a loan and its complexity, there appears to be an inappropriate alignment of LGPC staff. Figure 4 shows the relationship between the change in staffing level and requested loan amounts submitted to the LGPC.

Figure 3 Staffing Level vs. Loan Applications Submitted to the LGPC



Source: Staffing and application data provided by the LGPC
*The loan data in this graph includes all loan applications submitted to the LGPC each FY.
* Loan Specialists Assigned is defined as those performing only loan review activities estimated during each FY.
*During the Recovery Act and Jobs Act, the LGPC increased staff using temporary employees and employees redirected from the SBA Office of Disaster Assistance.

Figure 4 Staffing Level vs Average Amount Per Loan Application



Source: Staffing and application data provided by the LGPC
*The loan data in this graph includes all loan applications submitted to the LGPC each FY.
*Loan Specialists Assigned is defined as those performing only loan review activities estimated during each FY.
*During the Recovery Act and Jobs Act, the LGPC increased staff using temporary employees and employees redirected from the SBA Office of Disaster Assistance.

Furthermore, during 2011, the LGPC was assigned additional responsibilities that affected its loan approval activities. Table 2 below describes these additional projects.

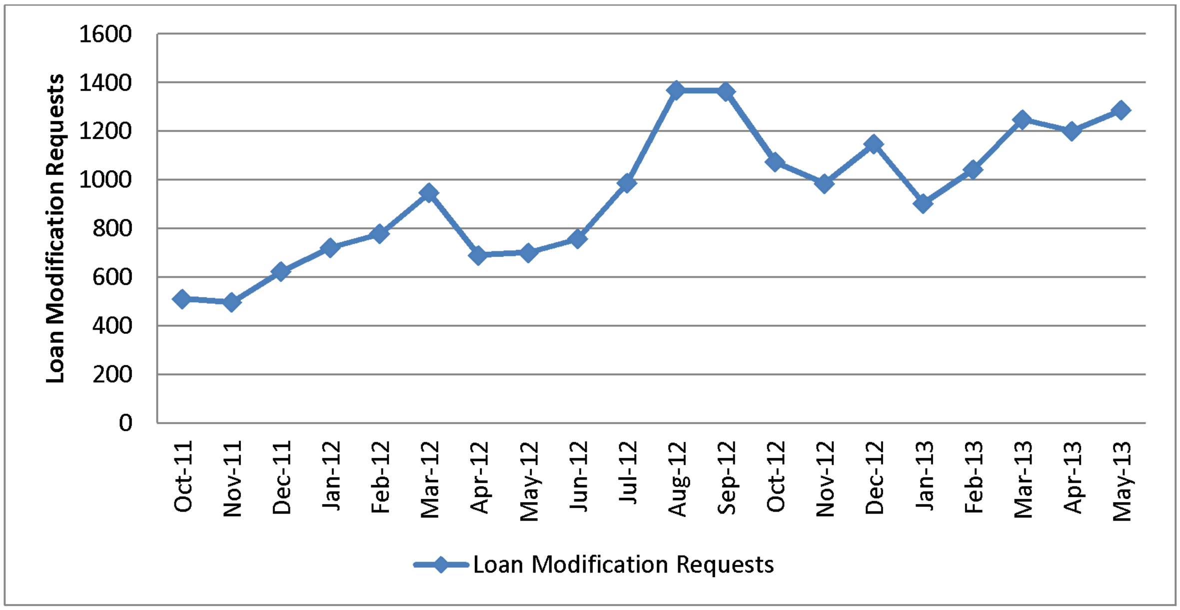
Table 2 Projects Assigned to the LGPC

Project	Project Description	Date Assigned to the LGPC	LGPC Staff Assigned to the Project
Secondary Market Reviews	Review loans that lenders are requesting to be sold on the secondary market to ensure they were properly processed, closed, and serviced, and being paid as agreed.	06/01/2011	2 Loan Specialists
ARC Interest Reconciliation	Reconcile interest to ensure the correct amount is paid to lenders.	08/01/2011	2 Loan Specialists
Lender Service Provider Reviews	Review agreements between lenders and lender service providers.	10/01/2011	1 Attorney
Increased Responsibility for Loan Modifications	Review requests for changes to loans submitted by lenders and determines whether the changes are appropriate.	Between 10/01/2011 and 12/15/2011	4 Loan Specialists

Source: SOP 50 10 5, LGPC Organization Chart (effective July 1, 2013), and interviews with LGPC management and staff.

As shown in table 2 above, in October 2011, the LGPC assumed increased responsibilities for loan modification requests. Specifically, the LGPC assumed responsibility for reviewing loan modification requests on SBA-approved loans submitted by lenders up to final disbursement. In December 2011, the LGPC assumed even more responsibility for reviewing loan modifications, including loans approved by lenders in addition to the SBA-approved loans. According to SBA management officials, these changes were made in an effort to improve the quality of loan modifications and mitigate risk. However, as a result, the demand on the LGPC for loan modification requests increased by 152 percent from October 2011 to May 2013. Additionally, data provided by the LGPC showed that staff was unable to meet the demand of modification requests, resulting in a backlog. Specifically, loan modifications "in process" increased from 26 in October 2011 to 375 in May 2013, or by 1,342 percent. Figure 5 below depicts the increase in monthly loan modification requests submitted to the LGPC.

Figure 5 Loan Modification Requests Submitted to the LGPC



Source: Data provided by LGPC management

Multiple LGPC management officials and loan specialists noted that the reduction in staff and additional projects assigned to the LGPC had affected their ability to review loan applications. This is further supported by recent actions taken by the SBA. Specifically, due in part to limited resources at the LGPC, the SBA temporarily waived its standard 7(a) loan guaranty review process in order to address a backlog of unprocessed applications created by the government shutdown in October 2013.[24]

The LGPC Loan Specialists Did Not Receive Adequate Supervision

We determined that one manager located in the Citrus Heights, CA, office conducted the performance evaluations for 64 employees, which included 10 leads and 32 loan specialists located in both Citrus Heights, CA and Hazard, KY. In general, loan specialists we interviewed stated that their interaction with this manager was minimal and most communication occurred during their quarterly and annual performance evaluations. For example, loan specialists noted the following concerns:

> *I do not meet with my manager unless I have a question or if it is time for quarterly reviews. [Manager] will hold a conference call once a quarter, but I do not get feedback between these quarterly reviews.*

[24] Notice of Regulatory Waiver for Standard 7(a) Loan Guaranty Processing Center (LGPC) Emergency Catch-up Pilot, 79 Fed. Reg 9,028 (February 14, 2014).

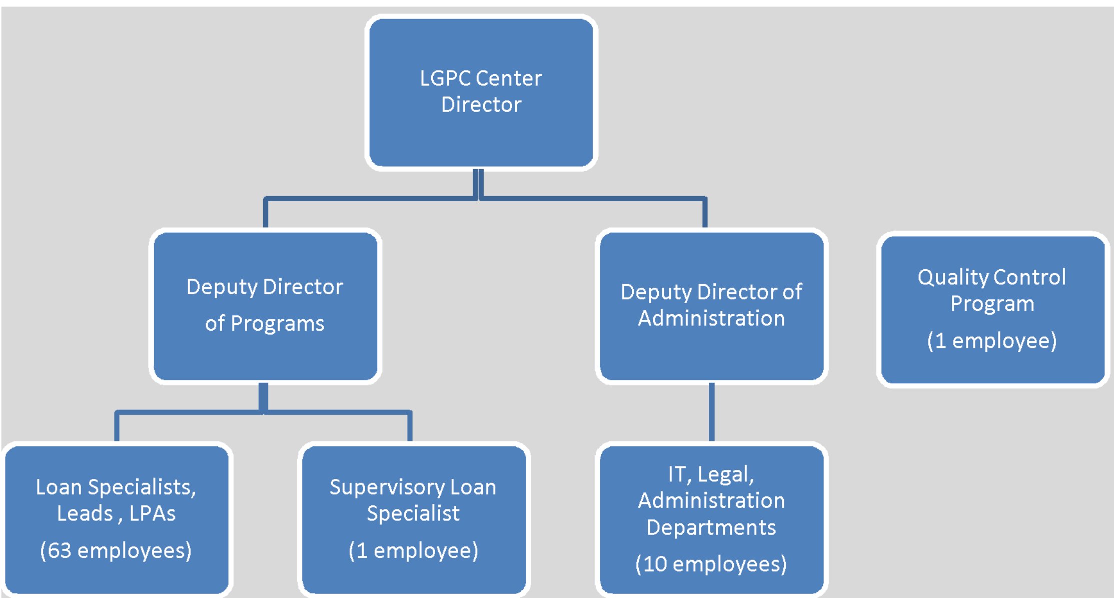
Management does not meet with lead loan specialists to discuss performance on a regular basis, unless it's time for evaluations or something comes up, such as a complaint from a lender.

Leads do not discuss performance with me, but it is discussed with management during the quarterly review briefing.

We noted that loan specialists received feedback specific to their loan reviews from the leads. However, the leads did not have the authority to conduct performance evaluations, and therefore, this was not adequate supervision.

In addition, we found that the Hazard, KY, location was officially operating without an on-site manager. The Hazard Information Technology Specialist was assigned the role of Manager, but did not have supervisory authority, worked on systems development, and did not work closely with the loan review process. Figure 6 below shows the organizational structure of the LGPC.

Figure 6 LGPC Organizational Structure (Effective July 1, 2013)



Source: LGPC Organizational Charts effective July 1, 2013
*LGPC staff may be removed from loan approval activities and assist the quality control specialist as needed.

Finding 4: Material Deficiencies Were Identified in SBA-Approved Loans

We determined that LGPC loan specialists approved loans that did not comply with SBA's requirements, which increased both the risk of loss and actual loss to the SBA. Based on a small judgmental sample of 13 loans approved for $13 million, we identified that 11 loans approved for $11.3 million had material underwriting deficiencies. Additionally, as of November 27, 2013, we identified that 6 of the 11 loans with material deficiencies defaulted and were purchased for $4.8 million, which resulted in unnecessary losses to the SBA. We also identified suspicious activity in 2 of the 13 loans we reviewed. These loans were referred to the OIG Investigations Division.

Moreover, we conducted limited reviews on another 57 SBA-approved 7(a) loans that had been transferred to liquidation. Each of these loans defaulted within the SBA established early default period. We found evidence indicating that eight of the loans approved for a total of $5.6 million should not have been approved due to repayment ability and eligibility deficiencies. In addition, 3 of the 57 loans had indications of suspicious activity related to the transaction. A listing of the loans reviewed during this audit is provided in Appendices II and III, and a detailed summary of the material underwriting loan deficiencies is provided in Appendix IV.

Repayment Ability

A review of the 13 loans in our judgmental sample identified 5 loans, approved by the LGPC for approximately $8.6 million, for which repayment ability was not appropriately assessed in compliance with SBA requirements. Title 13 CFR §120.150 states that the applicant must be creditworthy, and loans must be so sound as to reasonably assure repayment. Additionally, SOP 50 10 5 states that for loans submitted to the LGPC, the SBA approves the loan for both credit and eligibility. Further, according to the SOP, on SBA-guaranteed loans, the cash flow of the Small Business Applicant is the primary source of repayment, not the liquidation of collateral. Thus, if the lender's financial analysis demonstrates that the Small Business Applicant lacks reasonable assurance of repayment in a timely manner from the cash flow of the business, the loan request must be declined, regardless of the collateral available. For these five loans, the LGPC loan specialists either did not adequately assess or did not obtain documentation to verify the borrowers' repayment ability. Four of these loans were purchased by the SBA for $3.8 million. See Appendix IV for a summary of these material deficiencies.

We also found evidence indicating that 8 other loans from the 57 loans that were transferred to liquidation should not have been approved by the LGPC due to a lack of repayment ability. For example, notes in SBA's Loan Accounting System demonstrated that one loan defaulted without a single payment indicating the business had inadequate cash flow available to service its debt. For another loan, which defaulted within 13 months, the SBA's Office of Credit Risk Management determined that repayment ability was not justifiably based. See Appendix III for a summary of the evidence supporting these results.

Eligibility

For the 13 loans in our judgmental sample, we also found that the LGPC loan specialists did not ensure that borrowers on 9 loans, approved for $9.2 million, met the SBA's eligibility requirements. For example, on one loan, loan specialists approved the refinancing of a delinquent seller take-back note stemming from a previous change of ownership transaction. According to SOP 50 10 5, in order to refinance any seller take-back note with an SBA-guaranteed loan, the note must be current for the past 24 months. See Appendix IV for a summary of these material deficiencies.

In addition, for one of the 57 loans that were transferred to liquidation, the SBA's Office of Credit Risk Management determined the loan should not have been approved by the LGPC because change of ownership requirements were not met.

Conclusion

The size and complexity of loan applications submitted to the LGPC has increased. At the same time, LGPC staff assigned to perform loan reviews has decreased. Based on a judgmental sample of 13 loans, we determined that 11 loans were not approved in compliance with SBA's requirements, increasing risk, and resulting in $4.8 million of unnecessary losses to the SBA. We also identified multiple instances of suspicious activity demonstrating that individuals may be seeking to abuse the 7(a) guaranty loan program.

Significant opportunities exist to improve the SBA's management of the 7(a) loan guaranty approval process to mitigate its risk of loss and protect the integrity of the 7(a) program. Specifically, greater emphasis on quality is needed to improve LGPC loan decisions. We found that LGPC production and efficiency reports did not measure quality and quality performance initiatives were not communicated to staff. We also found that the LGPC did not issue appropriate guidance to staff and that training needs were not met. Finally, staffing levels, loan complexity, and inadequate supervision also contributed to inappropriate loan decisions and loss to SBA.

To ensure loan decisions are made in compliance with SBA requirements, the SBA will need to revise management reports to measure quality against established targets, communicate quality goals to staff, develop and issue appropriate guidance, develop and implement a staff training plan, and allocate LGPC resources in a manner to ensure risk is mitigated and quality is emphasized. If implemented, these changes will result in significant savings for the SBA. Based on the small judgmental sample of loans reviewed in this audit alone, the identified funds to be put to better use[25] over the next two years is at least $4.8 million.

Recommendations

We recommend that the Director of the Office of Financial Program Operations:

1. Revise management reports to measure quality against established targets, ensure production credit is given for all loan review actions, and promote compliance with SBA requirements.

2. Distribute the LGPC Strategic Plan to staff and establish a process to ensure that quality goals are regularly communicated to LGPC staff.

3. Develop and issue appropriate guidance that will assist loan specialists with their duties, including loan reviews and screen-outs, to ensure compliance with SBA's regulations and procedures.

4. Develop and implement a training plan and tracking system that ensures loan specialists develop and retain the required skills necessary to achieve organizational goals and changing needs.

5. Allocate LGPC resources to ensure risk is mitigated and quality is emphasized in accordance with the LGPC Strategic Plan.

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[25] Under the Inspector General Act of 1978, as amended, "funds be put to better use" is defined as funds that could be used more efficiently if management took actions to implement the recommended action.

Agency Comments and OIG Response

On April 17, 2014, we provided a draft copy of this report to the Director of the Office of Financial Program Operations for comment. On May 19, 2014, the Agency submitted formal comments, which are included in their entirety in Appendix V.

General Management Comments from the Office of Financial Program Operations

The Agency concurred with all of our recommendations, and provided additional comments regarding some of the information presented in the draft report. The OFPO acknowledged there are opportunities for improvement at the LGPC, but noted concerns with the tone and title of the report. Specifically, OFPO stated that the word "significant" should be dropped from the title as it overstated the findings of the audit.

The OFPO also raised concerns regarding the relevancy, scope change, and timeliness of the findings in the draft report. Further, OFPO noted its commitment to continuous improvement and that the rate of improper payments for the 7(a) loan approval process was significantly lower than the OMB acceptable threshold. In addition, OFPO is implementing a quality and complexity rating methodology for loan applications and has inititated a loan review process based on risk and complexity levels.

In addition, OFPO believed that the OIG used derogatory criteria to select a loan sample that targeted some of the most difficult, complex loans in the LGPC's loan portfolio.

The OFPO agreed that delegated lenders submit more complex and higher risk transactions to the LGPC. Specifically, OFPO noted that these types of loans account for 25 percent of the LGPC loan volume. As a result, the OFPO believes this justifies the slightly higher default rate for LGPC-approved loans. The OFPO also noted that improper payments on loans approved by the LGPC occurred less frequently than those approved under lender's delegated authority.

Furthermore, OFPO noted its appreciation of the draft report's discussion of the impact that the Recovery Act and Jobs Act had on SBA's lending and investment programs. The OFPO explained that while funding for additional staff members to address the provisions within the Acts expired, the increased loan amounts, along with complexity associated with them, have been permanently authorized. The OFPO acknowledged low staffing levels across its Centers as a current challenge. The OFPO agreed with the increase in loan modification requests, and that proactive measures have decreased loan modification requests since our audit. Further, OFPO noted that the responsibility of the ARC loan interest reconciliation was transferred to another loan center in May 2014 in order to allocate LGPC staff to traditional loan application reviews.

Finally, the OFPO raised concerns over the OIG's finding that training needs were not met, inclusion of interview responses, and discussion on the quality control reviews. Specifically, the OFPO stated their position that email correspondence is a useful and cost effective means for disseminating office procedures. The OFPO noted that our finding on training needs appeared to ignore several relevant training opportunities provided to the LGPC staff, which included a "Commercial Loans for Small Business" course and training on SBA policies and procedures. Furthermore, the OFPO noted that the usefulness of including the responses from the interviews, was undermined by not including the text of the questions. In addition, the OFPO stated that quality control reviews on smaller loans were being conducted prior to July 2012 and were reinstated on November 1, 2013.

OIG Response to OFPO

We commend the OFPO on its efforts to improve the 7(a) loan guaranty approval process at the LGPC. We note that the Agency generally agreed with our findings and agreed with all of our recommendations. Based on the findings issued in this report, we continue to support our position that significant opportunities for improvement exist at the LGPC. Specifically, we identified internal control weaknesses in the management of the 7(a) loan guaranty approval process that contributed to inappropriate loan decisions and loss to the SBA. According to the GAO *Standards for Internal Control in the Federal Government,* internal control serves as the first line of defense in safeguarding assets and preventing and detecting errors and fraud. We believe that our findings and recommendations are significant in order to mitigate risk, protect taxpayer dollars, and preserve the integrity of the 7(a) loan program. Further, we note that the OFPO agreed with all of our recommended actions that will address these internal control weaknesses.

While we acknowledge that the audit was not completed by August 2013, our audit began with a survey phase and we communicated with SBA management throughout the audit. Specifically, we discussed our initial concerns and observations regarding the 7(a) loan approval process with LGPC management in January 2013. We also met with SBA executive management in May 2013 to discuss the concerns identified during survey. Further, we briefed SBA management on the results of the audit in February 2014 and March 2014, prior to the exit conference. During those meetings, we discussed our proposed findings. Finally, on February 25, 2014, we provided the SBA with the details and any findings for the 13 loans on which we completed full file reviews.

Furthermore, the objective, scope, and methodology of our audit was communicated to SBA management during the entrance conference on August 30, 2012. The scope, as explained to SBA management, included a sample of SBA-approved loans that defaulted early, had screen-outs or exceptions to policy, and other loans. We also communicated to the SBA that the scope would be expanded, if necessary. We further noted that our methodology would include a review of the SBA loan files to assess compliance with requirements, a site visit to the LGPC to observe the operations and conduct interviews, and the use of an internal control questionnaire issued to LGPC staff.

We disagree that our sampling methodology was prejudiced and focused on deragotory criteria. Our audit objective sought to determine the extent to which the SBA was managing the 7(a) loan approval process to mitigate its risk of loss. In order to determine the risk of loss, it was necessary to assess some level of defaulted loans. Additionally, we selected loans with screen-outs and exceptions to policy to evaluate LGPC internal controls and compliance with SBA requirements. Further, we conducted full loan file reviews on both performing and defaulted loans with approval amounts ranging from $98,550 to $3,000,000. Finally, we note that the rate of deficiency was consistent regardless of the evaluated loan's size or performance.

We commend the SBA on taking steps to reduce the number of loan modification requests impacting the LGPC. Further, we acknowledge that submission volume decreased since our site visit to the LGPC in June 2013, when this issue and its impact on LGPC operations, was brought to our attention. However, we note that loan modification requests are still 78 percent higher than in October 2011 and require dedication of additional LGPC staff to process.

We acknowledge the actions the SBA has taken to train the LGPC staff on SBA policies and procedures, and believe these actions will help to mitigate the risk of loss to the SBA and protect the integrity of the program. We disagree that our draft report ignored relevant trainings given to LGPC staff as our draft report acknowledged the "Commercial Loans for Small Business" training. Our audit determined that there was a need for additional training and that training was not provided under a formalized plan based on employee needs. Developing and implementing a training plan and tracking system will ensure loan specialists' training needs will be met.

Finally, we disagree that the questions related to specific employee responses are necessary to understand their usefulness and context. The questions asked during our interviews with LGPC staff were open-ended and standardized. These questions covered general internal control areas including: training and guidance, staff qualifications, management focus and feedback, LGPC operations and resources, and the mission of the LGPC.

We made the following recommendations to the Director of the Office of Financial Program Operations:

Recommendation 1 – Revise management reports to measure quality against established targets, ensure production credit is given for all loan review actions, and promote compliance with SBA requirements.

Management Comments

The OFPO concurred with this recommendation. The OFPO stated that management reports will be revised to measure quality against established targets and conduct a review of production credit to ensure appropriate credit is given for loan review actions.

OIG Response

Management's comments were responsive to our recommendation. We consider this recommendation resolved and open pending completion of final action.

Recommendation 2 – Distribute the LGPC Strategic Plan to staff and establish a process to ensure that quality goals are regularly communicated to LGPC staff.

Management Comments

The OFPO concurred with this recommendation. The OFPO stated that it will continue to distribute the LGPC Strategic Plan with an increased emphasis on the communication of quality goals.

OIG Response

Management's comments were responsive to our recommendation. We consider this recommendation resolved and open pending completion of final action.

Recommendation 3 – Develop and issue appropriate guidance that will assist loan specialists with their duties, including loan reviews and screen-outs, to ensure compliance with SBA's regulations and procedures.

Management Comments

The OFPO concurred with this recommendation. The OFPO stated that it is inventorying existing guidance in an attempt to create a comprehensive electronic manual for all LGPC staff. A link to this manual will be provided on all staff members' desktop computers.

OIG Response

Management's comments were responsive to our recommendation. We consider this recommendation resolved and open pending completion of final action.

Recommendation 4 – Develop and implement a training plan and tracking system that ensures loan specialists develop and retain the required skills necessary to achieve organizational goals and changing needs.

Management Comments

The OFPO concurred with this recommendation.

OIG Response

Management's comment was responsive to our recommendation. We consider this recommendation resolved and open pending completion of final action.

Recommendation 5 – Allocate LGPC resources to ensure risk is mitigated and quality is emphasized in accordance with the LGPC Strategic Plan.

Management Comments

The OFPO concurred with this recommendation. The OFPO stated that the LGPC is committed to producing high quality work even when faced with severe resource constraints. It will continue to strategically allocate resources to the areas of highest risk in an effort to ensure risk is mitigated and quality is emphasized in accordance with the LGPC strategic plan.

OIG Response

Management's comments were responsive to our recommendation. We consider this recommendation resolved and open pending completion of final action.

Appendix I: Scope and Methodology

We reviewed Section 7(a) of the Small Business Act;[26] the Small Business Jobs Act of 2010;[27] and the Government Performance and Results Act of 1993 (GPRA) and the GPRA Modernization Act of 2010.[28] In addition, we reviewed the Code of Federal Regulations (CFR), Title 13, Parts 120 and 121;[29] and Standard Operating Procedures (SOPs) 50 10 5.[30] We also reviewed the Office of Management and Budget (OMB) Circular A-123;[31] OMB Circular A-11;[32] and the Government Accountability Office (GAO) Standards for Internal Control in the Federal Government.[33] In addition, we reviewed the SBA's Fiscal Year 2011-2016 Strategic Plan, the FY 2012-2013 *OFPO/Standard 7(a) Loan Guaranty Processing Center's (LGPC) Strategic Plan* (LGPC Strategic Plan), and mission statements for offices responsible for managing the 7(a) loan program.

Furthermore, we conducted a survey of internal controls using a random sample of 34 representatives from the Office of Capital Access (OCA) and the LGPC. We examined LGPC 7(a) loan guaranty review reports and performance standards of LGPC loan specialists. We also examined LGPC organizational charts and position descriptions. In addition, we conducted a site visit at the LGPC located in Citrus Heights, CA in June 2013. We interviewed the LGPC Director, all LGPC managers, 5 lead loan specialists, 10 loan specialists, one information technology specialist, and the LGPC quality control specialist. We also obtained and analyzed historical loan portfolio and resource data related to the 7(a) loan guaranty approval process. In addition, we interviewed officials at the National Guaranty Purchase Center (NGPC) and representatives from seven lenders that submitted loan applications to the LGPC.

We selected and reviewed 70 loans approved by the Loan Guaranty Processing Center (LGPC) during the period of April 1, 2011, to April 30, 2013. The approved amounts for these loans totaled $58 million. All 70 sampled loans were selected from a universe of 7,489 loans totaling $6.2 billion. Using an Office of Inspector General (OIG) review methodology—that we prepared based on applicable SBA regulations and Standard Operating Procedures (SOP)—we reviewed 13 SBA loan files to assess compliance with SBA's regulations and procedures. These 13 loans totaling $13 million were selected based on both random and judgmental selection processes that considered the loan approval date, the number of screen-outs issued, exceptions to policy granted to small businesses, and whether they defaulted early. See Appendix II for a list of the 13 loans. A limited review of the other 57 sampled loans totaling $45 million included an examination of the information in SBA's Loan Accounting System to identify instances where origination deficiencies contributed to loan defaults. These 57 loans were transferred to liquidation within 18 months of loan disbursement. See Appendix III for a list of these 57 loans.

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[26] Title 15 U.S. Code Section 636(a).
[27] Public Law 111-240, *Small Business Jobs Act of 2010*, September 27, 2010.
[28] Public Law 103-62, *Government Performance and Results Act of 1993*, August 3, 1993, Public Law 111-352, *GPRA Modernization Act*, January 4, 2011.
[29] Code of Federal Regulations, Title 13, *Business Credit and Assistance*.
[30] SOP 50 10 5, Lender and Development Company Loan Programs (Versions C, D, & E effective, respectively 10/01/2010, 10/01/2011, and 06/01/2012).
[31] OMB Circular A-123, *Management's Responsibility for Internal Control*, December 21, 2004.
[32] OMB Circular A-11, *Preparation, Submission, and Execution of the Budget*, July 26, 2013.
[33] GAO Publication AIMD-00-21.3.1, *Standards for Internal Control in the Federal Government*, November 1999.

Use of Computer-Processed Data

We relied on information from the SBA's Mainframe Loan Accounting System (LAS), the LGPC's Loan Guaranty Processing System (LGPS), and an offline excel spreadsheet, documenting loans with exceptions to policy, to select our judgmental sample of 7(a) loans approved by the LGPC and to analyze SBA's portfolio. Previous OIG engagements have verified that the information maintained in the LAS is reasonably reliable. In addition, we conducted reliability tests on the data obtained from the LGPS and excel spreadsheet. For example, we verified that the data was within the scope of our requests and did not include blank fields. Further, data elements associated to the reviewed loans were verified against source documentation maintained in the SBA's loan files. As a result, we believe the information is reliable for the purposes of this audit.

Prior Coverage

Small Business Administration-Office of Inspector General Reports

Audit Report ROM 10-19, *Material Deficiencies Identified in Early-Defaulted and Early-Problem Recovery Act Loans,* issued September 24, 2010.

Audit Report ROM 11-06, *Material Deficiencies Identified in Five 7(a) Recovery Act Loans Resulted in $2.7 Million of Questioned Costs, issued* August 22, 2011.

Audit Report ROM 11-07, *Origination and Closing Deficiencies Identified in 7(a) Recovery Act Loan Approvals,* issued September 30, 2011.

Evaluation Report 14-08, *Improvement is Needed to Ensure Effective Quality Control at Loan Operation Centers,* issued January 17, 2014.

Appendix II: LGPC-Approved Loans Reviewed by the OIG (Full)

#	Loan Number	Borrower Name	Deficiency Type	Deficiency Description	Approved Amount
1	5114185000	Southern Cut, Inc.	-		$1,188,000
2	[FOIA Ex. 4]	[FOIA Ex. 4]	Eligibility	Insufficient evidence to support whether debt refinanced with the SBA loan was current and had an acceptable payment history.	$700,000
3	[FOIA Ex. 4]	[FOIA Ex. 4]	Repayment Ability & Eligibility	(A) Historical net operating losses, interim operating loss, and projections were not being met, (B) Transfer of risk to the SBA.	$3,000,000
4	[FOIA Ex. 4]	[FOIA Ex. 4]	Eligibility	Inadequate support for debt being refinanced with SBA loan proceeds and form 912 not completed by a key employee.	$150,000
5	5299875001	Gallmar Industries, LLC	-		$500,000
6	[FOIA Ex. 4]	[FOIA Ex. 4]	Eligibility	The loan specialist did not identify outstanding delinquent loans and the lender failed to disclose a material fact.	$98,550
7	[FOIA Ex. 4]	[FOIA Ex. 4]	Eligibility	An exception to policy was granted by the Office of Financial Assistance, but the condition attached to this approval was not included in the loan authorization.	$370,000
8	[FOIA Ex. 4]	[FOIA Ex. 4]	Repayment Ability	Unsupported cash flow projections.	$243,000
9	[FOIA Ex. 4]	[FOIA Ex. 4]	Eligibility	Inadequate support for debt being refinanced with SBA loan proceeds.	$440,000
10	[FOIA Ex. 4]	[FOIA Ex. 4]	Eligibility	Loan proceeds were used to refinance a delinquent seller note and a business valuation was not completed.	$1,000,000
11	[FOIA Ex. 4]	[FOIA Ex. 4]	Repayment Ability & Eligibility	(A) Historical loss, universal cash flow showed inadequate debt service coverage, and inadequate loan term (B) Transfer of risk to the SBA.	$1,350,000
12	[FOIA Ex. 4]	[FOIA Ex. 4]	Repayment Ability & Eligibility	(A) Universal cash flow showed inadequate debt service coverage both historically and interim, delinquencies on credit report, and late payments made on the line of credit being refinanced (B) Transfer of risk to the SBA.	$2,059,000
13	[FOIA Ex. 4]	[FOIA Ex. 4]	Repayment Ability	Unsupported cash flow projections and unreliable financial statements.	$1,925,500
	Total				**$13,024,050**

Appendix III: LGPC-Approved Loans Reviewed by the OIG (Limited)

#	Loan Number	Borrower Name	Deficiency Type	Evidence That Supports Inadequate Approval Decision	Approved Amount
1	4636565010	JK Yogurt, LLC	-		$61,200
2	4655565005	G.T. Sloan Incorporated	-		$700,000
3	4663645005	New Age Steel, LLC	-		$1,207,000
4	4685005002	Front Range Markets, LLC	-		$750,000
5	4693845007	Adams Building Contractors, Inc.	-		$2,065,000
6	4706365005	Michael D. and Christine T. Maloney	-		$1,250,000
7	4708435006	CHP RX Consultants, LLC	-		$125,000
8	4716525009	SynCare of Missouri, LLC	-		$400,000
9	4718775007	Roma Restaurant Group, LLC	-		$175,000
10	4728735010	The Theatre Salon, Inc.	-		$215,000
11	4740365009	Susan M. Abeldt DDS, APC	-		$1,000,000
12	[FOIA Ex. 4]	[FOIA Ex. 4]	Repayment Ability	This loan defaulted without a single payment.	$105,000
13	4771655005	Jenali Group, Inc.	-		$519,700
14	4774785004	MYR Holdings	-		$1,370,000
15	4779425000	Bone-A-Spine Medical LLC	-		$260,000
16	[FOIA Ex. 4]	[FOIA Ex. 4]	Repayment Ability	The borrower only made three full payments on this loan that was used to refinance same institution debt. The SBA's guaranty was cancelled per the lender's request.	$1,091,000
17	4802705000	Carriage House Obstetrics and Gynecology	-		$30,000
18	4806495006	RSB Remodelers, LLC	-		$355,000
19	4814845004	Inflatable Adventure Zone, LLC	-		$150,000
20	[FOIA Ex. 4]	[FOIA Ex. 4]	Repayment Ability & Eligibility	The SBA's Office of Credit Risk Management (OCRM) determined repayment ability was not justifiably based. In addition, OCRM found that change of ownership guidelines were not met. The loan defaulted within 13 months of disbursement.	$2,490,000
21	4829255007	John A. Limberger, Inc.	-		$475,000
22	4832575010	Kreager Enterprises, LLC	-		$4,625,000
23	4834705005	Porterhouse of La, LLC	-		$106,100
24	4839555007	John C. Tulip	-		$80,000
25	4839905005	Buchan Trucking	-		$567,000
26	4846945004	Bella Bronze Tanning, LLC	-		$122,800
27	[FOIA Ex. 4]	[FOIA Ex. 4]	Repayment Ability	This loan received 9 months of deferred payments. The loan term included 6 months of interest only payments, and no payments were made towards the principal. This loan	$100,000

#	Loan Number	Borrower Name	Deficiency Type	Evidence That Supports Inadequate Approval Decision	Approved Amount
				defaulted within approximately 14 months of disbursement.	
28	[FOIA Ex. 4]	[FOIA Ex. 4]	Repayment Ability	The borrower made the 6 interest only payments as agreed, and then only made two full payments toward principal and interest. This loan defaulted within approximately 8 months of disbursement.	$97,000
29	4867125004	Tan Yu Tou, Inc.	-		$150,000
30	4874305008	Rembrandt Kitchens & Baths, LLC	-		$350,000
31	4879825010	Prahlad, LLC	-		$1,065,000
32	4890245003	Karl E. Brewer(EPC) and Burlingame Concrete	-		$805,600
33	4897945004	URR of NC Incorporated	-		$1,200,000
34	4914905006	Capitol City Coffee, Inc.	-		$165,000
35	4916675002	Furi Development, LLC	-		$4,292,000
36	4917105008	Enriquez Development, LLC	-		$2,270,000
37	4927275006	Edmond Trent Huddleston	-		$30,000
38	4934205005	Summit Civil Contractors, LLC	-		$1,500,000
39	4939025009	JDAM, Inc.	-		$95,000
40	4942565008	Alamosa True Value Hardware, Inc.	-		$800,000
41	4944775005	American Sign Factory, LLC	-		$1,265,000
42	[FOIA Ex. 4]	[FOIA Ex. 4]	Repayment Ability	Approximately 10 months after approval, a request was made by the lender to sell collateral in order to make loan payments. At this time, the borrower did not have sufficient cash flow, and was laying off employees and cutting expenses.	$380,000
43	4958495005	Quality Medical Equipment & Supply, LLC	-		$395,600
44	4959585010	AJ USA, LLC	-		$386,900
45	4974545007	Cowboy Properties, LLC	-		$345,000
46	5021015007	E3J, Inc.	-		$991,000
47	5028105002	Health Care Educational Institute, LLC	-		$140,000
48	[FOIA Ex. 4]	[FOIA Ex. 4]	Repayment Ability	Approximately 6 months after loan disbursement, the lender requested to cash out an existing CD to make payments on a couple of SBA loans, but the loans would still be delinquent. Further, the borrower only made three loan payments before missing a payment.	$850,000
49	5053305005	Miranda & Associates	-		$757,900
50	5097485004	MK Connections, LLC	-		$395,000
51	[FOIA Ex. 4]	[FOIA Ex. 4]	Repayment	The borrower missed a	$450,000

#	Loan Number	Borrower Name	Deficiency Type	Evidence That Supports Inadequate Approval Decision	Approved Amount
			Ability	payment after making only one interest payment and only made 4 interest payments prior to default. No payments were made towards the principal.	
52	5117155008	PharmDirect, LLC	-		$50,000
53	5126015003	Gym Jab, LLC	-		$404,000
54	5160935001	Perryville Investment Group, LLC	-		$3,980,000
55	5175335001	Loki's Garden, LLC	-		$240,000
56	5226835010	Brewer Educational Resources, Inc.	-		$350,000
57	5238065001	Sander's Drug Store, Inc.	-		$200,000
	Total				**$44,794,800**

Appendix IV: Summary of Material Deficiencies

Loan Number [FOIA Ex. 4] [FOIA Ex. 4]

Debt Refinancing
On August 31, 2012, LGPC loan specialists approved this loan for $800,000. However, the loan amount was reduced to $700,000 after approval. The SBA loan specialists did not obtain sufficient evidence to support whether debt being refinanced with the SBA loan was current and had an acceptable payment history. The SOP states that when refinancing any seller take-back financing with an SBA-guaranteed loan, it has to be current for the past 24 months.

The borrower/lender requested to refinance a seller take-back note for $620,000. The LGPC loan specialists accepted a letter from the seller as evidence showing that the borrower made timely payments on the loan and was current on his obligations. Under prudent lending practices and in compliance with the SOP, the LGPC should have requested more documentation, such as a schedule of payments made to the seller or payments from the borrower shown on bank statements.

Loan Number [FOIA Ex. 4] [FOIA Ex. 4]

Inadequate Assurance of Repayment Ability and Transfer of Risk to the SBA
On July 2, 2012, LGPC loan specialists approved this loan for $3,000,000. The lender submitted a reconsideration request to the LGPC to refinance same institution debt. The loan application had been previously declined by the LGPC because it did not meet the SOP requirements due to a transfer of risk to the SBA and several other reasons.

The borrower had historical net operating losses for four consecutive years from 2008 to 2011. As a result of the historical losses, the borrower hired a financial advisory consulting company that assisted the borrower with preparing the 2012 cash flow projections and a strategy for making the business profitable. The projections were based on the borrower's new plan of cost reduction measures, signed sales contracts, and sales contracts that were being negotiated. However, interim financial statements showed the borrower continued to have a net loss and that projections were not being met. Furthermore, the treasurer of the business noted it was not realizing many of its sales and expense projections. Based on the historical losses, interim financial statement, and statements from the business' officers, we determined that the 2012 cash flow projections were not supported.

A 2012 audit report, prepared by a Certified Public Accounting (CPA) firm, noted that the borrower had suffered recurring losses from operations and had negative stockholder's equity that raised substantial doubt about its ability to continue as a going concern. Additionally, the CPA firm noted that the borrower defaulted on its loan with the lender and violations were waived through August 1, 2012. Further, the lender overextended the company's line of credit by $900,000 and the audit report stated that there was no guarantee the company would obtain the required credit facilities or payoff the current loan when it came due. We determined the borrower essentially defaulted on its original loan from the lender and, therefore, we believe the loan approved by the LGPC constituted an inappropriate transfer of risk to the SBA.

The SOP states that if the financial analysis demonstrates that the Small Business Applicant lacks a reasonable assurance of repayment in a timely manner from the cash flow of the business, the loan request must be declined, regardless of the collateral available.

Loan Number [FOIA Ex. 4] [FOIA Ex. 4]

Debt Refinancing

On April 23, 2012, LGPC loan specialists approved this loan for $150,000 without adequate support for the debt being refinanced with SBA loan proceeds. The purpose of the loan was to refinance an existing line of credit provided by a previous lender. The lender stated that this refinancing would substantially improve cash flow of the business by over $1,600 per month. However, the lender did not provide the date of the original note, maturity date, or monthly payment amount to substantiate these statements.

While the LGPC loan specialists appropriately screened out the loan and requested a copy of the original notes for the debt being refinanced, the required documentation was not obtained. Instead, the loan specialists accepted statements from the lender that a note did not exist for the debt. Additionally, the SBA Form 4 *Application for Business Loan*, disclosed that the debt being refinanced was past due. There was no evidence in the file to show that the loan specialists addressed this delinquency issue. As a result, there is no assurance this loan was eligible for the SBA guaranty. Specifically, there was no evidence in the loan file to support that this debt refinance transaction would lower the interest rate as required by the SOP.

Form 912 Not Completed

In addition, a key employee did not complete an SBA Form 912 *Statement of Personal History,* as required. The SBA loan specialists correctly issued a screen-out letter requesting a completed Form 912 for the store manager. The lender responded that the owner did not feel the store manager was an integral part of the business operations. However, we found evidence that the store manager rotated between multiple businesses locations and was listed as the contact for one of the business locations. This supported that this store manager was a key employee. We found no additional evidence that the loan specialists questioned the lender's response or required the store manager to complete the Form 912.

Loan Number [FOIA Ex. 4] [FOIA Ex. 4]

Lender Failed to Disclose a Material Fact

On March 30, 2012, LGPC loan specialists approved this loan for $98,550 and did not identify that it was used to purchase an existing restaurant, equipment, and inventory that were owned by the lender. The borrower was the prospective new owner of the restaurant. However, the lender failed to disclose to the SBA that the previous restaurant on the same property had outstanding delinquent SBA loans. We found that the previous restaurant failed to make payments, and as a result, the lender took the property as collateral. We determined that the SBA loan specialists could have discovered the non-disclosure issue by searching for the business address in SBA's loan accounting system. Given that the restaurant, equipment and inventory were owned by the lender, it would have been prudent for the loan specialists to perform this search.

This transaction put the SBA at risk. The SBA ended up with two loans in liquidation with a total outstanding balance of $43,673.66 and the $98,550 subject loan, which were all associated to the same property. According to the CFR, the SBA is released from liability on a loan guaranty (in whole or in part, within SBA's exclusive discretion), if the lender's improper action or inaction has placed SBA at risk or the lender has failed to disclose a material fact to the SBA regarding a guaranteed loan in a timely manner. The borrower was essentially going to be operating the same business and hours as the previous failed restaurant. Therefore, disclosing that the previous restaurant was financed by an SBA loan and had defaulted was critical to the LGPC's approval decision. We determined this loan was ineligible for SBA financing.

Loan Number [FOIA Ex. 4] [FOIA Ex. 4]

Condition Not Included in Loan Authorization
On May 31, 2012, LGPC loan specialists approved this loan for $370,000, which was for the refinance of three loans used to purchase a commercial fishing vessel and Individual Fishing Quota Certificates (IFQ) that were in the owner's personal name. The LGPC submitted a request to the Office of Financial Assistance (OFA) for an exception to policy to waive the requirement that all loans being refinanced be in the name of business. This request was approved by OFA with a condition that the vessel and certificates be placed in the name of the business. Nevertheless, the LGPC loan specialists did not include the condition in the loan authorization as required, and therefore, there is no assurance the loan was eligible for approval.

Loan Number [FOIA Ex. 4] [FOIA Ex. 4]

Inadequate Assurance of Repayment Ability
On September 14, 2011, LGPC loan specialists approved this loan for $243,000 without adequate support for cash flow projections. The lender provided projections using estimated revenues and expenditures supplied by the borrower's franchisor for the first two years of the business. However, these revenue projections were based on the annual average sales for all 882 franchised restaurants and the lender did not provide supporting documentation to show how revenues and expenses were calculated for the subject borrower's franchise. Further, the lender's financial analysis did not address competition in the area in which the business would be operating. The information on business competition was important in determining whether the provided projections were reasonable. This business defaulted within eight months of disbursement and only two months after the initial six-month interest only period. Information within the SBA's purchase file supported that significant competition within the business's area of operation directly contributed to the loan's default.

The SOP states that for loans submitted to the LGPC, the SBA approves the loan for both credit and eligibility. Additionally, the SOP states that if the financial analysis demonstrates that the Small Business Applicant lacks reasonable assurance of repayment in a timely manner from the cash flow of the business, the loan request must be declined, regardless of the collateral available. It also states that the analysis must include a description of and comments on the need for the business in the area (if new), and competition. In addition, it must include a financial analysis of repayment ability based on historical income statements and/or tax returns (if an existing business) and projections, including the reasonableness of the supporting assumptions.

The LGPC loan specialists should have requested supporting documentation from the lender to verify projections and determine the competition in the area. Without this support, the loan specialists could not make an informed loan decision. The SBA purchased this loan for $111,213.

Loan Number [FOIA Ex. 4] [FOIA Ex. 4]

Debt Refinancing

On September 14, 2011, LGPC loan specialists approved this loan for $440,000 without adequate support for the debt being refinanced with loan proceeds. The borrower used the loan proceeds to refinance $403,450 of outstanding debt to four previous lenders. The lender noted that the loans were deemed unreasonable due to term, interest rate, payment or a combination of those factors, and that all debt was incurred for business purposes. However, the loan specialists did not obtain the original notes to support these statements. Further, the lender did not include the date of the initial notes or the maturity dates in its explanation of the existing debt, which was critical to determining if the debt was eligible for refinance.

The SOP states that for loans submitted to the LGPC, the SBA approves the loan for both credit and eligibility. Additionally, the SOP states that when refinancing debt, the loan file must include a written analysis with supporting documentation that addresses:

- why the debt was incurred,
- if the debt being refinanced was currently on reasonable terms,
- if the new loan would improve the financial condition of the borrower.

This $440,000 loan defaulted approximately 16 months after disbursement. The SBA purchased this loan for $311,170.

Loan Number [FOIA Ex. 4] [FOIA Ex. 4]

Debt Refinancing

On July 15, 2011, LGPC loan specialists approved this loan for $1,000,000. The borrower used loan proceeds to refinance a seller note that was not current and was not being paid. The seller note was executed four years prior to the SBA approval and evidence in the loan file showed that the borrower only made three payments on the seller's note. Based on the payment history of this note, we determined that the seller did not require payment of the note and did not intend to collect it from the borrower. The SOP states that for loans submitted to the LGPC, the SBA approves the loan for both credit and eligibility. Additionally, the SOP states that when refinancing any seller take-back financing with an SBA-guaranteed loan, it has to be current for the past 24 months. As this debt was not current, the refinancing of this seller note should not have been approved.

Questionable Eligibility (Change of Ownership)

Additionally, a business valuation was not completed for this change of ownership transaction as required by the SOP. The sales transaction resulted in a significant amount of goodwill, and there was no business valuation to support the purchase price of $1,700,000. Additionally, there was a close relationship between the parties as the borrower had operated the subject business for years prior to the subject SBA loan. Instead, the lender submitted, and loan specialists accepted, a real estate appraisal that valued the real estate and FF&E at $780,000. This loan defaulted within 16 months of disbursement. The SBA purchased this loan for $749,230.

Loan Number [FOIA Ex. 4][FOIA Ex. 4]

Inadequate Assurance of Repayment Ability and Transfer of Risk to the SBA
On May 19, 2011, the LGPC loan specialists approved this loan for $1,350,000. For this same institution debt refinance, the LGPC loan specialists did not address the fact that the Universal Cash Flow Analysis (UCA) statement provided by the lender demonstrated an inability to repay this loan from the operations of the business. Additionally, the loan specialists approved a loan term that was not beneficial to the borrower and placed significant risk on the SBA.

The UCA statement, provided by the lender, showed that the net cash from operations was $169,000, while the projected debt service was $343,000, resulting in inadequate debt service coverage. According to the credit memorandum, the business cash flow was stressed due to the loss in 2009 and the growing revenues in 2010, which increased expenses. The SOP states that if the financial analysis demonstrates that the Small Business Applicant lacks reasonable assurance of repayment in a timely manner from the cash flow of the business, the loan request must be declined, regardless of the collateral available. Although information within the file demonstrated an inability to repay the loan, the loan specialists approved this loan based on a "rule of thumb" cash flow analysis.

The lender stated that the purpose of the refinance was to provide "substantial benefit as the cash flow savings provides critical internal support for an industry with added cash flow pressure with operational volatility due to economic conditions." The lender requested a five-year term for the SBA loan. The loan specialists approved a 5-year term for this loan even though the maximum term allowed by SBA requirements was 10 years. The annual debt service prior to SBA's loan was $190,328 compared to the actual amount of $339,364 subsequent to the approved SBA loan. Nevertheless, the loan defaulted only six months after the SBA funds were disbursed, and the borrower made only five full payments before the loan defaulted.

The SOP states that for loans submitted to the LGPC, the SBA approves the loan for both credit and eligibility. It also states that when establishing the repayment period, lenders/SBA must consider the following:

- the borrower's ability to repay,
- use of loan proceeds, and
- useful life of the assets being financed.

Finally, the loan specialists did not correctly calculate the SBA's collateral position and this loan had a significant collateral shortfall. The borrower's equipment, inventory and account receivables were valued by the loan specialists at $541,400, which was significantly lower than the $1,350,000 SBA loan amount. According to the loan authorization, the SBA did not have first lien position on some of the assets as they were secured by a prior lien. Therefore, we determined that the collateral secured by the SBA only had a value of $203,900. The loan specialists did not mitigate the transfer of risk from the lender. Specifically, they approved a loan for a business that demonstrated an inability to pay its debt from the cash flow of the business. They also approved an inappropriate loan term that significantly increased the business debt service requirement and was not in the best interest of the business. Finally, they allowed the lender to maintain a first lien on the accounts receivable and inventory business assets even though the lender's exposure from this refinancing was significantly reduced. The SBA purchased this loan for $836,031.

Loan Number [FOIA Ex. 4][FOIA Ex. 4]

Inadequate Assurance of Repayment Ability and Transfer Risk of Loss

On August 12, 2011, the LGPC loan specialists approved this loan for $2,059,000 for same-institution debt refinancing in which the borrower did not demonstrate repayment ability based on several cash flow analyses provided by the lender. The SOP states that for loans submitted to the LGPC, the SBA approves the loan for both credit and eligibility. Further, the SOP states that if the financial analysis demonstrates that the Small Business Applicant lacks reasonable assurance of repayment in a timely manner from the cash flow of the business, the loan request must be declined, regardless of the collateral available. The lender performed repayment ability calculations that showed the borrower did not have sufficient cash. The 2010 and interim 2011 UCA Cash Flow Statements showed a negative cash balance from the business operations of ($69,228) and ($88,392), respectively. This indicated the borrower needed to use funds from the line of credit to keep the business in operation. Finally, documentation within the loan file supported that the borrower had delinquencies on its credit report and made several late payments on the line of credit from the lender, further supporting an inability to service its debts from the cash flow of the business.

We also determined that this loan had a significant collateral shortfall. We determined there was no business or personal assets available to secure the $2 million SBA loan. The SOP states that an SBA guaranteed loan may not be used to refinance same institution debt where there is an appearance that the lender will shift to the SBA all or part of a potential loss from that same debt. The borrower had an existing $4.5 million line of credit with the lender. Of the $4.5 million, the SBA loan was used to term out $2.0 million while $2.5 million remained as a line of credit with the lender. The lender kept its first lien position on the inventory and accounts receivable, and another lender had first lien position on business equipment. The lender stated the borrowing base for the line of credit was reduced by the $2 million SBA loan and noted that both the line of credit and the SBA loan had sufficient collateral. However, the value provided was the borrowing base calculation for these assets and not their liquidation value. As documented by the loan specialists, the SBA had a second lien position against these assets and their liquidation would not result in recovery for the SBA. Approving this SBA loan reduced the lender's risk while increasing the risk to the SBA. The borrower defaulted on the loan approximately 20 months after disbursement. The SBA purchased this loan for $1,368,771.

Loan Number [FOIA Ex. 4] [FOIA Ex. 4]

Inadequate Assurance of Repayment Ability

On July 12, 2011, the LGPC loan specialists approved this loan for $1,925,500 without adequate support for cash flow projections. The SOP states that for loans submitted to the LGPC, the SBA approves the loan for both credit and eligibility. Additionally, the SOP states that if the financial analysis demonstrates that the Small Business Applicant lacks reasonable assurance of repayment in a timely manner from the cash flow of the business, the loan request must be declined, regardless of the collateral available. Further, it states that the analysis must include a financial analysis of repayment ability based on historical income statements and/or tax returns (if an existing business), and projections, including the reasonableness of the supporting assumptions.

The lender submitted cash flow projections for a new urgent care location, but there was no support for a significant amount of the income source. Specifically, the projections had three line items for income, which included: 1) medical urgent, 2) lease of the remaining space, and 3) "product/service C."

However, there was no support or discussion about what made up the product/service C income line item, and there was no lease agreement in place. While the lender's credit memo indicated that income from the borrower's other urgent care locations could support this new location, the financial statements submitted with the loan package were unreliable due to (1) the appearance that they represented time periods that were not requested by the loan specialists and (2) the calculation errors. As a result, the applicant's ability to repay the SBA loan from the cash flows of the business was not appropriately verified.

The loan specialists' acceptance of 1) revenue streams that had not been realized (i.e. lease agreement) or adequately explained (product/service C), and 2) financial statements that did not appear to represent the time period requested was not prudent. This $1.9 million loan defaulted approximately 14 months after disbursement, and there is evidence supporting that the subject business never opened and a lease to rent out the remaining space was not executed. The SBA purchased this loan for $1,439,555.

Appendix V: Agency Comments

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

Date: May 19, 2014

To: Robert A. Westbrooks
Acting Assistant Inspector General of Auditing

From: John A. Miller
Director, Office of Financial Program Operations

Subject: Response to Draft Report on Significant Opportunities Exist to Improve the Management of the 7(a) Loan Guaranty Approval Process, Project No. 12015

Thank you for the opportunity to review the draft report. The Office of Financial Program Operations (OFPO) appreciates the role the Office of Inspector General (OIG) plays in assisting management to ensure that these programs are effectively managed, and for the feedback provided in this draft report.

Introduction

While we acknowledge that there are opportunities for improvement in the 7(a) Loan Guaranty Processing Center (LGPC), we take exception with the tone and title of the report. We believe the word "significant" should be dropped from the title, "Significant Opportunities Exist to Improve the Management of the 7(a) Loan Guaranty Approval Process," as it overstates findings of the audit. We believe the IG's report generally contains an unnecessarily critical tone, even though we consider the recommendations to be reasonable in nature. This results in an imbalanced juxtaposition between the tone of the report and its ensuing recommendations and we would feel more comfortable if the report's tone more closely aligned with the magnitude of its findings.

In addition, we have concerns regarding the relevancy, scope change, and timeliness of some of the findings in the draft report. This audit was initiated in August 2012, with the anticipated completion of August 2013. However, it was not completed until March 2014, seven months later. We have already instituted many new practices within the LGPC that have improved operations since the beginning of the audit period.

OFPO and the LGPC are committed to continuous process improvement in regards to the management of our 7(a) loan guaranty approval process, and are extremely conscious of the need to mitigate the risk of loss to the Agency. To that end, we would like to draw attention to the estimated 2013 improper payment rate for 7(a) loan guaranty approvals of 4.6 percent. This is significantly lower than the acceptable improper payment threshold of 10 percent set by the Office of Management and Budget

(OMB). Given our consistently low improper payment rate, we are confident that we continue to serve as a conscientious steward of taxpayer dollars. We remain committed to effectively managing our loan centers by continuing to emphasize high quality financial services transactions necessary to minimize improper payments and efficient processes necessary to meet customer demands of reasonable response times.

The draft report briefly mentions some of the actions the LGPC has taken that address the findings in the report (i.e. requiring lenders to submit loan applications in a streamlined manner, creating a temporary risk-based approach to streamline the review of 7(a) loan applications, etc.). However, there are other actions not explicitly stated in the report that demonstrate effective management and continuous improvement of the 7(a) loan approval process. One of these initiatives was a large-scale project during 2010 and 2011 to improve the accuracy and consistency of the LGPC screen-out process, which is the process for obtaining information missing from the loan application package. This extensive undertaking emphasized the importance of dedicating more upfront time to the review of loan applications in an effort to improve efficiency, quality, and customer service within the LGPC.

Currently LGPC is implementing a quality and complexity rating methodology at the individual loan application level. Additionally, LGPC has initiated a differentiated loan application review process based on risk and complexity levels to ensure staff is properly allocated to mitigate risk. The LGPC is also contributing to the development of "SBA-One," a comprehensive decision tree web interface for applications submitted to the LGPC that will further improve application quality.

Loans Reviewed in the Audit

OIG utilized derogatory criteria (i.e. screen-outs, exceptions to policy, early defaults) to select a prejudiced sample that targeted some of the most difficult, complex loans in the LGPC's loan portfolio. Casting the results of these reviews over the entire 7(a) loan approval process is misleading.

OIG selected and reviewed 70 loans approved by the LGPC and "all 70 sampled loans were selected from a universe of 7,489 loans totaling $6.2 billion." OIG also reviewed 13 SBA loan files to assess compliance with SBA's regulations and procedures. According to the draft report, these 13 loans totaling $13 million "were selected based on both random and judgmental selection processes that considered the loan approval date, the number of screen-outs issued, exceptions to policy granted to small businesses, and whether they defaulted early."

Default Rate of LGPC approvals

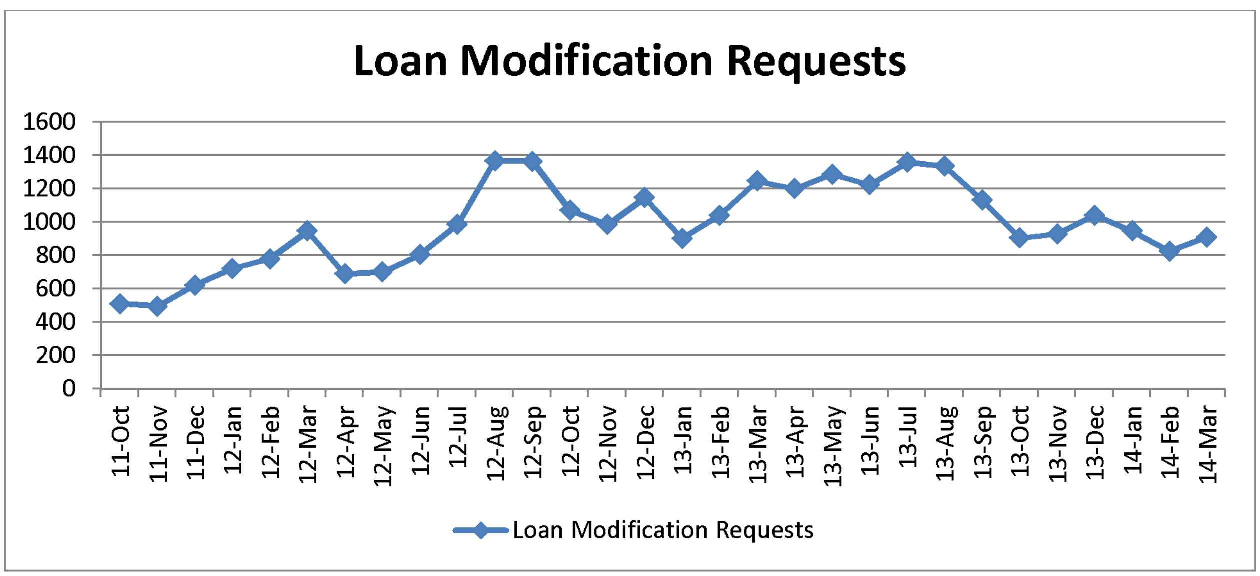
The OIG draft report mentions that default rates and early default rates for loans approved at the LGPC are slightly higher than lender-approved loans and makes an assumption that "the early default statistics provided above indicate there may be a higher number of origination deficiencies on SBA-approved loans." These statements are followed by an acknowledgement "that loans submitted to the LGPC include more complex and higher risk transactions, including the refinance of same institution debt and change of ownership transactions involving significant intangible assets." It is crucial to expand on these statements to provide context around the differences in default rates among loans approved by the LGPC and lender-approved loans. Also relevant to the discussion are the FY13 improper payment sample review results, which showed that improper payments on loans approved at the LGPC occurred less frequently than improper payments on loans approved under lenders' delegated authority.

Delegated lenders are known to submit more complex and higher risk transactions to the LGPC. When in doubt, they rely on center underwriting and expect the SBA guaranty to be more secure. These large, complex, and sometimes higher risk submissions from delegated lenders account for 25 percent of the LGPC's volume, which we believe justifies the slightly higher default rates for LGPC approved loans compared to the entirety of loans in the SBA's portfolio.

Staffing Levels

We appreciate the draft report's discussion of the impact of the American Recovery and Reinvestment Act (ARRA) and Small Business Jobs Act (SBJA) on SBA's lending and investment programs. Specifically, the draft report states that "in order to address the increase in loan applications submitted to the LGPC as a result of these Acts, the LGPC was required to ramp up the number of staff using temporary employees and employees redirected from the SBA Office of Disaster Assistance." It is important to point out that the additional staff at the LGPC was also required to address the increased complexity of loan reviews resulting from increasing the maximum 7(a) loan amount from $2 million to $5 million authorized under the SBJA. While the funding for the additional staff members expired, the increased maximum loan amounts and increased complexity associated with the larger loans have been permanently authorized. As a result, LGPC staffing levels that were considered adequate before the SBJA are not necessarily representative of the resources required to review the larger, more complex 7(a) loan applications that are now commonplace at the LGPC. Low staffing levels across all our loan centers represents a challenge that continues today and only reinforces the LGPC's pride in the low improper payment rate associated with its efforts.

In addition to the increased workload associated with larger, more complex loan applications, the LGPC has additional responsibilities outside traditional loan application reviews. The report references the large increase in loan modification requests received at the LGPC from October 2011 to May 2013. However, the report does not mention the significant decline in loan modifications requests since May 2013. Proactive actions taken by the LGPC, such as requiring delegated lenders to utilize their delegated authority and use ETran for eligible loan modifications, have resulted in a 29.3 percent decrease in loan modification requests between May 2013 and March 2014.



Similarly, reduced demand and processing efficiencies introduced by LGPC management resulted in a reduction of staff assigned to the America's Recovery Capital (ARC) Loan Interest Reconciliation from as many as 15 employees when the LGPC assumed responsibility for this function to only one employee as of early 2014. Further, this responsibility was transferred to another loan center in May 2014 in an effort to allocate staff to traditional loan application reviews.

Training

In support of the OIG's claim that LGPC staff training needs were not being met, the report states that, on occasion, LGPC management disseminated procedures to loan specialists via email. We believe that the issuance of procedures through email is a valid and appropriate method. All LGPC staff members have email accounts and consequently would have been made aware of any revised procedures that were issued via email. Email correspondence is a useful and cost effective means for disseminating office procedures.

OIG's assertion that LGPC staff training needs were not being met and were not designed to meet the specific needs of the loan specialists appears to ignore several relevant training opportunities provided to the LGPC staff, two of which are discussed in detail below.

The LGPC staff took part in a high quality, industry leading commercial lending course. Specifically, LGPC loan specialists and lead loan specialists took the a course entitled "Commercial Loans for Small Business" between January 2011 and March 2012. This course describes itself as teaching "a comprehensive analysis process for extending credit to small business borrowers." The course contains the following self-study modules, all of which directly relate to the daily duties of LGPC staff:

- Assessing the Opportunity
- Identifying Borrowing Causes
- Assessing Business, Industry and Management Risk
- Analyzing Business Financial Statements
- Analyzing Personal Financial Statements
- Analyzing Cash Flow and Projections
- Structuring the Loan

Additionally, training on SBA policies and procedures is provided to all new hires before they process loans. Additionally, refresher training is provided on eligibility annually, and any policy changes receive immediate training. For example, SBA's policy experts from the Office of Financial Assistance (OFA) trained all LGPC loan specialists and lead loan specialists in November 2013. The training was presented by webinar and supported by a PowerPoint presentation that was shared with LGPC staff. It focused on eligibility policy, with a special attention on policies that were about to be revised with the release of SOP 50 10 5 F that became effective on January 1, 2014. This webinar was followed with another formal training session in April 2014 presented by OFA in anticipation of the technical correction update to SOP 50 10 5 F.

We remain committed to ensuring LGPC staff is provided high quality training opportunities and believe the aforementioned trainings were beneficial and directly related to loan review activities at the LGPC. LGPC and OFPO management continue to ensure its staff is properly trained.

Other Comments/Concerns

While we certainly understand the usefulness of including interviews with LGPC staff as part of the OIG's audit methodology, that usefulness is undermined by the lack of context. Specifically, without including the text of the questions that were asked to solicit the quoted responses, we believe there is insufficient context to fully understand the responses provided in the draft report. It is unclear to us how these specific responses were solicited and how they were chosen to be included within the draft report. Moreover, without all of the questions and answers included, it is not clear where the four quotes cited in the report fall on the spectrum of responses given during the interviews.

In addition, it is important to mention that the draft report statement that there were no quality control reviews of LGPC loans approved for less than $1.5 million was only accurate between July 2012 and October 2013. Prior to July 2012, LGPC staff were reviewing a 3 percent random sample of LGPC approved loans, of which 25 percent were loans $1.5 million and over and 75 percent were loans under $1.5 million. Based on a discussion with the OIG in 2012, it was decided that there needed to be more focus on larger loans; therefore, the ratio changed so that the entire 3 percent random sample focused on loans $1.5 million and above. In October 2013, the LGPC QC team began to review 3 percent of all loans regardless of loan size, and on November 1st 2013, the team began reviewing all loans $3 million and above and 3 percent of loans under $3 million. In addition, as part of the annual Improper Payments Elimination Recovery Act (IPERA) audit, a review is conducted on a sample of loans from the entire loan portfolio.

Finally, the draft report identifies five loans with indications of suspicious activity that have been referred to the OIG Investigations Division for further review. It goes without saying that we are committed to helping to detect fraud, waste and abuse in all of our programs and appreciate the OIG's ongoing assistance in that effort. We are eager to take any necessary corrective actions once the details surrounding these five loans are shared with our management team.

Management's response to the recommendations in the draft report is noted as follows:

1. Revise management reports to measure quality against established targets, ensure production credit is given for all loan review actions and promote compliance with SBA requirements.

We agree with this recommendation, and will revise management reports to measure quality against established targets and conduct a review of production credit to ensure appropriate credit is given for loan review actions. It is important to ensure that production credit is not provided for screen-outs on loans that are ultimately approved or declined, because credit is provided in the approval or decline decision. For example, should a loan officer incorrectly screen out a complete loan package, credit should not be provided for such an action.

2. Distribute the LGPC Strategic Plan to staff and establish a process to ensure that quality goals are regularly communicated to LGPC staff.

We agree with this recommendation and will continue to distribute the LGPC Strategic Plan with an increased emphasis on the communication of quality goals.

3. Develop and issue appropriate guidance that will assist loan specialists with their duties, including loan reviews and screen-outs, to ensure compliance with SBA's regulations and procedures.

We agree with this recommendation and we are currently inventorying existing guidance in an attempt to create a comprehensive electronic manual for all LGPC staff. A link to this manual will be provided on all staff members' desktop computers to enable employees to quickly find applicable guidance to ensure compliance with SBA's regulations and procedures.

4. Develop and implement a training plan and tracking system that ensures loan specialists develop and retain the required skills necessary to achieve organizational goals and changing needs.

We agree with this recommendation.

5. Allocate LGPC resources to ensure risk is mitigated and quality is emphasized in accordance with the LGPC strategic plan.

We agree with this recommendation. As noted in this narrative, LGPC is committed to producing high quality work even when faced with severe resource constraints. We will continue to strategically allocate resources to the areas of highest risk in an effort to ensure risk is mitigated and quality is emphasized in accordance with the LGPC strategic plan.

Again, thank you for the opportunity to review the draft report. Please let us know if you need additional information or have any questions regarding our response.