

**AUDIT OF**

**A SBA LOAN TO [ EX. 4 ]**

**[ EX. 4 ]**

**[ FOIA EX. 4 ]**

**AUDIT REPORT NO. 2-05**

**FEBRUARY 27, 2002**

FOIA EX. 4

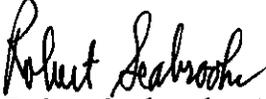
**The finding in this report is the conclusion of the OIG's Auditing Division based on testing of the auditee's operations. The finding and recommendation are subject to review, management decision, and corrective action in accordance with existing Agency procedures for follow-up and resolution. This report may contain proprietary information subject to the provisions of 18 USC 1905 and must not be released to the public or another agency without permission of the Office of Inspector General.**



U.S. SMALL BUSINESS ADMINISTRATION  
OFFICE OF INSPECTOR GENERAL  
WASHINGTON, DC 20416

<b>AUDIT REPORT</b>
<b>ISSUE DATE: FEBRUARY 27, 2002</b>
<b>REPORT NUMBER: 2-05</b>

**To:** Judith A. Roussel, District Director  
Illinois District Office

**From:**   
Robert Seabrooks, Assistant Inspector General  
for Auditing

**Subject:** Audit of a SBA Loan to [ ]      FOIA EX. 4      1

Attached is a copy of the subject audit report. The report contains one finding and recommendation addressed to your office. Your response and the lender's comments are synopsised in the report and included in their entirety at Attachments A and B, respectively.

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

Any questions or discussion of the finding and recommendation contained in the report should be directed to Garry Duncan, Director, Credit Programs Group, at (202) 205-7732.

Attachments

FOIA EX. 4

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## BACKGROUND

The Small Business Administration (SBA) is authorized under Section 7(a) of the Small Business Act to provide financial assistance to small businesses in the form of government-guaranteed loans. SBA guaranteed loans are made by participating lenders under an agreement (SBA Form 750) to originate, service, and liquidate loans in accordance with SBA regulations, policies, and procedures. SBA is released from liability on a loan guarantee, in whole or in part, within SBA's exclusive discretion, if a lender failed to comply materially with SBA regulations, the Loan Agreement, or failed to make, close, service, or liquidate a loan in a prudent manner.

Heller First Capital Corporation (the lender) was a Small Business Lending Company authorized by SBA to make guaranteed loans under the Preferred and Certified Lenders Programs. Under the Preferred Lenders Program (PLP), lenders are permitted to process, close, service, and liquidate SBA guaranteed loans with reduced requirements for documentation to and prior approval by SBA. Under the Certified Lenders Program (CLP), SBA processes loan guarantee applications and servicing actions on a priority basis. The lender also made loans under SBA's Low Documentation Loan Program (LowDoc). Although this program streamlined the guarantee application process, participating lenders are expected to perform a loan analysis in a manner consistent with prudent lending practices. The analysis is included with the lender's request for a SBA guaranteed loan. The lender stopped making SBA guaranteed loans in February 2001 and was acquired by General Electric Capital Corporation on October 25, 2001.

Prior audits of early default loans found that the lender did not always materially comply with SBA rules and regulations. In a January 2000 response to one of the audits, the lender acknowledged that the loan, which closed in 1997, would not have been approved under its current underwriting and closing procedures. A few months later in response to a SBA PLP review, the lender admitted that combined growth in volume and processing locations across the country was not in the best interest of the lender or SBA's lending program. Consequently, certain regions exercised more discretion in both credit analysis and compliance with procedures than the lender would have liked.

Based on the lender's acknowledgement of the lack of controls over the SBA guaranteed loan process, the Office of Inspector General initiated an audit of 140 loans originated by the lender that were purchased by SBA between January 1996 and February 2000, to determine if the loans were processed correctly. The audit identified several loans that were originated, serviced, and/or liquidated in material non-compliance with SBA rules and regulations. One of these loans was to [REDACTED] and is the subject of this report.

In [REDACTED] the lender approved a 22 year loan (loan number [REDACTED]) for \$522,000 to [REDACTED] (borrower) under the Preferred Lenders Program. The purpose of the loan was to purchase real estate for [REDACTED] machinery & equipment for [REDACTED] for working capital. The last loan disbursement occurred on [REDACTED] and the borrower defaulted on the loan in [REDACTED] after making only seven payments. SBA purchased the loan guaranty for \$404,468 on [REDACTED] In [REDACTED] the collateral real estate was sold and SBA received \$96,180, thus reducing the potential loss to \$308,288.

## AUDIT SCOPE AND OBJECTIVE

The objective of the audit was to determine if the lender originated, disbursed, and liquidated the loan purchased by SBA in accordance with SBA rules and regulations.

The subject loan was reviewed for compliance with 11 requirements found in SBA rules and regulations and the SBA-lender guarantee agreements. All identified lender deficiencies were evaluated to determine if it resulted in a material loss to SBA. A material loss was defined as exceeding \$25,000.

The audit was conducted during July 2000 in accordance with Government Auditing Standards.

## RESULTS OF THE AUDIT

### Finding 1 - The Lender Approved a Loan to an Ineligible Applicant

Pursuant to SOP 50 10 4, a lender must verify the resident alien status of an applicant to ensure that the principal is authorized to remain in the United States for at least half of the maturity of an approved loan. The principal clearly indicated on SBA Form 912, Statement of Personal History, that he was not a citizen and provided Alien No. [ ex. 6 ] The lender's loan file documents show this as the number of the Employment Authorization Card, which authorized employment for one year and expired in [ ex. 6 ] with a possible 7-year extension that would last until [ ex. 6 ] Consequently, the borrower was authorized to stay in the United States for only two months after the loan approved date. As a result, the borrower was not eligible to receive a SBA guaranteed loan, which resulted in a loss to SBA of \$308,288, after reducing the guarantee portion paid by the amount of recovery on collateral as of February 2001.

## RECOMMENDATION

We recommend that the Illinois District Office take the following action:

1. Seek recovery of \$308,228 from General Electric Capital Corporation on the guaranty paid to Heller First Capital, less any subsequent recoveries, for loan number [ ex. 4 ]

### District Office Comments

The Illinois District Office agreed that the guaranteed loan was made to an illegible borrower and stated that action would be taken to recover the amount of the guaranty paid to the lender.

### OIG Evaluation of District Office Comments

The district office comments and actions are responsive to the recommendation.

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### **Lender Comments**

The lender requested reconsideration of the finding because the principal's resident alien status did not cause the payment default or the loss upon liquidation.

### **OIG Evaluation of Lender's Comments**

We do not agree that SBA should reconsider its decision to seek recovery on this guaranteed loan based on the lender's position that the applicant's alien status did not cause the business to fail. As noted in the audit report, the lender had ample information to determine that the applicant was not eligible to receive a SBA guaranteed loan. Ignoring or overlooking this information does not excuse the lender from its responsibility to abide by program rules and regulations. By obligating SBA to guarantee an ineligible loan, the lender inappropriately placed SBA at unnecessary risk. Whether or not there is a link between the applicant's resident alien status and the loan default, SBA is not obligated to honor a guarantee on a loan to an ineligible applicant.



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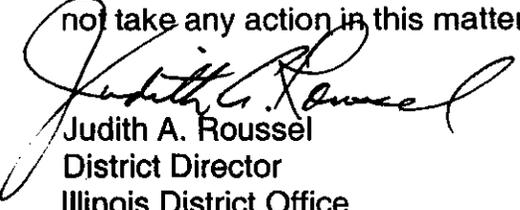
Appendix A

**DATE:** January 2, 2002  
**FROM:** Judith A. Roussel  
District Director  
Illinois District Office  
**TO:** Robert Seabrooks  
Assistant Inspector General For Auditing  
**SUBJECT:** IG Audit of SBA Guaranteed Loan to [ ]      FOIA EX. 4      ]  
[ex. 4 ] Loan No. [    ex. 4    ]

The Illinois District Office has reviewed the Office of Inspector General's memo and draft audit report dated December 6, 2001. This office agrees with the audit finding that Heller First Capital Corporation approved a loan to an ineligible applicant. The loan was ineligible because the principal of the borrower was a resident alien and was authorized to stay in the United States for only two months after the loan approval date. SBA SOP 50 10 4, Chapter 2, Para. 8.e.(3), page 31, Effective 12-01-97, provided that resident alien owners' status must provide the right to remain in the United States for at least half of the maturity of the approved loan. Loan maturity was 22 years.

This office also agrees with the draft audit report's recommendation that the Illinois District Office take action to recover from Heller the amount of \$308,288 (the guarantee paid to Heller less SBA's share of collateral recoveries as of February 2001) less SBA's share of any subsequent recoveries.

Please forward the Office of Inspector General's final report upon its issuance. This office will not take any action in this matter until the final report is issued.

  
Judith A. Roussel  
District Director  
Illinois District Office  
(312) 353-4528

FOIA EX. 4



[ Ex. 4 ]

Via First Class Mail

February 19, 2002

Robert Seabrooks, Assistant Inspector General  
Garry Duncan, Director  
Credit Programs Group  
U. S. Small Business Administration  
Office of the Inspector General  
409 3<sup>rd</sup> St. SW  
Mail Code 4112  
Washington, DC 20416

Re: Audit of SBA Guaranteed Loan to [ FOIA EX. 4 ]

Dear Sirs:

I have received your draft report concerning the SBA Guaranteed Loan to [ Ex. 4 ] and I would like to discuss the findings concerning the [ Ex. 4 ] loan.

With respect to the [ Ex. 4 ] loan, the draft report states that the principal of the Borrower had only two months left on his Employment Authorization Card. The photocopy in the file does show that fact. However, this fact is not the cause of the loss on the loan. The draft report correctly states that final disbursement of the loan did not occur until [ Ex. 4 ] seven months after the original expiration of the Employment Authorization Card. Moreover, Heller's special asset manager met with the principal to discuss the loan nearly a year later in [ Ex. 4 ], at which time, the principal was still involved in the business. A review of a current credit report indicates that the principal still has a current mortgage and two current car loans here in Illinois. The principal's resident alien status did not cause the payment defaults or the loss upon liquidation.

It was our understanding that the audit would cite only those issues that were material causes of the loss. We respectfully request that you reconsider the draft audit in light of the facts set forth above.

Sincerely yours,

[ FOIA EX. 4 ]

FOIA EX. 4

C: [ Ex. 4 ]

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