U.S. SMALL BUSINESS ADMINISTRATION
OFFICE OF INSPECTOR GENERAL
Washington, D.C. 20416

AUDIT-RELATED MEMORANDUM REPORT
Issued: April 28, 1998
Number: 8-7-S-001-013

To: Jane Butler, Acting Associate Administrator for Financial Assistance

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

Subject: Audit Related Memorandum - Use of Audited Financial Statements to Monitor the Small Business Lending Companies

At the request of the then Associate Administrator for Financial Assistance, we initiated a limited review of the financial statements of a major small business lending company. During the course of our review, we noted that SBA was not routinely receiving audited financial statements for some of the small business lending companies (SBLCs) that participate in the 7(a) loan program. SBLCs are required by 13 CFR 120.472 to submit audited financial statements to SBA within 3 months after the close of each fiscal year. As shown in the attached schedule A, the most recent financial statements received by SBA as of March 5, 1998, show that 9 of the 14 SBLCs had audited financial statements, one of which submitted only a balance sheet but no statements of income or cash flow; 4 SBLCs had unaudited financial statements; and 1 had audited consolidated financial statements for its parent company but not the SBLC entity.

SBLCs are non-depository lending institutions that are not subject to oversight by State and Federal bank regulators. SBA is solely responsible for supervising, examining, and regulating SBLCs. Audited financial statements are a key tool with which to monitor the financial stability of the SBLCs and ensure compliance with program regulations. For example, SBLCs are required to maintain an unencumbered paid-in capital and paid-in surplus of at least $1,000,000 or 10 percent of the aggregate of its shares of all outstanding loans, whichever is more. They also must avoid capital impairment, which exists when the retained earnings deficit exceeds 50 percent of the combined paid-in

capital and paid-in surplus, excluding treasury stock. Without audited financial statements, it is difficult, if not impossible, to ensure compliance with these requirements.

Recommendation

We recommend that the Acting Associate Administrator for Financial Assistance take steps to ensure that all SBLCs submit annual audited financial statements that include the necessary information needed to monitor compliance with SBA capital requirements.

Management's Response

The Office of Financial Assistance has worked closely with the Office of Inspector General (OIG) during this audit. As a result of this cooperation, OFA improved its efforts to insure compliance with this requirement prior to the issuance of the report. As of April 16, 1998, SBA has in hand FY 1997 financial statements from all 14 Small Business Lending Companies. We concur with the finding and appreciate the cooperation provided to us during this audit by the staff of the OIG.

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The finding included in this report is the conclusion of the Office of Inspector General Auditing Division based upon the auditor's testing of the auditee's operations. The finding and recommendation are subject to review and implementation of corrective action by your office following existing Agency procedures for audit follow-up resolution.

Please record your management decision on the attached SBA Form 1824, "Recommendation Action Sheet" and provide target dates for completion. We would appreciate receipt of this form within 15 days.

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 the permission of the Office of Inspector General.

Attachment

Schedule A

Financial Statements Received by SBA for Small Business Lending Companies

Financial Statements of the SBLC - Audited	For Year Ending
The Money Store Investment Corp.	12/31/96
Heller First Capital Corp.	12/31/96
First Western SBLC	12/31/96
Independence Funding Co. LLC	12/31/96
Allied Capital Lending Corp.	12/31/96
Small Business Loan Source, Inc.	12/31/96
Business Loan Center	06/30/96
Commercial Capital Corp.	12/31/95
The Loan Source Inc.	12/31/96
Consolidated Financial Statements - Audited	
GE Capital Corp. (GE Capital Small Business Finance Corp.) *	12/31/96
AT&T Capital (AT&T Small Business Lending Co.) *	12/31/96
Emergent Group Inc. (Emergent Business Capital, Inc.) *	12/31/96
Associates First Capital Corp. (Associates Commercial Corp.)	12/31/96
Financial Statements of the SBLC - Unaudited	
Grow America Fund, Inc. (6 months only)	06/30/97

* Although SBLC financial information was provided to SBA, a separate audit opinion was not issued on the SBLC portion of the company.

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