

**AUDIT OF
WISCONSIN DISTRICT OFFICE 7(a) LOANS
MADISON, WISCONSIN
AUDIT REPORT NO. 8-7-F-020-022
July 22, 1998**

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, D.C. 20416

AUDIT REPORT
Issue Date: July 22, 1998
Number: 8-7-F-020-022

To: Michael W. Kiser, District Director
Wisconsin District Office- Madison

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

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

Attached is a copy of the subject report. The report contains two findings with seven recommendations for the District Office.

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

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

Attachment

**AUDIT OF 7 (a) LOAN PROCESSING
WISCONSIN DISTRICT OFFICE
MADISON, WISCONSIN**

TABLE OF CONTENTS

	Page
SUMMARY	i
INTRODUCTION	
A. Background	1
B. Audit Objective and Scope.....	1
RESULTS OF AUDIT	
Findings and Recommendations	
1. SBA 7(a) Guaranteed Loans were not Always Processed, Disbursed, and Used in Accordance with SBA Requirements	2
2. Loan not Disbursed Within the Required Time Limit	6
OTHER MATTERS	
Borrower Misrepresentations.....	8
APPENDICIES	
A. - Schedule of Loans Reviewed	
B. - SBA Management Response	
C. - Audit Report Distribution	

SUMMARY

The audit was part of a nationwide review to determine whether 7(a) loans were processed, disbursed, and used in accordance with Small Business Administration (SBA) requirements. The Wisconsin District Office was assigned 613 loans valued at \$182.5 million from March 1, 1996 through June 30, 1997. The loans, made to small business concerns within the state of Wisconsin, were processed by the District Office and the Preferred Lender Program Processing Center. We selected a random sample of 30 loans valued at \$8.9 million for review.

SBA procedures for lenders and SBA loan officers are intended to reduce risk. Failure to follow these procedures increases the chance that ineligible or risky loans will be approved. We reviewed lenders' compliance with 22 such procedures. In the period audited, we determined that for 15 of the 30 loans, lenders did not follow at least one of the procedures reviewed.

For the 15 loans, the noncompliance with procedures consisted of the following:

- One loan for [redacted] was approved for an ineligible purpose, to pay taxes owed by the deceased owner's estate. The Code of Federal Regulations (CFR), Part 120, requires loan proceeds to be used for operating business purposes such as working capital expenses.
- A lender disbursed loan proceeds for an unauthorized purpose (1 loan). The Authorization and Loan Agreement (loan agreement) specifies how loan proceeds may be used. For a loan totaling [redacted], the lender improperly disbursed \$48,331 of the loan proceeds to another lender to pay the borrower's mortgage. This payment reduced the funds available for completing the construction project.
- Equity injections were not verified prior to disbursement (2 loans). Without the required cash injections, borrowers may have insufficient working capital to operate the business. For the two loans, borrowers did not inject a total of \$27,320 as required by the loan agreement. One of these loans also had an Internal Revenue Service (IRS) verification deficiency and is included in the next bullet.
- Financial information was not verified with IRS prior to disbursement of loan proceeds (10 loans). Without verified financial data, loan decisions could be based on financial data that is not credible. For one loan totaling [redacted] the lender did not verify business financial information with the IRS. The required verifications for the other nine loans were made after disbursement.
- Use of loan proceeds was not verified (1 loan). Without verification by lenders, borrowers could use proceeds for unauthorized purposes. For one loan totaling [redacted] the lender did not verify use of loan proceeds as required by the loan agreement and settlement sheet. Our subsequent review disclosed that the loan proceeds were used appropriately.
- Joint payee checks were not used to disburse loan proceeds for loans totaling \$560,000 (2 loans). Without the use of joint payee checks or other controls, the loan proceeds are at risk for improper use. A review of the use of the loan proceeds disclosed no problems.
- Business credit reports were not obtained for loans totaling \$376,600 (2 loans). Credit reports are necessary to determine the borrowers' credit history and whether the borrowers have shown past willingness to pay debts. Our subsequent review disclosed satisfactory credit history.

- Settlement sheets were not completed prior to March 1997 as required by SBA for loans totaling \$821,000 (3 loans). The deficiencies were not significant enough to invalidate the loan guarantees.

We also identified one loan with a guarantee totaling \$615,000 that was not executed and disbursed by the time specified in the loan authorization. In addition, three borrowers (two loans) made false statements concerning their criminal histories.

As of January 31, 1998, 25 of the 30 sampled loans were current, 2 were past due, and 3 were undisbursed. Lender responses regarding the loans indicated the deficiencies were due to both intentional and unintentional loan officer errors, as well as loan officer lack of knowledge of the SBA requirements.

We recommend that the Wisconsin District Director take the following actions to protect SBA's interests:

- Rescind the loan approval for one loan before disbursement.
- Reduce the guarantee percentage for one loan to reflect the ineligible use of loan proceeds.
- Obtain verification of equity injections from lenders or reduce the guarantee percentage for two loans to reflect the lack of injection.
- Require the lender to verify the seller's financial statements for one loan.
- Re-emphasize to lenders their responsibility to comply with SBA loan requirements, including:
 - ◆ approving loans and making disbursements only for eligible or authorized purposes,
 - ◆ verifying required equity injections,
 - ◆ validating financial data with the IRS,
 - ◆ verifying use of loan proceeds,
 - ◆ using joint payee checks, when appropriate, and
 - ◆ obtaining business credit reports.
- Cancel the guarantee for one loan that was not disbursed within the required time limit.
- Inform lenders to either request an extension of the disbursement period or cancel the loan guarantee when disbursement is not made within the specified time limit.

In response to a draft report (See Appendix B), the District Director generally agreed with the recommendations. The Director, however, stated that action for four loans could be delayed until loan purchase after default. Management comments and our evaluation are included on pages 6 and 7 of the report.

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

INTRODUCTION

A. BACKGROUND

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

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

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

B. AUDIT OBJECTIVE AND SCOPE

The audit objective was to determine whether 7(a) loans (excluding special programs such as LowDoc and FA\$TRAK) were processed and proceeds disbursed and used in accordance with SBA requirements. Special loan programs were excluded because the Office of Financial Assistance only wanted a review of the regular 7(a) loan program. The audit was based on a statistical sample of 30 loans valued at \$8.9 million out of a population of 613 loans valued at \$182.5 million made to small businesses and assigned to the Wisconsin District Office between March 1, 1996 and June 30, 1997.

The criteria used to evaluate loans consisted of 22 procedures selected from SBA's Standard Operating Procedures. These procedures were selected to facilitate a comparison to the results of the prior LowDoc audits.

The auditors reviewed lender and SBA file documentation for each loan in the sample; interviewed borrower, lender, and SBA district office personnel; and visited businesses to review records. Field work was performed from October 1997 through January 1998. The audit was conducted in accordance with Government Auditing Standards.

RESULTS OF AUDIT

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

SBA procedures for lenders and SBA loan officers are intended to reduce risk. The chance that risky or ineligible loans will be approved is increased when these procedures are not followed. In our sample, at least one processing or disbursing deficiency was identified for 15 of the 30 loans reviewed. Noncompliance with established procedures resulted in [redacted] for one loan being inappropriately guaranteed. Corrective actions are necessary to preclude guarantee adjustments for four loans totaling \$902,700. Adjustments to these loans would allow SBA to provide additional guarantees to other small business borrowers totaling \$645,600. The remaining 10 loans did not require guarantee adjustments because corrective actions had been taken.

Loan Guarantee Approved for and Loan Proceeds were Used for Ineligible Purposes

SBA approved a loan guarantee for an ineligible purpose and the lender for another loan disbursed funds for an ineligible purpose.

A loan (*sample number 3*) was approved to provide [redacted] of working capital to pay taxes owed by the deceased owner's estate. The taxes were not the liability of the borrower. Title 13, Code of Federal Regulation (CFR), Section 120.120 requires that an SBA loan be used for sound business purposes. Payment of estate taxes which are not the liability of the borrower does not constitute use of proceeds for sound business purposes and, thus, is an ineligible use of proceeds. In response to our draft audit recommendation, the District Office stated that the loan will be cancelled.

Another loan (*sample number 12*) totaling [redacted] was for borrowers to pay for building construction or improvements. The participating lender improperly disbursed \$48,331 of the loan proceeds to pay the borrowers' mortgage on their construction site. This payment reduced the funds available for completing the construction and was not authorized in the loan agreement. Proceeds not used for the purpose(s) specified in the loan authorization are considered an ineligible use of the SBA loan. The participating lender stated it was an oversight to release the funds and he thought that mortgage payments were permitted under the loan agreement. As of January 31, 1998, this loan was current.

Equity Injections were not Verified Prior to Disbursement

Guarantees for two loans should either be adjusted or proof of equity injections obtained from the lenders. Lenders did not ensure that required equity injections were made. The loan agreement for each of the loans stated that prior to the first disbursement the lender must be in receipt of satisfactory evidence (such as invoices, receipts and canceled checks) that the borrower and/or guarantor(s) has/have made the requisite equity injection.

By not complying with the loan agreement, lenders increased the risk that borrowers may not remain committed to the business or the business may not have sufficient cash flow to sustain operations. For the two loans, the borrowers did not inject \$27,320 as required by the loan agreement.

A loan for [redacted] (*sample number 31*) was approved in [redacted] to purchase land and a building. The loan agreement required an equity injection of \$25,000 in cash, as well as

\$27,300 in restaurant equipment. The lender stated the equipment was provided but could not prove the cash injection had occurred. The lender promised to provide the auditor details of the cash injection but failed to do so. When asked to prove the full cash amount was injected, the borrower claimed she injected more than the required amount but could not provide evidence of her cash injection because the business records had been stolen. During our site visit, the borrower provided support that about \$5,000 had been injected into the business. No support was provided for the remaining \$20,000. As of January 31, 1998, the loan was past due.

A loan to purchase land and buildings was approved in C * D (sample number 18). The loan agreement required the lender to inject \$192,320 into the business. The lender had evidence that the borrower had injected \$185,000, but could not provide support that the remaining \$7,320 was injected prior to disbursing the loan proceeds. As of January 31, 1998, the loan was current. This loan is also included in the discussion below regarding IRS verification of financial data.

Financial Information was not Verified Prior to Disbursement

For ten loans, lenders did not verify business and borrower financial information prior to disbursement as required by the loan agreement. The guarantee for one loan may need adjustment due to unresolved risks resulting from the lack of IRS verifications of financial information provided by the borrowers. SBA Policy Notice 9000-941 required lenders to obtain IRS verification of financial information of the small business concern or for a business being purchased prior to loan disbursement. This requirement ensures the financial information submitted by small businesses and used by SBA to make loan decisions is credible. The required verifications for the other nine loans were made after the loans were disbursed or upon our request to the lender.

A loan for C * D (sample number 6) was approved in C * D to purchase a gas station (land and building). Although required to verify the accuracy of the previous owner's financial information, the lender stated it did not do so because the purchased gas station was a small portion of the seller's holdings. Since the seller filed a consolidated tax return, obtaining an IRS verification would not have enabled the lender to adequately verify the seller's financial information for the gas station. The lender, however, did not use an alternative method, such as obtaining copies of financial statements prepared by an independent accountant or supporting schedules used to prepare the consolidated tax return, to verify seller financial information. As a result, neither the lender nor SBA had reasonable assurance that the financial information submitted in support of the loan was correct. As of January 31, 1998, the loan was current.

Lenders did not verify business financial information before disbursing nine other loans (sample numbers 2, 4, 5, 12, 13, 18, 24, 29, and 30). The verifications were made either after the loans were disbursed or at our request. As of January 31, 1998, eight of these loans were current and one was past due.

Use of Loan Proceeds not Verified

The lender for one loan did not verify the use of proceeds as required. SBA Form 1050 (Settlement Sheet) requires the lender to certify that the loan proceeds are disbursed and used in accordance with the loan authorization. Verification of the use of loan proceeds prevents a borrower from using loan proceeds for unauthorized purposes.

One loan (sample number 25) for C * D was approved to purchase machinery, equipment, furniture and fixtures. The lender did not verify use of the loan proceeds. The lender

accepted the borrower's detailed schedules of leased equipment purchases and did not require copies of the invoices or receipts. As a result, the lender could not prove the loan proceeds were used for authorized purposes. We determined that the loan proceeds were used appropriately. As of January 31, 1998, this loan was current.

Required Joint Payee Checks were not Used

Joint payee checks were not used to disburse two loans (*sample numbers 2 and 25*) totaling \$560,000. Disbursements of ζ * η , of loan proceeds designated as other than working capital were made payable to the borrowers. SOP 70 50 2, paragraph 3.F(1), and SBA Form 1050 require that the lender use joint payee checks to disburse loan proceeds when disbursements are for other than working capital. By not complying with this SBA loan requirement, the lenders increased the risk that the loan proceeds could be improperly used. A review of the use of the loan proceeds disclosed no problems. As of January 31, 1998, both loans were current.

Business Credit Reports were not Obtained

Lenders did not obtain business credit reports for two loans (*sample numbers 18 and 24*) totaling \$376,600. SBA requires lenders to evaluate a borrower's credit history as part of the creditworthiness determination. In addition, the Office of Management and Budget Circular A-129 requires that credit histories of applicants be verified through credit reports. Although our subsequent review of the borrowers' credit reports disclosed no significant credit problems, the risk of approving a loan for an applicant who was not creditworthy was increased by the lender's noncompliance. As of January 31, 1998, both loans were current.

Settlement Sheet Deficiencies

The settlement sheets for three loans (*sample numbers 1, 5, and 12*) totaling \$821,000 were not prepared properly. The settlement sheet states that it must be signed and returned to the SBA immediately after each disbursement. The settlement sheet for one loan (*sample number 1*), was signed but not disbursed for over 30 days. The lender stated that settlement sheets sometimes are signed at loan closing and completed when the disbursements are made. For two other loans (*sample numbers 5 and 12*), the settlement sheets were not prepared because the lenders were not knowledgeable of the SBA requirement to prepare a settlement sheet. By not complying with this requirement, the lenders violated one of the controls established to ensure proper disbursement and use of loan proceeds. These deficiencies, however, were not serious enough to invalidate the loan guarantees. As of January 31, 1998, the three loans were current.

Relationship of Loan Deficiencies to SBA Oversight

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

Of the 23 deficiencies identified, 20 were processing or disbursing actions not normally reviewed by or reported to SBA under existing procedures. As a result, the deficiencies generally would not be identified by SBA until after the loan defaulted and the lender requested the guarantee be honored. The remaining three deficiencies should have been identified during the SBA loan officer's review.

Reasons for lender deficiencies

Because lenders were responsible for most of the deficiencies identified, we asked why the deficiencies occurred. Lenders provided the following reasons:

Loan officer chose to use other than SBA policy	12 deficiencies
Loan officer made an unintentional error	4 deficiencies
Loan officer lacked knowledge of the SBA policy	3 deficiencies
Loan officer disagreed there was a deficiency	1 deficiency

This issue will be considered in a summary report because actions to minimize SBA's risk must be implemented agency-wide.

Recommendations

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

- 1.A. Rescind the ~~□~~ * □ loan approval for sample number 3.
- 1.B. Reduce the guarantee percentage for sample number 12 to reflect the ineligible use of \$48,331.
- 1.C. Obtain verification of equity injections from lenders or reduce the guarantee percentage for sample numbers 18 and 31 to reflect the lack of injection of \$27,320.
- 1.D. Require the lender to obtain copies of financial statements prepared by an independent accountant or the supporting schedules for the consolidated tax return from the seller for sample number 6 to determine the accuracy of the financial information.
- 1.E. Re-emphasize to lenders their responsibility to comply with SBA loan requirements, including
 - ensuring loans are approved and disbursements made only for eligible or authorized purposes,
 - verifying equity injections when required and properly documenting the injection in the loan file,
 - validating financial data with the IRS prior to disbursement,
 - verifying use of loan proceeds,
 - using joint payee checks for disbursement of loan proceeds other than for working capital, and
 - obtaining business credit reports.

Wisconsin District Director's Response

The District Director agreed with the finding and recommendations.

For sample number 3, the lender requested that the loan be canceled.

For sample number 12, the loan file will be reviewed to determine if SBA would have approved the use of proceeds and if a Form 327 loan modification action is needed. If a Form 327 action is not appropriate, the lender will be notified that SBA would seek to adjust the loan guarantee to reflect the ineligible use of proceeds if this loan comes in for purchase.

For sample numbers 6, 18, and 31, the District Office will either repair the problems through Form 327 actions or notify the lenders that any loan purchase will be adjusted to reflect the lenders not verifying tax returns and not requiring evidence that the equity was injected.

The District will develop a series of articles in its monthly newsletter to all lenders that address approving loans and making disbursements only for eligible purposes, verifying required equity injections, validating financial data with the IRS, notifying SBA when adverse changes in borrower conditions occur, verifying use of loan proceeds, using joint payee checks when appropriate, and obtaining credit reports. Since SBA rescinded the requirement settlement sheets, this item will not be discussed in a newsletter article.

Evaluation of the Wisconsin District Director's Response

The District Office response is acceptable.

We believe, however, that immediate steps are needed to protect SBA's interests for sample numbers 6, 12, 18, and 31. There is no assurance that SBA will identify the deficiencies for these loans during a purchase process. The severity of the deficiencies warrants the need for action to be taken to enforce lender compliance now. As a result of the Low Documentation Loan audit, the Acting Associate Administrator for Financial Assistance and the OIG are currently identifying deficiencies that are so material or serious that denial or repair of the guarantee prior to a request to purchase is warranted. This will provide the basis for a policy stating the circumstances when SBA will notify a lender, prior to loan default or a purchase request, that SBA will not honor or will request a repair of the guarantee. We will, therefore, postpone audit evaluation of management comments regarding these loans until audit follow-up on the LowDoc audit is completed.

Based on the District Director's responses, we dropped an earlier recommendation to re-emphasize to lenders their responsibility to complete and forward settlement sheets to SBA.

FINDING 2 A Loan was not Disbursed within the Required Time Limit

A loan for * was not disbursed within the time limits specified in the loan authorization agreement. Neither the lender nor the district office identified the expired loan and, therefore, action was not taken to cancel the guarantee. If issued, the guarantee for this loan would be based on outdated information. Loan cancellation would allow SBA to provide * in guarantees for other loans.

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

Once the loan application is approved, SBA, the lender, and the borrower execute a loan agreement containing the conditions and requirements for the loan. Among the conditions and requirements are time limits for the first and final disbursements of loan proceeds. These time limits cannot be exceeded without prior SBA approval.

The loan for ~~☒~~ * ☐ (sample number 28) was approved for the purchase of machinery, equipment, furniture and fixtures, and construction or improvement of buildings. The loan proceeds were required to be fully disbursed no later than 12 months from the date of the loan approval, which was ~~☒~~ * ☐. The lender stated the loan had not been disbursed because the borrower was unable to raise the required equity injection of \$300,000. As a result, the loan agreement for the ~~☒~~ * ☐ guarantee had not been executed nor had disbursements been made as of April 15, 1998, more than 15 months after loan approval. The guarantee should be rescinded and the borrower required to submit another application if the loan is still needed.

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

After discussing this situation with District Office personnel, additional discussions between SBA and the lender were held and the lender instructed to request an extension which the District Office approved. Final disbursement for the loan has been extended to September 30, 1998.

Recommendations

We recommend that the Wisconsin District Director take the following actions:

- 2.A. Cancel the guarantee for sample number 28 because the loan was not disbursed within the required time limit.
- 2.B. Inform lenders to either request an extension of the disbursement period or request cancellation of the loan guarantee when disbursement is not made within the specified time limit.

Wisconsin District Director's Response

The District Director stated that it was not necessary to cancel the guarantee because other corrective action was taken to resolve the reported problems. On April 21, 1998, the lender requested an extension of the loan disbursement date because of construction delays. Further, the lender has confirmed that there have been no adverse changes in the business finances and the required equity injection has been made.

The District Director further stated that he will include an article in the monthly newsletter which informs lenders to request an extension or cancellation of the loan guarantee when disbursement is not made within the specified time limit.

Evaluation of the Wisconsin District Director's Response

The District Director's corrective actions are responsive to the recommendations.

Other Matters

Borrower Misrepresentations

The auditors requested criminal history reviews for the principals of each loan. The results of the criminal history checks showed that three borrowers (two loans) did not state they have a criminal history when, in fact, they do. Their histories, however, did not include offenses which were serious enough to preclude financial assistance from SBA.

Schedule of Loans Reviewed and Their Status as of January 31, 1998

SAMPLE NUMBER	LOAN NUMBER	BORROWER	LOAN AMOUNT	LOAN STATUS	TYPE
1	┌			Current	CLP
2				Current	PLP
3				Not Disbursed	CLP
4				Past Due	REG
5				Current	REG
6				Current	REG
7				Current	CLP
8				Current	CLP
9				-----	-----
10				Current	PLP
11				Current	REG
12				Current	REG
13				Current	PLP
14				Current	CLP
15				Current	REG
16				Current	CLP
17				Current	REG
18				Current	CLP
19				Current	CLP
20				Current	REG
21				Not Disbursed	REG
22				Current	REG
23				Current	PLP
24				Current	CLP
25				Current	REG
26				Current	CLP
27				Current	REG
28				Not Disbursed	REG
29				Current	PLP
30	Current	CLP			
31	└			Past Due	REG

* Ex. 4



U. S. SMALL BUSINESS ADMINISTRATION
 WISCONSIN DISTRICT OFFICE - MADISON
 212 EAST WASHINGTON AVENUE, ROOM 213
 MADISON, WISCONSIN 53703

608-264-5261 • 608-264-5541 (FAX) • 608-264-5333 (TDD)

June 26, 1998

Mr. Peter L. McClintock
 Assistant Inspector General
 U.S. Small Business Administration
 Office of Inspector General
 Washington, DC 20416

RE: Audit of Wisconsin District Office 7(a) Loans
 Draft Audit Report No. 8-8-F-020 dated June 4, 1998

Dear Mr. McClintock:

This is my written response to the Draft Audit Report of the Wisconsin District Office.

- 1.A. In response to your recommendation to rescind the [*]
 [] the lender has requested that the loan be canceled. This loan will be cancelled, therefore there is no need to rescind the loan guarantee.
- 1.B. In response to your request to reduce the guaranty percentage for [*] to reflect the borrowers ineligible use of proceeds, the Wisconsin SBA proposes to review the file to determine if we would have approved this use of proceeds had this been requested initially or during the course of construction. If we would have approved this transaction we will complete a 327 action to modify the loan authorization. If we would not have approved it, we will notify the lender that if this loan comes in for purchase the SBA would seek an adjustment to reflect the harm that was done by the lender not disbursing the loan in accordance with the authorization. This is the procedure outlined in SOP 50 51 2.
- 1.C. In response to your request for a verification of equity injections from lender or a reduction of the guaranty percentage for [*] the Wisconsin SBA proposes to determine if this problem can be repaired or corrected. If it can be repaired the SBA will complete a 327 repairing the transaction. If his cannot be repaired or corrected the SBA will notify the lender that if a purchase is requested by the lender an adjustment would be recommended on the purchase to reflect the harm that was done by the lender not requiring evidence that the equity was injected. This is the procedure outlined in SOP 50 51 2.
- 1.D. In response to your request to obtain copies of financial statements prepared by an independent accountant or the supporting schedules for the consolidated tax return from the seller for [] and your recommendation that SBA obtain a guarantee release or an indemnification agreement to reflect the lack of IRS verification of tax return of the seller's financial information, the Wisconsin SBA proposes that we determine if this problem can be repaired or corrected. If it can be repaired the SBA will complete a 327 repairing the transaction. If this problem cannot be repaired or corrected the SBA will notify the lender that if a purchase is requested by the lender an adjustment will be recommended on the purchase to reflect the harm that was done by the lender not doing the verification of the tax return of the seller's financial information. This is the procedure outlined in SOP 50 51 2.

* Ex. 4

1.E. The Wisconsin SBA will be doing a series of articles in our monthly newsletter (that goes to all Wisconsin SBA lenders) on the following categories:

- Approving loans and making disbursements only for eligible purposes
- verifying required equity injections
- validating financial data with the IRS
- notifying SBA when adverse changes in borrower conditions occur
- verifying use of loan proceeds
- using joint payee checks, when appropriate
- obtaining credit reports

1.E. In response to your comment to train lenders on completing and sending settlement sheets to SBA, SBA Policy notice 5000-511 states that SBA form 1050 Settlement Sheet(s) are no longer required effective March 1997.

2.A. In response to your recommendation to cancel the guarantee for [*] the following additional data is provided:

The Wisconsin SBA has advised the lender, in a letter dated 11/6/97, not to close on the permanent financing due to the borrowers inability to secure necessary financing that was part of the project. The authorization allowed 12 months for full disbursement to [*] Several more discussions were held with the lender and packager to resolve the situation of the project cost adjustment and request for extension. The project financing problems were addressed and agree with a 327. Letters were sent to the lender on February 11, 1998 and April 14, 1998 requesting a written request for extension. A letter was received requesting an extension on April 21, 1998 indicating construction delays caused the need for an extension and that no proceeds had been disbursed under the SBA loan authorization. The request for extension was approved with final disbursement extended to September 30, 1998. This is allowed in SOP 50-10 7d page 172, which states that SBA must insure that no adverse change has happened,. At that time the business did not have financial statements as this is a start-up business so there were no statements to review. Also the SBA loan officer confirmed through discussions with the lender and packager that there was no adverse change. All equity was raised and the loan amount was changed per 327. The Wisconsin SBA would disagree with the request to cancel the guarantee for [*]

2.B. In response to your request to inform lenders to either request an extension of the disbursement period or request cancellation of the loan guarantee when disbursement is not made within specified time limit, the Wisconsin SBA will include an article on this topic in our monthly newsletter.

Thank you for the opportunity to comment on the findings and recommendations of the audit team. If you have any questions or comments, please contact me at (608) 264-5268.

Sincerely,



Michael W. Kiser
District Director

Cc: Acting Associate Administrator for Financial Assistance

* M X. F

**OFFICE OF INSPECTOR GENERAL
AUDIT REPORT DISTRIBUTION**

<u>Recipient</u>	<u>Number of Copies</u>
Administrator-----	1
Deputy Administrator-----	1
General Counsel-----	2
Associate Administrator for Field Operations-----	1
Associate Deputy Administrator for Capital Access-----	1
Acting Associate Administrator for Financial Assistance-----	1
Office of the Chief Financial Officer----- Attn: Jeff Brown	1
District Director, Wisconsin District Office-----	1
General Accounting Office-----	1