

AUDIT OF AN SBA GUARANTEED LOAN TO

JUST A CUT LAWN CARE, INC.

Brunswick, Georgia

Audit Report Number: 7-06

December 28, 2006



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

AUDIT REPORT
Issue Date: December 28, 2006
Report Number: 7-06

To: Janet A. Tasker
Acting Associate Administrator for Financial Assistance

/s/ original signed

From: Debra S. Ritt
Assistant Inspector General for Auditing

Subject: Audit of an SBA Guaranteed Loan to Just A Cut Lawn Care, Inc.

The purpose of this memorandum is to notify you of a \$28,660 improper payment that should be recovered. During our ongoing audit of the guarantee purchase process at the National Guaranty Purchase Center, we identified a problematic loan [Exemption 2] made by First Georgia Bank (lender) to Just A Cut Lawn Care, Inc. (borrower). First Georgia Bank was subsequently acquired by United Community Bank and therefore, United Community Bank became responsible for servicing and liquidating SBA guaranteed loans approved by the lender. The audit was conducted during May 2006, in Chicago, Illinois, in accordance with *Government Auditing Standards* prescribed by the Comptroller General of the United States.

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 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. If a lender fails to comply materially with SBA regulations, the loan agreement, or does not make, close, service, or liquidate a loan in a prudent manner, SBA has exclusive discretion to release itself from liability, in whole, or in part, on the loan guarantee.

On August 28, 2001, SBA approved a loan for \$66,395 to provide a borrower with working capital and to refinance business-related credit card debt and term loans. The loan was processed under Low Doc procedures and therefore, SBA was responsible for determining the eligibility and credit risk of the borrower. The loan was fully disbursed on September 11, 2001, and the borrower defaulted on August 11, 2003. A purchase review was completed by the National Guaranty Purchase Center on April 26, 2005, and no material deficiencies were identified. SBA purchased the guarantee on May 3, 2005 for \$42,172.

The Lender Did Not Ensure Loan Proceeds Were Used as Required by Loan Terms

The lender did not verify that credit card debt refinanced with loan proceeds was business-related as required by the loan authorization. This deficiency was not detected during the guarantee purchase process and, as a result, SBA made a \$28,660 improper payment when it honored the guarantee.

The loan authorization required the lender to document that the borrower used the loan proceeds for the purposes provided in the authorization. The loan authorization specifically required the lender to verify business-related debt on five of the credit cards being refinanced with loan proceeds. It also required the lender to complete and sign SBA Form 1050, *Settlement Sheet*, for each disbursement and retain the forms in its loan file. Upon signing the 1050s, the lender certified that the loan proceeds were used in accordance with the loan authorization.

The lender disbursed \$28,869 to pay off five credit cards for which it was required to verify that the debt was business-related. Only \$209 of the debt, consisting of purchases from Sears for a work belt, a tape holder, a tool bag, a padlock, and power tool bits, appeared to be business-related. The remaining \$28,660 of debt consisted of (1) unsupported cash advances totaling \$10,176, (2) charges that appeared to be personal in nature,¹ such as for bed and bath linens, an appliance repair, shoes, a bag, a log carrier, and a ride-on-vehicle, (3) unsupported credit card balances due to gaps in the provided statements, and (4) fees and penalties. There was no assurance that any of these charges were business-related and as a result, recovery of \$28,660 from the lender is warranted.

Recommendation

We recommend that the Acting Associate Administrator for Financial Assistance:

1. Seek recovery of \$28,660 from United Community Bank on the guarantee paid.

Lender Comments

The lender who assumed the loan provided written comments on a draft of this report. United Community Bank stated that the lender relied on support and authorization from the Coastal Area District Development Authority (CADD) to verify that the credit card debt refinanced with loan proceeds was business-related as required by the loan authorization. United Community Bank claimed that an August 15, 2001, letter from CADD, which was attached to its comments, indicated that the credit card statements and receipts were verified and determined to be business-related.

¹ For example, purchases were from the Tackle Shack, Wal-Mart, Golden Isles Marina, Island Rock Café, Atlantic Marine, Tommy Hilfiger, Dexter Shoe, First Coast Golf, Bonaventure Golf, Staples, Spanky's, Cellular One, The Stadium Club, JC Penney, and Sears.

With regard to the collateral issue presented in our draft audit report, United Community Bank claimed that the borrower's bankruptcy filing prior to loan default prevented the lender from performing a timely site visit until permission was granted by the Bankruptcy Court. The lender's comments are included as Appendix I.

Office of Inspector General Response

SBA's loan authorization was provided to First Georgia Bank which was subsequently acquired by United Community Bank. The loan authorization specifically required First Georgia Bank to verify that certain debt being refinanced with loan proceeds was business-related. The authorization did not include a provision for the lender to rely on an outside party for the required verification. Furthermore, the August 15, 2001 letter from CADDA does not state that the credit card statements and receipts were verified and determined to be business-related as claimed by United Community Bank. As a result, we continue to support our position with regard to this matter.

With regard to the bankruptcy issue, we believe the lender could have petitioned the court for permission to make a site visit shortly after the August 4, 2003, bankruptcy filing and certainly well before April 2004.

Agency Comments

The Agency provided written comments on a draft of this report. SBA Management agreed that the lender should be required to repay the \$28,660 of loan proceeds disbursed to repay credit card debt that the originating lender did not confirm to be business debt.

SBA Management also agreed that the lender should have petitioned the court to permit it to make the site visit. However, SBA stated that the lender's deficiency is not material because the loan collateral is primarily lawn mowing equipment and the realizable value for used equipment collateral is minimal. As a result, SBA Management would not be able to recover the recommended \$11,622 for this deficiency. SBA Management's comments are included as Appendix II.

Office of Inspector General Response

We agree that the realizable value for the used equipment collateral would have been minimal, and therefore, have modified our recommendation.

Actions Required

The finding in this report is the conclusion of the Office of Inspector General's Auditing Division based on testing of SBA 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. Please provide your proposed management decision for our recommendation within 30 days of the date of this report on

the attached SBA Form 1824, "Recommendation Action Sheet," and show your proposed corrective action and target date for completion.

We appreciate the courtesies and cooperation of the Office of Financial Assistance representatives during this audit. If you have any questions concerning this report, please call me at (202) 205-[Exemption 2] or Robert Hultberg, the Program Director, at (202) 205-[Exemption 2].



Chad Gasaway
Special Assets

United Community Bank
PO Box 398
Blairsville, Georgia 30514
706-745-2151 Ext. [Exemption 2]
Fax: 706-745-2019

December 6, 2006

Terry Settle
SBA Office Of Inspector General
1145 Herndon Parkway, Suite 900
Herndon, VA 20170

RE: Draft Audit Report On An SBA Guaranteed Loan To Just A Cut Lawn Care, Inc.

Dear Terry:

The following is a response to the draft audit report that was dated November 7, 2006 and issued by Debra Ritt, Assistant Inspector General for Auditing. The recommendation of the audit resulted in a \$40,322 improper payment based on two findings. (1) The lender did not ensure loan proceeds were used as required by loan terms and (2) The lender did not secure the collateral. The following outlines our disagreement to the recommendation of the audit.

The lender relied on support and authorization from the Coastal Area District Development Authority (CADD) to verify that the credit card debt refinanced with the loan proceeds was business related as required by the loan authorization. Please see the attached letter dated August 15, 2001. Teena Hicks at CADD has indicated that the credit card statements and receipts included in the refinance of this loan were verified and determined to be business related by CADD.

The borrower filed Chapter 7 bankruptcy on August 4, 2003 and the loan defaulted on August 11, 2003. The lender did not perform a site visit within 60 days after an unremedied default or within 15 days of an adverse event due to the fact that the borrower filed bankruptcy prior to the default date. As a result, the lender was not able to perform the site visit until permission was granted by the Bankruptcy Court.

Based on the information provided in the response above, United Community Bank believes that the payment should be honored.

Sincerely,

[Exemption 6]

Chad Gasaway
Special Assets



COASTAL AREA DISTRICT DEVELOPMENT AUTHORITY

Business and Economic Development Financing

1313 NEWCASTLE ST., 2ND FLOOR, BRUNSWICK, GA 31520
912-261-2500 FAX: 912-261-0032

OFFICE ALSO LOCATED IN SAVANNAH
912-341-0050

August 15, 2001

Mr. Robert Strange
First Georgia Bank
1703 Gloucester St.
Brunswick, GA 31520

RE: Just A Cut Lawn Care, Inc.
Potential Small Business Loan

Dear Robert:

We have reviewed the information on the above small business for the possibility of providing assistance in refinancing company debt to improve cash flow and providing additional working capital. As indicated by historical financial statements, the company is having difficulty meeting current debt service; the primary reason being that the majority of debt is credit card debt with high interest rates and no predetermined repayment terms.

After reviewing the overall debt and the financial statements, CADDA recommends refinancing specific debt (indicated on the attached Debt Schedule) with the assistance of the SBA Lo-Doc loan program, which would offer the bank an 85% guarantee. In addition, the applicant would be provided with \$10,000 in working capital to cover growth in A/R. The total loan amount would be \$64,992 (including applicable SBA fees). Given a 72 month repayment term at WSJP+2%, floating, the debt coverage ratio is projected at 1.44:1, given a salary cap of \$30,000 for [Exempt 6]. The collateral for the proposed loan would be a 1st lien on M/E, Inventory, and A/R. The total value of the collateral as of 8/1/01 is \$52M. (Liquidation value of collateral is \$31M.) No other personal collateral is available for the loan. [Exempt 6] have a first and second mortgage on their home with no remaining equity.)

Should the bank concur with the structure, the bank's initial risk would be \$9,749, (15% of the outstanding balance thereafter).

Please review the attached information and call me at your earliest convenience to discuss.

Sincerely,

Teena D. Hicks
Loan Officer



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

DATE: December 15, 2006
TO: Debra S. Ritt, Assistant Inspector General for Auditing
 [Exemption 6]
FROM: James W. Hammerslev, Acting Deputy AA/FA
SUBJECT: Draft Audit Report of SBA Guaranteed Loan to Just A Cut Lawn Care, Inc.

We appreciate the opportunity to respond to your draft audit report dated November 7, 2006 for the above referenced loan, which has two principal findings to which we respond below.

First, we agree that the lender should be required to repay the portion of the guaranty purchase amount disbursed by SBA that represents the Agency's guaranteed percentage of \$28,660 of loan proceeds disbursed to repay credit card debt that the originating lender did not confirm to be business debt. In this regard, we have contacted the lender and it is attempting to obtain the requisite documentation. If the lender provides satisfactory documentation to establish that the credit card debt was business debt, then this issue will be considered resolved.

The second issue pertains to the lender's failure to make a timely site visit to assess and secure loan collateral after default. We agree that even though the borrower filed bankruptcy, the lender should have taken some action such as petitioning the court to permit it to make the site visit. However, in this case the lender's deficiency is not material because of the nature of the loan collateral which consisted of business personal property, primarily lawn mowing equipment. The draft audit report indicates that there were 46 missing collateral items with a liquidation value of \$13,720 (of this amount, SBA's share would be \$11,662). Our experience with this type of used equipment is that the realizable value after expenses of securing, storage and sale is minimal. This is demonstrated by the fact that the lender sold the remaining 13 equipment items for only \$50. Consequently, our position is that the lender's failure to perform a timely site visit does not provide SBA a sound basis for recovery in this case.

We anticipate receiving the lender's reply regarding the credit card debt and providing a final response to the audit within 90 days. Thank you for your assistance.

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