

# **SBA**

SOP 10 09

---

# **SBIC Examinations Guidelines**

Office of SBIC Examinations  
Office of Investment and Innovation

U.S. Small Business Administration



## SMALL BUSINESS ADMINISTRATION STANDARD OPERATING PROCEDURE

SUBJECT: SBIC Internal Examinations Guidelines	S.O.P.	REV
	SECTION 10	NO. 09

### INTRODUCTION

1. Purpose. To provide current instructions and guidelines for the examination of Small Business Investment Companies.
2. Personnel Concerned. All personnel in Headquarters and field offices who are involved in the examination of Small Business Investment Companies.
3. Directives Canceled. The Office of SBIC Examinations is cancelling SOP 10 08 and is consolidating both SOP 10 08 and 10 09 into one SOP, SOP 10 09.
4. Originator. Office of SBIC Examinations, Office of Investment and Innovation

AUTHORIZED BY:		EFFECTIVE DATE October 28, 2013
Javier Saade Associate Administrator, Office of Investment and Innovation		PAGE 1

SBA Form 989 (5-90) Ref: SOP 00 23

Federal Recycling Program Printed on Recycled Paper



## Table of Contents

Paragraph	Page
Chapter 1. General Overview of the Examination Process	
1. What is The Purpose of an SBIC Examination?	6
2. What Authority Do Examiners Have to Conduct Examinations?	6
3. What Records Can an Examiner Obtain and Review?	6
4. What Restrictions Exist on Disclosing Information?	7
5. What Professional Standards Does SBA Expect of Examiners?	7
Chapter 2. Organization and Structure of the Office of SBIC Examinations	
1. How is the Office of SBIC Examinations Organized?	8
2. Where are Examinations Field Offices Located?	8
3. What is the Role of the Director of Examinations?	8
4. What is the Role of an Examinations Manager?	9
5. What is the Role of an Examiner?	9
Chapter 3. How Do I Prepare for an Examination?	
1. Why is Preparation So Important?	10
2. How Do I Notify the Licensee of the Examination?	11
3. How Do I Review Documentation Available Prior to the Examination?	13
4. When Should I Contact the Operations Financial Analyst?	14
5. How Do I Select Financings to be Reviewed?	14

6. How Do I Use Credit Reports in My Review of Financed Companies?	15
7. What Other Preliminary Steps Should I Complete?	15
Chapter 4. How Do I Conduct the On-Site Phase of the Examination?	
1. Must I Conduct a Site Visit to the Licensee?	18
2. How Do I Conduct an Entrance Conference?	18
3. What Should Be My Overall Approach to the Examination?	19
4. What Major Findings Should I Focus On?	20
5. What Financial Records Should I Review?	24
6. What Non-Financial Records Should I Review?	27
7. How Do I Review the Licensee's Portfolio Investments?	28
8. How Do I Review Licensees Using Participating Securities?	33
9. What Adjustments Do I Make for Section 301(d) Licensees?	35
10. What Adjustments Do I Make for Early Stage SBICs?	35
11. What Are the Additional Requirements for LMI Investments and Energy Qualified Investments?	36
12. What Adjustments Do I Make for Non-Leveraged SBICs?	36
13. When Do I Visit the Independent Public Accountant?	37
14. How Do I Conduct Visits to Portfolio Concerns?	38
15. What Issues Require an Immediate Telephone Call to My Manager?	40
16. How Do I Conduct an Exit Conference?	41
17. When Should I Brief the Operations Financial Analyst?	41
18. When Should I Make Return Visits to Licensees?	42
19. How Do I Prepare Examination Workpapers?	42

Chapter 5. How Do I Write an Examination Report?

1. What is the Purpose of an Examination Report? 44
2. What is the Standard Report Format? 44

Chapter 6. How Do I Recommend an OIG Referral?

1. What Situations Require an OIG Referral? 50
2. How Should I Make a Referral? 50
3. How Do I Prepare a Referral Memorandum? 50
4. How Do I Distribute Referrals? 50
5. How Do I Report Bribes and Gratuities? 51

Chapter 7. Managing the Examinations Process

1. What is My Primary Responsibility as an Examinations Manager? 52
2. How Do I Develop My Examinations Schedules? 52
3. What Should My Quarterly and Monthly Examinations Schedule Look Like? 54
4. When Should I Revise My Examinations Schedule? 54
5. How Do I Inform the Office of SBIC Operations of Schedule Changes? 56
6. What is My Role in Promoting Quality Examinations? 56
7. How Do I Ensure Quality Examinations? 56
8. What Management Reports Am I Required to Prepare? 57
9. What Is My Role in Maintaining Current Policies and Procedures? 59

Appendix 1

---

Effective Date: October 28, 2013

Index to Forms and Reports	60
Appendix 2	
Index of Workpapers	61

## Chapter 1

### General Overview of the Examination Process

#### 1. What is The Purpose of an SBIC Examination?

- a. The Office of SBIC Examinations conducts examinations of Small Business Investment Companies (“SBICs” or “Licensees”) to:
  - (1) Determine whether Licensees are complying with the Small Business Investment Company Act of 1958 and implementing regulations;
  - (2) Assess the financial condition of Licensees and SBA’s financial vulnerability; and
  - (3) Ensure the accuracy of information that Licensees submit to SBA.
- b. As examiners, our role is to independently gather and report objective, factual information to the Office of SBIC Operations so that it can effectively monitor and regulate the SBIC program.

#### 2. What Authority Do Examiners Have to Conduct Examinations?

Our authority to conduct examinations of SBICs is defined in the Small Business Investment Act of 1958, as amended (“Act”), and in Title 13, Code of Federal Regulations, §107.690.

#### 3. What Records Can an Examiner Obtain and Review?

##### a. Agency Records

As examiners, we have access to all Agency records that relate to the SBIC program, including reports, audits, documents, correspondence, recommendations, and other

material. SBA employees must provide any available information we request that relates to the SBIC examination function.

b. Licensee Records

Under Title 13, Code of Federal Regulations, §107.691, we have access to a Licensee's books, records, and other pertinent documents. We also have access to the working papers of the Licensee's independent public accountant ("IPA").

c. Records of Portfolio Concern

Title 13, Code of Federal Regulations, §107.620(c), gives us access to the books and records of portfolio concerns receiving financing from Licensees. This regulation requires Licensees to:

- (1) Obtain any information that we request to verify certifications made by portfolio concerns, including those concerning the use of proceeds; and
- (2) Ensure that financing documents contain provisions giving SBA access to the portfolio concern's books and records.

4. What Restrictions Exist on Disclosing Information?

- a. The information we obtain during examinations, including the contents of examination reports, is sensitive and privileged information. SBA employees, including examiners, should never disclose such information to anyone outside the Agency without prior approval of the Director of the Office of SBIC Examinations ("Director of Examinations"). An employee who violates this policy could be disciplined through prescribed Agency personnel regulations.
- b. We often receive requests for examination reports and workpapers under the Freedom of Information Act and the Privacy Act. These requests must be promptly referred to the Director of Examinations.

5. What Professional Standards Does SBA Expect of Examiners?

Given the frequency of our contacts with Licensees, we must always represent the Agency and the SBIC program in a professional manner. The Agency also expects that we:

- a. Maintain our independence, objectivity, and credibility at all times;
- b. Complete our examinations and issue our reports in a timely manner;

- c. Conduct quality examinations that respond to the needs and concerns of the Offices of SBIC Operations and SBIC Liquidation;
- d. Have a thorough knowledge of regulatory and statutory requirements pertaining to the SBIC program and the examination process; and
- e. Demonstrate proficiency in financial analysis and accounting principles, standards, and techniques.

## Chapter 2

### Organization and Structure of the Office of SBIC Examinations

#### 1. How is the Office of SBIC Examinations Organized?

- a. The Office of SBIC Examinations is one of four offices in the Office of Investment and Innovation (“OII”) with responsibility for oversight of the SBIC program. The other offices include the Office of SBIC Operations, the Office of SBIC Liquidation, and the Office of the Chief Administrative Officer.
- b. The Office of SBIC Examinations has a Headquarters staff and three field offices. The Director of Examinations reports directly to the Deputy Associate Administrator, OII.
- c. Examinations Managers supervise our field offices and report directly to the Director of Examinations. Examiners are located in the field offices and report to their assigned Examinations Manager.

#### 2. Where are Examinations Field Offices Located?

- a. Field offices are located in geographical areas to enhance the overall effectiveness and efficiency of our mission. While we try to have long-term stability in the field offices, we may adjust the number and location of examiners within the field offices to reflect:
  - (1) Changes in the number of Licensees within geographical areas;
  - (2) Imbalances in workload within existing offices; and
  - (3) Efficiencies in travel costs.
- b. We currently have field offices in the following locations:

- (1) Atlanta;
- (2) New York; and
- (3) San Francisco.

### 3. What Is the Role of the Director of Examinations?

The Director of Examinations has overall responsibility for managing and directing the Agency's program to examine Small Business Investment Companies. The Director's responsibilities include:

- a. Setting overall goals and priorities;
- b. Developing and revising examination policies and procedures;
- c. Coordinating the examination function with other OII offices;
- d. Monitoring the flow of examinations to make sure that they are scheduled, conducted, and reviewed in a timely manner throughout the country;
- e. Monitoring the consistency of examination findings among field offices;
- f. Evaluating the performance of Examinations managers; and
- g. Identifying training needs of examiners.

### 4. What Is the Role of an Examinations Manager?

- a. Examinations managers supervise the day-to-day operations of the examinations process; assist the Director of Examinations to develop and meet office-wide goals; and ensure that OII priorities are met. Examinations managers work closely with their examiners to:
  - (1) Schedule Licensees for examination;
  - (2) Assign examiners and teams of examiners to specific examinations;
  - (3) Review draft reports and supporting workpapers; and
  - (4) Issue final examination reports in a timely manner.

- b. Examinations managers have the authority to approve and issue examination reports. Before issuing a report, the manager must review it for clarity, conciseness, thoroughness, objectivity, soundness of findings, and consistency in the application of OII policies and procedures.

5. What is the Role of an Examiner?

Examiners work individually and in teams to determine whether Licensees are complying with the SBIC Act and implementing regulations. After completing an examination, the examiner prepares a draft report for review by the Examinations manager that explains what was found during the examination.

## Chapter 3

### How Do I Prepare for An Examination?

1. Why is Preparation So Important?

- a. Thorough preparation is vital to the examination process. The amount of work necessary to prepare for an examination of a Licensee depends on a variety of factors, including the Licensee's:
  - (1) Organizational structure;
  - (2) Size;
  - (3) Type of Leverage;
  - (4) Investment policy;
  - (5) Level of investment activity; and
  - (6) Number of years in the program.
- b. When preparing for an examination, you must:
  - (1) Notify the Licensee of the examination;
  - (2) Review existing documentation on the Licensee;
  - (3) Contact the Operations financial analyst by email to request comments;

- (4) Select the financings to be reviewed;
  - (5) Obtain credit reports for selected financings, as appropriate;
  - (6) Send confirmations to selected portfolio concerns using *SBA Form 857 (Request for Information Concerning Portfolio Financing by SBICs)*;
  - (7) Identify changes in the Licensee's capitalization and the on-site work necessary to determine compliance, including sending confirmations to selected investors; and
  - (8) Discuss the examination with the Examinations manager.
- c. You should access information available on SBA's information systems. As part of the preparation process, you should retrieve as much information as is available from SBA sources in order to minimize requests from Licensees for information already possessed by SBA. For example, data from a Licensee's *SBA Form 468 (Annual Financial Report)*, *1031/1031a (Portfolio Financing Report)*, *SBA Form 2182—Section M (Capital Certificate)*, or valuation reports may be accessible from an SBA database or web-based system. Also, during the on-site portions of the examination, you should utilize properly secured electronic storage devices in order to gather and transfer as much documentation in electronic format as possible.

## 2. How Do I Notify the Licensee of the Examination?

- a. First, contact the principals of the Licensee to establish an examination period end date ("cut-off date") and to arrange dates you will be working on-site.
- b. You should notify the Licensee in writing (generally by email) 30 days or more before the start of the on-site visit to the Licensee. The notification letter must inform the Licensee's management of the examination dates, as well as request specific information required during and prior to the on-site visit. You should request that all documents be provided in electronic format.
- c. In your notification letter, you should instruct the Licensee's management to prepare and have available specific information for the examination period, including, but not limited to:
  - (1) Books of account;
  - (2) Bank account reconciliations;
  - (3) Bank statements, cancelled checks, wire transfer authorizations;

- (4) List of all cash and idle fund accounts, including account numbers and the names and addresses of financial institutions;
- (5) Minutes of all board of directors meetings or partners meetings (including meetings of a Licensee's general partner as well as the general partner of a Licensee's general partner);
- (6) Documentation on the valuations of all portfolio concerns;
- (7) Current financial statements on all portfolio concerns;
- (8) All legal documents and correspondence relating to portfolio concerns;
- (9) Correspondence files (including emails);
- (10) Amendments to the Licensee's corporate governance documents (e.g., articles of incorporation, certificate of limited partnership, limited partnership agreement), ownership, capitalization, management, operating area, investment policies, or any other changes requiring notice or approval by SBA.
- (11) Parent entity's annual report, where applicable;
- (12) Distribution worksheets, where applicable;
- (13) General partner's trial balance, where applicable (including the trial balance of the general partner of the entity general partner);
- (14) Amendments to general partner's partnership agreement or other corporate governance documents, where applicable;
- (15) Correspondence files of Licensee's general partner, where applicable;
- (16) Calculation of Liquidity Ratio for Participating Securities Licensees under §107.1505(b);
- (17) Capital Impairment calculations under §107.1830;
- (18) Most recent *quarterly* SBA Form 468 (*Annual Financial Report*);
- (19) Inventory of all securities maintained in Licensee's safe deposit box or lock box;

- (20) List of officers and directors of the Licensee, its general partner and/or its management company, as applicable;
  - (21) List of portfolio concerns controlled by the Licensee, as well as date control was assumed; and
  - (22) Amendments to the management agreement and changes to the management company.
- d. In your notification letter, you should request that the Licensee send you certain documents prior to the on-site visit. This may include, where appropriate, advance copies of information listed under paragraph (c.) above, or it may include a document missing from the examination files. *For example, if the Licensee's latest SBA Form 468 (Annual Financial Report) is not in your files, you should request a copy of it in your letter.* At a minimum, you should request that the following items be sent to you, in any reasonable format, within 10 working days (or longer if circumstances dictate):
- (1) Licensee's working trial balance;
  - (2) Schedule of financings, including a list of all new or additional financings made since the last examination cut-off date, together with a list of officers, directors, and shareholders or partners of these portfolio companies;
  - (3) Schedule of the Licensee's portfolio, showing outstanding balances at cost;
  - (4) Schedule of loan delinquencies;
  - (5) An executed SBA *Form 856 or 856a (Disclosure Statement)*;
  - (6) Schedule of financings paid-off, written off, and sold since the last examination;
  - (7) Most recent SBA *Form 2182 – Section M (Capital Certificate)* submitted during examination period;
  - (8) Valuation reports as of the latest valuation date.
  - (9) Licensee's schedule/calculation of management fee at latest fiscal year end and as of the examination cut-off date.

3. How Do I Review Documentation Available Prior to the Examination?

- a. Review all available information concerning the Licensee, including:
  - (1) Prior examination reports and related workpapers;
  - (2) Actions taken by SBA and the Licensee on prior examinations;
  - (3) License application and any amendments to the application;
  - (4) Correspondence between the Licensee and the Office of SBIC Operations; and
  - (5) Reports submitted to SBA, such as financial reports, program evaluation reports, and the audit report of the IPA.
- b. Compare the *Schedule of Officers, Directors and Stockholders*, or the *Schedule of Partners* from the prior examination report with information shown on the Licensee's latest SBA Form 468 (*Annual Financial Report*), and note any changes in management or ownership.
- c. Where necessary or appropriate, you should review:
  - (1) SEC reports and financial statements of the parent entity (if applicable) or general partner; and
  - (2) Workpapers of the IPA.

4. When Should I Contact the Operations Financial Analyst?

- a. At least 14 to 30 days prior to starting the site work, you must send an email to the Operations financial analyst, inquiring about any issues or concerns that need to be addressed during the examination. You should use the standard pre-examination notification memo and request that the analyst reply by email at least one week before you begin the site work. According to SBIC Operations SOP 10 06, the Operations financial analyst is required to respond to your request by email. You should use the information gained from the response to help develop the scope of the examination.
- b. Although communications with the Operations financial analyst generally occur by email, you *may* need to contact the analyst by phone when, for example:
  - (1) There has not been a response to a pre-examination notification;
  - (2) You need clarification about a response to a pre-examination notification;

- (3) You have questions about a valuation review being conducted by a valuation contractor;
- (4) You need to discuss any prior examination report issues that remain unresolved; or
- (5) There are any other items that you have discovered that need clarification.

#### 5. How Do I Select Financings to be Reviewed?

- a. If sufficient time is not available to review all financings, after reviewing the existing documentation and the standard pre-examination notification memo response by the Operations financial analyst, select the financings to be reviewed during the examination. Time permitting, you should attempt to review all financings made since the last examination.
- b. Whenever you decide to review a sample instead of all financings made since the last examination, discuss the selection criteria with your Examinations manager. To the extent possible, the sample size should include at least five financings and should represent 50 percent or more of the dollar value of the total financings for the period, with a mixture of loan, debt security and equity financings. Additional factors to consider in establishing an appropriate sample may also include:
  - (1) Dollar amount and type of financings;
  - (2) Type of business financed;
  - (3) Whether financings are new to the portfolio or are follow-on financings;
  - (4) Financings that by amount or nature may have a significant impact on the portfolio valuation;
  - (5) Past examination findings; and
  - (6) Input from the Operations financial analyst.
- c. You may increase the sample size to include additional financings as a result of information you obtain during the examination.

#### 6. How Do I Use Credit Reports in My Review of Financed Companies?

- a. Generally, you should obtain a credit report (e.g., Dun & Bradstreet Business Information Report, Federal Information Report, or similar report from another service) for each small business financing selected for review in your sample. The Examinations manager may limit this requirement, for example where the type of business entity suggests limited information may be available (e.g., sole proprietorship), or for follow-on financings where a credit report was previously obtained and no valuation concerns have since arisen. While these reports have limitations, they are useful in determining or confirming:
  - (1) The name, address, NAICS Code, number of employees, and history of the identified business;
  - (2) That financings have been made by the Licensee to the business;
  - (3) Whether financings to businesses meet Agency size standards;
  - (4) The identify of any foreign affiliations with the business;
  - (5) The financial condition of the business;
  - (6) Affiliations between companies financed by the Licensee; and
  - (7) Indications of any self-dealing transactions.

## 7. What Other Preliminary Steps Should I Complete?

Before traveling to the Licensee's location for the on-site phase of the examination, complete the following steps:

- a. Analyze the Licensee's unaudited trial balance for indications of financial problems, unusual account balances, variances with other documents (e.g., SBA *Form 468*, portfolio reports), and potential regulatory violations. Document or reconcile any variances, then prepare a comparative balance sheet using the current and prior examination dates.
- b. Review cash receipts and disbursements schedule for any unusual transactions.
- c. Review the *Disclosure Statement (Forms 856 and 856A)* provided by the Licensee for indications of regulatory violations and other potential problems, especially, but not limited to:
  - (1) Conflicts of interest;
  - (2) Pledging or other hypothecation of the Licensee's assets;

- (3) Encumbrances of the Licensee's capital stock or partnership interests;
  - (4) Management services to portfolio concerns;
  - (5) Control of portfolio concerns; and
  - (6) Serious litigation involving the Licensee.
- d. Review the commitments shown on the *SBA Forms 856 or 856A (Disclosure Statement)*, and note items to document during the examination, including the effects on the overline limitation under §107.740, as well as the form, terms and fees charged in the commitment. Compare the level of commitments claimed by the Licensee with those shown in the Licensee's latest *SBA Form 468 (Annual Financial Report)*.
- e. Review the latest *SBA Form 468 (Annual Financial Report)* to identify other significant factors:
- (1) Overline financings;
  - (2) Delinquent financings;
  - (3) Financing participations bought or sold, and made with other Licensees;
  - (4) Unrealized appreciation/depreciation of portfolio assets;
  - (5) Capital Impairment; and
  - (6) Portfolio concerns at the same address or at the Licensee's address.
- f. Review the latest *SBA Form 2182 – Section M (Capital Certificate)*, and identify changes in the Licensee's capitalization that require additional work to determine compliance, such as sending ownership confirmations to selected investors (*SBA Form 1405 (Corporate SBICs) or 1405A (Partnership SBICs)*).
- g. Compute or reconfirm the Licensee's maximum management fee allowable in accordance with §107.140, §107.520 and TechNote 7a.
- h. Review valuation reports as of the latest valuation period and preliminarily select portfolio companies for valuation review.

- i. After completing your preliminary review, contact your Examinations manager and discuss:
  - (1) Scope and objectives of the on-site examination;
  - (2) Length of time to be spent on-site;
  - (3) Estimated travel costs;
  - (4) Need for additional staff; and
  - (5) Unusual items or documents not found during your review.

You are required to prepare for each examination you conduct. The time-frame for the preliminary review is one to three days, depending on the scope of the examination.

## Chapter 4

### How Do I Conduct the On-Site Phase of the Examination?

#### 1. Must I Conduct a Site Visit to the Licensee?

Generally, an examination will include a site visit to the subject Licensee, with much of the documentation being reviewed first hand on-site. However, when budget constraints restrict travel by the Office of SBIC Examinations, the Director of Examinations may direct that certain non-leveraged Licensees be examined without travel to Licensees' offices by performing "desk examinations." A desk examination requires that a Licensee mail or electronically transmit all documentation to the examiner, and that the examination take place at the SBA office. A desk examination only deviates from the standard procedures to the extent of not travelling to the Licensee's offices. Therefore, all other examination procedures should be performed consistent with this SOP for a desk examination.

Unless directed to perform a desk examination of a Licensee, the examiner should plan for adequate time to visit a Licensee's offices. Typically, the on-site phase will be between three and five days, depending on factors such as scope and complexity of the examination, and whether the Licensee is leveraged.

#### 2. How Do I Conduct an Entrance Conference?

- a. The on-site phase of the examination begins with an entrance conference. At this conference you should meet with the principals of the Licensee to give an overview of the examination process and inform them of what information, documentation and facilities you will need to conduct the examination. Also, advise the principals that

you will need to hold an exit conference with a general partner or principal at the end of the site visit.

- b. During the entrance conference, be sure to discuss:
  - (1) Information and documentation you have reviewed that needs clarification;
  - (2) Unresolved findings from the prior examination; and
  - (3) Recent amendments to the Licensee's operating plan.
- c. Explain to the principals of the Licensee that the Examination's Headquarters office will mail an invoice of the examination fee when the examination is completed. Explain that the fee is based on the Licensee's assets as of the date of its latest certified financial statement, and is computed using the rate table in §107.692.
- d. SBA normally does not assess fees for special examinations because these examinations are limited in scope and are made to obtain specific information for Agency officials. Do not assess a fee for a special examination unless your Examinations manager directs you to do so.
- e. SBA may assess an additional fee if the examination is delayed or prolonged due to a lack of cooperation on the part of the Licensee or the poor condition of the Licensee's records. For example, if a Licensee's records are not kept current, the resulting delay could be considered cause for such an assessment. The Associate Administrator, OII, after consulting with the Director of Examinations, has the authority to assess the Licensee an additional fee, up to \$500 a day, based on delays caused by the Licensee.

### 3. What Should Be My Overall Approach to the Examination?

- a. The examination process is a flexible one, and depends heavily on the examiner's judgment. The specific review procedures you use during the examination will depend on several factors, such as the Licensee's:
  - (1) Classification (debenture, participating security, 301(d), non-leveraged);
  - (2) Financial condition (e.g., Capital Impairment, liquidity for debt service, amount of accounts receivable);
  - (3) Amount and form of leverage;
  - (4) Prior regulatory history; and

- (5) Period of time since the last examination.
- b. With approval from your Examinations manager, you may expand the scope of the examination on the basis of information you gather as the review proceeds. At a minimum, your examination must include a review of:
- (1) Partnership or corporate minutes and ownership records;
  - (2) Correspondence files, including emails;
  - (3) Partnership agreements and amendments (if applicable);
  - (4) Any changes to the Licensee's organizational structure, ownership, investment policies, or operational practices and procedures;
  - (5) Books of account and supporting documentation;
  - (6) Selected assets, liabilities, and cash disbursements/receipts (including confirmations of capital with financial reports to SBA if changes have occurred since last exam);
  - (7) Financing files for selected portfolio concerns; and
  - (8) Valuation procedures and practices.
4. What Major Findings Should I Focus On?

Whether a particular transaction justifies a finding depends on the language of the Act, SBA regulations, and interpretive documents (e.g., SBIC TechNotes) in effect at the time of the transaction. If a particular transaction violates the regulations in effect at the time, a finding should be made even if a subsequent change in the law or regulations would now permit the transaction. Also, the examination report should include regulatory violations already known to the Office of SBIC Operations. For example, the report should include Capital Impairment even though the Office of SBIC Operations has already become aware of the condition and may be addressing the matter with the Licensee.

To more efficiently use examination resources, as well as focus attention on serious regulatory issues, the OII has identified nine major findings, plus unresolved and repeat issues, that should be of special concern to the examiner. The following sections describe the nine major findings and the typical examination coverage involved for each one.

- a. Activities Not Contemplated by the Act (§107.500; §107.700)

The Act contemplates that small businesses will be assisted in specific ways. The principal issues of concern in this area, as specified in the Act, are:

- (1) Financing a business that is not a “Small Business” under §107.700;
- (2) Financing provided by a 301(d) Licensee to a small business that is not owned, controlled, and managed by disadvantaged persons; and
- (3) A Licensee conducting operations of any business other than that for which it was licensed.

In reviewing this area, you should analyze the Licensee’s financing records and other documentation, including background information on the small business being financed and the owners of the small business. In making your evaluation, you need a working knowledge of the Small Business Investment Act and pertinent Agency regulations.

b. Prohibited Conflicts of Interest (§107.730; §107.885)

Licensees and those persons operating Licensees must not self deal to the prejudice of a small business, the Licensee itself, the owners of the Licensee, or SBA. A finding in this area usually involves Licensees providing financing to Associates (as defined in the regulations) or otherwise providing the Licensee’s assets for the use of an Associate either directly or indirectly, without SBA permission. In addition, Licensees with outstanding leverage or Earmarked Assets (as defined in the regulations) may not sell (or transfer) to Associates, title to assets without permission from SBA.

Review the terms of financings provided to portfolio concerns, and records pertaining to their principals, owners, and directors. Also review the disposition of assets not now on the Licensee’s books, but shown on the books during the prior examination. Review credit reports and written confirmations from portfolio concerns. Where appropriate, contact or visit a small business concern involved in a conflict of interest situation.

c. Prohibited Control of a Small Business (§107.865)

Licensees, either directly or with Associates, may exercise control over a small business, through ownership of voting securities, management agreements, voting trusts, majority representation on the board of directors, or otherwise. However, the period of that control is limited to seven years from the date on which it acquired

control. With SBA's prior written approval, control may be extended for an additional period as necessary to complete divestiture of control or ensure the financial stability of the portfolio company.

Review the SBA *Form 856 or 856a (Disclosure Statement)*, terms of financings, ownership, stock voting rights, shareholders' agreements, and board membership or partner rights, to determine if control exists and the period of control. You may also need to contact the small business when there is a question of prohibited control.

d. Short-term Financings (§107.830; §107.835; §107.845; §107.750)

A Licensee may not make a financing to a small business where the duration or term is shorter than one year. However, under §107.835, there are exceptions to the minimum one year term where: it is an interim financing in contemplation of long-term financing; it is for protection of the Licensee's prior investments; it is for the purpose of financing a change of ownership under §107.750; or it is for the purpose of aiding a small business in performing a contract awarded under a Federal, State, or local government set-aside program for minority or disadvantaged contractors.

Review the terms of the financing provided, including equity financings, to determine whether the terms of the financing, or any prepayment or redemption provisions, result in a prohibited short-term financing.

e. Overline Investments (§107.740; §107.760; §107.880)

Leveraged Licensees or those intending to issue leverage have investment concentrations in a single business (including affiliates) restricted by an overline limitation. For each portfolio concern, compare the Licensee's total outstanding financings and commitments (including amounts written off) to the appropriate overline limit.

Under §107.740, unless SBA approved the license application based upon a plan for less than two tiers of leverage, a Licensee is restricted to an overline limit of 30 percent of Regulatory Capital. For Licensees approved on a plan to issue less than two tiers of leverage, the applicable percentage is 20 percent if the plan contemplates one tier of leverage, and 25 percent if the plan contemplates 1.5 tiers of leverage. Note that Regulatory Capital for overline purposes includes an add-back for certain distributions made under §107.1570(b) and §107.585 during the five years before financing.

There are provisions for making follow-on investments where there is a change in size or activity of a portfolio concern, also subject to overline limitations under

§107.760. Also, there are additional limits for expenditures on assets acquired in the liquidation of a small business under §107.880(c).

f. Relending, Foreign, Passive or Other Prohibited Investments, Including Prohibited Real Estate Financings (§107.720)

Certain types of investments are prohibited. These prohibitions generally apply to financings in which the proceeds go to other than a domestic operating small business engaged in regular and continuing business, and to financings in which the proceeds are used to indirectly benefit Associates of the Licensee. Subject to the exceptions set forth in §107.720, a Licensee is generally not permitted to provide financing to relenders or reinvestors, passive businesses, real estate businesses, project finance businesses, farm land purchases, any investment contrary to the public interest, or foreign investments.

Determine the general nature of the small business receiving the financing, as well as how the proceeds of the financing were used. The nature of the business is determined by reviewing the Licensee's financing files, and is confirmed by a credit report and a visit to the small business. During the visit, discuss the use of proceeds with the small business owner. In most cases, you should also review the small business's bank records and other documentation to confirm the use of proceeds. If the small business's use of proceeds differs from the conditions of the financing, you should determine whether the Licensee has approved this change.

g. Excessive Cost of Money (§107.830; §107.850; §107.855; §107.860)

Licensees are restricted in the cost of money they can charge on loans and debt securities. The cost of money includes stated interest rates, discounts, and fees charged. Licensees also may charge only reasonable prepayment penalties. The regulations describe which fees and charges are included, as well as excluded, from calculating the cost of money.

Determine the rate of interest and any discount or fee charged on financings provided to portfolio concerns by examining the note and any other financing agreements. Also, review the terms of equity financings to determine whether the financing is, in fact, a debt security disguised as an equity financing. Evaluate equity redemptions to determine whether the terms have resulted in an excessive cost of money.

h. Excessive Management Expenses, Improper Distributions or Reductions in Regulatory Capital, and Excessive Expenditures (§107.520; §107.585; §§107.1520-107.1580; §107.1810; §107.1820)

Licensees are restricted in the types and amounts of capital and earnings distributions they may make. Management fees, operating expenses, and earnings distributions are restricted for leveraged Licensees. All Licensees are subject to restrictions on reducing paid-in capital.

Analyze capital accounts (paid-in and earned) for changes since the prior examination. In addition, compare earnings distributions with restrictions imposed by the regulations.

i. Impairment and Valuation Issues (§§107.1830-107.1850; §107.503; §107.650)

For those Licensees having leverage, Capital Impairment occurs when a Licensee's losses reach a threshold as defined in the regulations. Such impairment is directly affected by both operating and investment losses, as well as unrealized losses on portfolio assets. Review capital accounts, and the unrealized appreciation and depreciation of the portfolio, and calculate any Capital Impairment based on regulatory requirements.

Licensees are required to have a portfolio valuation policy approved by their boards of directors, or general partners, and by SBA. Most Licensees have adopted SBA's "Model Valuation Policy." Licensees with leverage are required to value their portfolios at the end of the second quarter and at the end of the fiscal year, and to provide valuation reports to SBA within specified time periods. Licensees without leverage must value their portfolios only at the end of the fiscal year.

Determine if portfolio valuations have been completed in accordance with the approved valuation policy and whether the valuations have been reported timely to SBA. Ensure that your valuation workpapers answer the following questions regarding a Licensee's valuations: 1) What section of the SBA-approved valuation policy did the Licensee follow in determining the appropriate valuation of the investment? 2) What specific methodology did the Licensee employ to value the investment? 3) What documentary evidence within the Licensee's files supports the valuation?

j. Other Matters in Prior Examination Not Resolved and New Regulatory Issues Involving Similar Prior Matters (Repeat Issues)

Regulatory issues other than the nine listed above are reported in examination reports as Other Matters rather than as Findings. These matters become findings, however, when they were reported in the previous examination and remain unresolved by the Licensee, or when they are new instances of the same regulatory issues previously reported as Other Matters.

Determine whether all previously reported Other Matters have been resolved to the satisfaction of SBA's Office of SBIC Operations. Report as Findings those issues that remain unresolved, or are new instances of the same previously reported issue in any of the last five examination reports.

5. What Financial Records Should I Review?

a. Purpose and Scope of Financial Review

The financial part of the examination is necessarily limited in scope and duration. To the extent possible, you should rely on the financial statements audited by the IPA.

The primary objectives of your financial review are to:

- (1) Verify that the Licensee's funds and unfunded commitments qualify as private capital and regulatory capital;
- (2) Document changes in private capital;
- (3) Determine whether private capital requirements have been met or maintained;
- (4) Verify the accuracy of reported financings;
- (5) Document the timely payment of funds due SBA, including whether exam fees have been paid;
- (6) Determine whether internal controls adequately safeguard the Licensee's assets, particularly portfolio securities;
- (7) Review and reconcile the Licensee's cash and invested idle funds deposits;
- (8) Review management expense accounts; and
- (9) Review other revenue or expense accounts, as appropriate, where regulatory issues have been implicated.

b. Review Licensee's Capital Accounts and Changes in Ownership

Review the Licensee's capital accounts, and document any changes in its Regulatory or Leverageable Capital as described in §107.585.

During the *first* examination, you should confirm that the initial capital with which the Licensee began operations matches the amount shown in its license application. In later examinations, you should confirm any reported increases in private capital.

During the *first* examination, be sure to request direct confirmations of ownership from all owners (shareholders or partners) of the Licensee, and from new owners as changes occur. *When the Licensee has more than 20 owners*, confirm the interests of only those owners who are officers or directors, or who own *at least 10% of the Licensee*.

During *every* examination, request direct confirmations from the Licensee's owners for any unfunded commitments representing 10% or more of total capital contributions to the Licensee. This requirement may be modified if, after consultation about the particular circumstances, your Examinations manager determines that there is a more appropriate threshold for confirmation.

c. Review Cash Disbursements and Receipts

Review the Licensee's cash disbursement journals and bank statements to identify those disbursements relating to the financings selected for review. While confirming disbursement transactions, document the date, payee, endorsement, check number, amount, purpose, and electronic transfer or wire authorization. For any questionable disbursements, review additional documentation.

Review cash disbursements unrelated to financings to determine whether the Licensee made its required payments due to SBA, as well as whether the Licensee:

- (1) Made financings not shown on the schedule it sent you; or
- (2) Made payments which appear to be unusual, irregular or excessive based on payee, amount, purpose, or other factors (e.g., improper payments to Associates or excessive management expenses).

Verify the disbursements you have identified in the above step to the source documents (cancelled checks or wire transfer documents, and bank statements if necessary).

Review the cash receipts journals and bank statements to identify:

- (1) Receipt of additional private capital due or claimed by the Licensee;
- (2) Receipts and deposits of SBA leverage in a timely manner; and
- (3) Prepayments that indicate possible Cost of Money violations;

Obtain and compare the Licensee's bank reconciliations with the bank statements, book balances and the trial balance provided to you as of the examination cut-off date. Resolve any discrepancies.

d. Review Idle Funds

Review documentation relating to idle funds deposits and compare the balances with the amounts shown on the trial balance. Resolve any discrepancies, and make any necessary copies of bank statements and idle funds documentation.

For Licensees with leverage or applying for leverage, determine whether cash accounts are in federally insured institutions and whether idle funds are held in investments permitted under §107.530. Where deposits are in excess of the insured amounts pursuant to §107.530(c), document in the workpapers whether the institution is "well capitalized" in accordance Federal Deposit Insurance Corporation regulations (the Examinations manager may limit documentation to local and regional financial institutions).

If during a review of cash and idle funds the examiner finds that there appears to be insufficient liquidity to meet future SBA payments (or other significant future obligations), the examiner may inform the Operations financial analyst about the liquidity issue, as appropriate.

e. Inactivity

For all Licensees, determine whether the Licensee's cash and idle funds amount to more than 20 percent of its total assets (at cost) for the most recent fiscal year end. If the amount exceeds 20 percent, perform the inactivity calculations required under §107.590.

f. Review Delinquencies

Review the Licensee's SBA *Form 468 (Annual Financial Report)*, together with the schedule of delinquencies provided by the Licensee, and note instances where interest continues to be accrued on investments delinquent more than 120 days. Analyze whether significant delinquencies suggest a need for accounting adjustments, such as putting debt on non-accrual status, adjusting valuations, adding additional allowances or deferring income. Record your analysis in the workpapers, and specifically address the extent to which accounting and valuation adjustments are required, and whether the delinquencies are affecting the Licensee's financial condition.

g. Review Management Expenses

Review the Licensee's expense accounts for compliance with its approved level of management expenses as described in §107.140; §107.250 and §107.520.

h. Other Financial Review Steps

§107.550 requires SBA's prior written approval prior to a Licensee incurring secured third party debt. Review the Licensee's liability accounts for any secured third party debt not approved by SBA (§107.550).

Perform one or more Capital Impairment calculations depending on the issuance dates of the Licensee's leverage. Use §§107.1830 through 107.1850 for leverage issued after April 25, 1994, or §107.203(d) of the prior version of the regulations for leverage issued before that date.

If the Licensee has any wholly-owned subsidiaries, examine their financial records, and confirm that the entities have been formed and meet the requirements of §107.720(b)(3).

If the Licensee is a limited partnership, examine the financial records of the Entity General Partner under §107.160(b)(2) (the Entity General Partner includes any general partner of the Licensee's general partner).

Prepare an unaudited comparative balance sheet for the cut-off dates of the current and prior examinations using the trial balances provided by the Licensee. Reconcile and explain any significant deviations between amounts shown on the two balance sheets.

Review any other general ledger accounts which, based on their nature, description, or amount, appear unusual and may suggest regulatory issues. Whenever you find discrepancies, inconsistencies, errors or omissions that you cannot resolve to your satisfaction, contact the IPA to get additional information or contact the Examinations manager for guidance.

6. What Non-Financial Records Should I Review?

- a. Obtain SBA's licensing approval letter from the Licensee (§107.501).
- b. Review the SBA-approved contract of the Licensee's Investment Advisor/Manager for material changes (§107.510).
- c. For each financing selected for review, confirm that the Licensee has electronically filed and received SBA confirmation of the SBA *Form 1031 (Portfolio Financing*

*Report*), as well as the related SBA *Form 1031A (Certification)*, for the filing dates required during the examination period.

- d. Review and document the following Licensee records required under §107.600:
  - (1) All minutes of meetings of directors, stockholders, executive committees, partners, or other officials;
  - (2) All documents evidencing ownership of the Licensee, including ownership ledgers, and transfer registers;
  - (3) All correspondence files and emails for the examination period involving the Licensee and SBA, as well as the Licensee and its IPA, attorneys (to the extent such correspondence is not subject to privilege), and portfolio concerns;
  - (4) Any quarterly or annual reports, prospectuses, letters, publications or any other communications issued by the Licensee to its investors.
  - (5) Any report, application, or document filed with the SEC;
  - (6) Litigation reports required to be filed with SBA; and
  - (7) Any other reports that SBA required the Licensee to file.
- e. Decide whether your review of non-financial records disclosed any facts that indicate possible violations of the following regulatory requirements:
  - (1) Management and ownership changes;
  - (2) Special rules for limited partnerships under §107.160(b)(1) and (c)(2);
  - (3) Changes in ownership or control as described in §§107.400 through 107.430;
  - (4) Changes in the structure of the Licensee under §107.470;
  - (5) Transfer of the SBIC license under §107.475;
  - (6) False filings and nonperformance of agreements with SBA under §107.507;
  - (7) Filing of financial statements with SBA *Form 468* under §107.630; and
  - (8) Reporting changes not subject to prior SBA approval under §107.680.

## 7. How Do I Review the Licensee's Portfolio Investments?

The purpose of this phase of the examination is to determine whether the Licensee is providing financings to eligible small businesses for legitimate purposes.

Time permitting, you should review all financings made since the last examination. However, with the concurrence of the Examinations manager, you may need to select only a sample of financings to review and should determine the appropriate sample in accordance with Chapter 3, Section 5.

### a. Review Financings

Review the Licensee's financing documents and prepare a *Loan and Investment Information Summary* for each financing that shows:

- (1) Name, address, and type of business of the portfolio concern;
- (2) Information on disbursements of financing proceeds, including the date, check number, amount and payee (if other than the small business);
- (3) Information on the portfolio concern's financial condition, collateral, management and owners (including ownership/control of corporate owners or entity partners);
- (4) Relevant summaries of final financing closing documents, legal binders and closing statements required by §107.691;
- (5) Summaries of the latest updated financial information on each portfolio investment obtained in compliance with §107.620; and
- (6) Any necessary background information on the portfolio concern from the credit report obtained prior to the on-site examination.

In addition, you should review and, if necessary, include any relevant information from the following:

- (1) Request and review the certification of the use of proceeds required under §107.610(d) and SBA *Forms 480 (Size Status Declaration)*, *652 (Assurance of Compliance of Nondiscrimination)* and *1031 (Portfolio Financing Report)*, as required under §107.610 and §107.640;
- (2) Review the financial statements of the small business prior to financing, and compare them with the *SBA Form 480 (Size Status Declaration)* and the requirements of §107.700; and

- (3) Review the correspondence files between the Licensee and the portfolio concern regarding the financing.

b. Eligibility for Financing

Based on the information you have summarized in the above examination step, determine if the small business is eligible for SBIC financing under the following regulations:

- (1) Size standards criteria, as described in §107.700 and §107.760;
- (2) Relenders or reinvestors; passive businesses; real estate businesses and project financings under §107.720;
- (3) Conflicts of interest under §107.730 and §107.885; and
- (4) Activities not contemplated by the Act under §107.500.

c. Limitations on Financing Terms

Determine if the terms of the financing violate any of the following regulations:

- (1) Restrictions on control of small business under §107.865;
- (2) Minimum financing term under §107.830; §107.835; §107.845 and §107.850(a);
- (3) Portfolio diversification (overline limitation) under §107.740; §107.825(d) and §107.880(c); and
- (4) Interest rate ceiling and limitations on fees charged to small businesses (Cost of Money) under §107.855, §107.830(c)(3), §107.850(b) and 107.860.

Determine if financings for a change in the ownership of a portfolio concern meet the requirements of §107.750.

Determine if financings in the form of Equity Securities meet the requirements of §107.800.

Determine whether there are any restrictions on the redemption of Equity Securities, as detailed in §107.850.

Determine if financings in the form of Debt Securities meet the requirements of §107.815.

Determine whether the terms of the financing include management services and related fees to the portfolio concern, and whether the Licensee has complied with the requirements under §107.900.

Determine if financings made in the form of guarantees meet the requirements of §107.820.

Review any securities purchased by the Licensee from or through an underwriter for compliance with §107.825(a), (b) and (c).

Review any securities purchased from, or exchanged with, another SBIC or from SBA under §107.825(d). Determine whether Licensee has contingent liabilities based on put rights or any other guarantees.

Determine if the Licensee has met the requirement to finance “smaller enterprises” under §107.710.

d. Licensee Commitments

Where a Licensee uses commitments to finance specific small businesses in order to qualify for SBA funding, you should review documentation of those commitments. This may include reviewing the commitment letter, verifying the terms of the commitment and confirming that the letter was signed by the small business owner.

Compare the commitments shown on the SBA *Form 856 or 856A (Disclosure Statement)* with those shown on the SBA *Form 468 (Annual Financial Report)* filed during the examination period, as well as with those shown on the SBA *Form 856 or 856a (Disclosure Statement)* from the prior examination. Multiple commitments to the same small business, and commitments which have been outstanding for more than 3 months, should be scrutinized to verify their legitimacy.

e. Valuation of Portfolio Investments

A Licensee’s portfolio of loans and investments usually represents the bulk of its assets. A realistic and timely valuation of these assets is needed because the performance of these loans and investments affects the Licensee’s viability as a going concern. The Licensee therefore must have procedures in place to ensure that its portfolio is properly valued, with sufficient documentation to support each valuation.

Other segments of your examination may reveal indicators of valuation problems—for example, Capital Impairment, delinquent loans, operating losses and significant amounts of unrealized appreciation. The purpose of this phase of the examination is not to arrive at a specific valuation for each of the Licensee’s assets, but rather, to

determine whether the Licensee has a written valuation policy approved by SBA, and whether that policy is being implemented and adequately documented.

Review the following documents to determine whether the Licensee's portfolio valuations have been completed in accordance with the SBA-approved valuation policy and whether the valuations have been reported timely to SBA (§107.503 and §107.650):

- (1) The written SBA-approved valuation policy, together with relevant SBA guidance (e.g. TechNotes);
- (2) The semi-annual and annual valuation reports submitted to SBA;
- (3) If necessary, the IPA's workpapers showing the latest review of valuations (otherwise, you should review the IPA's audit report for the statement that the Licensee's valuations were prepared in accordance with its valuation policy established in accordance with Section 310(d)(2) of the Act);
- (4) Licensee's latest delinquency listing;
- (5) Updated financial statements for each portfolio concern;
- (6) Current collateral appraisals (if available);
- (7) Valuations of portfolio co-investments with other SBIC's; and
- (8) Minutes of meetings that discussed and approved portfolio valuations (signed by all directors or partners).

You should generally select at least five portfolio companies for a valuation review. Ensure that your valuation workpapers answer the following questions concerning each portfolio valuation selected for examination review:

- 1) What section of the SBA-approved valuation policy did the Licensee follow in determining the appropriate valuation of the investment?
- 2) What specific methodology did the Licensee employ to value the investment?  
And
- 3) What documentary evidence within the Licensee's files supports the valuation?

You should not talk to prospective purchasers of small businesses when the Licensee's valuation is based on a proposed sale price. Instead, indicate that the

valuation is based on a proposed sale, and that you were unable to verify the terms of the proposed sale.

f. Licensee's Noncompliance with Terms of Leverage

You should be aware that §107.1810 and §107.1820 address a number of regulatory issues that violate the terms and conditions of a Licensee's leverage that are not addressed in other sections of the regulations, such as improper distributions, repeated non-substantive violations and fraud. These may be properly reflected as findings, other matters, or the subject of an OIG referral. Should any of these issues arise during your examination, you should contact the Examinations manager to discuss.

8. How Do I Review Licensees Using Participating Securities?

Participating Securities issued by SBICs are redeemable, preferred, equity-type securities in the form of Limited Partnership Interests, Preferred Stock, or Debentures with interest payable only to the extent of earnings. Participating Securities now exist only in the form of preferred limited partnership interests.

a. Eligibility for Participating Securities

As explained in §107.1500, there are special eligibility requirements for Participating Securities, including:

- (1) Minimal capital level (under §107.210);
- (2) Liquidity requirements (under §107.1505);
- (3) Non-SBA borrowing limits (under §107.570); and
- (4) Equity Capital Investment (under §107.1500(b)).

b. General Ledger Account Definitions

For Licensees using Participating Securities, you should be aware of the following general ledger account definitions:

- (1) *Accumulation Account*: a memo account whose balance represents accumulated unearned prioritized payments and adjustments.
- (2) *Distribution Account*: a liability account whose balance represents earned prioritized payments and adjustments not yet distributed.

- (3) *Earned Payments Account*: a memo account that holds the cumulative total of all additions to the Distribution Account.
- (4) *Profit Participation Account*: a liability account whose balance represents SBA's unpaid share of the Licensee's earmarked profits. The balance must be distributed within 120 days of the fiscal year end subject to liquidity requirements.

c. Payments To Be Made on Participating Securities

Licensees that issue Participating Securities agree to pay:

- (1) Prioritized payments under §107.1520;
- (2) Adjustments to prioritized payments under §107.1520;
- (3) SBA Profit Participation under §107.1530;
- (4) Required and optional distributions under §§107.1540 through 107.1580; and
- (5) Mandatory redemption of Participating Securities under §107.1500(e).

d. Other Rules Affecting Participating Securities SBICs

For Licensees having outstanding leverage or Earmarked Assets, review the following:

- (1) Frequency of portfolio valuations under §107.503(d);
- (2) Management expenses under §107.520;
- (3) Restrictions on third party debt under §107.550 and §107.570(a) and (b);
- (4) Voluntary reductions in capital under §107.585, §107.1560 and §107.1570;
- (5) Maximum amount of Participating Securities outstanding under §107.1170;
- (6) Equity Capital Investments required under §107.1500(b)(4); and
- (7) Liquidity Ratio under §107.1505.

e. Distributions

Any distributions made by a Participating Securities Licensee are subject to §§107.1500 - 1580. Prioritized Payments, tax distributions, profit distributions, and returns of capital are all determined and verified through distribution worksheets completed by the Licensee. When a Participating Securities Licensee wishes to make a distribution, its distribution worksheet and any supporting documentation is reviewed by the Office of Licensing and Program Standards, with any necessary assistance from the Office of SBIC Operations.

When you send an examination notification letter to a Participating Securities Licensee, request a schedule of any distributions made on these securities during the examination period. The schedule should include the date, type and amount of each distribution, and be made part of the permanent workpaper File E. As part of your review, you must:

- (1) Determine if any distributions were made by the Licensee;
- (2) Confirm that SBA has approved the distributions; and
- (3) Verify amounts reported to SBA as distributions to private partners with amounts shown in the Licensee's bank statements.

9. What Adjustments Do I Make for Section 301(d) Licensees?

- a. Review the SBA *Form 1941 (Financing Eligibility Statement)* required by §107.610(c) for each portfolio financing reviewed.
- b. Review the level of the Licensee's financings to disadvantaged businesses that are relenders or reinvestors under §107.720(a)(2), and determine whether the total of these financings outstanding at the fiscal year end exceed the Licensee's regulatory capital.
- c. Review the term of financings for any which are less than one year. Along with exceptions for interim financing, protection of prior investments and change of ownership, a financing may qualify for a short-term under §107.835(d) where the purpose is to aid in performing a contract under a set-aside program for "minority" or "disadvantaged" contractors.
- d. Determine whether the Licensee has paid its dividends or distributions due to SBA under §107.1400 and §107.1440.
- e. In calculating Capital Impairment for a 301(d) Licensee, be aware that a condition of Capital Impairment occurs only when the impairment percentage exceeds 75 percent.

#### 10. What Adjustments Do I Make for Early Stage SBICs?

There are a number of regulatory requirements that are unique to Early Stage SBICs. You should evaluate regulatory compliance by verifying compliance with the relevant sections of the SBA regulations, including, but not limited to:

- a. Interest reserve in §107.1181;
- b. Early Stage investment requirements in §107.1810;
- c. Distributions in §107.1180;
- d. Restrictions on third party debt in §107.565; and
- e. Capital Impairment limits in §107.1840 and §107.1845.

#### 11. What Are the Additional Requirements For LMI Investments and Energy Saving Qualified Investments?

Beyond the requirements for all SBIC financings, there are additional certification requirements for LMI Investments and Energy Saving Qualified Investments listed in §107.610(e) and (f), respectively.

#### 12. What Adjustments Do I Make for Non-Leveraged SBICs?

##### a. Regulations Exemptions

For Licensees having no outstanding leverage or Earmarked Assets, §107.1000 exempts these SBICs from the following regulations:

- (1) Overline limitation in §107.740;
- (2) Idle funds investment restrictions in §107.530;
- (3) Third party debt restrictions in §107.550;
- (4) Expense restrictions for maintaining or improving assets acquired in liquidation of portfolio concerns under §107.880; and
- (5) Record keeping requirements and fee limitations under §107.825(b) and (c), respectively, for securities purchased through or from an underwriter.

b. Exemptions from Prior SBA Approval

Agency regulations also exempt non-leveraged Licensees and Licensees with no Earmarked Assets from having to obtain SBA's prior approval for:

- (1) Decreases in Regulatory Capital of more than 2 percent under §107.585, but not below the minimum required by the Act or the regulations;
- (2) Disposition of any asset to an Associate under §107.885;
- (3) Contracts to employ an Investment Adviser/Manager under §107.510;
- (4) Initial management expenses under §107.140, and increases in these expenses under §107.520;
- (5) Options obtained from a portfolio concern by Licensee management or employees under §107.815(b); and
- (6) SBA's post approval of new directors and officers, other than the Chief Operating Officer. (Licensees still must notify SBA, within 30 days, of new officers and directors.)

c. Discretion of Examinations Manager to Eliminate Certain Steps

SBA's policy is to conduct limited-scope examinations of non-leveraged Licensees. These examinations should focus on major regulatory violations and the workpapers necessary to support their existence. For examinations of non-leveraged Licensees, the Examinations manager has the discretion to eliminate the following steps from the examination process:

- (1) Visit and inventory of safe deposit box;
- (2) Verification of securities held by third parties;
- (3) Review of control procedures;
- (4) Analysis of private capital;
- (5) Review of capital stock certificate book;
- (6) Analysis of the financial condition of the Licensee;
- (7) Analysis of trial balance accounts;

- (8) Analysis of provisions for losses;
- (9) Analysis of accrued interest receivable;
- (10) Reconciliation and analysis of retained earnings;
- (11) Review of valuation procedures and specific valuations;
- (12) Review of the IPA's workpapers;
- (13) Review of SEC reports; and
- (14) Conducting visits to portfolio concerns.

With non-leveraged Licensees, you should review no more than five new financings to different portfolio concerns. Obtain a credit report only for financings selected for review. Also, use the Licensee's Schedule of Portfolio Financings, instead of updating the Workpaper B File summary sheets.

### 13. When Do I Visit the Independent Public Accountant?

For leveraged and non-leveraged Licensees, you should use your discretion in deciding whether or not to visit the IPA. These visits may be helpful, for example, when developing findings concerning valuations of specific portfolio concerns. As authorized in §107.691, you may review the workpapers that support the IPA's opinion in the financial statements. Document your interview by completing *Comments on IPA Annual Report* (Workpaper G-10). If you find instances of substandard IPA work product, you may, after consultation with your Examinations manager, refer the matter to the relevant state licensing board, as appropriate.

### 14. How Do I Conduct Visits to Portfolio Concerns?

#### a. Criteria for Leveraged and Non-Leveraged Licensees

Field visits to portfolio concerns are done at the discretion of the examiner. For leveraged Licensees, while not required, you may consider scheduling a portfolio concern visit where the visit would meaningfully enhance the examination process (e.g., provide documentation or clarification regarding a significant regulatory issue), and where budgetary and time constraints permit. These visits are especially useful in confirming the existence of portfolio concerns and verifying the use of financing proceeds. Unless you suspect major regulatory problems or the Licensee has indicated an intent to apply for leverage, you should *not* visit portfolio concerns of a non-leveraged Licensee.

b. Focus on Use of Proceeds

When your examination includes a visit to a small concern, you should verify the use of proceeds by reviewing the small business's books and records. Always review financings made for working capital to make sure the proceeds were used for legitimate business purposes. Be alert for financings that appear excessive in relation to the working capital needs of the small concern, or where evidence suggests proceeds may have been used for paying debts not owed by the small concern. As a general rule, you should review the portfolio concern's bank statements and deposits, its canceled checks, the cash disbursement ledger, and any vendor invoices.

c. Additional Field Visits

You should use your discretion, after appropriate consultation with your Examinations manager, to determine whether you should make additional visits to portfolio concerns. For example, you should visit a portfolio concern whenever issues indicate the company may be involved in a serious regulatory violation. You should also consider additional visits whenever you find factors such as:

- (1) Questions have arisen about a portfolio concern's address including, for example: credit reports indicating that no business exists at the reported address; the portfolio concern only has a P.O. box address; or there are other portfolio concerns at same address (especially at Licensee's location);
- (2) A Licensee is closely-held and has minimal capitalization;
- (3) A Licensee has inadequate documentation to support its financings;
- (4) A Licensee has a high number of delinquent or charged-off loans;
- (5) A Licensee's files do not contain periodic financial statements (at least annually) from portfolio concerns; or
- (6) A Licensee has a portfolio of small businesses that have been non-responsive to requests for information from the Licensee.

In summary, you should consider making additional field visits whenever you are developing regulatory findings or find that there are significant unanswered questions about particular financings. You may wish to telephone the small business owner instead of making a field visit *when a visit is clearly unnecessary, or other factors (e.g., time or cost) prevent you from making a visit.* With questionable financings, it is generally preferable to make a field visit rather than making a telephone call.

Whenever a field visit involves a significant amount of time or travel funds, you should obtain prior approval from your Examinations manager. This is especially true when you believe that the scope of the examination should be significantly expanded to include additional visits.

d. Examination Steps During Field Visits

During your visit to a small business, be sure to:

- (1) Confirm details of the financing received from the Licensee;
- (2) Confirm the use of financing proceeds;
- (3) Verify the officers, directors, owners or partners;
- (4) Determine if any associate relationships exist;
- (5) Document any possible conflicts of interest;
- (6) Determine whether the Licensee or its Associates provide management services to the small business, and the nature of any such charges; and
- (7) Obtain copies of any relevant records.

e. Prior Notification of Field Visits

You are under no obligation to notify the Licensee that a particular visit will be made, nor are you obliged to explain the reason for making a visit. You may coordinate arrangements for the visit with a Licensee official if, in your opinion, his/her involvement will not jeopardize the integrity of the information you seek. You should not encourage Licensee officials to accompany you on these visits; however, you cannot prevent them from being present during the visit.

In general, whenever you anticipate reviewing the books and records of a small business, you should request both the Licensee official and the small business owner to make certain that specific documents be made available to you during the site visit.

f. Access to Records

§107.620(c) gives SBA access to the books and records of portfolio concerns receiving financing from Licensees. This regulation requires Licensees to:

- (1) Obtain any information that SBA requests to verify certifications made by portfolio concerns, including those concerning the use of proceeds; and

- (2) Ensure that financing documents contain provisions giving SBA access to the portfolio concern's books and records.

If the small business owner denies or restricts your access to the portfolio concern's records, or is uncooperative with your request for access, promptly report the matter to your Examinations manager. In these situations, consider having a Licensee official call the owner in an effort to obtain cooperation. Under no circumstances should you try to intimidate or threaten officials of the Licensee or small business into complying with your requests for information. Document problems in obtaining information from a portfolio concern in the Other Matters section of your examination report.

g. Document Results of Field Visits

Document the results of each field visit in a memorandum. The length of the memorandum will depend on the results of the visit. At a minimum, the memorandum should include sufficient information to adequately address the questions that prompted your visit, including a record of discussions held with officials of the small business. Include the memorandum in the "B" section of the workpapers, along with other documentation you obtained during the visit.

15. What Issues Require an Immediate Telephone Call to My Manager?

Depending on the requirements of the Examinations manager, at some point during the on-site phase of your examination, you may email or phone the manager to report on your progress and to discuss possible regulatory violations. However, on certain sensitive matters, you should immediately phone the manager for guidance. These matters include, but are not limited to:

- a. Indications of fraud or other criminal acts;
- b. Need for timely action to protect SBA's financial interests; or
- c. Conditions either precluding or handicapping the examination.

16. How Do I Conduct an Exit Conference?

- a. As you finish the on-site examination, you must conduct an exit conference with a Licensee official such as a corporate officer or general partner. During this meeting, present the results of your examination, obtain comments from the Licensee on each finding, and clarify any misunderstandings relating to the facts. You must hold the exit conference in person, not by telephone, unless the examination is being

- performed remotely (desk exam). The results of this meeting should be detailed in the examination workpapers as part of the exit conference memorandum G-11.
- b. Never accept verbal representations of Licensee officials as proof that a finding does not exist, or that past findings have been resolved. Always require the Licensee official to give you documentation to show that a finding either does not exist, or has been resolved to the satisfaction of the Office of SBIC Operations.
  - c. During the exit conference, explain the process in which examination findings are handled by the Office of SBIC Operations. Emphasize that it is the responsibility of the Office of SBIC Operations to determine whether a finding is, in fact, a violation and the appropriate corrective action needed to resolve the finding. You must take special care not to discuss possible corrective actions that should be taken by the Licensee.
  - d. You should allow Licensee officials, whenever they request it, the opportunity to respond to your examination findings in writing. When they make such a request, explain that you must have their written comments within one week, and that you will not delay processing of the examination report by waiting longer than one week for their comments to arrive.
  - e. Regulatory issues should *always* be addressed in person or by telephone (if necessary) with the Licensee official. At no point during the examination should you give the Licensee a written statement (or email) of the finding. Your written explanation of the finding is included in the examination report only after the Examinations manager has reviewed the issue and given consideration to the Licensee's responses, if any.

#### 17. When Should I Brief the Operations Financial Analyst?

After finishing the on-site phase of the examination, you should email the Operations financial analyst a standard post-examination notification memo which provides a briefing on the results of the examination. You should send the memo within seven to ten calendar days after finishing the on-site examination unless a pressing issue would indicate a more immediate feedback is required.

#### 18. When Should I Make Return Visits to Licensees?

There may be occasions where the Office of SBIC Operations requests that a post-examination visit to a Licensee take place, for example, to confirm a corrective action on a significant regulatory violation. Where appropriate, your Examinations manager will discuss such a request with the Office of SBIC Operations and instruct you as to the necessity of performing a return visit to Licensee.

#### 19. How Do I Prepare Examination Workpapers?

- a. Workpapers are a significant part of the examination process. Examiners use a standardized set of workpapers to provide a systematic record of the work done in performing an examination, and a structured way of organizing information obtained and developed in support of an examination's findings. Workpapers should include the Licensee's name, the examination period covered, your source of information, your initials, and the date the workpaper was prepared. Your workpapers must be:
  - (1) Accurate;
  - (2) Complete;
  - (3) Well-organized;
  - (4) Neat and legible; and
  - (5) Self-explanatory.

b. Permanent and Current Workpapers

During an examination, you prepare two types of workpapers—permanent and current. You must update the permanent workpapers because they contain basic background information of continuing use from one examination to the next. You must prepare a distinct set of current workpapers each time you examine a Licensee because these files contain information that pertains only to the current examination. When preparing workpapers for the B File, you must follow the standard indexing system. See Appendix 2 for details.

For leveraged Licensees, use the Licensee's Schedule of Portfolio Financings (F-17), instead of updating the Workpaper B File summary sheets. When preparing workpapers for the B File, you must follow the standard indexing system.

c. Location of Workpapers

Although the Office of SBIC Examinations is in the process of transforming much of its documentation from paper to electronic format, physical file custody and security remains important. In general, you should maintain your workpapers in your field office or at an SBA-approved telework location. When workpapers must be removed from the SBA office, you must obtain approval from your Examinations manager before moving workpapers to another location, and you should return them to the SBA office as soon as practicable after the completion of the examination.

## Chapter 5

### How Do I Write an Examination Report

#### 1. What is the Purpose of an Examination Report?

When you write an examination report, you communicate the results of your examination to OII officials responsible for taking action involving the Licensee. Your report must be clear, concise, factual, accurate, objective, and in sufficient depth to allow these officials to understand the reported matters and take appropriate action. To ensure fairness, your reports must include pertinent comments and explanations of the Licensee.

#### 2. What is the Standard Report Format?

- a. There are two types of report formats: (i) examination reports that include Findings or Other Matters (“Findings Reports”) and (ii) examination reports that do not include Findings or Other Matters (“No Finding Reports”).
- b. Findings Reports

Findings Reports include a transmittal memorandum as well as a report cover, and they follow a standard report format in Times New Roman font. The standard format always includes the following sections:

- (1) Table of Contents;
- (2) Summary;
- (3) Introduction;
- (4) Background;
- (5) Objectives and Scope;
- (6) Status of Prior Findings;
- (7) Findings;

(8) Other Matters; and

(9) Exhibits.

c. Report Cover

Findings Reports use a cover that includes:

(1) Name of the Licensee;

(2) Licensee's location (City and State);

(3) License number; and

(4) Report Issue Date.

d. Table of Contents

The *Table of Contents* lists all the sections of the report, including the captions of the individual findings, and the pages on which each section and caption begins. The *Table of Contents* is page-numbered with lower case Roman Numerals, as follows: i, ii, iii, etc.

The top heading (*Table of Contents*) should be in bold lettering, centered, not underlined, and with only the first letters of Table and Contents capitalized.

The page column should be headed with the word *Page* underlined and only the first letter capitalized.

The major headings (*Summary, Introduction, Status of Prior Findings, etc.*) should be centered and have only the first letter of each word capitalized.

e. Summary

The *Summary* begins on page 1 and is a synopsis of the report. The heading (*Summary*) should be centered at the top of the page in bold letters, have only the first letter capitalized, and not be underlined. There should be a two-line gap before the beginning of the first paragraph. All paragraphs should be in block style, with first line of each paragraph not indented. All text should be in Times New Roman 12-point font. The *Summary* should generally be limited to one page and include:

- (1) An introductory paragraph with short statements giving background information on the Licensee you examined and your objectives and scope;
- (2) A paragraph or two that summarize the findings and other matters; and
- (3) A paragraph covering your discussion of the findings with the Licensee's management, including a reference to their comments elsewhere in the report.

f. Introduction

The *Introduction* section begins on a separate page immediately following the *Summary* and consists of two standard subsections: (i) *Background*; and (ii) *Objectives and Scope*. The heading (*Introduction*) should be centered at the top of the page, have only the first letter capitalized, and be in bold letter. There should be a one line gap before the beginning of the first subsection (*Background*).

Both of the subsections (*Background* and *Objectives and Scope*) should be in bold letters and underlined, with only the first letters of each word capitalized. A one-line gap should be used between each subsection heading and the beginning of the first paragraph in that section. At the end of each section, there should be a one-line gap before the next subsection heading. Paragraphs should be in block style, with the first line of each paragraph not indented.

The wording used in the *Introduction* should be in the format and style historically used in prior reports. In writing the *Introduction*, you must accurately detail the actual examination steps you took. Include the time-frame for the on-site phase of the examination and state when the on-site phase of the examination was completed.

g. Status of Prior Findings

The *Status of Prior Findings* section begins on a separate page following the *Introduction* and follows the same format. You must detail the prior examination's findings and state whether these have been corrected. If a prior finding is to be resolved over a time period set by SBA, this should be explained, and the finding should not be reported again unless the period for corrective action has expired.

h. Findings

Findings are factual situations found during an examination that you believe may indicate major violations of the Act or the SBIC regulations. The types of apparent violations to include in your report as findings are:

- (1) Activities Not Contemplated by the Act §107.500; §107.700;

- (2) Prohibited Conflicts of Interest  
§107.730; §107.885;
- (3) Prohibited Control of a Small Business  
§107.865;
- (4) Short-Term Financings  
§107.830; §107.835; §107.845; §107.750; §107.760;
- (5) Overline Investments  
§107.740; §107.880;
- (6) Relending, Foreign, Passive or Other Prohibited Investments, Including Prohibited Real Estate Financings §107.720;
- (7) Excessive Cost of Money  
§107.855 (*see also* §107.860; §107.830(d)(3); and §107.900);
- (8) Inappropriate Distributions, Including Improper Dividends and Excessive Expenditures  
§107.585; §§107.1520-107.1580; §107.50; §107.1810;
- (9) Impairment and Valuation Issues  
§§107.1830-107.1850; §107.503; §107.650; and
- (10) Other Matters From Prior Examinations Not Resolved and New Regulatory Issues Involving Similar Prior Matters (Repeat Issues).  
§107.1810(h); §107.1820(g).

The *Findings* section begins on a separate page immediately following the *Status of Prior Findings* section, using the same format as the other sections. Each finding subsection (including the description and regulatory cite), should be in bold letters, with only the first letters of each finding number and description capitalized. The entire *Finding* caption, including finding number, description and regulatory cite should be underlined. There should be a one-line gap between the heading of each finding and the beginning of the first paragraph in that section. At the end of each finding, there should be a two-line gap before the heading of the next finding. Paragraphs should be in block style, with the first line of each paragraph not indented.

Each finding begins with a heading that cites the regulation being discussed. The first paragraph summarizes the finding. The second paragraph cites the specific section of the regulations at issue and an explanation of that regulation. Subsequent paragraphs explain the details of the finding.

Each finding must include a discussion under the caption, *Licensee's Comments*. In this section, include any comments or explanations that Licensee officials have given about the finding, and specifically whether they agree or disagree with it. If necessary, give Licensee officials up to a week to comment in writing on the findings. After the Licensee's comments, include your response (if necessary) under the caption, *Evaluation of Licensee's Comments*.

The captions *Licensee's Comments* and *Evaluation of Licensee Comments* must be aligned to the left margin, italicized, and have the initial letter of each word capitalized, except for the word *of*. Both captions should be underlined. Place a one-line gap between each caption and the beginning of the first paragraph. A one-line gap must be used to separate the end of the *Licensee's Comments* section from the beginning of the *Evaluation of the Licensee's Comments* section. Paragraphs must be in block style, with the first line of each paragraph not indented.

i. Other Matters

Use the *Other Matters* section of the examination report to present regulatory issues that appear to be violations but are less serious than the nine major findings discussed in Chapter 2. This section should *not* include any "potential" violations, but such matters may be included in the post-examination notification transmittal memo or No Finding Report.

The *Other Matters* section begins on a separate page immediately following the *Findings* section. The heading (Other Matters) should be centered at the top of the page, have only the first letter of each word capitalized, and be in bold letters. There should be a two-line gap before the beginning of the first paragraph. The section should be written as succinctly as possible, while conveying all the important information about the matters raised during the examination.

You should also use the *Other Matters* section to describe situations in which the small business owner either does not produce records in a timely manner, or refuses to produce the records. In these cases, you should note that the records were requested, and that sufficient time was given to produce the records, but that the owner did not comply (or refused to comply) with the request. In general, SBA considers five days from the date of a request to be sufficient time for the small business owner to produce the requested records.

j. Exhibits and Attachments

Exhibits to the examination reports include:

Exhibit 1                      Comparative Balance Sheet

Exhibit 2	Schedule of Officer, Directors, or Partners and Ownership
Exhibit 3	Written Comments Provided by Licensee

k. Transmittal Memorandum

You must prepare a transmittal memorandum that forwards the examination report from your Examinations manager to the Director of the Office of SBIC Operations (“Director of Operations”). Transmittal memoranda are internal documents for use by officials in the OII, and *should never be provided to Licensee officials*.

In the transmittal memorandum, include the names of any small businesses you visited during the examination. Also include, if appropriate, any recommendations for action (such as a transfer to the Office of SBIC Liquidation or denial of a funding request), and any concerns you have about the Licensee’s management or operations.

In the transmittal letter, you must specify and address any issues raised by the Operations financial analyst. If the analyst responded to your inquiry, but did not provide you with issues to address during the examination, include the following wording in the transmittal letter:

“Prior to the examination, we contacted the Operations financial analyst to inquire whether the Office of SBIC Operations had any concerns or outstanding issues to be addressed during the examination. The analyst advised us that he (she) had no specific issues to be addressed at this time.”

If the analyst did not respond to your inquiry, include the following wording in the transmittal letter:

“Prior to the examination, we contacted the Operations financial analyst to inquire whether the Office of SBIC Operations had any concerns or outstanding issues to be addressed during the examination. The analyst did not reply to our inquiry (ies).”

l. No Findings Reports

No Finding Reports only use a brief memorandum report to document the examinations. The memorandum report does not include a report cover, but does include a *Comparative Balance Sheet* and a *Schedule of Officers, Directors and Stockholders*, or a *Schedule of Partners and Ownership* as attachments. The memorandum report should be addressed from the Examinations manager to the appropriate official receiving the report, usually the Director of Operations.

m. Report Distribution

Your Examinations manager reviews, approves and issues examination reports, usually sending the reports to either the Director of Operations or the Director of Liquidation. The time-frames for sending final reports depends on whether there are findings or other matters, with no-findings reports generally being issued within four weeks after the on-site visit, and reports with findings being issued within two months of the on-site visit. Under no circumstances should a report be issued later than two months from the end of the on-site visit without providing notice to the Director of Examinations and an explanation of the issues or exceptions causing the delay.

## Chapter 6

### How Do I Recommend an OIG Referral?

#### 1. What Situations Require an OIG Referral?

During your examinations, you may find situations or transactions that appear to indicate fraud, illegal expenditures or other illegal acts. Normally, you will not have enough time to adequately pursue these issues within the time-frame of a regular examination. In these cases, you should obtain whatever information is readily available to assist the Office of Inspector General (OIG) in making an informed decision about whether to investigate the matter.

#### 2. How Should I Make a Referral?

- a. Whenever you find or suspect illegal activity on the part of a Licensee, you must report the matter to the Investigations Division of the Office of Inspector General. Referrals should be made in writing, unless the urgency of the matter, such as a bribe or gratuity, demands an immediate telephone call. In such cases, prepare a written report following the call.
- b. No one has the authority to hinder, obstruct, or prevent a referral from being made to the Office of Inspector General. Any examiner or Examinations manager who believes that a referral is being hindered, obstructed, or prevented should immediately report this situation to the Assistant Inspector General for Investigations.

#### 3. How Do I Prepare a Referral Memorandum?

- a. When making an OIG referral, draft a memorandum from the Director of Examinations to SBA's Assistant Inspector General for Investigations. After your Examinations manager reviews the memorandum, send it to the Director of Examinations for signature. Fully explain why you suspect an illegal activity and include all pertinent documentation to support the referral. When appropriate, you should include your examination report as an attachment to the referral memorandum.
- b. If you are uncertain about whether to make a referral, prepare a referral memorandum for review by your Examinations manager, the Director of Examinations, and the Associate Administrator, OII.

#### 4. How Do I Distribute Referrals?

Whenever a referral is made to the Office of Inspector General, the Director of Examinations will promptly send copies of the referral to the following parties:

- a. Associate Administrator, OII;
- b. Deputy Associate Administrator, OII;
- c. Director of Operations;
- d. Director of Liquidation; and
- e. Additional parties, as deemed appropriate by the Director of Examinations (e.g. OGC).

#### 5. How Do I Report Bribes and Gratuities?

- a. A bribe or gratuity is a violation of Federal law (Title 18, United State Code, Section 201). You must immediately report a bribe or gratuity to the Office of Inspector General.
- b. Bribery is defined as the giving, offering, or promising of something of value to influence a public official in the conduct of business. A gratuity is defined as the giving, offering, or promising of something of value for any official act performed or to be performed. A gratuity does not have to influence an official act.
- c. Never delay reporting a bribe or gratuity by waiting to prepare a formal written response. Attempted bribery is of such a serious nature that it must not await a formal written report. In such cases, you should immediately report the matter to an

OIG Special Agent, Regional Inspector General for Investigations, or directly to the Assistant Inspector General for Investigations.

## Chapter 7

### Managing the Examination Process

#### 1. What Is My Primary Responsibility as an Examinations Manager?

As an Examinations manager, your primary responsibility is to make sure that examinations are scheduled and conducted in a timely manner, and that the reports you issue reflect quality examinations.

#### 2. How Do I Develop My Examinations Schedules?

You must prepare and submit to the Director of Examinations both quarterly schedules as well as monthly schedules for upcoming examinations in your area. In planning your schedules you will consider factors such as: statutory and regulatory requirements; the goals and priorities of the OII; the complexity of pending examinations; any needs or concerns of the Office of SBIC Operations or the Office of SBIC Liquidation; and any budgetary or travel restrictions.

##### a. Regulatory Requirements for Examining SBICs

- (1) When you develop your quarterly or monthly schedule, recognize that Section 310(c) of the Act requires SBA to examine each Licensee at least every two years. You should schedule the first examination of a new Licensee within the first six months of licensing, or sooner if the Operations financial analyst requests you to do so.

- (2) The Act permits a waiver of the two year examination requirement, for up to one additional year if such a delay would be appropriate based on leverage, repayment record, prior operating experience, the results of the last examination and the management of the Licensee. Alternatively, the examination may be waived where the Licensee has had its operations suspended while in litigation or in receivership. Any such waiver must be granted by the Associate Administrator, OII.
- (3) When a Licensee is the subject of an ongoing investigation by the Office of Inspector General or another Federal law enforcement agency, you should not conduct an examination unless you receive clearance to do so from the law enforcement agency conducting the investigation.

b. Investment Division Goals and Priorities

- (1) During the fourth quarter of each fiscal year, the Associate Administrator, OII meets with his/her senior staff, including the Director of Examinations, to develop goals and priorities for the upcoming year. The Director of Examinations will inform you of any new goals and priorities, and changes from the prior year. Because the SBIC program operates in a dynamic and changing environment, goals and priorities may be changed or modified at any time.
- (2) Unless you receive different guidance, make sure that your quarterly and monthly schedules reflect the following established OII priorities:
  - (a) All Licensees having leverage, using a 12 – 14 month cycle;
  - (b) All requests for priority examinations made by the Office of SBIC Operations or the Office of SBIC Liquidation;
  - (c) Those non-leveraged Licensees that had no findings in the last examination should be scheduled for examination using a 18 month cycle; and
  - (d) Those non-leveraged Licensees having findings in the last examination should be scheduled for examination using a 12 - 18 month cycle.

c. Concerns of the Office of SBIC Operations

In the fourth quarter of each fiscal year, you should contact the Area Chiefs in the Office of SBIC Operations to find out if any Licensees should be examined on an

expedited basis during the upcoming fiscal year. Also continue to maintain ongoing contact with the Area Chiefs throughout the year to understand any changes to their needs and concerns.

d. Concerns of the Office of SBIC Liquidation

- (1) In most cases, you should not schedule examinations of Licensees that have been transferred to the Office of SBIC Liquidation. There will be instances, however, when the analysts in the Office of SBIC Liquidation request an examination. For example, an examiner may be asked to conduct an examination to determine whether a Licensee is complying with the terms of a settlement agreement.
- (2) In the fourth quarter of each fiscal year, the Director of Examinations will meet with the Director of Liquidation to determine whether there are any Licensees in a liquidation status that need to be examined during the next year. In addition, it is important that you maintain ongoing contacts with the supervisory staff in the Office of SBIC Liquidation to learn of any special needs.

e. Complexity of Pending Examinations

Certain examinations, by their very nature, are more complex than others and may require additional time to complete, or require a team of more than one examiner. You should consider the complexity of each examination when preparing your quarterly and monthly examinations schedules. For example, a non-leveraged bank-owned Licensee will normally require one examiner for less than a week of on-site work. On the other hand, a leveraged Licensee may require more than one examiner or more than a week of on-site work if there are an inordinate number of highly complex issues to address.

3. What Should My Quarterly and Monthly Examinations Schedule Look Like?

- a. After considering all the factors that affect planning, prepare your quarterly and monthly schedule to show the names and addresses of all Licensees expected to be examined in the period. The schedule must be in chronological order by the estimated start date (month and year), and should include the exam cut-off date as well as the name of the assigned examiner. The five headings for the schedule are:
  - (1) Estimated start date (Month and Year);
  - (2) Period covered during examination;
  - (3) Name of Licensee and license number;

(4) Address of Licensee (City and State); and

(5) Assigned Examiner.

- b. You should submit your schedule to the Director of Examinations for review and comment by no later than the first day of the month or quarter being scheduled. The Director will forward copies of the examination schedule to the Associate Administrator, OII, as well as other managers or directors, as appropriate.

#### 4. When Should I Revise My Examinations Schedule?

- a. You must revise your examinations schedule whenever changes occur that alter the sequence of examinations. The examination schedule is a dynamic and flexible planning tool that reflects often changing priorities. You must continually update it and provide a revised copy to the Director of Examinations at least monthly, but possibly more often if appropriate. For example, you may drop some Licensees from the list, reschedule them to another date, or otherwise rearrange the order of your examinations, depending on status changes for the Licensees.
- b. Changes to the quarterly or monthly examination schedules often occur as a result of requests made by the Office of SBIC Operations. For example, the Office of SBIC Operations may request that you add a newly licensed SBIC to the schedule, or that you give higher priority to a scheduled examination due to the Licensee's request for funding. You must also revise your schedule whenever the OIG Investigations Division notifies the office that an investigation of a Licensee has started or ended. Other factors, as explained below, will also alter an examination schedule.

##### (1) Requests for Special Examinations

- (a) While most of your examinations are conducted on a regular 12 - 18 month cycle, there will be certain situations in which you must schedule and conduct an examination as soon as possible. These situations involve the immediate necessity to protect federal funds and safeguard the integrity of the SBIC program. For example, a Licensee may be in a precarious financial condition (such as a condition of Capital Impairment), or there may be indications of a pervasive, intentional or persistent disregard of the regulations.
- (b) The Associate Administrator, OII has the discretion to order the immediate examination of any Licensee. The Director of Operations and the Director of Liquidation also have the authority to request such an examination. Whenever you receive an order or request to conduct a special examination, you should consider it your top priority, and

schedule it on an expedited basis. In most cases, you should begin a special examination within 30 days of receiving the request.

- (c) You normally will initiate a special examination in response to a written request. The request should fully explain the need for a special examination, and specify those areas and financings the examination should focus on. After reviewing the request, you should work closely with the requesting office to define the scope of the special examination. Because special examinations are usually limited in scope, they generally do not take the place of periodic examinations.

## (2) Decisions to Postpone an Examination

- (a) You should postpone a scheduled examination only after you receive, and agree with, an appropriate written request from the Director of Operations or an Area Chief. Normally, this situation occurs when the examination would cause undue inconvenience, hardship, or conflict with other activities of the Licensee. If you disagree with a request to postpone an examination, promptly refer the matter to the Director of Examinations for resolution.
- (b) Whenever you postpone an examination, you should reschedule it for the earliest date possible and revise your quarterly or monthly schedule to show a new start date. Periodically review the status of postponed examinations to decide whether they should continue to be delayed.

## (3) Workload Imbalances

- (a) You must promptly revise your quarterly or monthly schedule whenever workload imbalances result in overall delays. For example, there may be times when you need to reassign examiners to handle unexpected priority examinations, or you may already have a backlog of high-priority examinations and need to use examiners from another field office to assist with the workload.
- (b) You must request and obtain approval from the Director of Examinations before using examiners from another field office or agreeing to allow your own examiners to handle examinations in another office.

## 5. How Do I Inform the Office of SBIC Operations of Schedule Changes?

At the beginning of each month, send the appropriate Area Chief a list of those Licensees

you plan to examine during the next month. You should send a copy of this list to the Director of Examinations.

## 6. What Is My Role in Promoting Quality Examinations?

Along with the Director of Examinations and other Examinations managers, you are part of the team that manages the examinations process. As a first-level supervisor, you have primary responsibility for ensuring that the examinations conducted by your staff and the reports you issue demonstrate a quality work product. A quality examination is one that:

- a. Reflects the examiner's professionalism, independence, and sound judgment;
- b. Is fair, objective, thorough, and accurate;
- c. Is conducted in sufficient depth to clearly support findings of regulatory noncompliance, or a determination that no findings exist;
- d. Includes findings and other issues that are fully supported by workpapers;
- e. Is completed in a timely manner with no undue delays; and
- f. Results in a report that is clear, complete, and concise.

## 7. How Do I Ensure Quality Examinations?

You have numerous supervisory tools available to you to ensure that examinations meet our standards for high quality. For example, you have the authority to:

- a. Assign examinations to individual examiners or teams;
- b. Participate in sensitive examinations as team leader;
- c. Determine and expand the scope of the examination;
- d. Direct and guide your examiners' efforts;
- e. Review draft reports and supporting workpapers;
- f. Follow up with examiners on possible/potential issues not fully developed during the on-site examination.

- g. Recommend needed training for examiners;
- h. Rate the performance of your examiners; and
- i. Recommend policy changes to enhance efficiency and productivity.

8. What Management Reports Am I Required to Prepare?

As Examinations manager you are required to submit current data on the scheduling and progress of examinations for your area as well as information about travel costs for your area.

a. Monthly Status Report of Examinations

The Office of SBIC Examinations maintains a monthly summary of all examinations completed and in process during the fiscal year, as well as those scheduled to begin over the next 2 months. You must update your section of the report to show the current status of the examinations you manage. The report includes the following headings:

- (1) Name of Licensee;
- (2) Licensee Number;
- (3) Date of Last Examination;
- (4) Examiner Assigned;
- (5) Date Examination Started;
- (6) Date Site Work Started;
- (7) Date Site Work Ended;
- (8) Date Draft Report Was Submitted to Examinations Manager; and
- (9) Date Report was Issued.

b. Travel Reports

The Office of SBIC Examinations maintains an office-wide travel report of actual versus budgeted travel costs so that amounts over or under the budgeted amounts can

be continuously monitored. You will be required to submit details regarding travel budgets, travel authorizations, vouchers, and travel costs in order to create these reports.

c. Weekly Reports

The Associate Administrator, OII and the Director of Examinations require you to submit additional management reports from time to time. These reports will normally concern:

- (1) Schedules of upcoming examinations;
- (2) Status of pending or ongoing examinations;
- (3) Problems encountered during an examination;
- (4) Recommended revisions to current examination procedures;
- (5) Reasons for departures from the quarterly or monthly examination schedules;
- (6) Operational issues (e.g., computer, records management, software problems);
- (7) Leave schedules for field office staff; and
- (8) Number of examinations issued or in process, as well as the minimum, maximum and expected number of examinations to be issued by the end of the fiscal year.

9. What Is My Role in Maintaining Current Policies and Procedures?

- a. As situations arise, SBA may need to update this SOP or issue additional directives that further explain, revise or cancel current policies and procedures. These directives are intended to clarify issues of such importance and magnitude that an immediate and written office position is needed.
- b. As an Examinations manager, you must be constantly alert to areas in our policies and procedures that need revision. In addition, the Director of Examinations may require you to assist in making these revisions.

Appendix 1  
Index to Forms and Reports

<u>Form</u>	<u>Pages</u>
SBA Form 468, Annual Financial Report	10, 12, 13, 16, 26, 28, 31
SBA Form 480, Size Status Declaration	29
SBA Form 652, Assurance of Compliance for Nondiscrimination	29
SBA Forms 856 & 856A, Disclosure Statement	13, 16, 21, 31
SBA Form 857, Request for Information Concerning Portfolio Financing by SBICs	10
Loan and Investment Information Summary	29
SBA Forms 1031 & 1031A, Portfolio Financing Report	11, 27, 28, 29
SBA Forms 1405 & 1405A, Ownership Confirmations	17
SBA Form 1941, Financing Eligibility Statement	35
SBA Form 2182, Section M, Capital Certificate	11, 13, 17

---

Effective Date: October 28, 2013

## Appendix 2

### Index of Workpapers

#### **A FILE**

A-1/1	Historical Information Summary Sheet, List of Associates and their relationships with the SBIC
A-1/2	Record of Licensing by SBA
A-1/3	Articles of Certificate of Incorporation/Partnership Agreement and Amendments
A-1/4	General Partner's Articles of Certificate of Incorporation/Partnership Agreement and Amendments
A-1/5	Management Agreement(s) to which the Licensee is a Party/Investment Advisor/Manager Agreement
A-1/6	Permanent correspondence, i.e. advice of action, change of control, change of name, preliminary exam visit, etc.
A-2/1	Minutes of Stockholders'/General Partners' Meetings
A-2/2	Minutes of Board of Directors'/General Partners' Meetings
A-2/3	Minutes of Executive/Advisory Committee Meetings
A-3/1	Review of Stock Certificate Books/Shareholders
A-3/2	Officers and Directors of the Licensee
A-3/3	Review of Capital Certificate/List of General and Limited Partners of Licensee
A-3/4	Shareholders'/Partners' Capital Confirmations
A-3/5	Statement of Personal History and Qualifications of Management
A-4	License Application/Proposal to Operate
A-4/1	Amendments to License Application/Proposal to Operate

A-4/2 Correspondence (Advice of Action)

**B FILE**

B-0/1 Capital Structure and Approved Operations Limits for compliance purposes

B-0/2 SBA Form 1031A filed with SBA

**B SUMMARY & SCHEDULE OF PORTFOLIO FOR CURRENT YEAR**

B-2 Schedule of Assets Acquired in Liquidation

B-3 Schedule of Warrants

B-4 SBCs Controlled

B-5 Visits to SBCs

**CURRENT YEAR**

B-EXAM YR/X Loan and Investment Summary

B-EXAM YR/X-1 Portfolio concern confirmation

B-EXAM YR/X-2 Credit Report (D & B or other)

B-EXAM YR/X-3 Small concern visit (when applicable)

B-EXAM YR/X-4 Financial Statements

B-EXAM YR/X-5 SBA Form 1031 confirmation from SBA

B-EXAM YR/X-6 Note (excerpts)

B-EXAM YR/X-7 Loan/Debt Agreement (excerpts)

B-EXAM YR/X-8 Stock purchase agreement/Subscription agreement/Private placement memorandum/prospectus (excerpts)

B-EXAM YR/X-9 Warrant or Warrant Agreements (excerpts)

B-EXAM YR/X-10 Certification for intended use of proceeds

B-EXAM YR/X-11 Stock certificate, shareholders agreement, if needed to show voting rights and redemption provision (excerpt)

B-EXAM YR/X-12 Management service contract

B-EXAM YR/X-13 Other documents

---

Effective Date: October 28, 2013

**C FILE**

- C-1 Prior examination report findings and their disposition
- C-2 Exam report and related correspondence
- C-3 Exam report and related correspondence
- C-4 Exam report and related correspondence
- C-5 Exam report and related correspondence

**D FILE**

- D-1 SBA Form 468 with IPA opinion letter, Annual IPA financial statement, & Report to investors if any
- D-2 IPA Certification (Form CO-112) and IPA errors and omission declaration (obtain the latter if IPA firm is local or regional firm)
- D-3 General Partner's trial balance, and/or trial balance and supporting working papers on SBIC wholly-owned subsidiaries
- D-4 SEC report (10K, 10Q and others)
- D-5 Financial reports of Licensee parent company, report to shareholders if any

**E FILE**

- E-1 Exam Billing
- E-1A Examiner's time summary
- E-2 Valuation policy (copy) with SBA's approval letter, if applicable; Asset account analysis (e.g. accrued interest receivable)
- E-3 Liability account analysis working papers (i.e. debentures, participating securities, 3rd party debt, etc.)
- E-4 Capital account analysis working papers (i.e. Schedule of capital, preferred stock, undistributed net realized earnings, include latest capital certificate)
- E-5 Distribution worksheet

**F FILE**

F/F	Indexed copy of issued report
F-1	Indexed copy of draft report
F-2	Supervisory review sheet
F-3	Trial Balance
F-4	Unaudited comparative balance sheet
F-5	Licensee's quarterly SBA form 468 as of exam date (if applicable)
F-6	Inactivity Evaluation
F-7	Capital impairment calculation based on applicable capital impairment percentages
F-8	Liquidity Impairment Calculation (year end calculations)
F-9	Review of cash disbursements
F-10	Review of cash receipts (i.e. payoff, leverage, significant receipts)
F-11	Summary of cash and idle fund accounts
F-12	Bank confirmations
F-13	Bank statements of cash accounts (checking, savings, and money market)
F-14	U.S. government obligations (Idle Funds - T Bills)
F-15	Schedule of time certificates of deposit and/or repurchase agreements
F-16	Schedule of Financings
F-17	Schedule of Current Portfolio Balances
F-18	Schedule of Delinquencies
F-19	Schedule of Sold, Written-Off, or Paid-Off investments
F-20	Review of Portfolio Valuation
F-21	Analysis of Management/Advisory Fees
F-22	Management Services Agreements

**G FILE**

- G-1 Indexed examination checklist
- G-2 Examination notification letter to licensee and response
- G-3 Pre-examination work/manager discussion
- G-4 Pre and post-exam notification to financial analyst
- G-5 Entrance conference
- G-6 Record of credit reports, confirmations, field visits and criteria for sample data
- G-7 Disclosure statement
- G-8 Review of financing commitments to SBCs
- G-9 Review of safeguarding of portfolio securities
- G-9A Safe deposit box certification, if applicable
- G-10 Review/copy of IPA working papers
- G-11 Exit conference (Include written licensee's comments to exam issues.)
- G-12 Financings no longer in the licensee's portfolio
- G-13 Non-current working papers