

AN EARLY DEFAULTED LOAN TO

[EX. 4]

AUDIT REPORT NO. 0-10

March 23 , 2000

FOIA EX. 4

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



US SMALL BUSINESS ADMINISTRATION
OFFICE OF INSPECTOR GENERAL
Washington, DC 20416

AUDIT REPORT
ISSUE DATE: MARCH 23, 2000
REPORT NUMBER: 0-10

To: Lavan Alexander, District Director
Dallas/Fort Worth District Office

From: *Garry J. Duncan*
for Robert G. Seabrooks, Assistant Inspector General
for Auditing

Subject: Audit of an Early Defaulted Loan to [EX-4]

Attached is a copy of the subject audit report. The report contains one finding and two recommendations addressed to your office. Your comments and the comments of the lender have been synopsized and included in the report.

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

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

Attachment

FEIA EX. 4

**AUDIT OF
EARLY DEFAULTED LOAN TO [ex. 4]**

TABLE OF CONTENTS

	<u>Page</u>
Background.....	1
Audit Scope and Objective.....	1
Results of Audit.....	1
Finding	
Improper Lender Processing Procedures were used to Approve a Loan.....	1
Appendices	
A- Management Response	
B- Lender Comments	
C- Audit Report Distribution	

FIA Ex. 4

BACKGROUND

The Small Business Administration (SBA) is authorized under section 7(a) of the Small Business Act to provide financial assistance to small businesses in the form of government-guaranteed loans. SBA guaranteed loans are made by participating lenders under an agreement (SBA Form 750) to originate, service, and liquidate loans in accordance with Administration rules and regulations.

Heller First Capital Corporation (lender) processed a \$300,000 loan (number [EX. 4] for [EX. 4] (borrower) under Preferred Lender Program procedures. The loan, used to lease [EX. 4] Texas, was approved and disbursed in [EX. 4] The loan was then placed in liquidation status in June 1998.

AUDIT SCOPE AND OBJECTIVE

This report provides the conclusions of an audit conducted on an SBA guaranteed loan. The loan was judgmentally selected for review as part of the Office of Inspector General's ongoing program to audit SBA guaranteed loans charged off or transferred to liquidation within 36 months of origination (early default).

The audit objective was to determine whether the early default was caused by lender or borrower non-compliance with SBA requirements. SBA and lender loan files were reviewed and district office and lender personnel were interviewed. The fieldwork was accomplished between May and October 1999. The audit was conducted in accordance with Government Auditing Standards.

RESULTS OF AUDIT

FINDING Improper Lender Processing Procedures were used to Approve a Loan

The lender did not follow prudent lending procedures in approving and disbursing the loan. The borrower's equity injection and personal financial information were not verified and the lender could not provide support that loan proceeds were used for the purposes designated by the Loan Authorization Agreement. In addition, the seller's financial information was not validated. When these facts were brought to the lender's attention, SBA's obligation to honor a \$204,866 guarantee on this loan was relieved.

The borrower's equity injection

The lender did not comply with the Loan Authorization Agreement to obtain evidence that the borrower made the required equity injection. The agreement stated that prior to loan disbursement, the lender must have evidence that the borrower injected \$130,000 into the business. The lender acknowledged that the borrower's capital injection had not been verified.

The borrower's personal financial statements

The lender did not verify information submitted on personal financial statements submitted by the borrower as required by SOP 50 10 3. The lender was responsible for reviewing the financial history of the borrower in order to assess the applicant's repayment ability or potential to repay the SBA loan. By not assuring the accuracy of the borrower's financial information, the lender could not determine the borrower's credit worthiness or repayment ability.

Use of loan proceeds

The Loan Authorization Agreement required that the proceeds of the loan be used for the acquisition of the business [EX.4] and inventory [EX.4]. The lender's files did not contain documentation to verify that the proceeds were used for the purposes designated by the agreement.

The seller's financial information

The lender did not validate seller financial information contained in the loan application. SBA Policy Notice 9000-941 states that the lender is responsible for ensuring the information submitted by small businesses is credible. In cases where the financial information to be verified is from the selling business, tax returns are required for three full years prior to the purchase.

Financial information furnished with the application should have been verified with data submitted to the IRS prior to any disbursement of loan proceeds. Instead of using tax returns, the lender used six months of sales tax filings as a basis for developing prospective financial statements. The lender stated that the seller was unable to provide financial data for the location being purchased because he maintained only a consolidated financial statement for several of his businesses. As a result, the lender did not ensure that credible data was used in making a determination as to whether the borrower could repay the loan.

The lender released SBA from loan guarantee liability

As a result of our audit, the lender sent a withdrawal of liability letter to the SBA Dallas/Fort Worth District Office in September 1999. The lender stated that since some erroneous decisions had been made with regard to this loan SBA was relieved of its obligation to honor the \$204,866 guarantee (see Appendix A).

RECOMMENDATIONS

We recommend that the Dallas/Fort Worth District Director take the following actions:

- 1A. Prepare a SBA Form 327, "Modification or Administrative Action" to document SBA's release from the guarantee for loan number [EX.4]

- 1B.** Remind the lender of its obligation to comply with SBA regulations, policies, and procedures for originating loans, particularly in the areas of equity injections, borrower and seller financial statements, and use of loan proceeds

District Office response

The District Office is in full agreement with the report. A modification action (SBA Form 327) was forwarded to Headquarters on 10/29/99 stating that at the lender's request the loan guarantee for the subject loan was canceled. The lender was reminded of its obligation to comply with SBA regulations, policies, and procedures for originating loans in a district office letter dated March 7, 2000 (see Appendix A).

Evaluation of District Office Comments

The District Director's comments are responsive to our recommendations.

Lender Comments

The lender agreed not to pursue the guarantee on this loan (see Appendix B).

Evaluation of Lender Comments

The lender comments are acceptable.



U. S. SMALL BUSINESS ADMINISTRATION
DALLAS/FORT WORTH DISTRICT OFFICE
4300 AMON CARTER BLVD. SUITE 114
FORT WORTH, TEXAS 76155
(817)684-5500 • (817) 684-5516 (FAX)

Appendix A

DATE: March 8, 2000
FROM: Lavan D. Alexander
District Director
TO: Robert G. Seabrooks
Assistant Inspector General
SUBJECT: Audit of an Early Defaulted Loan to [EX. 4] (Draft)
SBA Loan No. [EX. 4]

The Dallas/Ft. Worth District Office has reviewed the findings and recommendations set out in the subject draft audit report dated March 2, 2000.

Please be advised that this office is in agreement with these findings. Attached you will find (a) a copy of the 327 Modification Action that was forwarded to Headquarters on 10/20/99; and (b) a copy of my letter to the Participant (as suggested in your report).

If you have questions or need additional information, you may call me at [EX. 6]


Lavan D. Alexander
District Director

[EX. 6]

Enclosures

FOIA EX. 4 § 6

MODIFICATION OR ADMINISTRATIVE ACTION
 SBA FORM 327-PipeLine Version (8/97) Dallas/Fort Worth District Office/0610

OF BORROWER [Ex. 4]		PARTICIPANT Heller Financial 900 Circle 75 Parkway Atlanta, Georgia 30339	
LOAN NO.: [EX. 4]		REPORT DATE: October 19, 1999	ACTION #: 4
APPROVAL DATE: [Ex. 4]	TYPE: 07	INITIAL DISB. DATE: / /	
APPROVED AMOUNT: 300000.00	SERVICED BY: B	FINAL DISB. DATE: / /	
% OF GUARANTY: 75.000	PURCHASE DATE: / /	TOTAL AMT DISB.: \$0.00	
CURRENT BALANCE: \$264801.27	CLASSIFICATION: Charged-Off	SOP REF AND PARAGRAPH #:	
MATURITY DATE: 04/30/06	DATE TO LIQ. (IF APP.): 06/19/98		
	DATE CHG. OFF (IF APPL.): / /		
REF. 50-50-4, Chapter 10, para. 2 Voluntary Termination of Guaranty Cancel SBA's Guaranty Effective: 10/13/99 Guaranty Fee in the amount of \$6,750.00 was paid to Denver			

CAUSE FOR REPORT: Notification from participant bank requesting that SBA cancel the guaranty on subject loan.
COMMENTS: Notification received from participant bank on 10/13/99 requesting SBA cancel our guaranty on subject loan and refund guaranty fee.
RECOMMENDATION OF L/O: 1. Per bank's request, cancel guaranty on subject loan effective the date of bank notification. Participant Bank be reimbursed for any unused guaranty fee.

Comments of Counsel: [Ex. 6]
Complies w/ 130.524

Comments: [Ex. 6]

do I do not () Approve [Ex. 6]



U. S. SMALL BUSINESS ADMINISTRATION
DALLAS/FT WORTH DISTRICT OFFICE
4300 AMON CARTER BLVD, SUITE 114
FT WORTH TX 76155
817-684-5538 • 817-684-5516 (FAX)

Appendix A

March 7, 2000

[EX. 6]

Deputy General Counsel
Heller Financial
900 Circle 75 Parkway, Suite 900
Atlanta, Georgia 30339

RE: [EX. 4] - OIG Audit Findings
SBA Loan No [EX. 4]

Dear [EX. 6]

The U. S. Small Business Administration (SBA) Office of Inspector General submitted to this office, its findings and conclusions from the audit conducted on the subject loan. This audit was conducted in order to determine whether early default was caused by lender or borrower non-compliance with SBA requirements. SBA and lender loan files were reviewed and district office and lender personnel were interviewed. The audit was conducted according to Government Auditing Standards and was accomplished between May 1999 and October 1999.

Results of the audit: Improper Lender Processing Procedures were used in the following categories:

- Evidence that the Borrower made the equity injection required by the Loan Agreement and Authorization.
- Lender did not verify information submitted on personal financial statements submitted by the borrower.
- The lender failed to maintain proof of their verification that proceeds were used for the purposes designated in the Loan Agreement and Authorization.
- Lender did not validate the financial information submitted by the seller prior to disbursing loan funds.

SBA would like to take this opportunity to remind Heller Financial of its obligation to comply with SBA regulations, policies and procedures for originating loans, particularly in the areas of equity injection, borrower and seller financial statements and the use of loan proceeds.

Should you wish to discuss the above, you may contact [EX. 6] Acting ADD/ED at [EX. 6]
[EX. 6] As always, your Participation with SBA and its programs is greatly appreciated.

Sincerely,


Lavan D. Alexander
District Director

FIA EX. 4, 6

Heller Financial, Inc.
900 Circle 75 Parkway, Suite 900
Atlanta, Georgia 30339
Telephone: (770) 980-6016
Facsimile: (770) 980-6215

H Heller Financial

[Ex. 6]
Deputy General Counsel

VIA FEDERAL EXPRESS

March 15, 2000

Mr. Richard Benton
U.S. Small Business Administration
Office of Inspector General
4300 Amon Carter Blvd., Suite 116
Fort Worth, TX 76155

Re: *Audit of an Early Defaulted Loan to* [Ex. 4]

Dear Mr. Benton:

As we indicated directly to the Dallas office earlier this year, the above referenced loan, we had hoped, would be successful. At the time we did the transaction, we felt that this store and [Ex. 4] operated by a borrower with experience, would be successful. Hindsight being 20/20, obviously, the loan failed and because we value our relationship with the SBA and the local Dallas district, when asked, we agreed not to pursue our guaranty.

I suggest that you add to your report, if possible, just that; that we value our relationship with the SBA and each district that we do business and that on this [Ex. 4] loan, the government suffered no loss.

Please call me if you have any questions.

Cordially,
HELLER FINANCIAL, INC.

[Ex. 6]

Deputy General Counsel

[Ex. 6]
Enclosure

FOIA EX. 4, b

OFFICE OF INSPECTOR GENERAL
AUDIT REPORT DISTRIBUTION

<u>Recipient</u>	<u>Number of Copies</u>
District Director Dallas/Fort Worth District Office-----	2
Deputy Associate Administrator Capital Access-----	1
General Counsel-----	2
Associate Administrator for Financial Assistance-----	1
Associate Administrator for Field Operations-----	1
Office of Chief Financial Officers Attn: Jeff Brown-----	1
General Accounting Office-----	1