



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

<b>AUDIT REPORT</b>
<b>ISSUE DATE: March 2, 2006</b>
<b>REPORT NUMBER: 6-14</b>

**To:** James E. Rivera  
Associate Administrator for Financial Assistance

**From:** /S/ original signed  
Robert G. Seabrooks  
Assistant Inspector General for Auditing

**Subject:** Audit of an SBA Guaranteed Loan to [FOIA Ex. 6]

Attached is a copy of the subject audit report. The report contains one finding and recommendation addressed to you. Your response and the response of the lender have been synopsisized and included in the report.

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

Should you or your staff have any questions, please contact Stephen Seifert, Director, Credit Programs Group, at 703-487-[FOIA Ex. 2].

Attachment

cc: Acting IG

**AUDIT OF AN SBA GUARANTIED LOAN TO**

**[FOIA Ex. 6]**

**Lubbock, Texas**

**March 2, 2006**

**The finding in this report is the conclusion of the Office of Inspector General's Auditing Division based on testing of SBA operations. The finding and recommendation are subject to review, management decision, and corrective action in accordance with existing Agency procedures for follow-up and resolution. 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.**

**AUDIT OF AN SBA GUARANTIED LOAN TO  
[FOIA Ex. 6]**

**Lubbock, Texas**

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## **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 SBA regulations, policies, and procedures. SBA is released from liability on a loan guaranty, in whole, or in part, within SBA's exclusive discretion, if a lender failed to comply materially with SBA regulations, the loan agreement, or did not make, close, service, or liquidate a loan in a prudent manner.

During an on-going audit of the guaranty purchase process at the National Guaranty Purchase Center (Center) in Herndon, Virginia, we identified a problematic loan made by First Bank & Trust (lender) to [FOIA Ex. 6] (borrower) which is the subject of this audit report. The loan was part of a statistical sample selected from a universe of 7(a) loan guaranties purchased by the Center from October 1, 2004 through May 31, 2005.

The loan was processed under LowDoc procedures; therefore, SBA was responsible for determining the eligibility and the credit risk of the borrower. The lender was required to service and liquidate the loan in accordance with SBA regulations, policies, and procedures.

The loan (No. [FOIA Ex. 2]) was approved on January 10, 2002 for \$40,000. The purpose of the loan was to purchase \$21,422 of equipment and provide \$18,578 of working capital. The loan was disbursed between March 13, 2002 and August 13, 2002. The borrower defaulted on March 14, 2004 and SBA purchased the guaranty on December 3, 2004 for \$26,143.

## **AUDIT OBJECTIVE AND SCOPE**

The objective of the audit was to determine if the lender originated, serviced and liquidated the purchased loan in accordance with SBA rules and regulations. During the audit we examined loan files maintained by SBA and the lender and discussed the loan with SBA and lender officials. The audit was conducted in August 2005 in Herndon, Virginia, in accordance with Government Auditing Standards.

## **RESULTS OF AUDIT**

### **Finding - The lender Failed to Comply with Material SBA Loan Servicing Procedures**

The lender did not take prudent measures to ensure that the borrower made the required equity injection before the loan was disbursed and that loan proceeds were used in accordance with the loan authorization. Because neither deficiency was detected during the guaranty purchase process, SBA made a \$26,143 erroneous payment when it honored the guaranty.

#### **Equity Injection**

Pursuant to the loan authorization, the lender was required to obtain evidence that the borrower injected at least \$10,000 cash into the business prior to the first loan disbursement. The purpose of the equity injection was to provide working capital for the business.

According to the lender, the \$10,000 equity injection was made in the form of cash purchases for tools and equipment, which was evidenced by bank statements from the operating checking account for the business. A review of the borrower's bank statements showed the account was established on February 28, 2002 and that no funds were deposited into the account prior to the deposit of loan proceeds on March 14, 2002. Furthermore, there were no documents, such as paid receipts, found in the lender loan file showing that the borrower purchased any tools or equipment. Consequently, the lender had no evidence that the \$10,000 of equity was injected into the business prior to the first disbursement.

#### **Use of Proceeds**

The lender did not obtain evidence to substantiate that \$7,623 of loan proceeds were used to purchase equipment as required by the loan authorization. Loan proceeds were authorized to purchase equipment of \$21,422. Upon signing SBA Form 1050, Settlement Sheet, the lender certified that (i) loan proceeds were used in accordance with the loan authorization and (ii) disbursement was made by issuance of joint payee checks; checks to reimburse borrower for evidenced expenditures made after loan approval date, but before disbursement; checks for operating capital; or as otherwise directed by the loan authorization. The lender provided evidence of equipment purchases totaling \$13,799; thus leaving \$7,623 of the authorized equipment purchases undocumented.

Due to the materiality of the lender deficiencies as noted in this report, full recovery of the \$26,143 guaranty payment to the lender is warranted.

### **RECOMMENDATION**

We recommend that the Associate Administrator for Financial Assistance take the following action:

1. Seek recovery of \$26,143 from the lender on the guaranty paid, less any subsequent recoveries, for loan number [ FOIA Ex. 2 ].

## **Lender Response**

The lender stated that the equity injection included a \$4,400 distribution from the 401(k) plan of one of the principals and provided a loan request form as support for the withdrawal. The lender further stated that the borrower provided operating checking account statements with a third party bank showing the remaining cash injection. The lender was unable to locate or obtain copies of these statements to provide in response to the draft audit report, but claimed they were provided to SBA with its purchase package.

The use of proceeds, according to the lender, was documented by invoices or illustrated by the payees on checks written. The lender explained that the \$17,023 of proceeds questioned in the draft audit report were not used to purchase equipment, but rather, were used as working capital to repay a \$13,000 loan to a friend of the borrower and \$4,023 in wages. The lender indicated that copies of all invoices for the purchases of equipment were included with its response. The lender's response (minus attachments) is included as Appendix A.

## **Evaluation of Lender Response**

The lender's assertion that the withdrawal from a 401(k) plan was evidence of equity injection was not supported by the documentation provided. The 401(k) loan request, which was for \$4,000 and not \$4,400, was signed on October 19, 2003, approximately 19 months after the initial loan disbursement. The loan authorization required the lender to verify that the equity was injected prior to the first disbursement. Furthermore, the lender did not provide any proof that the money received from the 401(k) loan was used for business purposes. Although the lender stated that copies of the bank statements supporting the remaining amount of the borrower's equity injection were provided to SBA with its purchase request, the lender was unable to locate or obtain copies of the statements and they were not in SBA's loan file.

Based on the lender's response to the draft report, we revised the section on use of proceeds. We originally questioned \$17,023 of equipment purchases presented on a loan settlement sheet because they were not supported by documentation in the SBA and lender's files. While a Form 1050, Settlement Sheet, indicated that \$17,023 of loan proceeds were used to purchase equipment, these funds were deposited into the borrower's checking account and there was no evidence to support the proceeds were used for equipment. Based on the lender's response to the draft report, the \$17,023 disbursement was not used to purchase equipment but was actually used as working capital to pay a \$13,000 loan from a friend of the borrower and \$4,023 in wages. As a result, we modified our report to question the \$7,623 of undocumented equipment purchases after considering the additional support provided by the lender in response to the draft report.

## **SBA Management Response**

SBA concurred with the section of our finding regarding equity injection and agreed to recover the entire guaranty payment from the lender. With respect to the use of proceeds, SBA stated that the copies of cancelled checks, paid invoices, and receipts provided by the lender adequately documented \$13,199 of equipment purchases, leaving undocumented equipment

purchases of \$7,623. Given the material injection deficiency warranting full recovery of the guaranty purchase amount, SBA concluded it was not necessary to seek any additional documentation of equipment purchases from the lender. SBA's response is included as Appendix B.

### **Evaluation of SBA Management Response**

SBA's agreement to recover the entire guaranty payment of \$26,143 from the lender is responsive to the recommendation.



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*TYE CHRISTENSEN*  
*ASSISTANT VICE-PRESIDENT*

**MEMORANDUM**

**DATE:** January 5, 2006

**TO:** Stephen Seifert

**RE:** [FOIA Ex. 6 ]

**Equity Injection:**

The borrowers equity injection was evidenced by existing equipment and tools purchased on behalf of the business in addition to a \$4,400 distribution from the 401K plan of [FOIA Ex. 6 ] Spouse ). The \$4,400 cash injection is illustrated in the attachment labeled "Exhibit 1".

The other proof of cash injection was provided in the form of checking account statements provided by the borrower. The operating checking account was held with Amarillo National Bank ( Account [ ] ABA [ ] ) and those statements were mailed along with the SBA repurchase package to Richard Blewett in the Herndon, Virginia office. FOIA Ex. 4

Officer has made attempts to contact borrowers to provide those statements to me once again, however, without any surprise the borrowers did not respond. The checking account held with our institution was merely used to fund the loan and transfer the funds to the Amarillo National Bank account. The loan was originated by the First Bank & Trust Lubbock office; however, the borrowers were customers of the First Bank & Trust branch in White Deer, TX.

Enclosed you will find the checking account transcript "Exhibit 2" for the First Bank & Trust checking account held in the name of [FOIA Ex. 6 ] There were 28 different transactions during the period between 3/11/02 and 9/21/02. There were no transactions on the account prior to 3/11/02.



**Use of Proceeds:**

As detailed by the checking account transcript "Exhibit 2" the use of proceeds are documented and determined by either an invoice or illustrated by who the payee on the checks written. All invoices are attached to denote purchase of equipment, furthermore, the "white slip" copy provided by the Texas Department of Transportation evidences the the \$8,574.38 used to purchase the 1993 GMC pickup that was later repossessed and liquidated.

There as a \$13,000 check made payable to [ ] who is a colleague of the borrower that provided short term working capital until the SBA loan funds were available. Check #4023 was used for payroll as illustrated by the attached invoice. Check #2598 was made payable to Lowe's Home Improvement to purchase a small equipment trailer. The trailer was never located by American Lenders ( Recovery Specialists) nor were any other equipment items or tools located. The borrower's residence was searched in addition to the shop location to find nothing other than the 1993 GMC truck.

FOIA  
Ex. 6

**Conclusion:**

Unfortunately the originating loan office of this credit is no longer employed with First Bank & Trust, however, current account officer has illustrated due diligence in confirming that First Bank & Trust knowingly issued funding on the credit in accordance with SBA Loan Servicing Procedures. First Bank & Trust has taken advantage of the SBA programs to provide our customers the capital needed to be successful in business while supporting the SBA program. It is not in our interests to knowingly issue funding for improper or undocumented use which can be illustrated by the long history of success with the SBA programs. Should you need any further information please contact my office as I will be glad to assist you. Thank you.

Respectfully,

[ FOIA Ex. 6 ]

Tye Christensen  
Assistant Vice-President



U.S. SMALL BUSINESS ADMINISTRATION  
WASHINGTON, DC 20416

DATE: January 19, 2006

TO: Robert G. Seabrooks, Assistant Inspector General for Auditing  
[FOIA Ex. 6]

THROUGH: James H. Kiver, AA/PA //  
[FOIA Ex. 6]

FROM: James W. Hammersley, Director, Loan Programs Division

SUBJECT: OIG Draft Audit of SBA Guaranteed Loans to Ford's Plumbing  
SBA Loan Numbers: LDP [FOIA Ex. 2]

We have reviewed the Office of Inspector General (OIG) December 16, 2005, memorandum and accompanying draft audit report for the subject loan that recommends full recovery of the guaranty payment of \$26,143 from the lender for this \$40,000 LowDoc loan. The basis for the OIG recommendation is 1) lack of evidence of the borrower's \$10,000 injection, and 2) lack of evidence that loan proceeds authorized for equipment (\$21,422) were disbursed for that purpose.

The lender responded to OIG's findings and provided additional documentation to overcome the deficiencies. We reviewed the documentation and considered it in our response below.

1). Lack of evidence of \$10,000 borrower injection:

The loan authorization required the lender to obtain evidence prior to disbursement that at least \$10,000 cash was injected into the business as equity capital. The authorization specified that the cash was for working capital. At the time of guaranty purchase, the lender submitted to the National Guaranty Purchase Center (NGPC) a bank account statement dated March, 17, 2002, as evidence for the injection. The statement indicates that the balance of the account was \$0 (zero) prior to the first account deposit of \$4,827 on March 14, 2002, which was also the first date of loan disbursement. The amount of the first disbursement was also \$4,827. Thus, the bank account statement provided no evidence that the borrower injected funds into the business prior to disbursement.

In the lender's response to the OIG's draft audit, it provided new documentation as injection evidence consisting of a \$4,400 loan the co-borrower had taken against her 401K retirement account. The distribution took place during October 2003, well after loan disbursement, and does not fulfill the authorization requirement of the injection prior to disbursement of the loan. It also does not indicate that the use of the funds was business-

business-related. The lender also provided as evidence a list of checks written on the borrower's bank account, but this, too, was insufficient because we have already determined that the first account deposit represented SBA loan proceeds, and there are no other large deposits to the account that might have represented the borrower's injection; rather, the deposits appear related to loan disbursements.

This borrower experienced early loan payment problems within six months of final disbursement, and continued to experience problems, including delinquencies of over 60 days and checks returned due to non-sufficient funds, throughout the remaining life of the loan. Therefore the loan is considered an early default/early problem loan, and failure to meet the \$10,000 injection requirement for a \$40,000 loan is a material deficiency that provides sufficient grounds to recover the entire guaranty payment from the lender.

2). Use of proceeds:

Loan proceeds were authorized to purchase equipment of \$21,422 and for working capital of \$18,578. Initially the borrower had proposed purchasing two vehicles, a 1994 Chevrolet van and a 1988 Ford pickup truck with the loan proceeds. The lender later notified the SBA Little Rock Commercial Loan Servicing Center that the borrower would purchase one vehicle, a 1993 GMC pickup truck, and requested a change in the use of proceeds to allocate additional funds to working capital. The lender has provided documentation verifying that the GMC pickup truck was purchased and registered at a total cost of \$8,574. The lender was listed as lienholder on the vehicle, and later repossessed and liquidated it.

The lender attempted to document the remaining \$12,848 of equipment purchases with copies of cancelled checks, paid invoices and receipts. We reviewed the documentation, some of which was illegible due to the poor quality of the copies, and determined that sufficient evidence of an additional \$5,225 was provided, leaving undocumented equipment purchases of \$7,623.

We could continue to follow up with the lender for documentation of equipment purchases, including legible copies of receipts. However, given the material injection deficiency warranting full recovery of the guaranty purchase funds, we believe it would not be necessary to invest any more time in seeking documentation of equipment purchases.

We agree that the entire guaranty payment of \$26,143 should be recovered from the lender due to its failure to document the borrower injection.

Thank you for your assistance.

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