

**AUDIT OF**  
**AN EARLY DEFAULTED LOAN TO**  
**My T Quick**  
**Dallas, Texas**  
**AUDIT REPORT NO. 3-07**  
**JANUARY 23, 2003**

**The finding in this report is the conclusion of the OIG's Auditing Division based on testing of the auditee's operations. The findings 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.**



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

<b>Audit Report</b>
<b>Issue Date: January 23, 2003</b>
<b>REPORT NUMBER: 3-07</b>

**To:** Lavan Alexander, District Director  
Dallas District Office

**From:** *Robert G Seabrooks*  
Robert G Seabrooks, Assistant Inspector General  
for Auditing

**Subject:** Audit of an Early Defaulted Loan to My T Quick

Attached is a copy of the subject audit report. The report contains one finding and two recommendations addressed to your office. Your response is synopsised in the report and included in its entirety at Attachment B.

The recommendations in this report are subject to review and implementation of corrective action by your office in accordance with the 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 Forms 1824, Recommendation and Action Sheet. The apparent false statements made by the borrower on personal financial statements will be referred to OIG Investigations.

Any questions or discussion of the finding and recommendations contained in the report should be directed to Garry Duncan, Director, Credit Programs Group, at (202) 205-7732.

Attachments

cc: AA/ Office of Financial Assistance  
AA/ Office of Field Operations

**AUDIT OF  
AN EARLY DEFAULTED LOAN TO  
MY T QUICK  
Dallas, Texas**

**TABLE OF CONTENTS**

	<b><u>Page</u></b>
<b>Background</b> .....	1
<b>Audit Objective and Scope</b> .....	1
<b>Results of Audit</b> .....	2
<b>Finding</b>	
Prudent Lending Procedures were not used to Approve and Close a Loan .....	2
<b>Appendices</b>	
A - Audit Report Distribution	
B - Management Response	

## BACKGROUND

To obtain a SBA guaranty, lenders must meet established requirements and execute a Loan Guaranty Agreement. Execution of the agreement binds the lender to abide by SBA regulations and procedures for loan origination, servicing, and liquidation. Standard Operating Procedure (SOP) 50 10 (4) required the lender to review the borrower's eligibility, repayment ability, management qualifications, use of proceeds, and adequacy of collateral.

In October 1999, Bank United (lender) processed a \$1.31 million SBA guaranteed loan to My T Quick (borrower) for the purchase of a convenience store. The application listed four borrowers ( [ EX. 6 ] ). One of the borrowers originally listed as a 50 percent shareholder, [ EX. 6 ] and was reduced to a 15 percent shareholder. [ EX. 6 ] listed as a guarantor, did not sign the SBA's Form 4 indicating [ 6 ] acceptance of the agreement. Loan proceeds were disbursed in November 1999. The loan was placed in liquidation status in June 2001.

## AUDIT OBJECTIVE AND SCOPE

The audit objective was to determine if the early loan default was caused by lender or borrower noncompliance with SBA's requirements. We reviewed the SBA and lender's loan file and interviewed district office, lender, and borrower personnel. Audit fieldwork was conducted between June and July 2002. The audit was performed in accordance with generally accepted Government Auditing Standards.

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

FOIA EX. 6

## RESULTS OF AUDIT

### **FINDING    Prudent Lending Procedures were not used to Approve and Close a Loan**

The lender did not use prudent lending procedures to approve and close a Section 7(a) loan to My T Quick. SOP 50 10 (4) states that the ability to repay a loan from the cash flow of the business is the most important consideration in SBA's loan making process. The PLP lender, however, did not adequately determine repayment ability and misrepresented the borrower's equity injection. In addition, the borrower misrepresented material facts in applying for the loan. The borrower defaulted because sufficient cash flow was not available to service business debts. As a result, the SBA could owe the lender as much as \$650,000 if the guaranty is purchased.

#### **Repayment Ability**

SOP 50 10 (4) states that when interim results are inconsistent with prior operating results, interim financial data could be misleading for loan approval. The projected debt coverage ratio as computed by the lender was inaccurate and misleading. The debt coverage ratio for fiscal year (FY) 2000 was based on interim financial data that was inconsistent with prior year results. The lender used interim data from FY 1999 to project revenues for FY 2000. The interim statements submitted by the seller for FY1999 reported monthly revenue of \$218,643, nearly a 33 percent increase in monthly revenue from the prior year. A reasonable justification was not provided to support the increase.

The unsupported increased projection is questionable since the business averaged only \$94,753 per month in revenue during FY 2000. In addition, financial data submitted by the seller for FY 1998 showed general and administrative expenses to be about 22 percent of gross sales. The lender, however, used a percentage that more closely resembled the questionable interim financial data for FY 1999 that reported general and administrative expenses of 9.6 percent (more than 12 percentage points below the prior year). Therefore, the lender did not use prudent lending practices to determine borrower repayment ability.

#### **Equity Injection**

The lender misrepresented the borrower's equity injection in an attempt to induce approval of the loan. The lender's loan officer report stated that the equity injection was 21 percent (\$350,000) of the total project cost of \$1,660,000. This figure was comprised of \$184,000 injected by the borrowers and a \$166,000 subordinated note from the seller. According to SOP 50 10 (4), borrowed funds may be considered equity for loan purposes if the lender from which the funds were borrowed signs a standby agreement, and payment of principal and interest will be waived until the SBA loan is paid in full. The standby agreement executed by the seller allowed for payment of principal and interest prior to settlement of the SBA loan. Therefore, the note from the seller should not have been considered equity injection.

Also, 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 \$184,000 from personal funds. A review of the loan file, however, indicated that the borrower had injected \$164,000.

### **Personal Financial Statements**

The borrower misrepresented material facts in applying for the loan. A review of a CPA prepared compilation report, dated June 2000, indicated substantial differences from the financial statements submitted by one of the borrowers. The total liabilities reported by the borrower during the loan application process were [ Ex. 6 ] The CPA compiled personal financial statement dated less than a year later, however, reported total liabilities of [ Ex. 6 ] (excluding the personal guaranty of the subject SBA loan). Included in this amount was:

FOIA Ex. 6

### **Potential SBA Loss**

A defaulted loan balance of \$1,295,819 was transferred to liquidation in June 2001. The amount SBA will owe to the lender at purchase could be as much as \$650,000 depending on whether the collateral can be sold and what is received for it.

## **RECOMMENDATIONS**

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

- 1A. Request the lender to release SBA from the guaranty due to a failure to use prudent lending procedures. If SBA is not released from liability, repair or request denial of the guaranty.
- 1B. Remind the lender of its obligation to comply with SBA regulations and policies for using prudent lending procedures. Specifically, the lender should exercise reasonable judgment when computing projections for use in determining debt coverage ratios. The lender should also consider the borrower's character, reputation, and credit history and ensure sufficient equity is invested to allow the borrower to operate on a sound financial basis.

FOIA Ex. 6

**District Office Comments**

The Dallas/Fort Worth District Office concurred with the finding and recommendations in the audit report. An amicable reduction in the loan guaranty has been negotiated with the lender.

**Evaluation of District Office Comments**

The District Office comments are responsive to the recommendations.

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-----	3
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

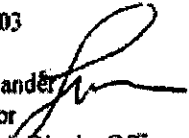


Appendix B



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)

DATE: January 10, 2003

FROM: Lavan D. Alexander   
District Director  
Dallas/Ft. Worth District Office

TO: Robert G. Seabrooks  
Assistant Inspector General for Auditing

SUBJECT: Audit of an Early Defaulted Loan to Ms. T Quick, SBA Loan [ FOIA EX. 4 ]

This memorandum is in response to the issues defined in the subject audit report. It should be noted that, as a result of deficiencies identified by this office during the pre-purchase review, an amicable reduction in guaranty has already been negotiated with the Lender; notwithstanding, this office is in agreement with the audit finding and recommendations.

Should you require additional information please contact me at (817) 684-5502.

FOIA EX. 4