



U.S. SMALL BUSINESS ADMINISTRATION  
OFFICE OF INSPECTOR GENERAL  
Washington, DC 20416

<b>Audit Report</b>
<b>Issue Date: March 26, 2001</b>
<b>Report Number: 2-14</b>

**TO:** Herbert L. Mitchell, Associate Administrator,  
Office of Disaster Assistance

Michael C. Allen, Area Director,  
Atlanta Disaster Office - Area 2

*Robert G. Seabrooks*

**FROM:** Robert G. Seabrooks,  
Assistant Inspector General for Auditing

**SUBJECT:** Audit of an Early Defaulted Disaster Loan to  
[FOIA EX. 6]

The Office of Inspector General, Auditing Division, is conducting an ongoing evaluation of Early Defaulted Disaster Loans. The results of early defaulted disaster loan audits are being provided on each individual loan reviewed. Our results are intended to bring deficient processing issues to your attention so that you can assess whether any actions are needed to prevent similar issues in the future.

The Small Business Administration (SBA) disaster loan program is the primary Federal disaster-assistance program for funding long-range recovery for victims of hurricanes, floods, earthquakes, tornadoes, wild fires, and other physical disasters. Disaster loans help business owners, individuals, and nonprofit organizations to fund rebuilding, replace personal property, and compensate for economic injury. When disaster victims need to borrow to repair or replace uninsured damages, the low interest rates and long terms available from SBA make recovery affordable. Standard Operating Procedure (SOP) 50 30 4 and 50 31 2 provide specific policy and procedural guidance for making disaster loans.

SBA approved a \$117,300 disaster loan to [FOIA EX. 6] (borrower) in [FOIA EX. 6] to repair/replace damaged manufactured housing, personal property, clean-up and debris removal, and refinancing to satisfy an outstanding lien. The borrowers made only four payments and defaulted in November 1999. The borrowers then abandoned the

property with SBA placing it in liquidation in September 2000. In February 2001 the property was auctioned resulting in a \$21,888 recovery for SBA.

## **OBJECTIVES & SCOPE**

The objective of the audit was to determine whether the early loan default was due to: SBA non-compliance with its policies and procedures, borrower non-compliance with the loan agreement, or borrower misrepresentations.

We reviewed documents in the SBA loan file and interviewed the borrower. Borrower tax returns, financial statements, and accounting records were examined. Additionally, we analyzed the borrower's credit report and bankruptcy filings. Finally, the borrower's cash flow and repayment ability were recalculated.

Our audit was conducted during the period June through September 2001. The audit was conducted in accordance with Government Auditing Standards.

## **AUDIT RESULTS**

### **Borrowers Lacked Repayment Ability**

The borrower defaulted on the SBA loan because of a lack of repayment ability. This occurred because SBA miscalculated a portion of the borrower's wages. Further, a discrepancy in financial information reported on the application was not reconciled against wages shown on the Federal tax return or other verifiable sources. Consequently, the wages used to calculate repayment ability were overstated.

SOP 50 30 4 states cash flow, not collateral, is the basis for establishing repayment ability. This would provide reasonable assurance of an applicant's ability to repay any proposed loan. Also, the SOP provides that [loan officers] must exercise credit analysis skills, use discretion, and evaluate all information. Only reasoned and thorough analysis of all relevant facts can help balance prudent lending of subsidized funds and sympathetic consideration of the disaster victim's needs. In addition, the SOP requires financial information reported on the application should be consistent with the tax return or other verified sources. If there is a discrepancy of more than \$500 annually between the reported and verified income, a determination of the correct amount must be documented on the Loan Officer's Report.

SBA did not reconcile the wage discrepancy. For example, there was a \$4,623 difference between the borrowers' 1997 Federal tax return (\$43,137) and the application (\$47,760). We found no evidence the loan officer determined the correct amount to use nor documentation of the Loan Officer Report, as required. In fact, wages of \$48,550 were used to determine repayment ability. We concluded the borrowers' wages for determination of repayment ability totaled \$43,845, not \$48,550 per the Loan Officer's Report. Consequently, the loan officer overstated wages by \$4,705 (\$48,550 - \$43,845) because of a calculation error and acceptance of unsubstantiated wages.

**Calculation error** SBA calculated the borrower's pay on a bi-weekly basis (\$120X26 = \$3,120). The borrower's pay stub indicated this was a monthly payment (\$120X12 = \$1,440). Therefore, SBA overstated wages by \$1,680.

**Unsubstantiated wages** SBA accepted the borrower's statement that the co-applicant earned \$13,000 annually. The actual pay stub indicated the weekly wage was \$191.82 or \$9,975 on an annualized basis (\$191.82 X 52 weeks). There was no evidence SBA reconciled these amounts. Therefore, SBA overstated wages by \$3,025.

Without the \$4,705 (\$1,680 + \$3,025), the borrower's repayment ability would have been negative as shown in the following table:

<b>Description</b>	<b>SBA Calculated</b>	<b>Audit Determined</b>
<i>Annual Income</i>	\$48,550	\$43,845
<i>Gross Monthly Income</i>	4,046	3,654
<i>Times Maximum Acceptable Fixed Debt (40%)</i>	1,618	1,462
<i>Monthly Fixed Debt</i>	<1,030>	<1,030>
<i>Incr. Ins. Prem.</i>	<38>	<38>
<i>= Cash Available</i>	550	394
<i>- SBA Payment</i>	533	533
<i>= Remaining Cash Flow</i>	17	<139>

The contents of this report were discussed with the Atlanta Disaster Area Office on December 4, 2001. The Assistant Area Director for Loan Processing responded he agreed completely with our findings. He stated that the loan officer did not follow established procedures in documenting income in cases where the applicant cites income that is different from what the return [IRS transcript] shows.

We suggest that you periodically remind loan officers of the importance of following established SBA procedures in documenting income where there is a difference between the IRS transcript and applicant provided information. You should maintain documentation of any actions you take to address the above issue for future review and follow-up.