

**AUDIT OF AN SBA GUARANTEED LOAN TO**

**[Exemption 6]**

**PALMAREJO SERVICE STATION**

**Lajas, Puerto Rico**

**Audit Report Number: 7-05**

**December 20, 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.**



U.S. SMALL BUSINESS ADMINISTRATION  
OFFICE OF INSPECTOR GENERAL  
WASHINGTON, D.C. 20416

**AUDIT REPORT**

**Issue Date: December 20, 2006**

**Report Number: 7-05**

**To:** Janet A. Tasker  
Acting Associate Administrator for Financial Assistance

/S/ original signed

**From:** Debra S. Ritt  
Assistant Inspector General for Auditing

**Subject:** Audit of an SBA Guaranteed Loan to [Exemption 6] dba Palmarejo  
Service Station

The purpose of this memorandum is to notify you of a \$31,463 improper payment that should be recovered. During our audit of the guarantee purchase process at the National Guaranty Purchase Center, we identified a problematic loan [Exemption 2] made by Banco Santander Puerto Rico to [Exemption 6] dba Palmarejo Service Station (borrower). We reviewed the loan to determine if the lender originated, serviced and liquidated the purchased loan in accordance with Small Business Administration (SBA) rules and regulations. The audit was conducted during July 2006 in Dallas, Texas in accordance with *Government Auditing Standards* prescribed by the Comptroller General of the United States.

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 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. If a lender fails to comply materially with SBA regulations, the loan agreement, or does not make, close, service, or liquidate a loan in a prudent manner, SBA has exclusive discretion to release itself from liability, in whole, or in part, on the loan guarantee.

On June 9, 1999, SBA approved a \$400,000 loan to the borrower and on September 27, 1999, approved an \$80,000 increase, bringing the total approved loan amount to \$480,000. The loan was approved using regular 7(a) loan procedures. Therefore, SBA was responsible for determining the eligibility and credit risk of the

borrower, and the lender was required to service and liquidate the loan in accordance with SBA's regulations, policies and procedures. The borrower was an existing gasoline service station and the purpose of the loan was to purchase adjacent land (\$73,000), renovate and expand the service station (\$117,814), payoff an interim loan (\$225,000), finance inventory (\$27,000), and provide working capital (\$37,186). The loan was fully disbursed on September 30, 1999. The borrower demonstrated repayment problems beginning in November 2000 and defaulted on November 2, 2001, after filing for bankruptcy. The borrower's bankruptcy filing was eventually dismissed on October 21, 2003 and the borrower re-filed for bankruptcy on January 7, 2004. Due to the borrower's early repayment problems, this is considered an early problem loan. The purchase review decision was approved by the National Guaranty Purchase Center on April 5, 2005, and no material deficiencies were identified. SBA purchased the guarantee for \$316,939 on April 7, 2005.

### **The Lender Misapplied Loan Payments to Interest**

The lender incorrectly applied a portion of the loan payments received while the loan was in liquidation status to interest. This deficiency was not detected during the guarantee purchase process and as a result, SBA made a \$31,463 improper payment when it honored the guarantee.

Standard Operating Procedures (SOP) 50 51 2 states that a loan must be transferred to liquidation status when a voluntary or involuntary bankruptcy petition is filed and cannot be removed from liquidation status unless either a workout plan has been developed, or a term compromise agreement or a judgment has been obtained and at least three monthly payments have been made, as agreed. All proceeds received while the loan is in liquidation must be applied to the principal balance of the loan.

The loan transcript showed that between the first and second bankruptcy filing, the borrower made 14 sporadic, partial payments totaling \$50,894. The lender inappropriately recorded \$30,677 of these payments as interest. Because the loan did not meet the requirements to be removed from liquidation status between the first bankruptcy filing on November 2, 2001, and when SBA purchased the guarantee on April 7, 2005, the loan payments should have been applied solely to the principal while the loan was in liquidation. Furthermore the lender recorded \$6,950 received subsequent to the second bankruptcy as interest.

The purchase reviewer properly adjusted the loan balance for the \$6,950 received subsequent to the filing of the second bankruptcy, but did not reduce the loan balance by the \$30,677 that was applied to interest between the two bankruptcy filings. Lenders are entitled to 120 days of accrued interest at the time of purchase. As a result, the purchase reviewer paid the lender for its share of the 120 days of interest which was calculated on the overstated loan balance. This resulted in \$786 of excess interest paid to the lender at the time of purchase. It appears the National Guaranty Purchase Center was not aware of the first bankruptcy filing as the related documents were only available in the lender's file.

Because the lender did not comply with SBA's policies and incorrectly applied a portion of the payments to interest after the loan was in liquidation status, a partial recovery in the amount of the \$31,463 (\$30,677 of misapplied interest plus \$786 of excess interest paid at purchase) is warranted. During the audit, this finding was discussed with the lender. The lender agreed with the finding and submitted a corrected loan transcript showing the adjustment for the \$30,677 misapplied to interest.

### **Recommendation**

We recommend that the Acting Associate Administrator for Financial Assistance:

Seek recovery of \$31,463 less any subsequent recoveries, from the lender on the guarantee paid.

### **Lender Comments**

The lender agreed that loan payments were misapplied to interest and that \$31,463 should be recovered by SBA. The lender's response is included as Appendix I.

### **Agency Comments**

SBA Management agreed with the finding and recommendation.

### **Office of Inspector General Response**

The lender and SBA Management comments were responsive to our finding and recommendation.

We appreciate the courtesies and cooperation of Office of Financial Assistance representatives during this audit. If you have any questions concerning this report, please call me at (202) 205- [Exemption 2] or Robert Hultberg, the Program Director, at (202) 205- [Exemption 2]



**Banco  
Santander  
Puerto Rico**

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November 29, 2006

Ms. Terry Settle  
SBA Office of Inspector General  
1145 Herndon Parkway  
Suite 900

Herndon, Virginia 20170

Subject: Audit of the case Palmarejo Service Station  
GPME [Exemption 2]

Dear Ms. Settle

In reference to the letter dated on November 7, 2006 we determinate the following comments:

- The case was "early default" since payments problems started early in the loan. Then client filed an bankruptcy petition.
- We agreed that the payment were incorrectly applied. The amount of \$31, 463.00 was improper payments that should be recover by SBA. However, we consider that if the case was analyzed and approved for the guarantee payment on April 5, 2005, we should be notified before the recommendation of the SBA Purchase.

We recommend the recover of \$31,463.00. We will send the requested amount as soon as possible.

Sincerely,

/S/ original signed  
[Exemption 6]

Guaranteed Loan Office  
Banco Santander Puerto Rico  
787-777- [Exemption 6]

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