

**AUDIT OF AN SBA GUARANTEED LOAN TO
ONE ONE NINE CONSULTING CORP. DBA ADOBEST**

New Brunswick, New Jersey

Audit Report Number: 7-07

December 29, 2006



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

AUDIT REPORT
Issue Date: December 29, 2006
Report Number: 7-07

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 One One Nine Consulting Corp. dba Adobest

The purpose of this memorandum is to notify you of a \$22,000 improper payment that should be recovered. During our ongoing audit of the guarantee purchase process at the National Guaranty Purchase Center, we identified a problematic loan [Exemption 2] made by New Millennium Bank (lender) to One One Nine Consulting Corp. dba Adobest (borrower). We reviewed the loan to determine if the lender originated, serviced and liquidated the purchased loan in accordance with SBA rules and regulations. The audit was conducted during June and July 2006 in Herndon, Virginia in accordance with *Government Auditing Standards* prescribed by the Comptroller General of the United States.

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 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 January 2, 2003, SBA approved a \$150,000 loan for a borrower's start-up of a computer imaging business. The loan was processed under LowDoc procedures, and therefore, SBA was responsible for determining the eligibility and 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 was disbursed on January 27, 2003, and the borrower defaulted on November 27, 2003, 10 months after disbursement. Thus,

this loan is considered an early default loan under SBA policy. The principal of the business filed Chapter 7 Bankruptcy on August 27, 2004. On September 21, 2004, SBA purchased the loan guarantee from the secondary market for \$36,023. SBA completed its post purchase review on October 5, 2004, and identified necessary interest adjustments that should have reduced SBA's loss by \$758 to \$35,265. The Fiscal Transfer Agent (Colson Services) reimbursed SBA for excess interest paid in the amount of \$150.75. The difference of \$607.67 was billed to the lender but never received by SBA. No material deficiencies were identified during SBA's post purchase review.

The Lender did not properly Protect and Secure Collateral

The lender did not perform a timely site visit to inventory and secure collateral after the borrower ceased making loan payments. The collateral for the loan consisted of equipment purchased with loan proceeds and three investment properties owned by the principal. SBA was in a first lien position on the equipment, a second lien position for two of the investment properties and a third lien position for the remaining property. The investment properties were properly liquidated, but the equipment collateral was not. When the site visit was made 5 months after the date required, the lender learned that the business had closed and collateral with an estimated net liquidation value of \$40,000 was missing.

Standard Operating Procedures 50 51 2, *Loan Liquidation & Acquired Property*, Chapter 8, Paragraph 8.b.(1) requires that collateral be properly secured to reduce the possibility of dissipation. Lenders are required to make a site visit within 60 days of an unremedied default in payment or as soon as possible when there are assets of significant value that could be removed or depleted. When a site visit is made, the lender must prepare a comprehensive and detailed report containing an inventory of assets and an assessment of their condition.

Based on SBA's policy, the lender should have made a site visit within 60 days after the borrower defaulted on November 27, 2003, or by January 27, 2004. The lender, however, did not make its site visit until June 22, 2004, or approximately 7 months after the date of default. During the site visit, the lender learned from the occupants that all of the borrower's equipment had been removed from the premises and the whereabouts of the borrower were unknown.

Per the lender's liquidation plan, the borrower's computer image equipment had an estimated liquidation value of \$50,000 and a projected recovery after expenses of \$40,000. If the site visit had been made timely, the equipment may have been recovered and SBA's losses reduced. According to SBA, however, used computer equipment usually has a minimal recoverable value. As a result, SBA recommended that \$22,000 be recovered from the lender due to the deficiencies identified in the audit rather than the \$34,608 originally questioned.

Recommendation

We recommend that the Acting Associate Administrator for Financial Assistance:

1. Seek recovery of \$22,000 from the lender on the guarantee paid.

Lender Comments

The lender provided written comments on a draft of this report. New Millennium Bank stated it was in contact with the borrower between December 2003 and April 2004, when the borrower was voluntarily liquidating the investment property collateral. The lender worked with the borrower to save the business and the loan during this period and there was no indication the loan would go into default. The lender stated that seizing the collateral in January 2004 would have put the borrower out of business in February 2004. This would have eliminated the possibility of further recovery of \$22,477 in April 2004 from the voluntary sale of the investment property collateral. In the lender's opinion, working with the borrower during this time actually resulted in a larger recovery than would have occurred if the collateral equipment was seized and the borrower effectively put out of business. The lender's comments, less attachments, are included as Appendix I.

Office of Inspector General Response

Although the lender claimed they were in contact with the borrower from December 2003 to April 2004 when the borrower was self-liquidating the investment property collateral, it was required and prudent for the lender to perform a site visit in January 2004. The lender may not have decided to seize the equipment at that time, but should have inventoried the collateral and assessed its condition. Furthermore, the borrower stopped all communications with the lender in April 2004, which should have prompted an immediate site visit. At this time, the lender may have been able to secure the equipment collateral. However, when the site visit was performed on June 22, 2004, all equipment collateral had been removed and the borrower's business was closed.

Agency Comments

SBA Management agreed that the lender may have been able to do more to safeguard the computer equipment, however, stated that used computer equipment usually represents minimal recoverable value. As a result, SBA Management agreed to seek recovery of only \$22,000 of the \$34,608 originally questioned.

Office of Inspector General Response

We agree that the realizable value for the used equipment collateral would have been less than originally estimated by the lender. Consequently, we have modified our recommendation to seek recovery of \$22,000, rather than the originally questioned amount of \$34,608 for the identified lender deficiencies.

We appreciate the courtesies and cooperation of the 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, Director of Credit Programs, at (202) 205-[Exemption 2].



October 23, 2006

Ms. Terry Settle
SBA Office of Inspector General
1145 Herndon Parkway, Suite 900
Herndon, VA 20170

Re: Audit of an SBA Guaranteed Loan to
One One Nine Consulting Corp. dba Adobest
SBA Loan [Exemption 2]

Dear Ms. Settle:

We wish to respond to the draft Audit Report, dated September 26, 2006, of the above SBA Guaranteed Loan and respectfully request that the SBA review its determination that a recovery of \$34,608 should be received from the lender.

The loan was fully disbursed in the amount of \$150,000 on 1/27/03 and sold on the secondary market on 5/23/03. As shown on the attached transcript, the borrower made ten consecutive monthly payments and became in default when the 12/1/03 payment was not made. However, after the November payment was made, the borrower contacted the lender and advised that he wanted to reduce the loan balance by selling the three properties securing the loan. The first two were sold in November, 2003, with all the net proceeds of \$67,494.44 applied to the loan. The third property was sold in April, 2004, with the net proceeds of \$22,477.03 applied to the loan balance, leaving a principal balance of \$40,368.20. The borrower's stated intention was to consequently reduce the monthly payment from \$2,979 to approximately \$1,000 per month, which could be more easily handled by the business.

During the time period between December, 2003, and April, 2004, the borrower was in contact with the Lender while voluntarily liquidating the collateral. There was no indication that the loan would go into default. The Lender was trying to work with the borrower to both save the business and the loan, and seizing the collateral at this time would have put the borrower out of business in February, 2004, without the possibility of the further recovery of \$22,477.03 in April, 2004, from the voluntary sale of collateral.

Also, with regard to the interest adjustment of \$607.67, the attached statement was received by the Bank on October 3, 2005. A clarification was requested and the correspondence concerning this matter is attached. The Lender did not receive a determination that the funds were, in fact, due the Agency.

It is the lender's opinion that working with the borrower during this time actually resulted in a larger recovery than would have occurred if the collateral equipment was seized and the borrower effectively put out of business in January, 2004. The Lender was trying to maximize any recovery by working with the borrower and was actively in communication with him and knew he was operating the business in April, 2004.

Based on the above, it is respectfully requested that the Agency reconsider its recommendation that a recovery of \$34,608 is due from the Lender.

Very truly yours,
[Exemption 6]

H. Robert Bechtel
Sr. Vice President

Attachments

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