



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

MEMORANDUM AUDIT REPORT
Issue Date: November 26, 1997
Number: 8-6-F-007-003

To: John E. Scott, II,
District Director, Las Vegas District Office

From: Peter L. McClintock
Assistant Inspector General for Auditing

Subject: Nevada State Development Company
Audit of Loan Origination and Servicing Practices

We have completed our audit of the Nevada State Development Company (Nevada State) loan origination and servicing practices. The audit objective was to determine whether there was compliance with SBA policies and procedures related to the Small Business Administration (SBA) Section 504 Program.

Fifteen loans valued at \$9.6 million originated by the CDC and approved by SBA were randomly selected for review (Exhibit B). We performed detailed examinations of the 15 loan files, interviewed SBA and Nevada State officials and borrowers, and visited projects. This was the first audit of Nevada State operations. The audit was conducted in accordance with Government Auditing Standards.

Background

The 504 Loan Program was established to foster economic development, create or preserve job opportunities, and stimulate small business growth, expansion, and modernization. Under this program, the Certified Development Company (CDC) was created to help small businesses obtain interim and permanent financing for the construction or purchase of real property used in business operations.

Permanent financing for each project requires small businesses to contribute a minimum of 10 percent of total project costs with up to 40 percent provided from the sale of

debentures guaranteed by SBA. These debentures are collateralized by a second lien on the property. The remainder of the financing comes from the private sector or a bank loan collateralized by a first lien on the property.

SBA certified Nevada State, a for profit corporation, as a CDC in 1983. Nevada State approved 408 loans valued at \$125.4 million from its inception to September 1996 (Exhibit A). Title 13 Code of Federal Regulations Section 120.826 requires CDC's to operate in accordance with applicable statutes and regulations including SBA's standard operating procedures. CDC's must also maintain records as required by SBA.

Results of Audit

While Nevada State generally complied with SBA's 504 Loan Program policies and procedures, loan files did not always contain documents relative to capital injection, site visits, collateral condition, or loan closing correspondence. Consequently, there was no evidence that SBA's policies and procedures, designed to minimize the risks associated with loan origination and closing, were followed.

Standard Operating Procedure (SOP) 50 22 3, Section 24e, states that a CDC shall maintain information and documents related to its loan portfolio for SBA review, including:

- (1) Evidence of the 10 percent capital injection
- (2) Evidence of field visits
- (3) Condition of the collateral
- (4) All correspondence related to the loan prior to closing

Examples of the deficiencies follow:

- Two of the fifteen loan files did not have evidence of the capital injection requirement. The Nevada State representative stated the firm had implemented new procedures during the last six months which should resolve this deficiency. The new procedure instructs the borrowers of the documentation requirements and indicates what is acceptable proof of capital injection.
- Site visit reports were not available for five of the fifteen loans reviewed. Borrowers stated that they were not aware of any site visits. The Nevada State representative stated its site visits were unannounced and the borrowers may not have been aware of their presence.
- Construction phase records were missing for all 15 projects. The loan file documents did not indicate the status of the projects after the SBA loan authorization was issued nor show which projects were completed. The Nevada State representative stated the status of each project was verbally discussed during the construction process with results maintained on a spreadsheet.

- Three of the fifteen loan files did not contain copies of bank commitment letters or a statement that the bank would not finance the entire project without SBA participation.

Recommendation

1. We recommended that the District Director, Las Vegas District Office direct Nevada State Development Company to maintain loan file documents in accordance with SBA SOP 50 22 3.

Management's Response

The District Director stated that the findings were discussed with the CDC Director who stated they had already implemented the necessary procedures to correct the finding and implement the recommendation. A copy of the response is included as Attachment 1.

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

Please sign the attached SBA Form 1824, "Recommendation Action Sheet" indicating that the recommendation has been implemented. We would appreciate receipt of the form within the stated timeframes.

This report may contain proprietary information subject to the provisions of 19 USC 1905 and must not be released to the public or another agency without the permission of the Office of Inspector General.

Attachments

NEVADA STATE DEVELOPMENT COMPANY

Loans Approved by Year and Amount

Fiscal Year	Loans Approved	Value (\$)
1983	02	245,000
1984	05	1,611,000
1985	14	2,983,000
1986	17	3,308,000
1987	11	2,175,000
1988	15	3,207,000
1989	22	4,834,000
1990	23	5,076,000
1991	27	9,431,000
1992	37	10,054,000
1993	36	13,419,000
1994	58	19,755,000
1995	64	23,822,000
1996	77	25,493,000
Totals	408	\$125,413,000

EXHIBIT B

NEVADA STATE DEVELOPMENT COMPANY

Loans Selected and Reviewed

Loan Number	Borrower Name	Date Approved	Approved Amount
<i>(FOIA Deletion)</i>	<i>(FOIA Deletion)</i>	<i>(FOIA Deletion)</i>	\$288,000
<i>(FOIA Deletion)</i>	<i>(FOIA Deletion)</i>	<i>(FOIA Deletion)</i>	640,000
<i>(FOIA Deletion)</i>	<i>(FOIA Deletion)</i>	<i>(FOIA Deletion)</i>	750,000
<i>(FOIA Deletion)</i>	<i>(FOIA Deletion)</i>	<i>(FOIA Deletion)</i>	1,000,000
<i>(FOIA Deletion)</i>	<i>(FOIA Deletion)</i>	<i>(FOIA Deletion)</i>	632,000
<i>(FOIA Deletion)</i>	<i>(FOIA Deletion)</i>	<i>(FOIA Deletion)</i>	125,000
<i>(FOIA Deletion)</i>	<i>(FOIA Deletion)</i>	<i>(FOIA Deletion)</i>	671,000
<i>(FOIA Deletion)</i>	<i>(FOIA Deletion)</i>	<i>(FOIA Deletion)</i>	558,000
<i>(FOIA Deletion)</i>	<i>(FOIA Deletion)</i>	<i>(FOIA Deletion)</i>	619,000
<i>(FOIA Deletion)</i>	<i>(FOIA Deletion)</i>	<i>(FOIA Deletion)</i>	1,000,000
<i>(FOIA Deletion)</i>	<i>(FOIA Deletion)</i>	<i>(FOIA Deletion)</i>	1,000,000
<i>(FOIA Deletion)</i>	<i>(FOIA Deletion)</i>	<i>(FOIA Deletion)</i>	605,000
<i>(FOIA Deletion)</i>	<i>(FOIA Deletion)</i>	<i>(FOIA Deletion)</i>	547,000

<i>(FOIA Deletion)</i>	<i>(FOIA Deletion)</i>	<i>(FOIA Deletion)</i>	504,000
<i>(FOIA Deletion)</i>	<i>(FOIA Deletion)</i>	<i>(FOIA Deletion)</i>	<u>655,000</u>
	Total Value		<u>\$9,594,000</u>

RECOMMENDATION ACTION SHEET
SBA AUDIT FOLLOWUP SYSTEM

AUDITEE: Nevada State Development Company
AUDIT TITLE: Audit of Loan Origination and Servicing Practices

GRANT/CONTRACT/LICENSE #:
QUESTIONED COST: \$
UNSUPPORTED AMOUNT: (\$)

RECOMMENDATION: 1
REPORT NUMBER: 8-6-F-007-003
DATE ISSUED: November 26, 1997

FUNDS FOR BETTER USE: \$

TYPE: Internal External

RECOMMENDATION (SBA Form 1779)	Action Office	Program Code	Mgt. Response Due Date	Final Decision Due Date	Amount	Code	
						1	2
	0944	504	1/16/98	5/27/98	N/A	N	
RECOMMENDATION NO: 1		Amount unsupported in Q code:				N/A	
Direct Nevada State Development Company to maintain loan file documents in accordance with SBA SOP 50 22 3.							
MANAGEMENT DECISION (SBA Form 1781)	Management Concurrence (Yes/No)	Target Date for FA	OIG Assessment		Amount	Code	
			Agreed ?	Referred ?		1	2
	YES	N/A					
Amount unsupported in QD code:							
The CDC Director has implemented procedures to ensure that loan file documents are maintained in accordance with SBA SOP 50 22 3. (Attach extra sheet if necessary.)							
Originating Official Signature:						Date:	
Approving Official Signature:						Date:	
OIG Signature:						Date:	
FINAL ACTION (SBA Form 1780)	Date FA Completed	Non-Monetary Results ?	Disallowed Costs		Funds Put to Better Use		
			Recoveries Code	Write-Offs	Implemented	Not Implemented	
(Attach extra sheet if necessary.)							
Originating Official Signature:						Date:	
Approving Official Signature:						Date:	

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AUDITING DIVISION**

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