



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

MEMORANDUM AUDIT REPORT
Issue Date: December 1, 1997
Number: 8-6-F-007-004

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

From: Peter L. McClintock
Assistant Inspector General for Auditing

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

We have completed our audit of the Southern Nevada Certified Development Company (Southern Nevada) 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.

Five loans valued at \$2.6 million originated by the CDC and approved by SBA were randomly selected for review (Exhibit B). We performed detailed examinations of the five loan files, interviewed SBA and Southern Nevada officials and borrowers, and visited projects. This was the first audit of Southern Nevada 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 Southern Nevada, a non-profit corporation, as a CDC on August 27, 1984. Southern Nevada approved 124 loans valued at \$38.4 million from its inception to September 30, 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 Southern Nevada generally complied with SBA's 504 Loan Program policies and procedures, loan files did not always contain documents relative to loan applications, collateral condition, site visits, capital injection, 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) Loan application
- (2) Condition of the collateral
- (3) Evidence of field visits
- (4) Evidence of the 10 percent capital injection
- (5) All correspondence related to the loan prior to closing

Examples of the deficiencies follow:

- Two of the five loan applications lacked evidence of the borrowers repayment ability.
- Construction phase records were missing for all five 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.
- Site visit reports were not available for any of the loans reviewed. An auditor site visit discovered part of a new building was occupied by a tenant. The loan file did not indicate that Southern Nevada knew that part of the building was rented out. Three of the interviewed borrowers reported they had been visited by a lender representative. Southern Nevada could not substantiate it had complied with the SBA site visit requirement.

- One of the five loan files did not have evidence of the capital injection requirement. As a result, there was no assurance that the borrowers had made capital injections.
- One of the five projects lacked an independent project appraisal and only one of the two completed projects had the attorney's required legal opinion relative to loan closing documents.

Recommendation

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

Management's Response

The District Director agreed with the recommendation and obtained the CDC's assurance that the necessary corrections will be implemented to solve the problems. A copy of the District Office response is included with the report as Attachment 1.

Evaluation of Management's Response

Management officials agreed with the results of the draft report. The actions planned are responsive to the recommendation.

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 record your management decisions on the attached SBA Form 1824, "Recommendation Action Sheet," and provide target dates for completion. 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

EXHIBIT A

SOUTHERN NEVADA CERTIFIED DEVELOPMENT COMPANY

Loans Approved by Fiscal Year and Amount

Fiscal Year	Loans Approved	Value
1985	6	\$ 1,431,000
1986	14	3,274,000
1987	13	2,779,000
1988	19	5,243,000
1989	14	4,634,000
1990	3	660,000
1991	9	1,920,000
1992	6	2,004,000
1993	12	4,580,000
1994	4	1,493,650
1995	8	3,774,369
1996	16	6,601,000
Totals	124	\$38,394,019

SOUTHERN NEVADA CERTIFIED 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>	\$119,000
<i>(FOIA Deletion)</i>	<i>(FOIA Deletion)</i>	<i>(FOIA Deletion)</i>	517,000
<i>(FOIA Deletion)</i>	<i>(FOIA Deletion)</i>	<i>(FOIA Deletion)</i>	579,000
<i>(FOIA Deletion)</i>	<i>(FOIA Deletion)</i>	<i>(FOIA Deletion)</i>	675,000
<i>(FOIA Deletion)</i>	<i>(FOIA Deletion)</i>	<i>(FOIA Deletion)</i>	750,000
	Total Value		\$2,640,000

RECOMMENDATION ACTION SHEET
SBA AUDIT FOLLOWUP SYSTEM

AUDITEE: Southern Nevada Certified Development Company
AUDIT TITLE: Audit of Nevada CDC Operations
GRANT/CONTRACT/LICENSE #:
QUESTIONED COST: \$
UNSUPPORTED AMOUNT: (\$)

RECOMMENDATION: 1
REPORT NUMBER: 8-6-F-007-004
DATE ISSUED: December 1, 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	1/18/98	6/1/98	N/A	N	
RECOMMENDATION NO: 1		Amount unsupported in Q code:				N/A	
Direct the Southern Nevada Certified 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
Amount unsupported in QD code:						(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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District Director, Las Vegas District Office.....	1