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

AUDIT REPORT

Issue Date: September 30, 1996

Number: 6-5-E-002-022

To: John R. Cox, Associate Administrator
for Financial Assistance

From: Peter L. McClintock, Assistant Inspector General
for Auditing

Subject: Audit Report - Audit of the Low Documentation (LowDoc)
Loan Program

Attached is a copy of the subject audit report. The report contains one finding with five recommendations directed to your office. A review of 70 loans showed that 5 were approved for borrowers with questionable repayment ability and 2 were approved for borrowers who did not meet LowDoc eligibility requirements. Also, 54 (including 6 of the 7 aforementioned) loans had at least one other processing or disbursement deficiency. Such deficiencies may lead to losses that could result in raising either the tax supported subsidy rate or fees to borrowers or lenders. In your response to a draft report, you agreed to take the recommended actions.

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

Please provide us your management decisions for the recommendations with 80 days. Record your management decision on the attached SBA form 1824, "Recommendation Action Sheet," and show your proposed corrective action and target date for completion.

We wish to extend our appreciation to you, your staff, district office staff, lenders' staff, and borrowers for their cooperation and courtesies during this audit.

If you have any questions, please contact Garry Duncan at (202) 205-7732.

Attachment

AUDIT REPORT ON

THE LOW DOCUMENTATION LOAN PROGRAM

AUDIT REPORT NO. 6-5-E-002-022

SEPTEMBER 30, 1996

SUMMARY

From the inception of the Low Documentation (LowDoc) Loan Program in December 1993 to May 1995, SBA approved 27,045 loans totaling $1.5 billion. To determine whether these loans were processed according to SBA's requirements, we audited a random sample of 70 loans totaling $3,746,540.

We found that five loans (valued at $300,000) were approved for borrowers with questionable repayment ability, and another two loans (valued at $90,000) were approved for borrowers who did not meet LowDoc eligibility requirements. As a result, some or all of SBA's guarantees for these loans could be in jeopardy or were inappropriately provided. Based on a statistical projection of the sample results, we estimate that loans totaling $115.9 million were approved for borrowers who had questionable repayment ability, and loans totaling $34.8 million were approved for borrowers who had not met eligibility requirements (see Appendix A). As of July 1996, only two of the sample loans with questionable repayment ability were either past due or in liquidation, indicating a relatively low failure rate due to LowDoc credit procedures.

Of additional concern is the potential exposure due to the loans with other types of deficiencies. Fifty-four loans (including 6 of the 7 aforementioned) had at least one other processing or disbursement deficiency. These deficiencies resulted from lenders and SBA not following regular 7(a) loan program guidance. At the time of the audit, adverse consequences were apparent for two of these loans, however, these problems have been corrected.

The most prevalent deficiencies included the following:

- Internal Revenue Service (IRS) verifications were either not requested, requested after loan disbursement, or not reconciled to applicants' financial data.

- Joint payee checks for non-working capital disbursements were not used, and use of proceeds was not verified. One applicant's documentation supporting the use of the loan proceeds appeared false, although after our inquiry, the borrower paid off the loan.

- Equity injections were not always incorporated in SBA's Authorization and Loan Agreement and were not verified. One borrower had not made the total required injection at loan closing but subsequently met the injection requirement.

These deficiencies may have been the result of the limited guidance and oversight required for processing LowDoc loans, and the limited monitoring performed of lenders and district offices. In April 1996, the Office of Financial Assistance issued more detailed

guidance which should clarify procedures to be followed.

We recommend that the Associate Administrator for Financial Assistance take the following actions:

- Develop standards to measure LowDoc loan performance for both lenders and district offices.

- Establish a periodic LowDoc loan review program of both lenders and SBA district offices. Based on the review results,

  - identify unacceptable performance within the LowDoc Program of both lenders and SBA district offices,
  - remove lenders from the LowDoc Program when performance standards are not met, and
  - initiate corrective action when district offices fail to meet these performance standards.

- Repair, deny, or withdraw the guarantee if an SBA review finds significant lender deficiencies. For those loans of $50,000 or less that default, request and analyze original loan processing documents before paying the guarantee.

- Establish criteria to be used by lenders to evaluate other sources of income that are used to supplement an applicants' repayment ability.

- Determine if the SBA should

  - deny or withdraw the guarantees for the loans to *[--- FOIA deletion---]* and *[--- FOIA deletion---]* based on the lenders' failure to obtain the IRS verification timely or to reconcile and report to SBA discrepancies between the IRS data and financial data submitted by the borrower,
  - withdraw the guarantee for the loan to *[--- FOIA deletion---]* due to the lender's failure to disclose material information concerning the borrower's eligibility, and
  - withdraw the guarantees if the lenders for *[--- FOIA deletion---]* and *[--- FOIA deletion---]* cannot show that repayment ability was properly calculated.

In response to a draft report, the Associate Administrator for Financial Assistance agreed with the report's findings and conclusions.

The findings included in this report are the conclusion of the OIG's Auditing Division based on testing of the auditee's operations. **The findings and recommendations are**

subject to review, management decision, and corrective action by your Office in accordance with existing Agency procedures for follow-up and resolution.

AUDIT OF
THE LOW DOCUMENTATION LOAN PROGRAM

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INTRODUCTION

A. BACKGROUND

Section 7(a) of The Small Business Act of 1958, as amended, gives SBA the authority to provide financial assistance to small businesses. SBA provides financial assistance primarily through loan guarantees to lenders. In December 1993, SBA initiated the Low Documentation (LowDoc) Loan Program as an alternative to the regular 7a Loan Program. LowDoc provided a method to obtain smaller dollar value loans ($100,000 or less) in a shorter time and with less documentation.

The LowDoc program was initially piloted among SBA district offices in Texas and expanded nationally in June 1994. SBA relies on an applicant's personal and business credit histories as indicators of ability and willingness to repay. For loans of $50,000 to $100,000, the applicant must support repayment ability with past and/or projected cash flows. LowDoc loans were subject to a 90 percent guarantee by SBA until October 1995 when the maximum guarantee was lowered to 80 percent. Although not a primary consideration, SBA expects participating lenders to apply traditional business credit criteria in the same manner as they would for their own commercial loans.

LowDoc applicants, besides meeting most standard 7(a) eligibility and use of proceeds requirements, must not have a criminal history, poor personal or business credit record, or previous bankruptcy within the past 10 years. A LowDoc borrower must also have average annual gross revenues of $5 million or less and 100 or fewer employees. To expedite the loan process, the documentation sent to SBA for loan approval was reduced from that required for other 7(a) loans. An application form, business tax returns, financial statements, and the lender's internal credit analysis are sent to SBA for loans greater than $50,000. For loans of $50,000 and less, only the application form is required. Based on a lender's processing requirements, additional borrower information may be requested.

As of July 31, 1996, SBA had approved 54,277 LowDoc loans valued at $3 billion. There were 29,758 loans worth $1 billion approved for $50,000 or less and 24,519 loans valued at $2 billion approved for more than $50,000 each.

B. AUDIT OBJECTIVE AND SCOPE

The audit objective was to determine whether LowDoc loans were processed following SBA's requirements. The audit was based on a statistical sample of loans approved from the program's inception in December 1993 to May 31, 1995. Descriptions of the statistical sample methodology and the projected results based on our audit are provided in Appendix A. From a universe of 27,045 loans valued at $1.5 billion, 70 were selected for detailed analysis. Appendix B lists the loans included in our sample.

The auditors reviewed lender and SBA file documentation for each loan in the sample; interviewed borrower, lender, and SBA district office personnel for selected loans; and visited businesses to review records, as required. Audit field work was performed between August 1995 and August 1996. The audit was conducted in accordance with Government Auditing Standards.

C. FOLLOW-UP ON PRIOR AUDITS

There were no prior audits of the LowDoc Loan Program.

RESULTS OF AUDIT

FINDING LowDoc Loans were not Always Processed According to SBA Requirements

From a statistical sample of 70 loans (valued at $3,746,540), 5 loans (valued at $300,000) were approved for borrowers with questionable repayment ability, and another 2 loans (valued at $90,000) were approved for borrowers who did not meet LowDoc eligibility requirements. As a result, some or all of SBA's guarantees for these loans could be in jeopardy or guarantee authority was inappropriately provided. Such risks may lead to losses that could either increase the tax supported subsidy rate or fees to borrowers or lenders. As of July 1996, however, only one of the loans was in liquidation and another loan was past due. Based on a statistical projection, we estimated that 1,932 loans totaling $115.9 million were at risk at the time of loan approval for borrowers who had questionable repayment ability and 773 loans totaling $34.8 million were approved for borrowers who did not meet eligibility requirements.

Fifty-four loans (including 6 of the 7 aforementioned) had at least one other processing or disbursement deficiency. These deficiencies resulted from lenders and SBA not following regular 7(a) loan program guidance. At the time of our audit, we found no adverse consequences, except in two instances, where the problems had been corrected.

The most frequent of these deficiencies included the following:

- Internal Revenue Service (IRS) verifications were either not requested, requested after loan disbursement, or not reconciled to applicants' financial data.

- Joint payee checks for non-working capital disbursements were not used or the use of proceeds were not verified. One applicant's supporting documentation appeared false, although after our inquiry, the borrower paid off the loan.

- Equity injections were not verified. One borrower had not made the total required injection by loan closing but subsequently met the injection requirement.

Loans made to borrowers who lacked repayment ability

The LowDoc program was expanded nationwide when the Administrator approved a Correspondence Digest (SBA Form 606), dated June 23, 1994, which provided guidance on implementing the program. Lender Instructions, attached to the Correspondence Digest, provided considerations concerning borrower repayment ability. It stated, in part, that primary considerations are:

1. Willingness to pay debts, as indicated by credit history. Co-signers may be considered if applicants have no credit history.

2. Historical or expected earnings evidencing repayment ability.

3. The requested financing provides the business a good chance of achieving success.

The Correspondence Digest also stated that:

> On loans between $50,000 and $100,000 the applicant must support repayment ability with past and/or projected cash flows.

Five loans in our sample had questionable repayment ability. The following paragraphs provide details about each of the five loans.

Loan Number *[--- FOIA deletion---]* In December 1994, a *[--- FOIA deletion---]* business applied for a *[--- FOIA deletion---]* LowDoc loan to purchase two *[--- FOIA deletion---]* machines. Although the business had been in operation for two years before the loan application, only a 9-month financial statement showing a net profit of $56,000 was submitted. The lender and SBA used this statement as evidence of repayment ability of the proposed $15,600 annual debt payment. The lender made an interim *[--- FOIA deletion---]* loan in January 1995 with the loan proceeds disbursed in June 1995.

Prior to disbursement, the lender received a December 31, 1994, year-end financial statement that showed a $17,212 net loss and insufficient cash flow to service the proposed debt. The lender also received data from the IRS that showed the applicant had reported a net loss of $37,762 for the same period. Both documents were forwarded to the SBA district office without explanation or a revision of the applicant's repayment ability. The loan was placed in liquidation in April 1996.

Loan Number *[--- FOIA deletion---]* In March 1995, a *[--- FOIA deletion---]* loan was approved for fixed assets and working capital for an existing *[--- FOIA deletion---]* business. The financial data submitted to the lender suggested that the business had repayment ability for the loan, based on the most recently completed fiscal year (1993). The lender obtained tax verification information from the IRS that showed that gross receipts were about $20,000 less than shown in the borrower's 1993 financial data. Based on IRS data, the borrower's historical cash flow would not have been enough to make the annual debt payments. Although projected cash flow did show repayment ability, the projected increase in gross revenue of almost 500 percent did not appear reasonable. The lender did not request IRS data until after the first disbursement of the loan proceeds and made disbursements of $12,600 after receiving the IRS data. There was no evidence that the lender resolved the discrepancy in gross receipts or notified SBA about the discrepancy, as required by the loan authorization. The loan was 60-days past due in July 1996.

Loan Number *[--- FOIA deletion---]* In February 1995, a *[--- FOIA deletion---]* loan was approved for equipment and working capital. The borrower operated a *[--- FOIA deletion---]* company. The loan application disclosed that the applicant had an outstanding loan with the same lender that processed the proposed loan. The loan had an outstanding balance of $362,000, monthly payments of $10,400, and an August 1995 maturity date. The lender's analysis of repayment ability included estimated annual payments for the new loan. The lender did not consider the effect of the existing debt, which placed annual debt obligations well above historical and projected cash available. The LowDoc loan was in a current repayment status in July 1996.

Loan Number *[--- FOIA deletion---]* In November 1994, a *[--- FOIA deletion---]* loan was approved for working capital as part of the acquisition of a *[--- FOIA deletion---]* . The principals acquiring the *[--- FOIA deletion---]* had recently sold another *[--- FOIA deletion---]* . The lender's file contained a narrative discussion of the financial data of the two businesses, but did not contain a cash flow analysis showing historical and projected cash flows.

The narrative discussion contained errors which resulted in a $130,000 overstatement of the projected gross revenue. In addition, the narrative implied that $41,000 collected by the principals from their former *[--- FOIA deletion---]* as rental payments for *[--- FOIA deletion---]* would not be collected from the new *[--- FOIA deletion---]* . Therefore, the new *[--- FOIA deletion---]* would have that money available to service debt. If the new *[--- FOIA deletion---]* had to make the rental payments, however, it would not have sufficient cash flow to service the proposed debt. The lender did not disclose that the former rental payments comprised 71 percent of the principals' personal income, making it unlikely they could forgo these payments. The loan was in current repayment status in July 1996.

Loan Number *[--- FOIA deletion---]* In December 1994, a *[--- FOIA deletion---]* two-year loan was approved for working capital as part of the purchase of a *[--- FOIA deletion---]* . The lender and SBA accepted the borrower's one year projection of $35,000 net income as the basis for cash flow to cover the $14,000 annual debt on the loan. The lender did not obtain historical financial statements or other financial data from the prior owner to determine reasonableness of the projected business income and expenses. Although this loan was approved, it was subsequently canceled at the borrower’s request.

No guidance for other sources of income

SBA did not provide guidance for situations when other sources of income are used to support repayment ability. For loans not processed under the LowDoc Program, SBA required lenders to evaluate an applicant's repayment ability based on the cash flow of the business. Although not specifically stated in the limited guidance provided prior to April 1996, SBA officials advised us that consideration of other sources of income was acceptable for the LowDoc Program.

Criteria were not distributed to lenders or SBA officials concerning how to evaluate the other sources of income. For some sources of income, such as outside employment of the principals, there was no evidence that lenders contacted employers to verify the continuation of employment or determined principals' discretionary income. As mentioned in the discussion of the *[--- FOIA deletion---]* loan, the lender considered rental income to supplement debt repayment without determining the principal's personal need for this income.

Two loans were made to ineligible applicants

Loans approved for two applicants did not meet LowDoc eligibility requirements. One applicant had a conflict of interest, and the total number of employees was not properly determined for another applicant.

Title 13, Code of Federal Regulations (CFR), Section 120.2-2, describes an associate of a lender as a close relative (spouse) of an officer or director who has or had an interest in the applicant for the 6-month period before the date of the application or at any time thereafter while the loan is outstanding.

Section 120.102-10 states that financial assistance will not be granted if the direct or indirect result will be to create or appear to create a conflict of interest. Without prior written approval of the responsible district office, SBA will not guarantee a loan to a business where the lender or an associate has an interest which constitutes a conflict of interest. Financial assistance will not be granted when the lender's application does not contain full disclosure, including negative statements, from the lender and from the small concern, relative to relationships discussed in section 120.2-2.

SBA's LowDoc pilot program authorization document, dated November 1993, states that SBA personnel will make eligibility determinations, and that permitted use of proceeds will be the same as in the normal 7(a) program. The pilot program's phase II authorization document, dated June 1994, restated these points and added that applicants must have 100 or fewer employees.

Section 121.407, states, in part, that the number of employees should be based upon an average of each pay period of the preceding 12 months, and that part-time and temporary employees are to be counted as full-time employees.

Details follow:

Loan Number *[--- FOIA deletion---]* A loan for *[--- FOIA deletion---]* was approved in September 1994 to start a *[--- FOIA deletion---]* . The owner of the business was the spouse of the senior vice-president at the bank requesting the guarantee. Although we confirmed that the bank loan officer discussed this situation with an SBA district office official, the loan application did not disclose that the spouse was employed by the applicant bank. The SBA official whom the bank contacted was not involved in the review and approval of the loan so those responsible for loan approval were not aware of the potential conflict of interest between the business owner and the bank. As a result, the lender submitted and SBA approved a loan to a business where an associate of the lender had an interest, contrary to the CFR. This loan was in a current repayment status in July 1996.

Loan Number *[--- FOIA deletion---]* A *[--- FOIA deletion---]* loan was approved by SBA in November 1994 to allow one owner of an *[--- FOIA deletion---]* to purchase the interest of the other owner (ex-spouse). To be eligible for a loan under the LowDoc program, businesses were required to have average annual revenues over a three year period of $5 million or less and 100 or fewer employees. The loan application reported 106 employees, but neither the lender nor SBA commented on the need to resolve this issue prior to approval. This loan was in a current repayment status in July 1996.

Lending procedures were not followed for other loans

A total of 110 deficiencies were identified for 55 of the 70 LowDoc loans in the statistical sample (see Appendix C). No deficiencies were noted for 15 loans. Nine of the deficiencies were significant enough to preclude loan approval and were applicable to the seven loans previously discussed. The remaining 101 deficiencies were applicable to 54 of the 55 loans and could indirectly impact the applicant's repayment ability, eligibility, or the LowDoc Program's integrity. None of the 101 deficiencies were unique to the LowDoc Program and might be found in any 7(a) loan.

The 101 deficiencies can be divided into two categories, loan processing (48) and loan disbursement (53). Loan processing includes those lending procedures that are part of the loan approval process. Loan disbursement includes those lending procedures involving disbursement and use of loan proceeds.

The processing and disbursement actions were not in accordance with either the authorization and loan agreement, or other SBA loan processing policies. At the time of our audit, however, we found no adverse consequences, except in two instances where the problems had been corrected. Types of noncompliance discrepancies included the following:

- For 9 loans, IRS verifications were either not requested, requested after loan disbursement, or not reconciled to applicants' financial data. In October 1994, SBA initiated a requirement that lenders obtain IRS tax return information for verification of applicants financial data before disbursement. As mentioned above, IRS verifications were not obtained timely or differences were not reported to SBA for two loans that lacked repayment ability.

- For 22 loans, joint payee checks were not used to disburse loan proceeds designated as other than working capital. SOP 70 50 2, paragraph 3.F(1), and SBA Form 1050 require that joint payee checks be used to disburse loan proceeds not designated as working capital.

- For 18 loans, lenders did not verify that loan proceeds were used as required by the loan agreement. One applicant's documentation supporting the use of proceeds appeared false; after our inquiry, the borrower paid off the loan.

- For 5 loans, an equity injection was requested by the lender but not incorporated in SBA's Authorization and Loan Agreement. Therefore, SBA could not hold either the lender or borrower responsible for a failure to make an equity injection. Equity injections provide an incentive for the borrowers to remain committed to the business and reduce the business' debt burden.

- For 10 loans, there was no evidence that the lender verified the equity injection. By not verifying that the equity injection was made, a 100 percent financing could result. One such loan for $100,000 required $250,000 equity injection. As of the closing date, only $200,000 had been injected, and $80,000 was withdrawn the next day. The lender was unaware that the applicant had not made the full equity injection.

- For 5 loans, lenders did not determine if the borrowers and their affiliates exceeded the 100 employees and $5 million gross revenue size standards established for LowDoc. Each of these borrowers had one or more affiliates. SBA and lenders could not determine whether established size standards were exceeded because employee and financial information of affiliates was not obtained.

- The remaining 32 miscellaneous deficiencies included lack of justification for the business purchase and settlement sheet (SBA Form 1050) problems.

<u>Type of lenders responsible for discrepancies</u>

Deficiencies were analyzed for loans processed by preferred, certified, and regular lenders to determine whether the more experienced lenders (preferred and certified) had fewer deficiencies. Of the 69 participating lenders responsible for making the 70 guaranteed LowDoc loans, 11 were preferred lenders, 20 were certified lenders, and 38 were regular lenders. Certified and preferred lenders were responsible, on average, for 32 percent more deficiencies than regular lenders (see Appendix D).

<u>LowDoc procedures precluded SBA's detection of deficiencies</u>

Lenders were responsible for 82 percent (83 of 101) of the processing and disbursing deficiencies. Guidelines make lenders responsible for obtaining supporting documentation for LowDoc loans of $50,000 or less and for conducting most disbursement actions. An analysis of the 55 loans with deficiencies showed that 38 loans were for $50,000 or less and had 69 deficiencies. Because lenders were not required to provide supporting documentation for loans of $50,000 or less, SBA would not have been aware of these errors. The remaining 17 loans, with amounts greater than $50,000, had 32 deficiencies. Fourteen of the 32 deficiencies were related to disbursement actions for which SBA would not have had knowledge. SBA, therefore, could not have taken corrective action for 83 of the noted deficiencies.

<u>Rapid expansion of the LowDoc Program and field office monitoring</u>

The LowDoc Program, which has grown to more than 54,000 loans valued at $3 billion, needs more effective monitoring by field offices. The program was expanded nationally in June 1994, based on the achieved goal of increasing the number of small loan approvals. This expansion was made after the SBA reviewed loans processed by 15 lenders reporting to 3 district offices. Problems were disclosed in lender training, credit analysis, and consistency of processing. The review also disclosed that district employees, new to the financing function, were overlooking credit and eligibility issues, and that approving officials were concurring with the decisions of the new employees without performing adequate reviews. Overall, SBA concluded that the program was functioning well.

Based on the review, a recommendation was made to expand the pilot in groups of two regions every 3 months to allow appropriate training and to minimize problems. Just 4 months later, the LowDoc Program was expanded to all regions without assurance that participants and SBA personnel were properly trained.

The need for more effective monitoring by field offices was also noted in subsequent SBA reviews made between December 1994 and February 1995. The same type of lender problems, as noted in our audit, were found. These included problems in eligibility, repayment
analysis, and credit worthiness. Other problems noted during SBA's reviews included

- affiliations and employee size not addressed,
- benefit of ownership changes not explained,
- advantages of refinancing not explained,

- fees charged to borrowers were not disclosed, and
- settlement Sheets (SBA Form 1050) were signed in blank or not submitted to SBA.

Conclusion

As of July 1996, only 2 of the 70 sampled loans had questionable repayment ability and were either past due or in liquidation, indicating a relatively low failure rate due to LowDoc credit procedures. Of concern is the potential exposure due to the extent of identified loans with questionable repayment ability, ineligible loans, and processing deficiencies. The extent of these deficiencies, on both a per loan basis and in total, may have been the result of the limited guidance and oversight required for processing LowDoc loans, and the limited monitoring performed of lenders and district offices. In April 1996, the Office of Financial Assistance issued more detailed guidance which should clarify procedures to be followed. Additional criteria, however, needs to be issued for lenders who use other sources of income to supplement repayment ability determinations.

As the audit noted, 82 per cent of the deficiencies related to loans of $50,000 or less and to disbursing actions where SBA did not receive detailed documentation. Furthermore, the more experienced lenders had a higher level of deficiencies per loan than less experienced lenders. Therefore, we believe SBA needs to establish improved monitoring of lender activities. This should include establishing LowDoc performance measurement standards and a periodic review program to monitor both the lender and SBA district office performance to reduce deficiencies.

With less ability to detect deficiencies on the front end, SBA needs to carefully review any requests for repurchase of the guarantee prior to honoring defaulted loan guarantees. When significant lender deficiencies are found, the SBA loan guarantee should be denied, or withdrawn. Further, documentation for all LowDoc loans of $50,000 or less that default should be obtained and reviewed prior to paying the guarantee because these documents have not been reviewed by SBA, and most deficiencies occurred in these loans.

RECOMMENDATIONS

We recommend that the Associate Administrator for Financial Assistance take the following actions:

1A. Develop standards to measure LowDoc loan performance for both lenders and district offices.

1B. Establish a periodic LowDoc loan review program of both lenders and SBA district offices. Based on the review results,

- identify unacceptable performance within the LowDoc program of both lenders and SBA district offices,

- remove lenders from the LowDoc program when performance standards are not met, and

- initiate corrective action when district offices fail to meet these performance standards.

1C. Repair, deny, or withdraw the guarantee if an SBA review finds significant lender deficiencies. For those loans of $50,000 or less that default, request and analyze original loan processing documents before paying the guarantee.

1D. Establish criteria to be used by lenders to evaluate other sources of income that are used to supplement an applicants' repayment ability.

1E. Determine if the SBA should

- deny or withdraw the guarantees for the loans to *[--- FOIA deletion---]* and *[--- FOIA deletion---]* based on the lenders' failure to obtain the IRS verification timely and to reconcile and report to SBA discrepancies between the IRS data and financial data submitted by the borrower,

- withdraw the guarantee for the loan to *[--- FOIA deletion---]* due to the lender's failure to disclose material information concerning the borrower's eligibility, and

- withdraw the guarantees if the lenders for *[--- FOIA deletion---]* and *[--- FOIA deletion---]* cannot show that repayment ability was properly calculated.

Management's Response

The Associate Administrator for Financial Assistance agreed with the findings and conclusions presented in the report (see Appendix E).

Evaluation on Management's Response

The Associate Administrator's response indicated corrective actions would be taken.

Statistical Sampling Techniques and Results

From the review population of 27,045 LowDoc loans, we randomly selected a sample of 70 to develop our estimates of population values. Because this was a random or statistical sample, the population estimates have a measurable precision, or sampling error. This precision is a measure of the expected difference between the value found in the sample and the value of the same characteristic that would have been found if a 100-percent review had been made using the same techniques.

Sampling precision is indicated by ranges, or confidence intervals, that have upper and lower limits and a certain level of confidence. Calculating at a 90 percent confidence level means the chances are 9 out of 10 that if we reviewed all of the LowDoc loans in the population, the resulting values would be between the lower and upper limits, with the population midpoint estimates being the most likely amounts of inappropriately approved LowDoc loans. We used the population mid-point estimates; however, the amounts could be as little as the lower limit or as high as the upper limit.

We calculated the following population estimates and lower and upper limits using the U.S. General Accounting Office 'SRO-STATS' program at a 90 percent confidence level.

LowDoc Loans Made to Borrowers Without Repayment Ability

Value	Population Midpoint Estimate	Lower Limit	Upper Limit
Gross Approval Amount	$115,907,200	$30,860,390	$220,759,300
Number of Loans	1,932	867	3,639

LowDoc Loans Made to Ineligible Borrowers

Value	Population Midpoint Estimate	Lower Limit	Upper Limit
Gross Approval Amount	$34,772,140	$90,000*	$75,667,080
Number of Loans	773	149	2,250

* The lower limit value calculated by SRO-STATS was negative, indicating the impossible situation of negative loan amounts approved to ineligible borrowers. Therefore, the amount shown is the sum of the actual dollar amounts identified in the sample.

Appendix B

Schedule of Loans Reviewed
and
Status - July 1996

[--- FOIA deletion---]

Appendix C

Low Doc Processing and Disbursement Errors

[--- FOIA deletion---]

Appendix D

DISCREPANCIES BY TYPE OF LENDER

TYPE LENDER	NUMBER OF LENDERS	NUMBER OF LOANS PROCESSED	TOTAL NUMBER OF DISCREPANCIES	AVERAGE NUMBER OF DISCREPANCIES PER LENDER
Preferred (PLP)	11	12	22	2.00
Certified (CLP)	20	20	35	1.75
Regular	38	38	53	1.39
Total	69	70	110	1.59

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