Performance Audit Report

504 Recovery Act Loans Were Originated and Closed in Accordance with SBA Policies

For Official Use Only

September 27, 2012 Report Number 12-23R

U.S. Small Business Administration
Office of Inspector General
Washington, D.C. 20416

REPORT TRANSMITTAL

DATE: September 27, 2012

TO: Grady Hedgespeth
Director, Office of Financial Assistance

John A. Miller
Director, Office of Financial Program Operations

SUBJECT: Report on whether the 504 Recovery Act Loans Were Originated and Closed in Accordance with SBA Policies

This report presents the results of our audit of the origination and closing of 504 Recovery Act loans. The objective of this audit was to determine whether 504 Recovery Act loans were originated and closed in accordance with Small Business Administration policies and procedures.

We request that you provide your management decision for each recommendation on the attached SBA form 1824, Recommendation Action Sheet, by October 27, 2012 (30 days after the final report date). Your decision should identify the specific actions taken or planned for each recommendation and the target dates for completion.

We appreciate the cooperation and courtesies of the Small Business Administration extended to the staff during this audit. Please direct any questions to me at (202) 205-6587 or Terry Settle, Director, Credit Programs Group at (703) 487-9940.

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/S/ original signed
John K. Needham
Assistant Inspector General for Auditing

EXECUTIVE SUMMARY:
504 Recovery Act Loans Were Originated and Closed in Accordance with SBA Policies

What OIG Audited

The SBA's 504 Program provides small businesses with long-term, fixed-rate financing for the purchase of land, buildings, machinery, or other fixed assets. The OIG audited a sample of 504 Program Recovery Act loans that were approved between June 1, 2009 and January 31, 2010. We selected all 10 loans involving refinancing from a universe of 1,141 loans. We then selected a random sample of 50 loans from the remaining 1,131 loans. The fieldwork was performed by RER Solutions, Inc., (RER) under contract with the OIG, with oversight and follow-up by the OIG. The contractor reviewed Small Business Administration (SBA) loan files using an OIG checklist. For all loans examined, RER also reviewed information in Colson's Services Corporation CDC Connection and SBA's Electronic Loan Information Processing System (ELIPS) to determine the status of the loans in the sample.

OIG Recommendations

The OIG recommended a total of three actions, all of which were addressed to the Director of the Office of Financial Program Operations, specifically:

- Determine how the deficiencies in the four SBA-approved loans occurred, and take corrective action to prevent similar deficiencies in other SBA-approved 504 loans.
- Provide feedback to the SBA loan officers who approved the 504 loans in which deficiencies were identified.
- Notify the improper payment review team of the improper 504 loan guaranties to ensure the proper estimation of improper payments in the 504 Loan Program.

Agency Comments and Actions Taken

The SBA agreed with two of the recommendations and partially agreed with one recommendation. The SBA said it has taken, or will take, steps to address many of our concerns in the 504 originating and closing process. Specifically, it will (1) analyze the four loans with deficiencies and will propose corrective actions to the OIG, (2) increase credit training mentoring of loan officers, and (3) notify the Improper Payments Review Team of the improper 504 loan guaranties identified during the audit.

What OIG Found

The SBA generally originated and closed 504 Recovery Act loans in accordance with SBA policies and procedures. However, we identified origination and closing deficiencies in 3 of the 50 randomly sampled loans reviewed. This resulted in unsupported or inappropriate loan approvals of $414,000.

All three loans with inappropriate or unsupported loan approvals were regular 504 Certified Development Company (CDC) loans approved by the SBA. The deficiencies in the three loans included:

- Unsupported or inaccurate repayment projections;
- Collateral shortfalls; and
- Inadequate equity injections.

In addition, one loan reviewed—in our judgmental sample of ten loans—also had questionable repayment projections. This loan had an inappropriate approval of $1,147,000. As of July 31, 2012, all four loans were current.

Deficiency	Loan Approval Amount
Lacked creditworthiness due to inaccurate repayment ability analysis	$150,000
Questionable repayment projections	$1,147,000
Loan approved with collateral shortfall	$161,000
Insufficient equity contribution	$103,000
TOTAL	$1,561,000

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Introduction

This report presents the results of our audit of the origination and closing of 504 Development Company Program (504 Program) loans made under the American Recovery and Reinvestment Act (Recovery Act). The Recovery Act and Office of Management and Budget (OMB) guidance encouraged Offices of Inspectors General to conduct oversight of potential risks posed by Recovery Act programs implemented by their respective agencies. Accordingly, we conducted this audit due to concerns that the Small Business Administration (SBA or the Agency) and companies participating in the Certified Development Company (CDC) Program would not exercise due diligence in originating and closing Recovery Act 504 loans. The concerns were due to the temporary fee elimination for the 504 Loan Program and the CDCs being reimbursed for processing fees by the SBA instead of charging the fees to the borrowers.

The objective of our audit was to determine whether 504 program loans, disbursed pursuant to the Recovery Act, were originated and closed in accordance with SBA policies and procedures, and to identify any evidence of suspicious activity. To answer our objective, we selected all 10 loans involving refinancing from the universe of 1,141 Recovery Act 504 loans that had been approved between June 1, 2009 and January 31, 2010 with at least one disbursement as of January 31, 2010. We then selected a random sample of 50 loans from the remaining 1,131 loans. The fieldwork was performed by RER Solutions, Inc., (RER) under contract with the OIG, with follow-up by the OIG. The contractor reviewed Small Business Administration (SBA) loan files using a standard OIG review methodology that we prepared based on applicable Standard Operating Procedures. For all loans examined, RER also reviewed information in Colson's Services Corporation CDC Connection and SBA's Electronic Loan Information Processing System (ELIPS) to determine the status of the loans in the sample. We also interviewed SBA's Directors of the Fresno and Little Rock Servicing Centers; the Director of the Sacramento Loan Processing Center; and the Director, Office of Financial Program Operations.

We conducted this audit between March 2010 and May 2012 in accordance with *Generally Accepted Government Auditing Standards*. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. Staff turnover and limited resources created delays in completing fieldwork and issuing the audit report.

Background

The SBA's 504 Program provides small businesses with long-term, fixed-rate financing for the purchase of land, buildings, machinery, or other fixed assets. The SBA issues these loans through a partnership with CDCs and private sector third-party lenders. The SBA then funds the loans through the issuance of government guaranteed debentures. The CDCs are non-profit corporations that the SBA certifies and regulates to package, process, close, and service CDC loans. Section 504 loans are financed as outlined in Table 1.

A 504 project has three main partners and generally: a Third Party Lender provides 50-percent or more of the financing; a CDC provides up to 40-percent of the financing through a 504 debenture (guaranteed 100-percent by SBA); and a borrower injects at least 10-percent of the financing. This standard financing and other variations of 504 Program financing are shown in Table 1.

Table 1 504 Loan Financing Structure

	Standard Financing Structure	New Business or Limited or Special Purpose Property[1]	Both New Business and Limited or Special Purpose Property
3rd Party Lender	50%	50%	50%
CDC/SBA	40	35	30
Borrower	10	15	20

Source: Standard Operating Procedure (SOP) 50 10

Congress enacted the Recovery Act on February 17, 2009 to stimulate the U.S. economy and increase credit to small businesses. Changes authorized in the Recovery Act and subsequent legislation temporarily eliminated 504 upfront fees and expanded the program to allow refinancing under certain circumstances.

Section 501 of the Recovery Act authorized the temporary elimination of two program fees for eligible loans approved through the Agency's section 504 Development Company Program on or after February 17, 2009. Borrowers no longer were required to pay Third-Party Participation fees or CDC processing fees. Further, the SBA was required to reimburse the CDCs for the waived processing fees.

Based on established criteria, including loan volume and quality, the SBA selects CDCs to participate in a streamlined loan application processing procedure known as the Abridged Submission Method (ASM). Under this process, the CDC is required to collect and retain all exhibits to SBA Form 1244, *Application for Section 504 Loan*. However, the CDC is only required to submit certain documents to the SBA with the application. The CDC files, including all of the exhibits, or supporting documents, must be available for review by the SBA at any time. This process causes the SBA to rely heavily on the CDC's analysis; therefore, continued quality performance of the CDC's portfolio is essential.

[1] SOP 50 10 5(A), effective date March 1, 2009, identifies a New Business as a business that is 2 years old or less at the time the loan is approved. This includes a change of ownership because it will result in new, unproven ownership/management and increased debt unrelated to business. SOP 50 10 5 (B), effective date October 1, 2009, modifies this to state that a business that is more than 2 years old at the time the loan is approved may be considered a New Business if it is a change of ownership that will result in new, unproven ownership/management and increased debt unrelated to business operations. If there is a change of ownership, the CDC must review the management and level of debt and make a determination whether an additional borrower's contribution of 5% is necessary. A Limited or Special Purpose Property is a limited-market property with a unique physical design, special construction materials, or a layout that restricts its utility to the use for which it was built.

Review of Internal Controls

The SBA's Standard Operating Procedure (SOP) 00 02, *Internal Control Systems*, provides guidance on the implementation and maintenance of effective systems of internal control as required by OMB guidance. According to OMB Circular A-123, effective systems of internal control improve the accountability and effectiveness of federal programs and operations by establishing, assessing, correcting, and reporting on internal controls. To assess the internal controls relevant to our objectives, we reviewed SBA SOPs 50 10 5(A) and 50 10 5(B).

We identified minor internal control weaknesses in the Agency's origination of 504 Program Recovery Act loans. We found that documentation supporting requests for loans was not always sufficient. Specifically, we identified four instances where the SBA accepted CDC loan requests with unsupported or inaccurate repayment projections, insufficient collateral, or insufficient equity contributions.

Implementing the recommendations in this report will address the identified minor internal control weaknesses, and improve the Agency's origination and closing of 504 loans. We will provide a copy of the final report to the senior official responsible for internal controls in the Office of the Chief Financial Officer.

RESULTS

Finding: *504 Program Recovery Act Loans were Generally Originated and Closed in Accordance with SBA's Policies and Procedures*

The SBA generally originated and closed 504 Recovery Act loans in accordance with established policies and procedures.[2] However, we identified origination and closing deficiencies in six percent of the randomly selected loans reviewed. These deficiencies resulted in inappropriate or unsupported loan approvals of approximately $414,000 of the $25,826,000 approvals in our sample. All three loans with inappropriate or unsupported loan approvals were made using the Abridged Submission Method (ASM) and were approved by the SBA.

In addition, one loan reviewed in our judgmental sample of all ten loans involving refinancing, also had origination and closing problems. This loan resulted in an unsupported loan approval of $1,147,000. We also identified one instance of a suspicious act that was unrelated to our audit objective, which has been referred to our Investigations Division.

Specifically, for the three loans with deficiencies, the SBA: (1) accepted an inaccurate repayment ability analysis, (2) allowed a collateral shortfall, and (3) mistakenly classified the business as existing rather than new which resulted in an insufficient amount of equity being required. Further, one loan from our judgmental sample also had

[2] SBA's SOP 50 10 5, *Lender and Development Company Loan Programs*, contains the requirements for lenders and CDCs to participate in SBA lending programs with different levels of SBA delegation.

questionable repayment projections. In accordance with the Improper Payments Elimination and Recovery Act of 2010 (IPERA), the SBA is required to report to Congress on its estimate of improper payments in the 504 Loan Program. Pursuant to IPERA, inappropriate or unsupported loan approvals are considered improper payments. Examples of the deficiencies are further outlined below.

The SBA Approved Two Loans that Lacked Creditworthiness

One of the loans reviewed in our sample lacked creditworthiness due to an inaccurate repayment ability analysis. The SBA's SOP 50 10 5 requires the CDCs to perform a financial analysis of repayment ability. This analysis should be based on historical income statements and/or tax returns (if an existing business) and projections, including the reasonableness of supporting assumptions. In addition, the applicant must exhibit a strong consistent cash flow that is sufficient to cover the debt. According to Chapter 13 Code of Federal Regulations (CFR) 120.150, the loan applicant must be creditworthy and the loans must be so sound as to reasonably assure repayment. In determining the creditworthiness, the SBA will consider: (a) character, reputation, and credit history of the applicant, it's associates and guarantors; (b) experience and depth of management; (c) strength of business; (d) past earnings, projected cash flow, and future prospects; (e) ability to repay the loan; (f) sufficient invested equity to operate on a sound financial basis; (g) potential for long-term success; (h) nature and value of collateral; and (i) the effect any affiliates may have on the ultimate repayment ability of the applicant.

We reviewed a loan, approved for $150,000, to a start-up business in Utah for which the CDC calculated the repayment ability based on the historical operations of two affiliated businesses located in Nevada. Although the affiliates' consolidated cash flow was sufficient to cover the debt service on the subject property, both affiliates were well-established businesses incorporated in 2002, and were located over an hour away from the start-up business. It does not appear reasonable to assume the newly established business would operate at the same capacity of the existing businesses. In addition, our review of this loan did not identify any supporting analysis for how the new business would achieve a similar level of sales as the existing businesses. Further, it did not appear that any consideration was given to allow for a ramp up period for the new business to achieve that same level of sales.

In addition, 1 loan reviewed in our judgmental sample of all 10 loans involving refinancing, also had questionable repayment projections. This loan was approved for $1,147,000. The interim financials for this business did not support first year projections. They showed a negative Debt Service Coverage Ratio (DSCR) in 2009, the year the loan was made, and there were no underlying assumptions for the projections. The business would have needed a drastic increase in sales in order to break even. Therefore, it does not appear to be reasonable to assume the business would have been able to achieve these increased sales in 2009 and meet even higher projections in year two, 2010.

The SBA Approved a Loan with a Collateral Shortfall

Another loan in our sample, approved for $161,000, had insufficient collateral coverage. According to the SBA's SOP 50 10 5,

> the SBA's second lien position will be considered adequate when the applicant meets all of the following criteria: a strong consistent cash flow that is sufficient to cover the debt; demonstrated and proven management; the applicant business has been in operation for more than two years; and the proposed project is a logical extension of the applicant's current operations.

If one or more of the four criteria is not met, additional collateral and/or increased equity contributions may be required.

The SBA's second lien position was not adequate for this loan because the applicant business had been in operation for less than two years and therefore, did not meet all of the required criteria in SOP 50 10 5 to accept a second lien position. In addition, there was no equity in SBA's second lien position because the liquidation value of the material and equipment was $222,900 and the first lien position was $225,000. Nevertheless, neither the CDC nor the SBA required additional collateral. Furthermore, an increased equity contribution was also not required. Our review of the loan file did not identify any analysis by the lender to determine if other collateral was available. If additional collateral was available, we believe it should have been taken to secure this loan to a new business.

The SBA Approved a Loan as an Existing Business Instead of As a New Business Transaction Resulting in an Insufficient Equity Contribution

Both the CDC and the SBA mistakenly classified a fourth loan, approved for $103,000, as an existing business transaction, instead of being correctly identified as a new business transaction. As a result, the SBA did not require a sufficient equity contribution. According to SOP 50 10 5, a new business is described as one that is less than two years old at the time the loan is approved. This includes a change of ownership because it will result in new, unproven ownership and/or management and increased debt unrelated to business operations. In addition, the SOP requires a 10-percent equity contribution for an existing business, and a 15-percent equity contribution for a new business or limited/special purpose property. The borrower of this loan had been operating a take-out restaurant/deli at a gas station convenience store and he purchased a full-service restaurant. In doing so, he sold his existing business to fund the purchase of a new one. This should be considered a change of ownership because an existing business was sold to a new owner who now operates the restaurant under the same name.
The misclassification of this borrower as an existing business rather than a new business allowed the borrower to contribute an equity contribution of 10-percent, or $12,750, less than the required 15-percent contribution.

Conclusion

The SBA generally originated and closed 504 Recovery Act loans in accordance with SBA policies and procedures. However, our audit results show that a small number of inappropriate or unsupported 504 loan approvals did occur. To prevent the occurrence of similar deficiencies in other SBA-approved 504 loans, the SBA will need to determine how the deficiencies occurred and provide feedback to SBA loan officers. Furthermore, as inappropriate or unsupported loan approvals are considered improper payments in accordance with the Improper Payments Elimination and Recovery Act of 2010, the SBA will need to ensure an accurate improper payment rate is reported in future years.

Recommendations

We recommend that the Director of the Office of Financial Program Operations:

1. Determine how the deficiencies in the four SBA-approved loans occurred and take corrective action to prevent the occurrence of similar deficiencies in other SBA-approved 504 loans.

2. Provide feedback to the SBA loan officers who approved the 504 loans—in which deficiencies were identified—to prevent similar issues in the approval of other 504 loans.

3. Notify the Improper Payment Review Team of the improper 504 loan guaranties identified during this audit to ensure the proper estimation of improper payments in the 504 Loan Program.

Agency Comments and Office of Inspector General Response

On August 17, 2012, we provided a draft of this report to the Director, Office of Financial Assistance and the Director, Office of Financial Program Operations for comment. On September 20, 2012, the Director, Office of Financial Program Operations submitted formal comments which are included in their entirety in Appendix VI. A summary of management's comments and our response follows.

Recommendation 1

Determine how the deficiencies in the four SBA-approved loans occurred and take corrective action to prevent the occurrence of similar deficiencies in other SBA-approved 504 loans.

Management Comments

The Office of Financial Program Operations (OFPO) partially agreed with this recommendation. It did not agree that two of the four loans were inappropriate or unsupported approvals. The OFPO will follow the recommendation for the remaining two loans and provide their analysis on all four loans and the proposed corrective actions to the OIG by October 31, 2012.

OIG Response

Management's comments were responsive to the recommendation. We continue to support our conclusion that all four loans represented inappropriate or unsupported approvals. We will work with the OFPO during the audit follow-up process to ensure corrective actions are taken to fully resolve this recommendation.

Recommendation 2

Provide feedback to the SBA loan officers who approved the 504 loans—in which deficiencies were identified—to prevent similar issues in the approval of other 504 loans.

Management Comments

The OFPO concurred with this recommendation and said that the loan officers involved with these loans have been notified. In addition, the Sacramento Loan Processing Center has increased its credit training and will continue to mentor loan officers and improve their credit analysis skills. This training will be completed by December 15, 2012.

OIG Response

Management's comments were responsive to the recommendation.

Recommendation 3

Notify the Improper Payment Review Team of the improper 504 loan guaranties identified during this audit to ensure the proper estimation of improper payments in the 504 Loan Program.

Management Comments

The OFPO concurred with this recommendation and said that they will issue a memorandum to the Improper Payment Review Team and include a copy of the final audit report along with a copy of the OFPO analysis on the four loans by December 15, 2012.

OIG Response

Management's comments were responsive to the recommendation.

Appendix I: Scope and Methodology

To answer our audit objective, we identified a universe of 1,141 Recovery Act Loans approved between June 1, 2009 and January 31, 2010 with at least one disbursement as of January 31, 2010. We judgmentally selected and examined all ten loans involving refinancing from the universe of 1,141 loans. We then selected a random sample of 50 loans from the remaining 1,131 loans.

The fieldwork was performed by RER Solutions, Inc., (RER) under contract with the OIG, with oversight and follow-up by the OIG. The contractor reviewed Small Business Administration (SBA) loan files using a standard OIG review methodology that we prepared based on applicable Standard Operating Procedures. For all loans examined, RER also reviewed information in Colson's Services Corporation CDC Connection and SBA's Electronic Loan Information Processing System (ELIPS) to determine the status of the loans in the sample. We also interviewed SBA's Directors of the Fresno and Little Rock Servicing Centers; the Director of the Sacramento Loan Processing Center; and the Director, Office of Financial Program Operations.

Prior Coverage

During the past 5 years, the GAO issued one report pertaining to SBA's oversight of the 504 program. In addition, the SBA OIG issued two reports.

GAO Report (s)

Shear, W. (2009). *Small Business Administration's Implementation of Administrative Provisions in the American Recovery and Reinvestment Act*. GAO-09-507R, April 16, 2009.

SBA OIG Reports

SBA OIG (2009). *SBA-Serviced Liquidation of Certified Development Company Loans*, Report Number 09-11. March 30, 2009.

SBA OIG (2010). *Audit of Premier Certified Lenders in the Section 504 Loan Program*, Report Number 10-10. March 23, 2010.

Appendix II Randomly Sampled Loans

	Loan Number	Loan Name	Approval Date	Approval Amount
1	3702875003	ADVINTAGE WINE AND DISTRIBUTION	10/20/2009	$396,000
2	3643695007	A.C.T. HOME CARE INC.	9/21/2009	263,000
3	3692755008	SILVER SPOON ENTERPRISES INC	10/14/2009	164,000
4	3555095004	CHICKEN SCRATCH AT CALERA INC.	8/4/2009	693,000
5	3521335006	ALICE NAIL LLC	7/16/2009	104,000
6	3509715010	JOHNSON R.V. SALES	7/10/2009	1,025,000
7	3543825001	CENTRAL ILLINOIS COURIER INC.	7/29/2009	198,000
8	3468115010	BRANDON V. CUCCIA D.D.S.	6/16/2009	288,000
9	3487945007	AGGREGATE CRUSHER SPECIALISTS	6/26/2009	633,000
10	3487845001	THE MELTAWAY CREAMERY AND SAND	6/26/2009	133,000
11	3477715004	BOUCHER’S FOOD SERVICES INC.	6/22/2009	103,000
12	3522905002	ENTERPRISE VALLEY PHYSICAL THERAPY	7/17/2009	150,000
13	3446645004	LOST RECOVERY INC.	6/2/2009	176,000
14	3480945004	BILL’S TOWING AND AUTO REPAIR LLC	6/23/2009	714,000
15	3559415001	THE PARTNERSHIP CENTER LTD	8/6/2009	114,000
16	3490205009	COMFORT INN	6/29/2009	1,513,000
17	3604935004	TRAFFIC MASTERS INC.	8/31/2009	106,000
18	3671665006	BOWEN CONSTRUCTION CO INC.	9/30/2009	66,000
19	3633235005	SMALL BAR	9/15/2009	382,000
20	3719175001	MURRAY HAMPTON INN	10/28/2009	1,500,000
21	3465475007	ELAN INTERNATIONAL INC.	6/15/2009	496,000
22	3565045004	MADIGAN PRATT & ASSOCIATES INC.	8/11/2009	168,000
23	3455905001	CENTRAL ALUMINUM SUPPLY CORP	6/8/2009	245,000
24	3666005002	R.A.H. INDUSTRIES INC.	9/29/2009	3,334,000
25	3482795000	EVS NEW HAMPSHIRE INC.	6/24/2009	474,000
26	3620705005	HERITAGE CROSSINGS	9/8/2009	335,000
27	3521615007	CLEAR VIEW WINDOWS INC.	7/16/2009	214,000
28	3610625001	TEQUIPMENT INC.	9/2/2009	1,337,000
29	3543815009	THE WATERFORD INN	7/29/2009	478,000
30	3476905000	SNIPPERS INC.	6/22/2009	51,000
31	3653665002	PADILLA & GARCIA PC	9/24/2009	82,000
32	3452135000	SECRET RECIPES RECEPTION CENTER	6/4/2009	184,000
33	3473945006	CYCLE VISIONS	6/18/2009	388,000
34	3481315005	LYNDEN LUBE & AUTO	6/24/2009	294,000
35	3586835004	CASA LATINA BAKERY	8/20/2009	$486,000
36	3584245000	PHOENIX RECYCLING TECHNOLOGIES	8/19/2009	797,000
37	3655055000	CNA ENTERTAINMENT INC.	9/24/2009	589,000
38	3697545003	POUCH CONVERTING TECHNOLOGIES	10/16/2009	161,000
39	3687385010	JEFFREY ELENBERGER D.D.S.	10/9/2009	313,000
40	3584615004	NICK’S INN 62 INC.	8/20/2009	126,000
41	3552295010	MODERN RECOVERY & REMARKETING	8/3/2009	244,000
42	3462695008	CONCESSION SPECIALISTS INC.	6/11/2009	127,000
43	3646725009	RAY’S APPLE MARKET	9/22/2009	900,000
44	3500975000	WASH TIME EXPRESS INC.	7/7/2009	750,000
45	3490125009	GH FOODS LLC	6/29/2009	2,409,000
46	3639375002	PACIFIC LIGHT FINANCIAL & INVEST	9/17/2009	91,000
47	3453185006	SDA DENTAL GROUP LLC	6/5/2009	539,000
48	3464815000	BROADWAY CHIROPRACTIC P.S.	6/12/2009	189,000
49	3624735000	X-PRESS ENTERPRISES LLC	9/10/2009	456,000
50	3645845008	PROFESSIONAL PHYSICAL THERAPY	9/21/2009	848,000
		Total		$25,826,000

Appendix III: Judgmentally Sampled Loans

	Loan Number	Loan Name	Approval Date	Approval Amount
1	3448675006	JOHNSON'S MEDICAL INC.	6/3/2009	$440,000
2	3559615002	SHERMAN MECHANCIAL INC.	8/6/2009	1,147,000
3	3572425009	STL OFFICE SOLUTIONS INC.	8/13/2009	1,803,000
4	3582505002	ACCURATE MEASUREMENT CONTROLS INC.	8/19/2009	386,000
5	3634365000	PARKE HOTEL $ CONFERENCE CENTER, LLC	9/16/2009	3,520,000
6	3643265007	ELEMENT CREATIVE, LLC	9/20/2009	305,000
7	3646875008	PLEASANT VALLEY DENTAL	9/22/2009	293,000
8	3659255009	SPLASH & DASH INC.	9/26/2009	1,208,000
9	3666885008	MIDWEST TWISTERS GYM. ACADEMY INC	9/29/2009	335,000
10	3698825006	MOONEY FARMS	10/16/2009	1,467,000
		Total		$10,904,000

Appendix IV: Loans with Deficiencies

Loan Number	Deficiency	Judgmental/Random	Loan Approval Amount
[Ex. 4]	Lacked creditworthiness due to inaccurate repayment ability analysis	Random	[Ex. 4]
[Ex. 4]	Questionable repayment projections	Judgmental	[Ex. 4]
[Ex. 4]	Loan approved with collateral shortfall	Random	[Ex. 4]
[Ex. 4]	Insufficient equity contribution	Random	[Ex. 4]
	TOTAL		$1,561,000

Appendix V: Management Comments

U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

MEMORANDUM
September 20, 2012

To: John Needham
Assistant Inspector General for Auditing

From: John A. Miller
Director, Office of Financial Program Operations

Subject: Response to Draft Report on the 504 Recovery Act Loans Were Originated and Closed in Accordance with SBA Policies, Project No. 10505C

Thank you for the opportunity to review the draft audit report. We appreciate the role the Office of Inspector General (OIG) plays in assisting management in ensuring that these programs are effectively managed.

The OIG report concluded that SBA generally processed and approved 504 Recovery Act loans in accordance with SBA policies and procedures. This is a very positive report of the quality work conducted at the SBA's Sacramento Loan Processing Center (SLPC). OIG sampled 50 randomly selected and 10 judgmentally selected loans approved between June 1, 2009 and January 31, 2010. Of the randomly selected and judgmentally selected loans, OIG stated that a small number of inappropriate or unsupported 504 loan approvals occurred.

The Office of Financial Program Operations, which oversees the SLPC, agrees with the OIG on two of the four approvals cited in the report as inappropriate or unsupported. Please note that all four loans are current and there is no indication at this time that any of the four loans noted above will not continue to perform.

OFPO's response to the recommendations in the draft report is as follows:

1. **Determine how the deficiencies in the four SBA-approved loans occurred and take corrective action to prevent the occurrence of similar deficiencies in other SBA-approved 504 loans.**

   Because OFPO believes that two of the four loans were not inappropriate or unsupported approvals, OFPO partially concurs with this recommendation as and will follow the recommendation for the remaining two loans. OFPO will provide its analysis on all four loans and its proposed corrective actions to OIG by October 31, 2012.

2. **Provide feedback to the SBA loan officers who approved the 504 loans-in which deficiencies were identified-to prevent similar issues in the approval of other 504 loans.**

   OFPO concurs with this recommendation. The loan officers involved have been notified. It should also be noted that the SLPC has increased its credit training and will continue to mentor loan officers and improve their credit analysis skills. The training will be completed by December 15, 2012.

3. **Notify the Improper Payment Review Team of the improper 504 loan guaranties identified during this audit to ensure the proper estimation of improper payments in the 504 Loan Program.**

   OFPO concurs with this recommendation and will issue a memorandum to the Improper Payment Review Team and include a copy of the final audit along with a copy of the OFPO analysis on the four loans by December 15, 2012.

Again, thank you for the opportunity to review the draft report. Please let us know if you need additional information or have any questions regarding our response.