



U.S. Small Business Administration
Office Inspector General

Memorandum

To: Eric Zarnikow
Associate Administrator for Capital Access
/s/ Original Signed

Date: December 15, 2009

From: Debra S. Ritt
Assistant Inspector General for Auditing

Subject: Inadequate Documentation to Support a Loan Approved Under Section 504 of the
Recovery Act
Report No. ROM 10-06

Attached is the Management Letter issued by KPMG LLP which identifies a matter that came to their attention during the audit of SBA's FY 2009 financial statements. The objective was to determine the adequacy of controls over the loan approvals funded under Section 504 – Stimulus for Community Development Lending of the Recovery Act.

KPMG addressed recommendations to the Director for the Office of Financial Program Operations. We provided a draft of KPMG's report to this official or designee, who concurred with the finding. The official or designee agreed to implement the recommendations or has already taken action to address the underlying conditions.

Should you or your staff have any questions, please contact Jeffrey R. Brindle, Director, Information Technology and Financial Management Group at (202) 205- [FOIA ex. 2]

Cc: Jonathan I. Carver



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**AMERICAN RECOVERY AND REINVESTMENT ACT
MANAGEMENT LETTER**

November 13, 2009

CONFIDENTIAL

Office of the Inspector General,
U.S. Small Business Administration, and
Administrator of the SBA:

We were engaged by the Office of Inspector General (OIG) to perform supplemental audit services for the purpose of testing certain transactions and system enhancements related to the U.S. Small Business Administration's (SBA) implementation of the American Recovery and Reinvestment Act of 2009 (ARRA). The procedures were performed as part of an expanded scope of our fiscal year 2009 audit of SBA's consolidated financial statements. In planning and performing our audit procedures related to SBA's implementation of ARRA, we considered internal control aspects related to the implementation and operation of the ARRA programs that were in place as of September 30, 2009. However, our audit services under this contract modification did not include issuing an opinion on the effectiveness of the controls, and accordingly, we do not express our opinion on such controls.

During our audit, we noted a matter involving internal control concerning inadequate documentation to support a Section 504 debt refinancing approval. The comments and resulting recommendations, presented in the Exhibit, have been discussed with the appropriate members of management and are intended to improve internal control or result in other operating efficiencies.

We would be pleased to discuss these comments and resulting recommendations with you at any time.

This report is intended solely for the information and use of the OIG, SBA management, and others within the organization and is not intended to be, and should not be, used by anyone other than these specified parties.

KPMG LLP

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INADEQUATE DOCUMENTATION TO SUPPORT A SECTION 504 DEBT REFINANCING APPROVAL

CONDITION:

During our testwork over the American Recovery and Reinvestment Act of 2009, section 504 refinancing loan approvals performed at the Sacramento Loan Processing Center, we noted for one of eight 504 program loans tested, that the supervisory loan specialist did not obtain a transcript of account or its equivalent prior to approval of the debt-refinancing transaction. A transcript of account is utilized to review the borrower's payment history with the lender whose debt is being refinanced to determine whether the loan has been current for at least one year. The loan officer confirms the receipt of the transcript or equivalent as part of their recommendation to approve, which is documented on the Loan Officer's Report (LOR).

CRITERIA:

- 1) American Reinvestment and Recovery Act, SEC. 504, *STIMULUS FOR COMMUNITY DEVELOPMENT LENDING*, states:

“(2) Low Interest Refinancing under the Local Development Business Loan Program – Section 502 of the Small Business Investment Act of 1958 (15 U.S.C. 696) is amended by adding at the end of the following:

(7) PERMISSIBLE DEBT REFINANCING – (a) In general – Any financing approved under the title may include a limited amount of debt refinancing. (b) Expansions – If the project involves expansion of a small business concern, any amount of existing indebtedness that does not exceed 50 percent of the project cost of the expansion may be refinanced and added to the expansion cost, if... (vi) the borrower has been current on all payments due on the existing debt for not less than 1 year preceding the date of refinancing...”

- 2) Office of Management and Budget Circular A-123, *Management's Responsibility for Internal Control*, states:

“Management is responsible for developing and maintaining effective internal control. Effective internal control provides assurance that significant weaknesses in the design or operation of internal control, that could adversely affect the agency's ability to meet its objectives, would be prevented or detected in a timely manner.”

CAUSE:

As the section 504 debt refinancing program was implemented in the fourth quarter of fiscal year 2009 the Sacramento Loan Processing Center was inexperienced in approving this type of loan. Additionally, the loan officer incorrectly confirmed on the LOR that the lender transcript or equivalent had been received by the agency. This error was not detected upon supervisory loan specialist review.

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EFFECT:

Approving section 504 refinancing loans without adequate supporting documentation increases the risk that ineligible individuals are approved for the program.

RECOMMENDATIONS:

We recommend the Office of Financial Program Operations Director:

1. Reinforce through the issuance of memorandum the importance of the transcript of account or equivalent document.
2. Ensure that the Supervisory Loan Officer properly verifies the accuracy and completeness of the LOR during their review. This should be accomplished through the issuance of memorandum or further training.

MANAGEMENT RESPONSE:

SBA management concurs with the finding and recommendations.