



Audit Report



Report Number: OIG-SBLF-13-004

SMALL BUSINESS LENDING FUND: Accuracy of Third-Quarter 2012
Dividend Rate Adjustments
January 29, 2013

Office of Inspector General

Department of the Treasury

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Abbreviations

Call Reports	Quarterly Financial Regulatory Reports
CDLF	Community Development Loan Fund
ISR	Initial Supplemental Report
QSBL	Qualified Small Business Loan
QSR	Quarterly Supplemental Report
SBLF	Small Business Lending Fund
The Act	Small Business Jobs Act of 2010

*The Department of the Treasury
Office of Inspector General*

January 29, 2013

Don Graves, Jr.

Deputy Assistant Secretary for Small Business, Housing, and Community
Development

This is the second in a series of reports on the accuracy of small business lending gains reported by institutions participating in the Small Business Lending Fund (SBLF). Participants can lower the cost of capital obtained through the program by increasing their small business lending. Program dividend or interest rates are based on lending gains identified in supplemental reports that participating institutions send to Treasury. Treasury also relies on these reports to measure and report the results of the SBLF program to Congress.

The objective of the audit was to determine the accuracy of qualified small business lending (qualified lending) volumes for the quarter ending March 31, 2012 reported by participants for 3rd quarter dividend rate adjustments on October 1, 2012 payments to Treasury. To accomplish our objective, a statistical sample of 64 institutions was drawn from the 179 participants that qualified for initial dividend rates below the maximum rates¹ set for the program. The 64 institutions in the sample will be reviewed through multiple consecutive audits. This report focuses on lending activity for 20 of the 64 institutions. However, one of the selected institutions (Cache Valley Bank) did not provide the appropriate supporting documentation needed to verify the accuracy of its reported qualified lending gains. As a result, the scope of our review was limited to the 19 institutions for which we could obtain the needed data.

¹ The highest dividend rate is 5 percent for C corporation banks and holding companies, and the highest interest rate is 7.7 percent for all other institutions.

Further, we compared adjusted small business lending baselines² and qualified lending volumes reported by the 19 institutions in their Initial Supplemental Reports (ISR), and March 31, 2012 Quarterly Supplemental Reports (QSR) to each institution's quarterly financial regulatory reports (Call Reports).³ We also examined loan files, accounting records, and minutes of board of directors' meetings, and other information to identify loan guarantees and merger and acquisition activities affecting each institution's qualified lending gains for the period sampled, and reviewed procedural guidance on calculating gains in qualified lending. Finally, we interviewed SBLF program staff at Treasury and senior officials from the participating institutions sampled. Appendix 1 contains a more detailed description of our audit objective, scope, and methodology.

We conducted our fieldwork from April to November 2012 in accordance with *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 objective. Accordingly, we believe that the evidence obtained to address our audit objective provides a reasonable basis for our findings and conclusions.

Results in Brief

We determined that 10, or 53 percent, of the 19 financial institutions reviewed inaccurately reported qualified lending gains for the quarter ended March 31, 2012. Of these institutions, 8 over-reported their gains by approximately \$21.4 million and 2 under-reported their gains by approximately \$36.7 million. Overall, the errors resulted in the underreporting of qualified lending by approximately \$15.3 million, but did not affect the dividend/interest rates on October 1, 2012 payments to Treasury.

The errors observed were largely caused by institutions: (1) incorrectly recording Call Report loan volumes on the ISRs and QSRs; (2) improperly

² The baseline period comprises September 30, 2009 through June 30, 2010. Each institution filed an Initial Supplemental Report (ISR) with Treasury reflecting its qualified lending for the baseline period. At the end of each quarter baseline activity reported on the ISR is adjusted for any loans acquired through acquisition or merger with another participating institution and loans not meeting qualified lending activity. The adjusted baseline is reported on each institution's Quarterly Supplemental Report.

³ These reports vary by type of institution and include Consolidated Reports of Condition and Income, Thrift Financial Reports, Y-9s, Uniform Bank Performance Reports, and Bank Holding Company Performance Reports.

adjusting lending volumes on the ISRs and QSRs; and (3) incorrectly classifying loans on Call Reports. Treasury's review process can identify recording and adjustment errors, but would not be able to detect misclassified loans, which is the responsibility of the financial regulators.

The errors observed in this audit were similar in nature to those noted in our August 2012 report on initial dividend rates.⁴ Our prior report recommended that Treasury incorporate review procedures into its program oversight activities to test for the types of reporting discrepancies noted by the OIG. If adopted, we believe such action will allow Treasury to detect the types of errors identified by this audit. Therefore, Treasury should provide an update of the progress it has made on our prior recommendations. In addition, we recommended that Treasury determine whether the 10 institutions should submit corrected ISRs and QSRs, review the submissions of these institutions for additional errors, and make the necessary adjustments to dividend rates, as appropriate. We also recommended that Treasury assess Cache Valley Bank the maximum dividend rate under the program until such time as the bank provides documentation supporting its lending gains, exclude lending activity reported by the bank if support is not provided, and ensure that the April 2013 *Use of Funds Report* correctly identifies qualified lending activity for the 10 banks flagged by the audit.

Treasury agreed with three of the four recommendations. Specifically, Treasury reported that it had implemented all corrective actions recommended in our August 2012 audit report, agreed to follow up with the 10 banks that made reporting errors, and stated it would correct its April 2013 *Use of Funds Report* for errors identified by the audit. However, Treasury did not agree to assess Cache Valley Bank the maximum dividend rate because it believes it does not have sufficient information needed to implement the OIG's recommendation and that its program contract limits its ability to do so. Treasury stated it would request the appropriate documentation from the bank to make a determination. We were compelled to subpoena Cache Valley Bank for the records the bank withheld during the audit, which were received on January 18, 2013. We will provide Treasury with the results of our analysis so that it can determine what actions are warranted. We also plan to explore Treasury's reasons for establishing a program contract that restricts its ability to withhold rate reductions from program participants that are unwilling to provide underlying support for their reported lending activity.

⁴ SMALL BUSINESS LENDING FUND: Initial Dividend Rate Calculations Used Incorrect Lending Information, OIG-SBLF-12-005, August 21, 2012.

Background

The SBLF program was created by the Small Business Jobs Act of 2010 (the Act) to increase the availability of credit to small businesses. Section 4103(a) of the Act gave the Treasury Secretary temporary authority to make capital investments in eligible financial institutions in exchange for preferred shares of stock or other financial instruments through September 27, 2011. In return, institutions that received capital investments under the program must pay dividends or interest to Treasury.

The more an institution increases its small business lending over the baseline level, the lower the dividend or interest rate it will pay for the SBLF funding. Initial dividend rates for participants that are C corporation banks and holding companies ranged from 1 percent to 5 percent, while rates for S corporations (banks and holding companies) and mutual institutions ranged from 1.5 percent to 7.7 percent. Participating community development loan funds (CDLF) have a constant interest rate of 2 percent for the first 8 years of participation in the program.

Until 2½ years in the program, the dividend or interest rate paid by a financial institution is adjusted quarterly as the institution increases its lending to small businesses. For example, for most participating institutions with a 10 percent or greater increase in qualified lending, the dividend rate will drop to 1 percent, while lesser increases will cause the rate to drop to between 2 percent and 4 percent. Fixed interest rates apply to most participants from 2½ years to 4½ years in the program. Finally, rates increase to 9 percent after 4½ years in the program for most participants.

Reduced dividend or interest rates are applied only to the amount of SBLF capital representing the increase in qualified lending. For example, if an institution received \$5 million in SBLF capital and increased its qualified lending by \$3 million, the reduced dividend rate would apply to only the \$3 million. However, if the institution's qualified lending had increased by \$5 million, the entire \$5 million of the SBLF investment would be subject to the lower dividend rate.

A bank's qualified lending volume is determined by adding the amounts of loans reported in its Call Report in the categories of: (1) commercial and industrial loans; (2) loans secured by owner-occupied nonfarm, nonresidential properties; (3) loans to finance agricultural production and other loans to farmers; and (4) loans secured by farmland. This total is then adjusted to exclude loans with an original principal and commitment amount greater than \$10 million; loans to businesses with more than \$50 million in revenues; and the portions of loans guaranteed by the U.S. government or for which the

risk is assumed by a third party. The total is further adjusted by adding net charge-offs back to the qualified lending volume. For participants that are holding companies, qualified lending activity is determined by combining all of the qualified lending activity of the holding company's insured depository institution subsidiaries.

Small business lending gains are measured by the volume of outstanding loans each quarter versus the amount that was outstanding in the four quarters ending June 30, 2010 (the baseline period). To establish initial dividend or interest rates for the SBLF program, participating banks completed ISRs using small business lending data from their quarterly Call Reports and loan records, and submitted them to the SBLF program office a few days prior to the date of Treasury's investment.

To report increases in qualified small business lending, participating banks complete QSRs using business lending data from their quarterly Call Reports and loan records. Each quarter banks adjust their qualified lending baseline as appropriate to reflect any loans acquired through acquisitions or mergers with other institutions, excluding loans that do not meet the definition of "qualified lending activity." Banks also report all activity meeting the definition of qualified lending activity during the quarter, excluding loan charge-offs.

Because the initial dividend or interest rate is based on increases in qualified lending that occurred prior to entering the SBLF program (i.e., between the baseline level and the lending reported in the second calendar quarter preceding the SBLF closing date), an institution may be eligible for a reduced dividend or interest rate at program entry. Excluding CDLF participants, whose initial interest rate is set at 2 percent, 179 institutions admitted to the SBLF program qualified for reduced initial dividend or interest rates.

Fifty-three Percent of Banks Reviewed Inaccurately Reported Qualified Lending Gains

We determined that 10, or 53 percent, of the 19 institutions reviewed inaccurately reported their qualified lending gains for the quarter ended March 31, 2012. Collectively, the 10 banks made just over \$78 million in reporting errors. As shown in Table 1 below, 8 banks overstated their increases in qualified lending by approximately \$21.4 million and 2 banks understated their increases in qualified lending by approximately \$36.7 million. The aggregate errors by the 10 banks resulted in an approximate \$15.3 million understatement in qualified lending for the quarter ended March 31, 2012, which was primarily attributable to one bank understating its qualified lending gains by \$36.6 million.

Table 1. Qualified Lending Activity Misreported for the Adjusted Baseline and Quarter ended March 31, 2012 (dollars in thousands)

Bank	Under-reporting of Adjusted Baseline	Over-reporting of Adjusted Baseline	Over-reporting of Quarter Activity	Under-reporting of Quarter Activity	Over or (Under) Statement of Lending Gains	Total Value of Errors
1	\$9,485	\$0	\$0	\$46,152	(\$36,667)	\$55,637
2	\$0	\$0	\$271	\$0	\$271	\$271
3	\$0	\$0	\$1,100	\$0	\$1,100	\$1,100
4	\$0	\$0	\$88	\$0	\$88	\$88
5	\$226	\$10	\$0	\$0	\$216	\$236
6	\$0	\$0	\$8,815	\$0	\$8,815	\$8,815
7	\$7,252	\$24	\$488	\$0	\$7,716	\$7,764
8	\$0	\$52	\$0	\$0	(\$52)	\$52
9	\$3,614	\$426	\$0	\$0	\$3,188	\$4,040
10	\$30	\$0	\$0	\$0	\$30	\$30
Totals	\$20,607	\$512	\$10,762	\$46,152	(\$15,295)	\$78,033

Cache Valley Bank is not included in the table above as it did not provide the appropriate supporting documentation to support its reported lending gains. Because of the bank's failure to provide the requested documentation, we believe it should be assessed the maximum dividend rate allowable under the program beginning with the January 1, 2013 payment to Treasury and subsequent quarterly payments.

If the magnitude of the error is large enough, inaccurate reporting of lending activity in either the adjusted baseline or the quarter can affect the dividend or interest rates applied to institutions. Over-reporting an institution's adjusted baseline understates the increase in qualified lending and can cause an institution to pay a higher dividend rate. Under-reporting the adjusted baseline overstates the increase in qualified lending, potentially lowering an institution's dividend rate.

Conversely, overstating qualified lending in the quarter would inflate lending gains (and potentially reduce the dividend rate), while understating lending in the quarter would reduce reported gains (and potentially raise the dividend rate). Because the dividend or interest rate is generally not subject to additional adjustment for increases in lending that are less than 2.5 percent or more than 10 percent above baseline levels, incorrect reporting of changes in lending outside of this range would not typically yield changes in the dividend or interest rate.

The ISRs and QSRs were incorrect largely because banks:

- inaccurately recorded Call Report loan volumes on the ISRs and QSRs (recording errors);
- improperly adjusted loans on the ISRs and QSRs (adjustment errors); and
- Incorrectly classified loans on Call Reports (classification errors).

As recommended in our August 21, 2012 report on initial dividend rates, Treasury will need to incorporate review procedures in its program oversight to test for discrepancies between participant supplemental reports and Call Reports caused by recording or adjustment errors.

Some Errors Were Due to Recording and Adjustment Errors

Banks are required to record on the ISRs and QSRs the amount of loans they made in various loan categories identified on their Call Reports and subtract from these amounts: (1) loans with an original principal and commitment amount greater than \$10 million; (2) loans to businesses with more than \$50 million in revenues; (3) the portions of loans guaranteed by the U.S. government; and (4) loans for which the risk is assumed by a third party.

As summarized below, one bank did not accurately transfer Call Report volumes, another bank incorrectly recorded participation loans and an additional two banks did not correctly deduct ineligible portions of loans. In total, the four banks made approximately \$70.9 million in recording and adjustment errors. Specifically:

- One bank inappropriately excluded approximately \$55.6 million in loans recorded on the Call Reports from its adjusted baseline and quarter-end activity. This resulted in an understatement of its lending gains. The bank attributed the exclusions to reporting and loan capture issues.
- One bank incorrectly recorded approximately \$6.2 million of participation loans on its ISR, which resulted in an overstatement of the bank's lending gains.
- Two banks did not correctly adjust loan volumes to exclude approximately \$9.1 million in loans with principal amounts greater than \$10 million. This resulted in an overstatement of each bank's lending gains.

Some Errors Were Due to Institutions Misclassifying Loans

We also identified loan misclassifications that caused qualified lending to be misreported. Reporting guidance issued by Treasury directs institutions to calculate their qualified lending using loan activity data identified in their Call Reports. Call Reports are financial reports that banks are required to file with their regulators based on loan activity captured in their accounting systems. Regulators use these reports to determine the safety and soundness of institutions and whether they are meeting their capital requirements.

Institutions participating in SBLF use loan activity data from their Call Reports to complete their ISRs and QSRs, which determines their SBLF dividend or interest rates. Institutions are to report loans under \$10 million and under the \$50 million revenue limit that are classified as: (1) commercial and industrial loans; (2) loans secured by owner-occupied nonfarm and nonresidential real estate; (3) loans to finance agricultural production and other loans to farmers; or (4) loans secured by farmland.

We identified approximately \$6.4 million in discrepancies in loan volumes reported by 5 banks that were due to misclassified loans on Call Reports, which affected the accuracy of reported lending gains. Specifically:

- One bank inappropriately included a \$1.1 million loan to a nonprofit organization on its QSR because it was incorrectly classified on the Call Report. This resulted in an overstatement of the bank's lending gains.
- Two banks inappropriately included approximately \$700,000 in loans on their ISRs and QSRs that had been misclassified on their Call Reports. The loans were made to individuals for personal use, or were not secured by owner-occupied, nonfarm, nonresidential properties. This resulted in an understatement of the banks' reported lending gains.
- One bank inappropriately excluded four loans from its ISR totaling approximately \$3.6 million. Bank staff acknowledged the errors and attributed them to issues in the coding process, which caused them to be incorrectly classified on the bank's Call Report. This resulted in an overstatement of the bank's lending gains.

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- One bank inappropriately excluded a commercial loan for approximately \$1 million from its ISR, which inflated the bank's lending gains.

Lending Volume Errors Did Not Affect Dividend Rates but Resulted in Inaccurate Reporting of Program Results

We noted that the reporting errors made by the 10 banks were not large enough to trigger corresponding changes in their dividend or interest rate payments due to Treasury on October 1, 2012. However, we believe that because a large percentage of the institutions we tested made reporting errors, similar errors may be prevalent throughout the remaining population of participants.

Although the reporting errors did not affect dividend rates, the errors resulted in the inaccurate reporting of program results. The Act directs Treasury to provide a quarterly written report to Congress on how institutions have used the funds they received from the SBLF program. To meet this requirement, Treasury issues a quarterly *Use of Funds Report*, which provides information reported by SBLF participants on changes in small business lending relative to baseline levels and compares business lending activity to non-SBLF banks. In making the comparison, Treasury reports small business lending activity in the four categories of loans mentioned previously, with exclusions for loans to businesses over \$10 million and loans to businesses with over \$50 million in revenue. Treasury also makes additional adjustments for net charge-offs and portions of loans guaranteed by the U.S. government, or for which risk has been assumed by third parties, as well as for mergers and acquisitions and for purchases of loans.

The misstatements identified in our audit indicate that in the October 2012 *Use of Funds Report*, Treasury over-reported qualified lending gains for eight institutions and under-reported them for two. The errors in reporting will continue to be reflected in all subsequent reports to Congress unless corrected. Because increases in qualified lending are calculated as the difference between an institution's adjusted baseline and the balance of loans outstanding at the end of each quarter, corrections will be needed to both the adjusted baseline activity and quarter-end loan balances that roll forward to each new quarter. Based on the timing of our audit, the next opportunity for Treasury to correct the reporting errors we identified would be in the April 2013 *Use of Funds Report*.

Additional Call Report Errors Were Noted that Did Not Impact Reported Lending Gains

In addition to the Call Report errors previously noted for 5 of the 10 banks, our audit identified errors on the Call Reports of another 2 banks. However, these errors did not impact the lending gains reported by the two banks. Specifically:

- One bank did not include approximately \$8.1 million in qualifying loans on its Call Report, but included them on its ISR. Bank officials stated that the loans were acquired through a merger/acquisition during the quarter and properly reflected on the ISR, but that the Call Report had not been updated.
- One bank amended its ISR for approximately \$3 million in loans that were misclassified on its Call Report. The error in classification was noted during the bank's internal review process.

Because 7, or 37 percent, of the 19 banks reviewed made errors on their Call Reports, we will continue to look at this issue in future audits of SBLF dividend rates. Additionally, because Federal bank regulators rely on the Call Reports to determine the safety and soundness of financial institutions, we will continue to share our findings with the relevant bank regulators, as appropriate.

Recommendations

We recommend that the Deputy Assistant Secretary for Small Business Housing and Community Development:

1. Provide a progress update of all management responses noted in the Initial Dividend Rate Audit Report issued on August 21, 2012.
2. Follow up with the 10 banks that made reporting errors to determine whether corrected ISRs and QSRs should be submitted, review the submissions of these institutions for additional errors, and make the necessary adjustments to dividend rates, as appropriate.
3. Assess Cache Valley Bank the maximum dividend rate allowable on the January 1, 2013 payment due to Treasury and all subsequent quarterly payments until it provides appropriate supporting documents showing the accuracy, appropriateness, and classification of amounts reported on the ISR and the QSR. Also, exclude the bank's reported qualified lending

gains from the small business lending activity reported to Congress in Treasury's April 2013 *Use of Funds Report*.

4. Ensure that the Use of Funds Report for April 2013 contains corrections for errors identified by this audit.

Management Comments and OIG Response

We provided a draft of this report to Treasury on December 13, 2012, and received formal written comments on January 16, 2013, in which management concurred with recommendations 1, 2, and 4. Specifically, Treasury stated that it had completed corrective actions in response to all recommendations in the *Initial Dividend Rate* audit report issued on August 21, 2012. Treasury also agreed to direct the identified banks to resolve any errors in this quarter, including submitting corrected ISRS and QSRs, as appropriate. Finally, Treasury stated that in July 2012 it had started publishing updated lending data based on revised supplemental reports and that the April 2013 *Use of Funds* report will contain corrections for errors identified by the audit.

However, Treasury did not agree to assess Cache Valley Bank the maximum dividend rate as directed in recommendation 3 because it believes it lacks sufficient information to implement the OIG's recommendation and because its program contract limits its ability to do so. Treasury stated it would request the appropriate documentation from Cache Valley Bank showing the accuracy, appropriateness, and classification of amounts reported on the ISR and QSR. If these errors would result in an upward adjustment in the dividend rates payable for prior periods, Treasury will recover the additional payment that should have been made.

We believe that management's proposed actions are responsive to the four recommendations. While Treasury will not assess Cache Valley Bank the maximum dividend rate allowable as recommended, we believe its plans to evaluate whether the bank is paying the appropriate dividend rate meets the intent of our recommendation. The OIG was also compelled to issue a subpoena to Cache Valley Bank for the records the bank withheld during the audit, which were received on January 18, 2013. We are analyzing the loan documentation to determine whether lending activity reported is accurate and will share the results of our analysis with Treasury. We also plan to explore Treasury's reasons for establishing a program contract that restricts its ability to withhold rate reductions from program participants that are unwilling to provide underlying support for reported lending activity.

* * * *

We appreciate the courtesies and cooperation provided to our staff during the audit. If you wish to discuss the report, you may contact me at (202) 622-1090, or Lisa DeAngelis, Audit Director, at (202) 927-5621.

/s/

Debra Ritt

Special Deputy Inspector General for

Office of Small Business Lending Fund Program Oversight

Appendix 1: Objective, Scope, and Methodology

The objective of the audit was to determine the accuracy of qualified small business lending (qualified lending) volumes for the first quarter of 2012 reported by participants for 3rd quarter dividend rate adjustments on October 1, 2012 payments to Treasury. A total of 332 institutions were approved to participate in the Small Business Lending Fund (SBLF) with initial dividend rates ranging from 1 percent to 7.7 percent. Of the 332, 51 are Community Development Loan Funds for whom initial dividends are automatically set at 2 percent and are not based on qualified lending volumes.

The scope of the audit was limited to the 179 participating institutions whose initial dividend rates were based on reported lending activity and who qualified for initial dividend rates below the highest possible rates established for the program.⁵ We focused our audit on just the 179 institutions with initial dividend rates below maximum levels because that was where the risk of dividend underpayments would be the greatest. Participants with the highest possible initial dividend rates were considered lower risk for this audit because initially they will be required to pay the maximum interest rate possible in the SBLF program.

A statistical sample of 64 institutions was drawn from the group of 179 institutions based on a 90-percent error rate, and a 90-percent confidence interval with a 5-percent rate of precision. This audit focused on the dividend rates for the third quarter of 2012 for a group of 20 of the 64 institutions, and following audits will focus on dividend rates for the fourth quarter of 2012 and first quarter of 2013 for the remaining institutions in the sample. However, one of the selected institutions (Cache Valley Bank) did not provide the appropriate supporting documentation needed to verify the accuracy of its reported qualified lending gains. As a result, the scope of our audit was limited to the 19 of the 20 institutions for which we could obtain the needed data.

The audit was conducted by performing testing procedures designed to determine the accuracy of balances reported by SBLF participants on the ISRs and QSRs for adjusted baseline and adjusted quarter-end qualified lending activity as of March 31, 2012. Testing included reviewing supporting details for balances on the ISRs and QSRs from participant financial reports, loan files, loan histories, board minutes, and other supporting information, as well as publicly available information on participant activities and U.S. government loan

⁵ The highest possible initial dividend rate was 5 percent for C corporation banks and holding companies, and 7.7 percent for S corporation banks and holding companies, mutual institutions, and savings institutions. There were 102 SBLF participants with the highest possible initial dividend rates.

guarantees. The audit team discussed testing exceptions or questions with senior personnel at SBLF institutions.

We conducted the audit from April to November 2012 in accordance with *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 objective. We believe that the evidence obtained provided a reasonable basis for our findings and conclusions based on our audit objective.

Appendix 2: Management Response



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

January 14, 2013

Debra Ritt
Special Deputy Inspector General for
Office of Small Business Lending Fund Program Oversight
U.S. Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Dear Ms. Ritt:

Thank you for the opportunity to review your draft report (the Report) on the accuracy of small business lending increases reported by institutions participating in the Small Business Lending Fund (SBLF). This letter provides the Department of the Treasury's (Treasury) official response.

We reviewed the Report's findings, which were based on a sample of twenty SBLF participants. Your audit found that certain program participants made errors in reporting their qualified small business lending to Treasury, but that these errors in aggregate resulted in the under-reporting of increases in small business lending and did not affect the amounts payable to Treasury by individual participants.

Treasury has initiated a review of the errors identified for the institutions cited in the Report. Treasury will work with each institution to verify that they have addressed all issues identified by your team and resubmit supplemental reports as appropriate. Further, Treasury will contact the Cache Valley Banking Company to seek additional information regarding the Report's findings.

Starting with the July 2012 *Use of Funds Report*, Treasury has published updated institution-specific lending data for all previously reported quarters based on revised supplemental reports. We will continue to update this information in subsequent Use of Funds reports.

Attached, please find more specific responses to each of your recommendations. Thank you once again for the opportunity to review the Report. We look forward to working with you and your team in the future.

Sincerely,

Don Graves, Jr.
Deputy Assistant Secretary

Attachment

Recommendations

1. Provide a progress update of all management responses noted in the Initial Dividend Rate Audit Report issued on August 21, 2012.

Management Response

Treasury has completed its planned corrective actions in response to the recommendations in the Initial Dividend Rate Audit Report issued on August 21, 2012:

Recommendation #1 and #2: Treasury has reviewed the Initial Dividend Rate Audit Report's findings with each of the eight institutions cited in the report. These institutions have submitted revised Initial Supplemental Reports (ISRs) and Quarterly Supplemental Reports (QSRs) as appropriate. These submissions did not result in adjustments to the dividend or interest rates payable.

Recommendation #3: Treasury reviewed with the applicable institutions the two loans cited in the Initial Dividend Rate Audit Report. For the first loan, the institution communicated that the loan in question was fully participated prior to the baseline period and was appropriately excluded from the supplemental report. For the second loan, the institution reported that the loan was neither eligible for inclusion nor was it included in the institution's qualified small business lending, and consequently the borrower revenue threshold would not apply.

Recommendation #4: Treasury conducted training webinars on July 30th and August 7th and published updated supplemental report forms on May 9th. The document supporting the webinar presentation and updated reporting forms are available at <http://www.treasury.gov/resource-center/sb-programs/Pages/Supplemental-Reporting-Requirements.aspx>. Treasury will continue to work to identify opportunities to improve the reporting process.

Recommendation #5: In March 2012, Treasury initiated a review process for all ISRs and QSRs. This process includes tests for discrepancies between each bank's supplemental reports and corresponding Call Reports. The review process was further enhanced in June 2012 to include additional statistical tests, such as peer group analysis on certain reported exclusions, and comparisons against lending data publicly available from the Small Business Administration (SBA). To date, 147 institutions have submitted revised supplemental reports following the initiation of this review process.

Recommendation #6: On October 9, 2012, Treasury published the *October Use of Funds Report*, which includes information from the most recently submitted ISRs and QSRs from each institution as of the preparation of the report. This report includes

information from the ISRs and QSRs that were resubmitted by the institutions cited in the Initial Dividend Rate Audit Report.

2. Follow up with the 10 banks that made reporting errors to determine whether corrected ISRs and QSRs should be submitted, review the submissions of these institutions for additional errors, and make the necessary adjustments to dividend rates, as appropriate.

Management Response

Treasury agrees with this recommendation. Treasury will review the identified errors with each institution and will direct these institutions to resolve any errors in this quarter, including submitting corrected ISRs and QSRs, as appropriate.

OIG Comments

3. Assess Cache Valley Bank the maximum dividend rate allowable on the January 1, 2013 payment due to Treasury and all subsequent quarterly payments until it provides appropriate supporting documents showing the accuracy, appropriateness, and classification of amounts reported on the ISR and the QSR. Also, exclude the bank's reported qualified lending gains from the small business lending activity reported to Congress in Treasury's March 2013 *Use of Funds Report*.

Management Response

Under the program contract, there are limited circumstances in which rate reductions can be withheld from program participants. Based on the information that Treasury has regarding Cache Valley Banking Company and its compliance with SBLF requirements at this time, we do not have enough information to know whether we can implement the OIG's recommendation as written. Treasury will request and review appropriate supporting documents from Cache Valley Bank showing the accuracy, appropriateness, and classification of amounts reported on the ISR and QSR. Treasury will then direct Cache Valley Bank to resolve any errors identified. If these errors would result in an upward adjustment in the dividend rates payable for prior periods, Treasury will exercise its contractual right to recover, upon demand, the additional payment that should have been made but for the inaccuracies identified. Treasury will publish updated information regarding Cache Valley Bank's lending activity in the April 2013 *Use of Funds Report* as appropriate.

4. Ensure that the *Use of Funds Report* for March 2013 contains corrections for errors identified by this audit.

Management Response

Treasury agrees with this recommendation. Starting with the July 2012 *Use of Funds Report*, Treasury has published updated institution-specific lending data for all previously reported quarters based on revised supplemental reports. The April 2013 *Use of Funds* report will contain corrections for errors identified by this audit based upon revised supplemental reports as appropriate.

Appendix 3: Major Contributors

Debra Ritt, Special Deputy Inspector General

Lisa DeAngelis, Audit Director

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Shola Epemolu, Auditor

Steve Encomienda, Auditor

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William Malloy, Auditor

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Appendix 4: Report Distribution

Department of the Treasury

Deputy Secretary

Office of Strategic Planning and Performance Management

Risk and Control Group

United States Senate

Chairman and Ranking Member

Committee on Small Business and Entrepreneurship

Chairman and Ranking Member

Committee on Finance

Chairman and Ranking Member

Committee on Banking, Housing and Urban Affairs

United States House of Representatives

Chairman and Ranking Member

Committee on Small Business

Chairman and Ranking Member

Committee on Financial Services

Government Accountability Office

Comptroller General of the United States