



OFFICE OF  
**INSPECTOR GENERAL**  
U.S. DEPARTMENT OF THE INTERIOR

# **STRONGER INTERNAL CONTROLS NEEDED OVER INDIAN AFFAIRS LOAN GUARANTEE PROGRAM**

**This is a revised version of the report prepared for public release.**



OFFICE OF  
**INSPECTOR GENERAL**  
U.S. DEPARTMENT OF THE INTERIOR

Memorandum

NOV 09 2017

To: Michael Black  
Acting Assistant Secretary – Indian Affairs

From: Mary L. Kendall *Mary L. Kendall*  
Deputy Inspector General

Subject: Final Evaluation Report – Stronger Internal Controls Needed Over Indian Affairs  
Loan Guarantee Program  
Report No. 2016-CR-036

This memorandum transmits the findings of our evaluation of the Office of Indian Energy and Economic Development's (IEED's) controls to effectively manage the Loan Guaranty, Insurance and Interest Subsidy Program. We found that the Division of Capital Investment's (DCI's) controls were inadequate and did not provide reasonable assurance of meeting the Program's purpose and activities. We make 13 recommendations to assist IEED with improving its internal controls and clarifying the responsibilities of its staff. The monetary impact of our findings totaled \$12.9 million.

In response to our draft report, IEED concurred with all recommendations and provided target dates and officials responsible for implementation. We consider 3 recommendations resolved and implemented, and 10 recommendations resolved but not implemented. We will forward the recommendations to the Office of Policy, Management and Budget for tracking and implementation.

The legislation creating the Office of Inspector General requires that we report to Congress semiannually on all audit, inspection, and evaluation reports issued; actions taken to implement our recommendations; and recommendations that have not been implemented.

If you have any questions regarding this report, please contact me at 202-208-5745.

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## Results in Brief

The Division of Capital Investment (DCI) plays a critical role in helping Indian nations develop and use their own resources through the loan guarantees it approves. DCI is part of the Office of Indian Energy and Economic Development (IEED) and its key responsibility is managing the Loan Guaranty, Insurance and Interest Subsidy Program (Program). We evaluated whether DCI had controls in place to effectively manage its loan guarantee program.

We found that DCI's controls were inadequate and did not provide reasonable assurance of meeting the Program's purpose and activities. As a result, we found loan guarantees that DCI approved without proof of benefit to Indian communities and in excess of the monetary cap required by regulation. This created unnecessary risk for loans already considered risky.

Specifically, we found issues with DCI's:

- compliance with regulations
- loan guarantee approval process
- segregation of duties
- monitoring activities
- employee performance plans
- authority to issue loan guarantees and approve reimbursement for defaulted loans

These issues occurred because IEED has provided limited oversight over the Program, and DCI management believes that internal controls do not pertain to programs of this size. Appropriate controls are important due to the level of risk of this Program. Between 2010 and 2016, DCI paid approximately \$12.4 million in claims resulting from defaults, and received an additional claim for approximately \$20 million, which had not been paid at the time of our review. As of September 30, 2016, DCI was potentially liable for \$606 million in guaranteed loans. Should any of the borrowers default on these loans, it is ultimately taxpayers who would carry the burden of bailing out the lenders since their obligations are guaranteed by the U.S. Government. We make 13 recommendations to assist IEED with improving DCI's internal controls and clarifying responsibilities of DCI and its staff.

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# Introduction

## Objective

Our objective, was to determine to what extent, if any, the Office of Indian Energy and Economic Development (IEED) had internal controls in place to effectively oversee the Indian Affairs Loan Guarantee Program and to ensure the Program's purpose was met.

## Background

The Indian Financing Act of 1974<sup>1</sup> as amended, established the Loan Guaranty, Insurance and Interest Subsidy Program (Program). Congress created the Program to address the historic reluctance of private lenders to make business financing available to American Indian borrowers on commercially reasonable terms.<sup>2</sup> The Program addresses this reluctance, in part, by guaranteeing up to 90 percent of the unpaid principal and interest due on any eligible loan.<sup>3</sup> Congress created the Program to assist Indians with developing and using their resources so they “will fully exercise responsibility for the utilization and management of their own resources and will enjoy a standard of living from their own productive efforts comparable to that enjoyed by non-Indians in neighboring communities.”<sup>4</sup>

Managing the Program is the key responsibility of the Division of Capital Investment (DCI), which is part of IEED. DCI is comprised of four zones and a central office in Washington, D.C. As of May 2016, DCI employed 13 staff including contractors. As of December 6, 2016, DCI managed \$606 million in outstanding loan guarantees, with individual loan balances ranging from \$12,000 to \$28 million. The Departmental Manual currently describes DCI's management responsibilities as including education and outreach to Indian communities, and providing access to capital markets by coordinating with government loan programs.

Bureau of Indian Affairs (BIA) regulations and congressional appropriations define and limit eligibility for these loan guarantees. The regulatory provisions define eligible borrowers as individual Indians, tribes or tribal enterprises, and Indian-owned business entities that are at least 51 percent Indian-owned.<sup>5</sup> The businesses these borrowers finance must contribute to the economy of an Indian reservation or a tribal service area recognized by BIA. Annual appropriations determine the funds that DCI has available to issue loan guarantees. For fiscal year (FY) 2017, the Program's budget request is about \$7.8 million, which will support approximately \$106 million in new loans. During our evaluation, we

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<sup>1</sup> 25 U.S.C. § 1451 *et seq.*

<sup>2</sup> S. Rep. No. 93-348, at 1-2 (1973).

<sup>3</sup> 25 U.S.C. § 1481(a).

<sup>4</sup> 25 U.S.C. § 1451, “Congressional declaration of policy.”

<sup>5</sup> 25 C.F.R. § 103.25.

selected and reviewed a judgmental sample from the 248 active loan guarantees that had a balance during our scope, FYs 2010 through 2016.

Federal loan guarantee programs such as DCI's create a legal liability to pay the amount guaranteed in the event a borrower defaults. The U.S. Office of Management and Budget (OMB) requires these programs to implement appropriate internal controls over programmatic functions and operations. OMB Circular A-123, *Management's Responsibility for Internal Control*, implements the Federal Managers' Financial Integrity Act (FMFIA) and defines all Federal managers' responsibilities for implementing internal controls within their agencies. It establishes internal controls in accordance with the Government Accountability Office's (GAO) *Standards for Internal Control in the Federal Government*, known as the Green Book. OMB Circular A-129, *Policies for Federal Credit Programs and Non Tax Receivables*, applies to all Federal credit programs including the loan guarantee program managed by DCI.

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# Findings

DCI plays a critical role in helping Indian nations develop and use their own resources through the loan guarantees it approves. Overall, we found that DCI did not have adequate internal controls in place and managed the Program with limited oversight from IEED, creating unnecessary risk for an already risky program. Specifically, we found that DCI:

- did not comply with the Code of Federal Regulations at 25 C.F.R. 103.5
- did not provide clear guidance for interpreting equity and collateral sections of the Indian loan guarantee regulations
- approved loan guarantee applications without key information, such as how the financed business would benefit a reservation or tribal area
- did not document the rationale for rejecting credit committee recommendations
- did not appropriately segregate key Program responsibilities among staff
- did not complete all required monitoring activities, such as lender quarterly reports and strategic program review
- included a performance measure in zone managers' appraisal plans that could incentivize unethical behavior
- had no clear line of authority for issuing loan guarantees or approving reimbursement for defaulted loans

## Noncompliance with Regulation for Issuing Loan Guarantee

During our review of the 248 active loan guarantees, we found that DCI approved guarantees for loans to sole owners that exceeded the monetary cap established by 25 C.F.R. § 103.5 in 5 of the 22 loan guarantees we sampled (23 percent). This regulation states, in part, that: “[n]o individual Indian may have an outstanding principal balance of more than \$500,000 in guaranteed or insured loans at any time.”<sup>6</sup> Only tribes and entities “involving two or more persons” are allowed to

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<sup>6</sup> This largely restates the statutory requirement at 25 U.S.C. § 1484 which provides: “No loan to an individual Indian may be guaranteed or insured which would cause the total unpaid principal indebtedness to exceed \$500,000.”

exceed the \$500,000 limit on total indebtedness.<sup>7</sup> When finalizing this regulation, BIA was concerned about preventing individual Indians from “apply[ing] for more than one loan in a manner that would enable the borrower to exceed the statutory limitation of \$500,000 for an individual Indian.”<sup>8</sup>

DCI’s noncompliance with this regulation allowed individual Indians to obtain loans well in excess of the cap. In one case, DCI guaranteed an \$836,400 loan for an individual borrower who had incorporated as an Indian business entity and whose total indebtedness already exceeded \$2.5 million for a previously guaranteed loan. In another case, however, DCI’s credit committee denied a guarantee for a \$6.5 million loan to an individually owned company. The credit committee’s denial was based, in part, on the business entity not meeting the “two or more persons” provision of 25 C.F.R. § 103.5.

We issued a Notice of Potential Findings and Recommendations (NPF) on this issue and, in response, DCI acknowledged its regulatory noncompliance. DCI held two staff teleconferences and the acting DCI chief sent an email to all staff in December 2016. The email stated: “Effective immediately, we can no longer entertain any application involving a loan of over \$500,000 where the borrower is a corporation, limited liability company, or other entity without at least 2 members. See 25 CFR 103.5.” Also, DCI said that it will incorporate appropriate guidance in the new policies and procedures manual that OMB and DOI are having DCI prepare. In addition, DCI said its new loan management software can likely be configured to require confirmation that loan guarantee applications exceeding \$500,000 meet the requirements of 25 C.F.R. § 103.5. DCI did not identify when the system would be implemented and configured.

## Recommendations

We recommend that DCI:

1. Stop approving loan guarantee applications that result in total indebtedness exceeding \$500,000 for borrowers incorporated as the sole owner of an Indian business entity.
2. Communicate the importance of approving loan guarantee applications in compliance with 25 C.F.R. § 103.5.
3. Implement a process to periodically verify that loan guarantees are being approved in accordance with 25 C.F.R. § 103.5.

<sup>7</sup> 25 C.F.R. § 103.5.

<sup>8</sup> Loan Guaranty, Insurance, and Interest Subsidy, 66 Fed. Reg. 3861, 3862 (Jan. 17, 2001).



## Inconsistent Interpretations of Equity and Collateral

We found instances where DCI staff inconsistently interpreted the equity and collateral sections of the Program regulations. This occurred because DCI's policy in this area is vague and DCI provided little guidance to staff on how to apply the regulation so that it is implemented appropriately and consistently. We noted that the credit committee denied applications in an effort to ensure that regulations were followed, and in one instance the acting DCI chief overturned their recommendation [REDACTED].

[REDACTED]. Program regulations at 25 C.F.R. § 103.7 state that borrowers "must be projected to have at least 20 percent equity in the business being financed, immediately after the loan is funded." If a borrower defaults on a loan, and DCI incorrectly determined equity or collateral, then an asset may not be available to offset the liability of the loan guarantee. In addition, a business in one zone could be approved for a loan, whereas a similar business in another zone would not.

For example, one zone recommended a loan guarantee for credit committee review that used tax credits as equity. The credit committee denied the application, reasoning that tax credits cannot be used for equity. According to regulations at 25 C.F.R. § 103.44, however, this tax credit can be used as equity. Per BIA's regulations, only tangible assets such as cash or cash equivalent instruments can be used as equity. For a tax credit to count as equity it would need to be assignable and not subject to expiration before maturity of the loan. This type of tax credit can be used in such a manner.

In another instance, a different zone recommended a loan guarantee for credit committee review that used another loan as collateral. The credit committee denied the application. The regulations state at 25 C.F.R. § 103.16 that "lenders are expected to obtain a first lien security interest in enough collateral to reasonably secure repayment of each loan guaranteed or insured under the Program, to the extent that collateral is available." The acting DCI chief approved the loan guarantee, which went against the credit committee's recommendation. The acting DCI chief explained that the definition of equity in DCI's own policy needed additional work. He said, "it looks to me like confusion led to denial of this request... [and] the program has a long history of accepting as collateral all kinds of arrangements that represent something other than a first lien..., though obviously this isn't something we should do regularly or without very specific guidelines on procedure."

We noted that according to Program regulations, loan guarantee decisions are based on many factors, such as "whether there is a reasonable prospect of loan repayment from business cash flow, or if necessary, from liquidating loan collateral."<sup>9</sup> In their application, borrowers must submit "[a] detailed list of all proposed collateral for the loan, including asset values and the method(s) of

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<sup>9</sup> 25 C.F.R. § 103.16.

valuation.”<sup>10</sup> The regulations, however, do not specify what defines a reasonable prospect of repayment, allowing DCI staff to have different interpretations.

According to GAO’s *Standards for Internal Control in the Federal Government*, also known as the Green Book,<sup>11</sup> management should communicate information to its staff that is necessary to make decisions allowing the Program to achieve its objectives. As shown in the example above, management had not provided clarifying guidance necessary for staff to make such a decision, which led to different interpretations. The Small Business Administration has loan guarantee programs for small businesses and has implemented some processes to help ensure its loan guarantee programs are administered consistently nationwide.<sup>12</sup> For instance, its supervisors and loan reviewers meet to discuss and standardize discordant interpretations of policies and regulations, then distribute the guidance to the teams within each office and region. We believe that this process is a best practice that DCI could consider.

## Recommendations

We recommend that DCI:

4. Develop and implement clarifying guidance for how to interpret the equity and collateral sections of the loan guarantee rule to ensure consistent application.
5. Have the Solicitor review the guidance to ensure it is in compliance with the collateral and equity sections of the loan guarantee rule.

## Incomplete Application Files

We found that only 2 of the 22 loan guarantee application files we examined contained all the documents and information required for DCI to properly approve an application under the regulations.<sup>13</sup> The missing information included how the financed businesses would benefit a reservation or tribal area, verification of borrower’s eligibility under the program, and determination as to whether the borrowers were delinquent on Federal debts. As a result, DCI staff made loan guarantee decisions based on insufficient information.

DCI does not have an effective control in place to ensure that application files are complete and accurate. In some files, we found informal controls created by staff

<sup>10</sup> 25 C.F.R. § 103.26(i).

<sup>11</sup> Standards for Internal Control in the Federal Government: Principle 14.01 – Communicate Internally, “Management should internally communicate the necessary quality information to achieve the entity’s objective.”

<sup>12</sup> Under SBA’s 7(a) Loan Program, SBA guarantees loans provided by other institutions for a variety of business purposes.

<sup>13</sup> 25 C.F.R. §§ 103.4, 103.5, 103.12, and 103.26.

to track the mandatory documents, such as a checklist of the required documents for staff to mark when analyzing the applications. These checklists, however, did not ensure complete information. For instance, one of the files contained a completed checklist; however, the checklist did not include an explanation of how the business contributed to the economy of an Indian reservation or tribal service area. Without this information, DCI cannot assess whether the loan is eligible under 25 C.F.R. § 103.4, or – after the fact – how well the Program promoted economic development. Other than these inadequate checklists, we did not find a control that provided reasonable assurance the loan application packages were complete and accurate.

OMB Circular A-129 requires Federal executive branch entities to establish internal controls in accordance with Green Book standards. Since the loan guarantee approval process is an important programmatic function, DCI needs controls over this process designed to achieve the Program’s objectives and respond to risks.

### Recommendation

We recommend that DCI:

6. Develop and implement a process where the credit committee declines to review incomplete applications.

## No Written Justification for Rejecting Credit Committee Recommendations

We were informed of two instances in which the acting DCI chief approved loan guarantee applications that the credit committee recommended for denial, without formally documenting his rationale.

All loan guarantee applications are presented by a zone manager or assistant to a group of at least four qualified DCI officials at a scheduled credit committee meeting. The credit committee reviews the application and supporting documents, then assesses whether the prospective loan is within Program requirements and if there is a reasonable prospect of repayment. Since the credit committee only has an advisory role, the acting DCI chief has the sole authority to approve or deny the loan guarantee applications.

We found that DCI has a policy requiring the credit committee to document its recommendations to approve or deny applications. The acting DCI chief, however, does not have to document the justifications for his decisions. For example, the credit committee recommended that a \$16 million loan guarantee application for a film project be denied. The acting DCI chief, however, approved the application without formally documenting his rationale for disregarding the

recommendation. [REDACTED]

[REDACTED] In addition, the credit committee recommended another loan guarantee for denial due to collateral they felt violated the regulation. The loan officer who presented the application disagreed with the credit committee's decision and appealed it with the acting DCI chief, explaining why he thought the application should be approved. The acting DCI chief subsequently approved the application without formally documenting his justification for doing so.

The Green Book states that control activities should be designed by management "to achieve objectives and respond to risks."<sup>14</sup> IEED has provided limited oversight over the Program and its use of the credit committee. As a result, the credit committee's recommendations can be easily ignored, giving one individual within DCI the ability to unilaterally make decisions with no review process in place.

### Recommendations

We recommend that IEED:

7. Require the DCI chief to document justifications for disagreeing with the credit committee's recommendations for a loan guarantee application.
8. Review instances where the DCI chief's determination differs from the credit committee's decision, and make the final determination on approving or disapproving the loan application.

### Inadequate Segregation of Duties

We found instances where the Program did not have the appropriate segregation of duties, meaning that DCI did not always separate key responsibilities among different people to reduce the risk of errors, fraud, and misuse. In one instance, the same person reviewed the application for and signed the final certification that approved a \$25 million loan guarantee while acting as the division chief. In addition, DCI's position descriptions for supervisory loan specialists require them to market the Program, review loan applications, monitor loan repayments, manage troubled loans, and evaluate claims for loss in the regions they manage. Having one person perform all these functions could increase the risk of errors and fraud within the Program.

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<sup>14</sup> Standards for Internal Control in the Federal Government: Principle 10:01 – Design Control Activities.

A well-designed Federal credit program separates staff’s critical functions, such as those listed above, to ensure that more than one person completes them. OMB Circular A-129 defines these “critical functions” as:

- Promoting the program to prospective applicants;
- Reviewing and approving applications for credit assistance;
- Monitoring and servicing the outstanding portfolio;
- Reviewing and approving modifications to outstanding loans; [and]
- Collecting delinquent debts.

Ideally, separate employees would perform each of these major duties. In general, application processing and related activities would be designed so that the work of one individual is either independent of, or serves to check on, the work of another. Such arrangements reduce the risk of undetected error and limit opportunities to misuse Program loans.

When duties cannot be sufficiently segregated due to the small size of a unit, then mitigating controls, such as a detailed supervisory review of the activities, may be put in place to reduce risks. It could include specified time frames, types of transactions and related dollar limits, and scope of authority.

### Recommendation

We recommend that DCI:

9. Redesign functions to segregate duties of staff, including when delegating authority to staff, and update position descriptions as necessary. If unable to segregate duties due to staffing size, then mitigating controls should be established.

## Monitoring Deficiencies

### Lender Quarterly Reporting Requirements

We found that DCI staff were not regularly monitoring loan guarantees to ensure that quarterly reporting conditions were met. The Green Book states that managers should monitor their internal control systems by establishing and operating monitoring activities, and evaluating the results.<sup>15</sup> In addition, 25 C.F.R. § 103.33 requires lenders to regularly report information about borrowers to DCI, so DCI can accurately update the contingent liability calculation.<sup>16</sup> According to DCI’s Loan Guarantee Agreement form, lenders must submit quarterly loan transaction history reports. These reports provide information such as how often

<sup>15</sup> Standards for Internal Control in the Federal Government: Principle 16.01 – “Perform Monitoring Activities.”

<sup>16</sup> 25 C.F.R. § 103.33.

the borrower makes payments, the remaining unpaid principal, and the calculation of any late fees that might be associated with the payments.

During our review of the 248 active loan guarantees, we identified 31 loan guarantees with a total balance of \$37.9 million that did not have the required quarterly reports submitted. In addition, the current balances of 12 of those 31 loan guarantees had not been updated in 2 or more years. One loan guarantee, in particular, was approved in 2011 with an original loan amount of \$10 million. Four years later, the balance was still \$10 million. At the end of fiscal year 2016, however, the loan guarantee balance had been reduced to \$6.7 million, with no record of DCI receiving payment histories from the bank. Without current loan transaction histories, DCI cannot determine the correct loan balances for many of its multi-million dollar loans. If DCI monitored all lender payment histories, it could recognize when a contingent loss is possible and could intervene and seek assistance for the borrower. In addition, payment histories that are provided quarterly would ensure that the Government's contingent liability is accurate.

DCI relies on an Excel spreadsheet to record and monitor all pertinent data for each loan guarantee. In addition, DCI must rely on DOI's Office of the Chief Financial Officer, who is responsible for all aspects of Indian Affairs' loan accounting, to provide notification to DCI of any loans going into default. DCI, however, recently purchased a new cloud-based software database to track all loan guarantees. According to management, this database will be able to monitor and track all transactions and processes for all DCI loan guarantees.

### Recommendation

We recommend that DCI:

10. Implement a tracking process to ensure that loan guarantee conditions, including quarterly reporting, are monitored regularly.

### Strategic Program Review Requirements

DCI has not conducted strategic program reviews as required by OMB Circular A-129. Guidance in the Circular states that these reviews must occur biennially or under another timeframe approved by OMB. We found, however, that DCI conducted the last such review in 2007.

Agencies use information from strategic program reviews to assess whether programs are effectively achieving stated policy goals while mitigating risks and costs to the taxpayer. OMB Circular A-129, Appendix A, provides guidelines and best practices for performing these types of reviews. Given the length of time between DCI's reviews, we cannot assure that DCI has effectively achieved its stated goals or efficiently monitored the Program. The acting DCI chief told us of

the changes he has made over the past 2 years to improve the Program’s efficiency, but without a baseline of the Program’s past proficiencies, we could not determine if the changes had meaningful impact.

### Recommendation

We recommend that DCI:

11. Conduct an A-129 strategic program review within the current fiscal year, and conduct a review every 2 years or under other such timeframe as approved by OMB.

## Performance Plans Could Incentivize Approval of Unnecessarily Risky Loan Guarantees

We found that the appraisal plan for DCI zone managers included a performance measure and standard that could incentivize unethical behavior. Critical Element 3, “generate economic activity,” measures staff on how “rapidly, efficiently, and judiciously” they process loan guarantee applications. The corresponding standard rates staff on how many applications they process, but does not include a standard to determine their “judiciousness.” Consequently, staff who approve or obtain approval for an increasing volume of guarantees “are eligible to receive, or increase their likelihood of receiving, higher and higher ratings.”

The Green Book directs management to demonstrate the importance of integrity and ethical values.<sup>17</sup> This standard, however, does the opposite by creating a productivity incentive that rewards staff for quickly analyzing complex applications, potentially rushing their work and focusing on the quantity of applications they approve rather than the quality. In addition, since the guarantee ceiling could be met before some staff have approved an application, this is a potentially unachievable measure. For example, in FY 2010, a single loan approved for \$38 million obligated over 40 percent of all the funds available to guarantee or insure the total loan principal available for that year. In effect, the standard does not measure the quality of employee performance because the act of approving a deal does not indicate the quality of the analysis.

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<sup>17</sup> Standards for Internal Control in the Federal Government: Principle 1.01 – Demonstrate Commitment to Integrity and Ethical Values.

## Recommendation

We recommend that DCI:

12. Modify the performance measure to mitigate the incentive.

## Unclear Authority for Issuing Loan Guarantees and Approving Payment for Defaulted Loans

We found that regulations do not provide DCI authority to commit funds under the Program. Secretarial Order 3296 (Order) previously provided this authority to DCI, but it expired in November 2014. The Departmental Manual currently describes DCI's "management" authority, but it does not appear to include the ability to approve or disapprove loan applications, or approve payments on defaulted loans. As a result, DCI has guaranteed \$153.6 million in loan guarantees (from May 2015 to September 2017), and approved payment of \$3.6 million for defaulted loans, without the authority to do so.

The Program's regulations state that in the absence of a Secretarial decision, "Program authority" is delegated to "BIA officials through the U.S. Department of the Interior Departmental Manual."<sup>18</sup> Because DCI is not a part of BIA, DOI attempted to change this delegation—but without amending the regulations. Instead, DOI has issued internal delegations and manual provisions to move the program from BIA to IEED. The manner in which these authorities have evolved, however, calls into question where the authorities to approve loan guarantee applications and approve payment for defaulted loans currently lie.

Until November 2014, Secretarial Order 3296 explicitly provided the DCI Chief the ability to "authorize loan guaranties, loan insurance, interest subsidies, transaction terms, and debt collection strategies."<sup>19</sup> This Order was originally issued in January 2010 and was amended four times. DOI did not convert the provisions of the Order to the Departmental Manual, however, and did not renew the Order when the last version expired. Therefore, this delegation became obsolete when the Order, as amended, expired in November 2014.

Further, in May 2015, the Department amended part 110, chapter 8 of the Departmental Manual (110 DM 8), to remove the prior version's language stating that DCI was responsible for "the approval and/or disapproval of loan applications, loan cancellations, trust mortgages, and compromises."<sup>20</sup> In June 2015 DOI amended 210 DM 8, which addresses the Secretary's delegations of authority to Indian Affairs. The transmittal memorandum that accompanied the revised 210 DM 8 expressly noted that the revised Departmental Manual does

<sup>18</sup> 25 C.F.R. § 103.3.

<sup>19</sup> Secretarial Order 3296A4 (archived, effective date November 29, 2013).

<sup>20</sup> 110 DM 8.3 (archived version, effective date June 21, 2007).



“not incorporate authorities that were temporarily delegated” under Secretarial Order 3296.<sup>21</sup> This indicates that the expiration of Secretarial Order 3296 was intentional; yet, DCI continues to operate as though its authority to approve loan guarantees and payments for defaulted debt is unchanged.

Because of the unamended BIA regulations and the evolution of DCI’s delegated authority, DOI needs to clarify DCI’s authority to approve and disapprove loan guarantee applications, and to approve payments for defaulted loans. In addition, OMB Circular A-129 states that agencies should operate credit programs with “clear and accountable lines of authority.”

The obligated appropriation to support the \$153.6 million in guaranteed loans is \$9.3 million. DCI has also approved payment of \$3.6 million for defaulted loans since the change in authority. As such, we are questioning \$9.3 million as funds to be put to better use and \$3.6 million in questioned costs.

### Recommendation

We recommend that the Assistant Secretary—Indian Affairs:

13. Work with the Office of the Solicitor to clarify DCI’s authority and update the Program regulations.

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<sup>21</sup> 210 DM 8.

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# Conclusion and Recommendations

## Conclusion

We found that DCI managed the Program with limited oversight from IEED and approved many loans without proof of benefit to Indian communities. In addition, DCI did not have adequate internal controls in place, which created unnecessary risk for an already risky program. Further, DCI has no clear line of authority for issuing loan guarantees. We found that DCI needs to add to existing controls and put in place controls where none currently exist.

Most of our review was based on the internal control framework defined by the Green Book and OMB Circulars A-123 and A-129, which are designed to help establish and implement controls. The first principle of the internal control framework emphasizes the importance of management's attitude towards an internal control system. The principle specifically notes: "Tone at the top can be either a driver . . . or a barrier to internal control."<sup>22</sup>

The internal control deficiencies we identified likely result from DCI management's view that internal control standards should not apply to small programs. This is best illustrated in an IEED newsletter article about DCI:

It doesn't matter that the Indian Financing Act (IFA) created the [Program] years before either of these circulars were written, and is structured in a manner that doesn't lend itself to easy compliance. It doesn't matter that these circulars were written to govern much, much larger Federal programs.

The tone and culture of an organization are fundamental to an effective internal control system. Strong internal controls are especially important for a loan guarantee program that approves complex financial transactions and operates in numerous, widespread locations—regardless of that program's size. DCI is putting Federal dollars at risk by operating without adequate controls. Should any of the borrowers default on these loans, it is ultimately taxpayers who would carry the burden of bailing out the lenders since their obligations are guaranteed by the U.S. Government.

## Recommendations Summary

In response to our draft report, IEED concurred with all recommendations, and provided target dates and officials responsible for implementation. Based on DCI's response, we updated our report to include the monetary impact associated with the loan guarantees issued since DCI's authority expired. IEED's full response is included in Appendix 2.

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<sup>22</sup> Standards for Internal Control in the Federal Government: Principle 1.01 – "Demonstrate Commitment to Integrity and Ethical Values."

We recommend that—

1. DCI stop approving loan guarantee applications that result in total indebtedness exceeding \$500,000 for borrowers incorporated as the sole owner of an Indian business entity.
2. DCI communicate the importance of approving loan guarantee applications in compliance with 25 C.F.R. § 103.5.
3. DCI implement a process to periodically verify that loan guarantees are being approved in accordance with 25 C.F.R. § 103.5.
4. DCI develop and implement clarifying guidance for how to interpret the equity and collateral sections of the loan guarantee rule to ensure consistent application.
5. DCI have the Solicitor review the guidance to ensure it is in compliance with the collateral and equity sections of the loan guarantee rule.
6. DCI develop and implement a process where the credit committee declines to review incomplete applications.
7. IEED require the DCI chief to document justifications for disagreeing with the credit committee's recommendations for a loan guarantee application.
8. IEED review instances where the DCI chief's determination differs from the credit committee's decision, and make the final determination on approving or disapproving the loan applications.
9. DCI redesign functions to segregate duties of staff, including when delegating authority to staff, and update position descriptions as necessary. If unable to segregate duties due to staffing size, then mitigating controls should be established.
10. DCI implement a tracking process to ensure that the loan guarantee conditions, including quarterly reporting, are being monitored regularly.
11. DCI conduct an A-129 strategic program review within the current fiscal year, and conduct a review every 2 years or under other such timeframe as approved by OMB.
12. DCI modify the performance measure to mitigate the incentive.
13. Assistant Secretary—Indian Affairs Work with the Office of the Solicitor to clarify DCI's authority and update the Program regulations.

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# Appendix 1: Scope and Methodology

## Scope

We reviewed the internal control structure used by DCI and the loan guarantees approved from fiscal years 2010 through 2016.

## Methodology

To accomplish the evaluation objective, the team:

- Interviewed IEED and DCI personnel to identify internal control policies and procedures
- Used the five components of internal control listed in Government Accountability Office's "Standards for Internal Control in the Federal Government" to evaluate DCI's internal controls
- Participated in walkthroughs of the loan guarantee application approval process with DCI staff in each of the zones
- Reviewed Office of the Chief Financial Officer (OCFO)-generated lists of loan guarantees approved from fiscal years 2010 through 2016
- Selected and reviewed a judgmental sample of these approved loan guarantees
- Analyzed DCI's reviews of loan guarantee applications and approval/disapproval procedures based on Federal regulatory requirements and internal policies
- Determined borrower's use of Program funds for purposes of the Indian Financing Act of 1974, as amended, and reviewed supporting file documentation
- Reviewed DCI reporting plans and annual performance plans to determine if they meet the requirements and intent of OMB circulars
- Consulted with the Office of General Counsel concerning DCI's violations of 25 C.F.R. § 103.5 and authority to approve or disapprove loan guarantee applications

We visited or contacted:

- Division of Internal Evaluation and Assessment, Indian Affairs, Reston, VA

- Office of Policy Analysis, Department of the Interior, Washington, DC
- U.S. Small Business Administration, Citrus Heights, CA
- Office of Indian Energy and Economic Development, Washington, DC
- Division of Capital Investment, Office of Indian Energy and Economic Development, Washington, DC
- DCI Alaska Zone Credit Office, Anchorage, AK
- DCI Eastern Zone Credit Office, Washington, DC
- DCI Northwest Zone Credit Office, Lakewood, CO
- DCI Southwest Zone Credit Office, Albuquerque, NM

This assignment was conducted as an evaluation in accordance with the Quality Standards for Inspection and Evaluation as put forth by the Council of the Inspectors General on Integrity and Efficiency.

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## Appendix 2: Monetary Impact

Description	Category	Amount (in millions)
Authority to Authorize Loan Guarantees	Funds to be Put to Better Use	\$9.3
Authority to Approve Payments on Defaulted Loans	Questioned Costs (Ineligible)	\$3.6
<b>Total</b>		<b>\$12.9</b>

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## **Appendix 3: Response to Draft Report**

The Office of Indian Energy and Economic Development's response to our draft report follows on page 21.

## MEMORANDUM

To: Mary L. Kendall, Deputy Inspector General

Through: Michael Black, Acting Assistant Secretary—Indian Affairs  
Jack Stevens, Acting Director, OIEED

From: David Johnson, Acting Chief, DCI

Subject: Response to Draft Evaluation Report – *Stronger Internal Controls Needed Over Indian Affairs Loan Guarantee Program*, Report No. 2016-CR-036

Date: September 14, 2017

As requested in your transmittal memorandum of July 24, 2017, the Division of Capital Investment (DCI) responds to the Office of Inspector General’s Draft Evaluation Report No. 2016-CR-036, issued in July of this year (hereafter, the Report), as follows:

### **Recommendation 1.**

Stop approving loan guarantee applications that result in total indebtedness exceeding \$500,000 for borrowers incorporated as the sole owner of an Indian business entity.

**Response.** DCI concurs with Recommendation 1.

This recommendation stems from a technical glitch involving the interpretation of 25 U.S.C. § 1484 and its corresponding regulatory provisions in 25 CFR § 103.5. Despite the wording of 25 CFR § 103.5, DCI officials have been advised over the years that a one-person LLC or S corporation could avoid the restriction in 25 U.S.C. § 1484 because the borrower was not an “individual Indian.” While that might be correct as far as the statute is concerned, that is not the way the regulation is written. The long term fix is to harmonize the regulation with the preferred interpretation of 25 U.S.C § 1484. But until then, DCI must stop approving loan guarantees and/or insurance in excess of \$500,000 to entities with fewer than 2 members.

At the first weekly DCI staff call following the May 30, 2017 OIG evaluation exit conference, the DCI Acting Chief announced the discovery of this problem and required immediate compliance with the strict wording of 25 CFR § 103.5.

**Responsible party(ies):** David Johnson, Acting Chief, DCI

**Target Date:** Done.

### **Recommendation 2.**

Communicate the importance of approving loan guarantees in compliance with 25 C.F.R. § 103.5.



**Response.** DCI concurs with Recommendation 2.

As stated above, the DCI Acting Chief promptly announced the discovery of this problem at the weekly staff meeting following the May 30, 2017 exit conference relating to the Report. He then issued written direction to all DCI personnel to the same effect.

In addition, DCI plans to issue specific written guidance on this subject in a policies and procedures manual that OMB is having DCI prepare.

**Responsible party(ies):** David Johnson, Acting Chief, DCI

**Target Date:** Done.

**Recommendation 3.**

Implement a process to periodically verify that loan guarantees are being approved in accordance with 25 C.F.R. § 1.05.

**Response.** DCI concurs with Recommendation 3.

DCI plans to issue specific written guidance on this subject in a policies and procedures manual that OMB is having DCI prepare. DCI is also exploring the possibility of having its new loan accounting and management software, LMS, configured with a prompt or other requirement to remind DCI staff to assure compliance with 25 CFR § 103.5. Either way, DCI is in the midst of implementing a process to periodically verify compliance with § 103.5.

**Responsible party(ies):** David Johnson, Acting Chief, DCI

**Target Date:** March 31, 2018 if LMS can be configured to help DCI officials verify; if not, August 1, 2018 when new policies and procedures are issued.

**Recommendation 4.**

Develop and implement clarifying guidance for how to interpret the equity and collateral sections of the loan guarantee rule to ensure consistent application.

**Response.** DCI concurs with Recommendation 4.

Recommendation 4 may suggest a closer connection between the concepts of equity and collateral than is the case, but the confusion surrounding the interplay of these topics is genuine, and found among lending officials both inside and outside DCI.

DCI plans to review and refine the definition of equity in 25 CFR § 103.44 when it is able to issue revised regulations. The effort will hopefully create sufficient clarity on the topic such that no definition of “collateral” will be necessary. (There is no definition of collateral in current Program regulations, and except for occasional confusion associated with the tougher concept of equity, none should be necessary.) But in the shorter term, OMB is having DCI write new, comprehensive policies and procedures, and it is in this effort DCI plans to issue clarifications answering Recommendation 4.

**Responsible party(ies):** David Johnson, Acting Chief, DCI

**Target Date:** August 1, 2018.

**Recommendation 5.**

Have the Solicitor review the guidance to ensure it is in compliance with the collateral and equity sections of the loan guarantee rule.

**Response.** DCI concurs with Recommendation 5.

DCI will seek whatever guidance and approval SOL is able to offer.

**Responsible party(ies):** David Johnson, Acting Chief, DCI  
John Hay, SOL  
Andrew Caulum, SOL

**Target Date:** August 1, 2018.

**Recommendation 6.**

Develop and implement a process where the credit committee declines to review incomplete applications.

**Response.** DCI concurs with Recommendation 6.

DCI has tasked its Collections Coordinator, Sherrie Miller, with scheduling credit committee meetings, with specific instructions not to do so until she is certain all the prerequisites to application consideration have been met and documented. This procedure is already in place, and will be memorialized in our forthcoming policies and procedures manual.

**Responsible party(ies):** David Johnson, Acting Chief, DCI  
Sherrie Miller, Collections Coordinator, DCI

**Target Date:** Done.

**Recommendation 7.**

Require the DCI chief to document justifications for disagreeing with the credit committee's recommendations for a loan guarantee application.

**Response.** DCI concurs with Recommendation 7.

DCI has now adopted the policy of fully documenting any future disagreements with credit committee's recommendations in order to justify a different determination by the deciding official. The policies and procedures manual we are preparing for OMB will address this topic, too. To the extent Recommendation 7 requires documenting the Acting Chief's past rejection of two cited credit committee recommendations, the first concerns the [REDACTED] loan to [REDACTED], but the Acting Chief will need clarification as to which loan guarantee the Report

mentions as the second instance. Pending identification of that matter, documentation of the Acting Chief's rationale can occur shortly after commencement of fiscal year 2018.

**Responsible party(ies):** David Johnson, Acting Chief, DCI

**Target Date:** November 30, 2017.

**Recommendation 8.**

Review instances where the DCI chief's determination differs from the credit committee's decision, and make the final determination on approving or disapproving the loan application.

**Response.** DCI concurs with Recommendation 8.

All future disagreements with the credit committee's recommendations will be spelled out, and depending on who has authority to commit the Program, any disagreements will be clearly presented and decided at that level pursuant to the procedure articulated in the forthcoming policies and procedures manual we are preparing for OMB.

**Responsible party(ies):** David Johnson, Acting Chief, DCI

**Target Date:** August 1, 2018.

**Recommendation 9.**

Redesign functions to segregate duties of staff, including when delegating authority to staff, and update position descriptions as necessary. If unable to segregate duties due to staffing size, then mitigating controls should be established.

**Response.** DCI concurs with recommendation 9.

DCI has already re-designed the various functions of its small staff to more clearly delineate specified tasks under the headings of Zone Manager, Zone Assistant, Reporting Officer, and Collections Coordinator. In this manner, decisions concerning the approval of loan guarantees are separated from actions taken to collect loans that have gone bad, and both of those functions are separated from the duties of persons who track Program statistics and report them to internal and external oversight performed by Treasury, OMB, and others. DCI has also reinstated the regular use of a credit committee, which would have provided a check on the one large loan approval noted in the Report as an example of poor separation of duties. Note also that AS-IA's Loan Accounting Section (LAS) performs the actual movement of Program money in FBMS, including the payment of claims, collection of premiums, and application of debt recoveries. As part of a separate office within AS-IA, its actions are not under the control of DCI.

In seeking any further separation of duties, DCI must live with inherent limits presented by its staffing level. It is currently delivering the Program with the smallest staff ever – less than half of what the Bureau of Indian Affairs is believed to have had to prior to the Program being aligned under AS-IA's Office of Indian Energy and Economic Development (IEED). DCI position descriptions therefore must overlap, to allow for continuity in the event of further attrition, prolonged illness, or details. But to the maximum extent possible, DCI will revise its EPAPs and SEPAPs to further narrow the scope of specified

duties expected of personnel within a given fiscal year, thereby addressing OIG's recommendation. Much of the Program promotional work has already been given to a designated IEED official. Application review and recommendation is already provided by Zone Managers and Zone Assistants. The function of monitoring existing loans is currently shared between Zone officials, Reporting Officers, and LAS. Loan modifications are considered and recommended at the Zone level, then determined (as OMB has requested) at the level of DCI's Chief. Collections are handled by our Collections Coordinator, in conjunction with input from the DCI Chief, SOL, the Department of Justice, and Treasury. EPAPs and SEPAPs can be fashioned to clarify these roles, eliminating references to functions not actually expected of individual officials during the current fiscal year.

Policies and procedures locking these current practices into place are being developed, as requested by OMB. Most if not all of these topics are expected to be finalized by approximately August, 2018. DCI also expects that LMS, when complete, will provide greater transparency concerning Program decision-making, providing new tools for tracking accountability. LMS is expected to come online as early as the end of this calendar year.

**Responsible party(ies):** David Johnson, Acting Chief, DCI

**Target date:** EPAP/SEPAP modifications by November 30, 2017; policies and procedures by August 1, 2018.

**Recommendation 10.**

Implement a tracking process to ensure that loan guarantee conditions, including quarterly reporting, are monitored regularly.

**Response.** DCI concurs with Recommendation 10.

Tracking the progress of existing loans guaranteed or insured under the Program, for instance by assuring receipt of quarterly history reports, is currently complicated by staff shortages and a lack of Program software. Program guarantees and insurance can cover loans with terms as long as 30 years, meaning that current staff must monitor Program commitments made by other Department officials, sometimes many years before DCI took over responsibility. DCI is in the process of securing new software to simplify this task, and that is expected to vastly improve DCI's capacity to keep up with this need.

**Responsible party(ies):** David Johnson, Acting Chief, DCI

**Target date:** March 31, 2018

**Recommendation 11.**

Conduct an A-129 strategic program review within the current fiscal year, and conduct a review every 2 years or under such other timeframe as approved by OMB.

**Response.** DCI concurs with Recommendation 11.

DCI has solicited bids for an A-129 review, and is currently considering three proposals it has received in response. Assuming one of these is adequate to properly fill the need, we will have a kick-off meeting for the selected contractor on or before September 25, 2017.

DCI notes with interest that A-129 review compliance appears to be rare. Extensive inquiry among Department offices and other agencies has turned up very few examples of any sincere effort by other Federal organizations to meet this requirement. Even much larger organizations appear either never to have conducted a proper A-129 review, or else performed a review significantly reduced in scope to meet perceived financial, staffing, or time restrictions. DCI will nonetheless pursue compliance as directed.

DCI also notes that it had a review conducted in 2014-2015 by the Department's Office of Policy Analysis (OPA), which the Department pursued in lieu of an A-129 review at a time DCI was just about to solicit an outside A-129 review. Department officials at the time instructed DCI to terminate its solicitation of an outside review, to avoid the possibility of inconsistent conclusions when compared with OPA's review. OPA's review was briefed to OMB, but its written report was never finalized due to serious concerns about it.

**Responsible party(ies):** David Johnson, Acting Chief, DCI

**Target date:** December 31, 2017.

**Recommendation 12.**

Modify the performance measure to mitigate the incentive (to rush application reviews, sacrificing quality for quantity).

**Response.** DCI concurs with Recommendation 12.

DCI is in the process of evolving SEPAP and EPAP performance measures to further separate functions and responsibilities, heighten accountability, and allow for more objective year-end grading. Recommendation 12 has already been addressed to some extent in FY 2017 EPAPs and SEPAPs. With the benefit of OIG's Report, these standards will receive further refinement in the FY 2018 versions of these documents.

**Responsible party(ies):** David Johnson, Acting Chief, DCI

**Target date:** November 30, 2017.

**Recommendation 13.**

Work with the Office of the Solicitor to clarify DCI's authority and update the Program regulations.

**Response.** DCI concurs with Recommendation 13.

DCI has already consulted with SOL to learn who now has authority to sign Program commitments. DCI has also engaged in preliminary discussions about how best to restore signature authority to the level of DCI, and how to ratify 67 outstanding, unenforceable IFA commitments issued while DCI was unaware of the May 5, 2015 changes made to 110 DM 8. We are awaiting confirmation that our proposed

Secretarial Order (concerning a new delegation of authority) and ratification procedures (to be followed for each of the 67 unenforceable commitments) are acceptable, or if not, what should take their place.

DCI also has revised regulations written and prepared for renewed Department scrutiny, tribal consultation, OMB critique, public comment, refinement and finalization. Staff and work levels, including administrative distractions, are the only impediments to pursuing this task.

**Responsible party(ies):** David Johnson, Acting Chief, DCI  
John Hay, SOL  
Andrew Caulum, SOL  
Tim Murphy, SOL

**Target date:** March 31, 2018 for re-delegation of authority and commitment ratifications.

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## Appendix 4: Status of Recommendations

In response to our draft report, the Office of Indian Energy and Economic Development, Division of Capital Investment concurred with all 13 recommendations and stated that it was working to implement them. The response included target dates and an official for each recommendation (see Appendix 2). Based on this response, we consider 3 recommendations resolved and implemented, and 10 recommendations resolved but not implemented. We will forward them to the Office of Policy, Management and Budget to track their implementation.

Recommendations	Status	Action Required
1, 2, and 6	Resolved and implemented	No further action is required.
3-5, and 7-13	Resolved but not implemented	We will refer these recommendations to the Assistant Secretary for Policy, Management and Budget to track their implementation.

## **Report Fraud, Waste, and Mismanagement**



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