AUDIT REPORT

AUDIT OF THE ACCURACY OF THE FY 2015 DISASTER LOAN PROGRAM IMPROPER PAYMENTS RATE

FEBRUARY 13, 2018 **REPORT NUMBER 18-12**

EXECUTIVE SUMMARY

AUDIT OF THE ACCURACY OF THE FY 2015 DISASTER LOAN PROGRAM IMPROPER PAYMENTS RATE

Report No. 18-12

February 13, 2018

What OIG Reviewed

This report presents the results of our audit of the Small Business Administration's fiscal year (FY) 2015 improper payments rate for the Disaster Loan Program. The Improper Payments Elimination and Recovery Act of 2010 (IPERA) and related legislation require agencies to annually report statistically valid estimates of their improper payments, and Inspectors General to annually determine agency compliance with key criteria in the Act.

Our audit objective was to determine whether the FY 2015 estimated improper payments rate was accurate.

From July 1, 2014, to June 30, 2015, SBA made 11,491 disaster loan disbursements totaling $302.3 million. SBA tested a sample of 500 of those disbursements totaling $93.6 million for improper payments. Based upon its test results, SBA estimated that the FY 2015 Disaster Loan Program improper payments rate was 8.13 percent.

To evaluate the accuracy of this rate, OIG performed its own improper payments testing for a sample of 31 loan disbursements totaling $8.7 million from SBA's test sample of 500. We also met with SBA officials and staff to gain an understanding of the process the Office of Disaster Assistance used for its improper payments testing and obtained documents regarding its estimation process.

What OIG Found

SBA did not detect all improper payments when conducting improper payment reviews to estimate its FY 2015 rate for the Disaster Loan Program. Consequently, they understated the FY 2015 improper payments rate for the Disaster Loan Program. SBA reported improper payments of $24.6 million, or 8.13 percent, of the $302.3 million in disaster loans disbursed during the year. We determined the improper payment rate to be at least 9.89 percent, or $29.9 million. Our audit of a statistical sample of 31 loans identified 10 improper payments totaling $1,698,700, while SBA's review of the same loans resulted in 4 identified improper payments, totaling $650,200.

We found that SBA did not detect all improper payments when conducting its review because the review guidance used by Quality Control (QC) staff excluded relevant laws and regulations, the QC staff did not always follow the standard operating procedure, management overturned identified improper payments without clear justification, and QC staff disregarded relevant documents in the loan file if they were dated after loan disbursement. We also determined that SBA did not include all detected improper payments. As a result, SBA did not accurately report and assess the risk of improper payments related to the Disaster Loan Program, and therefore, could not establish appropriate reduction targets or properly implement corrective actions to reduce improper payments and enhance program integrity.

Our audit found one loan in the sample with fraud indicators that has been referred to OIG Investigations Division.

OIG Recommendations

We provided four recommendations to improve SBA's accuracy in reporting the estimated improper payments rate for the Disaster Loan Program.

Agency Response

SBA management agreed with three recommendations and partially agreed with one recommendation. Management has committed to implementing our recommendations related to the incorporation of Code of Federal Regulations requirements into improper payment test criteria, management override of improper payments, consideration of all documentation available during review, and ensuring that all identified improper payments are included in the final improper payment rate calculation.

U.S. SMALL BUSINESS ADMINISTRATION
OFFICE OF INSPECTOR GENERAL
WASHINGTON, D.C. 20416

Final Report Transmittal
Report Number: 18-12

DATE: February 13, 2018

TO: Linda E. McMahon
Administrator

FROM: Hannibal "Mike" Ware
Acting Inspector General

SUBJECT: *Audit of the Accuracy of the FY 2015 Improper Payments Rate for the Disaster Loan Program*

This report presents the results of our audit of the accuracy of the FY 2015 improper payments rate for the Disaster Loan Program.

We considered management comments on the draft of this report when preparing the final report. Management Agreed with three recommendations and partially agreed with one recommendation.

We appreciate the courtesies and cooperation extended to us during this audit. If you have any questions, please contact me at (202) 205-6586 or Andrea Deadwyler, Assistant Inspector General for Audits, at (202) 205-6616.

cc: James E. Rivera, Associate Administrator for Disaster Assistance
Althea Coetzee Leslie, Deputy Administrator
Pradeep Belur, Chief of Staff
Christopher M. Pilkerton, General Counsel
Martin Conrey, Attorney Advisor, Legislation and Appropriations
Timothy Gribben, Chief Financial Officer and Associate Administrator for Performance Management
LaNae Twite, Director, Office of Internal Controls

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Introduction

Disaster Loan Program

The mission of Small Business Administration's (SBA's) Office of Disaster Assistance (ODA) is to provide low interest disaster loans to businesses of all sizes, nonprofit organizations, homeowners, and renters to repair or replace real estate, personal property, machinery and equipment, inventory, and other business assets that have been damaged or destroyed in a declared disaster. Additionally, the Economic Injury Disaster Loan Program (EIDL) can provide up to $2 million of financial assistance (actual loan amounts are based on the amount of economic injury) to small businesses or private, nonprofit organizations that suffer substantial economic injury as a result of the declared disaster, regardless of whether the applicant sustained physical damage.

History of Improper Payments Legislation

Congress passed the Improper Payment Information Act of 2002 (IPIA) requiring agencies to annually review programs, estimate improper payments, and report on actions to reduce them. In 2009, the President issued Executive Order 13520 which required greater transparency and the development of a website that provides information about current and historical rates, targets for reducing improper payments, and accountable officials. Next, Congress passed the Improper Payments Elimination and Recovery Act of 2010 (IPERA). This Act expanded the 2002 Act by providing more guidance on risk assessment, requiring estimates to be statistically valid, and lowered the threshold for programs that must perform recovery audits to $1 million in annual outlays. It also required Inspectors General (IGs) to annually determine compliance with key criteria listed in the Act.

In 2012, Improper Payments Elimination and Recovery Improvement Act (IPERIA) was passed. IPERIA further expanded IPIA by requiring the Office of Management and Budget (OMB) to annually designate a list of "high priority programs" that are subject to additional reporting requirements and oversight by IGs. It also required OMB to determine current and historical recovery rates for improper payments, establish targets for recovery rates, and gave statutory authority to the "do not pay" initiative.

Definition of Improper Payments

OMB Circular A-123, Appendix C, *Requirements for Effective Estimation and Remediation of Improper Payments*, defines improper payments as any payments that should not have been made or that were made in an incorrect amount under statutory, contractual, administrative, or other legally applicable requirements. The Circular also states that incorrect amounts are overpayments or underpayments that are made to eligible recipients (including denials of payment or service, any payment that does not account for credit for applicable discounts, payments for an incorrect amount, and duplicate payments). An improper payment also includes any payment that was made to an ineligible recipient or for an ineligible good or service, or payments for goods or services not received (except for such payments authorized by law). In addition, when an agency's review is unable to discern whether a payment was proper as a result of insufficient or lack of documentation, this payment must also be considered an improper payment.

SBA's Disaster Assistance Improper Payments Testing Process

SBA identified the Disaster Loan Program as being susceptible to significant improper payments. As a result, SBA is required to annually review disaster loan disbursements and report improper payments in accordance with IPERA. To comply with these requirements, the ODA Quality Control (QC) supervisor develops preliminary test plans, and the QC staff, consisting of five staff members, conducts reviews of selected sampled disbursements for improper payments. In fiscal year (FY) 2015, the QC team reviewed 500 disaster loan disbursements (2 reviews of 250). In FY 2016, management revised the process to quarterly reviews, reducing the number of disbursements reviewed from 500 to 300, in an effort to reduce the burden on available resources.

Table 1: Disaster Loan Program Historical Improper Payment Rates

Fiscal Year	Reported IP Rate (%)
2007	0.55[1]
2008	0.74[2]
2009	20.9
2010	34.2
2011	28.4
2012	17.9
2013	18.4
2014	12.0
2015	08.1
2016	05.3

OIG Annual Evaluation of Improper Payments Reporting

OMB Circular A-123, Appendix C, *Requirements for Effective Estimation and Remediation of Improper Payments*, instructed Offices of Inspectors General (OIGs) to determine whether agencies were in compliance with IPERA. Since FY 2011, we have annually evaluated the compliance of ODA's improper payments reporting. The evaluation also includes a qualitative assessment of the Agency efforts to prevent and reduce improper payments.

Our reviews of the Disaster Loan Program indicate that the Agency has made significant improvements in its processes to prevent, detect, and correct improper payments since the advent of the review process. Due to resource constraints, OIG's annual evaluation of SBA's compliance with IPERA does not include a detailed assessment of the accuracy of the Agency's reported improper payment rate. Instead, OIG's annual evaluation primarily focuses on the internal processes and improper payments reporting requirements. Therefore, as we did in this audit, OIG sometimes conducts a more detailed audit to determine whether the Agency's controls to assess and report an accurate improper payment rate are effective.

[1] OIG determined the actual rate was 46 percent and $1.5 billion in Audit Report 9-10, *The Small Business Administration's Fiscal Year 2007 Improper Payment Rate for the Disaster Assistance Loan Program.*

[2] Based on OIG's finding in Audit Report 9-10 that the rate was 46 percent in FY 2007, we recommended that SBA recalculate the Disaster Loan Program's FY 2008 improper payment estimate and provide a corrected estimate to OMB. SBA responded that it would revise the FY 2008 estimate and disclose this in the FY 2009 AFR. However, SBA did not publish a corrected rate in the FY 2009 AFR.

Prior Work

A prior OIG Audit Report, *The Small Business Administration's Fiscal Year 2007 Improper Payment Rate for the Disaster Loan Program* (Report Number 9-10, March 26, 2009), found that SBA's Disaster Loan Program improper payment estimate for FY 2007 was not statistically valid and significantly understated the improper payment rate. SBA reported an improper payment rate of 0.55 percent, or $4.5 million of the $819.7 million in loans approved in FY 2007. OIG determined the improper payment rate to be at least 46 percent, or approximately $1.5 billion of $3.4 billion in loans disbursed, rather than approved, in FY 2007. SBA did not properly calculate the error rate in the sample or properly apply that rate in projecting the total value of improper payments. This occurred because SBA did not consult with a statistician, as required by OMB guidance. OIG made seven recommendations, including revision of sampling design methodology, consultation with a statistician, instructions for reviewers, implementation of a corrective action plan, and recalculation of both the FY 2007 and FY 2008 improper payments rates.

Objective

Our audit objective was to determine whether SBA's FY 2015 estimated improper payments rate for the Disaster Loan Program was accurate.

Finding 1: SBA's FY 2015 Improper Payments Rate for the Disaster Loan Program Was Inaccurate

We found that SBA did not detect all improper payments when conducting improper payment reviews to estimate its FY 2015 rate for the Disaster Loan Program. As a result, SBA understated the 2015 improper payments rate for the Disaster Loan Program. SBA statistically estimated and reported an improper payment rate of 8.13 percent, or $24.6 million, in its FY 2015 Agency Financial Report (AFR).[3] In contrast, OIG statistically estimated the improper payment rate to be at least 9.89 percent, or $29.9 million. Specifically, in our review of a sample of 31 loans, we identified 10 improper payments totaling $1,698,700, while the Agency's review of those same 31 loans identified 4 improper payments, totaling $650,200—a difference of $1,048,500.[4,5]

SBA did not detect all improper payments when conducting its review because the review guidance used by QC staff excluded relevant laws and regulations, the QC staff did not always follow the standard operating procedure (SOP) provisions, management overturned identified improper payments without clear justification, and QC staff disregarded relevant documents in the loan file dated after the loan was disbursed. We also found, during our review of the statistical projections, that SBA erroneously omitted 11 improper payments totaling $2,039,100 from its improper payment rate calculation. As a result, SBA was not able to accurately report and assess the risk of improper payments related to the Disaster Loan Program, and therefore, could not have established appropriate reduction targets or implemented corrective actions to reduce improper payments and enhance program integrity.

Table 2 outlines the improper payments OIG identified that were not detected by SBA and the sections that follow provide further details.

Table 2: Summary of OIG Identified Exceptions

Improper Payment Amount	Exception Description
$28,800	Ineligible use of proceeds
$200,000 $201,300	Lack of repayment ability
$158,800	Required building permit not in loan file
$21,000	Damage not related to disaster
$438,600	Agreement of Compliance not obtained for all contractors
$1,048,500	**Total Exception Amount**

Ineligible Use of Proceeds – Improper Payments Review Guidance Excluded Relevant Laws and Regulations

SBA provided EIDL funds to pay a business principal's delinquent property taxes on his personal residence. This disbursement did not comply with SOP 50 30 7, which defines economic injury as a

[3] SBA used disbursement data from July 1, 2014, through June 30, 2015, to estimate the FY 2015 Disaster Loan Program improper payments rate.
[4] We sampled 31 loans from the 500 loans that SBA reviewed.
[5] The OIG audit identified $1,048,500 (62 percent) more in improper payments for the 31 sampled loans than the Agency did.

change in the financial condition of a small business concern attributable to the effect of a specific disaster, resulting in the inability of the concern to meet its obligations as they mature, or to pay ordinary and necessary operating expenses. The SOP restricts EIDL loan amounts to working capital needed to return the business to normal operations. ODA staff stated that the loan was issued for this purpose because the SOP also permits loan proceeds to be used to repay stockholder loans due to hardship; therefore, they did not consider the disbursement improper. Additionally, ODA staff stated that payment of the delinquent property taxes was necessary to protect the loan collateral, so they increased the loan amount specifically to pay the principal's delinquent property taxes. However, the applicant was required to pay property taxes on his personal residence prior to loan approval.

ODA did not consider the Code of Federal Regulations (CFR) as criteria when evaluating this disbursement for improper payments.[6] We found that the disbursement conflicted with the following provisions of the CFR:

1. 13 CFR 123.303(b)(3): loan proceeds may not be used to pay any penalty resulting from noncompliance with a law, regulation or order of a Federal, state, regional, or local agency. The receipt for payment of the real estate taxes showed that the delinquent tax amount included a five percent penalty.

2. 13 CFR 123.303(a): economic injury loan proceeds can only be used for working capital necessary to carry the concern until resumption of normal operations and for expenditures necessary to alleviate the specific economic injury.

3. 13 CFR 123.19: SBA will only consider loan increase requests when the borrower can show that the increase is essential for the business to continue. Additionally, the increase must be based on events beyond the borrower's control that occurred after SBA approved the original loan.

Lack of Repayment Ability – QC Staff Did Not Always Follow SOP Provisions

During loan origination, the loan officer omitted a recurring installment payment from the repayment ability calculation and approved the loan. However, the loan officer should have included this payment and declined the loan for lack of repayment ability. During the improper payment review, the QC department did not consider the loan an improper payment because the borrower claimed that they had overtime pay and child support available to cover the installment payment. However, SOP 50 30 7 required a 2-year history of overtime pay and proper documentation of child support for inclusion in the repayment ability analysis. Although this criterion was not met, the loan was still approved, and the QC department did not identify it as improper.

SBA made another disbursement to a condominium association without reasonable assurance of its repayment ability. Although the association charged owners an assessment fee equal to the annual SBA loan payments, the loan officer significantly overstated this amount in the repayment ability analysis. Based upon the actual assessment amount, the borrower did not have sufficient cash flow to repay the SBA loan, as required by SOP 50 30 7. ODA acknowledged that the repayment analysis was lacking but did not consider this disbursement improper because the borrower was current on loan payments and the association had the ability to increase the assessment if needed.

[6] 13 CFR, Business Credit and Assistance, Chapter 1, Small Business Administration, Part 123, Disaster Loan Program.

Required Building Permit Not in Loan File – Management Overturned an Improper Payment Determination

For another loan, although the loan authorization and agreement stipulated that a building permit was required, SBA did not obtain one for a loan to make extensive structural repairs to a roof. The QC department and the Loan Processing Department agreed that this disbursement was an improper payment. However, ODA management directed the QC department to remove this disbursement and six others with building permit issues from the improper payments. This decision was not due to an appeal as defined in ODA Memorandum 11-08, *Quality Control Department Processes*. Management's reversing of improper payment determinations outside of the appeal process defined in the Memorandum impairs the integrity of ODA's improper payment review process.

Damage Not Related to the Disaster – QC Staff Did Not Consider Loan Documents Added After Disbursement Date

The QC department has a policy of only reviewing documents included in the loan file that are dated prior to date of the disbursement. As a result, they did not identify that a borrower received $21,000 to repair roof damage that did not occur as a result of the disaster. SOP 50 30 7 states that, generally, only property damaged or destroyed by a disaster is eligible for disaster loan financing. An independent engineering report asserting that the roof damage predated the disaster was provided to SBA after the disbursement, but SBA did not take actions to remedy the improper disbursement for roof repairs. The report was included in the loan file at the time of ODA's improper payments review, but the QC department did not review it because it was created after the date of the disbursement. This disbursement demonstrates that loan file documentation dated after disbursement may indicate an improper payment and should be considered in the Agency's improper payments review.

Agreement of Compliance Not Obtained for All Contractors – Management Instructions Conflicted With SOP 50 30 7

The QC department was instructed not to consider a disbursement an improper payment when the Agency did not obtain completed agreements of compliance from subcontractors that performed construction work exceeding $10,000 as required by SOP 50 30 7. SBA uses Form 601, *Agreement of Compliance*, to obtain assurance from borrowers and contractors performing construction work over $10,000 with Government funds that they will comply with Civil Rights and antidiscrimination laws as specified by Executive Order 11246. On a loan for construction work, SBA obtained an Agreement of Compliance from the borrower and primary contractor as required by the SOP that was in effect when the disbursement was made; however, it did not obtain agreements from seven subcontractors that each performed work exceeding $10,000. Based upon guidance from Headquarters management, the QC department determined that the absence of the subcontractors' Agreement of Compliance Forms was not an improper payment. Management believed that the primary contractor would enforce the Compliance Agreement terms with subcontractors.

ODA Omitted Improper Payments From Its Estimate

During our review of the statistical projections, we found that SBA erroneously omitted 11 identified improper payments totaling $2,039,100 from its improper payment rate calculation. OIG's statistician determined that 102 SBA sample items, containing 11 improper payments valued at $2,039,100, were excluded from SBA's improper payment estimate. Had SBA included these improper payments in its calculations, the rate reported would have been 8.8 percent, or $26.6

million. This omission represents a $2 million understatement of the published improper payment rate based on SBA's sample results.

Investigative Referral

One loan in our sample was referred to OIG Investigations Division because our review identified potential fraud.

Recommendations

We recommend that the Associate Administrator for Disaster Assistance:

1. Incorporate 13 CFR Section 123 requirements into the Disaster Loan Program improper payments rate test criteria and incorporate these into the QC review checklist to ensure consistent application.

2. Ensure that management does not override designated improper payments that have not been appealed as part of the process specified in ODA Memorandum 11-08, *Quality Control Department Processes*.

3. Issue supplemental guidance to emphasize to QC staff the importance of considering all documents in the loan file, and the SOP requirements related to repayment ability.

4. Ensure that future improper payment rate estimates are correctly computed using all improper payments identified in sampling.

Analysis of Agency Response

SBA management agreed with three of our recommendations and partially agreed with one. SBA plans full implementation of its corrective actions by July 2, 2018. Additionally, SBA management stated they do not agree with four of the six improper payments identified by the OIG and provided comments on three, which are summarized below. The Agency's response is included in its entirety in Appendix IV.

Ineligible Use of Proceeds - Improper Payments Review Guidance Excluded Relevant Laws and Regulations

Comment - Management disagreed with our finding that a disbursement of $28,800 to pay delinquent personal property taxes of the business principal for an EIDL constituted an improper payment. Management stated that this is not an ineligible use under SOP 50 30, which allows EIDL use of proceeds for working capital, accounts payable, and notes payable. Based on the eligible working capital calculation, management believes the principal demonstrated that these funds would have been earned if not for the disaster.

OIG Response - We disagree with SBA's premise that this disbursement did not constitute an improper payment. SBA approved the original loan on June 25, 2014, and modified the loan on September 11, 2014, to increase the amount by $28,800 specifically to pay a business principal's delinquent residential property tax. Per 13 CFR 123.19, an EIDL loan increase request may be approved if the increase is essential for the business to continue and is based on events that occur after original loan approval and are beyond the applicant's control. In this case, neither condition holds true. The business's ability to operate was independent of payment of the principal's personal property taxes, and those taxes were delinquent prior to original loan approval.

Required Building Permit Not in Loan File - Management Overturned an Improper Payment Determination

Comment - Management responded that "ODA management instructed the Quality Control supervisor to follow Standard Operating Procedures and guidance provided in the Improper Payment meeting minutes; management does not overturn or direct the removal of disbursements from the improper payment rate calculation." Management also stated that "the Quality Control Supervisor did not disclose to ODA management that the case file only contained a certification from the chief building inspector that a building permit was not required due to the roof repair not including structural work."

OIG Response - OIG reaffirms its position that a building permit was required due to significant structural roofing work. Since a building permit was not obtained, the disbursement remains an improper payment.

Damage Not Related to the Disaster - QC Staff Did Not Consider Loan Documents Added After Disbursement Date

Comment - Management responded that IPERIA does not permit the collection of missing or corrective loan documentation after the disbursement in question; therefore, the engineering report obtained after the disbursement should not impact the improper payment rate.

OIG Response - The engineering report, which provided evidence that the initial loss verification performed to support the disbursement was in error, was available at the time the QC department performed its review. Thus, the disbursement should have been considered an improper payment.

Summary of Actions Necessary to Close the Recommendations

This section provides the status of recommendations and actions necessary to close them.

1. **Resolved**. SBA management concurred with the recommendation and plans to incorporate 13 CFR 123 requirements into the Disaster Loan Program improper payment rate test criteria and incorporate these into the QC review checklist to ensure consistent application. This recommendation can be closed when SBA provides evidence that the QC checklist has been updated to incorporate 13 CFR Section 123 requirements.

2. **Closed**. SBA management partially agreed with the recommendation, stating ODA agrees that it is important to ensure that management does not override designated improper payments. However, management maintained that it did not act outside of the scope of ODA Memo 11-08 by overriding designated improper payments. Management stated it will continue to advise the QC department to strictly follow the relevant laws, regulations, policies, and procedures when making improper payment determinations. Although management's comments were responsive to the recommendation, their planned actions did not fully address the issues identified. The OIG will not pursue this issue through the audit resolution process, as we will have opportunities to assess SBA's adherence to this policy when we conduct our annual IPERIA reviews. OIG considers final action to be complete.

3. **Resolved**. SBA management concurred with the recommendation and plans to issue supplemental guidance to emphasize to QC staff the importance of considering all relevant documents contained in the loan file at the time of disbursement, as well as the SOP requirements related to repayment ability. This recommendation can be closed when SBA provides evidence that it has issued supplemental guidance to the QC staff.

4. **Resolved**. SBA management concurred with the recommendation and plans to ensure that future improper payment rate estimates are correctly computed using all improper payments identified in the sampling. This recommendation can be closed when SBA provides specific plans regarding how it will prevent this type of error from occurring in the future.

Appendix I: Objective, Scope, and Methodology

Our audit objective was to determine whether SBA's FY 2015 estimated improper payments rate for the Disaster Loan Program was accurate.

To answer our objective, we reviewed the Improper Payments Elimination and Recovery Improvement Act of 2012 and OMB Circular A-123, Appendix C, *Requirements for Effective Estimation and Remediation of Improper Payments* for improper payments guidance. We reviewed the Small Business Act Section 7(b), 13 CFR 123, and SBA's SOPs including 50 30 7, *Disaster Loan Program*, ODA numbered memoranda, and the business and home loan officer training guidance to determine compliance with Agency-specific guidelines in the determination of an improper payment.

We leveraged the internal control assessment performed during OIG evaluation report on SBA's FY 2015 progress in reducing improper payments. Detailed internal control testing was performed during that audit on the exact process from which sampling occurred in our audit.

- We met with the QC department prior to reviewing our audit sample. Additionally, we acquired documents from the OIG FY 2015 official evaluation work papers and obtained other needed documentation from the Program Policy & Evaluation Director and the QC department supervisor.

- We selected a statistical sample, using a statistical consultant, of 31 loan disbursements (totaling $8.7 million) occurring between July 1, 2014, and June 30, 2015, from a sample of 500 loan disbursements reviewed by SBA's QC department as part of its improper payment estimation process. SBA's 500 loan disbursements (totaling $93,574,000) were sampled from a universe of 11,491 loan disbursements between July 1, 2014, and June 30, 2015, totaling $302.3 million disbursed.

- We reviewed the loan disbursements using an OIG-designed review checklist based on ensuring compliance with Agency criteria stated above.

- We met with the QC supervisor at the completion of fieldwork to discuss results and to determine cause for differences in results between SBA and OIG.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

Use of Computer-Processed Data

We relied on information provided by ODA from SBA's Loan Accounting System, and documentation in the Disaster Credit Management System for loan disbursements occurring between July 1, 2014, and June 30, 2015. Previous OIG engagements have verified that the information maintained in these systems are reasonably reliable. Further, data elements associated with reviewed loans were verified against source documentation maintained in SBA loan files. As a result, we believe the information is reliable for the purposes of this audit.

Review of Internal Controls

SBA's internal control systems SOP provides guidance on implementing and maintaining effective internal control systems, as required by OMB Circular A-123.[7] OMB Circular A-123 provides guidance to Federal managers on improving the accountability and effectiveness of Federal programs and operations by establishing, assessing, correcting, and reporting on internal controls.[8]

We leveraged the assessment of internal controls performed during OIG's *Evaluation Report on SBA's FY 2015 Progress in Reducing Improper Payments* (Report Number 16-15, May 13, 2016).

[7] SOP 00 02, *Internal Control Systems* (January 1986).
[8] OMB Circular A-123, *Management's Responsibility for Internal Control* (July 15, 2016).

Appendix II: Sampling Results

Table 3: Improper Payments Comparison for Loan Disbursement Samples

Sample	Amount Disbursed	SBA IP Amount	OIG IP Amount	Difference
1	$22,000	$0	$0	$0
2	$28,800	$0	$28,800	$28,800
3	$39,800	$0	$21,000	$21,000
4	$40,300	$0	$0	$0
5	$42,200	$0	$0	$0
6	$64,200	$0	$0	$0
7	$67,000	$0	$0	$0
8	$70,800	$70,800	$70,800	$0
9	$72,200	$0	$0	$0
10	$74,600	$0	$0	$0
11	$86,794	$0	$0	$0
12	$137,000	$0	$0	$0
13	$200,000	$0	$0	$0
14	$154,300	$0	$0	$0
15	$154,900	$0	$0	$0
16	$158,800	$0	$158,800	$158,800
17	$161,500	$0	$0	$0
18	$162,700	$162,700	$162,700	$0
19	$166,700	$166,700	$166,700	$0
20	$177,100	$0	$0	$0
21	$179,400	$0	$0	$0
22	$200,000	$0	$200,000	$200,000
23	$188,100	$0	$0	$0
24	$201,300	$0	$201,300	$201,300
25	$246,500	$0	$0	$0
26	$250,000	$250,000	$250,000	$0
27	$316,000	$0	$0	$0
28	$438,600	$0	$438,600	$438,600
29	$633,100	$0	$0	$0
30	$2,000,000	$0	$0	$0
31	$2,000,000	$0	$0	$0
Totals	**$8,734,694**	**$650,200**	**$1,698,700**	**($1,048,500)**

Source: Generated from audit results.

Appendix III: Questioned Costs

Table 4: Questioned Costs for Loan Guaranty Purchase Samples

Sample	Disbursed Amount	OIG Questioned Costs
1	$22,000	$0
2	$28,800	$28,800
3	$39,800	$21,000
4	$40,300	$0
5	$42,200	$0
6	$64,200	$0
7	$67,000	$0
8	$70,800	$0
9	$72,200	$0
10	$74,600	$0
11	$86,794	$0
12	$137,000	$0
13	$200,000	$0
14	$154,300	$0
15	$154,900	$0
16	$158,800	$158,800
17	$161,500	$0
18	$162,700	$0
19	$166,700	$0
20	$177,100	$0
21	$179,400	$0
22	$200,000	$200,000
23	$188,100	$0
24	$201,300	$201,300
25	$246,500	$0
26	$250,000	$0
27	$316,000	$0
28	$438,600	$438,600
29	$633,100	$0
30	$2,000,000	$0
31	$2,000,000	$0
Totals	**$8,734,694**	**$1,048,500**

Source: Generated from audit results.

Appendix IV: Agency Comments

U.S. SMALL BUSINESS ADMINISTRATION
Washington, DC 20416

Date: January 29, 2018

To: Hannibal "Mike" Ware
Acting Inspector General

From: James E. Rivera
Associate Administrator
Office of Disaster Assistance

Subject: OIG Draft Report – Audit of the Accuracy of the FY 2015 Improper Payments Rate for the Disaster Loan Program
(Project No. 16803)

We have reviewed the OIG Draft Report. The objective of this audit was to determine whether SBA's FY 2015 estimated improper payments (IP) rate for the Disaster Loan Program was accurate. Thank you for the opportunity to respond to the Draft Report.

The mission of the SBA Disaster Loan Program is to help businesses of all sizes, private non-profit organizations, homeowners and renters recover from disasters and rebuild their lives by providing affordable and timely financial assistance. Consistent with the mission to provide affordable and expedient disaster assistance, SBA remains committed to providing disaster loan assistance quickly and effectively while working to prevent, detect and correct improper payments in the Disaster Loan Program.

OIG reviews of the Disaster Loan Program indicate that SBA has made significant improvements in its processes to prevent, detect, and correct improper payments since the advent of the review process.

In 2010, SBA reported an improper payment rate of 34.2 percent. SBA successfully reduced the rate in 2011 to 28.4 percent and again in 2012 to 17.9 percent. The rate increased slightly in 2013 to 18.4 percent but dropped again the following three years to 12 percent in 2014, 8.1 percent in 2015 and 5.3 percent in 2016.

SBA partially agrees with OIG's finding that SBA's FY 2015 Improper Payments Rate for the Disaster Loan Program was inaccurate.

The audit report finding states that SBA understated the improper payment rate of 8.13 percent, or $24.6 million, for FY 2015 because it did not detect all improper payments in its review of the Disaster Loan Program. The report statistically estimated the rate to be 9.89 percent, or $29.9 million. However, SBA does not agree with four of the six improper payments identified by OIG which would reduce the OIG's estimated rate and bring the recalculated rate closer to the SBA's original reported improper payment rate of 8.1 percent.

I. Ineligible Use of Proceeds – Improper Payments Review Guidance Excluded Relevant Laws and Regulations

The audit report identified an improper payment in the amount of $28,800 due to SBA provided EIDL funds to pay a business principal's delinquent property taxes on his personal residence. The OIG assertion that ODA did not consider the Code of Federal Regulations (CFR) as criteria when evaluating this disbursement for improper payments is incorrect. ODA improper payment audit guidelines are defined in ODA Memorandum 11-08, *Quality Control Department Processes* as the following:

> *"An Improper/Erroneous payment is defined as a loan approval that does not meet the underwriting/eligibility requirements as contained in SOP 50 30 or as amended by a numbered memorandum or a disbursement that has been made and is not in compliance with SOP 50 30 or as amended by a numbered memo."*

As stated above, SOP 50 30 underwriting guidelines determines whether a loan is an improper payment. All SOP 50 30 policies are based on the Small Business Act, CFR and prudent lending standards. Although the EIDL funds were used to pay property taxes, this use is not ineligible under SOP 50-30 that allows EIDL use of proceeds for working capital, accounts payable and notes payable. Based on the eligible working capital calculation, the principal illustrated these funds would have been earned if not for the disaster.

II. Required Building Permit Not in Loan File – Management Overturned an Improper Payment Determination

The audit report identified an improper payment in the amount of $158,800 due to required building permit not in the loan file. The report incorrectly claims that the disbursement was omitted from the improper payment rate calculation at the direction of ODA management; this is not accurate. It should be noted that the Processing and Disbursement Center Director requested through ODA management that the building permit issue be re-reviewed. In the process of its review, the QC supervisor requested guidance from ODA management on the IP determination; however, ODA management did not overturn or instruct QC to omit the improper payments.

<u>ODA management instructed the Quality Control supervisor to follow Standard Operating Procedures and guidance provided in the Improper Payment meeting minutes; management does not overturn or direct the removal of disbursements from the improper payment rate calculation.</u>

On two separate occasions, ODA management directly advised and instructed the Quality Control supervisor to follow SOP 50 30 guidance regarding building permits and to use the July 24, 2013 biweekly Improper Payment meeting minutes as further SOP policy clarification. These IP meetings allow the interpretation of ODA policy, in order to make a determination based on what is an improper payment. In an email dated July 29, 2015, ODA management stated the following, *"…the attached IP meetings [minutes] is the policy that QC must use to conduct the IP audit. And, that said, all issues pertaining to building permits must be followed under the SOP and the IP meetings clarification…all building permit IP exceptions where the borrower obtained a permit should also be removed."* Approximately one month later, on August 31, 2015, the QC supervisor again asked ODA management if the building permit improper payments should be removed as IPs. ODA management responded, *"…based on the July 2013 IP meeting's minutes (attached), the files reflected in [sample] #s 20, 23, 28 and 41, have a building permit that is not for debris removal, thus, all should be removed."* The QC department decision to reverse its original improper payment determination was based on a review of the IP meeting minutes building permit clarification and an incorrect assertion (entered in QC audit work papers) that the case file contained an original building permit. The QC supervisor did not disclose to ODA management that the case file only contained a certification form the chief building inspector that a building permit was not required due to the roof repair not including structural work.

III. Damage Not Related to the Disaster – QC Staff Did Not Consider Loan Documents Added After Disbursement Date

The audit report identified a disbursement of $21,000 for roof repair as an improper payment because an independent engineering report completed more than 10 weeks after the disbursement showed that the roof damage was pre-existing and did not result from the disaster. SBA's improper payment review takes into consideration all of the loan documents that are available at the time of disbursement. Loan documents obtained after the disbursement should not be considered as part of the improper payment review. The *Improper Payments Elimination and Recovery Improvement Act (IPERIA)* does not permit the collection of missing or corrective loan documentation after the disbursement in question; therefore, the subsequent documents obtained after the disbursement should not impact the improper payment rate.

OIG Recommendations and Agency Response

1) *OIG recommends that ODA incorporate 13 CFR Section 123 requirements into the Disaster Loan Program improper payments rate test criteria and incorporate these into the QC review checklist to ensure consistent application.*

   ODA Response: ODA agrees with the recommendation to incorporate 13 CFR Section 123 requirements into the Disaster Loan Program improper payments rate test criteria and incorporate these into the QC review checklist to ensure consistent application.

2) *OIG recommends that ODA ensures that management does not override designated improper payments that have not been appealed as part of the process specified in ODA Memorandum 11-08, Quality Control Department Processes.*

   ODA Response: ODA partially agrees with the recommendation; ODA already agrees on the importance to ensure that management does not override designated improper payments; however the report based this determination on an incorrect assumption without obtaining documentation from ODA management. ODA maintains that it does not override designated improper payments; ODA management will continue to advise the Quality Control Department to strictly follow all relevant laws, regulations, policies and procedures when making improper payment determinations.

3) *OIG recommends that ODA issue supplemental guidance to emphasize to QC staff the importance of considering all documents in the loan file, and the SOP requirements related to repayment ability.*

   ODA Response: ODA agrees with the recommendation to issue supplemental guidance to emphasize to QC staff the importance of considering all relevant documents contained in the loan file at the time of disbursement, and the SOP requirements related to repayment ability.

4) *OIG recommends that ODA ensures that future improper payment rate estimates are correctly computed using all improper payments identified in sampling.*

   ODA Response: ODA agrees with the recommendation to ensure that future improper payment rate estimates are correctly computed using all improper payments identified in sampling.