

STATEMENT OF

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BEFORE THE

**SUBCOMMITTEE ON GOVERNMENT MANAGEMENT,
FINANCE, AND ACCOUNTABILITY OF THE
COMMITTEE ON GOVERNMENT REFORM,
UNITED STATES HOUSE OF REPRESENTATIVES**

CONCERNING A HEARING ENTITLED:

**“AFTER KATRINA: THE ROLE OF THE DEPARTMENT OF JUSTICE
KATRINA FRAUD TASK FORCE AND AGENCY INSPECTORS GENERAL IN
PREVENTING WASTE, FRAUD, AND ABUSE”**

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Introduction:

- I appreciate the Subcommittee's invitation to speak about our oversight of the Small Business Administration's disaster relief effort for the victims of the 2005 Gulf Hurricanes. Although the destruction of the Gulf Hurricanes has been widely reported, it is difficult to truly understand the impact of these storms until you have actually visited and seen the affected areas. I recently visited the Gulf Area, and I can tell you that the extent of the devastation is almost beyond comprehension.

- Inspector General Oversight Will Be Needed. It is clear that a massive effort by governments and the private sector will be needed for many years to come. Given the level of expenditures that will be directed at rebuilding the lives, infrastructure, and economy of the Gulf Area, the Inspector General community will play a vital role in controlling wasteful expenditures, overseeing agency management, and detecting and prosecuting wrongdoers who try to take advantage of this disaster by committing fraud to improperly obtain benefits or contracts.

- Oversight of SBA's Disaster Program is a Top Priority. One of my highest priorities is to conduct effective, aggressive, and proactive oversight of the extensive SBA disaster relief efforts. One of my first actions is the establishment of an office in New Orleans so that we are on the ground near the devastated areas where the brunt of the rebuilding effort will occur. We are in the final steps of hiring additional investigators and auditors to staff this office, using supplemental appropriations that became available at the end of January. I will discuss our ongoing and planned audit and investigations in greater detail below. But first, I would like to quickly summarize the SBA's disaster assistance mission for those who may not be familiar with this program.

Overview of Disaster Loan Program:

- SBA Disaster Loan Program is Vulnerable to Fraud and Losses. SBA makes direct loans to victims of natural and man-made disasters to assist with long-term recovery needs. Loans are made at a low interest rate, generally less than 4 percent, with generous repayment terms, which can last up to 30 years. By law, SBA is authorized to make two types of disaster assistance loans in this kind of disaster scenario: (1) physical disaster loans to homeowners, renters, businesses, and nonprofit organizations, which fund permanent rebuilding and replacement of uninsured real and personal property; and (2) economic injury disaster loans, which provide necessary working

capital to small businesses until normal operations can be resumed after a disaster. The SBA disaster program is especially vulnerable to fraud and unnecessary losses because loan transactions have been expedited in order to provide quick relief to disaster victims. Given the vast amount of money that SBA is making available, and the pressure that has been directed at the Agency to get the money out quickly, we anticipate that this vulnerability will be greatly exacerbated.

- SBA Unprepared for Scope of Gulf Hurricanes. SBA was not prepared for a disaster on the scale of the Gulf Hurricanes (although I am not sure how any Federal agency could have been prepared for what I saw). Indeed, Hurricane Katrina could not have come at a worse time for the Agency. In August, 2005, just before Katrina hit, the Agency initiated a major reorganization of the disaster office, revising and consolidating the functions of all offices. At the same time, SBA was just introducing a new computer system, called the Disaster Credit Management System, to process loans electronically and transfer loan data between offices. The system had never been used in a significant disaster and, as discussed below, was not originally configured to accommodate the vast numbers of employees and loan applications that were needed for a disaster of this magnitude.

- Significant Agency Response. Despite significant obstacles, the Agency appears to have responded well to many of the challenges of this relief effort. Between the beginning of September through November, SBA hired over 3,300 employees to work on the disaster relief effort, more than SBA's entire workforce prior to Hurricane Katrina. The Agency has received more than 414,000 applications for disaster loans and has approved over 136,000 loans totaling almost \$9 billion. To date, SBA has approved almost \$1.9 billion in business disaster loans and almost \$7 billion have been approved for homeowners and renters. In addition, close to \$400 million in loans have been approved for businesses in the Gulf Area through SBA's 7(a) loan guarantee and 504 programs.

- In comparison, in response to the Northridge Earthquake in 1994, which was the biggest disaster relief effort the Agency had faced prior to the Gulf Hurricanes, SBA made approximately \$4 billion in disaster loans. In only two other disasters had SBA made more than \$1 billion in disaster loans: the September 11, 2001 terrorist attacks and the Florida hurricanes of 2004.

- Delays in Disbursement. Although SBA has approved close to \$9 billion in disaster loans for the Gulf Hurricane victims, it has disbursed only slightly more than a billion dollars. We are

looking into whether agency inefficiencies are contributing towards delays in the disbursement process. However, it is important to note that the Agency has a number of important controls in place to protect against fraud and waste, which necessarily delay the disbursement of disaster loans. For example, loans for physical damage are generally not disbursed until the borrower can show that the necessary building permits have been obtained and a contractor has been lined up to do the work. Disbursements are then generally made incrementally based upon submission of contractor invoices for completed work by the borrower. The shortage of available contractors and any delay in local government issuance of permits are factors that are beyond SBA's control. Obtaining flood insurance is also a prerequisite to loan disbursement. Since many of the borrowers are still in the basic process of putting their lives together, moreover, it may not be to their benefit to start drawing on the loans until they are in a position to begin actual construction. Because once that money is disbursed, the clock starts ticking on when they have to begin paying back the loan, and interest accrues on the disbursed amounts.

- OIG's Long-Term Planning. I should note some important differences between SBA's long-term disaster relief program and other Federal programs. Many other agencies have already issued the contracts and grants, or will have completed much of their efforts in the months to come. However, the delays in the disbursement of SBA disaster loans, and the fact that borrowers will not be obligated to begin repaying their disaster loans until a year after disbursement, mean that a great deal of fraudulent borrower conduct may not come to light for a long time. Similarly, agency loan processing and servicing errors may not be detected for quite a while. Thus, although we have initiated a number of reviews and proactive investigatory efforts, the SBA OIG has also developed a long-term plan to guide its oversight of SBA's disaster relief.

Summary of OIG Actions:

- Inter-Agency Coordination and Cooperation. You have asked me to address the level of coordination between the various offices of Inspectors General in the recovery and rebuilding efforts. Although I only recently joined SBA, my staff has advised that the collective response of the Inspectors General has been extremely well coordinated. We are participating in the President's Council on Integrity and Efficiency (PCIE) and Executive Council on Integrity and Efficiency (ECIE) Homeland Security Roundtable. Under the leadership and coordination of Rick Skinner at the Department of Homeland Security (DHS), the PCIE/ECIE Roundtable is coordinating the Inspector General efforts and sharing information to aggressively respond to potential fraud, waste, and abuse issues in the Gulf Coast region. More importantly, based upon

the accumulated knowledge and previous experience in identifying internal control weaknesses and fraud schemes in agency programs, the IG community is uniquely positioned to ensure that agency activities and funds are utilized as effectively as possible. Reporting to Congress and the public on Inspector General efforts has been consolidated and well organized, and the IG community has established effective lines of communication to eliminate and coordinate overlapping and duplicative efforts where they arise.

- Work With DHS OIG on Interaction of SBA and FEMA Computer Systems. For example, we have been working with the DHS Office of Inspector General to coordinate our review of the interaction between SBA's Disaster Computer System and the Federal Emergency Management Agency (FEMA) System. Although applications for business disaster loans can be submitted directly to SBA, all applicants for SBA home disaster loans must register with FEMA first. The SBA and FEMA computer systems have been designed to "talk" to one another; when someone registers with FEMA for assistance, they are automatically referred to SBA. A disaster loan application is then mailed to the victim.

- Issuance of Advisory Reports Addressing Problems Found. Our work with DHS has identified a number of problems with the interface between these two systems. Deficiencies in communications between the systems, or agency failure to promptly correct errors, have resulted in delays in providing disaster assistance to needy victims. Additionally, problems with data requested by the FEMA system resulted in an excessive number of referrals to SBA and applications being mailed to victims, which resulted in the expenditure of unnecessary resources. We have issued a series of advisory reports to the Agency, discussing these concerns. Rather than issuing extensive audit reports, our intent has been to bring these concerns quickly to the Agency's attention so that problems can be resolved, thereby expediting delivery of disaster assistance to those in need. These reports are available on the OIG website which is accessible through the Agency's main webpage, www.sba.gov/ig.

- Effectiveness of Hurricane Katrina Fraud Task Force. You have also asked for our opinion as to the importance and assistance of the Department of Justice multi-agency Hurricane Katrina Fraud Task Force. By establishing the Task Force, the Attorney General has signaled that prosecutions resulting from fraud investigations in the Gulf Coast region will be a high priority. The Task Force has established a centralized case management system to track all hurricane related investigations, reduce duplicative efforts, and identify fraud trends. By creating this

tracking system, and establishing a focal point of investigative representatives at the Baton Rouge operations center, the Department of Justice Katrina Task Force has developed an effective structure to investigate these fraud cases.

- Current Investigations of Fraud and Wrongdoing. SBA OIG has investigated -- and is currently investigating -- multiple allegations of wrongdoing related to the Gulf Hurricanes. Thus far, allegations involve claims for property damage that never occurred or for property not owned by the borrower during the disaster; false statements about prior criminal records; wrongful collection of FEMA payments while applying for an SBA loan; attempted bribery of SBA officials; misuse of SBA loan funds for gambling or other unauthorized purposes; and overstatements of financial loss. We have referred several cases to the Department of Justice for criminal prosecution and have other investigations underway.
- Integrity in Small Business Contracting. One of the significant issues facing the enormous Federal procurement activity in the Gulf Area is ensuring that small businesses are given adequate contracting opportunities. Further, to ensure integrity in small business contracting, it is vital that contracts reserved for small firms are not actually performed by large businesses. We are working with other agency OIGs on this issue. We have developed and issued to other OIGs a guide on small business procurement requirements for their use in auditing agency compliance with contracting requirements. We have also coordinated with the Government Accountability Office on their recently-initiated review of small business procurement in the Gulf region.
- Reviews of SBA Disaster Computer System. We are also conducting an overall review of SBA's Computer System for the Disaster Program in addition to the review of the system's interaction with FEMA's system, discussed above. SBA's system was designed to accommodate 1,500 employees involved in processing SBA disaster loans. Our review noted that, initially, the system was overwhelmed and would repeatedly be inoperative because there were too many users on the system, among other reasons. SBA then took steps to stabilize its system.
- OIG Will Continue to Monitor the Upgrade of the System. Since the Gulf Hurricanes, SBA has upgraded the system -- and employed multiple shifts -- to be able to support a total of 4,000 users. SBA has also announced that it plans to implement a significant hardware and software upgrade to support 7,000 or possibly more users. The OIG is carefully reviewing the upgrade of this system to ensure that the system will function correctly for this many users, will meet

Federal requirements, and is developed and implemented in a controlled manner. In a recent advisory report, we determined that SBA's plan to upgrade the computer system did not include a review of security requirements that is mandated by Federal information system guidelines.

- Work With HUD and FEMA to Identify and Prevent Duplicative Benefits. As another example of interagency cooperation, through the PCIE/ECIE Homeland Security Roundtable, we are working with the Inspector General Offices from DHS and the Department of Housing and Urban Development (HUD) to develop a system to identify individuals who may have received duplicative benefits. The Stafford Act directs the Federal Government to reduce duplicative payments to disaster victims so people are not provided more assistance than they need. SBA regulations require that the amount of a disaster home loan be reduced by any insurance payment, grant or other compensation. We are coordinating efforts to develop an information sharing program, within applicable legal requirements, to identify individuals who have received both an SBA disaster home loan and a HUD or FEMA grant. Matches will be reviewed to determine whether the homeowner has accurately disclosed the HUD or FEMA grant to SBA and whether the amount of SBA's loan has been appropriately reduced. As an example of one of the proactive measures we are undertaking to identify applicant fraud, we will investigate borrowers that appear to have falsely certified that they have not received a grant or other assistance, and refer these cases for prosecution, where appropriate.

- Oversight of SBA Disaster Loan Operations. The Office of Inspector General also has an ongoing review of the Agency's disaster loan approval and disbursement process to determine if disaster loans are being processed and disbursed in a timely and sound manner. In addition, the OIG is looking at external impediments, such as local governments and other Federal requirements that may unduly delay disaster loan funds that home and business borrowers need to initiate the rebuilding process. We will also review the Agency's loss verification process, the modification and servicing of disaster loans, loans that experience an unusually early default to assess whether adequate underwriting was employed, and SBA's liquidation of loans after they have gone into default to examine whether sufficient resources are being allocated to ensure a sufficient recovery of taxpayer dollars.

- Proactive Investigatory Efforts. In addition to the duplication of payments initiative discussed above, we have also initiated several proactive projects to identify fraudulent conduct by disaster borrowers. One project is designed to identify borrowers who submit false statements on their SBA applications for disaster assistance business loans relating to past

criminal records. It is SBA's policy that individuals with poor character, such as those who have committed felonies and other crimes, not receive disaster loan assistance. Applicants for loans are required to disclose whether they have any criminal background. We have initiated a program of conducting criminal history checks on a statistical sample of disaster loans to determine whether applicants have made false statements regarding their background.

- A second project is a joint effort with the DHS OIG and other OIGs to identify applicants for disaster assistance loans who did not reside in the affected areas during the Gulf Hurricanes. Initial steps include verifying employment records of certain subjects and examining names of persons currently residing in Texas who have applied for SBA and/or FEMA hurricane assistance for losses allegedly incurred in other states. We have also initiated a program to review SBA's data of hurricane-related disaster assistance loans to proactively identify potential fraud in disaster loans. Fraud indicators will be similar to those used by an SBA OIG group examining regular business loans. Where indicators exist, we will investigate and bring to prosecution culpable parties.

Additional OIG Activities:

- Background Investigations. The SBA OIG's Office of Security Operations (OSO) has conducted background investigations on thousands of employees who have been hired for SBA's loan processing and operations for the Gulf Hurricanes disasters. The OSO has also conducted name checks and FBI fingerprint checks on hundreds of borrowers whose disaster loan applications indicated a criminal history. The results of these checks are reported to SBA program officials for character eligibility determinations.
- Fraud Awareness Briefings. The SBA OIG has provided fraud awareness information briefings to numerous SBA disaster employees, and OIG fraud hotline posters were disseminated throughout SBA field disaster centers in the Gulf states so that SBA officials and the public could readily report fraud.

Conclusion:

- What Additional Steps Can Congress Take. You have also asked for our views on whether Congress needs to take additional action to support the Inspector General Community. In light of the significant Federal resources being devoted to the recovery and rebuilding effort, Inspector General oversight will be critical to deter and prosecute fraud and identify and prevent agency

inefficiencies. Congress needs to ensure that OIGs receive adequate resources to allow them to undertake effective and necessary oversight. We are grateful for the supplemental appropriations that were provided for the SBA Office of Inspector General. We will use those funds effectively and will produce notable results. Although some have called for the appointment of a special Inspector General to oversee the recovery effort, we believe that the high level of cooperation and coordination in the IG Community that has taken place to date should alleviate any such concerns. Frankly, the existing Inspector General Offices have the greatest expertise and understanding of the various Federal disaster assistance programs. Establishing a new oversight authority with personnel that are not familiar with these programs will not likely expedite OIG efforts or produce a higher level of accountability. Indeed, for over 27 years, the Inspectors General have exhibited a high level of professionalism and accountability. The IG Community will continue to meet these high standards in its current oversight of the recovery effort.

- Thank you for the opportunity to comment. I look forward to answering any questions that you may have.