

AUDIT REPORT

AUDIT OF SBA'S DESKTOP LOSS VERIFICATION PROCESS





EXECUTIVE SUMMARY

AUDIT OF SBA'S DESKTOP LOSS VERIFICATION PROCESS

Report No.
19-23

September
26, 2019

What OIG Reviewed

This report presents the results of our audit of the Small Business Administration's (SBA's) desktop loss verification process. Loss verification is used to estimate and validate the cost of restoring disaster-damaged property to its pre-disaster condition. In the past, loss verifiers conducted damage assessments solely through on-site inspections. However, in January 2017, SBA implemented the desktop loss verification process to expedite assistance to disaster survivors.

The desktop loss verification process uses a two-pronged approach: an initial desktop verification used to estimate the cost of repairs and a post desktop review (PDR) used to validate the estimates provided from the initial verification. For loans \$25,000 or less, SBA's loss verifiers can conduct a PDR using information from the Federal Emergency Management Agency's (FEMA's) on-site inspection reports. If FEMA did not perform an on-site inspection, SBA must conduct its own on-site inspection or use acceptable documentation submitted by the applicant to validate the initial desktop estimates. Beginning June 1, 2018, SBA established that loans \$25,000 or less must have a PDR prior to any disbursement. For loans approved for greater than \$25,000, the borrower may receive up to \$25,000 prior to having a PDR. However, SBA's loss verifiers must conduct on-site inspections prior to any subsequent disbursement exceeding \$25,000.

Our objective was to assess the desktop loss verification process. To answer our objective, we interviewed SBA personnel from the Office of Disaster Assistance, the Disaster Verification Center, and the Processing and Disbursement Center. We also reviewed applicable policies and procedures. Additionally, we reviewed statistical samples from the 73,313 home loans approved for presidentially declared Hurricanes Harvey, Irma, and Maria, totaling \$1.4 billion from August 25, 2017, through June 30, 2018.

What OIG Found

The desktop loss verification process contributed to SBA meeting its timeliness goals for processing disaster loan applications for Hurricanes Harvey, Irma, and Maria. However, controls needed

strengthening to mitigate the risk of fraud and ensure program integrity for the loss verification process. Specifically, SBA did not always validate the cause and extent of damages and repair and replacement costs prior to disbursing loan funds. Further, SBA inappropriately relied on FEMA reports that did not contain pertinent information to validate damages and losses reported in the initial loss verification, and loan files did not contain sufficient documentation to support loan-making decisions.

As a result, SBA disbursed 36,869 of the 73,313, or 50 percent, loans included in our scope, totaling \$594,286,878 of \$1.4 billion, without validating the cause and extent of damages, and there was no assurance that disaster loans were only provided to individuals impacted by Hurricanes Harvey, Irma, or Maria.

OIG Recommendations

We recommended that SBA update its Disaster Credit Management System procedures to coincide with its policies to conduct after loan approval and prior to disbursements; establish controls to ensure PDRs are conducted for all approved loans \$25,000 or less prior to any disbursements of funds; ensure tools or methods used to substitute SBA on-site inspections for PDRs contain appropriate and sufficient information to validate the damages, losses, and estimated repair and replacement cost obtained during the initial desktop loss verification; and implement controls to require loss verifiers to provide sufficient documentation to support their PDR conclusions.

Agency Response

Management partially agreed with recommendations 1 and 2 and agreed with recommendations 3 and 4. Management's planned actions resolved recommendations 3 and 4. Management plans to explore substitutes to the PDR and ensure they contain the information needed to support the damages estimated during the initial desktop loss verification. Further, management stated that it will implement additional controls to require loss verifiers to provide documentation that sufficiently supports the PDR conclusions. While SBA partially agreed with recommendations 1 and 2, its proposed actions did not fully address them.




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

Final Report Transmittal
Report Number: 19-23

DATE: September 26, 2019

TO: Christopher M. Pilkerton
Acting Administrator and General Counsel

FROM: Hannibal "Mike" Ware 
Inspector General

SUBJECT: Audit of SBA's Desktop Loss Verification Process

This report presents the results of our audit on the Small Business Administration's (SBA's) desktop loss verification process. We considered management's comments on the draft of this report when preparing the final report. Management partially agreed with recommendations 1 and 2 and agreed with recommendations 3 and 4.

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.

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Introduction

The Small Business Administration's (SBA's) disaster loan program is the federal government's primary federal assistance program for providing disaster assistance to homeowners and renters who suffered damages from declared disaster events. SBA provides low-interest loans for up to \$200,000 to repair or replace homeowners and renters' primary residence to its pre-disaster condition and up to \$40,000 to repair or replace personal property.

Loss Verification Process

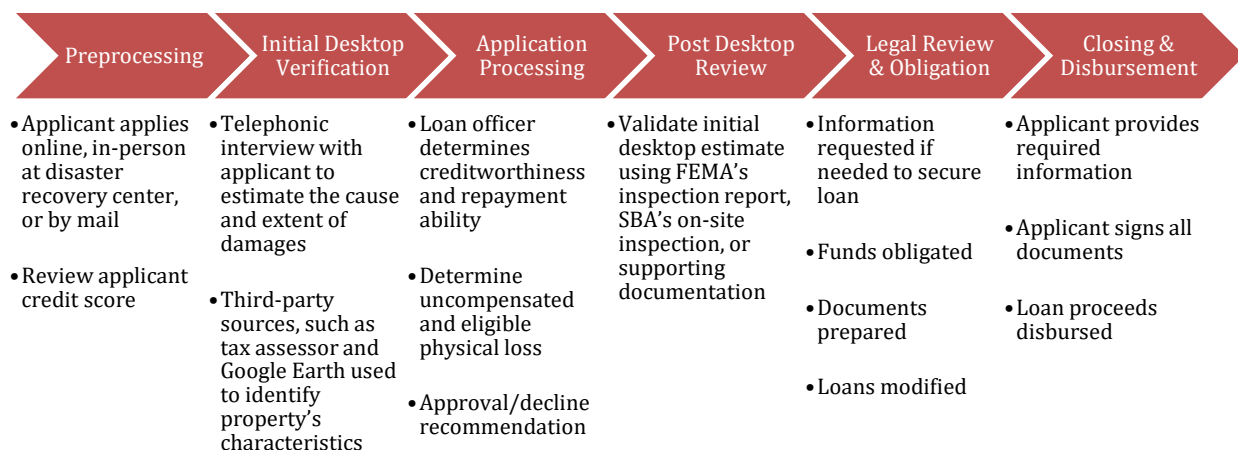
A critical part of the disaster loan-making process is evaluating the cause and extent of property damages, which provides SBA the information necessary to make appropriate decisions when establishing eligibility for disaster loan funds. In the past, loss verifiers conducted damage assessments solely through on-site inspections. However, in January 2017, after increased use of electronic loan applications, SBA implemented the desktop loss verification process to expedite assistance to disaster survivors.

The desktop loss verification process uses a two-pronged approach: an initial desktop loss verification and a post desktop review (PDR). The initial desktop loss verification is used to estimate the cost of repairs. Information is gathered and evaluated through telephonic interviews with applicants in conjunction with third-party information, such as tax assessors' websites, Google Earth, and Zillow. Following the initial desktop loss verification, SBA requires a PDR to validate the total damage estimates obtained from the initial desktop loss verification, as follows:

- For loans less than or equal to \$25,000, SBA's loss verifiers can conduct a PDR using information from the Federal Emergency Management Agency's (FEMA's) on-site inspection reports. If FEMA did not perform an on-site inspection, SBA must conduct its own on-site inspection. If an on-site inspection is not possible, the loss verifier may use acceptable documentation submitted by the applicant to validate the initial desktop estimates. Beginning June 1, 2018, SBA established that loans less than or equal to \$25,000 must have a PDR prior to any disbursement.
- For loans greater than \$25,000, applicants may receive up to \$25,000 prior to any PDR. However, SBA's loss verifiers must conduct on-site inspections prior to any subsequent disbursement exceeding \$25,000.

PDRs validate (1) that the correct damaged property address was verified, (2) that damages discussed are equivalent to the initial desktop loss verification damages allowed, (3) that the property was occupied at the time of the disaster, (4) the property type, (5) the property square footage, and (6) the damage description such as water entry, depth and duration, wind, fire, etc. See figure 1 for a summary of SBA's disaster loan process.

Figure 1: SBA’s Disaster Loan Process



Home Loans Approved for Hurricanes Harvey, Irma, and Maria

SBA approved 73,313 home loans, totaling \$1.4 billion (current loan amount), for presidentially declared disasters Hurricanes Harvey, Irma, and Maria from August 25, 2017, through June 30, 2018. (See table 1.)

Table 1: SBA-Approved Loans for Hurricanes Harvey, Irma, and Maria, August 25, 2017–June 30, 2018

Loans Approved for \$25,000 or Less	Loans Approved for More Than \$25,000, but Modified to \$25,000 or Less	Loans Approved for Less Than \$25,000, but Modified to Greater Than \$25,000	Total Approved Loans
46,322	25,746	1,245	73,313

Prior Work

SBA OIG 18-09, Audit of RISE Act Eligibility Controls (January 19, 2018). This report found that SBA did not establish controls to ensure that loss verifiers obtained documentary evidence of incurred costs prior to RISE Act loan approval when real estate already had been repaired. For 6 of 26 loans we reviewed, loss verifiers did not obtain receipts, invoices, and other documentation of incurred costs needed to support damage claims. When projecting these results to the population of 640 disbursed loans, we estimate that proper controls were not applied to ensure that approximately 63 loans and disbursements of approximately \$415,579 were awarded in accordance with program requirements. As a result, SBA approved loans without sufficiently verifying damages and determining eligible loan amounts. We also found that 5 of 26 RISE Act disaster loans reviewed, totaling \$1,714,110, contained ineligible disbursements due to wrongful acts by borrowers or errors in loan processing.

GAO 14-760, Additional Steps Needed to Help Ensure More Timely Disaster Assistance (September 29, 2014). This report found that SBA did not meet its 21-day processing time goal for Hurricane Sandy business loan or economic injury disaster loan (EIDL) applications. SBA took an average of 45 days to process physical business loan applications and 38 days for EIDL applications. SBA stated that it was challenged by an unexpectedly high volume of loan applications received early in its response to the disaster, and by technological difficulties. The Government Accountability Office recommended that SBA revise its disaster planning documents and take steps to implement previously authorized private sector disaster loan programs.

Objective

Our objective was to assess the desktop loss verification process.

What We Found

The desktop loss verification process contributed to SBA meeting its timeliness goals for disaster loan applications for presidentially declared Hurricanes Harvey, Irma, and Maria. However, controls needed strengthening to mitigate the risk of fraud and ensure program integrity for the loss verification process. Specifically, SBA did not always validate the cause and extent of damages and repair and replacement costs prior to disbursing loan funds. Further, SBA inappropriately relied on FEMA reports that did not contain pertinent information needed to validate damages and losses reported in the initial desktop verification, and loan files did not contain sufficient documentation to support loan-making decisions.

These conditions occurred because although SBA recognized that the loss verification report and information gathered during the PDR were critical to establish eligibility and validate damages, it did not explicitly require that PDRs be conducted on loans \$25,000 or less prior to any disbursement until June 1, 2018. Also, for loans processed beginning June 1, 2018, the requests for PDRs were system generated in SBA's Disaster Credit Management System (DCMS) to occur at loan disbursement, contrary to SBA's established policies and procedures. SBA's policies and procedures required that PDRs be conducted after loan approval and prior to disbursement. Additionally, SBA did not ensure FEMA reports were an appropriate tool to substitute SBA conducting its own on-site inspections for PDRs. Also, SBA did not establish requirements for loss verifiers to provide sufficient documentation to support their loan-making decisions. As a result, SBA disbursed 36,869 of 73,313 loans, or 50 percent, totaling \$594,286,878, without validating the cause, extent, or cost of damages, and there was no assurance that disaster loans were only provided to individuals impacted by Hurricanes Harvey, Irma, or Maria.

Finding 1: SBA Disbursed Loan Funds Before Validating Losses

Of the 73,313 home loans that were approved for Hurricanes Harvey, Irma, and Maria, 46,322 were approved for \$25,000 or less. Based on our data analysis, which compared the date of initial disbursement to the date the PDR was conducted, SBA disbursed 36,448 of 46,322, or 79 percent, of the loan funds, totaling \$585,737,678, prior to conducting PDRs, thus without validating the cause, extent, and estimated cost of damages.

Further, 25,746 of the 73,313 home loans were initially approved for more than \$25,000 but modified to \$25,000 or less. We statistically sampled 501 of these loans and found that SBA disbursed 190 of 501, or 38 percent, totaling \$3,810,900, prior to conducting PDRs.

Although SBA recognized that the loss verification reports, which included PDRs, were critical to establish eligibility and validate damages, it did not explicitly require that PDRs be conducted on loans \$25,000 or less until June 1, 2018, for presidentially declared disasters.¹ In January 2017 when the Office of Disaster Assistance (ODA) established the desktop loss verification process, it stated the loss verification process would use the same principals as the on-site inspections, which were conducted prior to loan disbursements. Also, it is important to note that ODA did require PDRs be conducted on loans \$25,000 or less prior to disbursement for Agency-declared disasters when it established the desktop loss verification process in January 2017.

Also, in our review of home loan files in DCMS that were approved after June 1, 2018, we found loans were disbursed before PDRs were conducted because the requests for PDRs were system generated in DCMS, and the timing of the requests did not coincide with SBA's established policies and procedures. Specifically, we found the system-generated requests to have a PDR performed were made during the closing and disbursement stage, which is also when initial disbursements could be made. SBA's policies and procedures required that the PDRs be conducted before loan decisions, following preprocessing and the initial desktop verification. PDRs validate damage eligibility and provide loan officers with critical information needed for determining the loan amount.

Further, conducting a PDRs after the loans are disbursed increases the risk of fraud and financial loss because loans are disbursed prior to SBA validating loan eligibility and the amount of damages and losses. For example, we found 30 loans that were disbursed prior to the PDR being conducted that exceeded the amount of the damages and repairs identified in the initial verification, resulting in overpayments to borrowers. Subsequently, after conducting the PDRs, SBA issued letters to the borrowers demanding they pay back the overpayment. Examples included the following:

- loan disbursed for \$20,900 with only \$12,700 in validated damages, resulting in an overpayment of \$8,200
- loan disbursed for \$25,000 with only \$17,700 in validated damages, resulting in an overpayment of \$7,300
- loan disbursed for \$24,600 with only \$17,500 in validated damages, resulting in an overpayment of \$7,100

¹ We identified 1,630 loans, totaling more than \$31 million, that were disbursed without PDRs after June 1, 2018, when SBA explicitly stated that PDRs must be conducted prior to disbursement.

All the PDRs for these loans were conducted after loan disbursement and contained discrepancies with the structural measurements and damage descriptions reported in the initial desktop verification. Not validating losses prior to disbursement could also place undue strain on the borrowers, who believe they've been rightfully approved for a disaster assistance loan but are subsequently required to repay a significant lump sum portion of the disbursed amount to SBA.

We commend ODA for establishing specific requirements to conduct PDRs prior to loan disbursement in June 2018. However, controls needed strengthening to ensure staff adhered to the policy and to mitigate the risk of financial loss.

Recommendations

We recommend that the Administrator require the Associate Administrator for the Office of Disaster Assistance to:

1. Update Disaster Credit Management System to coincide with the SBA policies and procedures that require post desktop reviews be conducted after loan approval and prior to disbursements.
2. Establish controls to ensure post desktop reviews are conducted for all approved loans \$25,000 or less prior to any disbursements of funds, as required.

Finding 2: SBA Relied on FEMA Reports That Did Not Contain Pertinent Information Needed to Validate Damages and Losses

SBA used FEMA's on-site inspection reports to complete the PDRs for 13,995 of the 73,313 loans approved for Hurricanes Harvey, Irma, and Maria. We statistically sampled 492 of the 13,995 to determine whether the reports contained sufficient information to validate the cause and extent of damages and the estimated cost obtained in the initial desktop verification. Based on our review, 317 of 492, or 64 percent, totaling \$2,213,900, did not contain pertinent information needed to validate the cause and extent of damages, and/or the estimated damage and repair cost.² Specifically, we found the following:

- 148 of 317 FEMA reports were blank and did not contain any information that could be used to validate the cause, extent of damages, or cost reported in the initial loss verification.
- 169 of 317 loans we reviewed included reported damage to real property, personal property, or vehicles in the initial desktop verification. However, the corresponding FEMA on-site inspection reports that were used to validate the initial loss verifications did not contain any information regarding damages or losses for real property, personal property, or vehicles.

SBA officials did not ensure that the FEMA on-site inspection reports were an appropriate tool to substitute SBA conducting its own on-site inspections for the PDRs. Additionally, SBA did not establish minimum requirements and guidelines to assist verifiers in determining whether FEMA reports contained sufficient information to validate damages, losses, and estimated repair and replacement cost obtained during the initial desktop loss verification. By not establishing a minimum requirement, SBA could not ensure it had consistent and sufficient information to support its loan-making decisions.

FEMA's on-site inspection reports did not suit SBA's needs because FEMA focuses on assessing the dwelling to restore it to a safe, sanitary, and habitable condition. This generally involves repairing structural issues, broken windows, doors, roofs, HVAC systems, utilities, etc. However, SBA focuses on validating the extent and cause of damages and the estimated cost to return the dwelling and its belongings to the pre-disaster condition, which could involve replacing flooring, drywall, kitchen cabinets, personal property, etc. Therefore, information needed to sufficiently complete an SBA on-site inspection is more in-depth than a FEMA on-site inspection.

SBA prioritized using FEMA reports over conducting its own on-site inspections because of the expected benefits. Using the 13,995 FEMA on-site inspections reduced the number of on-site inspections that SBA had to perform and allowed SBA more time to define its processing needs and manage its resources in response to the disasters. FEMA on-site inspections are generally completed sooner and faster than SBA's on-site inspections because FEMA is responsible for coordinating the federal government's response to disasters, and as such, are generally on the ground before other agencies. Also, FEMA reports are designed to gather information to satisfy the intent of FEMA's mission, which was less in scope from the information that SBA required to fulfill its mission and obligation to restore property to its pre-disaster condition.

² The total number of loans and the loan amount for this exception were 317 and \$5,513,598.51, respectively. However, we reduced the loan amount by \$3,299,698.51 to eliminate overlap and double counting because 210 of the loans were also identified in finding 1, leaving only 107 loans that could be used for this exception.

Usage of the FEMA reports also helped SBA keep pace with the initial influx of electronic loan applications for Hurricanes Harvey, Irma, and Maria, which were large, unprecedented disasters. However, SBA approved the loans without sufficiently validating the cause and extent of damages, or the estimated damage and repair cost.

Recommendation

We recommend that the Administrator require the Associate Administrator for the Office of Disaster Assistance to:

3. Ensure that tools or methods used to substitute SBA on-site inspections for post desktop reviews contain appropriate and sufficient information needed to validate the damages, losses, and estimated repair and replacement cost obtained during the initial desktop loss verification.

Finding 3: SBA's Disaster Loan Files Did Not Contain Sufficient Information to Support Loan-Making Decisions

SBA conducted PDRs using its own on-site inspections for 59,318 of the 73,313 approved loans. However, we were unable to assess the effectiveness and accuracy of these on-site inspections because the disaster loan files did not contain sufficient documentation to support how the loss verifier validated the cause and extent of damage reported in the initial desktop verification.

We planned to review a statistical sample of 510 loans but stopped our review at 293 because the loan files reviewed did not contain sufficient documentation to support the loss verifier's decision about the validity of damages and replacement costs reported in the initial desktop verification. For example:

- None of 293 contained critical information needed to sufficiently establish damage eligibility for loan funds, such as how the loss verifier verified ownership, whether the property was occupied during the disaster event, and that the damage was caused by the disaster.
- 71 PDRs had the same date and time the loss verifier spoke to the applicant as the initial loss verification report. The date and time are critical in determining whether loss verifiers conducted PDRs.
- 180 PDRs contained the same damage description, property/damage observation, and measurement source as the initial loss verification report, which did not provide any evidence that a loss verifier was on-site and verified the information obtained in the initial desktop verification.

Further, there was no evidence such as photos, video or recordings, bids, insurance information, etc., typically used by insurance companies to support the loss verifiers report. This occurred because SBA's PDR report is prepopulated with information from the initial desktop verification and loss verifiers are only required to make an annotation in the PDR report and comment in DCMS about any noted material differences. Additionally, SBA does not require loss verifiers to provide additional evidence to support their validations.

Consequently, because of the lack of documentation, we were unable to determine if loss verifiers validated the damages and losses obtained in the initial desktop verifications. Therefore, we concluded all 293 loans, totaling \$2,524,400, were disbursed without sufficient information to support the loss verifier's validation assessment.³

³ The total number of loans and the loan amount for this exception were 293 and \$5,343,100, respectively. However, we reduced the loan amount by \$2,818,700 to eliminate overlap and double counting because 169 of the loans were also identified in finding 1, leaving only 124 loans that could be used for this exception.

Recommendation

We recommend that the Administrator require the Associate Administrator for the Office of Disaster Assistance to:

4. Implement controls to require loss verifiers to provide sufficient documentation to support their post desktop review conclusions regarding the validity of the initial desktop verification and their assessment of the extent and cost of damages and losses to restore the property to its pre-disaster condition.

Analysis of Agency Response

Management provided formal comments, which are included in their entirety in appendix III. Management partially agreed with recommendations 1 and 2 and agreed with recommendations 3 and 4.

Summary of Actions Necessary to Close Recommendations

The following provides the status of the recommendations and the necessary actions to close them.

1. **Unresolved.** Management partially agreed with our recommendation, stating that it will update its policies and procedures and the loss verification training manual to be clear and consistent. SBA disagreed that PDRs for loans \$25,000 or less were required prior to initial disbursements and stated that conducting PDRs prior to disbursements would slow the delivery of disaster loan funds to survivors and delay overall recovery. SBA stated the desktop verifications reduced loan processing times, eased the burden on disaster survivors, expedited the delivery of loan funds, and reduced the overall cost associated with administering the disaster loan program. Management plans to complete final action on the recommendation by September 30, 2020.

We recognized in the report that the desktop loss verification process contributed to SBA meeting its timeliness goals for disaster loan applications. However, disbursing loans prior to conducting PDRs to validate the cause, extent, and estimate of damages increases the risk of fraud and financial loss. In SBA's process and procedures used during Hurricanes Harvey, Irma, and Maria, loans were disbursed based on information gathered and evaluated through telephonic interviews with applicants in conjunction with third-party information, such as tax assessors' websites, Google Earth, and Zillow, prior to validating the losses. None of these third-party sources used contained information regarding the cause, extent, and estimate of damages. As noted in the report, SBA disbursed \$589,548,578 prior to validating the losses.

Further, SBA acknowledges the importance of having PDRs conducted on loans \$25,000 or less prior to disbursing loan funds for Agency-declared disasters. We believe that loans for presidentially declared disasters pose greater risk of fraud and financial loss due to the increased loan volume compared to Agency-declared disasters. SBA should balance its ability to expedite loans and services to disaster survivors while also mitigating the risk of fraud and financial loss associated with disbursing loan funds prior to validating the cause and extent, and estimated cost of damages.

This recommendation can be resolved when SBA (1) updates its policies, procedures, and DCMS to ensure PDRs are conducted prior to disbursing loan funds, or (2) develops tools, technology, or other methods to ensure SBA continues to provide loans and services to disaster survivors timely and validate the cause, extent, and estimate of damages prior to disbursing loan funds to mitigate the risk of fraud and financial loss.

2. **Unresolved.** Management partially agreed with our recommendation, stating that it will establish internal controls to ensure that PDRs are conducted on all approved loans for \$25,000 or less. However, management stated that it disagreed that PDRs should be conducted prior to disbursements. Management plans to complete final action on the recommendation by September 30, 2020.

As stated in the report, disbursing loans prior to conducting PDRs to validate the cause, extent, and estimate of damages increases the risk of fraud and financial loss. SBA should balance its ability to expedite loans and services to disaster survivors while also mitigating the risk of fraud and financial loss.

This recommendation can be resolved when SBA (1) establishes controls to ensure PDRs are conducted for all approved loans \$25,000 or less prior to any disbursement of funds, or (2) develop tools, technology, or other methods and to validate the cause, extent, and estimate of damages prior to disbursing loan funds to mitigate the risk of fraud and financial loss.

3. **Resolved.** Management agreed with our recommendation, stating that it will explore additional technology, tools, and methods that can be used to substitute the PDR, and ensure that all approved substitutes contain the appropriate information needed to support the damages estimated during the initial desktop loss verification. Management plans to complete final action on this recommendation by September 30, 2020. This recommendation can be closed once management provides evidence that tools or methods used to substitute SBA on-site inspections for PDRs contain appropriate and sufficient information needed to validate the damages, losses, and estimated repair and replacement cost obtained during the initial desktop loss verification.
4. **Resolved.** Management agreed with our recommendation, stating that it will implement additional controls to require loss verifiers to provide documentation that sufficiently supports the PDR conclusions regarding the validity of the initial desktop verification. Management plans to complete final action on this recommendation by September 30, 2020. This recommendation can be closed once management demonstrates that it has implemented controls that require loss verifiers to provide sufficient documentation to support their PDR conclusions regarding the validity of the initial desktop verification, and their assessment of the extent of damages and losses and the cost to restore the property to its pre-disaster condition.

Appendix I: Objective, Scope, and Methodology

This report presents the results of our audit of SBA's desktop loss verification process. Our objective was to assess the desktop loss verification process. To accomplish our objective, we interviewed SBA personnel from the Office of Disaster Assistance, the Disaster Verification Center, and the Processing and Disbursement Center to gain an understanding of the loan process, loss verification process, and their roles and responsibilities. We also reviewed applicable policies, procedures, training guides, and laws and regulations. We conducted analysis regarding approved disaster home loans by answering the following four primary questions:

1. How many loans originally approved for and currently equal to \$25,000 or less were disbursed prior to receiving a PDR?
2. Were the FEMA reports effective for use in assessing damages and estimating costs?
3. Were the on-site loss verifications effective for use in assessing damages and estimating costs?
4. How often were loans that were initially greater than \$25,000 but modified to \$25,000 or less prior to disbursement, disbursed prior to receiving a PDR?⁴

Our scope included 73,313 disaster home loans, totaling \$1.4 billion, that SBA approved for Hurricanes Harvey, Irma, and Maria from August 25, 2017, through June 30, 2018.

Based on our data analysis of loans in DCMS, we identified 46,322 of 73,313 loans originally approved for and currently equal to \$25,000 or less that had been disbursed prior to receiving a PDR.

Additionally, we statistically sampled:⁵

- 501 of 25,746 loans that were originally approved for more than \$25,000 but were modified to \$25,000 or less prior to any disbursements to determine if the loans were disbursed prior to receiving a PDR.
- 492 of 13,995 loans that SBA used FEMA on-site inspections for PDRs to determine if the inspections were effective to validate the assessment of damages and estimated costs.
- 510 of 59,318 loans that SBA conducted its own on-site inspections for the PDRs to determine if the inspections were effective to validate the assessment of damages and estimated cost. However, we stopped our analysis at 293 because the results were the same.

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 objectives. We believe the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

⁴ For the report we combined questions 1 and 4.

⁵ We elected not to project the statistical results to the universe and reported on the loans we reviewed, because we determined the findings were adequate to demonstrate the extent and impact of the issues identified.

Use of Computer-Processed Data

We relied on data from the DCMS Applications Development, Telecommunications & Support Systems Center, Office of Disaster Assistance, and the SBA officials responsible for oversight and management of DCMS data. The DCMS operations office identified the approved and disbursed disaster loans between August 25, 2017, and June 30, 2018, which were processed to loan approval, loan modification, and disbursement decisions. We tested the reliability of information by tracing DCMS records on a sample basis to source documents such as FEMA reports, loan modifications, and loan disbursement information. We also reviewed available supporting documentation and conducted walkthroughs to understand DCMS functionality. In addition, we compared the records with loan information provided by Office of Disaster Assistance officials. As a result, we believe the loan information was reliable for the purposes of this audit.

Review of Internal Controls

SBA's standard operating procedure (SOP) provides guidance on implementing and maintaining effective internal control systems, as required by OMB Circular A-123.⁶ 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.⁷ Accordingly, we assessed internal controls used for the desktop loss verification process and compliance with laws and regulations to the extent necessary to satisfy the audit objective. We interviewed Office of Disaster Assistant management and responsible personnel, to identify controls to ensure program integrity and mitigate fraud and financial loss. Additionally, we reviewed loan files and loan transactions in the DCMS. We made recommendations in this report to address deficiencies identified.

⁶ SOP 00 02, Internal Control Systems (January 1986).

⁷ OMB Circular No. A-123, Management's Responsibility for Enterprise Risk Management and Internal Control (July 15, 2016).

Appendix II: Questioned Cost Summary

Each finding pertains to a subset of the loan universe, and these subsets are overlapping. For example, some loans in the subset used to assess the effectiveness of the on-site reviews were also in the subset of loans used to determine if loan funds were disbursed prior to having a PDR. The sampling information shown here reflect the magnitude of the problems for the isolated issues identified with their corresponding population. The overall questioned cost was reduced to eliminate overlap and double counting of the loan amounts used in one or more subsets. As a result, the total questioned cost is \$594,286,878.

Table 2: OIG Schedule of Questioned Cost⁸

Subset Description	Number of Loans	Actual/ Amount Excluding Overlap	Explanation
1. Loans Disbursed Before Validating Losses	36,448	\$585,737,678	(1) SBA approved 46,322 loans for \$25,000 or less out of the 73,313 loan universe. (2) Based on data analysis, SBA disbursed 36,448 out of the 46,322 loans prior to conducting a PDR.
2. Modified Loans Disbursed Before Validating Losses	190	\$3,810,900	(1) There were 25,746 loans that were initially approved for more than \$25,000 but modified to \$25,000 or less. (2) We found 190 of 501, or 38 percent, loans that were sampled were disbursed prior to the PDR.
3. FEMA Reports Without Pertinent Information	107 (originally 317, reduced by 210 to eliminate overlap and double counting of loans that were also identified in finding 1)	\$2,213,900	(1) There were 13,995 loans that SBA used FEMA's on-site inspection to conduct the PDR. This subset included loans that were approved for \$25,000 or less; loans that were approved for less than \$25,000 but modified to more than \$25,000; and loans that were approved for more than \$25,000 but modified to \$25,000 or less. (2) We found 317 of 492, or 64 percent, loans that were sampled were disbursed without sufficient information to validate initial desktop estimates.
4. Unsupported SBA On-sites	124 (originally 293, reduced by 169 to eliminate overlap and double counting of loans that were also identified in finding 1)	\$2,524,400	(1) There were 59,318 loans that SBA conducted its own on-site inspections. This subset included loans that were approved for \$25,000 or less; loans that were approved for less than \$25,000 but modified to more than \$25,000; and loans that were approved for more than \$25,000 but modified to \$25,000 or less. (2) We concluded that all 293 of 293, or 100 percent, loans that were sampled were disbursed without sufficient information to support the loss verifier's validation assessment.
Total Overall Questioned Costs	36,869	\$594,286,878	

⁸ Questioned costs are expenditures that are not supported by adequate documentation or otherwise do not comply with legal, regulatory, or contractual requirements.

SBA RESPONSE TO AUDIT REPORT



U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

Date: September 18, 2019

To: Hannibal "Mike" Ware
Inspector General

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

Subject: OIG Draft Report – Audit of Desktop Loss Verification Process
(Project No. 18803)

We have reviewed the OIG Draft Report. The objective of this audit was to assess the SBA's desktop loss verification process. 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 which was the basis for moving from initial onsite inspections to a desktop loss verification process.

In late October 2012, Hurricane Sandy made landfall in New Jersey and devastated the Mid-Atlantic and New England states. Until the 2017 Hurricane Season (Harvey-Irma-Maria), Hurricane Sandy was the SBA's 2nd largest disaster response effort, second only to the 2005 Hurricane Season (Katrina-Rita-Wilma). Hurricane Sandy presented serious logistical challenges which SBA identified as being the cause of loan processing delays and ultimately slowing the receipt of disaster loan funds to survivors. Issues such as gas shortages, road closures, weather-related issues, limited access to damaged properties, and lack of available lodging contributed to delays in the loss verification phase of loan processing. SBA developed its remote desktop verification process in order to mitigate these issues and reduce the probability that these same challenges would hinder future response efforts to major disaster events.

SBA began piloting the desktop verifications in January 2016, and later implemented it for two major disaster events, the 2016 Louisiana Floods and Hurricane Matthew. Effective January 31, 2017, SBA implemented the use of desktop verifications on all home disaster loan files and any business disaster loan file for a residential structure (e.g. rental properties). On August 25, 2017, SBA extended the use of desktop verifications to most business disaster loan files, including retail/convenience stores, small manufacturers, contractors, retail/office spaces, and apartment complexes.

SBA's use of desktop verifications has reduced loan processing cycle times, eased the burden on disaster survivors, expedited the delivery of disaster loan funds, and reduced the overall cost associated with administering the disaster loan program.

Reduced Cycle Times

SBA compared average disaster verification cycle times and file age from Hurricane Sandy and Hurricanes Harvey, Irma and Maria (HIM), in order to demonstrate the positive impact of the desktop verification process. During Hurricane Sandy, the average loss verifier (LV) completed three home verifications per day; the average home file aging, or time taken to complete the full verification process was 10.54 days. However, during HIM, the average cycle time was six verifications completed per day, and the average home file aging time was 5.62 days.

In response to the 2017 hurricanes, loss verifiers were able to double the number of home files completed per day and reduce cycle times by nearly half due to efficiencies gained from the desktop verification process.

Table 1: Average DVC Cycle Times and DVC File Aging for Home Files – Sandy and HIM

Metrics	Sandy	Harvey, Irma and Maria
Total # of Verifications Required	71,686	256,601
Average Home Cycle Time (Verifications per LV)	3 per day	6 per day
Avg DVC Home File Aging	10.54 days	5.62 days
Total # of Applications Received	88,047	344,051
Avg Home Loan Processing	25 days	16 days

Although the aggregate number of applications received for HIM was 3.91 times greater and the total number of verifications required was 3.58 times greater than in Hurricane Sandy, the peak loss verifiers needed for HIM was only 2.64 times greater than those needed in Sandy. If SBA had used a similar proportion of LVs as was used in Sandy for the response to HIM, the peak LV staff would have reached approximately 1,000 LVs instead of the actual peak of 806. In other words, SBA became more efficient at processing and was able to hire fewer loss verifiers in comparison to the verification proportion.

Faster loss verification cycle times contributed to the reduction of overall application processing time from Hurricane Sandy to HIM. During Sandy, the average loan processing time was 25 days for a home loan and 42 days for a business. Following the implementation of the desktop verification process, the average processing time dropped during HIM from 25 days to 16 days for home applications and from 42 days to 23 days for business applications. The improvement is particularly noteworthy because HIM resulted in 222,000 more disaster loan applications submitted and 154,000 more damage verifications completed compared to Sandy.

Cost Savings

As a result of the desktop verification process, fewer LVs were traveling to perform initial onsite inspections. When averaged per LV, SBA estimates that nearly \$52,000 was saved per LV during HIM. When averaged per LV, SBA also spent an estimated \$6,500 less per LV on overtime expenses, as LVs were able to complete more work within prescribed work hours. The reduction of the

number of LVs required contributes to overall cost savings. The average annual salary and benefits of an LV totals approximately \$86,500, or approximately \$7,200 per month per LV.

Table 2: Travel and Overtime Costs – 6 Months Post-Initial Declaration

Metrics	Sandy	HIM
DVC Travel Costs (Averaged per LV)	\$88,332	\$36,425
DVC Overtime (Averaged per LV)	\$23,315	\$16,833
Peak Loss Verifiers (Staff)	305	806

The adoption of the desktop verification process produced benefits during HIM that were identified in the initial planning stages dating back to January 2016. When compared to Hurricane Sandy, the Agency’s 2nd largest disaster event, SBA experienced reduced loss verification aging and reduced individual production cycle times during HIM. These abatements contributed to the decrease of overall loan approval times. Not only did SBA realize reduced travel costs, it also achieved reduced overtime costs and personnel expenses during HIM.

Audit Findings

The audit report identified three findings: (1) SBA disbursed loan funds before validating losses; (2) SBA relied on FEMA reports that did not contain pertinent information needed to validate damages and losses; and (3) SBA’s disaster loan files did not contain sufficient information to support loan-making decisions.

The audit report, particularly in Finding 1, makes several references to a supposed change to SBA’s post desktop review (PDR) policy that did not occur. The report incorrectly states that beginning June 1, 2018, SBA established that loans less than or equal to \$25,000, must have a PDR prior to any disbursement. Confused by the audit team’s assumption that SBA had modified its policy, we asked for the source documentation. The audit team shared with us that they had found a short passage in the 2018 Loss Verification Training Manual which incorrectly states that the PDR using either the FEMA database information or an onsite inspection should be completed prior to disbursements of any amount.

The policy and processes established by SBA in January 2017 to conduct desktop verifications and post desktop reviews was consistent throughout the response to Hurricanes Harvey, Irma and Maria and remains unchanged.

SBA disputes the audit report’s use of the statement in the 2018 LV Training Manual as evidence for any policy change to the PDR process for the following reasons: 1) the LV manual is a training tool and does not establish the PDR policy, which was established by Numbered Memo 17-06 in January 2017 and remains unchanged; 2) the manual contains an inaccurate statement that the PDR will be completed prior to disbursements of any amount, which is not consistent with the actual policy established by Numbered Memo 17-06, and will be corrected in the next release of the LV Training Manual; and 3) the scope of the audit covered HIM loans approved from August 25, 2017, through June 30, 2018, but the supposed policy change referenced by the audit report in the LV Training Manual was not released until June 1, 2018, which means the incorrect information about the PDR process was only included in the training manual for the final 30 days of the audit scope.

SBA appreciates the audit team's work and for bringing to our attention the inconsistency between the LV Training Manual and Numbered Memo 17-06 which establishes the desktop verification and PDR policy and processes. SBA plans to correct the LV Training Manual, before its next release in calendar year 2019, so that it is consistent with the original policy which requires a PDR after loan approval but does not require it to be completed prior an initial disbursement. It should be noted that requiring the PDR prior to an initial disbursement would significantly slow down the delivery of disaster loan funds for survivors. Furthermore, there is no evidence that changing SBA's policy and processes so that the disaster survivor's initial disbursement is withheld until after the PDR is completed will result in fewer improper payments or attempts to defraud the disaster loan program.

After loan approval, SBA uses housing inspection data collected by FEMA to validate the original damage and loss estimates calculated during the initial desktop verification.

The second finding in the audit report claims that in some cases SBA relied on FEMA reports that did not contain pertinent information needed to validate damages and losses. Numbered Memo 17-06 established SBA's policy and processes to complete the PDR using FEMA inspection data, when available. The housing inspection data collected by FEMA has been determined to be the most suitable to determine if the damages are "in agreement" with SBA's initial desktop verification, including:

- Address Verification;
- Residency (Was anyone occupying the damaged property at the time of the disaster?);
- Type of Property (Single Family, Multi-Family, Business);
- Foundation Type;
- Property Square Footage (Using a tolerance range of +15 percent); and
- How much water entered the home and for how long, if applicable.

While FEMA and SBA both conduct housing inspections to estimate damages and determine assistance eligibility, the data that each agency collects are unique to our respective programs. For example, the goal of FEMA home repair grant assistance is to make the damaged home safe, sanitary, and functional for the disaster survivor. The goal of the SBA home disaster loan program is to repair or replace the damaged property back to its pre-disaster condition. SBA attempts to use the FEMA inspection data to complete the post desktop review and expedite the delivery of disaster loan funds to the survivor. However, SBA will complete an onsite inspection if the data points obtained from the FEMA database are not consistent with the initial desktop verification completed by SBA or if other data in the report renders it non-conclusive. In some cases, a FEMA inspection report is not available, in which case SBA will conduct an onsite inspection to fulfill the PDR requirement. Regardless if the PDR requirement is completed using FEMA inspection data or an onsite inspection, there is no SBA policy or process that requires the PDR to be completed prior to the initial disbursement.

SBA plans to explore additional technology, tools and resources that can be used to validate the initial desktop verification with higher confidence.

The audit report did find some instances where the PDR was completed using FEMA inspection data that did not contain sufficient details to conclude that the damages were "in agreement" with SBA's initial desktop verification. In these cases, the PDR should have been completed using an onsite inspection, consistent with SBA's policy established in Numbered Memo 17-06. SBA plans to explore additional technology, tools and resources that can provide a greater level of detail about the damages estimated in the initial desktop verification.

In the third finding, the audit report claimed that SBA disaster loan files did not contain sufficient information to support loan-making decisions because files where the PDR completed by the loss verifier was found to be “in agreement” with the initial desktop verification contained only minimal information. If the loss verifier notated in the file that the PDR was “in agreement” in with initial desktop verification it means that the desktop verification was accurate. However, unless the loss verifier included additional documentation to further support their conclusion that the PDR and initial desktop verification are “in agreement,” which is not a current requirement in SBA’s established processes, the audit team concluded that the case file was disbursed without sufficient information to validate the PDR. The audit report provides no evidence that funds were disbursed incorrectly for any of the files reviewed.

The audit report also suggests that SBA loss verifiers should have attempted to collect from disaster survivors additional evidence similar to the supporting documentation typically used by insurance adjusters, such as photos, videos, recordings, bids, insurance information, etc., despite concluding that the post desktop review was in full agreement and consistent with the initial desktop verification. While we found that the case files where the PDR was in agreement with the initial desktop verification were correctly notated, consistent with SBA’s current processes, SBA does agree that more details and supporting documentation, if available, can be included in the case file to clearly demonstrate the information used by loss verifier to support their conclusion.

In summary, SBA agrees with the audit report recommendations to bolster the post desktop review process by expanding the technology, tools and resources used to validate the damage estimates established in the initial desktop verification. Since it was fully implemented in January 2017, the SBA’s practice of using desktop verifications in place of initial property inspections has reduced loan processing cycle times, eased the burden on disaster survivors, expedited the delivery of disaster loan funds, and reduced the overall cost associated with administering the disaster loan program. However, these benefits are contingent on the SBA’s ability to continue its current policy to conduct the post desktop review after the initial loan approval without postponing the disaster survivor’s initial disbursement of \$25,000 or less and delaying the recovery process. SBA does not agree with audit report’s recommendation to change its current PDR policy by establishing a strict requirement to withhold disaster loan funds until after the PDR, which would undermine the SBA’s significant gains made in recent years.

OIG Recommendations and Agency Response

- 1) *Update Disaster Credit Management System to coincide with the SBA policies and procedures that require post desktop reviews be conducted after loan approval and prior to disbursements.*

ODA Response: ODA partially agrees with the recommendation. ODA agrees to update our policies and procedures, as well as the loss verification training manual, to be clear and consistent with our current policy to conduct post desktop reviews after loan approval and the initial disbursement of \$25,000 or less. ODA does not agree with the OIG's recommendation to change its current policy by adding a requirement to conduct the post desktop review prior to the initial disbursement of \$25,000 or less, which would slow the delivery of disaster loan funds to disaster survivors and delay the overall recovery.

- 2) *Establish controls to ensure post desktop reviews are conducted for all approved loans \$25,000 or less prior to any disbursements of funds, as required.*

ODA Response: ODA partially agrees with the recommendation. ODA agrees to strengthen internal controls to ensure that post desktop reviews are conducted for all approved loans of \$25,000 or less, as is required in the current policy established by Numbered Memo 17-06 and has been in effect since January 31, 2019. ODA does not agree to change its current policy by adding a requirement to conduct the post desktop review prior to the initial disbursement of \$25,000 or less.

- 3) *Ensure that tools or methods used to substitute SBA on-site inspections for post desktop reviews contain appropriate and sufficient information needed to validate the damages, losses, and estimated repair and replacement costs obtained during the initial desktop loss verification.*

ODA Response: ODA agrees with the recommendation. ODA agrees to explore additional technology, tools and methods that can be used to substitute the post desktop review. ODA also agrees to ensure that all approved resources being used to substitute an onsite post desktop review contain the appropriate information needed to support the damages estimated during the initial desktop loss verification.

- 4) *Implement controls to require loss verifiers to provide sufficient documentation to support their post desktop review conclusions regarding the validity of the initial desktop verification and their assessment of the extent of damages and losses and the cost to restore the property to its pre-disaster condition.*

ODA Response: ODA agrees with the recommendation. ODA agrees to implement additional controls to require loss verifiers to provide documentation that sufficiently supports the post desktop review conclusions regarding the validity of the initial desktop verification.