

Audit of SBA's Compliance with the Debt Collection Improvement Act, as Amended

REPORT NUMBER 20-20 | September 30, 2020





EXECUTIVE SUMMARY

AUDIT OF SBA'S COMPLIANCE WITH THE DEBT COLLECTION IMPROVEMENT ACT, AS AMENDED

Report No. 20-20

September 30, 2020

What OIG Reviewed

This report presents the results of our audit to determine if the Small Business Administration (SBA) was in compliance with the Debt Collection Improvement Act of 1996, as amended, for delinquent disaster loans as of April 30, 2019.

Under the law as amended in 2014, if a disaster loan is delinquent for 120 days, the SBA is required to refer the obligors to the U.S. Department of the Treasury Offset Program for administrative offset.

The Act also requires SBA to transfer all disaster loans that are 180 days delinquent to Treasury for collection action unless they are exempt.

To accomplish our objective, we extracted and reviewed data for all delinquent disaster loans in liquidation as of April 30, 2019, to identify the number and dollar value of loans that were 180 days or more delinquent and did not appear to comply with the Debt Collection Act.

We also tested a judgmental sample of 20 of the delinquent loans assigned to the National Disaster Loan Resolution Center.

Finally, we interviewed SBA management officials and personnel, consulted officials from the SBA Office of Disaster Assistance, and visited the National Disaster Loan Resolution Center in Santa Ana, California, and the Birmingham, Alabama, Disaster Loan Servicing Center.

What OIG Found

We found SBA was not fully in compliance with the Debt Collection Improvement Act as of April 30, 2019, because the agency had not sent more than 250 past-due loans totaling more than \$30.5 million and 180 days or more delinquent to Treasury Cross-Servicing for collection. None of the 250 loans that SBA was maintaining without sending to Treasury Cross-Servicing were exempt from collection action.

In addition, a number of delinquent loans were incorrectly classified as exempt from transfer to Treasury for collection. In our 20-loan sample, eight (40 percent) totaling \$1.2 million, were incorrectly classified as exempt.

We also determined that although SBA could assess administrative fees to offset the overhead costs of operating the resolution center, they have chosen not to do so. Consequently, U.S. taxpayers bear the full cost of operating the resolution center, a total of approximately \$49.6 million from fiscal years 2011-19.

OIG Recommendations

We recommend 10 actions for SBA to strengthen its controls and improve compliance with the Debt Collection Improvement Act.

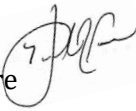
Agency Response

Management agreed with the findings and all recommendations. Management's implemented and planned actions will resolve all recommendations, including conducting loan reviews, revising, and establishing policies and procedures, and conducting training to ensure compliance with the Debt Collection Improvement Act.



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

Report Number: 20-20

DATE: September 30, 2020
TO: Jovita Carranza
Administrator
FROM: Hannibal "Mike" Ware 
Inspector General
SUBJECT: Audit of SBA's Compliance with the Debt Collection Improvement Act, as Amended

This report presents the results of our audit of the Small Business Administration's Compliance with the Debt Collection Improvement Act, as Amended. We considered management's comments on the draft of this report when preparing the final report. Management agreed with the findings and all recommendations and took actions to address recommendations 5 and 8 during the audit.

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

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Christopher S. Gray, Deputy Chief of Staff
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Introduction

The Small Business Administration's (SBA's) Disaster Assistance Program is the federal government's primary program for assisting in the repair and rebuilding of nonagricultural enterprises of all sizes, as well as supporting nonprofit organizations, homeowners, and renters who have suffered damages from declared disaster events.

SBA provides low-interest loans for up to \$200,000 for homeowners to repair or replace their primary residence to pre-disaster condition and up to \$40,000 to repair or replace homeowners' and renters' personal property. In addition, SBA provides up to \$2 million in disaster assistance for substantial economic injury loss to businesses and nonprofit organizations to help meet financial obligations and operating expenses.¹

When borrowers do not make disaster loan payments on time, the loan becomes a delinquent debt. The Debt Collection Improvement Act requires SBA to transfer delinquent debts and refer the obligors to the United States Department of the Treasury for collection action when the debts become 180-days delinquent. An obligor is any borrower, co-borrower, or guarantor of the loan.

Legislation and Delinquent Debts

Congress has passed several pertinent laws allowing debt collections following specific guidelines to ensure that delinquent federal debts get collected and that agencies can focus on their primary missions rather than collecting delinquent debts.

Debt Collection Act of 1982. This law was the first one to allow federal offset of delinquent debts. The Debt Collection Act also imposed the requirement for federal agencies to charge late fees, penalties, additional interest, and administrative costs to delinquent debtors.

However, SBA is exempt from that requirement because the loans it provides are at a fixed rate of interest. SBA does charge delinquent debtors some administrative fees that arise from the debt being delinquent. Specifically, SBA only charges delinquent debtors fees imposed by third parties, such as the departments of Justice and Treasury, appraisers of collateral, etc., but does not charge a fee that covers its own administrative costs associated with processing and handling delinquent debts.

Debt Collection Improvement Act of 1996. This law consolidated debt collection for all federal agencies at the U.S. Department of the Treasury and required that federal agencies refer delinquent debts for Treasury offset and collection when the debts become 180-days delinquent. Federal agencies can transfer their delinquent debts to Treasury as soon as the debtors are notified of their rights.

In 2014, Congress amended the Debt Collection Improvement Act of 1996 when it passed the Digital Accountability and Transparency Act (Data Act). The Data Act modified the offset

¹ The Coronavirus Preparedness and Response Supplemental Appropriations Act deemed Coronavirus Disease 2019 (COVID-19) a disaster and authorized SBA to provide Economic Injury Disaster Loans to businesses and nonprofits affected (P.L. 116-123, March 6, 2020). In addition, the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) provides Economic Injury Disaster Loans and grants to businesses, cooperatives, and Employee Stock Ownership Plans with 500 or fewer employees; sole proprietors; independent contractors; private nonprofit organizations; small agricultural cooperatives and tribal businesses with 500 or fewer employees (P.L. 116-136, March 27, 2020). Paycheck Protection Program and Healthcare Enhancement Act (P. L. 116-139, April 24, 2020) expanded EIDL eligibility to agricultural enterprises. Agricultural enterprises means small business concerns engaged in the production of food and fiber, ranching, and raising of livestock, aquaculture, and all other farming and agricultural-related industries, as defined by section 18(b) of the Small Business Act (15 U.S.C. 647(b)).

requirement and now requires agencies to refer delinquent debts that are not tax related to the Treasury Offset Program when the debts become 120-days delinquent. However, federal agencies still have up to 180-days to transfer their delinquent debts to the Treasury Bureau of the Fiscal Service for collection action, known as Treasury Cross-Servicing for collection.

Offset means redirecting federal or state payments due to the loan's obligor, such as tax refunds or military and civilian retirement pay, to satisfy the delinquent debt.

Treasury Debt Collection Structure

Treasury Cross-Servicing. Treasury Cross-Servicing pursues delinquent debts not actively being collected by the federal agency that is the creditor. Treasury Cross-Servicing activities include, among other things, telephone calls to the obligor to negotiate repayment arrangements, credit bureau reporting, referral to at least one private collection agency, and administrative wage garnishment.

Some debts are exempt from being transferred to Treasury Cross-Servicing (See Finding 2, p. 7).

Treasury Offset Program. The Treasury Offset Program centralizes the offset of federal and state benefit payments due to delinquent debtors and redirects the payments to any delinquent federal debts owed by the debtor. Offsets include administrative payments, salary, tax refunds, benefit payments, military and civilian retirement pay, contractor payments, and other federal and state payments.

Unless an obligor meets an exception to the requirement, all obligors must be referred to Treasury Offset Program when a debt reaches 120-days delinquent.

SBA Disaster Loan Centers

SBA operates two centers to manage approved and disbursed disaster loans. SBA also operates a third center that manages disaster loans delinquent over 90 days. The Birmingham, Alabama, Disaster Loan Servicing Center receives all loans stemming from disasters east of the Mississippi River. The El Paso, Texas, Disaster Loan Servicing Center receives all loans from disasters west of the Mississippi River and from Puerto Rico. Both locations perform routine loan servicing actions and initiate calls to borrowers when a loan becomes delinquent.

At 90-days delinquent, the Disaster Loan Servicing centers charge-off delinquent loans less than \$25,000 and without collateral and refer them to Treasury for further collection action. If a loan has collateral backing and is 90-days delinquent, the Disaster Loan Servicing centers transfer it to the National Disaster Loan Resolution Center in Santa Ana, California.

National Disaster Loan Resolution Center

SBA's National Disaster Loan Resolution Center is responsible for resolving delinquencies over 90-days for disaster loans with balances of more than \$25,000 and secured with collateral. The resolution center's mission is to maximize recovery of delinquent loans promptly and efficiently.

Delinquent loans are assigned to loan specialists to develop a liquidation plan. A liquidation plan is a written plan outlining the actions the agency intends to take to maximize recovery of a specific disaster loan.

Loan specialists continue to contact delinquent obligors, attempting to either collect a lump sum payment or persuade the obligor to resume regular loan payments. If the borrower does not resume payments and make the loan current before the loan becomes 180-days delinquent, the resolution center should either initiate foreclosure on collateral or transfer the delinquent debt to Treasury for collection.

The resolution center assesses the loan’s real estate collateral value for potential foreclosure. The resolution center also is responsible for initiating foreclosure, if it is cost effective, to pay off or significantly reduce the delinquent loan balance. To comply with the Debt Collection Improvement Act, the resolution center must assess the collateral and initiate foreclosure before the debt becomes 180-days delinquent.

Under the Debt Collection Improvement Act, as amended by the Data Act in 2014, the resolution center must refer all obligors to the Treasury Offset Program for any debt that reaches 120-days delinquent, unless that debt is exempt. When a debt becomes 180-days delinquent but does not meet an exception, the resolution center must transfer it to Treasury Cross-Servicing.

As of April 30, 2019, there were 1,922 delinquent disaster loans totaling approximately \$222 million assigned to the resolution center. About 64 percent (1,232) of the loans, totaling approximately \$161 million, were delinquent 180-days or more. This report focuses on those loans. (See Table 1, p. 4).

SBA classified some of the loans as exempt from transfer to Treasury Cross Servicing because the resolution center staff believed the obligors were in litigation, including bankruptcy; in a workout plan or deceased; or the loan collateral was in foreclosure.

Table 1. Exempt Status of Loans More than 180 Days Delinquent (as of April 20, 2019)

Exempt or Not Exempt Status	Number of Loans	Percent of Delinquent Loans (%)	Dollar Amount in Millions (\$)
Not Exempt	260 ^a	21	32
Exempt	972	79	129
Total	1,232	100	\$161

Source: Data extract from Capital Access Financial System

^aThe 260 loans included 4 loans miscoded with a loan status comment code intended to be used exclusively at the time of charge-off. The four loans, totaling approximately \$1.8 million, were incorrectly coded with loan status comment code 85 (Collateral Having Minimal Equity). The error had minimal impact on the resolution center’s compliance; consequently, we did not cite these loans as audit exceptions. Subtracting those loans, SBA should have transferred 256 loans totaling \$30.5 million to Treasury because they were not exempt from Cross-Servicing or offset (See Finding 1, p. 5).

Note: We tested 20 of the loans coded as exempt from transfer to Treasury. (See Finding 2, p. 7).

Previous Work

Our prior audits also found that SBA faced challenges complying with the Debt Collection Improvement Act in the management of disaster loans with payments in arrears

SBA OIG 12-14, *The Small Business Administration Did Not Maximize Recovery for \$171.1 Million in Delinquent Disaster Loans in Liquidation (July 9, 2012)*. In this audit, we found that SBA was not fully complying with the Debt Collection Improvement Act. Our analysis found that approximately 1,553 of 3,958 delinquent disaster loans (39 percent) totaling approximately \$171.1 million as of December 31, 2011, were past due over 180 days and did not meet a valid exception from transfer to Treasury Cross-Servicing.

SBA OIG 13-18, *The SBA Did Not Effectively Manage Defaulted Disaster Loans to Maximize Recovery from 2006 to 2011 (September 27, 2013)*. In this report, we determined that the National Disaster Loan Resolution Center did not use all the appropriate collection tools required

by the Debt Collection Improvement Act or its SOPs before charging off delinquent and defaulted disaster loans.

Audit Objective

This report details the results of our audit begun in 2019 to determine if SBA was in compliance with the Debt Collection Improvement Act of 1996, as amended, for delinquent disaster loans as of April 30, 2019.

What We Found

As in our two previous audits, we determined that SBA was not fully compliant with the Debt Collection Improvement Act. The following sections detail our findings in this report that the SBA was still not fully compliant with the Debt Collection Improve Act as of April 30, 2019.

Finding 1: SBA Did Not Transfer About \$30.5 Million in Delinquent Loans to Treasury for Collection

We determined that as of April 30, 2019, SBA had not transferred 256 loans totaling about \$30.5 million that were 180 or more days delinquent to Treasury Cross-Servicing as required. The delinquencies ranged from 180 days to 15 years, averaging approximately 2.3 years.

In addition, we determined the following from our analysis of the system:

- 178 loans, totaling approximately \$22.5 million, were classified in the Capital Access Financial System (loan status comment code 66, Lien or Mortgage/Refer to Treasury Offset Program Only) as having real-estate collateral.

The delinquencies ranged from 189 days to more than 15 years (an average of 1,045 days or approximately 3 years).

- 78 loans, totaling approximately \$8 million, were classified in Capital Access Financial System, (loan status comment code 00, Clear Existing Status) as still being evaluated to determine what actions to take to resolve the delinquencies.

The delinquencies ranged from 180 days to 7 years (an average of 356 days).

For the 178 loans classified as having collateral, the resolution center misinterpreted internal training related to loans with collateral and erroneously believed the loans should be retained in its loan portfolio indefinitely and not transferred to Treasury. We also found the resolution center does not have a formal, ongoing training program or require employees to have refresher training on the Act each year.

We also reported in 2012 that SBA was not transferring loans with collateral to Treasury at 180-days delinquent.

For the 78 loans coded as under evaluation, the weekly loan portfolio reports used by resolution center management to monitor compliance with the Act did not list all the delinquent loans assigned. We determined that the report accounted for only 17 percent of all delinquent loans and about 6 percent of loans delinquent 180 days or more as of April 30, 2019.

Management of the resolution center did not require staff to monitor all assigned loans at regular intervals (such as at least every 30 days). Managers also could not explain why the report listed only a small percentage of all loans assigned to the resolution center. Essentially, management was not aware of all of the loans that were 180-days or more delinquent because there was no regular monitoring and the reports were incomplete.

Because the loans were not transferred to Treasury Cross-Servicing, no collection actions against delinquent obligors had been taken as of April 30, 2019, resulting in about \$30.5 million owed to the federal government not being paid.

Although it is difficult to quantify the effect of not promptly initiating collection actions, according to Treasury guidance, the ability of an agency to collect its delinquent debts will generally decrease as debts get older.

Considerations Surrounding the COVID-19 Pandemic

It is important to note that we began this audit in 2019, well before the current pandemic crisis. However, on March 23, 2020, SBA issued a memorandum to Treasury in response to the

Coronavirus (COVID-19) pandemic requesting exemption from the mandatory transfer requirements of the Debt Collection Improvement Act for Offset and Cross-Servicing until December 31, 2020. SBA also requested Treasury to suspend its collection activities on delinquent loans already at Treasury for both Offset and Cross-Servicing also through December 31, 2020.

On March 27, 2020, SBA issued a follow-up memorandum to Treasury to clarify that Treasury should suspend all debt collection activities it was conducting for SBA on all SBA debts and debtors until December 31, 2020. SBA also stated it was suspending debt collection referrals to Treasury until December 31, 2020.² Collection activities may include administrative wage garnishment; sending demand letters; and diverting federal tax refunds and Social Security Administration payments, among other actions.

On March 30, 2020, SBA also issued a policy to provide an automatic deferment of principal and interest payments through December 31, 2020, for all existing disaster home and business loans that were in “regular servicing” status as of March 1, 2020.³

Recommendations

We recommend the Administrator direct the Associate Administrator for Office of Capital Access to:

1. Review all loans assigned to the resolution center that are 180 days or more delinquent and classified with code 66 (Lien or Mortgage/Refer to Treasury Offset Program Only) and 00 (Clear Existing Status Code) and transfer the loans to Treasury Cross-Servicing, unless verified as exempt when the temporary suspension of debt collection activities because of the pandemic is lifted.
2. Revise SOP 50 52 to clearly communicate that all loans with collateral must be evaluated for foreclosure and placed in foreclosure status before they are 180-days delinquent.
3. Revise SOP 50 52 2 to clearly communicate that all debts 180-days delinquent must be transferred to Treasury Cross-Servicing unless the debt meets a valid transfer exemption.
4. Establish requirements to provide annual training on Debt Collection Improvement Act requirements to all staff of the resolution center.
5. Ensure that information used to monitor compliance with the Debt Collection Improvement Act includes all loans assigned to the resolution center as identified in the Capital Access Financial System.

² SBA memorandums dated March 27, 2020, “Follow-up to Exemption from Mandatory Notice and Transfer Provisions” and March 23, 2020, “Request for Suspension of Debt.”

³ SBA Procedural Notice 5000-20012, March 30, 2020.

Finding 2: SBA Did Not Transfer Delinquent Loans to Treasury

We judgmentally selected and tested 20 of 972 delinquent loans that were identified as exempt from transfer to Treasury, totaling about \$3 million, to determine if all obligors and associated debt met the exemption requirements of the Act as of April 30, 2019.

We determined that 8 of 20 loans, totaling approximately \$1.2 million, did not meet the exemption requirements specified in the Act. The eight loans included three that were classified as in foreclosure, three loans classified as in workout, one loan classified as in bankruptcy, and one loan classified as in litigation.

However, our analysis showed the loans were erroneously classified (See Appendix I, p. 11).

We found that as of April 30, 2019, SBA had not referred 12 obligors for the eight loans that were 120 days or more delinquent, totaling about \$1.2 million, to the Treasury Offset Program. Once the loans aged to 180 or more days delinquent, SBA also did not transfer the debts to Treasury Cross-Servicing.⁴

Treasury guidance states a debt is not eligible for transfer to Treasury Cross-Servicing if the debt is:

- not past due or legally enforceable;
- less than \$25 (including interest, penalties, and administrative costs);
- owed by a deceased debtor;
- owed by a debtor who has filed for bankruptcy protection or had the debt discharged in bankruptcy proceedings; or
- the subject of an administrative appeal, until the appeal has concluded and the amount of the debt is fixed.

Treasury guidance also says agencies are not required to transfer a debt for Cross-Servicing if the debt is:

- in litigation, that is, the debt has either been referred to the Department of Justice for litigation or is the subject of proceedings pending in a court, including bankruptcy and post-judgment matters;
- in foreclosure;
- scheduled for sale within one year under an asset sales program approved by the Office of Management and Budget; or
- otherwise exempt from the statutory referral requirement by law or official action of Treasury.⁵

Of the 20 loans we reviewed, 8 were misclassified. Consequently, we determined the loans were not exempt from transfer to Treasury. We believe routine monitoring of loans should ensure that management is aware of changing status of loans and promptly transfers the debts to Treasury.

⁴ Foreclosure is a legal proceeding taken by the lender to gain title or force a sale of collateral. Workout refers to the debt collection and negotiation process and the agreed plan to cure a default that restructures the terms and conditions of the delinquent loan to avoid foreclosure or bankruptcy. Bankruptcy is a legal procedure used to deal with debt problems by filing a court case under one of the chapters of the United States Bankruptcy Code. Litigation involves any lawsuit or court action to determine a legal question or enforce collection on a debt.

⁵ "Managing Federal Receivables" guide. The list presented here is not all inclusive.

Recommendations

We recommend that the Administrator direct the Associate Administrator for Office of Capital Access to:

6. Review all loans currently assigned to the Center and designated exempt from Treasury Offset Program and verify that each of the obligors is exempt from referral to Treasury Offset Program, and if not, refer the obligors to Treasury Offset Program, as required.
7. Review all loans currently assigned to the Center and designated as exempt from Treasury Cross-Servicing that are 180-days or more delinquent and verify that each of the obligors is exempt from transfer to Treasury Cross-Servicing, and if not, transfer the debt to Treasury Cross-Servicing, as required when the temporary suspension of debt collection activities due to COVID-19 is lifted.
8. Establish policies and procedures to require routine follow-up on delinquent loans to ensure full compliance with the Debt Collection Improvement Act.
9. Reiterate the requirements for workout agreements to responsible personnel to ensure compliance with the Debt Collection Improvement Act.

Finding 3: SBA Elected Not to Assess Administrative Fees for Delinquent Disaster Loans to Offset the Cost of Its Collection Efforts

The SBA Disaster Assistance Servicing Manual and Loan Promissory Notes provides the capability to assess some administrative costs. SBA does assess some administrative costs such as Department of Justice litigation, Treasury collection, preserving and disposing of collateral, property taxes, prior liens, insurance, appraisals, environmental remediation, and reasonable attorney's fees to offset these associated costs.⁶

However, since 1982, SBA has elected not to assess administrative fees sufficient to offset its costs for processing and handling delinquent disaster loans, including salaries and other overhead costs. The cost to operate the resolution center was approximately \$49.6 million for FYs 2011 through 2019, an average of \$5.5 million annually.

The Debt Collection Act, enacted in 1982, and amended by the Debt Collection Improvement Act in 1996, required federal agencies to assess charges to cover the costs of processing and handling delinquent claims unless a statute, regulation required by statute, a loan agreement, or a contract either prohibit the charging of interest or charges or explicitly fixed the interest rate or charges that apply to the debt.

Additionally, 31 CFR 901.9 (c), reiterates that agencies should assess administrative costs and states that the calculation of administrative costs should be based on actual costs incurred or on estimated costs as determined by the assessing agency.

Officials from SBA's offices of Disaster Assistance and Capital Access said because the disaster assistance loan promissory note explicitly fixes the interest rate, these debts qualified as an exception. We agree SBA is not *required* to assess administrative fees directly related to operating the Center.

However, we note that SBA *is not barred* from doing so. The agency was not aware of any studies or analysis that have evaluated the impact of charging fees to cover the costs of processing and handling delinquent disaster loans. Because SBA does not collect administrative fees, the taxpayers bear the full cost of operating the resolution center, more than \$5 million a year.

From January to December 2019, the number of delinquent loans processed and handled by the resolution center increased from 1,537 to 2,166 delinquent loans. Should this trend continue, the administrative costs for processing these delinquent debts also will continue to rise.

SBA should perform a cost-benefit analysis to determine whether to assess fees to offset the cost of operating the resolution center. SBA should also assess whether it is prudent for the taxpayer to continue to bear these costs through appropriations or if the agency should assess additional administrative fees sufficient to offset its operating cost for the resolution center.

⁶ SBA adds these third-party costs to the principal loan balance when and if they are incurred.

Recommendations

We recommend the Administrator direct the Associate Administrator for Office of Capital Access in conjunction with the Associate Administrator for Disaster Assistance to:

10. Perform a cost benefit analysis to determine if SBA should begin assessing fees to offset the cost of processing and handling delinquent disaster loans.

Analysis of Agency Response

Management provided formal comments, included in their entirety in Appendix III. They also provided the implementation dates for all recommendations in separate correspondence. Management agreed with the findings and all recommendations. Management stated they took corrective actions to address recommendations 5 and 8 but did not provide evidence to substantiate the recommendations were implemented. Management's implemented and proposed actions resolve the recommendations.

Summary of Actions Necessary to Close the Recommendations

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

1. **Resolved.** Management agreed with our recommendation and indicated the Center will review all loans currently assigned, which are coded 66 or 00, to verify that each account is coded correctly and referred to Treasury properly. The current temporary suspension of debt collection activity is effective through December 31, 2020. Assuming there are no extensions to this suspension, the Center will complete this task by June 30, 2021. This recommendation can be closed when management provides evidence that they have performed a review of loans in liquidation that are coded 66 or 00 and has transferred the loans to Treasury or changed the code to one that is exempt from transfer to Treasury.
2. **Resolved.** Management agreed with our recommendation, stating that Office of Financial Program Operations recently drafted revisions to SOP 50 52 2, Disaster Loan Servicing and Liquidation, which will be submitted into Agency clearance no later than September 30, 2020. Proposed revisions include the evaluation of all loans with collateral for foreclosure and placed into foreclosure status before they are 180-days delinquent. Additionally, a new chapter dedicated to Debt Collection Improvement Act and SBA's requirements has been added to this SOP. This recommendation can be closed when management provides evidence that they have issued the revised SOP 50 52 2 that includes the requirement that all loans with collateral must be evaluated for foreclosure and placed in foreclosure status before they are 180-days delinquent.
3. **Resolved.** Management agreed with our recommendation and stated that the Office of Financial Program Operations recently drafted revisions to SOP 50 52 2, Disaster Loan Servicing and Liquidation, which will be submitted into Agency clearance no later than September 30, 2020. Proposed revisions include all debts 180-days delinquent must be transferred to Treasury Cross-Servicing unless the debt meets a valid transfer exemption. Additionally, a new chapter dedicated to Debt Collection Improvement Act and SBA's requirements was added to this SOP. This recommendation can be closed when management provides evidence that it has issued the revised SOP 50 52 2, which includes a requirement to transfer all debts 180-days delinquent to Treasury Cross-Servicing unless the debt meets a valid transfer exemption.
4. **Resolved.** Management agreed with our recommendation and stated that the Office of Financial Program Operations has developed a training plan and related course materials discussing the requirements of the Debt Collection Improvement Act. Training will be mandatory for all NDLRC employees and will be conducted annually. Training will be provided to all disaster loan operations staff by December 31, 2020. This recommendation

can be closed when management provides the training plan, course materials, and attendance sheets as evidence that all Center staff received the training in 2020.

5. **Resolved.** Management agreed with our recommendation, stating that the Center's internal portfolio monitoring application implemented an automated process using daily data files generated by the Capital Access Financial System – SBA's system of record. Management stated this critical enhancement was completed, November 9, 2019, and ensures all assigned loans are accurately monitored. This recommendation can be closed when management provides OIG a reconciliation report, including a brief narrative of the actions performed and results, which demonstrate that all loans assigned to the Center in the Capital Access Financial System are included in the internal portfolio monitoring application.
6. **Resolved.** Management agreed with our recommendation and stated that it will review all loans currently assigned to the Center, designated as exempt from Treasury Offset Program, and verify that each of the obligors is exempt from referral to Treasury Offset Program. The Center will complete any required updates identified as part of this review. In the event an obligor is incorrectly coded as exempt from referral to Treasury, the referral information will be coded to reflect the appropriate referral code when the temporary suspension of debt collection activities due to COVID-19 is lifted. The existing temporary suspension is effective through December 31, 2020; barring any subsequent extensions to the suspension, the NDLRC will complete this task by June 30, 2021. This recommendation can be closed when management provides evidence that it has reviewed all loans currently assigned to the Center, designated as exempt from Treasury Offset Program, and verified that each obligor is exempt from referral to Treasury Offset Program.
7. **Resolved.** Management agreed with our recommendation, stating that the NDLRC will review all loans currently assigned to the Center, which are designated as exempt from Treasury Cross-Servicing and are 180 days or more delinquent to verify that each of the obligors is exempt from transfer to Treasury Cross-Servicing. NDLRC will complete any required action when the temporary suspension of debt collection activities due to Coronavirus 2019 (COVID-19) is lifted. The existing temporary suspension is effective through December 31, 2020; barring any subsequent extensions to the suspension, the NDLRC will complete this task by June 30, 2021. This recommendation can be closed when management provides evidence that they verified that all obligors for all loans assigned to the Center are exempt from transfer to Treasury and has transferred any non-exempt obligors to Treasury and their plans to conduct ongoing reviews to ensure that the Center is continuously complying with the Debt Collection Improvement Act.
8. **Resolved.** Management agreed with our recommendation, stating that the Center has established policies and procedures to require routine follow-up on delinquent loans. With the use of the daily data file generated from SBA's system of record, and implementing an automated process to update the internal web-based application, it will ensure that all loans assigned to the Center are monitored timely to ensure full compliance with the Debt Collection Improvement Act. This corrective action can be closed when management provides evidence that it established and issued policies and procedures requiring routine follow-up on delinquent loans and support to show that ongoing monitoring of assigned loans is taking place.

9. **Resolved.** Management agreed with our recommendation, stating that the Center will issue an internal memorandum to staff reinforcing the requirements of workout agreements to ensure compliance with the Debt Collection Improvement Act. This recommendation can be closed when management provides the internal memorandum issued to staff reinforcing the workout requirements.

10. **Resolved.** Management agreed with our recommendation and stated that the Office of Financial Program Operations will perform a cost benefit analysis to assist in its determination regarding whether SBA will begin assessing fees on delinquent disaster loans. This recommendation can be closed when management provides the analysis performed and the resulting decision.

Appendix I: Delinquent Loans Not Transferred to Treasury (Finding 2)

The following information details our findings for the eight loans in our judgmental sample of 20 that should have been transferred to Treasury Cross-Servicing but were not transferred because of errors.

Three Loans Classified as in Foreclosure

1. The resolution center put the loan collateral in foreclosure on October 29, 2015. On May 31, 2016, the resolution center agreed to postpone the foreclosure when the borrower indicated they would voluntarily sell the property and pay off the loan. On March 23, 2017, the borrower agreed to pay off the loan by March 27, 2018. However, this did not occur, and SBA never resumed foreclosure action. We did not note any monitoring activity for this loan between March 28, 2018, and April 30, 2019.
2. The resolution center put the loan collateral in foreclosure on June 13, 2016. On March 30, 2017, the resolution center agreed to postpone the foreclosure to pursue a workout. Then on April 6, 2017, the guarantor's attorney discussed an offer in compromise and other options with the SBA. However, on April 17, 2017, the guarantor's attorney informed SBA that the guarantor did not want to complete a workout package and offered a deed in lieu of foreclosure. The last comment in the loan file was dated January 11, 2018, indicating that the loan specialist called the guarantor's attorney and left a message to return SBA's phone call. We did not note any monitoring activity for this loan between January 12, 2018, and April 30, 2019.
3. The resolution center put the loan collateral in foreclosure on October 18, 2016. On October 17, 2018, the resolution center agreed to postpone the foreclosure when the borrower indicated they wanted to pursue a workout. However, the borrower submitted incomplete workout documentation and SBA requested additional required documents by November 7, 2018. This was the last activity documented in the loan file. SBA did not reach a decision on the workout nor did it resume the foreclosure action. We did not note any monitoring activity for this loan between November 8, 2018, and April 30, 2019.

Three Loans Classified as in "Workout" Status

1. The resolution center put this loan in workout status, however, we did not identify a workout agreement. The principal voluntarily resumed monthly payments after SBA sent the borrower a pre-foreclosure letter. Center staff did not obtain information regarding the borrower's income, expenses, repayment ability, or hazard insurance or provide a written workout agreement, as required.
2. SOP 50 52 2 says the final decision and justification for a workout must be documented in the loan file and be supported by a credit memo that includes a cash flow and complete liquidation analysis based on the financial information provided by the borrower.
3. The loan maturity date passed on July 7, 2010, and the current monthly payment amount will result in the loan being paid in full in about 47 years from the date of disbursement. However, the Small Business Act limits the term of a disaster loan to 30 years including renewals and extensions. Because a workout agreement does not exist, the obligors were

not exempt from referral to Treasury Offset Program or transfer of the debt to Treasury Cross-Servicing as of April 30, 2019.

4. The resolution center staff inappropriately approved a workout agreement for an ineligible borrower. The borrower was ineligible because the loan was at least 106 payments past due, the borrower did not pay their delinquent property taxes, and never made a workout payment. The Small Business Act allows deferment of a total of 60 payments during the life of the loan. Similarly, SOP 50 52 2 states generally no more than a total of five years of payments should be deferred over the life of the loan and limits the number of monthly payments that can be deferred to no more than 12 at one time. SOP 50 52 2 says for a workout agreement to be legally-binding, the debtor must provide a good faith payment or other consideration before or at the same time the debtor receives the benefit of the workout agreement.
5. The resolution center staff inappropriately approved an ineligible assumption in lieu of a workout agreement. The assumption was ineligible because the assumptor's evidence of income indicated it lacked the ability to repay the loan and did not reside at the disaster property. An assumptor is a party who takes or assumes responsibility for a loan's repayment after the original borrower, either because of default or some other reason.
6. There was no evidence in the loan file that the resolution center evaluated the assumptor's financial information or obtained evidence of hazard insurance. In addition, the loan was 107 payments past due, which the resolution center deferred after the loan was transferred to regular servicing.

One Loan Classified as in Bankruptcy

1. For the loan incorrectly designated as in bankruptcy, the resolution center considered all debtors for the loan exempt from transfer to Treasury because one or more obligors filed bankruptcy under Chapter 7. However, some of the obligors were not in bankruptcy. The resolution center should have referred the obligors that were not in bankruptcy to Treasury for collection action.

One Loan Classified as in Litigation

2. The final loan was still classified in litigation, although a junior lienholder foreclosed and paid SBA to release its lien against the collateral on August 2, 2018. There was a remaining balance on the loan that should have been referred to Treasury. During the audit, the resolution center agreed to refer the obligor to Treasury Offset Program and transfer the remaining balance debt to Treasury Cross-Servicing.

Appendix II: Objective, Scope, and Methodology

Our objective was to assess SBA's compliance with the Debt Collection Improvement Act, as amended, for delinquent disaster loans.

To accomplish our objective, we reviewed a data extract from Capital Access Financial System containing all disaster loans in liquidation status as of April 30, 2019, to identify the number and dollar value of the loans that were 180 days or more delinquent. We obtained and reviewed the resolution center's training records from July 2018 through April 2019 to determine whether the staff received training in federal delinquent debt collection, agency regulations, or SOP 50 52 2, the agency's written procedures for debt collection and collateral liquidation. We reviewed seven quality control (QC) reports from January through July 2019 and obtained the selection criteria for QC review to determine if QC had identified trends in noncompliance with the Debt Collection Improvement Act. We found the QC reports did not specifically check for compliance with the Act.

We also judgmentally sampled and tested 20 loans in liquidation status that were past due 180 days or more and identified as exempt from transfer to Treasury to verify the accuracy of the loans' exempt status. We reviewed supporting information contained in Capital Access Financial System, Loan Track System (LTrack) and the Edox electronic document storage system and determined whether the obligors were exempt from submission to Treasury Offset Program and Treasury Cross-Servicing as of April 30, 2019. We also reviewed loan history information and verified the accuracy of this information against Capital Access Financial System data.

In addition, we reviewed applicable federal laws and other federal guidance, reviewed SBA policies and procedures, and conferred with SBA OIG legal counsel regarding the requirement for SBA to assess late charges. We also conferred with Treasury officials regarding requirements of the Data Act and Treasury policy.

We also interviewed SBA Headquarters' management officials from the Office of Capital Access, Office of Financial Program Operations, management and personnel at the National Disaster Loan Resolution Center in Santa Ana, California, and the two Disaster Loan Servicing centers located in Birmingham, Alabama, and El Paso, Texas. We also consulted officials from the SBA Office of Disaster Assistance. We also visited the resolution center and the Birmingham Disaster Loan Servicing Center.

Use of Computer -Processed Data

We relied on data from the Capital Access Financial System, LTrack, and, Edox systems for this audit. The Office of Capital Access provided us with a spreadsheet from the Capital Access Financial System containing a list of all disaster loans in liquidation at the resolution center as of April 30, 2019.

The Birmingham and El Paso Disaster Loan Servicing centers also provided us with information extracted from the Capital Access Financial System. We conducted our own limited testing of the Capital Access Financial System data for a selected sample of loans and did not find any material data errors. Also, Capital Access Financial System is audited annually by an external accounting firm and no material issues related to its disaster loan data were identified by the accounting firm audit, dated December 10, 2019. As a result, we considered the Capital Access Financial System data to be reliable for the purposes of our audit. We found the monitoring reports used by the resolution center staff only accounted for only 17 percent of all assigned delinquent loans and about 6 percent of loans delinquent 180 days or more as of April 30, 2019. However, we did not use the monitoring reports for our analysis, relying instead on the Capital Access Financial System information.

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.

Review of Internal Controls

Internal control includes the plan, policies, methods, and procedures adopted by management to meet its missions, goals, and objectives. It includes the systems for measuring, reporting, and monitoring program performance. Internal control serves as a defense in safeguarding assets and in preventing and detecting errors, fraud, noncompliance with provisions of laws, regulations, contracts or grant agreements, and abuse.

We reviewed OMB Circular A-123, which 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 compliance with laws and regulations to the extent necessary to satisfy the audit objective. We also interviewed management of the Office of Capital Access and responsible officials and personnel at the resolution center to identify controls to ensure program integrity and mitigate fraud and financial loss.

SOP 50 52 2, Disaster Loan Servicing and Liquidation, dated September 1, 2015, was the primary internal control mechanism used to communicate management directives regarding daily operations to all levels of the resolution center. The SOP is intended to ensure that specific tasks and activities are performed as directed to ensure the resolution center achieves its mission of maximizing recovery for delinquent debts efficiently, effectively, and as required by laws and regulations.

However, we identified some instances in which the resolution center did not consistently comply with the SOP controls and other instances for which appropriate controls were not in place. We made recommendations in this report to address deficiencies identified.

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

SBA RESPONSE TO AUDIT REPORT

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



TO: Hannibal M. Ware, Inspector General
Office of Inspector General (OIG)

FROM: William Manger, Chief of Staff
Associate Administrator, Office of Capital Access

SUBJECT: Response to Draft Report on SBA's Compliance with the Debt Collection
Improvement Act, as Amended

DATE: September 16, 2020

We appreciate the role the Office of Inspector General (OIG) plays in working with management in ensuring that our programs are effectively managed, and for the feedback provided in this draft report.

The 2020 draft report details the OIG's evaluation results of the Small Business Administration's (SBA) compliance with the Debt Collection Improvement Act (DCIA) of 1996, as amended. The OIG's purpose was to determine whether (1) SBA complied with the 2014 amended requirement by referring delinquent disaster borrowers to the U.S. Department of Treasury Offset Program (TOP) for administrative offset, and (2) transferred all disaster loans 180 days delinquent to Treasury for collection, unless otherwise exempt. The OIG determined that as of April 30, 2019, SBA was not fully compliant with DCIA requirements as not all eligible loans over 180 days delinquent had been transferred to Treasury Cross-Servicing for collection. Further, the OIG assert that some loans were incorrectly classified as exempt and as a result, had not been referred to Treasury Cross-Servicing for collection.

The Office of Financial Program Operations (OFPO), within the Office of Capital Access (OCA), substantially agrees with the OIG's audit findings and recommendations as presented in the draft report. OFPO would like to take this opportunity to emphasize important factors the National Disaster Loan Resolution Center (NDLRC or Center) and OFPO management discussed with the OIG during its course work. The NDLRC is responsible for the liquidation and timely resolution of collateralized disaster loans with an outstanding balance exceeding \$25,000. While the NDLRC's mission seeks to maximize recovery and ensure quick action to enforce debt recovery using all necessary means, the Center also recognizes that its borrowers are disaster victim who have experienced a significant loss to their home and/or business – some of which are experiencing multiple or reoccurring disasters. When a loan is transferred to the NDLRC for liquidation, timely and immediate contact with the borrower is critical. The Center's initial goal is to enter into a workout agreement with the borrower with the intent of securing some form of regular monetary payments. This approach benefits the borrower, the SBA, and the American taxpayer.

Unfortunately, not all borrowers have the means to enter into a workout agreement or cannot maintain the terms of the workout, and liquidation of the collateral is appropriate.

The NDLRC leverages an internal web-based application to manage and monitor the Center's assigned portfolio. The application, initially developed in 2014, contains loan level data, which is utilized to assign liquidation and resolution activities and monitors each step of the process. Initially, the application was manually populated when a loan was transferred from the assigned disaster loan servicing center to the NDLRC. As the application evolved, OFPO management and the Center identified efficiencies to enhance and improve the application; specifically, developing an automated process, using a validated data file, to populate the application, thus eliminating the manual data entry process. With the application serving as the Center's main portfolio management tool, it was imperative that the application contain complete, comprehensive, and accurate data. This critical enhancement was achieved by implementing an automated process utilizing a daily data file generated from the SBA's system of record, which updated the application daily. In conjunction with improving the reliability of the application's data, the automated process promoted a more efficient and effective process resulting in improved processing times.

The NDLRC takes its role in complying with DCIA requirements, including the responsibility they have been entrusted with in protecting taxpayer dollars, very seriously. To promote a thorough and up-to-date understanding of the DCIA and its requirements, SBA's Treasury Offset Division in Birmingham, AL developed a comprehensive training plan and materials to be provided to all disaster loan servicing and liquidation centers. This dedicated training will be provided, at least annually, with its successful completion a requirement amongst all OFPO disaster loan employees.

It is imperative that the centers stay abreast of revised regulations and statutes to ensure compliance not only with DCIA, but other statutory regulations, including Regulation X, which specifically impacts the NDLRC's foreclosure department. Most recently, SBA's SOP 50 52 2, *Disaster Loan Servicing and Liquidation*, underwent an exhaustive review of the policies governing the disaster loan operations centers by chapter; including but not limited to: workout requirements, collateral evaluation requirements, referral requirements, and exemptions.

OFPO would like to reinforce its commitment and continued efforts to fully comply with DCIA requirements.

OIG made the following recommendation:

1. Review all loans assigned to the resolution center that are 180 days or more delinquent and classified with code 66 (Lien or Mortgage/Refer to Treasury Offset Program Only) and 00 (Clear Existing Status Code) and transfer the loans to Treasury Cross-Servicing, unless verified as exempt when the temporary suspension of debt collection activities because of the pandemic is lifted.
2. Revise SOP 50 52 to clearly communicate that all loans with collateral must be evaluated for foreclosure and placed in foreclosure status before they are 180 days delinquent.
3. Revise SOP 50 52 2 to clearly communicate that all debts 180 days delinquent must be transferred to Treasury Cross-Servicing unless the debt meets a valid transfer exemption.

4. Establish requirements to provide annual training on Debt Collection Improvement Act requirements to all staff of the resolution center.
5. Ensure that information used to monitor compliance with the Debt Collection Improvement Act includes all loans assigned to the resolution center as identified in the Capital Access Financial System.
6. Review all loans currently assigned to the Center and designated exempt from Treasury Offset Program and verify that each of the obligors is exempt from referral to Treasury Offset Program, and if not, refer the obligors to Treasury Offset Program, as required.
7. Review all loans currently assigned to the Center and designated as exempt from Treasury Cross-Servicing that are 180 days or more delinquent and verify that each of the obligors is exempt from transfer to Treasury Cross-Servicing, and if not, transfer the debt to Treasury Cross-Servicing, as required when the temporary suspension of debt collection activities due to COVID-19 is lifted.
8. Establish policies and procedures to require routine follow-up on delinquent loans to ensure full compliance with the Debt Collection Improvement Act.
9. Reiterate the requirements for workout agreements to responsible personnel to ensure compliance with the Debt Collection Improvement Act.
10. Perform a cost benefit analysis to determine if SBA should begin assessing fees to offset the cost of processing and handling delinquent disaster loans.

Management's response to the recommendations in the draft report is noted as follows:

Management acknowledges the recommendations listed in the report:

1. The NDLC will review all loans currently assigned to the Center, which are coded 66 or 00 to verify that each account is coded and or referred properly. NDLC will complete any required action when the temporary suspension of debt collection activities due to COVID-19 is lifted.
2. OFPO recently drafted revisions to SOP 50 52 2, *Disaster Loan Servicing and Liquidation*, which will be submitted into Agency clearance no later than September 30, 2020. Proposed revisions include the evaluation of all loans with collateral for foreclosure and placed into foreclosure status before they are 180 days delinquent. Additionally, a new chapter dedicated to DCIA and SBA's requirements has been added to this SOP.
3. OFPO recently drafted revisions to SOP 50 52 2, *Disaster Loan Servicing and Liquidation*, which will be submitted into Agency clearance no later than September 30, 2020. Proposed revisions include transferring all debts 180 days delinquent must be transferred to Treasury Cross-

Servicing unless the debt meets a valid transfer exemption. Additionally, a new chapter dedicated to DCIA and SBA's requirements has been added to this SOP.

4. OFPO's Treasury Offset Division previously developed a training plan and related course materials discussing the requirements of the Debt Collection Improvement Act. Training will be mandatory for all NDLCRC employees and will be conducted annually. Training will be provided to all disaster loan operations staff by the end of the calendar year.
5. The NDLCRC's internal portfolio monitoring application implemented an automated process utilizing daily data files generated by the Capital Access Financial System – SBA's system of record. This critical enhancement was completed, November 9, 2019, and ensures all assigned loans are accurately monitored.
6. The NDLCRC will review all loans currently assigned to the Center, designated as exempt from Treasury Offset Program, and verify that each of the obligors is exempt from referral to Treasury Offset Program. The Center will complete any required updates identified as part of this review.
7. The NDLCRC will review all loans currently assigned to the Center, which are designated as exempt from Treasury Cross-Servicing and are 180 days or more delinquent to verify that each of the obligors is exempt from transfer to Treasury Cross-Servicing. NDLCRC will complete any required action when the temporary suspension of debt collection activities due to COVID-19 is lifted.
8. The NDLCRC has established policies and procedures to require routine follow-up on delinquent loans. With the utilization of the daily data file generated from SBA's system of record, and implementing an automated process to update the internal web-based application, it will ensure that all loans assigned to the Center are monitored timely to ensure full compliance with the Debt Collection Improvement Act.
9. NDLCRC will issue an internal memorandum to the Center reinforcing the requirements of workout agreements to ensure compliance with the Debt Collection Improvement Act (DCIA).
10. OFPO will perform a cost benefit analysis to assist in its determination if SBA will begin assessing fees on delinquent disaster loans.