SBA INSPECTOR GENERAL INSPECTION REPORT

Follow-up Inspection of SBA's Internal Controls to Prevent COVID-19 EIDLs to Ineligible Applicants

Report Number 22-22 | September 29, 2022

Executive Summary

Follow-up Inspection of SBA's Internal Controls to Prevent COVID-19 EIDLs to Ineligible Applicants

Report 22-22

September 29, 2022

What OIG Reviewed

This report presents the results of our follow-up inspection to assess the effectiveness of the U.S. Small Business Administration's (SBA) enhanced internal controls to prevent Coronavirus Disease 2019 (COVID-19) Economic Injury Disaster Loans (EIDL) to ineligible applicants.

The Coronavirus Aid, Relief, and Economic Security (CARES) Act mandated SBA provide COVID-19 EIDLs based on the applicants self-certifying that they were in business on or before January 31, 2020, a date prior to the onset of the crisis. The COVID-19 EIDLs were intended to assist qualifying small businesses adversely affected by the pandemic. The CARES Act prohibited the agency from requiring tax return transcripts to prove eligibility. Congress eliminated this restriction 9 months later with the Consolidated Appropriations Act, 2021.

To meet our objective, we reviewed SBA policies and procedures for COVID-19 EIDLs and eligibility controls the agency put in place after passing the Consolidated Appropriations Act, 2021. To test the controls, we selected 40 COVID-19 EIDL disbursements to entities with Taxpayer Identification Numbers that the Internal Revenue Service did not issue nationwide prior to January 2020, showing it's likely that the business was not operational before the onset of the pandemic. We also examined the loan files to determine if the business was in operation before the date set by the CARES Act.

What OIG Found

We found SBA did not implement the tax transcript requirement in a timely manner, potentially disbursing COVID-19 EIDLs to ineligible entities. For about 4 months after Congress removed the tax return prohibition, SBA made 133,832 COVID-19 EIDL disbursements, totaling about $8.5 billion without proving applicant eligibility using official tax information. Of that amount, more than $92 million was disbursed to businesses with suspect tax ID numbers.

We reviewed 30 of these loans approved before SBA implemented the requirement for tax return transcripts and found that 16 of them, totaling about $1.1 million, should not have been approved. Specifically, we found disbursements to 13 businesses that did not exist on or before January 31, 2020, or had an unknown start date. We also found three businesses that did exist on or before January 31, 2020, but had other red flags, including change of registered agent shortly before the application date, evidence of falsified documents, or evidence the applicant did not own the business.

We also reviewed 10 COVID-19 EIDL disbursements approved after the tax transcript requirement was implemented. We found four of these disbursements, totaling $838,000, should not have been approved because the loan files did not contain conclusive evidence that the businesses existed on or before January 31, 2020.

We also found evidence of potential fraud in 10 of the 40 loan disbursements we sampled. SBA did not obtain tax transcripts for these 10 loans prior to approval. Two of the loans were approved after SBA implemented the tax transcript requirement to verify eligibility. After the loans were initially funded, SBA flagged the 10 loans for suspected COVID-19 EIDL fraud and placed a hold on future funding.

OIG Recommendations

We recommended SBA recover funds disbursed to ineligible applicants identified in our sample and review the remaining COVID-19 EIDL disbursements with suspect tax ID numbers to determine if the business applicant was legitimate and met CARES Act eligibility requirements. If not, SBA should flag the borrower as ineligible and recover the funds.

Agency Response

SBA agreed with our recommendations and plans to review the 20 loans identified in the report to determine if the applicant business qualifies for assistance under the COVID-19 EIDL eligibility criteria and attempt to recover funds provided to ineligible businesses. SBA also agreed to review the 1,536 loans we identified that may not meet the eligibility criteria. If the business is ineligible, SBA will attempt recovery of those loan funds.

Office of Inspector General

U.S. Small Business Administration

DATE: September 29, 2022

TO: Isabella Casillas Guzman
Administrator

FROM: Hannibal "Mike" Ware
Inspector General

SUBJECT: Follow-up Inspection of SBA's Internal Controls to Prevent COVID-19 EIDLs to Ineligible Applicants

This report presents the results of our inspection *Follow-up Inspection of SBA's Internal Controls to Prevent COVID-19 EIDLs to Ineligible Applicants* (Report 22-22). We considered management's comments on the draft of this report when preparing the final report. Management agreed with the two recommendations we made.

We appreciate the cooperation and courtesies provided by your staff. If you have any questions or need additional information, please contact me or Andrea Deadwyler, Assistant Inspector General for Audits, at (202) 205-6586.

cc: Arthur Plews, Chief of Staff
Peggy Delinois Hamilton, Special Counsel for Enterprise Risk
Katherine Aaby, Associate Administrator, Office of Performance, Planning, and the Chief Financial Officer
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Tonia Butler, Director, Office of Internal Controls

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Introduction

The Coronavirus Disease 2019 (COVID-19) pandemic caused businesses everywhere to shut down, resulting in widespread financial hardship. Congress appropriated significant funding to the U.S. Small Business Administration (SBA) to provide financial relief for businesses adversely affected by the crisis. Several new laws gave SBA the authority to use these appropriated dollars to make low-interest COVID-19 Economic Injury Disaster Loans (EIDL). These low-interest loans assisted eligible entities in meeting financial obligations and operating expenses they were unable to meet after the declared disaster. COVID-19 EIDLs provided borrowers with working capital for ordinary and necessary operating expenses.

The SBA Office of Inspector General (OIG) produced a series of reports recommending stronger controls to ensure compliance with applicable laws, to mitigate fraud, and to verify applicant eligibility (see Appendix III). In this report, we follow up on a previous finding in our October 2020 report *Inspection of SBA's Initial Disaster Assistance Response to COVID-19*.[1] Our October 2020 report found that SBA relaxed internal controls to expedite capital to struggling small businesses, significantly increasing the risk of fraud in the EIDL program.

Specifically, the October 2020 report found potentially ineligible businesses received $917.7 million in COVID-19 EIDLs and $135.1 million in emergency EIDL grants as of August 5, 2020. We found the agency did not have sufficient controls to verify that the entities were in business on or before January 31, 2020, prior to the onset of the pandemic, and the eligibility date chosen by Congress. The OIG report recommended that SBA strengthen its controls for verifying a business's operation date to ensure applicants met eligibility requirements and recover funds from ineligible businesses as it continued to respond to the ongoing pandemic.

This report focuses on the effectiveness of SBA's internal controls to prevent COVID-19 EIDLs to applicants who were ineligible because they were not in business as of January 31, 2020.

Background

The Coronavirus Preparedness and Response Supplemental Appropriations Act, signed by the President on March 6, 2020, declared COVID-19 a disaster and authorized SBA to provide EIDLs to eligible entities under the Small Business Act.[2]

The President signed the Coronavirus Aid, Relief, and Economic Security (CARES) Act on March 27, 2020, which included funding for both COVID-19 EIDLs and emergency EIDL grants.[3] The CARES Act required that applicants be in business on or before January 31, 2020 to be eligible for COVID-19 EIDLs or emergency EIDL grants. The CARES Act

[1] OIG Report 21-02, *Inspection of Small Business Administration's Initial Disaster Assistance Response to the Coronavirus Pandemic*, (October 28, 2020).

[2] Public Law 116-123 - Coronavirus Preparedness and Response Supplemental Appropriations Act, 2020.

[3] Public Law 116-136 - CARES Act.

mandated SBA provide COVID-19 EIDLs based on the applicants declaring, or self-certifying, that they were in business on or before January 31, 2020. The CARES Act prohibited the agency from obtaining tax returns or tax return transcripts to prove eligibility, such as business ownership and date of operation. Tax returns are income tax returns provided by the applicant and tax transcripts are income tax return data provided by the Internal Revenue Service (IRS). In the past, and for other types of disaster assistance business loan applications, SBA requested tax transcripts to verify applicant eligibility.

SBA began accepting COVID-19 EIDL applications on March 12, 2020, and in less than a month, the agency received more than 4.5 million applications. By July 31, 2020, SBA received over 14 million COVID-19 EIDL applications and approved 3.2 million for $169.3 billion. In contrast, SBA approved over 2.2 million disaster loans for $66.7 billion in the 67 years from SBA's inception in 1953 until early 2020 prior to the pandemic. SBA continued to accept COVID-19 EIDL applications until December 31, 2021, and as of April 27, 2022, had approved 3.9 million COVID-19 EIDL applications for $378.4 billion.

Tax Identification Numbers Less Likely to Have Been Issued Before January 31, 2020

The Consolidated Appropriations Act, 2021, enacted on December 27, 2020, ended the CARES Act mandate for SBA to rely on applicant self-certification of eligibility and allowed SBA to obtain tax return transcripts from the IRS to verify eligibility. Between our prior report's finding, which reported on data through August 5, 2020, and the enaction of the tax transcript requirement on December 27, 2020, or from August 6, 2020 to December 26, 2020, SBA made 492, 505 more COVID-19 EIDL disbursements totaling about $25.7 billion.

Until late December 2020, SBA could not request tax return transcripts to verify applicant eligibility, proving even the existence or ownership of a business. Some entities that received COVID-19 EIDL disbursements during this period were potentially ineligible because they had Taxpayer Identification Numbers that were more likely to have been issued after January 31, 2020. These tax ID numbers began with a two-digit prefix that the IRS did not issue nationwide until after January 31, 2020, the date all COVID-19 EIDL applicants were required by the CARES Act to be in business to receive the loan.

SBA Delayed Implementation of the Tax Transcript Requirement

Although SBA informed OIG that it implemented the requirement to obtain tax transcripts for all new COVID-19 EIDL applications effective January 1, 2021, we learned that the agency did not actually implement this requirement until 4 months later, on April 28, 2021.

- January 7, 2021 – In response to the Consolidation Appropriations Act, 2021, SBA's contractor modified its system to include the capability of uploading tax return transcripts to the loan file.
- February 19, 2021 – The contractor added the functionality of automatically generating an IRS form for the applicant to consent to SBA obtaining their tax return transcripts. The contractor added rules requiring that the form be signed and submitted before loan approval.
- March 1, 2021 – The SBA Office of Disaster Assistance and IRS signed a written agreement creating a process so that SBA could send requests for tax return transcripts to the IRS and SBA could receive the tax return transcripts.
- April 21, 2021 – SBA obtained approval from the Office of Management and Budget to revise the COVID-19 EIDL application and include the applicant authorization to request a tax transcript from the IRS.
- April 28, 2021 – SBA fully implemented the requirement to obtain tax return transcripts, 4 months after Congress removed the prohibition.[4]

Objective

Our objective was to conduct a follow-up inspection to assess if enhanced internal controls prevented SBA from providing COVID-19 EIDLs to ineligible applicants. To achieve this objective, we focused our assessment on COVID-19 EIDL disbursements made after the Consolidated Appropriations Act, 2021 was passed allowing SBA to obtain tax return transcripts.

Results

We found SBA did not implement the tax transcript requirement in a timely manner, potentially disbursing COVID-19 EIDLs to ineligible entities. For about 4 months after Congress removed the tax return prohibition, SBA made 133,832 COVID-19 EIDL disbursements, totaling about $8.5 billion, without proving applicant eligibility using official tax information. Of that amount, more than $92 million was disbursed to businesses with more suspect tax ID numbers. These businesses needed a higher level of scrutiny to verify that the business existed on or before January 31, 2020 to qualify for pandemic relief assistance.

We tested a judgmental sample of 40 COVID-19 EIDL disbursements made between January 1, 2021 and June 30, 2021 to determine how the agency handled the removal of the tax transcript prohibition and implemented the new requirement. Our sample testing was already in progress when we discovered that the tax transcript requirement was actually not implemented until April 28, 2021, several months after expectation. As a result, our sample contained 30 COVID-19 EIDL disbursements made before the tax transcript requirement and 10 disbursements made after it was implemented.

[4] ODA Memorandum 21-13, Coronavirus (COVID-19) Economic Injury Disaster Loans to $500,000.

We found that the controls before the tax transcript requirement was implemented were ineffective because the loan officers did not obtain conclusive evidence the businesses existed on the CARES Act eligibility date for 16 of the 30, totaling about 1.1 million.

We also found the controls after the tax transcript was implemented were more effective in the sample we tested; however, we still found 4 of the 10 disbursements should not have been approved for $838,000 because the loan files did not contain conclusive evidence that the businesses existed on January 31, 2020. In some instances, the loan files contained conflicting evidence that required further analysis or contained evidence that the documents had been altered and were potentially fraudulent.

Finding: SBA Provided COVID-19 EIDLs to Potentially Ineligible Applicants

During the 4 months after Congress removed the restriction to obtain official tax information, SBA made 133,832 COVID-19 EIDL disbursements totaling about $8.5 billion without proving applicant eligibility using official tax information. Of that amount, more than $92 million was disbursed to businesses with more suspect tax ID numbers. These businesses needed a higher level of scrutiny to verify that the business existed before January 2020 to qualify for pandemic relief assistance.

Effectiveness of SBA's Tax Transcript Control

We analyzed loan disbursements from the first 6 months of 2021, and we found 1,818 disbursements, totaling $136 million, made to businesses with tax ID numbers that were likely issued after the official eligibility date for a COVID-19 EIDL. The tax ID numbers for these businesses were not issued nationally until after January 2021.

We then selected a judgmental sample of 40 COVID-19 EIDL disbursements made between January 1, 2021 and June 30, 2021 to determine how the agency handled the removal of the tax transcript prohibition and implemented the new requirement. Our sample testing was already in progress when we discovered that the tax transcript requirement was actually not implemented until April 28, 2021, several months after expectation. As a result, our sample contained 30 COVID-19 EIDL disbursements made before the tax transcript requirement and 10 disbursements made after it was implemented.

COVID-19 EIDLs Before the Tax Transcript Requirement

For the sample of 30 disbursements approved before SBA implemented the tax transcript requirement, we concluded that 16 of the disbursements, totaling about $1.1 million, should not have been approved because the loan file did not contain conclusive evidence that the business existed on January 31, 2020, or contained strong evidence that the business was not in operation on the mandated date.

Specifically, we found SBA should not have approved the following loan disbursements:

- 13 to businesses that did not exist on or before January 31, 2020, or had an unknown start date;
- 3 to businesses that did exist on January 31, 2020 but had other red flags, including change of agent for the business that was registered with the Secretary of State shortly before the application date, evidence of falsified documents, or evidence the applicant did not own the business. The red flags suggest that while the business did exist, the owner may not have been the loan applicant and identity theft could have occurred, making it possible that the person who applied for the loan was not the business owner.

We found other issues with these 16 loans. For one loan, SBA was contacted by an individual whose identity appeared to have been stolen. He informed the agency that he did not apply for a loan and did not own a small business. The loan officer initially declined the loan due to a fraud alert on the credit report and other red flags. One red flag was that the telephone number of the applicant was not registered to the business owner. However, the team lead reversed the decline and instructed the loan officer to obtain a Social Security card, proof of Taxpayer Identification Number, and a bank statement. The loan officer obtained an IRS letter as proof of the tax ID number and a bank statement dated February 2020, which was after the CARES Act eligibility date of January 31, 2020. The loan officer did not obtain a Social Security card but still approved the loan.

Four of the loan files contained screen shots of online searches made by loan officers showing that the businesses were not established until after the eligibility date. One of these businesses was not established until nearly a year after the eligibility date mandated by the CARES Act. Despite all these red flags, these loans were approved and disbursed.

Taxpayer funds were put at greater risk because the agency was unable to quickly enact the tax transcript requirement. The delay opened the COVID-19 EIDL program to potential fraud and misuse of taxpayer funds. More concerning is the $92.1 million in COVID-19 EIDLs disbursed to high-risk tax Taxpayer Identification Numbers. Since more than half of our sample was determined to be ineligible entities, SBA should review the entire population of $92.1 million for any other ineligible entities and attempt to recover the loan funds from any found.

COVID-19 EIDLs After the Tax Transcript Requirement

SBA began requiring tax return transcripts on April 21, 2021. It communicated this change to loan officers responsible for approving COVID-19 EIDLS on April 28, 2021; however, the IRS was experiencing significant backlogs in processing 2019 tax returns. As a result, when SBA began requiring a tax transcript to verify applicant eligibility, the IRS often could not provide them. To address this problem, on May 4, 2021, SBA began requiring that loan officers request applicants provide a copy of their 2019 income tax return as evidence of eligibility. We found this control did not work as intended because loan officers did not always obtain the tax returns from the applicants and disbursed funds without them.

In a sample of 10 COVID-19 EIDL disbursements approved after the tax transcript requirement was implemented, we found four disbursements, totaling $838,000, should not have been approved. The loan files did not contain conclusive evidence that the businesses existed on January 31, 2020.

We found several issues with these ineligible loans. SBA approved one for $90,000 after it obtained a 2019 partial tax transcript and a copy of the applicant's personal income tax return; however, these documents indicated that the applicant did not have business income from the property rental business. The applicant reported supplemental income from rental of his property on Schedule E, which does not indicate business income, yet SBA approved this loan. Additionally, our search of the Secretary of State website showed that the business was registered on April 19, 2021, well after the eligibility date.

SBA approved a $500,000 loan although no evidence was on file that the business existed and there were no loan officer notes indicating why the loan was approved. The 2019 tax return was added to the loan file on September 27, 2021, well after the loan was approved and disbursed. Both tax transcripts read "tax return was not found" and SBA did not obtain a copy of the applicant's unofficial 2019 tax return before approving the loan. Our search of the Secretary of State database showed that the business was established on September 24, 2020, after the eligibility date. SBA added a copy of the business owner's personal 2019 Form 1040 tax return to the loan file on September 27, 2021. The tax return listed a limited liability company with a different Taxpayer Identification Number and a different name than on the COVID-19 EIDL application.

SBA approved a loan for $70,000 that did not contain any evidence that the business existed on January 31, 2020. The loan officer notes stated that IRS was not providing tax return transcripts at the time and that the loan officer obtained a copy of the applicant's 2019 tax return; however, the tax return was not in the loan file. The Secretary of State Certificate of Existence in the loan file showed that the business was created on April 20, 2021, well after the eligibility date.

SBA approved a loan for $178,000 for a business with no 2019 tax return. SBA did obtain a copy of the applicant's unofficial 2019 tax return; however, the revenue provided on the tax return was $21,000 more than stated on the loan application. The tax return indicated that the business start date was August 31, 2018, while the loan application stated that the business start date was August 31, 2019. The loan file contained a December 2019 bank statement, which showed a beginning balance of $1,297, no deposits, and an ending balance of $1,279. This was inconsistent with the loan decision screen, which indicated a December 2019 revenue of $9,000. In addition, on April 15, 2021, SBA placed an agency hold on a related application filed by the same applicant due to suspected fraud. Despite the agency hold on the related loan and the inconsistent information in the loan file, SBA approved the loan. Our research indicated that the business address on the loan application was for a U.S. post office. The business address on the applicant's tax return was a 1,000-square-foot residence. SBA provided a second COVID-19 EIDL to the applicant for a daycare business operating from the same address.

Potential Fraud

We also found evidence in the loan files suggesting the applicants may have fraudulently obtained 10 of the 20 loans. SBA did not obtain tax transcripts for these 10 loans prior to approval and 2 of the loans were approved after SBA implemented the tax transcript requirement to verify eligibility. After the loans were initially funded, SBA later flagged them for suspected fraud and placed a hold on future funding.

Conclusion

At the start of the pandemic economic crisis, the CARES Act restricted SBA from requesting tax return transcripts. Although lessening requirements can speed up governmental processes, it also opens the door to fraudsters and unscrupulous borrowers. The requirement to obtain tax return transcripts is a necessary control to help prevent ineligible applicants from receiving COVID-19 EIDLs.

In late 2020, Congress authorized SBA to obtain official tax information to prove applicant eligibility, which would help stop potential misuse or abuse of funds. It took SBA 4 months to implement this vital eligibility requirement, even though the agency has prior experience implementing this internal control. In the first 6 months of 2021, SBA made 133,832 COVID-19 EIDL disbursements, totaling about $8.5 billion, without obtaining tax transcripts to verify that new applicants were eligible to receive the loan funds. Of these, 1,536 disbursements, totaling about $92.1 million, had more suspect tax ID numbers indicating that many of these applicants were likely ineligible for the COVID-19 EIDL funds.

The results of our review of a sample of COVID-19 EIDL disbursements confirm that many loan recipients were ineligible for the funds they received. We identified evidence of potential applicant fraud for 10 of the 40 loans we reviewed. Had SBA obtained a tax transcript for all these applicants, the agency could have minimized the potential for fraud to occur and ensured that the applicants were eligible to receive the COVID-19 EIDL funds.

Loans to ineligible borrowers reduce the amount of capital available for eligible businesses to withstand the effects of the pandemic. Obtaining tax return transcripts to confirm eligibility prior to approving COVID-19 EIDLs ensures that needed funds go to the applicants Congress intended and minimizes the potential of COVID-19 loan fraud.

Recommendations

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

1. Review the 20 loans identified in this report as ineligible for the COVID-19 EIDL that the applicants received and recover approximately $2 million improperly disbursed to the applicants.
2. Review the COVID-19 EIDL disbursements with suspect Taxpayer Identification Numbers made after December 27, 2020 to determine if the loan file contains conclusive evidence that the applicant business existed on January 31, 2020, and therefore, met the CARES Act eligibility requirements. If not, flag the borrower as ineligible and recover the funds.

Analysis of Agency Response

SBA management provided formal comments to the draft report, which are included in their entirety in Appendix IV. Management agreed with recommendations 1 and 2 and plans to implement corrective actions to close them. Management's planned actions will resolve both recommendations and their comments included target dates for implementing the corrective actions.

Management said OIG's review covered a period where the program had not implemented authorized controls. OIG's objective was to conduct a follow-up inspection to assess if enhanced internal controls prevented SBA from providing COVID-19 EIDLs to ineligible applicants. To achieve this objective, we focused our assessment on COVID-19 EIDL disbursements made after the Consolidated Appropriations Act, 2021 was passed, allowing SBA to obtain tax return transcripts. It was after our sample testing was already in progress when OIG discovered that the tax transcript requirement was actually not implemented until April 28, 2021, several months after expectation. Additionally, OIG's objective was focused on the effectiveness of internal controls, as opposed to productivity relative to management's comments on the transference of the program to the purview of the Office of Capital Access.

Management also offered comments on the use of Tax Identification Numbers as an internal control element. Management noted that there are legitimate reasons why a business that was already in operation on January 31, 2020 might request and obtain a taxpayer ID number after that date. Management also pointed out that some businesses, such as independent contractors, may not have been required to register a taxpayer ID number, but chose to do so because it benefited the business in some way. OIG was aware of these issues, which is why we recommended that SBA review the loans in question to verify applicant eligibility.

Summary of Actions Necessary to Close the Report

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

Recommendation 1: Review the 20 loans identified in this report as ineligible for the COVID-19 EIDL that the applicants received and recover approximately $2 million improperly disbursed to the applicants.

Status: Resolved

Management agreed with the recommendation and will conduct a thorough review of the 20 loans identified in the report to determine if the applicant business qualifies for assistance under the COVID-19 EIDL eligibility criteria. Management will determine the final monetary impact upon completion of the review. Management noted that if it determines the applicant business is ineligible, SBA will attempt recovery of the loan funds. Furthermore, management stated SBA will continue to refer all suspected cases of fraud to OIG to be investigated and will support resulting criminal investigations and prosecutions. The target completion date for this corrective action is September 30, 2023.

This recommendation can be closed when management provides evidence the agency has (1) completed the review of the 20 loans identified by OIG to determine if the businesses met COVID-19 EIDL eligibility criteria; and (2) recovered, or at a minimum, attempted to recover funds and referred potentially fraudulent loans to OIG.

Recommendation 2: Review the COVID-19 EIDL disbursements with suspect Taxpayer Identification Numbers made after December 27, 2020 to determine if the loan files contain conclusive evidence that the applicant business existed on January 31, 2020, and therefore, met the CARES Act eligibility requirements. If not, flag the borrower as ineligible and recover the funds.

Status: Resolved

Management agreed with the recommendation and will conduct a review of the 1,536 loans identified by OIG to determine if the applicant business qualifies for assistance under the COVID-19 EIDL eligibility criteria. If management determines the applicant business is ineligible, the agency will attempt recovery of the loan funds. Furthermore, management stated SBA will continue to refer all suspected cases of fraud to OIG to be investigated and will support resulting criminal investigations and prosecutions. The target completion date for this corrective action is September 30, 2023.

This recommendation can be closed when management provides evidence the agency has (1) completed the review of the 1,536 loans identified by OIG to determine if the businesses met COVID-19 EIDL eligibility criteria; and (2) recovered, or at a minimum, attempted to recover funds and referred potentially fraudulent loans to OIG.

Appendix I: Objectives, Scope, and Methodology

This report presents the results of our follow-up inspection to assess if enhanced internal controls prevented SBA from providing COVID-19 Economic Injury Disaster Loans to ineligible applicants. We focused on businesses that had a high likelihood of not being in operation on January 31, 2020 based on their Employer Identification Number, also called a Taxpayer Identification Number. These Taxpayer Identification Numbers began with the prefix "85" or "86." According to the IRS, Employer Identification Numbers beginning with these prefixes became available for issuance via the online EIN application after January 31, 2020, the eligibility date mandated by the CARES Act. IRS issued some of these numbers in a limited number of states prior to January 2020. In our analysis, we identified all COVID-19 EIDL disbursements that had a Taxpayer Identification Number likely issued after January 31, 2020 and removed all sole proprietorships.

To meet our objective, we reviewed SBA's policies and procedures for COVID-19 EIDLs, focusing on the controls SBA implemented after December 27, 2020, when the Consolidated Appropriations Act, 2021 was enacted. We interviewed Office of Disaster Assistance officials regarding the controls SBA implemented and the guidance the agency provided to staff. We then obtained a universe of loans disbursed between January 1, 2021 and June 30, 2021. We selected a judgmental sample of 40 loans with Taxpayer Identification Numbers we suspected may have been issued after January 31, 2020. To test the loans in our sample, we reviewed the COVID-19 EIDL decision screen with flags and alerts, the loan application data screen loan application intake summary, loan officer notes, and other documents included in the loan file to determine if it contained conclusive evidence that the business was in operation on January 31, 2020. We also performed online research of Secretary of State registration and other information for each loan to support or refute whether the business existed on or before January 31, 2020.

Use of Computer-Processed Data

We relied on data (Office of Disaster Assistance Data Warehouse, ETRAN file extract, monthly EIDL Disbursement Extract file, and a consolidated table of all weekly ODA identity theft referrals) produced by SBA from the Office of Disaster Assistance for this inspection. We conducted our own limited testing of the data for a selected sample of loans and did not find any material data errors. As a result, we considered the SBA data to be reliable for purposes of this inspection.

We performed this review in accordance with the Council on Inspectors General on Integrity and Efficiency's *Quality Standards for Inspections and Evaluations*. Those standards require that we plan and perform the review to obtain sufficient and appropriate evidence to provide a reasonable basis for our findings and conclusions based on our objective. We believe the evidence obtained provides a reasonable basis for our conclusions and observations based on our objectives.

Appendix II: Questioned Costs

Under the Inspector General Act, questioned costs are expenditures that do not comply with legal, regulatory, or contractual requirements; are not supported by adequate documentation at the time of the audit; or are unnecessary or unreasonable.[5] Questioned costs may be remedied by offset, waiver, recovery of funds, the provision of supporting documentation, or contract ratification, where appropriate.

OIG Schedule of Monetary Impact

Description	Amount (dollars)	Explanation
COVID-19 EIDLs Disbursed to 20 Ineligible Applicants	$1,969,200	Loans were disbursed to applicants who were not in business on January 21, 2020, as required by the CARES Act for COVID-19 EIDL eligibility

Source: OIG analysis of a sample of 40 COVID-19 EIDLs disbursed between January 1 and June 30, 2021

[5] Inspector General Act of 1978, as amended, section 5(f)(1).

Appendix III: Prior Work

Table 1. OIG Prior Oversight Work on SBA's COVID-19 EIDL Program

Report Title	Report Number	Final Report Date
Evaluation of COVID-19 EIDL Applications Submitted from Foreign IP Addresses	SBA OIG 22-17	September 12, 2022
COVID-19 EIDL Recipients on the Department of Treasury's Do Not Pay List	SBA OIG 22-06	November 30, 2021
SBA's Emergency EIDL Grants to Sole Proprietorships and Independent Contractors	SBA OIG 22-01	October 7, 2021
SBA's Handling of Identity Theft in the COVID-19 EIDL Program	SBA OIG 21-15	May 6, 2021
Inspection of Small Business Administration's Initial Disaster Assistance Response to the Coronavirus Pandemic	SBA OIG 21-02	October 28, 2020
Serious Concerns of Potential Fraud in EIDL Program Pertaining to the Response COVID-19	SBA-OIG 20-16	July 28, 2020
Risk Awareness and Lessons Learned from Audits and Inspections of EIDLs and Other Disaster Lending	SBA OIG 20-12	April 3, 2020

Source: SBA OIG

Appendix IV: Management Comments

SBA Response to Inspection Report

U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, DC 20416

To: Hannibal "Mike" Ware
Inspector General
Office of Inspector General (OIG)

From: Jihoon Kim
Director, Office of Financial Program Operations
Office of Capital Access

Subject: Response to OIG Draft Report entitled "Follow-up Inspection of SBA's Internal Controls to Prevent COVID-19 EIDLs to Ineligible Applicants"

Date: September 26, 2022

Thank you for providing the Office of Capital Access (OCA) the opportunity to respond to OIG's Draft Report entitled, "Follow-up Inspection of SBA's Internal Controls to Prevent COVID-19 EIDLs to Ineligible Applicants," dated August 24, 2022. The objective of this audit was to conduct a follow-up inspection to assess if enhanced internal controls prevented SBA from providing COVID-19 EIDLs to ineligible applicants. In particular, the audit attempted to focus on loan recipients that were potentially ineligible because they applied using a Tax Identification Number containing a two-digit prefix that the IRS did not issue nationwide until after January 31, 2020, the date applicant businesses were required to be in business to be eligible for COVID EIDL assistance.

As stated in our previous responses to recent OIG audits concerning the COVID EIDL program, the SBA is firmly committed to strengthening internal controls and mitigating fraud, waste, and abuse in all our programs. The scope of the audit covers loan disbursements for the COVID EIDL program that occurred between January 1, 2021, to June 30, 2021. The SBA shifted management of the COVID EIDL program from the Office of Disaster Assistance to the Office of Capital Access on July 1, 2021. It is important to note that following the transfer of the COVID EIDL program to the Office of Capital Access, we increased loan officer productivity from less than two applications per day to an average of 15 while overhauling the customer service experience and solidifying robust fraud controls. Unfortunately, those enhancements implemented by the Office of Capital Access team were not included in this audit because the scope of loan disbursements was limited to the first six months in 2021.

The OIG report found that controls were more effective after the SBA fully implemented the internal control to obtain tax transcripts directly from the IRS into its systems on April 28, 2021.

The OIG audit focuses on COVID EIDL disbursements made during the months immediately following enactment of the Consolidated Appropriations Act, 2021, and before SBA fully implemented a new internal control to validate eligibility using IRS tax records. SBA continued to disburse much needed emergency working capital funds to small businesses while the agency worked to complete implementation of the control into its COVID EIDL processing system. The OIG found that SBA disbursed $8.5 billion in COVID EIDL loan funds during this period; however, the report fails to acknowledge that disbursements did not increase rapidly until after the control was implemented – the period the OIG acknowledged where controls were more effective. SBA approved over $184 billion in COVID EIDL loan funds following the full implementation of the control to validate eligibility by obtaining tax transcripts directly from the IRS. In other words, SBA approved nearly 22 times the amount of COVID EIDL funds when the controls were more effective compared to the 4-month period examined by the OIG's limited audit scope.

OIG Recommendation 1 – Review the 20 loans identified in this report as ineligible for the COVID-19 EIDL that the applicants received and recover the $1,969,200 improperly disbursed to the applicants.

SBA Response: SBA agrees with the recommendation and will conduct a thorough review of the 20 loans identified in the OIG report to determine if the applicant business qualifies for assistance under the COVID EIDL eligibility criteria. The final monetary impact will be determined upon completion of the review. If we determine that the applicant business is ineligible, SBA will attempt recovery of the loan. Furthermore, SBA will continue to refer all suspected cases of fraud to the OIG to be investigated and will support those criminal investigations and prosecutions conducted by the OIG, DOJ, and other law enforcement agencies.

OIG Recommendation 2 – Review the COVID-19 EIDL disbursements with suspect Taxpayer Identification Numbers made after December 27, 2020, to determine if the loan files contain conclusive evidence that the applicant business existed on January 31, 2020, and therefore met the CARES Act eligibility requirements. If not, flag the borrower as ineligible and recover the funds.

SBA Response: SBA agrees with the recommendation and will conduct a review of the 1,536 loans identified by the OIG to determine if the applicant business qualifies for assistance under the COVID EIDL eligibility criteria. If we determine that the applicant business is ineligible, SBA will attempt recovery of the loan. Furthermore, SBA will continue to refer all suspected cases of fraud to the OIG to be investigated and will support those criminal investigations and prosecutions conducted by the OIG, DOJ, and other law enforcement agencies.

The Office of Capital Access (OCA) has the following comments with respect to recommendation 2:

While we agree to review the loans identified in the OIG report, we must point out that the logic used to determine suspected fraud based on Tax Identification Numbers is by itself insufficient. The OIG report repeatedly refers to Tax Identification Numbers with a two-digit prefix of either "85" or "86" as being "more suspect" tax ID numbers. However, the report does not acknowledge the legitimate reasons why an eligible business who was in operation by January 31, 2020, and therefore eligible COVID EIDL assistance, may obtain a tax ID number after January 2020. There are several legitimate reasons why a business required to have an EIN and already in operation on January 31, 2020, might register a tax ID number after that date. These reasons include, for example:

- Recently formed, covered businesses prepare to enter their first tax year.
- Recently sold, covered businesses prepare to enter their first tax year after the change in
- ownership.
- A corporation receives a new charter.

- A subsidiary of a corporation is using the parent corporation's EIN.
- A new corporation is created after a statutory merger.

Furthermore, businesses other than sole proprietors, such as independent contractors, may not have been required to register tax ID numbers but chose to do so. There are many reasons why a business already in operation but not required to register an EIN might nonetheless choose to register one. These reasons include, but are not limited to:

- EINs may help separate personal and business finances and limit liability in case of a lawsuit.
- EINs may be used to file business taxes and avoid tax penalties in case a business has erroneously determined that it was not required to register an EIN.
- Tax advisors may suggest that certain business tax deductions are less likely to be audited by the IRS if filed using an EIN.
- Use of an EIN may be an effective way to protect against identity theft because it separates personal and business finances and allows one can avoid using an SSN.
- Use of an EIN may add credibility to businesses operating as freelancers or independent contractors.
- Businesses may prefer to hire independent contractors using an EIN to make clear that they are not employees.
- Having an EIN may improve chances that vendors will work with independent contractors because they enable business credit checks.
- Some wholesale distributors may require that retailers have EINs.
- For other forms of business lending, use of an EIN may expedite the process. Banks may not require an EIN for the business loan, but they do require a business bank account, and for most lending institutions, one must have an EIN to obtain a business bank account.
- Having an EIN may help build business credit.