



U.S. SMALL BUSINESS ADMINISTRATION OFFICE OF INSPECTOR GENERAL

ADVISORY MEMORANDUM
REPORT NO. 11-17

DATE: SEPTEMBER 26, 2011

To: James E. Rivera
Associate Administrator for Disaster Assistance
/s/ Original Signed

From: John K. Needham
Assistant Inspector General for Auditing

SUBJECT: Release of Collateral by SBA's Disaster Processing and Disbursement Center Raises Concerns

This is to notify you that we identified an issue during our review of the Release of Collateral by the Processing and Disbursement Center (PDC). The issue concerns whether the proceeds from a sale of damaged property in a relocation should be retained by SBA.

This review was initiated because of issues identified in our recent *Audit of Release of Collateral by the Disaster Loan Servicing Centers, Report No. 11-15*, issued June 3, 2011. During the audit of the servicing centers, we observed questionable collateral release decisions made by the PDC and later executed by the Agency's servicing centers. For three of these collateral releases, the borrowers had relocated and sold the damaged property, however, the Agency did not retain the land value portion, totaling \$93,000, of the sale proceeds for the disaster properties.¹

Our objective was to determine whether the decisions made by the PDC to release collateral properties were in the best interests of the agency and taxpayers. We interviewed agency officials and selected for testing a random sample of collateral release decisions made between April 1, 2009 and March 31, 2011 to determine the extent they complied with SBA policy. The universe sampled for this review contained few relocation loans. We reviewed Disaster Credit Management System data, as well as Electronic Loan Information Processing Systems accounting entries for the sample of collateral release decisions. We conducted the review between May 2011 and July 2011 in accordance with *Generally Accepted Government Auditing Standards* prescribed by the Comptroller General of the United States.

Results

Of the 37 collateral releases that we reviewed during this review, only 3 involved relocations. From these three, we observed a questionable collateral release decision made by the PDC. In this case, the Agency did not retain all of the net proceeds from the sale of the damaged properties, totaling \$15,000. Between this review and the earlier audit, we noted four exceptions totaling \$108,000.

¹ We did not include this issue in Report No. 11-15 because the audit scope was limited to the collateral release decisions made by the Disaster Loans Servicing Centers.

The Agency has based its position for not retaining all net proceeds upon the premise that these funds did not constitute a duplication of benefits.² This justification, however, does not appear to be relevant because the loan authorization requires proceeds from the sale of collateral to be used to pay down the loan balance. Chapter 4 of SOP 50 30, which addresses the sale of the damaged property involving relocations, states that collateral should have a “due on sale” clause. The loan authorizations, for each of the loans, contained such a clause which required the borrower to submit “all net proceeds from any sale of the disaster damaged real estate to reduce the outstanding balance of this loan.” Therefore, the expectation is that proceeds from the sale of the damaged property is to be used to pay down the outstanding loan balance. The SOP does not contain a provision permitting the borrower to retain any portion of the sale proceeds from collateral.

Conclusion

Should the Agency experience a disaster resulting in a high number of relocations, in which the damaged property is taken as collateral, there is a risk that the Agency will not recover some proceeds from the sale of damaged properties. The practice of considering duplication of benefits as the determinant of whether or not to obtain the sales proceeds from the sale of damaged properties is of concern, because collateral release decisions should protect the Agency’s interests as a creditor. Between this review and the earlier audit, we found that the agency has incorrectly allowed four borrowers to retain a total of \$108,000 that should have been used to pay down the SBA loans.

Recommendation

We recommend that the Associate Administrator for Disaster Assistance:

1. Provide official written notification to the PDC to discontinue the practice of considering duplication of benefits as the determinant of whether or not to obtain the sales proceeds from the sale of damaged properties.

Agency Comments and Office of Inspector General Response

On September 2, 2011, we provided the Office of Disaster Assistance (ODA) with the draft report for comment. On September 19, 2011, ODA submitted its formal response which is contained in Appendix I.

Agency Comments

ODA stated that it would ensure the PDC provides justification for any decision not to require the borrower to submit all proceeds from the sale of the disaster damaged property.

² Section 312 of the Robert T. Stafford Disaster Relief and Emergency Assistance Act (42 U.S.C. 5155), amended in June 2007, requires the Federal Government to ensure that no person or entity be provided disaster assistance if he or she has received financial assistance under any other program or from insurance or any other source.

OIG Response

Management's comments are not responsive to the recommendation. As stated in this advisory memorandum, SBA's SOP and the loan authorization do not contain any provision that would allow the borrower to retain any portion of the sale proceeds from collateral. Additionally, management's comments do not specifically address discontinuing the practice of using duplication of benefits as the determining factor. Instead, it provides leeway to utilize the duplicate benefits consideration as its justification to allow the borrower to retain sales proceeds from disaster damaged property.

Actions Required

Please provide your management decision for the recommendation on the attached SBA Form 1824, Recommendation Action Sheet, within 180 days from the date of this memorandum. Your decision should identify the specific action(s) taken or planned for the recommendation and the target date(s) for completion. We appreciate the courtesy and cooperation of the Office of Disaster Assistance during the audit. If you have any questions regarding this memorandum, please contact me at (202) 205-7390 or Craig Hickok, Director, Disaster Assistance Group, at (817) 684-5341.

Appendix I. Agency Response



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

Date: SEP 19 2011

To: Peter L. McClintock
Deputy Inspector General

From: James Rivera
Associate Administrator
Office of Disaster Assistance

Subject: Advisory Memorandum – Release of Collateral by SBA’s Disaster Processing and Disbursement Center Raises Concerns, (Project No. 11804)

We have reviewed the advisory memorandum regarding SBA’s release of collateral by the Processing and Disbursement Center (PDC). The objective was to determine whether the decisions made by the PDC to release collateral properties were in the best interest of the agency and taxpayers.

OIG Recommendation

We recommend that the Associate Administrator for Disaster Assistance:

Provide Official written notification to the PDC to discontinue the practice of considering duplication of benefits as the determinant of whether or not to obtain the sales proceeds from the sale of damaged properties.

Agency Response

We will ensure that the PDC provides justification for any decision not to require the Borrower to submit all net proceeds from any sale of the disaster damaged real estate to reduce the outstanding balance of the Loan.

[FOIA ex. 6]

James E. Rivera