

Performance Audit

Two Economic Injury Disaster Loans Defaulted After the SBA Made Approval Decisions Totaling \$1.4 Million without Mitigating the Reasons for Prior Denials



**Final Report
For Official Use Only**

DATE December 20, 2013



**U.S. Small Business Administration
Office of Inspector General
Washington, D.C. 20416**

**FINAL REPORT TRANSMITTAL
REPORT No. 14-06**

DATE: DECEMBER 20, 2013

TO: James E. Rivera, Associate Administrator for Disaster Assistance

SUBJECT: Two Economic Injury Disaster Loans Defaulted After the SBA Made Approval Decisions
Totaling \$1.4 Million without Mitigating the Reasons for Prior Denials

This report is the first in a series of two reports resulting from our audit of the Economic Injury Disaster Loan (EIDL) Program. This report addresses SBA's approval decisions on two defaulted Economic Injury Disaster Loans. The second report will address SBA's controls to ensure working capital loans under the EIDL Program were approved for eligible borrowers in the correct amount.

We conducted this 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 that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

We appreciate the courtesies and cooperation of the SBA extended to the staff during this audit. Please direct any questions to me at (202) 205-6587 or Terry L. Settle, Director, Credit Programs Group at (703) 487-9940.

/s/
Robert A. Westbrook
Deputy Inspector General

Executive Summary

Two Economic Injury Disaster Loans Defaulted After the SBA Made Approval Decisions Totaling \$1.4 Million without Mitigating the Reasons for Prior Denials

Final Audit Report 14-06

What the OIG Reviewed

The SBA is authorized to provide Economic Injury Disaster Loans by Section 7(b)(2) of the Small Business Act. These loans are intended to provide businesses with working capital to recover from an economic injury caused by a disaster. The SBA's Standard Operating Procedure, (SOP) 50 30 6 designates loan approval authority levels for Economic Injury Disaster Loans based on loan complexity and dollar amount. It also provides loan eligibility, repayment ability, reconsideration or appeal, and documentation requirements for Economic Injury Disaster Loans.

Our audit objective was to determine whether the SBA had sufficient controls to ensure working capital loans under the Economic Injury Disaster Program were approved for eligible borrowers in the correct amount. During the audit, we reviewed a sample of 65 economic injury disaster loans. From the sample, we identified three large defaulted Economic Injury Disaster Loans that involved inquiries by elected officials and loan reconsiderations. As a result, we reviewed these loans in the Disaster Credit Management System to determine if SBA's Processing and Disbursement Center (PDC) staff adequately addressed or mitigated prior loan denial factors before it approved the loans.

This report addresses SBA's approval decisions on two large defaulted Economic Injury Disaster Loans. We did not identify reportable issues of concern related to the third defaulted economic injury disaster loan. We will issue a subsequent report addressing the overall audit objective.

What the OIG Found

During the audit, we found that the PDC made two Economic Injury Disaster Loan approval decisions that, in effect, reversed previous denial decisions. In doing so, the PDC did not adequately address or mitigate the prior denial factors or obtain supporting documentation to overcome deficiencies.

The decisions involved a \$736,300 working capital disaster loan and a \$671,900 loan increase to separate businesses, totaling approximately \$1.4 million. Both loans involved repeated denials by the PDC staff, which were later overturned. In both

cases, the loans rapidly defaulted. One borrower made 9 monthly payments, while the other made 11 payments.

The SBA loan files did not support that either business was eligible for the requested economic injury assistance. One of the businesses appeared to be ineligible for working capital disaster funds because it lacked repayment ability and the loan applicant indicated it intended to use the funds to relocate, not for working capital. The other business also appeared to be ineligible for a loan increase because the business had already recovered from the losses it incurred due to the disaster.

In reviewing the loan files, we observed that the SBA had received multiple inquiries from elected officials on behalf of the two applicants. We recognize that elected officials routinely contact the SBA on behalf of constituents, and that constituent casework is an important part of our system of government. While some of the constituent letters were missing from the loan files, the letters that were documented in the files contained routine inquiry language.

The responsible loan officials told auditors that they were not influenced by these contacts, and that they based their reversal decisions on additional information provided by the borrowers. We found no evidence that the loan decisions were the result of the external contacts, but the loan files were incomplete and did not explain how the prior denial factors were addressed or mitigated. Therefore, we were unable to independently verify the loan officer's assertions that the contacts had no impact on the loan decisions. It is in the best interest of SBA to fully document reversal decisions to respond to any potential allegations of external influence in lending decisions.

OIG Recommendations

We recommended that the Associate Administrator for Disaster Assistance require an adequate approval justification and supporting documentation to address and resolve all prior denial factors when a previous denial decision on a loan is overturned. The approval justification and supporting documentation should be retained in the Disaster Credit Management System.

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Introduction

This report is the first in a series of two reports resulting from our ongoing audit of the Economic Injury Disaster Loan (EIDL) Program. Our overall audit objective was to determine whether the SBA had sufficient controls to ensure working capital loans under the EIDL Program were approved to eligible borrowers for the correct amount. During the audit, we identified three large defaulted EIDLs that involved inquiries by elected officials¹ and loan reconsiderations. As a result, we reviewed these loans to determine if SBA's Processing and Disbursement Center (PDC) staff adequately addressed or mitigated prior loan denial factors when it approved the loans. We did not identify reportable issues of concern related to the third defaulted economic injury disaster loan. This report addresses SBA's approval decisions on two of the large defaulted EIDLs. We will issue a subsequent report addressing the overall audit objective.

To accomplish our objective, we interviewed Agency officials at the SBA's Processing and Disbursement Center in Fort Worth, Texas and at the Office of Disaster Assistance Headquarters (ODA) in Washington, D.C. We selected a random statistical sample of 65 loans from a universe of Economic Injury Disaster Loans (working capital loans) with a final disbursement date between January 1, 2008, and April 30, 2012. From the sample of 65 loans, we identified three large defaulted working capital loans that involved inquiries by elected officials and loan reconsiderations. We also reviewed the agency's electronic loan files maintained within the Disaster Credit Management System (DCMS).

We conducted this performance audit in Fort Worth, Texas, between April 2012 and November 2013, 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 that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

Background

Section 7(b)(2) of the Small Business Act authorizes the SBA to provide Economic Injury Disaster Loans. These loans are intended to provide a business with working capital to recover from an economic injury caused by a disaster. The PDC in Fort Worth, Texas is the primary loan processing center for the disaster loan program.

The SBA's Standard Operating Procedure (SOP) 50 30 6² designates loan approval authority levels for EIDLs based on loan complexity and dollar amount. It also provides loan eligibility, repayment ability, reconsideration or appeal, and documentation requirements for EIDLs. For loans greater than \$750,000 and up to \$1 million, the approval of the PDC's Center Director or the Assistant Director for Loan Processing, or designee for either position, is required. Loans exceeding \$1 million require approval by the senior executive of the Disaster Loan Program, the Associate Administrator for Disaster Assistance or designee, located in Washington, D.C.

The SOP states the Agency must have reasonable assurance that the borrower has the ability to repay any proposed loan. The SOP also addresses eligibility for EIDLs. To be eligible, loan proceeds for

¹ For purposes of this report, inquiries or contacts by elected officials include contacts by the officials themselves or by staff members on their behalf.

² SOP 50 30 6 *Disaster Assistance Program*

economic injury loans may only be used for working capital purposes.³ Repair of physical damage is not an eligible use of EIDL proceeds. Further, the SOP requires that when the applicant requests reconsideration or appeal of a declined loan application, the applicant must provide all information necessary to overcome the reasons for declining the loan. In addition, the SOP requires that all documents be scanned, so they can be stored electronically in the loan file.

Nature of Limited or Omitted Information

No information was omitted due to confidentiality or sensitivity, nor were there limitations to information on this audit.

Review of Internal Controls

Office of Management and Budget (OMB) Circular A-123⁴ 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.

We will include our assessment of the internal controls for approval of economic injury disaster loans in a forthcoming audit report addressing the remainder of our findings.

Results

Finding 1: Two Approval Decisions Made without Mitigating Reasons for Prior Denials

During the audit, we found that the PDC made two EIDL approval decisions that, in effect, reversed previous denial decisions. In doing so, the PDC did not adequately address or mitigate the prior denial factors or obtain supporting documentation to overcome deficiencies. The decisions involved a \$736,300 working capital disaster loan and a \$671,900 loan increase to separate businesses, totaling approximately \$1.4 million. Both loans involved repeated denials by the PDC staff that were later overturned. In both cases, the loans rapidly defaulted. One borrower made 9 monthly payments, while the other borrower made 11 payments. One of the businesses appeared to be ineligible for working capital disaster funds because it lacked repayment ability and the loan applicant indicated it intended to use the funds to relocate, not for working capital. The other business also appeared to be ineligible for a loan increase because it had already recovered from the losses it incurred due to the disaster.

A timeline of events for each loan is provided in Appendices II and III.

\$736,300 Ineligible Economic Injury Disaster Loan Approved by SBA's Processing and Disbursement Center

The PDC approved a \$736,300 Economic Injury Disaster Loan for working capital on February 15, 2008, without addressing or mitigating prior denial factors or obtaining supporting documentation to overcome deficiencies.

³ Federal Regulation 13 CFR 123.303(a) Disaster Loan Program also contains the same restriction.

⁴ OMB Circular A-123, *Management's Responsibility for Internal Control*, December 21, 2004.

The applicant operated a marina on a lake impacted by a U.S. Army Corps of Engineers' decision to reduce the lake water level for dam repairs. The initial loan application was automatically declined due to unsatisfactory credit on July 17, 2007. However, on August 22, 2007, the loan officer received an inquiry about the status of the loan from the Public Information Officer at the PDC indicating that an elected official contacted the agency about the status of the loan. The next day, the business owner was informed that additional information was needed to process the EIDL application. The requested information included the cost and sources of funding for its marina relocation project and the financial information necessary to project the business' cash flow following its relocation. The loan officer recommended that the business owner withdraw the disaster loan application until he could provide the additional information. On the same day, a state elected official wrote to the PDC asking for favorable consideration of the application.

Over the next month, while the borrower continued to submit additional information, two other elected officials contacted the PDC on behalf of this borrower. Nevertheless, the Agency declined the loan again on October 3, 2007. While the PDC cleared the poor credit issue that resulted in the first denial, this denial was based on the business' lack of repayment ability and the fact that the intended use of the loan proceeds for the relocation project constituted an ineligible use of Economic Injury Disaster Loan funds. Following this loan denial, a public official called the Disaster Assistance Field Operations Center requesting the loan's approval status.

On November 27, 2007, the SBA's senior Disaster Assistance Program executive, the Associate Administrator for Disaster Assistance, wrote a letter to one of the elected officials who had contacted the SBA on the business' behalf. The letter explained that the Agency had declined the application due to concerns that the projected revenue and expense levels might not be attainable. Also, the letter stated that the business may not provide sufficient cash flow to meet current business and personal financial obligations, service the sizable level of current debt, and repay additional SBA debt. Further, the letter stated that the business owner advised the SBA that his intent was to use the EIDL funds to relocate the marina. As EIDL assistance is intended for working capital, these funds may not be used for the physical costs of any relocation project.⁵

The loan file indicates that on the next day, November 28, 2007, the SBA's Assistant Director for Loan Processing called the applicant. Following the phone call, the Assistant Director noted in the file that the applicant still did not have any idea of how long it would take to relocate the marina and that he "may likely get a new investor." Two days later, on November 30, 2007, the Assistant Director again contacted the applicant and his consultant and noted in the file that the consultant still wanted the SBA funds for the relocation of the marina. These facts illustrate that the applicant was still intending to use the loan proceeds to relocate the marina, however, economic injury loan funds may not be used for this purpose.

On January 8, 2008, the Assistant Director noted in the loan file that the applicant's consultant had emailed details about the project. As a result, the loan application was once again reactivated. However, this email was not stored/captured/found in the electronic loan file that we reviewed.

⁵ The SBA disaster declaration limited financial assistance to working capital from Economic Injury Disaster Loans and did not provide funds for physical injury.

On January 23 and 31 of 2008, the loan officer noted in the loan file that information was still needed to process the application. The file notations indicated that the applicant might obtain a new investor and the marina would possibly not be relocated until June 2008. While the loan file indicated that the loan officer performed additional analysis, the supporting documentation was not in the electronic loan file. On February 15, 2008, the PDC approved the \$736,300 economic injury loan. The approval justification stated that “at appeal level, applicant provided detailed and reasonable projections to support repayment ability . . . they also provided detailed explanation as to how the relocation and project costs would be funded. . . .”

We determined that the financial information and projections the loan officer used to assess repayment capacity and approve the loan were identical to those the previous loan officer used to decline the loan on October 3, 2007. The loan officer who denied the loan used an average of the 2006 historical data, combined with projections for 2008 and 2009. The use of 2006 historical data was necessary because the applicant had purchased the business in April of 2006 and this was the only available historical data. This original analysis also questioned the reasonableness of the 2009 projections and indicated the applicant lacked repayment ability.

The analysis supporting the loan approval, however, assessed repayment capacity solely based on the average of projections for 2008 and 2009. The approval analysis did not consider the business’ actual historical financial data for 2006. The inclusion of this data when the loan was denied, and exclusion of it when the loan was approved, may create the appearance that the historical financial data was excluded for the sole purpose of justifying the loan approval. The loan officer who approved the loan did not explain why his methodology was superior to that used to deny the loan and also did not address or mitigate the original questions regarding the unreasonableness of the 2009 projections.

While loan officials noted there was additional information supporting the loan’s eligibility, there were no such supporting documents in the electronic file. Furthermore, the loan officials were unable to produce these documents during the OIG’s audit. The loan officials also told auditors that they were not influenced by the elected official inquiries made on this loan. We found no evidence that the loan decisions were the result of the external contacts, but the loan file was incomplete and did not explain how the prior denial factors were addressed or mitigated. Therefore, we were unable to independently verify the loan officer’s assertions that the contacts had no impact on the loan decisions.

The PDC should not have approved this \$736,300 loan because the borrower lacked repayment ability, as stated in the PDC’s previous denial. As a result, the SBA received only nine monthly payments totaling \$33,201 before the loan quickly defaulted. Additionally, there was no documentation to support the existence of an adequate alternative source of funding for the relocation project. This loan approval decision is deemed an improper payment as defined by the Improper Payments Elimination and Recovery Act (Public Law 111-204).

\$671,900 Ineligible Economic Injury Disaster Loan Increase Approved by SBA's Processing and Disbursement Center

The PDC approved an \$828,100 disaster loan for a combination of working capital and repair of physical damage injury on December 5, 2008. The physical injury portion of the loan included \$313,900 for the replacement of inventory lost due to Hurricane Wilma. On October 8, 2009, the PDC approved a \$671,900 loan increase to the working capital portion of the loan. The concerns outlined below pertain to this subsequent loan increase.

The applicant was a wholesale vendor providing food-service supplies to institutional organizations. The business was impacted by Hurricane Wilma in October 2005. In response to a Presidential Disaster Declaration, the SBA offered both physical injury and Economic Injury Disaster Loans for victims of Hurricane Wilma. The deadlines for filing applications were initially set at January 31, 2006, for physical damage and July 24, 2006, for economic injury. However, the deadline for economic injury was later extended by the PDC until December 31, 2007.

Nearly eleven months after the filing deadline, on October 14, 2008, the applicant requested that the SBA accept its loan application. An elected official contacted the SBA's Field Operations Center on behalf of the business on October 30, 2008, and the PDC agreed to accept the late application on November 1, 2008. While the loan application was still being processed, a second elected official contacted the Field Operations Center regarding the loan application. On December 5, 2008, the PDC approved a combination working capital and physical loan.

Approximately seven months later, the borrower requested that the SBA increase the loan by \$266,000 to purchase or replace its inventory. The PDC denied this request because it had already provided \$313,900 to replace inventory. The loan officer also noted that the borrower had already recovered from its economic injury as evidenced by increased revenues and the profitability of the business. On July 23, 2009, the loan officer informed the borrower that the loan request would be denied. That same day, an elected official wrote a letter on the borrower's behalf. The borrower then made two other attempts, on August 4 and August 31, 2009, to obtain a loan increase (the reconsideration and an appeal of the previous denial), but the PDC denied both requests. In its last denial, the Deputy Director of the PDC wrote a letter to the borrower stating that this decision was final since the borrower had exhausted the appeal process.

During the PDC's reconsideration of the loan increase in August 2009, the borrower disclosed to the PDC that it was the victim of an alleged fraud committed in 2008. Based upon this information, the PDC determined that this was the reason the business did not have adequate cash flow. The adverse event took place almost two and half years after Hurricane Wilma and prior to the borrower's application for the SBA disaster loan. Nevertheless, it was not disclosed by the borrower prior to the approval of the original loan in December 2008. These facts significantly affected the PDC's denial of the economic injury loan increase. The August 27, 2009, and September 11, 2009 denials were based on: (1) the alleged fraud's impact on cash flow; (2) the fact that the SBA had already loaned the business \$313,900 to replace its inventory lost as a result of Hurricane Wilma, and (3) the fact that the business had already recovered from its economic injury. On September 23, 2009, another elected official contacted the SBA on the borrower's behalf. On September 30, 2009, the borrower called the ODA Headquarters located in Washington, DC. Subsequently, the PDC was asked by SBA Headquarters "to review the file . . . for additional EIDL eligibility."

Although the borrower had requested a loan increase of \$266,000 to purchase or replace inventory, on October 8, 2009, the SBA approved an increase of \$671,900. Following this loan increase, the total loan amount equaled \$1,500,000 (the maximum loan limit at that time). We found no explanation of why the approved loan amount exceeded the amount requested by the borrower. Also, when it overturned the prior denial decisions, the PDC did not address or mitigate the documented reasons for the denials. Instead, the PDC justified its decision to approve the increase by indicating that the borrower had used personal funds to keep the business operating. This, however, was not new information and the PDC had considered this fact at the time of the prior denials.

An SBA official told auditors that he was not influenced by the elected official inquiries made on this loan. We found no evidence that the loan decisions were the result of the external contacts, but the loan file was incomplete and did not explain how the prior denial factors were addressed or mitigated. Therefore, we were unable to independently verify the official's assertions that the contacts had no impact on the loan decisions.

The PDC and Headquarters should not have approved this loan increase of \$671,900 because the borrower had already recovered from the economic injury caused by the disaster and the SBA had already loaned the borrower funds to replace inventory lost during the hurricane, as stated in the PDC's previous denial. The SBA received only eleven monthly payments for this loan, totaling \$81,917 before the loan quickly defaulted. The loan increase of \$671,900 approved by the Office of Disaster Assistance is deemed an improper payment as defined by the Improper Payments Elimination and Recovery Act (Public Law 111-204).

Conclusion

The PDC made approval decisions involving a \$736,300 working capital disaster loan and a \$671,900 disaster loan increase that, in effect, reversed previous denial decisions. In doing so, the PDC did not adequately address or mitigate the prior denial factors or obtain supporting documentation to overcome loan repayment and eligibility deficiencies. Both loans involved repeated denials by PDC staff that were later overturned. In both cases, the loans rapidly defaulted. One borrower made 9 monthly payments, while the other borrower made 11 payments. One of the businesses appeared to be ineligible for working capital disaster funds because it lacked repayment ability and the loan applicant indicated it intended to use the funds to relocate, not for working capital. The other business also appeared to be ineligible for a loan increase because it had already recovered from the losses it incurred due to the disaster.

In reviewing the loan files, we observed that the SBA had received multiple inquiries from elected officials on behalf of the two applicants. We recognize that elected officials routinely contact the SBA on behalf of constituents, and that constituent casework is an important part of our system of government. While some of the constituent letters were missing from the loan files, the letters that were documented in the files contained routine inquiry language. The responsible loan officials told auditors that they were not influenced by these contacts, and that they based their reversal decisions on additional information provided by the borrowers. We found no evidence that the loan decisions were the result of the external contacts, but the loan files were incomplete and did not explain how the prior denial factors were addressed or mitigated. Therefore, we were unable to independently verify the loan officer's assertions that the contacts had no impact on the loan decisions. It is in the best interest of the

SBA to fully document reversal decisions to respond to any potential allegations of external influence in lending decisions.

Recommendation(s)

We recommend that the Associate Administrator for Disaster Assistance:

1. Require an adequate approval justification and supporting documentation to address and resolve all prior denial factors when a previous denial decision on a loan is overturned. The approval justification and supporting documentation should be retained in the Disaster Credit Management System.

Agency Comments and Office of Inspector General Response

On December 5, 2013, we provided a draft copy of this report to SBA management for comment. On December 16, 2103, SBA management provided a formal response, which is included in its entirety in Appendix IV. A summary of management's comments and our response follows.

The SBA disagreed with the report's conclusion. However, the SBA agreed to implement the recommendation.

Agency Comments

The SBA disagreed with the report's conclusion that both borrowers were ineligible for EIDL assistance and that both loans should be deemed improper payments. The SBA also disagreed with the implication that elected officials influenced their loan decisions. In both cases, the SBA asserts the decision to approve the loans were made in accordance with SOP 50 30 6 and were justified through documented financial analysis and written justification in the file. Management indicated that the loan officers approving these two loans followed ODA policy, which does not require loan officers to address and resolve prior denial factors when reviewing reconsiderations or appeals.

OIG Response

As stated in the report, the SBA did not sufficiently mitigate previous denial factors. For one borrower, the SBA addressed the prior denial factor, but did not have the documentation to support the loan officer's assertion that the prior denial factor was mitigated. For the other borrower, the SBA did not address the primary reason for the loan denial. Therefore, the OIG was unable to verify that either borrower was eligible for EIDL assistance. Since eligibility for these two borrowers has not been established and documentation was missing from the loan files, both loans meet the definition of an improper payment.

Recommendation 1**Management Comments**

Management concurred with the recommendation. Management agreed to implement new procedures that require justification and supporting documentation to address all prior denial factors when a previous denial decision on a loan is overturned. The approval justification and supporting documentation should be retained in DMCS.

OIG Response

Management comments were responsive to the recommendation.

Appendix I: Scope and Methodology

Our audit objective was to determine whether the SBA had sufficient controls to ensure working capital loans under the EIDL Program were approved to eligible borrowers for the correct amount. To achieve our objective, we interviewed Agency officials at the SBA's Processing and Disbursement Center in Fort Worth, Texas, and at SBA Headquarters in Washington, D.C.

From the universe of loans, a statistical consultant selected a statistically valid random sample of 65 economic injury disaster loans with a final disbursement date between January 1, 2008, and April 30, 2012, excluding loans of \$24,999 or less. The final universe of 2,264 loans totaled \$282.4 million.

From the sample of 65 loans, we identified 3 large defaulted working capital loans that involved inquiries by elected officials and loan reconsiderations. As a result, we reviewed these three loans to determine if staff at the Processing and Disbursement Center adequately addressed or mitigated prior loan denial factors when it approved the loans. We did not identify reportable issues of concern related to the third defaulted economic injury disaster loan. For these loans, we reviewed the agency's electronic loan files maintained within the Disaster Credit Management System.

Use of Computer-Processed Data

For our audit, we relied on information maintained by the SBA in the Loan Accounting System and Disaster Credit Management System. Previous OIG engagements have verified that the information maintained in these systems is reasonably reliable. Further, data elements associated with reviewed loans were verified against source documentation scanned into the electronic loan files. As a result, we believe the information is reliable for the purposes of this audit.

Prior Coverage

U.S. Government Accountability Office Audit Reports

Report GAO-12-253T, *Progress Continues in Addressing Reforms to the Disaster Loan Program*, issued November 30, 2011.

Report GAO-09-900T, *Additional Steps Should Be Taken to Address Reforms to the Disaster Loan Program and Improve the Application Process for Future Disasters*, issued July 29, 2009.

Report GAO-06-860, *Actions Needed to Provide More Timely Disaster Assistance*, issued July 28, 2006.

Report GAO-06-605T, *Improvements Made, but Loan Programs Face Ongoing Management Challenges*, issued April 6, 2006.

Small Business Administration-Office of Inspector General Reports

Audit Report 09-06, *The Uses of Proceeds from Gulf Coast Disaster Loans*, issued January 15, 2009.

Audit Report 3-13, *Audit of Economic Injury Disaster Loans*, issued March 14, 2003.

Appendix II: Summary of Events for Loan One

Figure 1 Summary of Agency Loan Actions and Inquiries by Elected Officials for Loan One

Date	Event
07/17/2007	The SBA auto declines the loan application due to unsatisfactory credit.
08/22/2007	SBA's Public Information Officer inquires about the application.
08/23/2007	The PDC / Borrower withdraw the loan application.
08/23/2007	Elected Official # 1 (State Governor) – sends letter to the PDC.
09/13/2007	Elected Official # 2 (U.S. Senator) – is written letter by the ODA.
09/14/2007	Elected Official # 3 (U.S. Representative) – places phone call to the PDC.
09/24/2007	Elected Official # 3 (U.S. Representative) – places additional phone call to the PDC.
10/03/2007	The PDC denies the loan application.
10/22/2007	Public Official #1 (State's Small Business Division) – places phone call to Field Operations Center.
11/27/2007	Elected Official # 2 (U.S. Senator) – is written another letter by the ODA.
02/15/2008	The PDC approves the loan.

Appendix III: Summary of Events for Loan Two

Figure 2 Summary of Agency Loan Actions and Inquiries by Elected Officials for Loan Two

Date	Event
10/2005	Hurricane Wilma strikes.
12/31/2007	Final Deadline for EIDL Loans for this disaster.
04/8 & 9/2008	Borrower's lender shuts down the business' Line of Credit because the business was sold; however, the business claims that a potential buyer defrauded it.
10/14/2008	The business asks the PDC for late acceptance of loan application, but the PDC denies it.
10/30/2008	Elected Official # 1 (U.S. Representative) writes to the Field Operations Center on behalf of the applicant.
11/1/2008	The PDC notifies the business applicant that a late application will be accepted, if filed within 14 days.
11/6/2008	The PDC receives the loan application.
11/7/2008	Elected Official # 2 (U.S. Senator) - writes to the Field Operations Center on behalf of the applicant.
12/5/2008	The PDC approves a Combination EIDL & Physical loan for \$828,100.
07/23 -28/2009	The borrower requests an increase of the EIDL loan by \$266,000 to purchase inventory, but the PDC denies the request (Loan Modification # 3).
07/23/2009	Elected Official # 3 (The White House) - writes a letter on behalf of the borrower.
08/27/2009	The borrower asks for reconsideration of the prior denial and the PDC denies again.
09/11/2009	The borrower requests appeal of prior loan denial; however, the PDC issues a "final" denial.
09/23/2009	Elected Official #4 (U.S. Representative) called the SBA District Office.
09/30/2009	The borrower called the ODA Headquarters in Washington, D.C. Subsequently, the Headquarters management instructed the PDC to review file again.
10/8/2009	The ODA approved an increase in the loan to a total amount of \$1.5 million.

Appendix IV: Management Comments

**U.S. SMALL BUSINESS ADMINISTRATION
Disaster Assistance**

DATE: December 16, 2013

TO: Robert A. Westbrook
Deputy Inspector General

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

Subject: Two Economic Injury Disaster Loans Defaulted After the SBA Made Approval Decisions Totaling \$1.4 Million without Mitigating the Reasons for Prior Denials

We have reviewed the OIG Draft Report regarding SBA's approval decisions on two defaulted Economic Injury Disaster Loans (EIDL). The audit report concludes that neither borrower was eligible for EIDL assistance and that both loans should be deemed improper payments. We disagree with the report's conclusion. The report further concludes that although OIG found no evidence that loan decisions were influenced as a result of external contacts by elected officials, OIG is unable to independently verify that the contacts had no impact on the loan decisions because the loan files were incomplete and did not explicitly detail how the prior denial factors were addressed or mitigated. While we realize the importance and value of external contacts by elected officials, we also disagree with the implication that these officials influenced our loan decisions.

The two files in question were complex in nature and not typical EIDLs. The factors in each case are unique and do not lend themselves to a "cookie cutter" approach to underwriting. We reviewed each loan file in question and found no departures from standard operating procedures in determining eligibility or reviewing requests for reconsideration and appeal of earlier decisions. In both cases, the decision to approve the loan was made in accordance with SOP 50 30 6 and was justified through documented financial analysis and written justification in the file. Therefore, we strongly object to your determination that these two loans constitute improper payments.

In order to provide the disaster loan applicant every opportunity to obtain loan approval, applicants who request reconsideration or appeal are assigned a new loan officer. Current policy is for the new loan officer to take a "fresh look" at all of the information. This determination is made independently without considering the previous loan officers' reasons for denial. The loan officers who approved the two loans in question followed this existing procedure, as explained further below:

Loan #1: \$736,300 Economic Injury Disaster Loan

As stated in the OIG report, this loan applicant operated a marina impacted by a U.S. Army Corps of Engineers' decision to reduce the lake water level for dam repairs. The final decision to reverse the previous declines was based on a new review of existing information along with a review of new information. During the appeal, the applicant provided new information detailing how the business would cover the costs of opening a new location without the use of SBA EIDL funds (i.e., through grants and other programs of the State and County). Information in the file indicates that rather than fully relocating the existing marina, the applicant would continue to sell fuel and rent cottages and RV spaces at the existing location. Repayment ability at the appeal level was assessed using existing information in

light of the new information provided by the applicant during the appeal. Projections were enhanced by the fact that the applicant planned to continue to maintain a presence at the old location, and were determined to be realistic and supported repayment. The loan officer did adequately justify the decision under existing ODA policy, which does not require loan officers to address and resolve prior denial factors when reviewing reconsiderations or appeals.

We acknowledge that certain documents used to support the loan officer's decision were not properly scanned into the electronic file in DCMS. However, we believe that the written justification of the loan officer provides sufficient evidence that the loan decision was correct. This loan was approved in 2008 and the processes for ensuring that documentation was scanned into the electronic file were flawed. Since 2008, we have changed the procedure for scanning documentation into the file. We are confident the changes now ensure that all documents sent in by the applicant are correctly placed in the file before they are used in a final determination.

Loan #2: \$671,900 Economic Injury Disaster Loan Increase

This loan applicant received an SBA disaster loan for physical damage and economic injury as a result of damages caused by Hurricane Wilma in 2005. As stated in the OIG report, the applicant requested a working capital loan increase, which was denied because the PDC determined that the applicant had already recovered from the economic injury caused by the disaster. Because the applicant provided little new information during reconsideration and appeal, both requests were again denied. However, the request for loan increase was later re-opened because the file received further review at the AA/DA level which revealed that we did not properly assess the borrower's EIDL eligibility in the previous two decline decisions. In a final review, the new loan officer identified adequate cause to extend the injury period and ultimately increase the borrower's EIDL eligibility.

The OIG report maintains that the loan file did not explain how the prior denial factors were addressed or mitigated. However, we believe that the loan officer adequately justified the decision to increase the loan under existing ODA policy, which does not require loan officers to explicitly address and resolve prior denial factors when reviewing reconsiderations or appeals. Additionally, the loan officer exhaustively detailed the methodology he applied in determining the additional economic injury (see Loan Modification #6 comments). By documenting the measures taken by the borrower to meet the business' working capital needs following the disaster, the loan officer was able to quantify an amount not previously calculated during previous analysis.

Conclusion:

The decisions to approve the two loans were adequately justified under existing standard operating procedures; therefore, we disagree with the OIG's determination that neither business was eligible for EIDL assistance. While we believe that our justifications clearly delineate why these two loans were approved, and made independently without influence from external contacts, we recognize that the documentation was not adequate to the satisfaction of the OIG.

We agree to implement new procedures that require approval justification and supporting documentation to address all prior denial factors when a previous denial decision on a loan is overturned. The approval justification and supporting documentation should be retained in DCMS.