

**WITHDRAWAL OF DISASTER LOAN
APPLICATIONS TO INDIVIDUALS AND
BUSINESSES IMPACTED BY THE GULF
COAST HURRICANES**

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**Prepared by the
Office of Inspector General
U.S. Small Business Administration**



U.S. Small Business Administration
Office Inspector General

Memorandum

To: Herbert L. Mitchell, Associate Administrator
Office of Disaster Assistance

Date: March 28, 2008

From: Debra S. Ritt
Assistant Inspector General for Auditing

Subject: Audit of the Withdrawal of Disaster Loan Applications to Individuals and
Businesses Impacted by the Gulf Coast Hurricanes
Report No. 08-11

This report summarizes the results of our audit of disaster loan applications to victims of the Gulf Coast Hurricanes that were withdrawn by the Small Business Administration (SBA) during calendar year 2006. We initiated the audit in response to complaints by two former SBA employees that the Agency unnecessarily withdrew loan applications to meet production standards. Our audit objectives were to determine (1) whether SBA inappropriately withdrew loan applications prior to loan approval, and (2) the impact that withdrawals had on the applicants.

We focused our analysis on 9,348 of the 30,325 withdrawn loan applications that were identified as missing documents needed for processing, and statistically sampled 96 for review. We analyzed data entries in SBA's Disaster Credit Management System (DCMS) associated with the 96 loan applications, and interviewed loan officers at SBA's Processing and Disbursement Center (PDC) in Fort Worth, Texas to determine the reasons why loan applications were withdrawn and whether proper procedures were followed. To determine how the withdrawals impacted loan applicants, we were able to reach and interviewed 34 of the 96 applicants. We conducted the audit from August to September 2007 in accordance with *Government Auditing Standards* prescribed by the Comptroller General of the United States.

BACKGROUND

The 2005 Gulf Coast hurricanes resulted in SBA approving more than 160,000 disaster loans for Hurricanes Katrina, Rita, and Wilma with \$6.3 billion disbursed to borrowers as of January 25, 2008. Due to the unprecedented number of loans, by the fall of 2006 SBA had accumulated a backlog of more than 90,000 undisbursed loans. To expedite disbursement, SBA launched a *90-in-45*

Campaign to resolve the backlog within 45 days. Several SBA employees involved in this initiative complained that, to meet performance goals, SBA disbursed funds against borrowers' wishes, circumvented loan processing requirements, unnecessarily cancelled approved loans and inappropriately withdrew loan applications. In February 2007, the Chairman of the Senate Committee on Small Business and Entrepreneurship forwarded these complaints to the OIG for review. In April, May, and September of 2007, the OIG issued reports on the first three complaints.¹

The fourth complaint alleged that during four separate campaigns in FY 2006, loan applications were either withdrawn by applicants because they were frustrated with SBA's non-responsiveness or by SBA employees who wanted to get the applications off the Agency's books to meet production goals. As of January 25, 2008, SBA reported that 68,456 loan applications had been withdrawn.

According to SBA's procedures,² withdrawal of loan applications can be initiated at the verbal or written request of the applicant. Additionally, SBA may initiate withdrawal action if the applicant does not respond to a 14-day letter requesting missing information needed to process the loan application. Before the Agency initiates action to withdraw incomplete loan applications, SBA procedures require that the loan processor contact the applicant by phone, and if unreachable, by a letter that provides the applicant 14 calendar days to provide the necessary information to process the loan application to a decision. The letter must specify the actions and documents needed to prevent the applicant's loan application from being withdrawn. After an application is withdrawn, SBA is required to send the applicant a separate letter notifying the applicant of the withdrawal, and specifying the information required for re-submission of the loan request and the reacceptance deadline for the application.

RESULTS IN BRIEF

SBA acted appropriately when withdrawing 66 of the 96 incomplete loan applications we reviewed, however, 30 applications were withdrawn without contacting the applicants. One of the 30 applications was also withdrawn in error because SBA mistakenly identified the applicant as not having filed tax returns. Projecting these results to the universe of loans, we estimate with 95 percent confidence that SBA inappropriately withdrew between 2,075 and 3,879 loan applications.

¹ *Audit of Borrower Acceptance of Disbursements*, Report No. 7-20, April 17, 2007; *Securing Collateral for Disaster Loan Disbursements*, Report No. 7-22, May 9, 2007; and *Cancellation of Approved Disaster Loans to Individuals and Businesses Impacted by the Gulf Coast Hurricanes*, Report No. 7-30, September 7, 2007.

² Standard Operating Procedure 50 30 (5) Chapter 7, *Processing of Applications*, Paragraph 82.

SBA attempted to contact all but one of the 30 applicants by phone, but when not successful, did not send letters in advance notifying them that their applications would be withdrawn. Further, in 12 of the 30 instances, applications were withdrawn within 4 days of the loan processors' first attempted contact with the applicants, giving them insufficient time to respond. After SBA withdrew the 30 applications, it did not send withdrawal letters to 12 of the applicants, providing them no notice of the withdrawal action as required by SBA procedures.

We believe the lack of contact with applicants and hasty withdrawals occurred due to production goals, set forth in a directive issued by the Director of Disaster Loan Processing. In order to meet these goals, loan officers told us they were aware that some loan officers would withdraw incomplete applications as doing so was easier than getting them approved. Loan officers we spoke to stated that the expected production levels were unreasonable, especially if management desired quality work that put customer needs as a priority.

Although SBA did not contact some applicants and withdrew loan applications hastily, we were unable to determine how the withdrawals impacted them as we were only able to contact 7 of the 30 applicants. Only 1 of the 7 applicants we reached was still interested in getting an SBA loan. The remaining applicants we interviewed were properly notified of their application withdrawals.

To address the issues identified, SBA should implement better internal controls, preferably through DCMS, to ensure that 14-day letters and withdrawal letters are sent to applicants, as required, and revise production goals, as appropriate, to ensure loan officers are not motivated to withdraw applications rather than processing them to a decision.

RESULTS

SBA Appropriately Withdrew Most Incomplete Loan Applications, but Did Not Always Properly Notify Applicants

SBA appropriately withdrew 66 of the 96 incomplete loan applications after properly notifying applicants. However, SBA did not provide 30 applicants advance notice of the withdrawals. SOP 50 30 (5) 71(b) states that, if a review of the applicant's file uncovers missing information, that information should be obtained by phone whenever possible. It also states that if a 14-day letter is necessary, the applicant must be cautioned that his/her application will be withdrawn if the missing information is not received within 14 calendar days.

We found that while SBA made one or more attempts to contact all but one of the 30 applicants by phone, after not reaching them, it withdrew the applications without sending a 14-day letter in advance of the withdrawals, as required by SBA procedures. Further, in 12 instances, loan applications were withdrawn within 4 days of the first attempted contact with the applicant, giving the appearance that loan officers were quickly trying to get the applications off the books. As discussed below, two of these applications were withdrawn the same day that the application was first assigned to a loan officer:

- One application was withdrawn less than an hour after the loan officer's first attempt to contact the applicant. The loan officer called all three phone numbers on file for the applicant at 8:27 a.m. on January 7, 2006, but did not reach the applicant. At 9:03 a.m., 36 minutes later, the loan officer recommended withdrawal of the application, stating that the application was being withdrawn, "...because (applicant) has not responded to telephone calls requesting a call back or request to complete a SBA Form 413." The application was withdrawn later that day.
- A second application was withdrawn the same day it was assigned to a loan officer, who made no attempt to contact the applicant.

Given that applicants were entitled to a 14-day letter to allow them an opportunity to prevent the loan applications from being withdrawn, giving applicants less than four days notice gave the appearance that loan officers were more interested in getting the incomplete applications off of SBA's books than they were in ensuring that applicants received proper consideration for disaster assistance.

While we acknowledge that applicants were difficult to contact by phone, especially given that many lived in transient conditions while trying to rebuild their lives, SBA should have sent notification letters, as required by operating procedures, to allow applicants an opportunity to prevent their applications from being withdrawn. Moreover, the inability to make phone contact with applicants increased SBA's obligation to notify the applicants by letter in advance of the withdrawals.

In addition to the lack of advance notice, one of the 30 loan applications was erroneously withdrawn noting "IRS no record found," even though the Internal Revenue Service (IRS) provided SBA with actual transcripts for the applicant. Specifically, the application was withdrawn under a special project set up to withdraw applications when IRS had indicated the applicant had not filed tax returns. However, a review of DCMS indicated that the applicant had filed taxes for both years in question, but SBA did not scan the documents into DCMS until 1 month after the application was withdrawn and about 3 months after IRS sent

them to SBA. DCMS also did not contain any correspondence from IRS indicating that the applicant had not filed his tax returns. Thus, SBA was incorrect in its decision to withdraw the application.

Finally, after SBA withdrew the 30 applications, it did not send withdrawal letters to 12 of the applicants, providing them no notice of the withdrawal action as required by SBA procedures. Applicants who were not contacted by phone, provided 14-day letters, or notified after the withdrawals occurred, had no way of knowing that their applications had been withdrawn. For example, an 82-year-old applicant said that because he did not receive either a 14-day or withdrawal letter, he was not aware that his application had been withdrawn. He simply gave up trying to get the loan, although he had hoped to receive assistance from SBA. Another applicant only found out that his application had been withdrawn when he contacted SBA for the status of his application.

SBA Production Goals May Have Led To Hasty Withdrawals

According to a February 24, 2006, directive issued to all loan officers by the Director of Disaster Loan Processing, loan officers were held to the production goals shown in Table 1. These goals included the number of loan applications per day that loan officers were expected to process as well as the maximum number of hours loan officers were to spend in processing each application.

Table 1.
PDC Production Standards for Disaster Loan Processing

Loan Application Type	Number of Applications per 8-Hour Day	Number of Applications per 10-Hour Day	Hours to Process an Application
Home	4.0	5.0	2.0
Home Expedited	6.4	8.0	1.25
Business/Economic Injury	1.6	2.0	5.0
Business Expedited	4.0	5.0	2.0
Economic Injury	.5	.7	14.2
Economic Injury Expedited	2.4	3.0	3.3

Source: February 24, 2006 Memo from Director of Disaster Loan Processing

Loan officers we interviewed stated that the established goals were unreasonable and frequently took priority over providing customer service. In an effort to meet these goals, loan officers reported that “corners were often cut” because it was easier to withdraw loan applications rather than try to get them approved. For example, one missing document was reason enough to withdraw an application,

because loan approval would take longer as it required processing numerous documents.

Additionally, the following percentage ranges shown in Table 2 were used as general guidelines by the PDC to assess loan officer performance.

Table 2.
Appraisal Guidelines for PDC Employees

Performance Level	Percentage of Goal Achieved
Extraordinary	150 and Above
Exceeds Expectations	120 to 149.9
Meets Expectations	80 to 119.9
Below Expectations	60 to 79.9
Fails to Meet Expectations	0.0 to 59.9

Source: February 24, 2006 Memo from Director of Disaster Loan Processing

For example, a loan officer working an 8-hour day would be expected to process 4 home loan applications per day (2 per hour). To meet expectations, the loan officer would have to process a minimum of 3.2 loan applications per day (i.e., the goal of 4 applications multiplied by 80 percent).

In addition to the loan officers we interviewed, a review of exit surveys regularly conducted by the PDC Human Resources Office of departing employees showed that many of the employees commented that the center's focus on production goals negatively impacted applicants. For example, departing employees commented that:

- “There was a disconnect between helping disaster victims with sound decisions and the push to rack up the numbers.”
- “The focus is on goals rather than helping borrowers.”
- “The pressure to meet production goals made me feel that some hurricane victims were overly rushed or shortchanged.”
- “There was pressure to produce with no regard for applicants/borrowers.”

We believe that withdrawals were inappropriately counted in measuring loan officer performance in meeting loan processing goals, and consequently may have influenced the actions of loan officers. For example, if loan officers were able to meet their goals by simply withdrawing loan applications assigned to them, one can expect that some would do so to meet production goals, especially given that many employees were temporary and needed to meet the goals in order to save their jobs. Therefore, while counting withdrawals toward achievement of loan

processing goals may have helped to reduce the backlog of undisbursed loans, it was not always in the best interest of the applicants served.

Impact of Inappropriate Loan Application Withdrawals Could Not Be Determined

We were unable to determine how the withdrawals impacted applicants as we were only able to contact 7 of the 30 applicants whose loans were inappropriately withdrawn. Therefore, we could not determine whether the other 23 applicants were inappropriately denied disaster assistance.

However, of the seven applicants we reached, only one was still interested in getting an SBA loan, but had not yet applied for reacceptance. As discussed below, applicants that still wanted their loans applied for reacceptance:

- Two applicants still wanted SBA assistance and had applied for reacceptance.
- Two applicants submitted loan applications in order to get declined so that they could qualify for FEMA grants, but were no longer interested in the loans.
- One applicant did not know what had happened to her application and wasn't sure if she was still interested in a loan.
- One applicant gave up applying for SBA assistance because she believed her application had been denied due to a lack of repayment ability, and she pursued other financing options.
- One applicant, who was unemployed, had his application withdrawn because IRS indicated he hadn't filed tax returns for 2003, but was still interested in an SBA loan.

RECOMMENDATIONS

We recommend that the Associate Administrator for Disaster Assistance:

1. Strengthen internal controls, preferably through DCMS, to ensure that 14-day letters and withdrawal letters are sent to applicants, as required.
2. Readjust production goals, as appropriate, regarding loan application withdrawals, to ensure loan officers are not motivated to withdraw applications rather than to process them to a decision.

AGENCY COMMENTS AND OFFICE OF INSPECTOR GENERAL RESPONSE

On February 21, 2008, we provided SBA with a draft of the report for comment. On March 25, 2008, the Office of Disaster Assistance (ODA) submitted its formal response, which is contained in its entirety in Appendix II. ODA made one general comment regarding the audit report, and agreed with both recommendations.

General Comment

ODA rejected the idea that production goals may have led to inappropriate withdrawals, and stated that the February 24, 2006, memo from the Director of Loan Processing merely re-stated the Agency's long standing production goals. According to ODA, these goals were not new and were not specifically tailored to for Gulf Coast hurricane disaster loans.

OIG Response

Our report does not claim that these production goals were new. We merely reported that loan officers we interviewed believed that the established goals were unreasonable and frequently took priority over providing customer service. The goals may have seemed unreasonable because many newly hired employees were processing these loans and may have lacked the experience needed to achieve these goals.

Recommendation 1

Management Comments

ODA agreed with the recommendation and stated it has already modified its process so that all withdrawal letters can be immediately scanned into DCMS, and that signed copies will be immediately sent to borrowers.

OIG Response

ODA's comments are responsive to our recommendations, and we commend ODA for taking prompt action. We will request documentation from SBA to verify that the action has been taken so that we can close this recommendation.

Recommendation 2

Management Comments

ODA stated that it has modified its production standards in Application Processing Memo 07-01 to reduce the credit that is given for withdrawals in determining achievement of production goals. The Agency has also developed reports that track the number of withdrawn loans for trend analysis, and has implemented routine quality assurance reviews since the Gulf Coast Hurricanes.

OIG Response

ODA's comments were responsive to our recommendation. We will request a copy of memo 07-01 showing the adjustment to withdrawn loans.

ACTIONS REQUIRED

We appreciate the courtesies and cooperation of the Office of Disaster Assistance representatives during this audit. If you have any questions concerning this report, please call me at (202) 205-7203 or Pamela Steele-Nelson, Director, Disaster Programs Group, at (202) 205-[Exemption 2].

APPENDIX I. WITHDRAWALS WITH NO ADVANCE NOTICE

Sample	Application #	Withdrawn in 4 days or less	No Withdrawal Letter	Erroneous Withdrawal
1	[Exemption 2]			
6	[Exemption 2]	X	X	
8	[Exemption 2]	X	X	
10	[Exemption 2]		X	
12	[Exemption 2]			
13	[Exemption 2]	X	X	
16	[Exemption 2]			
17	[Exemption 2]			
18	[Exemption 2]			
24	[Exemption 2]			
27	[Exemption 2]		X	
31	[Exemption 2]			
47	[Exemption 2]			
48	[Exemption 2]	X	X	
51	[Exemption 2]		X	
53	[Exemption 2]	X		
57	[Exemption 2]	X	X	
61	[Exemption 2]			
65	[Exemption 2]	X		
66	[Exemption 2]	X		X
67	[Exemption 2]		X	
68	[Exemption 2]	X		
69	[Exemption 2]	X		
70	[Exemption 2]		X	
72	[Exemption 2]	X	X	
76	[Exemption 2]			
85	[Exemption 2]			
87	[Exemption 2]		X	
89	[Exemption 2]	X		
93	[Exemption 2]			
30	TOTALS:	12	12	1



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

Date: March 25, 2008

To: Debra S. Ritt
Assistant Inspector General for Auditing

From: Herbert L. Mitchell
Associate Administrator
for Disaster Assistance

Subject: OIG Draft Report – Withdrawal of Disaster Loan Applications to Individuals and Businesses Impacted by the Gulf Coast Hurricanes (Project No. 7412)

We have reviewed the draft audit report on Withdrawal of Disaster Loan Applications to Individuals and Businesses Impacted by the Gulf Coast Hurricanes prepared by your office.

The report summarized the results of an OIG audit of disaster loan applications to victims of the Gulf Coast Hurricanes that were withdrawn by the Small Business Administration during calendar year 2006. The basis of the audit was to validate two former employee's assertions that the Agency unnecessarily withdrew loan applications to meet production standards.

Therefore the OIG audit objective was to:

- (1) Determine whether SBA inappropriately withdrew loan applications prior to loan approval, and
- (2) Determine the impact that withdrawals had on the applicants

The OIG focused their analysis on 9,348 applications of the 30,325 applications that were withdrawn out of more than 400,000 loans SBA processed under the Gulf Coast Hurricane disaster. The focus on the 9,348 applications resulted in statistically sampling 96 withdrawn applications for the OIG review.

In the review of the 96 files, the OIG concluded SBA *appropriately* withdrew 66 of the 96 files in their review. However, the review could not find where SBA provided all applicants with advance notice of the withdrawals. The OIG also stated that it was unable to determine how the withdrawals impacted applicants and therefore could not conclude that applicants were inappropriately denied disaster assistance.

Production Standards

Although the OIG concluded that SBA appropriately withdrew loan applications, the OIG asserts that "*SBA Production Goals May Have Led to Hasty Withdrawals*". We disagree with this assertion and believe it to be unfounded. The OIG cites a February 24, 2006, memo from the Director of Loan Processing, the complaints of the *two* former employees who were interviewed and various comments on exit interviews from departing employees as the basis of the of their assertion.

The OIG report fails to note the February 24, 2006, memo from the Director of Loan Processing merely "re-stated" the long standing processing goals that have been in place in the four previous disaster

assistance offices prior to Hurricane Katrina. The processing standards in one form or another had been in place for years. The processing standards were not new. The standards were not put in place specifically for the Gulf Coast Hurricanes. Private industry uses productivity standards to measure the effectiveness of individuals, departments, divisions, etc. and the SBA Loan Processing Department is not any different. The management staff emphasized consistent production, portfolio management, loan quality, and customer service. The production standards are also used as a guide for the loan officers with regard to processing expectations.

Production Standards going forward

We had a very large staff of newly hired loan officers and newly appointed supervisors and with that comes a risk, some of which have been noted in the OIG report. The SBA recognizes that improvements can be made in all facets of its operation and SBA is committed to this endeavor. The SBA is committed to improving overall communication with employees and making sure that the employees understand the significance of processing files within all stated guidelines and in accordance with SBA policy. The SBA will continue to improve upon the importance of customer service and loan quality but the SBA will also continue to have loan processing standards that we believe are reasonable. SBA will improve training so the existing production standards can be achieved. Finally, we will continue to hold staff accountable and utilize production standards and processing goals to assist the Agency in helping disaster victims recover quickly from disasters.

Summary

SBA has made considerable improvements since the processing of the Hurricane Katrina files.

- The management staff has re-emphasized customer service and the importance of making every attempt to contact applicants regarding their files.
- The Processing and Disbursement Center has re-issued and revised the production standards.
- The Processing and Disbursement Center has been successful at developing production reports that can identify trends with regard to the number of files that are declined, withdrawn and approved by each loan officer and SLO on a daily, weekly and monthly basis.
- The Processing and Disbursement Center has implemented regular Quality Assurance Reviews for the staff.
- The Processing and Disbursement Center has conducted various targeting training sessions.
- The Scanning Department has implemented efficiency and Quality Assurance controls that will ensure that letters are properly scanned and downloaded into DCMS.

Comments on the Recommendations:

Recommendation #1: Strengthen internal controls, preferably through DCMS, to ensure that 14-day letters and withdrawal letters are sent to applicants as required.

ODA Response: SBA has already modified its process so all withdrawal letters can be immediately scanned into DCMS and a copy proofed, signed by a Supervisory and mailed immediately to the applicant.

Recommendation #2: Readjust production goals, as appropriate, regarding loan application withdrawals, to ensure loan officers are not motivated to withdraw applications rather than to process them to a decision.

ODA Response: SBA has already modified its production standards in Application Processing Memo #07-01 dated October 19, 2007. Files that are withdrawn have been allocated production credit of half the credit of a fully processed file. The Supervisor has the discretion to award additional points if the files were fully processed. These files are approved by the Senior Supervisory Loan Specialist. Reports have been developed that enable management to measure the number of withdrawals of each loan officer and Supervisor on a regular basis to identify trends. Routine Quality Assurance Reviews have been implemented since Hurricane Katrina to ensure compliance with procedures and policies.

Thank you for the opportunity to comment on this draft report and if you have any questions on this response please feel free to contact me or James Rivera.

[Exemption 6]

Herbert L. Mitchell
Associate Administrator
for Disaster Assistance