

**SBA'S ROLE IN ADDRESSING
DUPLICATION OF BENEFITS BETWEEN
SBA DISASTER LOANS AND
COMMUNITY DEVELOPMENT BLOCK
GRANTS**

Report Number 10-13

Date Issued: September 2, 2010

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



U.S. Small Business Administration
Office Inspector General

Memorandum

To: James E. Rivera,
Associate Administrator, Office of Disaster
Assistance

Date: September 2, 2010

From: Debra S. Ritt
Assistant Inspector General for Auditing

Subject: Report on SBA's Role in Addressing Duplication of Benefits
between SBA Disaster Loans and Community Development Block
Report No. 10-13

This report consolidates the results of findings from audits of the Small Business Administration's (SBA) efforts to prevent duplication of benefits between SBA disaster loans and Community Development Block Grants (CDBG) for Iowa, Louisiana, and Mississippi. The objective of these audits was to determine whether SBA's efforts to prevent duplicate disaster assistance were consistent with Federal Emergency Management (FEMA) guidance implementing the Stafford Act.

In conducting these audits, we reviewed entries in SBA's Disaster Credit Management System (DCMS), information in the Agency's Centralized Loan Chron System, and information obtained from state and local government offices or title companies responsible for distributing CDBG funds to disaster victims in the states of Louisiana, Mississippi, and Iowa. We compared the duplicate benefit requirements of the Stafford Act, Small Business Act, FEMA regulations, SBA regulations, and SBA's standard operating procedures to SBA's process for managing duplicate benefits. Further, we interviewed officials from SBA's Office of Disaster Assistance (ODA) located in headquarters and the Fort Worth Processing and Disbursement Center. We also interviewed officials from the Department of Housing and Urban Development's (HUD) Disaster Program Office. To obtain an understanding of the states' grant payment processes in Louisiana and Mississippi, we held discussions with officials contracted by these states to administer their CDBG programs. Additionally, we interviewed officials from the Iowa Department of Economic Development, Iowa Finance Authority, and various local organizations responsible for administering the grant programs in Iowa. The audits were conducted between May 2009 and May 2010 in accordance with *Government Auditing Standards* prescribed by the Comptroller

General of the United States and included such tests considered necessary to provide reasonable assurance of detecting abuse or illegal acts.

We found that to prevent duplicate benefits, SBA recovered \$643.8 million of CDBG funds from the three states (Louisiana, Mississippi, and Iowa) and applied them to pay down 19,449 fully-disbursed SBA disaster loans, reducing SBA loan balances. Additionally, SBA applied \$281.8 million of duplicate assistance from CDBG funds to pay down undisbursed loan balances. However, these practices were inconsistent with a FEMA regulation implementing the Stafford Act's prohibition on duplicate disaster benefits.

Under the FEMA regulation, agencies that are assigned a higher order in the delivery sequence are expected to provide disaster assistance before assistance from lower level agencies. FEMA has also issued guidance indicating that CDBG grants have the lowest priority in the delivery sequence. Therefore, funds that HUD could have used for additional CDBG awards were instead used to pay down SBA loans to victims who had already received assistance and who SBA determined had sufficient resources to repay their loans. This shifted \$925.6 million in primary assistance from SBA disaster loans that have to be repaid to CDBG grants, which are not repaid, placing the financial burden on taxpayers. It also reduced available grant money for disaster victims that did not qualify for SBA disaster loans.

We recommended that for future disasters, SBA coordinate with HUD and FEMA to formalize a memorandum of understanding, which defines the functions of each agency so that its disaster assistance procedures are consistent within applicable FEMA guidance. Additionally, SBA should coordinate with HUD to establish better procedures to prevent duplicate benefits, including the development of a duplication of benefits instructional guide to be incorporated into HUD's *Information Toolkit* provided to grantees. Lastly, SBA should modify its regulations and the assignment of compensation section of the standard loan authorization and agreement to be consistent with FEMA's delivery sequence of benefits, and cease using resources to perform duplicate benefit calculations involving CDBG funds. SBA management generally disagreed with the report findings and the OIG's interpretation of the Small Business Act and Agency regulations, partially agreed with two recommendations, and disagreed with the remaining three recommendations.

BACKGROUND

The Federal Government provides disaster assistance funding through a variety of agencies and programs. SBA's Disaster Loan Program, which is administered by ODA, is the primary Federal program for funding long-term recovery for private sector and non-farm disaster victims, including home and business owners. SBA

provides physical disaster loans to fund repairs to damaged homes and business facilities. SBA's regulations provide that there must be reasonable assurance the applicant can repay the loan, and the applicant must possess satisfactory character and credit. Section 7(b) of the Small Business Act authorizes SBA to make such disaster loans provided that the repairs or reconstruction is not compensated by insurance or otherwise.

Section 5155 of the Stafford Act requires Federal agencies providing disaster assistance to ensure that businesses and individuals do not receive disaster assistance for losses for which they have already been compensated. An individual receiving Federal assistance for a major disaster is liable to the United States when the assistance duplicates benefits provided for the same purpose.

FEMA regulation, 44 CFR 206.191, establishes policies and procedural guidance to ensure uniformity in preventing duplication of benefits. The regulation includes a "delivery sequence" of disaster assistance provided by certain Federal agencies and organizations. According to the regulation, the agency or organization that is lower in the delivery sequence should not provide assistance that duplicates assistance provided by a higher level agency or organization.

SBA regulation, 13 CFR 123.101(c), which was reissued after FEMA published its regulation discussed above, states that applicants are not eligible for a home disaster loan if their damaged property can be repaired or replaced with the proceeds of insurance, gifts or other compensation. These amounts must either be deducted from the amount of the claimed losses or, if received after SBA has approved and disbursed a loan, must be paid to SBA as principal payments on their loans.

In response to the Gulf Coast disasters and the Iowa floods, Congress appropriated funding for the CDBG program as Disaster Recovery grants to rebuild the affected areas and provide crucial seed money to start the recovery process. The grants, which were intended to supplement disaster assistance provided by FEMA and SBA, were available to states, units of general local governments, Indian tribes, and insular areas designated by the President of the United States as disaster areas. Guidance provided on HUD's website instructed that grantees could use the CDBG funds for housing, economic development, infrastructure and the prevention of further damage to affected areas, if such use did not duplicate funding available from FEMA, SBA, and the U.S. Army Corps of Engineers.

To receive CDBG benefits, the affected grantees (in this case the states) were required to submit to HUD an action plan that described how they planned to use the grant funds and the procedures that would be implemented to prevent recipients from receiving duplicate benefits.

In several previous reviews,¹ the OIG examined SBA's efforts to prevent duplication of benefits between the disaster loan program and HUD's CDBG program. Those reviews accepted SBA's practice of reducing loan balances as an appropriate control to prevent duplication of benefits and, unlike this report, did not examine whether this practice was consistent with FEMA guidance.

RESULTS

In response to the Gulf Hurricanes of 2005 and the Midwest flooding in 2008, SBA took the lead in working with the states to identify and recover duplicate benefits. Although SBA did so because it thought it was acting in the best interest of the Government to reduce duplicate benefits, these efforts resulted in \$643.8 million of CDBG funds being sent to SBA to pay down 19,449 fully-disbursed SBA loans, and the undisbursed balance of 5,675 loans being reduced by \$281.8 million. The CDBG funds replaced SBA disaster assistance that had already been approved to borrowers found to have sufficient resources to repay their loans, contrary to FEMA's duplicate benefit regulation. FEMA's regulation provides that disaster assistance by an agency that is lower in the delivery sequence, such as HUD in this case, should not be used to duplicate assistance that has already been provided by a higher level agency, such as SBA. As a result, \$925.6 million in CDBG funds were used to pay down or reduce SBA disaster loans rather than to provide grants to other disaster victims with unmet needs who may have lacked sufficient financial resources to obtain these loans. This also shifted additional costs to the taxpayers because disaster loans are required to be repaid and CDBG grants are not.²

FEMA regulation, 44 CFR 206.191, which implements the duplication of benefits section of the Stafford Act, establishes a specific sequence for the delivery of benefits that generally is to be followed when Federal agencies provide disaster assistance. The delivery sequence specifies the following order in which a program should provide assistance and the other resources that must be considered before doing so:

- Volunteer agencies' emergency assistance programs;

¹ OIG Report 6-28, *Preliminary Assessment of Controls over the Automated Coordination of Disaster Assistance Benefits Distributed by Mississippi Development Authority's Grant Assistance Program*, September 25, 2006; OIG Report 07-25, *Duplicate Benefit Adjustments to Disaster Assistance Loans Associated with Housing and Urban Development Grants*, May 15, 2007; OIG Report 9-09, *Audit of Borrower Eligibility for Gulf Coast Disaster Loan*, March 31, 2009.

² The OIG did not calculate these additional costs, and notes that a certain percentage of the disaster loans that were paid down or reduced as a result of the CDBG payments would have defaulted.

- Hazard and flood insurance;
- FEMA Home Repair and Replacement;
- SBA and Department of Agriculture disaster loans;
- FEMA Individuals and Households Program; and
- Other Federal, state and local government funds.

While HUD CDBG grants are not specifically listed in the regulation, guidance since issued by FEMA considers these grants to be “other Federal ... funds” that follow SBA disaster assistance loans in the sequence of disaster benefits.³ SBA’s Standard Operating procedure 50 30 6 reiterates FEMA’s delivery sequence, and specifically states that CDBG funds are lower than SBA disaster loans in the sequence of delivery.

FEMA regulations state that duplicate benefits can occur when any agency provides assistance for a loss, which is the primary responsibility of another agency that is higher in the delivery sequence. Each agency should, in turn, offer and be responsible for delivering its program(s) without concern about duplication with a program later in the sequence. Further, agency programs listed later in the sequence are responsible for preventing duplication from programs listed earlier, and thus are responsible for rectifying any duplication and recovering payments from the disaster relief recipient.

However, 13 CFR 123.101 is inconsistent with FEMA’s delivery sequence guidance concerning CDBG assistance. SBA’s regulation generally requires that homeowners receiving compensation for their damaged properties after SBA has disbursed loans for the same properties must send such compensation to SBA to be used as principal payments on their loans. Additionally, the “assignment of compensation” section of SBA’s Loan Authorization and Agreement requires borrowers to remit duplicate grants or other reimbursement to SBA. These requirements do not make an exception for HUD CDBG funds, which is considered lower than SBA disaster loans in FEMA’s delivery sequence.

SBA believes that this regulation is consistent with the Small Business Act prohibition on duplication of disaster benefits, which authorizes SBA to “make” a disaster loan unless the damage is compensated by insurance or otherwise. Although the Act states that SBA is not authorized to make a disaster loan for

³ *Disaster Assistance - A Guide to Recovery Programs*, FEMA, September 2005 and February 2009; and *National Disaster Housing Strategy Annexes*, FEMA, January 16, 2009.

damage that is otherwise compensated, the statute is silent on the actions that SBA should take if a potentially duplicate benefit is discovered after an SBA loan is disbursed. The statute does not provide authority for SBA to ignore FEMA's delivery sequence regulation for disaster assistance and to use CDBG money to reduce disbursed disaster loans.

In appropriation legislation that funded CDBG assistance for victims of the Gulf Hurricanes and Midwest Floods, Congress directed HUD to prevent duplication of benefits. In a series of Federal Register notices issued by HUD in response to these appropriations, HUD emphasized the steps it planned to take to prevent duplicative benefits. However, SBA advised that despite its repeated attempts to coordinate with HUD, HUD and the state agencies in Louisiana, Mississippi and Iowa made it clear that they intended to provide CDBG assistance regardless of whether an SBA loan existed or not. Therefore, SBA believed its only choice was to use these duplicative funds to repay or reduce existing SBA loans, consistent with its regulation and interpretation of the Small Business Act. HUD officials did not agree with SBA's characterization of their discussion and stated that they did not in any way imply that they intended to provide duplicative assistance.

SBA's actions appeared to be driven by the approach taken in state recovery plans that were submitted to HUD when applying for CDBG assistance. If the state planned to reduce grant benefits by SBA loan amounts prior to disbursing the grant, SBA's designated role was to notify the state of the approved loan amounts. However, if states disbursed the grants without first reducing the grant benefits by the amount of the SBA loans, SBA was responsible for calculating and requesting remittance of the duplicate benefits to be recovered from CDBG recipients. Consequently, SBA's role varied based on the terms of the state recovery plans. For example, SBA did not take the lead in computing duplicate CDBG benefits from Alabama, Texas, and Florida, but did for Mississippi, Louisiana, and Iowa. Therefore, CDBG funds in the former three states were not used to pay down disbursed SBA loans and to reduce the balances of undisbursed loans.

Under FEMA's duplication of benefits regulation, agencies and organizations that are considered lower in the delivery sequence are responsible for preventing duplicate benefits. Therefore, it is HUD's responsibility to ensure that state action plans that are submitted in order to receive CDBG funding appropriately assign responsibility for identifying and recovering duplicate benefits to the states, which act as HUD's agents in administering the CDBG funds. In discussing this issue with HUD officials, they told us that they relied on SBA to determine the amount of duplicate benefits because SBA did a good job of monitoring the duplicate benefits process and the states had little experience in performing the duplicate benefit calculation. However, they agreed there is a need for consistency in how state plans describe SBA's role, and that the plans should not assign responsibility

to SBA for calculating and collecting duplicate benefits. HUD officials suggested that because the states and localities that disburse the grants may not understand how to correctly calculate duplicate benefits, it would be beneficial if SBA were to provide an information package on such calculations to be included in HUD's instructional guide furnished to grantees.

Although SBA thought it was acting appropriately in pursuing duplicate benefits, its efforts resulted in \$925.6 million of CDBG funds being used to pay down debts owed by recipients of SBA disaster loans or to reduce the undisbursed balances of SBA loans. As a result, disaster loans to homeowners that SBA had determined had sufficient repayment ability were reduced through the use of CDBG grant funds that were intended to benefit lower income individuals. This money could have been used to provide grants to other disaster victims with unmet needs and who may have lacked the financial resources to qualify for an SBA disaster loan.

According to HUD officials, after CDBG program funds were depleted, it was necessary to obtain congressional approval of an additional \$3 billion supplemental appropriation for Louisiana. The additional appropriation could have been reduced by Louisiana's share of the \$925.6 million had the duplicative grant assistance not been either remitted to SBA to pay down fully disbursed loans or applied by SBA to reduce undisbursed loan balances.⁴ Going forward, we recommend that SBA coordinate with FEMA and HUD to reach an agreement with HUD about their respective roles to ensure that duplicate CDBG benefits stay within the CDBG program.

Further, by managing the duplicate benefit process for HUD, SBA did not make the most appropriate use of its resources. SBA established a grant team to identify and resolve duplicate benefits associated with CDBG funds. The team obtained grant information from the states, calculated the amount of duplicate benefits, requested remittances of the duplicate benefits, and processed loan modifications to reduce loan eligibility and to pay down the loans. While SBA will always need to devote resources to identify potential duplication of benefits, ODA advised that it could have eliminated seven positions if the states, as HUD's grantees, were to make the duplicate benefit calculations and if ODA ceased processing state remittances and loan modifications. We estimate that SBA spent over \$626,000 in FY 2009 on these activities. This expenditure is not only unnecessary, but constitutes administrative costs for which states administering CDBG benefits are already reimbursed. CDBG appropriations language provides that a percentage of the CDBG funds can be used to reimburse grantees for administrative costs

⁴ We were unable to determine the exact amount of the \$925.6 million that was associated with loans to Louisiana residents, but were able to positively identify that at least \$443.6 million involved Louisiana residents. This would constitute funds put to better use as defined by the Inspector General Act of 1978, as amended.

associated with disbursing CDBG funds. By making more appropriate use of these resources on other disaster loan processing activities, we estimate that SBA can save \$2.1 million over the next 5 years.⁵

Although we are not in a position to make recommendations to HUD or FEMA, we have sent a copy of this report to these agencies and their Inspectors General.

RECOMMENDATIONS

We recommend that the Associate Administrator for the Office of Disaster Assistance:

1. Coordinate with FEMA and HUD to formalize a memorandum of understanding with HUD, which defines the functions of each agency in a manner that is consistent with FEMA's duplicate benefits regulation and other applicable regulations.
2. Coordinate with HUD to develop more appropriate procedures to reduce duplication of benefits, including the development of a duplication of benefits instructional guide to be incorporated into HUD's *Information Toolkit* provided to grantees.
3. Modify SBA's duplication of benefit regulations to address FEMA's delivery sequence of disaster benefits.
4. Modify the "assignment of compensation section" of the Standard Loan Authorization and Agreement to be consistent with FEMA's delivery of sequence regulation.
5. Cease using resources to calculate duplication of benefits, pursue remittances, and modify loan balances involving CDBG funds so that the Agency can save salary costs associated with these activities.

AGENCY COMMENTS AND OFFICE OF INSPECTOR GENERAL RESPONSE

On July 14, 2010, we provided ODA with a draft of the report for comment. On August 13, 2010, ODA and SBA's General Counsel submitted a formal response, which is contained in its entirety in the Appendix to this report. Management

⁵ The savings represent the salary costs of one GS-12, three GS-11s, and three GS-9s at the step 1 level, which were inflated by 2 percent each year for years two through five.

generally disagreed with the report findings and the OIG's interpretation of the Small Business Act and Agency regulations. Management also partially agreed with recommendations 1 and 2, stating it would work with HUD to improve the delivery of services to disaster victims. However, management did not indicate whether it would identify a role for itself that was consistent with FEMA regulations or develop more appropriate procedures to reduce duplication of benefits. Additionally, management disagreed with recommendations 3, 4, and 5. A summary of management's comments and our response follows.

Comment 1 - SBA Does Not Concur With the OIG's Interpretation of the Small Business Act or Its Applicable Regulations.

Management Comment

Management advised that it is aware of FEMA's regulation prescribing a sequence of delivery of disaster assistance, and that agencies later in the delivery sequence are required to ensure the assistance they provide does not duplicate prior Federal assistance. However, management interprets the Small Business Act and its regulations to "require SBA, after a loan is made or approved, to monitor the borrower's situation and to recover from the borrower *all compensation* for the borrower's injury received by the borrower from any source." Based upon this interpretation, management disagrees with the OIG's finding in the report that SBA acted inconsistently with the FEMA regulation when it recovered \$643.8 million of CDBG funds and applied them to pay down fully-disbursed disaster loans.

OIG Response

OIG disagrees with management's interpretation of the Small Business Act. The Act provides in subsection 7(b)(1) that SBA is only authorized to "make" a disaster loan if the borrower has not received compensation from another source for the same damage. The statute, however, is silent on what action SBA should take if it discovers duplicate compensation after a loan has been made, and, accordingly, in our view, does not require SBA to use CDBG funds to pay down disbursed disaster loans. SBA's duplication of benefit regulation (13 C.F.R. § 123.101) also does not "require SBA, after a loan is made ... to recover from the borrower *all compensation* for the borrower's injury received by the borrower from any source." In fact, the regulation provides an "exception" for amounts received under the FEMA Individuals and Household Program (IHP), which is lower in FEMA's sequence of delivery regulation than SBA disaster loans. Therefore, the OIG believes that neither the Small Business Act nor SBA regulation provide authority to ignore the FEMA regulation.

Management Comment

Management takes issue with the OIG's suggestion that SBA should have "returned" to HUD the CDBG money it received rather than using these funds to pay down disbursed disaster loans. SBA contends that this would be impermissible under the miscellaneous receipts statute, 31 U.S.C. 3302(b). (Note: SBA's response erroneously refers to 31 U.S.C. § 3302(h), but there is no such provision.)

OIG Response

Without determining whether the proposed action would have violated the miscellaneous receipts statute, the OIG has revised the audit report to remove language suggesting that SBA should have "returned" the CDBG funds.

Comment 2 - SBA Does Not Concur with the OIG's Recommendation that SBA Amend its Applicable Regulation, or with the Policy Underlying that Recommendation.

Management Comment

Management disagrees with the report's recommendation that SBA should revise its regulation so that it is consistent with FEMA guidance on the sequence of disaster assistance delivery. SBA points out that its regulation requiring that disaster loans be reduced by amounts recovered from compensation a borrower receives from other sources has been in place for over 50 years, and that SBA is entitled to deference in issuing regulations that interpret the Small Business Act. Further, SBA contends that revising its regulations to be consistent with FEMA guidance would promote duplication of benefits.

OIG Response

The OIG agrees that SBA is entitled to deference in issuing regulations that interpret the Small Business Act, but disagrees with management's comment. As noted above in the OIG's response to management comment 1, SBA's duplication of benefit regulation (13 C.F.R. § 123.101) provides an "exception" for amounts received under the FEMA IHP, which is lower in FEMA's sequence of delivery regulation than SBA disaster loans. It is unclear why SBA's regulation follows the FEMA delivery sequence for IHP assistance, but not for CDBG assistance. Regardless of the length of time that SBA's regulation has been in place, however, it is FEMA, and not SBA, that has authority under the Stafford Act to issue regulations establishing government-wide rules to promote "uniformity in

preventing duplication of benefits.” Moreover, SBA’s duplication of benefit regulation has a process to prevent a duplication of benefits if the borrower receives IHP assistance, and there is no reason why the regulation could not contain a similar process for CDBG assistance. Finally, the audit report recommends that SBA work with HUD to establish better procedures to prevent duplication of benefits, and with such procedures in place, a revision of SBA’s regulation to conform to FEMA’s guidance would not promote duplicative assistance.

Comment 3 - SBA Does Not Concur With OIG's Conclusion that It Constituted "Waste" of Taxpayer Funds to Use CDBG Funds to Repay or Reduce Prior Disaster Loans.

Management Comment

Management asserts that the OIG inconsistently argues it was improper and wasteful for SBA to consider grants made by HUD and other agencies lower in the FEMA delivery sequence, while at the same time asserting that SBA should have prevented HUD and other agencies lower in the sequence from making grants to SBA borrowers. Management does not believe it has the authority to tell HUD or state agencies what grant decisions they should or should not make. Further, management states that it attempted to coordinate with HUD to reduce duplication of benefits, but had no choice but to use the CDBG money to reduce SBA disaster loans after it became clear that neither HUD nor certain of the state agencies disbursing CDBG grants were going to prevent duplication of benefits.

OIG Response

Management is incorrect in its analogy and portrayal of the OIG’s findings and assertions in this regard. The OIG does not consider it improper and wasteful for SBA to coordinate with HUD to provide it with the necessary information to ensure that CDBG funds do not duplicate assistance provided by SBA’s disaster loans. Indeed, the OIG believes SBA has an obligation to do so under the Stafford Act and the Small Business Act. However, the OIG believes SBA should not have accepted CDBG funds from the state agencies and used those funds to pay down SBA loans, nor should it have reduced SBA loan balances on loans that had not been fully disbursed. These actions resulted in CDBG funds replacing SBA disaster assistance that had already been approved to borrowers found to have sufficient resources to repay these loans, thereby shifting additional costs of assistance to the taxpayers.

Further, the report does not assert that SBA should have prevented HUD and other agencies lower in the sequence from making grants to SBA borrowers, nor do we

believe that the Agency has the authority to prevent and dictate which grants HUD can award. As discussed previously, FEMA regulation and other guidance clearly place the responsibility on agencies lower in the sequence to prevent duplication of assistance provided by programs listed earlier, and to rectify any duplication. Further, contrary to SBA's position, we do not believe that acting responsibly means performing the tasks of another agency lower in the sequence when that agency fails to prevent the duplicate benefit. If HUD was unwilling to prevent the duplication of benefits, SBA should have sought assistance from FEMA and the Office of Management and Budget, instead of attempting to collect the duplicate benefits from HUD's grantees (the state agencies). As management stated in its response, SBA does not have authority to tell HUD or the state agencies what grant decisions they should or should not make." For the same reason, SBA does not have authority to direct HUD or its grantees to remit CDBG funds to SBA to offset disaster loans.

Comment 4 – The Draft Report is Inconsistent with Prior OIG Reports and Guidance.

Management Comment

Management expressed its surprise with the report findings and recommendations, which it believes are inconsistent with earlier OIG reports that addressed the recovery of duplicate payments and reduction of SBA loan balances.

OIG Response

The OIG understands SBA's difficulty in reconciling the findings of the current report with prior OIG findings from preliminary assessments and reviews of data exchanges between SBA and various state agencies. We have added clarifying language to the report acknowledging this. Based upon the limited scope of OIG's earlier work, no determination was made as to whether SBA's use of CDBG funds was consistent with FEMA's regulations and guidance. Having now done so, and having now concluded that SBA's efforts were not consistent with these regulations and guidance, the OIG believes it has a responsibility to report these findings to management and present recommendations to resolve this discrepancy.

Comment 5 – SBA Does Not Concur With the Finding that Monitoring Duplication of Benefits in this Circumstance Constituted a Misuse of SBA Employee Resources

Management Comment

Management agreed that it allocated significant resources to identifying and recovering duplicate benefits resulting from CDBG funds. However, it disagrees that the resources could have been put to better use. Regardless of its interpretation of the laws and regulations, management believed it needed to use significant resources to address duplication of benefit issues. ODA disagrees with OIG's assertion that the OIG's interpretation of the law would require no resources to deal with duplication of benefits issues that will continue to exist under any circumstances.

OIG Response

The OIG continues to believe that SBA could have utilized its resources more appropriately and disagrees with management's characterization of the OIG's comments. The report does not assert that SBA needs zero resources to deal with the duplication of benefits issues. Based on information provided by ODA, two employees would still be required to provide the necessary information to HUD to ensure that CDBG funds do not duplicate assistance provided by SBA's disaster loans. This would represent a reduction from the nine employees that were still assigned to perform grant work at the time of the audit. We have revised the audit report to clarify this point.

ACTIONS REQUIRED

Please provide your management decision for each recommendation on the attached SBA Forms 1824, Recommendation Action Sheet, within 30 days from the date of this report. Your decision should identify the specific action(s) taken or planned for each recommendation and the target date(s) for completion.

We appreciate the courtesies and cooperation of the Office of Disaster Assistance during the audit. If you have any questions regarding this report, please contact me at (202) 205-7203 or Craig Hickok, Director, Disaster Assistance Group, at (817) 684-5341.



U.S. SMALL BUSINESS ADMINISTRATION

WASHINGTON, D.C. 20416

MEMORANDUM

To: Debra S. Ritt
Assistant Inspector General for Auditing

From: James E. Rivera *JER*
Associate Administrator for Disaster Assistance

Sara Lipscomb *ML for SDL*
General Counsel

Subject: Draft Report on SBA's Role in Identifying Duplication of
Benefits from Community Development Block Grants
Project No. 9601 and Project No. 9701

Date: August 13, 2010

We have reviewed the July 14, 2010 Draft Report entitled "SBA's Role in Identifying Duplication of Benefits from Community Development Block Grants," which presents the results of findings from two OIG audits of SBA's efforts to prevent duplication of benefits from Community Development Block Grant (CDBG) programs in Louisiana, Mississippi and Iowa. The stated purpose of the audits was to determine whether SBA complied with the Stafford Act requirement to ensure that businesses¹ and individuals did not receive duplicate disaster assistance from any other source, including grant awards. Because the audits had similar findings, OIG consolidated the results into one report.

In summary, the Draft Report concludes that SBA improperly applied \$925.6 million in post-disaster CDBG funds to pay down fully-disbursed SBA disaster loans or to decrease undisbursed SBA disaster loan balances. It states that SBA should have disregarded the grant-making activities of HUD and State Agencies further down the delivery chain from SBA, and that SBA "wasted" its own disaster employees' time and resources by tasking them with reviewing HUD and State-made CDBG grants. Alternatively -- and inconsistently -- OIG argues that that SBA should have caused HUD and such State agencies to refrain from making grants to disaster victims who had already received an SBA disaster loan.

¹ Although the stated purpose was to review both business and individual loans, the Draft Report discusses only loans to homeowners.

OIG's interpretation of the Small Business Act and Agency regulations is inconsistent with long-standing Agency interpretation and practice. Furthermore, OIG's conclusions about what SBA "should have done" with duplicative CDBG grant payments are internally inconsistent with each other; are inconsistent with OIG's own prior Reports and guidance to the Agency; and assume that SBA did not coordinate with HUD and State agencies (which it did) and that SBA can -- or should -- override grant-making decisions made by other state or federal agencies. Had OIG's suggestions actually been implemented in the post-disaster circumstances which are the subject of the Draft Report, they would have sanctioned enormous potential duplication of benefits and waste of taxpayer funds.

1. SBA Does Not Concur With OIG's Interpretation Of The Small Business Act Or Its Applicable Regulation.

We note as a threshold matter that the Draft Report's findings depend on the Inspector General's interpretation of SBA's authority under the Small Business Act. Based on that interpretation, the Draft Report concludes that the Agency's differing and longstanding interpretation of the same statutory authority has resulted in "waste." This is a strained definition of "waste" that depends on an interpretation of the relevant law that is inconsistent with fifty years of Agency interpretation and practice well known to and, indeed, supported by OIG prior to the Draft Report.

We are, of course, aware of the duplication of benefits provisions of the Stafford Act and the delivery sequence outlined in FEMA's regulations that OIG relies upon in the Draft Report. In this respect, the key requirement of the Stafford Act and the applicable regulations is that a fair and reasoned determination be made about the total dollar amount of a disaster victim's overall injury.² This determination then forms the basis for each step of the delivery sequence to make sure that delivery of federal assistance stops when the assistance for the same injury has already been delivered. Under the FEMA delivery sequence, agencies later in the delivery sequence are required to be aware of the full extent of the disaster victim's injury as well as the full amount of all prior federal assistance, so that they can decide whether further assistance from them is duplicative.

At the same time, the Small Business Act and SBA's pertinent regulation require SBA, after a loan is made or approved, to monitor the borrower's situation and to recover from the borrower *all compensation* for the borrower's injury received by the borrower from any source. This is a basic feature (and indeed, a basic limitation) on SBA's disaster lending authority: To ensure that a disaster loan is made solely for a victim's uncompensated injury, SBA is required to monitor borrower's sources of compensation. If a victim receives compensation before an SBA loan is made, the loan is approved only for the amount of the remaining, uncompensated injury; if

² We note that SBA worked closely with disaster victims to ensure that they were given the benefit of the doubt regarding calculation of the total amount of their injury, and thus regarding whether or not grant funds duplicated SBA assistance. Action to recover duplicate benefits was taken only when the total amount of injury involved was clear and thus the duplication of benefits was unambiguous.

compensation is received after a loan is disbursed or approved, such compensation is applied by SBA to reduce the loan balance or remaining available loan funds.

The post-disaster issue which arose in Louisiana, Mississippi and Iowa was as follows: Notwithstanding the Stafford Act and the FEMA delivery sequence, in action plans approved by HUD, those States were prepared to disburse grant funds to disaster victims *who had already received an SBA disaster loan for the same injury*. By definition, this would have constituted duplication of benefits. This was so in spite of SBA's efforts to coordinate with them on this topic. Consequently, SBA had a clear obligation under the Small Business Act, as discussed below, to remedy such duplication of benefits. SBA acted correctly and in conformity with its clear and long-standing regulations when it did so.

The prohibition against duplication of benefits has been an important principle in SBA programs, including SBA's disaster assistance program, for over 50 years. Since 1958, Section 18(a) of the Small Business Act has mandated that SBA not provide benefits that duplicate the assistance provided by another department or agency. Since 1958, SBA's disaster assistance regulations have also stated that an SBA disaster loan must be *reduced* by amounts recovered from insurance *or other sources*. (Emphasis added.) See, 13 CFR § 123.7-8, 1959 ed. In 1981, Congress amended Section 7(b)(1) of the Small Business Act to incorporate the Agency's longstanding interpretation and practice, specifically requiring that disaster loans be made only when the disaster victim's injury was "not compensated by insurance *or otherwise*." (Emphasis added.) This statutory provision is clear, unambiguous and all-inclusive. In accordance with this mandate, SBA's current regulation, in effect in substantially the same form for at least 25 years,³ makes clear that "proceeds of insurance, gifts *or other compensation* must be deducted from the amount of the claimed losses, or, *if received after SBA has approved and disbursed a loan, must be paid to SBA as principal payments on [the] loan.*" (Emphasis added.) 13 CFR § 123.101(c).

Accordingly, SBA disagrees with OIG's finding in the Draft Report that SBA acted incorrectly when it recovered \$643.8 million of CDBG funds and applied them to pay down fully-disbursed disaster loans, thereby reducing SBA loan balances instead of "returning" the funds to HUD. OIG asserts that the funds should have been returned to HUD so that HUD could have recycled the funds for other disaster victims.⁴ But OIG identifies no provision or procedure in the Small Business Act or the Miscellaneous Receipts statute [31 U.S.C. 3302(h)] for "return of grant funds" when another state or federal agency has chosen to make a grant to an existing SBA borrower. To the contrary, the Small Business Act, as interpreted by SBA, says just the

³ On page 5 of the Draft Report, OIG cites to the current version of SBA's longstanding regulation which is now codified at 13 CFR § 123.101(c) and emphasizes that the current version was "issued in 1996 after FEMA issued its duplication of benefits regulation." As OIG knows, there was a complete revision of SBA's regulations in 1996, with no intent to change the underlying substantive determinations except as specifically identified. Thus, it is irrelevant that the 1996 recodification occurred after FEMA issued its regulation in 1989. The original version of SBA's regulation, codified at 13 CFR § 123.22, was issued in 1983, six years before FEMA issued its regulation. See, 48 Fed. Reg. 45225 (Oct. 4, 1983).

⁴ OIG fails to address whether HUD would have been able to recycle returned grant funds given the requirements of the Miscellaneous Receipts statute [31 U.S.C. 3302(h)], which states that an agency that receives money from any source shall deposit the money in the Treasury.

opposite: It requires reduction of loan balances for compensation received by victims from all sources. If SBA had ignored its statutory responsibility under the Small Business Act and allowed HUD or the subject States to disburse duplicative grant monies to SBA borrowers without requiring repayment of the SBA loans previously made to the same borrowers for the same injury, SBA would have *violated* the Small Business Act and there would have been an additional cost to the taxpayers because the borrowers would have received double federal assistance (in the form of a loan and a grant) for the same injury.

Similarly, SBA also disagrees with OIG's finding that SBA acted incorrectly when it applied \$281.8 million of duplicate assistance from CDBG funds to decrease undisbursed SBA disaster loan balances, thereby reducing SBA loan amounts instead of rejecting or returning these funds to HUD or the State agencies. SBA communicated proactively with HUD and the involved State agencies as they were preparing to disburse CDBG funds for these disasters. Through these communications, SBA learned that the States were not prepared to reduce the amount of the grant monies disbursed to SBA borrowers by the amount of the previously-approved SBA loans and to re-direct these CDBG funds to other disaster victims. In view of this, SBA had no choice under the Act and the applicable regulation but to make arrangements to apply such funds to reduction of these victims' approved SBA loans.

In sum, SBA's actions prevented the outflow of \$925.6 million in duplicate benefits. If SBA had allowed its borrowers to receive and retain grant funds as compensation for the very same injury for which the borrower had already received federal assistance in the form of a loan for the full amount of the disaster injury, SBA would have expected OIG to criticize the Agency for waste and SBA would have agreed with that conclusion. It cannot be over-emphasized that in this post-disaster process, SBA undertook in each instance to determine the full amount of the victim's injury and (to the full extent permitted by statute) authorized a loan for that injury. In the subject instances, so far as the Agency was aware, neither HUD nor the State agencies disagreed with SBA's determination of the extent of injury; nor did they assert that an additional grant was appropriate because the victim's injuries had not yet been fully compensated. Accordingly, for any such victim also to receive a grant for the same injury would have been, by definition, duplicative.

2. SBA Does Not Concur With OIG's Recommendation that SBA Amend Its Applicable Regulation, Or With The Policy Underlying That Recommendation.

In the Draft Report, OIG recommends that SBA modify 13 CFR § 123.101(c) "to address FEMA's delivery sequence of disaster benefits." OIG states that under the FEMA sequence, each agency theoretically can deliver its benefits "without concern about duplication with a program later in sequence." This is because agencies later in the sequence are "responsible for preventing duplication from programs listed earlier," and thus are responsible for "rectifying" any duplicative payments. [Draft Report, p. 5] OIG thus concludes that it is essentially none of SBA's business what other agencies lower in the delivery sequence do with their monies. Indeed, OIG asserts that the Small Business Act "does not provide authority" for SBA to reduce

or repay loans out of grants made by agencies lower in the FEMA delivery sequence, because it does not explicitly state that a subsequent disaster grant made after an SBA loan is an appropriate “other source” for repayment. [Draft Report, p. 6] OIG therefore asserts that SBA’s regulation should be modified to provide that SBA will ignore all benefit decisions made by agencies later-in-time in the FEMA delivery sequence behind SBA.

SBA disagrees very strongly with this statutory interpretation and recommendation to modify the regulation. As set forth above, the statute has long required SBA to make loans only in the amount of uncompensated loss, and that it is to take account of compensation received from all “other sources.” The Agency long ago clarified the provision in its regulations, and requires that “proceeds of insurance, gifts or other compensation must be deducted from the amount of the claimed losses, or, if received after SBA has approved and disbursed a loan, must be paid to SBA as principal payments on [the] loan.” (Emphasis added) This regulation makes clear, and SBA’s practice has been, that it will look to *all sources* of a disaster victim’s pre and post-loan compensation in order to ensure that no duplicative federal assistance is provided.

It is a bedrock principle of administrative law that an agency has authority to interpret its authorizing statute and to provide detail for implementing the statute’s requirements. SBA’s regulation reflects SBA’s longstanding interpretation of the Small Business Act. An agency’s interpretation of its statutory authority as expressed through regulations properly promulgated under the Administrative Procedure Act is afforded deference by the courts. *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984).

OIG has not demonstrated that SBA’s interpretation of the Small Business Act is unreasonable. SBA is forced to conclude, however, that the OIG interpretation is unreasonable and ill-considered. Significantly, if SBA were to modify the regulation as OIG recommends, it would lead to waste and possibly abuse in SBA’s disaster assistance program. This is so because SBA would be forced to turn a blind eye to benefits received by the disaster victim after the SBA disaster loan had been approved or disbursed – *even if the SBA were aware of these duplicative benefits and even if those benefits are in excess of the amount of the victim’s injury as determined by SBA*. Under the OIG interpretation, SBA could not reduce the amount of an approved disaster loan if the disaster victim, prior to disbursement of the loan, received a recovery in the form of a state-funded grant, a gift, or a tort claim payment, for example. SBA would be forced to disburse the duplicative funds, knowing that the disaster victim had already been compensated for the same injury. Similarly, under the OIG interpretation, SBA could not require a borrower to use the proceeds of any such recovery received after disbursement of the disaster loan to pay down the loan. Under the OIG’s interpretation, SBA would have to stand by while a disaster victim retained both a loan and a grant for the same injury. This is precisely the duplication of benefits which the Small Business Act, the Stafford Act and the FEMA delivery sequence are intended to prevent.⁵

⁵ This is particularly relevant in light of expected duplicate benefit recoveries by SBA borrowers from the BP Deepwater Oil Spill Compensation Fund.

3. SBA Does Not Concur With OIG's Conclusion That It Constituted "Waste" Of Taxpayer Funds To Use CDBG Funds To Repay Or Reduce Prior Disaster Loans.

SBA believes it would be grossly wasteful to allow the above-referenced potential duplicative payments -- and windfall -- to occur. Therefore, if a disaster victim already received federal assistance in the form of an SBA loan for his or her injury, and if the victim then receives a duplicative federal grant for the same injury, SBA captures the grant funds and repays the loan out of those funds. The net effect of this process is to transform a disaster victim in this situation from a borrower to a grantee.

OIG asserts that this is "improper," because borrowers have the ability to repay a loan but grantees are presumably of lower income and could not qualify for a loan. For this reason, OIG claims, the SBA should not have "allowed" other agencies to give grants to borrowers, thus transforming them to grantees instead of borrowers.

Of course, in the same Draft Report, OIG also argues that it was *improper* and wasteful for SBA even to consider what grants were being made by HUD and other State agencies lower in the FEMA delivery sequence than SBA. But at the same time, and frankly inconsistently, OIG asserts that SBA should somehow have prevented HUD and such other agencies from making these grants to existing SBA borrowers, so that such funds could be "put to better use to provide grants to other disaster victims with unmet needs and who may lack the resources to qualify for an SBA disaster loan." [Draft Report, p. 7]

SBA does not have authority to tell HUD or these State agencies what grant decisions they should or should not make. And in this instance, HUD and these State agencies made it clear they intended to make grants to these existing SBA borrowers. HUD and these State agencies presumably decided that all recipients were eligible to receive these funds. The issue was therefore not whether these funds should have been put to a "better" use. The sole issue was what SBA was to do in the face of this duplicative assistance.

The Draft Report suggests that SBA could have coordinated better with HUD and the State agencies to avoid this duplication of benefits. As OIG is well aware, SBA *did* confer with HUD and the involved State agencies to avoid duplication of benefits. In this respect, SBA agrees with the statement in the Draft Report that, "SBA's role [in addressing CDBG duplicate benefits] varied based on the terms of the state recovery plans." This was because certain state grant programs were clear and well-planned to avoid duplication of benefits. Such states worked with SBA to share information about the total amount of disaster victims' injury, and limited their grant programs to "unmet needs" only. Those states refrained from providing duplicate benefits to disaster victims who had already received an SBA disaster loan equal to the full amount of the victim's ascertained injury.

In spite of SBA's efforts to coordinate, HUD and the State agencies in Louisiana, Mississippi and Iowa made it clear that they intended to provide duplicative assistance. Repeatedly, they were made aware of SBA's prior assistance and its calculations of loss and injury. But contrary

to the OIG assertions in the Draft Report, HUD was not prepared to prevent a duplication of benefits in the Louisiana, Mississippi and Iowa programs, in spite of SBA's repeated efforts to coordinate with HUD to prevent such potential duplication.⁶ In other words, the states made clear that these grants were *going* to be made and that duplicative benefits were *going* to be awarded. The only coordination they would provide was regarding disbursement of the actual grant funds, once the grants were made. Accordingly, SBA's only choice was to ignore such duplicative benefits or to act responsibly and in accordance with the Small Business Act and its own regulations by using these duplicative funds to repay or reduce existing SBA loans.

Thus, the post-disaster events which *actually* occurred in Louisiana, Mississippi and Iowa demonstrate the fundamental problem with OIG's analysis and conclusions: OIG asserts that SBA is supposed to "ignore" decisions made by agencies further down in the delivery sequence, because it is "their job" (not SBA's) to avoid duplication of benefits. But as these events show, in spite of SBA's coordination with them, such other agencies did not avoid duplication of benefits. SBA firmly believed – *and continues to believe* – that ignoring known intended duplication of benefits is inconsistent with the Small Business Act. For that reason, when HUD or a State agency made clear that it intended to make a grant to a disaster victim who already had an existing or approved SBA loan for the same injury, SBA treated such funds as compensation and used such funds to repay or reduce the loan as it was required to do.

Fortunately, OIG's unusual interpretation of SBA's statutory authority is advisory only for purposes of its audits and is not the official Agency interpretation of these provisions for programmatic purposes. While we have considered the OIG's new interpretation, we strongly disagree with it and, therefore, with the Inspector General's recommendations in the Draft Report that follow from this interpretation. Of course, the Agency is and has been willing to work with HUD to improve the delivery of our respective services to disaster victims to ensure that we are not duplicating their efforts or assistance. We are in agreement with the Draft Report recommendations to the extent they are recommending such course of action.

4. The Draft Report Is Inconsistent With Prior OIG Reports and Guidance.

We were particularly surprised by the findings and recommendations in the Draft Report because the matters under review in these audits have been the subject of numerous discussions with OIG since the inception of the 2005 Gulf Coast Hurricanes CDBG programs. In fact, the process used by SBA to prevent duplication of benefits was established, in large part, due to suggestions and recommendations from OIG. OIG and ODA had frequent meetings to formulate and outline the policies and procedures for addressing duplication of benefits and determining loan eligibility, including the requirement that grant funds be used to pay down SBA loans. As OIG is aware, SBA executed a computer matching memorandum of understanding (MOU) with both Louisiana and Mississippi which dealt with the use of information to preclude a duplication of benefits. All

⁶ As ODA was made aware of each state grant program, efforts were made to include HUD in meetings, planning and decisions, and HUD declined repeatedly, contrary to the assertions made in the Draft Report. OIG Report 06-28, discussed below, acknowledges the difficulties SBA had in obtaining HUD participation in the duplication of benefits review process.

the members of the SBA Data Integrity Board, including the then Inspector General, approved the computer matching agreements.

Additionally, on September 25, 2006, the Assistant Inspector General for Auditing issued Report No. 06-28 entitled “Preliminary Assessment of Controls over the Coordination of Disaster Assistance Benefits Distributed by Mississippi Development Authority’s Grant Assistance Program.” The objective of the review, as stated by OIG, was “to develop a preliminary understanding of SBA’s internal controls and related capability to accurately identify, obtain *reimbursement* for, and *reduce* SBA disaster loans that duplicate HUD grant benefits administered by MDA.” (Emphasis added.) The Report stated that “to comply with the Stafford Act and the Small Business Act, SBA must be able to identify disaster loans that may be impacted by grant assistance and take appropriate action to ensure that individuals do not receive assistance for any losses for which they have been compensated by other program sources.” The Report further stated that to comply with the Stafford Act and the Small Business Act, “SBA and MDA will have to regularly exchange data to identify individuals applying for both types of benefits, detect duplicate payments that may have occurred and appropriately *reduce* SBA loan balances or *recover* duplicate payments.” (Emphasis added.) In the current Draft Report, OIG is now criticizing SBA’s use of the very procedure that OIG reviewed in its earlier Report 06-28 and urged SBA to implement expeditiously. In the Draft Report, OIG is now stating that the reduction of SBA loan balances and recovery of duplicate payments under the process discussed in Report 06-28 was incorrect and resulted in waste. ODA finds it hard to reconcile the findings of the current Draft Report with the findings and recommendations in Report 06-28. OIG fails to even acknowledge these divergent findings in its Draft Report.

5. SBA Does Not Concur With The Finding That Monitoring Duplication Of Benefits In This Circumstance Constituted A Misuse of SBA Employee Resources.

On the matter of allocation of ODA resources, while ODA agrees that it “allocated significant resources to identifying and recovering duplicate benefits resulting from CDBG funds,” it disagrees with OIG’s finding in the Draft Report that the resources “could have been put to better use.” ODA used staff resources to prevent a duplication of benefits as required under applicable law and by the authorized computer matching agreements. Regardless of the interpretation of the laws and regulations, ODA needs to use significant resources to address duplication of benefits issues. Based on the actual CDBG program requirements, ODA must use significant resources in order to extract the information that needs to be shared to evaluate CDBG programs, potential recoveries, and possible duplication of benefits. ODA disagrees with OIG’s assertion that OIG’s interpretation of the law would require no resources to deal with duplication of benefits issues that will continue to exist under any circumstances.

6. Conclusion

In sum, SBA believes its interpretation of the Small Business Act is correct and in accordance with its longstanding practice. SBA also believes its implementing regulations are correct and require no modification. And SBA firmly maintains that ODA did not waste any of its resources and acted properly and in accordance with applicable law by applying known duplicative assistance from HUD and State agencies to reduce outstanding or undisbursed SBA disaster loans. But for ODA's diligence, \$925.6 million in taxpayer funds would have been disbursed in duplicative benefits to SBA borrowers and not recovered by SBA as required by law. SBA is unwilling to implement policies or recommendations which require it to ignore funding decisions by agencies lower in the delivery sequence; or alternatively, which require it to turn a blind eye to known duplicative benefits being disbursed to SBA borrowers in spite of SBA's repeated consultations with involved agencies to avoid such duplication.