



U.S. SMALL BUSINESS ADMINISTRATION
OFFICE OF INSPECTOR GENERAL
Washington, DC 20416

Advisory Memorandum Report

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

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SUBJECT: Review of "Out-of-Sequence" Payments

The purpose of this memorandum report is to bring to your attention an issue that we identified during our review of collateral requirements for disaster loans. During the course of our review, we identified an area where SBA's Office of Disaster Assistance could improve its procedures for preventing duplication of benefits when returning "out-of-sequence" advances to agencies that incorrectly disburse payments to borrowers.

Background

The Small Business Administration (SBA) Disaster Loan Program is the Federal Government's primary program for funding small business disaster victims' recovery. When disaster victims need to borrow funds to repair or replace uninsured damages, SBA's low interest rates and long terms make recovery affordable. The law does not require collateral on disaster loans. However, SBA policy establishes collateral requirements based on a balance between protection of the Agency's interest as a creditor and as a provider of disaster assistance. The Small Business Act prohibits requiring collateral on physical disaster loans of \$10,000 or less at time of approval.

To avoid duplication of benefits for approved loans, every Loan Authorization Agreement stipulates borrowers must promptly notify and pay to SBA any insurance proceeds or other compensation which exceeds the amount taken into consideration during the determination of eligibility. Duplication can also occur when any agency provides assistance for a loss which is the primary responsibility of another agency. Each agency should, in turn, offer and be responsible for delivering its program(s) without concern about duplication of benefits caused by another program.

We conducted a survey of North Carolina disaster home loans approved during FY 2000. We reviewed SBA loan files, visited the Atlanta, Georgia Disaster Area Field Office, and inspected a sample of 14 borrowers' disaster damaged homes during the period of June through August, 2002. We also interviewed the borrowers, SBA disaster officials, and FEMA disaster officials. Our survey included a review of the disaster damage sustained, the disaster repairs made, and the total disaster assistance received from all sources. We determined what disaster assistance was received from the Federal and state assistance programs, voluntary agencies, hazard insurance, and from personal resources.

RESULTS

SOP guidance on Duplication of Benefits (DOB) states the "sequence list" determines the order in which a program should provide assistance and what other resources it must consider before it does so. Under a Presidential declaration, generally the delivery sequence is (a) volunteer agencies' emergency assistance programs; (b) temporary housing assistance, including limited home repairs or minimal repairs (MRP); (c) hazard insurance (including flood insurance); (d) SBA and Department of Agriculture disaster loans; (e) Individual Family Grant Program (IFGP) assistance; (f) volunteer agencies additional assistance programs; and (g) The Cora Brown Fund administered by the Federal Emergency Management Agency (FEMA).

Occasionally, IFGP, FEMA, or similar agencies will make an "out-of-sequence" advance to disaster victims financially able to meet full SBA loan eligibility. If this happens, FEMA will notify SBA of the "out-of-sequence" assistance by updating the duplication of benefit information it provides. The borrower should then repay the IFGP for that portion of the loan made for any eligible purpose(s). If SBA learns of the assistance after the loan approval but before full disbursement, SBA must repay the affected program via loan modification action.

SBA procedures for repaying agencies for "out-of-sequence" advances need improvement. To illustrate, for four North Carolina disaster home loans reviewed, borrowers previously received IFGP funds from FEMA. During loan origination, SBA determined that three borrowers were not eligible for the IFGP funds, since they were eligible for the entire disaster loan with SBA. To correct this duplication, SBA loan checks were prepared as co-payable to the borrowers and to the Individual Family Grant Program of North Carolina. The borrowers were supposed to forward these checks to FEMA to reimburse erroneous IFGP payments. However, two of the three borrowers who received co-payment checks totaling \$19,800 cashed the checks instead of repaying their IFGP payments.

This condition occurred because SBA procedures require that it send a co-payee check directly to the borrower instead of the agency that made the "out-of-sequence" payment. Further, SBA does not have a follow-up procedure in place for verifying that the borrower has sent the check to FEMA. Particularly, it does not follow-up with the borrower or FEMA. As a result, SBA procedures for repaying agencies that make "out-of-sequence" advances create an environment that is conducive to fraud.

Recommendations

We recommend that the Office of Disaster Assistance take the following actions:

1. A Develop a more effective method of returning disaster loan proceeds to agencies that make "out-of-sequence" payments.
- 1.B Provide FEMA with information concerning the two identified SBA disaster borrowers who have not returned the \$19,800 of incorrect disbursements of IFGP funds.
- 1.C In coordination with FEMA, provide information on similar co-payment checks to SBA borrowers receiving IFGP funds. This would allow SBA to determine the extent of misuse of funds and take appropriate actions to ensure return of incorrect disbursements.

Management Response

The Associate Administrator, Office of Disaster Assistance was briefed on the report and agreed to take action to implement the recommendations.