



**U.S. SMALL BUSINESS ADMINISTRATION
OFFICE OF INSPECTOR GENERAL
WASHINGTON, D.C. 20416**

ADVISORY MEMORANDUM

Issue Date: September 25, 2006

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To: Herbert P. Mitchell
Assistant Administrator
Office of Disaster Assistance

Cc: Jennifer E. Main,
Chief Financial Officer

From: /S/ Original Signed
Debra S. Ritt
Assistant Inspector General for Auditing

Subject: Preliminary Assessment of Controls over the Automated Coordination of
Disaster Assistance Benefits Distributed by Mississippi Development
Authority's Grant Assistance Program

This report presents the results of the Office of Inspector General's (OIG) preliminary assessment of controls over the coordination of Department of Housing and Urban Development (HUD) grants distributed by the Mississippi Development Authority (MDA). HUD disaster assistance, administered by state agencies as block grants, is intended to provide Mississippi and other Gulf Coast residents with grants of up to \$150,000 to rebuild their hurricane-damaged homes. 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 programs or sources.

The magnitude of Federal disaster assistance from HUD, which will impact SBA disaster loans, presents the SBA with significant challenges, including:

- Coordinating aid distribution efforts with HUD and Gulf Coast state agencies;
- Complying with Federal mandates of the Stafford Act and Small Business Administration Act that prohibit SBA from providing disaster loan assistance to borrowers who have already been compensated for their losses from other sources; and

- Ensuring that related loan modifications and financial transactions are properly initiated, recorded, processed and reported in the Agency's financial statements.

Recognizing that the HUD grant program will present challenges to SBA, the OIG initiated a review of potential duplication of benefits associated with the MDA-administered HUD grants. The objective of our review 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. Although Louisiana and other Gulf Coast States are receiving supplemental HUD disaster grants, the scope of our review was limited to those HUD grants administered by MDA.

Our review revealed that although MDA began grant distribution in August, SBA had not implemented key computer process controls to prevent and detect duplication of benefits and ensure that financial reporting processes were effectively working to avoid material misstatements in its financial statements.

Background

The Federal government provides disaster assistance funding through a variety of agencies and programs. SBA's Disaster Loan Program is the primary Federal program for funding long-range recovery for private sector and non-farm disaster victims. It is also the only form of SBA assistance not limited to small businesses. HUD's assistance, administered under the Community Development Block Grant program, is intended to provide Gulf Coast state residents with grants of up to \$150,000 to rebuild their hurricane-damaged homes. MDA plans to administer these HUD grants under the state's Katrina Recovery Homeowner Grant program.

SBA estimates that 15,850 applications were filed with MDA for HUD grants, 10,823 applications were filed for SBA disaster loans in the affected counties, and that an estimated \$500 million in SBA loans will be impacted by MDA grants. The amount of duplicate benefits resulting from MDA grants will depend on the timing of the loan disbursement and the financial circumstances of the homeowner. However, SBA anticipates that SBA loan amounts and balances will be materially affected by the HUD grants administered by MDA. MDA grant activity began on a pilot basis in August, 2006. Full implementation of the MDA grant program has been planned thereafter.

The Stafford Act requires that disaster relief agencies ensure that entities do not receive assistance for any losses for which they have been compensated by other programs, insurance, or sources. The Small Business Act also directs that disaster loan assistance is available only when the damage or destruction is not compensated for by insurance or otherwise. To comply with these requirements, SBA and MDA will have to regularly exchange data to identify individuals applying for both types of benefits, detect any duplicate payments that may have occurred and appropriately reduce SBA loan balances or recover duplicate payments. It will also have to ensure that benefit transactions and adjustments are properly recorded in SBA's accounting system and reflected in Agency financial statements.

Results of Review

Although MDA desired to issue grants by August 2006, SBA had not taken adequate steps to coordinate aid distribution efforts with MDA and identify SBA disaster loans to be impacted by the HUD grants. Because SBA could not implement an electronic interface, they plan to manually exchange data with MDA. While SBA plans to develop automated tools, data transfer mechanisms remain to be fully tested to ensure that information shared between agencies is safeguarded and that duplicate benefit transactions are properly recorded for financial reporting purposes. Specific progress in each of these areas is summarized below:

- **Coordination of aid distribution efforts.** SBA had drafted, but not finalized, a Memorandum of Understanding (MOU) with MDA. This draft agreement should have been in place prior to the sharing of sensitive information. The draft MOU should define agency roles and responsibilities for identifying duplicate benefits. It should also document each agency's understanding of the related risks of data sharing, the sensitivity of data involved, and how sensitive information is to be safeguarded.
- **Identification of SBA loans impacted by the MDA grant program.** At the time of our review, SBA had not yet determined the dollar amount of the loans affected by MDA grants due to problems it encountered in isolating the data for the affected counties and obtaining the appropriate real estate data codes. While SBA had developed a preliminary estimate, a complete assessment was needed so that SBA could more accurately forecast the financial impact of the grant program on SBA loans, assess resource requirements and monitor project status.
- **Testing of data transfer mechanisms.** As of August 10, 2006, SBA had conducted preliminary tests of data transfer and reporting mechanisms at its Herndon Operations Center, and discussed testing requirements with its Denver Finance Center and the Dallas Processing and Disbursement Center. However, it had not developed or executed formal test plans to ensure that its software and operational procedures were adequate for exchanging data with MDA and properly updating SBA's accounting records and financial statements.

While HUD did not express an interest in participating in the testing process, SBA understands the importance of HUD's oversight during the coordination of benefits effort. We also believe that HUD's participation is essential to ensure adequate controls exist over the entire aid distribution process before MDA disburses funds. SBA officials told us they planned to invite HUD to participate in future tests as they are scheduled.

In summary, key controls that were critical to ensuring that material financial transactions were properly executed in accordance with Federal guidance and regulations

were not in place. Moreover, controls will also need to be established for all Gulf Coast states administering HUD's disaster grants to prevent SBA loan recipients from receiving duplicate benefits from HUD disaster grants disbursed by state agencies. As a result, SBA was not in a position to ensure correct and complete processing of loan transactions relating to HUD benefits administered by MDA and other participating Gulf States. Given the tight program timelines for distribution of HUD grants by MDA and other participating Gulf States, SBA needed to expedite its efforts to ensure key processing procedures and controls were implemented before the HUD grants were distributed.

OIG staff met with SBA's Office of Disaster Assistance to discuss SBA's plans for coordinating the disbursement of HUD grants to recipients of SBA loans with MDA and other state agencies. We learned that SBA had not defined critical tasks, identified project deliverables and responsible parties, or established project timelines for system interface activities. Because the processing of benefit transactions will impact the updating SBA's accounting records and financial statements, we have discussed this matter with KMPG – our external auditor that is performing the audit of SBA's financial statements.

Recommendations

We recommend that the Assistant Administrator for Disaster Assistance:

1. Define critical tasks, identify deliverables and responsible parties, and establish key project time frames for executing either system interface activities or processing manual transactions for each state which plans to participate in the HUD Community Development Block Grant program for Gulf Coast Hurricanes.
2. Ensure that a Memorandum of Understanding is completed for states planning to participate in the HUD Community Development Block Grant program for Gulf Coast Hurricanes, before grant funds are disbursed.
3. Complete an assessment of SBA loans impacted by MDA and other state-administered HUD grants.
4. Execute test plans and procedures with state agencies and HUD to ensure that data transferred electronically or entered manually into SBA's disaster loan systems are correctly processed and SBA disaster loans are accurately adjusted before grant funds are disbursed to disaster loan victims.

Management Response

SBA generally concurred with the recommendations, noting that the entity providing the additional funding has the responsibility to ensure that there is no duplication of benefits. SBA has provided MDA with guidance on what SBA considers to be duplicate benefits under MDA's grant program. In this case, it is MDA's

responsibility to assure that none of its grant monies duplicate funds approved or disbursed from either SBA or the Federal Emergency Management Agency (FEMA).

SBA further stated that it could not finalize the Memorandum of Understanding before the MDA grant program was initiated. SBA and MDA instituted a manual process where: (1) MDA notifies SBA of the grant recipient and total amount of the grant awarded; (2) SBA reviews its records to determine if the homeowner received an SBA disaster loan and if so, calculates the duplicative benefits identifying the amount of funds that MDA is to remit to SBA for payment on the loan; and (3) SBA modifies the loan as appropriate. In the interim process, SBA makes the duplication of benefits determination instead of MDA, as it has the needed disaster loan information. Additionally, SBA verifies that funds it identified are remitted by SBA. The interim process is performed manually because SBA is prohibited from performing electronic data matching with MDA until an MOU is in place and all notification periods have expired. Finally, SBA stated that HUD has declined to participate in tests of data transfers, but agreed to continue to seek HUD participation. SBA's response in its entirety is included as an appendix to this report.

OIG Evaluation of Management Comments

SBA's comments were responsive to our report. We modified recommendations 1 and 4 from the draft report to reflect that manual processing of SBA loan adjustments would be an acceptable method for preventing duplicate benefits due to time constraints in finalizing the MOU between SBA, HUD and other state agencies.

* * *

Our review was conducted in conjunction with the President's Council on Integrity and Efficiency's (PCIE) examination of Federal relief efforts in the aftermath of Hurricanes Katrina and Rita. As such, a copy of the report has been forwarded to the PCIE Homeland Security Working Group which is coordinating reviews of this important subject by the Inspector General Community. Because the nature and brevity of this assessment precluded the use of our normal audit protocols, this review was not conducted in accordance with generally accepted government auditing standards. Had we followed such standards, other matters might have come to our attention.

The finding and recommendation in this report are subject to review and management decision, and corrective action by your office in accordance with existing Agency procedures for audit follow-up and resolution.

If you have any questions, please contact Jeff Brindle, Director Information Technology and Financial Management Audit Group at (202) 205-[Exemption 2]



MEMORANDUM

To: Debra S. Ritt
Assistant Inspector General for Auditing

From: Herbert L. Mitchell
Associate Administrator for Disaster Assistance

RE: Draft Advisory Memorandum entitled “Preliminary Assessment of Controls over the Coordination of Disaster Assistance Benefits Distributed by Mississippi Development Authority’s Grant Assistance Program.”

Date: September 19, 2006

We have reviewed your Draft Advisory Memorandum entitled “Preliminary Assessment of Controls over the Coordination of Disaster Assistance Benefits Distributed by Mississippi Development Authority’s Grant Assistance Program.” We understand the stated purpose of the review to assure that SBA has “taken adequate steps to coordinate aid distribution efforts with MDA (Mississippi Development Authority), identified SBA disaster loans to be impacted by the HUD (Housing and Urban Development) grants, or adequately tested data transfer mechanisms to ensure that information shared between agencies is safeguarded and that duplication of benefits transactions are properly recorded for financial reporting purposes.”

While we generally agree with your recommendations, several issues identified in your memorandum we believe require additional clarification.

- We agree that it is critical that SBA have the ability to identify disaster home loans, and disaster home loan applicants that receive grants from MDA. We think it is important to recognize that it is the responsibility of the entity providing the additional funding to assure that there is no duplication of benefits (DOB). SBA has provided MDA with guidance of what SBA considers a DOB under MDA’s grant program. In this case, it is MDA’s responsibility to assure that none of their grant monies duplicate funds approved or disbursed from either SBA or the Federal Emergency management Agency (FEMA). For example, when SBA receives an application it is our responsibility to do a DOB check with FEMA to assure that none of our loan funds duplicate FEMA grant monies. Therefore, it is MDA’s responsibility to make the DOB determination and to make any necessary pay down

of the SBA loan and to inform SBA of the grant award so that we can make adjustments to the loan, if needed.

- Memorandum of Understanding (MOU) – We recognize the need to have a signed MOU in place with MDA and other state entities that administer similar grant programs. Our office has worked diligently with the Office of General Counsel (OGC) in an effort to craft an MOU that addresses everyone’s concerns. ODA has agreed to all the changes recommended by Counsel and others; however, implementation of these new requirements has made the MOU process take much longer than ODA had anticipated and added additional time to when a fully executed MOU can be implemented.
- As we were unable to get an MOU executed and implemented as quickly as originally planned, in an effort to address the needs of MDA to obtain the information necessary so that they could begin issuing checks to disaster victims we worked with MDA and the OGC to develop and implement an interim process that met everyone’s needs while complying with all relevant statutes (including the Privacy Act). Simply stated, the interim process agreed upon by all parties (including OGC) is as follows: MDA (or other like agency) identifies grant recipient and total award amount to SBA, SBA then reviews our records to determine if the homeowner received an SBA disaster loan and if so, SBA calculates the DOB amount identifying the amount of funds that MDA is to remit to SBA for payment on the loan and SBA then makes loan modifications as appropriate. In the interim process, SBA actually makes the DOB determination instead of MDA, as SBA is the entity that has the needed disaster loan information not MDA. SBA additionally assures that funds are remitted as identified by SBA. The interim process is performed manually, as SBA is prohibited from performing any electronic data matching with MDA until the MOU is in place and all notification periods have expired (Privacy Act requirement).
- To date, HUD has declined SBA’s invitation to participate in previous testing of procedures and we cannot compel HUD participation. SBA will continue to invite HUD to participate in future tests.
- Under the interim procedures in place (as well as proposed procedures under the draft MOU) SBA is providing MDA (and like entities) the information needed for the administration of their grant program and SBA is obtaining the information necessary to make the DOB determination for MDA, determine appropriate amount of remittance to SBA, assure remittance received, and will make all necessary loan modifications (e.g., adjust real estate loan eligibility amount).

On page 3 of the draft, line 29, “Herndon Data Center” should read Herndon Operations Center.

In the draft Memorandum you recommend four actions and our response to each recommendation is as follows.

1. Define critical tasks, identify deliverables, etc.
SBA has defined critical tasks, identified deliverables and established project timelines. ODA will work with the OIG to deliver information needed for this audit and performed

under this initiative such as executed MOU's, Letter's of Agreement, project milestones, timelines, etc.

2. Ensure MOU is completed...

ODA is working aggressively to obtain Agency approval of the proposed MOU. The Data Integrity Board (DIB) is meeting Thursday, August 31, 2006 to review draft MOU's for MDA and the Louisiana Recovery Authority. Once DIB approved received, MOU's will be executed and sent to the relevant state agency for signature, SBA will coordinate with OMB and MOU information will be published in the Federal Register. Once MOU's are fully executed, signed copies will be forwarded to appropriate House and Senate Committees and if no comments received, MOU's will be implemented 30-days after notification to Congress (Privacy Act requirement).

3. Complete an assessment of SBA loan impacted by MDA and other state-administered HUD grants...

We agree that such an assessment is needed. The most efficient and preferred method to perform a complete assessment of the total impact of the State's grants to homeowners to SBA approved disaster home loans requires electronic data matching between MDA and SBA. Unfortunately, under the Privacy Act SBA cannot perform such electronic data matching until MOU is in place and the time periods for comments have lapsed. SBA plans to perform such an impact assessment once we have MOU's in place that allow for matching of electronic data.

4. Execute test plans and procedures with state agencies and HUD to ensure tat data transfers and processing work before grant funds are distributed to disaster loan victims.

We will continue to test processes and procedures to assure that MDA and SBA are receiving accurate information and that it is received timely, recognizing that some of the processes and procedures will differ between the interim solution and the exchange of information under the MOU.

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