

QUALITY ASSURANCE REVIEWS OF LOSS VERIFICATIONS

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U.S. Small Business Administration
Office Inspector General

Memorandum

To: Jovita Carranza, Deputy Administrator

Date: July 23, 2007

Herbert L. Mitchell, Associate Administrator for
Disaster Assistance

From: Debra S. Ritt
Assistant Inspector General for Auditing

Subject: Audit of Quality Assurance Reviews of Loss Verifications
Report No. 07-29

This is the first of two reports on Quality Assurance Reviews (QAR) of loss verifications conducted by the Small Business Administration's (SBA) Office of Disaster Assistance (ODA). Loss verifications provide the initial damage estimates for repair or replacement of real, personal and/or business property and are used to establish the amount of loans approved under SBA's Disaster Assistance Program.

In February 2005, a group of SBA employees assigned to ODA was determined to be the Most Efficient Organization¹ (MEO) of an A-76 competition² and awarded a 5-year contract to conduct the initial loss verifications. As of July 2006, the MEO had conducted approximately 300,000 verifications. This report addresses an employee complaint that QARs of individual loss verifications were inappropriately altered so that performance metrics required under the A-76 process would be met. We plan to issue a separate report that addresses more fully the overall adequacy of the QAR process and the quality of loss verification reports supporting damage assessments.

In July 2006 SBA performed its first QAR review of a sample of 748 loss verifications associated with the Gulf Coast hurricanes. The 748 QARs were conducted by 12 ODA loss verifiers who were independent of the MEO.

¹ The Most Efficient Organization is the staff the Agency identifies will provide the needed services detailed in the contract solicitation. This will be explained in more detail in this report.

² OMB Circular No. A-76 establishes Federal policy requiring that commercial activities performed by the government be subject to competition, and that inherently governmental activities be performed with government personnel.

To address the allegation, we compared 246 original QARs provided by complainants to the final QAR results entered into the Disaster Credit Management System. We also interviewed the four reviewers who prepared the 246 QARs and the SBA supervisor who allegedly altered the QAR results. We assessed the extent to which any differences between the original and final results impacted the overall conclusions reached about the MEO's achievement of performance metrics in the Letter of Obligation.

We interviewed 6 of 12 reviewers and QAR managers to assess the MEO's involvement in the QAR process and to determine whether QAR managers discussed the ramifications of a poor evaluation with the reviewers. We conducted the audit from April 2 through May 21, 2007 in accordance with *Government Auditing Standards* as prescribed by the Comptroller General of the United States. A more detailed description of our audit scope and methodology is provided in Appendix I.

BACKGROUND

Applications for physical disaster loans require on-site inspections to verify disaster losses. These inspections are referred to as loss verifications. The initial damage estimates for disasters that occur within the continental United States are conducted by loss verifiers assigned to ODA Field Inspection Teams.³ The loss verification process includes making site visits to properties that have been damaged or destroyed by disasters to assess financial losses, and estimating the cost to repair or replace those items and structures eligible for SBA disaster funding.

In February 2005, an A-76 competition was conducted to outsource the initial on-site loss verifications. Under the A-76 process, government employees may submit a bid to compete with outside contractors to perform the work based on a "Most Efficient Organization" study. If the employees win the competition, they must operate as the MEO and meet performance metrics. SBA employees assigned to ODA were determined to be the MEO and won the competition. On July 7, 2005, a Letter of Obligation was issued that required SBA to prepare and implement a Quality Assurance Surveillance Plan in accordance with OMB A-76 to monitor the MEO's performance and to conduct formal performance meetings during the first year of the contract.

Instead of preparing a plan, SBA elected to monitor MEO performance through an existing QAR process that had been established for in-house loss verifications

³ Initial loss verifications that occur outside the continental United States are conducted by Field Operation Center-East or Field Operation Center-West.

performed prior to the A-76 competition. In July 2006, SBA conducted its first review of the MEO's performance using a team of ODA loss verifiers that were not assigned to the MEO. The team evaluated 748 of approximately 300,000 loss verifications prepared by the MEO between October 1, 2005 and March 31, 2006. The evaluation was based on 13 questions that addressed steps in the loss verification process required by SBA's *Loss Verifier's Handbook* and *ODA Memo 05-65*⁴. Questions answered with a "yes" indicated acceptable performance, while a "no" constituted poor performance, or an exception.

In some instances, the errors impacted the loan amounts that SBA approved for the borrowers. For example, in one loan an applicant was identified as a renter when he was the owner of the property which would have qualified him not only for personal property damages, but also real property losses.

The number of exceptions noted determined whether the MEO met performance requirements specified in SBA's Letter of Obligation. The letter also provided that if exceptions exceeded 2 percent, the MEO would be assessed financial penalties and could face termination for repeated high exception rates. Any penalties assessed would be borne by ODA, and if the MEO were terminated, reduction-in-force procedures would likely be necessary to implement the result. The 748 QARs completed in July 2006 collectively showed that the MEO performed at an exception rate of 1.3 percent, which was well within the acceptable rate.

RESULTS IN BRIEF

We substantiated the complainant's allegation that QARs conducted of disaster loss verifications were altered to reduce the number of exceptions, allowing the MEO to meet performance requirements. Specifically, we found that 72 of 246 QARs reviewed were materially altered, lowering the MEO's exception rate for the 246 QARs from 4.8 percent to 0.6 percent. The 0.6 percent rate was well below the 2 percent maximum exception rate stipulated in SBA's Letter of Obligation. Also, while copies of the original QARs were available from the complainants, ODA could not produce the originals, which may have been destroyed.

The QARs were altered by the Supervisor of Loss Verifications at the Fort Worth Processing and Disbursement Center in collaboration with MEO managers. In most cases, reviewers were not consulted about the changes. Further, in contrast to the reviewers' answers, which were generally supported by references or

⁴ ODA Memorandum No. 05 – 65 provides policy on assessing damages for personal property losses where an applicant is unable to meet with a loss verifier for an onsite visit.

explanations, the alterations were not supported by documentation as required by the Letter of Obligation, nor were there credible bases for the changes. For example, the supervisor revised several QARs to show there was an accurate and complete property observation in sketch without obtaining the sketch or inspecting the property. In other cases, the supervisor changed responses to show that borrowers were contacted, although reviewers noted the chronological logs showed no contact was ever made. Generally, reviewers were not consulted before these changes were made.

When questioned about changes to the QARs, the SBA supervisor was unable to provide support for his changes. He explained he was not required to document the basis for changing reviewers' answers, because this was not the practice in prior QARs. However, unlike previous reviews, the current QAR was an assessment of the MEO, and the Letter of Obligation required SBA to retain a file of all results.

The supervisor also acknowledged that he met with MEO officials to reach immediate agreement on the validity of the exceptions and generally did not consult with reviewers before making the changes. While we believe it may be appropriate to seek the MEO's comments on the final QAR results, it is inappropriate to change results based solely on the MEO's objections. Also, the discussion with the MEO occurred *prior to* concluding the QAR, giving the appearance that the MEO helped determine the final results. Finally, making changes as a result of the meeting with the MEO without consulting the reviewers further cast doubt on the integrity of the process. In our opinion, allowing the MEO to influence the assessment of its performance in this manner is a serious breach of independence that compromised the integrity of the QAR process.

The supervisor and another manager admitted that in their opening statements to the QAR team they suggested the MEO could lose their jobs based on the QAR results. Four reviewers remembered two managers making these statements, and interpreted these statements to mean that the MEO would receive a passing score no matter what the results were because jobs were at stake. Another reviewer remembered only one of the managers making the statement, and the last reviewer could not recall whether such a statement was made.

Based on the results of our audit, we believe the QAR process was compromised, allowing a senior official to alter results in order for ODA to avoid penalties and to retain the work under the A-76 contract. Not only did managers make statements regarding the impact that adverse findings would have on ODA, but the QAR results were altered in collaboration with the MEO, bypassing the reviewers. Further, because ODA both managed the MEO and performed the QAR, and

would also incur the penalties for non-performance, we believe it lacked the independence needed to fairly evaluate the MEO's performance.

Consequently, SBA is not realizing the full benefits of the A-76 competition, such as getting the best value and performance, and lacks assurance that loan values reflect the true costs to repair or replace damaged properties. We identified 32 instances where errors made by loss verifiers impacted the damage estimates used to support loan amounts. We are, therefore, recommending that SBA reassign responsibility for the QAR to an independent organization outside of ODA and that it perform a new QAR of the loss verification process. We also recommend that SBA take steps to ensure that the initial QAR results be documented and that any changes be justified in writing and coordinated with the reviewers. Finally, given the seriousness of the SBA supervisor's misconduct, the Agency should evaluate the circumstances and take appropriate disciplinary actions.

RESULTS

An SBA Supervisor Materially Altered QARs, Which Resulted in the MEO Meeting Contractual Benchmarks

A review of 246 QARs that were completed by the review team in July 2006 disclosed that 72 reviews were altered materially to show that the initial loss verifications were in compliance with SBA procedures. More specifically, a total of 136 answers were changed from "no" to "yes" on the 72 QARs. For example, one question that reviewers addressed in the QARs was whether there was an accurate and complete property observation in sketch. Reviewers noted the following exceptions; which the SBA supervisor subsequently removed:

- In one report, the damage assessment described a duplex. The reviewer took exception to the report because there was no assessment of damages for the second apartment.
- In another report, the reviewer took issue with the loss verifier's report because the sketch of the property was inconsistent with the square footage reported in the loss verification.

Responses were also altered to another question concerning whether loss verifiers had made additional contacts with the applicants. The reviewers reported exceptions because after reviewing the chronological logs they could find no evidence of contact with the applicants. However, the supervisor removed these exceptions. For example:

- One reviewer responded “no,” noting that according to the log, the borrower was not contacted because she did not speak English.
- Another reviewer recorded an exception because the log indicated the verifier was required to return a call to the applicant to discuss the loss verification results, but no entry was made in the log to show that he did.

We also found the SBA supervisor revised responses to questions about whether the verified real property loss was consistent with the description of damage; and whether the report addressed all damaged areas. It appears the supervisor made these changes without additional support to refute the reviewer’s responses. For example:

- On three reports, the reviewers noted exceptions because the loss verifiers failed to address damages associated with either the crawl space, electrical system, or landscaping.
- Another reviewer took exception to additions that were not consistent with the damage description.
- One reviewer took exception with the length of skirting reported and the associated cost to replace it.

Finally, on another question, the QAR reviewer took exception to the original loss verification because the applicant was reported as being a renter when he was actually the owner of the property, which qualified him not only for personal property damages, but also real property losses. Had the initial loss verification correctly reported the status of the applicant, he would have been approved for a larger loan. In 31 other loss verifications, errors made by the loss verifiers impacted the damage estimates used to support loan amounts.

In all of these instances the reviewers provided explanations for their findings and noted the evaluation criteria they used from the *Loss Verifier’s Handbook*, and an ODA memorandum. However, the SBA supervisor changed the QAR reviewers’ results from an exception to acceptable performance without consulting with the reviewers or obtaining additional documentation to support the changes. The 13 questions used for the QAR evaluation, number of files reviewed, volume of exceptions, the exception rate, and accuracy rate are provided in Appendix II.

We interviewed the SBA supervisor responsible for making the changes who could not provide support for his changes. Another Supervisor told us that because the exceptions were not clearly defined in the *Loss Verifier’s Handbook*,

he gave the MEO the benefit of the doubt. He mentioned that the *Loss Verifier's Handbook* was being revised because the current version is too general and open to interpretation.

We were further told by the supervisor that all exceptions required a reference defining where the MEO's performance was lacking. Therefore, if a reference was not provided, he changed the results to acceptable performance. As we reported previously, the reviewers generally provided explanations for their findings and noted the evaluation criteria they used. Specifically, we found that 84, or 62 percent, of the 136 reviewer responses were supported by explanations; and another 52, or 38 percent, were supported by specific references. Only 14 answers lacked support. Consequently, the supervisor had no basis for changing the majority of the reviewers' responses.

The supervisor explained that in prior QARs, the basis for changing reviewers' answers was never documented. Therefore, he did not believe that the current QAR process required documentation. However, SBA's Letter of Obligation required the supervisor to retain a file of all results. Also unlike previous reviews, the QAR was an assessment of the MEO's performance that would be used as the basis for making decisions about whether the MEO met contractual requirements. He also explained it was not feasible to consult with reviewers before making changes given the large size of the review team.

After the supervisor changed the QAR results, the MEO's exception rate significantly decreased from 4.8 percent to only 0.6 percent for the 246 QARs. Consequently, the MEO's performance was found to be acceptable because its exception rate was below 2 percent. Based on our review of the 246 QARs, we believe the error rate for the 748 QARs is much higher than the 1.3 percent reported by the SBA supervisor. Consequently, there is no assurance that the MEO is performing in accordance with the quality standards.

SBA Supervisor Allowed the MEO to Influence Changes to the QAR

We also found that the SBA supervisor consulted with the MEO in making changes to the initial QAR results. Upon completion of the initial QARs, the SBA supervisor and MEO officials reviewed the results together, without the reviewers, and decided which exceptions were valid and those that should be reversed.

The SBA supervisor acknowledged that he met with MEO officials without the reviewers to reach immediate agreement on the validity of the exceptions. While we believe it is appropriate to get the MEO's comments on the final results, especially on any deficiencies noted, the discussion with the MEO occurred *prior to* concluding the QAR. Therefore, the sequence of events gave the appearance

that the MEO helped determine the final results. Further, making changes as a result of the meeting without consulting the reviewers further cast doubt on the integrity of the process. Allowing the MEO to influence the assessment of its performance in this manner is a serious breach of independence that compromised the QAR process.

Two SBA Supervisors Told QAR Reviewers that a Negative Review Could Cause SBA Employees to Lose Their Jobs

We also substantiated the complainant's claim that QAR reviewers were told their results could cause SBA employees to lose their jobs. We interviewed 6 of 12 reviewers to determine if SBA managers made statements suggesting that adverse results could cause SBA employees to lose their jobs. Four reviewers remembered two managers making these statements, and interpreted these statements to mean that the MEO would receive a passing score no matter what the results were because jobs were at stake. Another reviewer remembered only one of the managers making the statement, and the last reviewer could not recall whether such a statement was made.

We also interviewed the SBA managers who were reported as making these statements. They both admitted that in their opening statements to the QAR team they suggested the MEO could lose their jobs based on the QAR results. The managers further stated there was animosity between the SBA loss verifiers and the MEO, and they wanted to ensure that the reviews were fair. However, both managers denied saying that the review would pass regardless of the QAR results. Nevertheless, QAR reviewers we interviewed perceived manager statements as meaning that the MEO would receive a passing score regardless of the results.

CONCLUSIONS

We believe there was a lack of independent oversight over the MEO, which allowed a senior official to alter results in order for ODA to avoid penalties and retain the contracted work. Not only did managers make statements regarding the impact adverse findings would have on ODA, but the QAR results were altered in collaboration with the MEO, deliberately bypassing the reviewers. Consequently, SBA is not realizing the full benefits of the A-76 competition, such as best value and performance. SBA also lacks assurance that the initial loss verifications reflect the true cost to repair or replace damaged property supporting loan values it approved. In at least 32 instances, it appears that damage estimates were for the wrong amounts.

In addition, we believe that ODA is in a conflicted position of assessing the performance of its own employees, and as such, has no incentive to find

deficiencies which could inflict financial penalties on its own organization or eventually cause a termination of the contract. Any penalties assessed would be ultimately borne by ODA and if the MEO were terminated, reduction-in-force procedures would likely be implemented. Finally, given the seriousness of the SBA supervisor's misconduct, the Agency should evaluate the circumstances and determine whether disciplinary action should be taken.

RECOMMENDATIONS

We recommend that the Deputy Administrator:

1. Pursue a reassignment of QAR responsibilities to an SBA organization outside of ODA.
2. Ensure QAR guidance is developed that requires the responsible QAR officials to document the reasons for exceptions and any changes to initial QAR results; and that the MEO's involvement in the QAR process be limited to the resolution of issues associated with final QAR results.

We recommend that the Associate Administrator for Disaster Assistance:

3. Request that a new QAR be performed as soon as practicable to determine if the MEO complies with all performance requirements and quality standards as defined in the Letter of Obligation.
4. If appropriate, consider disciplinary action against the SBA supervisor who altered the QAR results.

AGENCY COMMENTS

A draft report was provided to SBA on May 24, 2007, with a request for a response within 30 days. SBA subsequently requested and was granted, an extension of the comment period to July 20, 2007. SBA submitted its formal response on July 19, 2007, which is contained in its entirety in Appendix III. Although the Associate Administrator for Disaster Assistance (AA/DA) stated he had not yet finalized an assessment of our findings, he indicated ODA would consider the actions proposed in the four audit recommendations.

The AA/DA acknowledged that there were several problems regarding the QAR process and stated he is taking steps to improve the process. In response to our specific recommendations, he agreed to consider the feasibility of a reassignment of QAR responsibilities and to work with the Deputy Administrator to develop procedures to electronically document exceptions and to recognize the proper rôle

of the MEO in the QAR process. He also plans to conduct another QAR to determine if the MEO is complying with performance requirements and quality standards. ODA will also consider whether any action is warranted regarding the SBA supervisor who altered the QAR results. Lastly, he stated that the Loss Verifier Training manual is being updated.

The AA/DA also emphasized the outstanding performance and significant accomplishments of the Field Inspection Team in its first year of operation. He added that the QAR audit was the first conducted by ODA after the creation of the Field Inspection Team, the execution of the Letter of Obligation and the implementation of DCMS.

OFFICE OF INSPECTOR GENERAL RESPONSE

We believe that the AA/DA's comments on the proposed actions are responsive to our recommendations. However, he did not identify target dates and specific actions for implementing each of the recommendations.

ACTIONS REQUIRED

Because the AA/DA provided no target dates or specific actions for completing proposed actions on any of the recommendations, we are requesting that he provide this information by August 6, 2007.

We appreciate the courtesies and cooperation of the Office of Disaster Assistance representatives during this audit and in the preparation of Congressional testimony regarding the audit results. 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. AUDIT SCOPE AND METHODOLOGY

To assess the appropriateness of the QAR process, we reviewed photocopies of 246 of 748 QARs which supported the complainant's allegation that the Office of Disaster Assistance (ODA) changed results so that the winner of the A-76 competition, ODA employees, would not lose their jobs. We reviewed the *Loss Verifier's Handbook* and *ODA Memorandum 05-65 - Katrina/Rita Personal Property Only Verifications* to obtain an understanding of the requirements for conducting initial loss verifications. We also reviewed SBA's Letter of Obligation for the initial verifications to identify the contract and performance terms for the MEO.

We reviewed SBA's electronic loan files in the Disaster Credit Management System for information regarding loss verification reports. Finally, we interviewed 6 of 12 members of the QAR team responsible for evaluating the 748 loss verification files; the Director for Program, Policy, and Evaluation, ODA; and the Supervisor of Loss Verification from the Processing and Disbursement Center in Fort Worth, Texas accused of altering the QARs.

We conducted the audit from April 2 through May 21, 2007 in accordance with *Government Auditing Standards* as prescribed by the Comptroller General of the United States.

APPENDIX II. LOSS VERIFICATION SUMMARY

Questions	Number of Files	Number of Exceptions	Exception Rate	Accuracy Rate
1. Does the report contain enough to allow for accurate loan processing?	748	13	1.7%	98.3%
2. Did the report contain accurate information on water entry?	748	5	0.7%	99.3%
3. Was there an accurate and complete property observation and sketch?	748	27	3.6%	96.4%
4. Did the on-site report have complete comments that outlined the on-site conversation and or justified the allowances?	748	17	2.3%	97.7%
5. Were additional contacts with the applicant recorded in the chronological log?	748	7	0.9%	99.1%
6. Was the verified real property loss consistent with the description of damage?	748	18	2.4%	97.6%
7. Was the unit pricing consistent with the quality of construction and description of damage, or were inconsistencies justified?	748	5	0.7%	99.3%
8. Was the damage to the vehicles correctly addressed?	748	8	1.1%	98.9%
9. Was the vehicle ownership and registration correctly addressed?	748	13	1.7%	98.3%
10. Were all the corrections dated and commented on?	748	0	0.0%	100.0%
11. Did the report address all damage area identified by the applicant?	748	1	0.1%	99.9%
12. Were personal property losses consistent with damage descriptions, or were inconsistencies justified?	748	13	1.7%	98.3%
13. Was the correct geographic multiplier used?	748	0	0.0%	100.0%
Total Responses	9,724	127	1.3%	98.7%
Total Number of Files Reviewed				
	748			
Total Number of Files With Exceptions				
	94			
Total Number of Files With No Exceptions				
	654			
Total Percent of Files With No Exceptions				
	87.0%			

Source: The information contained this table was extracted from the *Evaluation Report for Small Business Administration Disaster Loss Verification* prepared by the Jupiter Corporation.

APPENDIX III. AGENCY COMMENTS



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

Date: July 19, 2007

To: Debra Ritt, Assistant Inspector General for Auditing

From: Associate Administrator for Disaster Assistance

Subject: Response to IG Report No. 7402 Quality Assurance Reviews of Loss Verifications

Thank you for the opportunity to provide this response to the draft audit report on Quality Assurance Reviews of Loss Verifications prepared by your office. As we have advised you, we have conducted a preliminary review of the issues you raised in the report, but have not yet finalized our assessment. Accordingly, these are our current views on the draft report.

We appreciate your suggestions for improving the QAR process, and are taking steps to rectify imperfections in that important process. ODA recognizes that the integrity of the QAR process is paramount to running a successful program and is committed to ensuring that all QARs are conducted properly. While your report points out the need for improvements in the QAR process, it is important that we recognize the outstanding performance of the Field Inspection Team in its first year of operation. Faced with having to set up its organization within three months rather than the usual six month phase-in period because of the need to address the largest natural disaster in the history of the country, they successfully completed over 320,000 inspections compared to the estimated annual volume of 60,000 indicated in the performance work statement.

We also want to emphasize that the QAR process you audited was the first QAR conducted by ODA after the Field Inspection Team was created and the Letter of Obligation was executed. This was the first QAR conducted after the Gulf Coast Hurricanes and the implementation of the Disaster Credit Management System (DCMS). Many of the necessary written instructions and systems had not been developed and implemented prior to the occurrence of the QAR. As a result, the employees participating in the QAR may not have had the benefit of detailed instructions to guide them through the process, and we have started taking steps to remedy that situation. We also would like to note that the Supervisory Loss Verifier who headed the QAR had the authority and responsibility to make adjustments to the files where appropriate. Moreover, contrary to the implications of the draft report, we believe it is highly unlikely that there would have been any imminent loss of jobs or any fees assessed against ODA even if the original results of the QAR had remained unmodified.

Although we have not completed our assessment, based on our preliminary review we have been unable to confirm all of your initial findings. Our preliminary review of the

APPENDIX III. AGENCY COMMENTS

report and the files has confirmed, however, several problems and concerns concerning the QAR process. In addition, ODA has identified a problem in the recording of QARLV comments and we recognize that the electronic record may not reflect proper documentation in many of these files. We are in the process of correcting these problems.

Our written Loss Verifier Training manual is currently being updated to specifically address the differences in the QAR for Loss Verification assessment of an exception and the final determination of an exception. As we update both our training materials and our QAR processes, we will be able to clarify many of the issues identified in the draft report and establish clearer instructions and processes for the conduct of future QARs.

Our specific responses to the Recommendations are as follows:

Recommendation #1: The Deputy Administrator will consider whether a reassignment of QAR responsibilities to an SBA organization outside of ODA is feasible.

Recommendation #2: ODA will work with the Deputy Administrator to develop procedures to document in its electronic files the reasons for exceptions and to recognize the proper role of the MEO in the QAR process.

Recommendation #3: ODA intends to request that a new QAR be performed as soon as practicable to determine if the MEO comply with all performance requirements and quality standards as defined in the Letter of Obligation.

Recommendation #4: As part of its final assessment, ODA will consider whether any action is warranted.

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

[Exemption 6]

Herbert L Mitchell
Associate Administrator
Office of Disaster Assistance