

**REVIEW OF THE ADEQUACY OF
SUPPORTING DOCUMENTATION FOR
DISBURSEMENTS**

**Report Number 08-07
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**Prepared by the
Office of Inspector General
U. S. Small Business Administration**



U.S. Small Business Administration
Office of Inspector General

Memorandum

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

Date: January 29, 2008

From: Debra S. Ritt
Assistant Inspector General for Auditing

Subject: Review of the Adequacy of Supporting Documentation for Disbursements
Report No. 08-07

This report is the final in a series resulting from our review of the Small Business Administration's (SBA's) efforts to expedite loan disbursements during its *90-in-45 Campaign*. The campaign was initiated in the fall of 2006 to disburse funds on approximately 90,000 loans approved for Hurricanes Katrina, Rita, and Wilma within 45 days. We initiated the audit in response to an employee complaint that loans processed during the campaign were disbursed without receiving the required supporting documentation.

We previously reported¹ that SBA had disbursed loans without obtaining all of the documents required to protect its interest in collateral on secured loans. The purpose of this audit was to determine whether SBA secured other documents prior to disbursing loan proceeds. To address the audit objectives, we reviewed general information about 40 of 1,154 statistically sampled loans disbursed by the 10 case managers within the Fort Worth Processing and Disbursement Center (PDC) who made the highest average daily disbursements during the *90-in-45 Campaign*. This information included the borrower's name, loan number, and amount of the disbursement. We also examined loan documentation in SBA's Disaster Credit Management System (DCMS) and the chronology log maintained by the PDC to determine the required documents applicable to each loan. These included hazard insurance, flood insurance, insurance injections, building permits, builder's risk insurance, worker's compensation, duplication of benefits

¹ *Securing Collateral for Loan Disbursements*, Report Number 07-22, dated May 9, 2007.

declarations, and real estate injection documents pertaining to each of the 40 loans in DCMS. Finally, we interviewed attorneys at the PDC.

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

BACKGROUND

The Small Business Administration provides disaster loans to help homeowners, renters, businesses and nonprofit organizations return to pre-disaster condition. SBA disaster loans are the primary form of Federal assistance for non-farm, private sector disaster losses and are the only form of SBA assistance not limited to small businesses.

In 2005, Gulf Coast Hurricanes Katrina, Rita and Wilma caused more than \$118 billion in estimated property damage. Because rebuilding efforts had progressed slowly, a backlog of approximately 90,000 approved but not fully disbursed, Gulf Coast Hurricanes disaster loans had accumulated by September 2006. To reduce the backlog of loans, on October 2, 2006, SBA initiated the *90-in-45 Campaign*. The goal of the campaign was to disburse the 90,000 loans within 45 days. As a result of the campaign initiative, SBA disbursed over \$858 million to borrowers.

Borrowers are required to submit proof of the following 7 items on all secured loans in excess of \$10,000 to protect all insurable collateral. Flood insurance is the only exception where the borrower is required to submit proof for all secured loans.

Hazard Insurance - Proof of hazard insurance is required on both the damaged property and any collateral property that is substituted to secure the loan.

Flood Insurance – Proof of existing flood insurance is required on all secured loans for both the damaged property and the collateral substituted to secure the loan.

Insurance Injections – Evidence is required to show that all insurance proceeds and other funds received for real estate construction or repair have been spent as intended.

Building Permits - Building permits are required to protect all insurable collateral.

Builder's Risk Insurance -Evidence of the builder's risk insurance must be provided to protect all insurable collateral. This insurance covers owners and builders for the property that was damaged or destroyed during construction, renovation, or repair.

Worker's Compensation - Worker's compensation insurance must be provided to protect all insurable collateral. This insurance covers medical care and compensation for employees who are injured in the course of employment.

Real Estate Injections - The borrower must provide evidence that any funds outside of SBA loan funds have been injected into the construction project before SBA will fully disburse the loan. This may arise when the borrower is upgrading beyond the size and quality of the structure's pre-disaster condition.

Borrowers are also required to notify SBA of the receipt of any disaster funds from other programs that would constitute a duplication of benefits and sign a Loan Authorization and Agreement regarding this requirement. The borrower must pay SBA any insurance proceeds or other compensation, which exceeds the amount of damages incurred at the time of loan approval.

RESULTS

Nearly Half of the Loans Reviewed were Disbursed without Securing the Required Documentation

The audit disclosed that nearly half, or 19, of the 40 loans reviewed were disbursed by SBA without securing the proper documentation needed to protect SBA's interest in the collateral and to document that insurance proceeds were used to offset the SBA loans. Projecting our sample results to the universe of 1,154 loans evaluated, we estimate that SBA disbursed 554 loans without securing all of the documents required to make disbursements. Of the 19 loans, 12 were missing 3 or more documents required to process the disbursement. In total, 55 documents were missing for the 19 loans in question. Specifically:

- 7 lacked proof of hazard insurance.
- 4 did not have flood insurance documentation.
- 8 lacked supporting documentation verifying that insurance injections had been made.

- 7 did not have building permits on file in DCMS.
- 13 were missing proof of builder's risk insurance.
- 13 did not have worker's compensation insurance documents.
- 3 lacked supporting documentation verifying real estate injections.

Of the 19 loans, 14 of these were fully disbursed and five were partially disbursed. Of the five, all of the loans were over the \$10,000 minimum, which would require that all documents were obtained prior to disbursement.

According to July 25, 2007 testimony and prepared statements provided to Congress by loan officers previously employed by the PDC, SBA made disbursements without securing the proper documentation because PDC managers put abnormally high pressure on loan officers to disburse 90,000 loans within 45 days. This caused employees to circumvent the Loan Authorization and Agreement stipulations and Standard Operating Procedure requirements for securing documentation. SBA officials also stated that their staffs were relatively new during the *90-in-45 Campaign*, which may have contributed to the large number of exceptions noted by the audit. Without securing the proper documentation SBA cannot be certain that the 19 borrowers were eligible to receive disaster funds or whether disaster disbursements duplicated insurance benefits that borrowers received.

RECOMMENDATIONS

We recommend that the Associate Administrator for Disaster Assistance:

1. Contact borrowers associated with the 19 loans and request the missing documents needed to protect SBA's security interest in the damaged property.
2. Review all loans that have been disbursed to borrowers and, in cases where all required documents were not obtained, contact borrowers to obtain the missing documents.
3. Implement a review process and establish thorough written procedures to ensure that all required loan documents are obtained and noted in loan files prior to making disbursements over \$10,000 (in accordance with the requirement regarding the loan amount).

AGENCY COMMENTS AND OFFICE OF INSPECTOR GENERAL RESPONSE

On December 7, 2007, we provided SBA with a draft of the report for comment. We discussed the findings and recommendations with the Office of Disaster Assistance staff. On January 11, 2008, SBA submitted an informal response showing concurrence with our recommendations. The Associate Administrator agreed to contact the borrowers associated with the 19 loans to request the missing documents needed to protect SBA's security interest in the damaged property. SBA also agreed to review the 1,154 loans and, if necessary, contact borrowers to obtain missing documents. Finally, SBA agreed to establish written procedures to ensure that all required loan documents are obtained and noted in loan files prior to disbursements over \$10,000. SBA's comments are responsive to our findings and recommendations.

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