AUDIT REPORT

HURRICANE SANDY
EXPEDITED LOAN PROCESSES

July 13, 2015 REPORT NUMBER 15-13

EXECUTIVE SUMMARY

Audit Report
No. 15-13

HURRICANE SANDY EXPEDITED LOAN PROCESSES

What OIG Reviewed

The Small Business Administration (SBA) Office of Inspector General (OIG) audited two Small Business Administration (SBA or Agency) expedited loan processes implemented during Hurricane Sandy: the Sandy Alternative Processing Pilot (SAPP), which streamlined the home loan process, and a modified Phase II method for processing economic injury disaster loans (EIDL). Both of these processes were intended to address a backlog of loan applications in the wake of Hurricane Sandy.

Our objectives were to determine whether these procedures reduced SAPP home loan and EIDL processing times while mitigating the risks of loan default, and to ensure SBA complied with the processes. To accomplish our objectives, we compared the average processing time for loans using the expedited processes to the average processing time for loans processed under standard guidelines. We also reviewed electronic files for 120 home loans and 40 economic injury disaster loans within the Disaster Credit Management System, which were processed and approved by SBA's Office of Disaster Assistance (ODA) Processing and Disbursement Center (PDC) staff in Fort Worth, Texas.

What OIG Found

We found that the Agency's home loan expedited process, SAPP, slightly reduced loan application processing time by loan officers and mitigated loan default risk. However, the expedited EIDL method for business loans did not result in any time savings. Neither of the expedited methods reduced the overall time from application acceptance to initial loan disbursement.

Also, we found that the SAPP memo lacked specific guidance on how to address complex loan situations. This led to SBA loan officers needing to deviate from SAPP procedures in order to more accurately determine applicants' actual income and debt obligations.

Furthermore, SBA incorrectly implemented the modified Phase II EIDL procedures in 15 loan applications, resulting in incorrect loan amounts. This was due primarily to insufficient training for loan officers.

If another disaster occurs with a similar magnitude to Hurricane Sandy, the Agency could encounter similar challenges processing loans correctly and efficiently unless proper measures are timely implemented to address these deficiencies.

OIG Recommendations

We recommend that the Agency conduct an internal review to determine why Hurricane Sandy loans processed using the expedited SAPP and Modified Phase II EIDL processes took longer than standard loans from application acceptance to initial disbursement.

For SAPP, which was subsequently implemented as a permanent process called RAPID, we recommend that SBA clarify income continuity standards and materiality thresholds for different income sources, and provide guidance on debt analysis.

For modified EIDL, we recommend that SBA implement a training plan to ensure loan officers have a clear understanding of the processes for determining loan amounts and all applicable policies and procedures for effectively processing EIDLs. We also recommend that SBA implement additional oversight of EIDL processing to alleviate errors and improve accuracy in applying modified Phase II EIDL procedures.

Agency Response

SBA generally concurred with our findings and four recommendations.

ODA researched the cause of increased disbursement times for expedited home loans and determined that it was unrelated to the expedited processing procedures. Additionally, ODA updated home and business expedited loan processing procedures in its new standard operating procedures, implemented training for loan officers and supervisors, and developed a modification to the Disaster Credit Management System that will improve the accuracy of the Economic Injury Disaster Loan process.

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

Final Report Transmittal
Report Number: 15-13

DATE: July 13, 2015

TO: James Rivera, Associate Administrator for Disaster Assistance

SUBJECT: *Hurricane Sandy Expedited Loan Processes*

This report presents the results of our audit of the Small Business Administration's (SBA) Hurricane Sandy expedited loan processes. The objectives of our audit were to determine whether these procedures reduced loan processing times while mitigating the risks of loan default, and to ensure SBA complied with the processes.

The report contains four recommendations. SBA already implemented one recommendation, and agreed to implement the remaining three. Please provide us your progress in implementing the three open recommendations within 90 days.

We appreciate the courtesies and cooperation extended to us during this audit.

/s/
Troy M. Meyer
Assistant Inspector General for Auditing

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Introduction

The Small Business Administration (SBA or Agency) provides long-term disaster recovery loans to homeowners, renters, businesses, and nonprofit organizations who are victims of a declared disaster. Within SBA, the Office of Disaster Assistance's (ODA) Processing and Disbursing Center (PDC) is responsible for processing disaster loan applications. In the event of a disaster, it is especially important for PDC to disburse loans timely while still minimizing the risk of loan default.

On October 29, 2012, Hurricane Sandy made landfall in southern New Jersey. Hurricane Sandy was the second costliest Atlantic storm in U.S. history, causing approximately $67 billion in damages and economic injury, displacing more than 775,000 persons, and resulting in at least 159 fatalities. As of May 12, 2015, SBA had approved 36,911 Hurricane Sandy disaster loans, totaling approximately $2.49 billion. In FY 2013, the peak of Hurricane Sandy activity, SBA approved over three times as many disaster loans as in each of the previous three years.

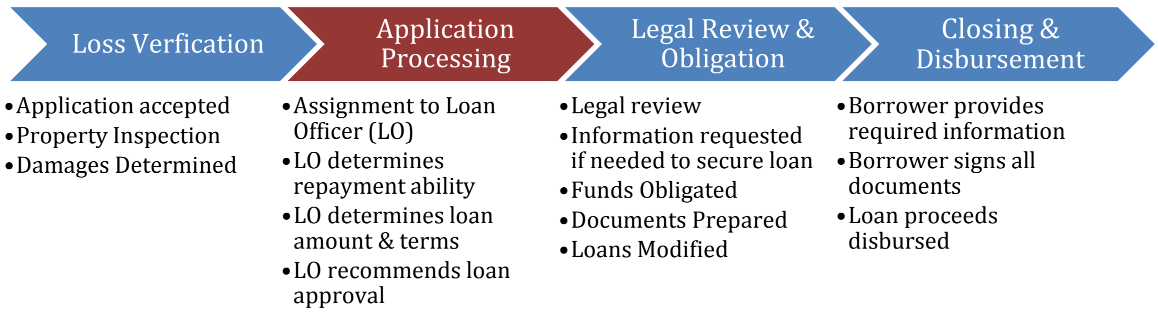
ODA did not anticipate the volume of electronic loan applications and was not fully prepared for the surge in workload. This created a backlog of applications needing to be processed. The total number of applications received reached its peak in early December 2012, and in January 2013, there was a backlog of over 29,000 loan applications pending processing. To address this backlog, ODA extended hours, shifted human resources within PDC, allocated work to other ODA field offices, and hired additional personnel. Five months after Hurricane Sandy, ODA reached its peak staffing level of 2,451. About 80 percent of personnel were pre-identified processing staff or new hires. New loan officers were assigned to process home loans until they demonstrated proficiency, and then they were trained to process business loans. Due to the complexity of business loans, the training of loan officers during the period of peak application volume did not immediately help to improve production.

In response to the backlog, ODA also created two expedited processes: one for home loans, called the Sandy Alternative Processing Pilot (SAPP), and another for business loans, which modified Phase II of the standard Economic Injury Disaster Loan (EIDL) process. In January 2013, SBA created a team of loan officers to process SAPP loans exclusively; this team demonstrated higher production levels than non-SAPP teams. As a result of these efforts by the Agency to increase production, the backlog was reduced to about 3,000 by April 2013.

Disaster Loan Processing

Once an application is submitted, it goes through a screening process. After all application requirements are met, the application is accepted by PDC for further processing. If the application includes physical property damages, the application is assigned to the loss verification process. Once loss verification is complete, the application is assigned to a loan officer for processing. The loan officer then processes the application and recommends approval to the legal department, which then reviews the loan documents for errors and completeness, approves the loan, and sends loan closing documents to the borrower for signature. After the borrower signs the loan documents during the closing process, the Agency makes an initial loan disbursement (See Figure 1).

Figure 1: SBA Disaster Loan Process



The expedited procedures created for Hurricane Sandy only impacted application processing. The remaining processes were performed in accordance with standard procedures.

Sandy Alternative Processing Pilot Method for Home Loans (SAPP)

SBA provides eligible disaster victims with low-interest loans to repair or replace disaster-damaged real estate and personal property. Loan amounts and terms are determined on a case-by-case basis depending on eligibility, repair or replacement costs, insurance or other reimbursements, and the applicant's repayment ability.

Management realized that a large percentage of Hurricane Sandy loan applicants had relatively high incomes and good credit scores, and developed a process to expedite the application process for these loans. On December 10, 2012, ODA issued Memorandum 12-48, *Sandy Alternative Processing Pilot (SAPP),* which established an alternative processing method for Hurricane Sandy home loan applications meeting specified criteria. SAPP allowed loan officers to immediately approve eligible home loan applications based on received IRS transcripts and credit reports without spending additional time analyzing and verifying income or debts, or justifying high debt-to-income ratios that could be required under the standard method (See Table 1).

Table 1: Home Loan Requirements

	Standard Home Loan	Sandy Alternative Processing Pilot (SAPP) Memo #12-48
Minimum Income	$22,340	$70,000
Reconcile income and debts	Required	Not required
Eligible loan proceeds	Real estate repair, personal property, refinancing, relocation, hazard mitigation	Real estate repair, personal property

According to ODA's Hurricane Sandy closeout report, the goal of the SAPP method was to increase the loan approval production rate to five loans per loan officer per day. ODA reported that after SAPP was implemented, each loan officer was able to process an average of 2.5 loans per day, compared to 1.7 in the five weeks before SAPP was implemented.

Economic Injury Disaster Loans (EIDL) Phase II Expedited Process

EIDLs are intended to provide businesses with working capital to recover from the economic injury caused by a disaster. The loan amount is based on the lesser of the economic injury losses or the working capital needs.

As with SAPP, on December 7, 2012, ODA issued Memorandum 12-47, *Modified Phase II EIDL Processing Procedures for Hurricane Sandy Loans*, which expedited processing for business loans.[1] The modified Phase II EIDL method maintains the majority of the standard Phase II EIDL procedures, but was intended to cut processing time spent estimating disaster-related economic injury losses and working capital needs while still maintaining normal repayment analysis (See Table 2).

Table 2: Business Loan Requirements

	Standard Phase II EIDL	Modified Phase II EIDL
Loan Amount	Up to $2.0 million	Up to $300,000
Injury Period	Up to 12 months	6 months
Needs Analysis	To date needs and future needs	Future needs only
Variable Expenses	Considered	Not considered
Year to Date Financial Statements	Required	Not required

According to the memorandum, the recommended maximum loan amount for loans processed using the modified Phase II EIDL is $300,000, compared to $2,000,000 using the standard Phase II EIDL. The estimated economic injury losses are equivalent to a normal gross margin of 6-month injury period on all applications. Loan officers are still required to perform an abbreviated needs analysis for the 6-month injury period.

Objectives

The objectives of this audit were to determine the effectiveness of two expedited loan processing policies and whether SBA complied with:

1) Memorandum 12-47, *Modified Phase II EIDL Processing Procedures for Hurricane Sandy Loans*, and
2) Memorandum 12-48, *An alternative processing method for Hurricane Sandy home loans, Sandy Alternative Processing Pilot (SAPP).*[2]

[1] EIDL loan applications are normally processed using either Phase I or Phase II processes. Phase I assumes a business that has been physically damaged has also sustained economic injury and provides immediate working capital to eligible applicants up to $100,000, based on 2 months of lost gross margin. The Phase II EIDL process is used for economic injury loans over $100,000 and requires a needs analysis to assess the essential working capital needs of the business.
[2] See Appendix I for a discussion on our scope and methodology.

Finding 1: SBA's Expedited Processes Reduced Application Processing Time for Home Loans but not Business Loans

The expedited processes were created to help reduce the application backlog. We compared application processing time for loans processed using the expedited processes with loans that were processed using the standard processing method. We found that SAPP reduced home loan application processing time by an average of 2.3 days. Based on our analysis of loan officers' application processing time, home loans assigned to be processed using the standard processing method took an average of 21 days from assignment to the loan officer's recommendation for approval. On the other hand, loans assigned to SAPP processing took 18.7 days for loan officers' recommendation—a time savings of 2.3 days. The expedited EIDL method for business loans resulted in an average increase in processing time of 4.4 days. The EIDLs assigned to be processed using the standard methods took an average of 38.9 days for the loan officer to recommend approval, while the expedited EIDL-processed loans took 43.3 days.

Although the expedited processes that were implemented for home and business loans only impacted the application processing procedures, the focus for this audit, we found that neither of the expedited methods reduced the overall time from application acceptance to initial loan disbursement. We found that expedited home loans took an average of 15 days longer to initial disbursement than non-expedited home loans, while expedited business loans took 7 days longer to disburse than non-expedited business loans. Specifically, based on our analysis we found it took on average 82.6 days until initial disbursement for standard, non-SAPP loans, while SAPP loans took 97.5 days until disbursement. Similarly, it took loans under the standard Phase II EIDL process an average of 93.7 days until initial disbursement, while modified Phase II EIDLs took 100.3 days.

The modified Phase II EIDL process shortened the time it takes loan officers to estimate economic losses from the disaster and working capital needs, proportionately; however, this is only a small part of the complete process. Both the standard and modified Phase II EIDL processes require the same repayment ability analysis, which comprise the most substantial and lengthiest part of the process. While this helped mitigate the risk of default and helped ensure loan repayment ability, it also resulted in no time savings under the modified process. Of the 40 loans we reviewed, we noted that the process was delayed because loan officers had to request additional documents from applicants in order to make a loan decision. Loan officers requested information and detailed tax returns on affiliates, and in some cases, the loan applications were reassigned to different loan officers, or the process had unexplained gaps, all these factors contributed to the increase in overall loan approval processing time.

We asked ODA management why disbursements took longer for loans processed using the expedited loan processes. While they responded that there was nothing in the expedited processes that would delay loan disbursements, they did not offer any explanations or provide specific causes for the delays.

We found that the longest period in the overall process was from the original loan approval date to initial loan disbursement date. Based on our analysis of a sample of expedited loans with longest time until initial disbursement, we noted that the time period varied significantly, depending on many factors, including: waiting for additional documents, waiting for applicants to sign loan closing documents, requests to extend the disbursement period, and loan modifications. However, we were unable to determine the exact causes for the difference in overall processing time for loans processed using the expedited processes. As a result, we believe ODA should review their processes to determine the reasons why loans made under the expedited processes took longer to disburse.

Recommendation

1. We recommend that ODA conduct an internal review to determine why Hurricane Sandy loans processed using the expedited SAPP and Modified Phase II EIDL processes took longer than standard loans from application acceptance to initial disbursement. Based on the results of the internal review, determine whether policies and procedures should be modified.

Finding 2: Clarification Needed for More Complex Disaster Loan Applications

While loan officers generally complied with the expedited policies and procedures, they had to deviate in some instances, when processing expedited applications, to adequately assess repayment ability. OIG and PDC loan officers noted that the SAPP memorandum, which serves as the basis of all SAPP loan processing procedures, does not sufficiently address issues that may arise when loans eligible for SAPP have more complicated income and debt scenarios. Both of these attributes can impact loan repayment ability and should be addressed in order to mitigate risk.

Both OIG and PDC loan officers identified instances when the SAPP guidance provided in the memorandum did not clearly address more complex scenarios that might complicate a loan officer's ability to determine the actual amount and continuity of applicants' income and the full extent of their debt obligations. The effective guidance at the time, Code of Federal Regulations, Part 13 Section 123.6 stated, "there must be reasonable assurance that you can repay your loan out of your personal or business cash flow. . . ."[3] Additionally, Standard Operating Procedure (SOP) 50 30 7 states that cash flow is the basis for establishing repayment ability, and that loan officers must consider all sources of income to assure that income is continuing. The SOP also requires loan officers to analyze self-employment income to determine whether this income is continuing, and consider trends if income fluctuates from year to year. The new Disaster Assistance SOP 50 30 8, effective July 1, 2015, maintains similar requirements regarding income continuity.

The policy memorandum, which lays out the foundation for SAPP, only requires loan officers to use the total income from IRS transcripts in their repayment ability analysis regardless of the income source. However, the total income field on IRS transcripts poses a particular problem because it only demonstrates one year and can potentially contain non-recurring or fluctuating sources of income—such as capital gains, unemployment compensation, or one-time IRA distributions—which cannot be relied on for the life of the loan. Additionally, the total income may exclude non-taxable portions of social security, pension, and annuity income. It is also reduced by non-cash expenses from any pass-through entities. Moreover, the policy memorandum only requires loan officers to obtain debts from the applicant's credit report, which may not include all sources of debt such as mortgages on rental properties held as part of a partnership.

As a result of our analysis, we conclude that the memorandum did not sufficiently cover:

- How to address situations where a more comprehensive income or debt analysis was appropriate to determine income amount and continuity, and a process for loan officers to request additional supporting documents for income verification or to reconcile debt;

- Whether to consider significant, non-recurring items such as one-time IRA withdrawals, annuities, capital gains and losses, unemployment compensation, and State income tax refunds that could affect the borrower's repayment ability; and

- Whether additional analysis was needed for individual income tax transcripts that included pass-through entity income or loss to determine the amount of cash available from these sources for a loan repayment.

[3] 13 CFR Section 123.6 was amended on April 25, 2014 and now reads: "There must be reasonable assurance that you can repay your loan based on SBA's analysis of your credit or your personal or business cash flow. . . ."

Several of these issues were identified by loan officers.

In order to meet the criteria established in the SOP and CFR, when processing more complex applications, such as those listed above, some loan officers told OIG they felt the need to do more research and deviate from SAPP guidance. When we spoke to loan officers, several stated that in such cases, they performed additional steps to the SAPP process—such as reconciliation of income and debt, especially for applications with income or losses from pass-through entities—to gain a more accurate analysis of significant debts and recurring income.[4] Even though these deviations required additional research and time (typically taking about 18.7 days to process—the approximate time of the SAPP process), we agree with PDC loan officers that these steps were necessary to comprehend more complex situations, and appropriate from a loan origination standpoint. Loan officers choosing to deviate from SAPP procedures in processing these complicated loans helped SBA to mitigate the risk of default.

On April 25, 2014, ODA issued memorandum 14-14, *SOP Paragraph 88*, which allows for a modified expedited process (RAPID) for business and home loans based on applicant credit score and verified income, without performing full cash flow analysis. The RAPID process has the same eligibility requirements and most of the procedural requirements as SAPP. On October 1, 2014, the Agency issued an application processing bulletin as guidance to fully implement the RAPID process.[5] While the bulletin provides improved guidance on income determination, it does not specify which income components must be verified as ongoing for inclusion in the gross annual income, nor does it address any analysis of debt.

Although OIG cannot make a qualitative assessment of the long-term performance of the Sandy loans due to the limited time these loans have been active, we did find that at the time of our audit, SAPP-processed loans did not have a higher rate of default or non-performance compared to non-SAPP loans.[6] As of February 2015, loan applications processed under the SAPP method were experiencing a lower delinquency, liquidation, and charge-off rate compared to standard-processed loans.

Nevertheless, without a process to consider the applicant's total debt obligations and continuity and accuracy of income, ODA may overestimate the borrower's ability to repay their loans, which could increase the risk for default. By determining which circumstances require more safeguards than the streamlined SAPP process and the newly implemented RAPID process provide, ODA will strengthen its disaster loan programs.

Recommendation

2. We recommend that ODA clarify income continuity standards and materiality thresholds for different income sources and provide guidance on debt analysis for RAPID loan applications.

[4] See Appendix II for a list of loan officers' additional steps.
[5] AP Bulletin 10.01.14, *RAPID Processing – Home/Business Criteria & Process* (October 1, 2014, revised January 14, 2015).
[6] We considered loans that were past due, delinquent, in liquidation or charged off to be non-performing. As of February 1, 2015, 1.72 percent of SAPP dollars disbursed were non-performing while 6.52 percent of non-SAPP disbursed dollars were non-performing.

Finding 3: Modified Phase II EIDL Loans Contained Inaccurate Loan Determination Calculations

We determined that 15 of the 40 modified Phase II loan applications we reviewed incorrectly applied the modified Phase II EIDL procedures used to determine the eligible loan amount. These 15 loans totaled $1,060,300.[7] Specifically, we found that:

- For six loan applications, loan officers used an incorrect injury period or deviated from the required 6-month injury period in the computations determining the loan amount.

- For seven loan applications, loan officers miscalculated working capital needs by using incorrect adjustments or recovery period.

- Two of the applying businesses did not have working capital needs to qualify for EIDL loans under the modified Phase II EIDL process but were still approved.

- For one loan application, the business was ineligible for a loan under the modified Phase II EIDL process, since that business was in operation for less than one year prior to the disaster.

- For another loan application, the final loan amount was greater than the calculated loan, and the loan officer did not support this discrepancy with explanations.

- For six loan applications, loan officers made errors in the analysis, including using incorrect normal and injury period sales figures and incorrect modified contribution margin percentages.

As a result of these errors, SBA did not always provide the correct loan amounts to recipients. Of the 15 loans with errors, SBA approved a total of $106,400 more than it should have for 8 loan applications. For five other loan applications, SBA approved $176,960 less than the businesses were qualified for. Two loan applications with noted errors had insufficient information in the file for us to determine the correct loan amount, and three additional loan applications did not have support for normal monthly sales numbers, which are also necessary to calculate the appropriate loan amount—putting those loans at risk for $521,800. [8]

This occurred due primarily to insufficient training for loan officers. While most were preexisting PDC personnel, some had not handled EIDL loans, which by nature are significantly more complex than home loans. During our interviews with the PDC loan officers and management, loan officers noted that the policy was implemented immediately—without sufficient preparation. While we found that SBA has training materials on the standard Phase II EIDL process, according to five senior loan officers we interviewed, the training for the modified Phase II EIDL process was limited to reading the memorandum and asking questions. SOP 50 30 7 requires that an approving official review and concur with all recommendations to approve or deny a loan. However, errors processing EIDL loan applications still occurred, despite supervisory review. As a result, ODA should increase oversight and review of EIDL loans and improve its training for both loan officers and supervisory loan officers.

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[7] Some of these 15 loans had more than one error.

[8] These three loans were not included in the 15 loans with errors; the loan files did not contain required support and certification of monthly sales figures.

Recommendations

We recommend that ODA:

3. Establish and implement a training plan for loan officers, supervisory loan officers, and those hired in response to an emergency, to ensure they have a clear understanding of the processes for determining loan amounts and all applicable policies and procedures for effectively processing EIDLs.

4. Implement additional oversight of EIDL processing to alleviate errors and improve accuracy in applying modified Phase II EIDL procedures.

Agency Comments

SBA management provided formal comments, which are included in their entirety in Appendix III. The following provides a summary of management's comments and the actions necessary to close the report.

ODA stated that while the SAPP process did save some time in reaching a loan decision, it did not meet management's expectations because SAPP files were not assigned exclusively to SAPP processing teams from the onset of the expedited pilot program as originally intended. The experience gained from Hurricane Sandy and a regulatory change now allows for a modified loan approval process, known as RAPID, which adds flexibility to consider an applicant's credit without undertaking a full cash flow analysis. RAPID has been implemented with separate processing tracks for home and business loans, including routing of applications eligible for expedited processing.

ODA also stated that the expedited loan processing procedures did not affect SBA's ability to disburse loans in a timely manner, and that disbursement timeliness is greatly dependent on the borrower's willingness to sign and return loan closing documents promptly. ODA agreed that guidance clarification was needed for more complex loan applications, and has updated its SOP to include specific guidelines for RAPID processing, which is the permanent replacement to SAPP. ODA will also issue updated training materials that provide clear guidance to loan officers processing complex RAPID files. ODA also agreed that Modified Phase II EIDL loans contained inaccurate loan amount determinations. ODA stated that the updated SOP contains refinements to EIDL loan processing and that they will provide training to its loan processing staff. Additionally, ODA will implement an upgrade to the Disaster Credit Management System (DCMS) that will ensure loan officers properly determine the eligible EIDL loss amount and that the final loan amount is calculated correctly.

ODA agreed with all four recommendations in the report. ODA has fully implemented one recommendation and initiated actions on the remaining three recommendations. The following provides a summary of management's comments and the actions necessary to close the report.

<u>Summary of Actions Necessary to Close the Report</u>

1. **Conduct an internal review to determine why Hurricane Sandy loans processed using the expedited SAPP and Modified Phase II EIDL processes took longer than standard loans from application acceptance to initial disbursement. Based on the results of the internal review, determine whether policies and procedures should be modified.**

   ODA has implemented the recommendation, and as a result, no further action is needed. The Agency stated the expedited pilot programs were challenged more so by the implementation of SAPP than they were by the specific underwriting modifications used to process individual files. ODA conducted a study of the files sampled by OIG for this audit, and determined that following the loan approval decision, borrowers with SAPP files took an average of 54 days to return loan closing documents while non-SAPP borrowers took an average of 41 days to return loan closing documents .

   Once borrowers signed and returned the documents, ODA was able to make an initial disbursement within 2 days. ODA concluded that the borrower's ability or willingness to sign and return the closing documents was the direct cause of the timing of loan disbursements and that no changes to policies and procedures were required.

2. **Clarify income continuity standards and materiality thresholds for different income sources and provide guidance on debt analysis for RAPID loan applications.**

   ODA agreed with the recommendation and stated it has completed the actions by updating processing guidelines and incorporating them into the new SOP 50 30 8 and providing training for loan officers. However, we believe that more clarity is needed regarding (1) the threshold amount of nonrecurring and fluctuating income sources when determining if the loan qualifies for RAPID processing; and (2) identification and treatment of significant debts not listed in the credit reports—especially since RAPID allows for higher than normal debt-to-income ratios.

   This recommendation can be closed when ODA has provided clarification on the two points outlined above such as a policy memorandum or training manual that supplements the implemented SOP 50 30 8.

3. **Establish and implement a training plan for loan officers, supervisory loan officers, and those hired in response to an emergency, to ensure they have a clear understanding of the processes for determining loan amounts and all applicable policies and procedures for effectively processing EIDLs.**

   ODA agreed with the recommendation and stated it has completed the actions by updating processing guidelines and incorporating them into SOP 50 30 8 and providing training for loan officers.

   The updated SOP included improved guidance on factors such as the duration of injury period, calculating lost sales and reduced operating margins, determining impairment to the balance sheet and extraordinary items, determining working capital and essential needs and determining the appropriate loan amount. Additionally, ODA is in the process of developing upgrades to DCMS that will ensure loan officers follow the proper steps in determining eligible EIDL loan amounts. This recommendation can be closed upon ODA providing: (1) the content of the training performed; and (2) evidence the training was provided to loan officers.

4. **Implement additional oversight of EIDL processing to alleviate errors and improve accuracy in applying modified Phase II EIDL procedures.**

   ODA agreed with the recommendation and has developed a modification to DCMS that will ensure loan officers follow the steps to determine the eligible EIDL loss amount and the final loan amount. This recommendation can be closed upon ODA providing evidence that the DCMS modification has been implemented and is operating as intended to alleviate errors.

Appendix I: Scope and Methodology

We conducted this performance audit in accordance with Generally Accepted Government Auditing Standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our conclusions based on our audit objectives.

Our audit reviewed the effectiveness of two expedited processes used to approve Hurricane Sandy home and business EIDL loans. To achieve the audit objectives, we obtained two data sets from the DCMS operations office that identified home and business applications assigned to be processed using expedited methods (SAPP and modified Phase II EIDL) or standard methods. The data sets contained a comprehensive list of all Hurricane Sandy home and business loan applications with a loan approval decision between October 1, 2012, and June 30, 2014. They also contained the following fields needed for our analysis: (1) credit score, (2) gross annual income, (3) approved loan amount, (4) assignment to loan officer date, (5) loan officer's recommendation to approve date, (6) loan approval date, and (7) initial disbursement date.

We reviewed a random sample of 120 home loans from the home loan data set to determine whether the loans were eligible for SAPP, and if applicable, determined if SBA complied with the alternative processing pilot procedures as outlined in Memorandum 12-48. To assess the compliance with the modified Phase II EIDL processing procedures for Hurricane Sandy, we reviewed a random sample of 40 business loans with EIDL loan proceeds only. The loan reviews determined if the loan was eligible for the modified Phase II process and if SBA was in compliance with the processing procedures outlined in Memorandum 12-47.[9]

To determine if the expedited processes were effective, we computed the average processing time for applications assigned to be processed as SAPP and modified Phase II EIDL. The average time was based on the date the application was originally assigned to a loan officer to the date the loan officer recommended the loan for approval. We did not include days the application was in the initial intake stage nor in the loss verification department. For both SAPP and modified Phase II EIDL loans, we compared the average processing time of loans using the expedited processes to the average processing time of loans processed under standard guidelines. We also computed average overall time from the application acceptance date to initial disbursement date for applications assigned to be processed as SAPP and modified Phase II EIDL and compared the average overall time using the expedited processes to the average overall time of loans assigned to be processed under standard guidelines. To evaluate the risk and performance of the loans processed alternatively, we obtained Loan Accounting System (LAS) data and determined the dollar amounts of loans that were non-performing. We considered the following loan statuses as non-performing: charged-off, delinquent, in liquidation, and past due.

To accomplish our audit, we performed site visits to the Fort Worth PDC and interviewed loan officers and senior loan officers who processed Hurricane Sandy disaster loans. Finally, we interviewed key officials from the Office of Disaster Assistance regarding modified processing procedures for Hurricane Sandy loans.

[9] The SAPP policy was in effect between December 10, 2012 and September 30, 2013, and the Phase II EIDL policy was in effect between December 7, 2012 and May 1, 2013. The samples we selected for review were based on the dates the policies were in effect.

To determine whether SBA had adequate oversight of SAPP and modified Phase II EIDL loans, we reviewed SOPs, Agency memorandums, and interviewed Agency and project officials. We also analyzed loan files in DCMS to determine whether the qualified loan applications conformed to the expedited procedures in the memorandums.

Review of Internal Controls

We assessed relevant internal controls over the implementation and execution of Hurricane Sandy expedited application processing methods for home and business loans. The assessment focused on the controls governing the expedited processes, including the effectiveness of processes implemented, compliance to the processes, and the accuracy and precision of the calculations performed. Our methodology consisted of interviews, analytical procedures, and performance of key calculations.

Our internal control review found inconsistencies in the application of SAPP, and we recommended that ODA clarify the process. We also determined that the application of modified Phase II EIDL process resulted in computation errors due to insufficient training and oversight. We recommended that ODA improve training and implement additional oversight in order to improve the accuracy of modified Phase II EIDL procedures.

Use of Computer-Processed Data

We relied on data provided by the DCMS operations officer that was generated from DCMS. The DCMS operations office identified the disaster loan applications received between October 1, 2012 and June 30, 2014, which were processed to a final loan decision. We traced DCMS records on a sample basis to source documents such as tax returns, credit reports, and loan authorization agreements. From this, we determined that DCMS data is sufficiently reliable to support the audit objectives. Additionally, we obtained data from SBA's LAS to determine loan performance. We performed analytical procedures such as duplication checks to determine the completeness and accuracy of LAS data. We also reviewed prior OIG audit work done to validate the reliability of LAS data and determined that the data is sufficiently reliable to support the audit objectives.

Nature of Limited or Omitted Information

No information was omitted due to confidentiality or sensitivity, nor were there limitations to information on this evaluation.

Prior Coverage

U.S. Government Accountability Office Audit Reports

Report GAO-14-760, *Additional steps needed to help ensure more timely disaster assistance* (September, 2014).

Small Business Administration Office of Inspector General Reports

Audit Report 14-20, *Controls Governing Economic Injury Disaster Loan Approval Need Improvement* (September, 2014).

Appendix II: SAPP Process Deviations

We noted a few instances when PDC loan officers deviated from SAPP guidelines in order to more accurately and precisely determine the applicants' repayment ability. In these instances, loan officers used their judgment to take additional steps, even though the loans were listed as SAPP-processed.

- For 31 SAPP-processed loan applications, the income was based on IRS transcripts, but income line items were analyzed to exclude non-recurring items and include non-taxable income.
- For two SAPP-processed applications with income or losses from pass-through entities, in lieu of using the total income on the IRS transcript as specified in SAPP procedures, loan officers performed a detailed analysis of business cash available to service additional debt to determine the amount of cash flow from these entities. To complete this additional step, the loan officer had to request the pass-through entity's tax returns, personal financial statements, and a schedule of liabilities.
- For seven SAPP-processed loan applications, loan officers obtained paystubs to verify current income if the applicant had changed employment within the last two years. This additional step is required under the standard method but not SAPP.
- For seven SAPP-processed applications, loan officers used paystubs to verify current income if there was a discrepancy between the IRS transcripts and the application—rather than merely using the IRS transcripts, as specified in the SAPP guidelines.
- For six SAPP-processed applications, loan officers took additional steps to request paystubs to determine the applicant's share of income in cases when married applicants who filed a joint tax return applied for SBA loans independently from their spouses.
- For eight SAPP-processed applications, loan officers performed additional debt analysis to include debts that were not on the applicant's credit report in the monthly fixed debt schedule—instead of basing the monthly fixed debt solely on the applicant's credit report, as specified in SAPP guidelines. In some of these cases, the additional debts that the loan officers identified were substantial.
- For nine SAPP-processed applications, we found that even though they were eligible for SAPP processing, loan officers processed the application under the standard method without any explanation.
- For 11 SAPP-processed applications, there were errors in debt calculation, such as excluding debts that were on the credit report or counting the same debt twice.

Appendix III: Agency Comments

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

Date: June 22, 2015

To: Troy M. Meyer
Assistant Inspector General for Auditing

From: James E. Rivera
Associate Administrator
Office of Disaster Assistance

Subject: OIG Draft Report – Hurricane Sandy Expedited Loan Processes
(Project No. 14807)

We have reviewed the OIG Draft Report. The objectives of this audit were to determine the effectiveness of two expedited loan processing policies and whether SBA complied with Memorandum 12-47, *Modified Phase II EIDL Processing Procedures for Hurricane Sandy Loans,* and Memorandum 12-48, *An Alternative Processing Method for Hurricane Sandy Home Loans, Sandy Alternative Processing Pilot (SAPP)*. Thank you for the opportunity to respond to the Draft Report.

The mission of the SBA Disaster Loan Program is to help businesses of all sizes, private non-profit organizations, homeowners and renters recover from disasters and rebuild their lives by providing affordable and timely financial assistance. Consistent with the mission to provide affordable and expedient disaster assistance, SBA remains committed to providing disaster loan assistance quickly and effectively which was the basis for implementing alternative and expedited processing pilots.

The audit report concluded that (1) *SBA's expedited processes reduced application processing time for home loans but not business loans, and disbursements took longer;* (2) *more clarification is needed for more complex disaster loan applications;* and (3) *modified Phase II EIDL loans contained inaccurate loan determination calculations*. As discussed in greater detail below, SBA's Office of Disaster Assistance (ODA) partially agrees with OIG's findings regarding the expedited loan processing pilots implemented during Sandy; however, the pilots have since been replaced by improved and permanent processing guidelines and have been incorporated into an updated standard operating procedure, SOP 50 30 8, which is effective July 1, 2015.

Finding 1: SBA's Expedited Processes Reduced Application Processing Time for Home Loans but not Business Loans; Disbursements Took Longer

We generally agree with the OIG's finding regarding application processing times for home and business loans processed under the Sandy Alternative Processing Pilot (SAPP) and the Modified Phase II Processing Procedures. While SAPP home loans were processed, on average, faster than non-SAPP home loans, the average processing times for those expedited loans did not meet ODA's expectations. However, based on ODA's observations, the expedited pilot programs were challenged more so by the implementation of SAPP than they were by the specific underwriting modifications used to process individual files. For example, it was ODA's original intention that upon being accepted, files meeting the SAPP criteria would be identified and assigned to designated teams of loan officers focused solely on processing expedited files. While a team of loan officers was created to process SAPP loans exclusively, SAPP loans were not exclusively assigned to this team. Maximum results, i.e. faster processing times, could have been realized if SAPP files were assigned exclusively to SAPP processing teams from the onset of the expedited pilot program, as originally intended.

As a result of the lessons learned from Hurricane Sandy, particularly the observations made while implementing SAPP and the Modified Phase II Processing Procedures, ODA was able to adapt and improve the permanent expedited processing programs that followed. On April 25, 2014, ODA made a regulatory change to 13 CFR §123.6 allowing for a modified approval process (RAPID) for both home and business loans which adds flexibility to consider an applicant's credit without the need to complete an entire cash flow analysis. Furthermore, ODA has implemented distinct processing tracts for home and business loans, including routing loan applications eligible for RAPID processing.

Expedited loan processing procedures does not affect SBA's ability to disburse loans in a timely manner.

With regard to disbursements, ODA disagrees with OIG's finding that expedited files took longer to disburse than non-expedited files. ODA did a closer examination of the files sampled by OIG for its audit and found that following the approval decision, borrowers with SAPP files took an average of 54 days to return loan closing documents (the borrower has a deadline of 60 days to sign and return their loan closing documents or the loan may be canceled). By comparison, non-SAPP borrowers took an average of 41 days to return loan closing documents. However, once the borrowers did sign and return their loan closing documents, ODA was able to make the initial disbursement in an average of two days.

In Fiscal Year 2013, ODA had an average processing time of 26 days for all disaster loans; 24 days for homes and 40 days for businesses. By comparison, SAPP home loans were processed and approved in an average of 19 days.

Additionally, 99.7 percent of all borrowers who signed and returned their loan closing documents to SBA received a disbursement within 5 days.

Expedited loan processing procedures does not affect SBA's ability to disburse loans in a timely manner; however, the borrower's ability or willingness to sign and return loan closing documents and other required documents greatly affects the timing of their disbursement.[10]

Finding 2: Clarification Needed for More Complex Disaster Loan Applications

ODA recently updated its standard operating procedures, SOP 50 30 8, which is effective July 1, 2015. The SOP refresh includes specific guidelines for processing of RAPID files, which was the permanent replacement to SAPP, consistent with the regulatory change to 13 CFR §123.6 made on April 25, 2014. Additionally, updated training materials that will coincide with the release of the new SOP 50 30 8 will provide clear guidance to loan officers processing RAPID files that are more complex.

Finding 3: Modified Phase II EIDL Loans Contained Inaccurate Loan Determination Calculations

It should be noted that the sample size for Modified Phase II EIDL Loans was extremely small. We approved over 4,000 business loans with EIDL assistance and only 281 were approved using the Modified Phase II processing procedures. ODA is in agreement that sufficient training is always needed to ensure that loan officers and supervisory loan officers have a clear understanding of the processes for determining loan amounts as well as all policies and procedures for effectively processing EIDLs. As stated above, the release of SOP 50 30 8 includes refined processing guidelines and training is planned for ODA staff, particularly staff working in loan processing functions. Additionally, ODA is in the process of developing upgrades to its Disaster Credit Management System (DCMS) that will ensure loan officers follow the proper steps to determine the eligible EIDL loss amount and that the final loan amount is calculated correctly.

Draft Report – Comments

We have the following technical comment on statements in the Draft Report:
Page 1, Paragraph 4
In January 2012, SBA created a team of loan officers to process SAPP loans exclusively; this team demonstrated higher production levels than non-SAPP teams.

Agency Response: The SAPP loan officer team was created in January 2013, following the issuance of SAPP Memo 12-48 on December 10, 2012.

OIG Recommendations and Agency Response

1) *OIG recommends that ODA conduct an internal review to determine why Hurricane Sandy loans processed using the expedited SAPP and Modified Phase II EIDL processes took longer than standard loans from application acceptance to initial disbursement. Based on the results of the internal review, determine whether policies and procedures should be modified.*

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[10] Audit Report 14-16, *Effectiveness and Timeliness of the Hurricane Sandy Disaster Loan Closing and Disbursement Processes*, did not identify significant concerns regarding the disaster loan closing and disbursement processes. OIG determined that after receipt of executed closing documents from the borrowers, the SBA made initial disbursements within its strategic goal of five days after receipt of executed closing documents.

ODA Response: ODA agrees with this recommendation and has completed the action.
Based on ODA's internal review, we determined that no policies and procedures need to be modified, because the additional time to disbursement was not caused by the expedited processing procedures, rather it was the direct result of borrowers taking longer to return required loan closing documents. The original intent of SAPP/RAPID processing procedures is for the expedited processing of loan decisions; the expedited processing procedures do not have a direct impact on SBA's ability to make disbursements to disaster survivors.

2) *OIG recommends that ODA clarify income continuity standards and materiality thresholds for different income sources and provide guidance on debt analysis for RAPID loan applications.*

ODA Response: ODA agrees with this recommendation and has completed the actions.
Updated processing guidelines have been incorporated into the new SOP 50 30 8 refresh and ODA provided updated training to loan officers, supervisory loan officers and those hired in response to an emergency. Training was completed in June with SOP effective date of July 1, 2015.

3) *OIG recommends that ODA establish and implement a training plan for loan officers, supervisory loan officers, and those hired in response to an emergency, to ensure they have a clear understanding of the processes for determining loan amounts and all applicable policies and procedures for effectively processing EIDLs.*

ODA Response: ODA agrees with this recommendation and has completed the action.
Updated processing guidelines have been incorporated into the new SOP 50 30 8 refresh and ODA will provide updated training, which will coincide with the SOP release, to loan officers, supervisory loan officers and those hired in response to an emergency. Training was completed in June with SOP effective date of July 1, 2015.

4) *OIG recommends that ODA implement additional oversight of EIDL processing to alleviate errors and improve accuracy in applying modified Phase II EIDL procedures.*

ODA Response: ODA agrees with this recommendation.
ODA has developed a modification to its Disaster Credit Management System (DCMS) that will ensure loan officers follow the steps to determine the eligible EIDL loss amount and the final loan amount. This is consistent with ODA's response to recent OIG Audit 12801, *Controls Governing Economic Injury Disaster Loan Approval Need Improvement*.