

U.S. SMALL BUSINESS ADMINISTRATION

OFFICE OF INSPECTOR GENERAL

# **7(a) Loan Approval for Borrowers with Unresolved COVID-19 Pandemic Loan Compliance Issues**



**Inspection Report**

**Report 24-17**

**May 21, 2024**



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### **NOTICE:**

Pursuant to the James M. Inhofe National Defense Authorization Act for Fiscal Year 2023, Public Law 117-263, Section 5274, any nongovernmental organizations and business entities identified in this report have the opportunity to submit a written response for the purpose of clarifying or providing additional context as it relates to any specific reference contained herein. Comments must be submitted to [AIGA@sba.gov](mailto:AIGA@sba.gov) within 30 days of the final report issuance date. We request that any comments be no longer than two pages, Section 508 compliant, and free from any proprietary or otherwise sensitive information. The comments may be appended to this report and posted on our public website.



# U.S. Small Business Administration Office of Inspector General

## EXECUTIVE SUMMARY

### 7(a) Loan Approval for Borrowers with Unresolved COVID-19 Pandemic Loan Compliance Issues (Report 24-17)

#### What OIG Reviewed

The U.S. Small Business Administration (SBA) is authorized under Section 7(a) of the Small Business Act to provide financial assistance to businesses in the form of guaranteed loans.

During the Coronavirus Disease 2019 (COVID-19) pandemic, eligible businesses and entities had access to over \$1.2 trillion in the Paycheck Protection Program (PPP) and COVID-19 Economic Injury Disaster Loan (EIDL) program. Our prior reviews of these programs reported systemic issues regarding borrowers' eligibility and potentially fraudulent loans.

From October 1, 2019 through May 8, 2023, SBA approved and disbursed 172,598 7(a) loans, totaling \$83.4 billion. The 7(a) lenders who have delegated approval authority approved 92 percent of these loans. SBA approved the remaining 8 percent that non-delegated lenders processed.

Our objective was to assess SBA's process for approving 7(a) loans for borrowers with unresolved pandemic loan compliance issues. To accomplish our objective, we analyzed loan program data and interviewed SBA personnel.

#### What OIG Found

SBA implemented a process to screen 7(a) loan applications for eligibility, which included screening for PPP and COVID-19 EIDL hold codes prior to loan approval. However, the process was not implemented until August 2023, after we initiated this review. Prior to August 2023, neither SBA nor lenders reviewed approved 7(a) loans to ensure borrowers did not have unresolved compliance issues that could

negatively impact their eligibility for the 7(a) loan.

As a result, there were 5,044 approved and disbursed 7(a) loans, totaling \$4.5 billion, where the borrower had a PPP loan or COVID-19 EIDL with an unresolved eligibility or potential fraud issue.

SBA stated it resolved hold codes for 3,015 of 5,044 loans. We did not assess SBA's methodology or whether the hold codes were appropriately removed. Our evaluation of *SBA's Eligibility and Forgiveness Reviews of PPP Loans Made to Borrowers With Treasury's Do Not Pay Data Matches*, which documented the use of similar hold codes, found that SBA did not always appropriately review and resolve hold codes. We will assess the appropriateness of SBA's removal of hold codes for the 3,015 loans prior to closing the recommendation.

#### What OIG Recommended

We recommend SBA review and appropriately resolve hold codes related to the 5,044 7(a) loans to determine impact on 7(a) eligibility and seek remedy or repayment of all 7(a) loans deemed ineligible.

#### Agency Response

SBA management partially agreed with the recommendation. Management stated they already resolved 3,015 of the 5,044 7(a) loans and plan to review the remaining 2,029 loans. We consider the recommendation resolved and will assess the appropriateness of SBA's removal of the hold codes for all 5,044 loans when SBA provides clear and sufficient evidence to close the recommendation.



**OFFICE OF INSPECTOR GENERAL  
U.S. SMALL BUSINESS ADMINISTRATION**

**MEMORANDUM**

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**Date:** May 21, 2024

**To:** Isabella Casillas Guzman  
Administrator

**From:** Hannibal "Mike" Ware  
Inspector General

A handwritten signature in black ink, appearing to be "H. Ware", written over the name of the sender.

**Subject:** 7(a) Loan Approval for Borrowers with Unresolved COVID-19 Pandemic Loan Compliance Issues (Report 24-17)

This report presents the results of our inspection of *7(a) Loan Approval for Borrowers with Unresolved COVID-19 Pandemic Loan Compliance Issues*. We considered management comments on the draft of this report when preparing the final report. SBA management partially agreed with the recommendation.

We appreciate the cooperation and courtesies provided by your staff. If you have any questions or need additional information, please contact me or Andrea Deadwyler, Assistant Inspector General for Audits, at (202) 205 6586.

cc: Dilawar Syed, Deputy Administrator  
Arthur Plews, Chief of Staff  
Isabelle James, Deputy Chief of Staff  
Therese Meers, General Counsel, Office of General Counsel  
Kathryn Frost, Associate Administrator, Office of Capital Access  
John Miller, Deputy Associate Administrator, Office of Capital Access  
Michael Simmons, Attorney Advisor, Office of General Counsel  
Anna Maria Calcagno, Director, Office of Performance, Analysis, and Evaluation  
Walter B. Hill Jr. Chief Risk Officer, Office of Performance, Planning, and Chief Financial Officer  
Deborah Chen, Deputy Chief Financial Officer, Office of Performance, Planning, and Chief Financial Officer  
Katherine Aaby, Associate Administrator, Office of Performance, Planning, and Chief Financial Officer  
Tonia Butler, Director, Office of Internal Controls  
Peter Meyers, Senior Advisor, Office of Capital Access  
Rachel Wilson, Program Analyst, Office of Capital Access

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# Introduction

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This report presents the results of our inspection of the U.S. Small Business Administration's (SBA) process for approving 7(a) loans with related, unresolved Coronavirus Disease 2019 (COVID-19) pandemic loan compliance issues. The Office of Inspector General (OIG) conducted this inspection to identify potential risks for SBA's 7(a) loan program.

## Background

SBA is authorized under Section 7(a) of the Small Business Act to provide financial assistance to small businesses in the form of government-guaranteed loans. Participating lenders enter into an agreement with SBA to make loans to small businesses in accordance with SBA rules, regulations, policies, and procedures. From October 1, 2019 through May 8, 2023, SBA approved and disbursed 172,598 7(a) loans, totaling \$83.4 billion.

## COVID-19 Pandemic Loan Programs

The Coronavirus Aid, Relief, and Economic Security (CARES) Act was enacted on March 27, 2020, to provide economic relief to borrowers impacted by the COVID-19 pandemic. Section 1102 of the CARES Act established the Paycheck Protection Program (PPP) with \$349 billion to provide fully guaranteed loans under section 7(a) of the Small Business Act. The PPP provided loans for certain eligible borrowers that can be fully forgiven if loan proceeds were used as required by the law. Through additional legislation, total program funding increased to \$813.7 billion.

Under the Coronavirus Preparedness and Response Act, Paycheck Protection Program and Health Care Enhancement Act, and administrative actions taken by SBA, SBA also offered a special COVID-19 Economic Injury Disaster Loans (EIDL) program to help small businesses and other entities. SBA was authorized to administer \$373 billion for its EIDL program.

SBA's administration of the PPP and COVID-19 EIDL program included identifying issues with eligibility requirements and potential fraud. For example, SBA screened for disqualifying factors, such as criminal history and bankruptcy. When identified, SBA placed hold codes on these pandemic-related loans with the intent of reviewing and resolving the issues before further processing of the loan.

## **7(a) Loans and Hold Codes**

From October 1, 2019, through May 8, 2023, SBA approved and disbursed 172,598 7(a) loans, totaling \$83.4 billion. Of these loans, there were 5,044, totaling \$4.5 billion, with borrowers and/or principals who also had a PPP loan or COVID-19 EIDL with an unresolved hold code (compliance issue) at the time of their 7(a) loan approval.

SBA assigned the Loan Guaranty Processing Center (LGPC) the responsibility of determining whether hold codes on related pandemic loans were resolved prior to approving 7(a) loans. The LGPC is responsible for approving all 7(a) loans processed by non-delegated lenders, which accounted for approximately 8 percent of the 7(a) portfolio since fiscal year (FY) 2020. Non-delegated lenders do not have authority to approve 7(a) loans. The 7(a) lenders who have delegated approval authority approved the remaining 92 percent of the loans.

## **Objective**

Our objective was to assess SBA's process for approving 7(a) loans for borrowers with unresolved COVID-19 pandemic loan compliance issues.

## **Results**

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SBA implemented a process to screen 7(a) loan applications for eligibility, which included screening for PPP and COVID-19 EIDL hold codes prior to loan approval. However, the process was not implemented until August 2023, after OIG initiated this review. We found that neither SBA nor the lenders reviewed 7(a) loans made from FY 2020 to May 8, 2023 to ensure borrowers did not have unresolved compliance issues with PPP loans or EIDLs that could negatively impact their eligibility. In addition, prior to August 2023, SBA did not have any automated controls in its loan application system to screen for the unresolved issues during the 7(a) loan approval process. The absence of such controls increased the risk that ineligible or fraudulent borrowers could obtain 7(a) loans and hindered SBA's ability to mitigate potential fraud and financial loss in its programs.

SBA's corrective actions taken during our review to implement the screening process for 7(a) loan applications addressed our concerns and should help ensure that, moving forward, only eligible borrowers are approved for 7(a) loans. However, to reduce the impact of potential fraud



and promote program integrity, SBA should take immediate action to address the 5,044 approved and disbursed 7(a) loans identified in this report that were not reviewed under the new screening process.

## **Finding 1: 7(a) Loans Approved Without Review of Potential Risks**

Prior to August 2023, SBA did not, nor did it require, delegated lenders to review hold codes on pandemic loans to ensure borrowers met eligibility requirements. Additionally, SBA did not have any controls in its loan application system (ETran) to screen for the unresolved hold codes during the 7(a) loan approval process.

Not all hold codes on related pandemic loans pose a risk to 7(a) loan approvals. This is because some hold codes were specific to pandemic loan requirements that would not impact the 7(a) loan. For example, SBA used multiple hold codes on pandemic loans for borrowers exceeding the allowed loan amount; therefore, our analysis excluded hold codes that did not impact 7(a) eligibility requirements. We focused on hold codes that could impact eligibility in the 7(a) loan program, such as those related to criminal records, bankruptcy, potential fraud, and the U.S. Department of Treasury’s Do Not Pay (DNP) list. The absence of sufficient controls to review borrowers’ applicable unresolved compliance issues with PPP loans and COVID-19 EIDLs exposed the 7(a) loan program to increased financial risk from potentially ineligible or fraudulent borrowers.

Beginning FY 2020 through May 8, 2023, there were 5,044 approved and disbursed 7(a) loans totaling approximately \$4.5 billion with related PPP loans or COVID-19 EIDLs with unresolved hold codes. SBA stated it resolved the applicable hold codes for 3,015 of these loans after the 7(a) loan was approved and disbursed. We sampled 133 of the 3,015 loans

**We found**  
**5,044**  
**loans totaling**  
**\$4.5 billion**  
**with related PPP or COVID-19 EIDL**  
**loans with unresolved hold codes**  
**during the 7(a) loan approval process**

and found that the hold codes were removed for 132 loans. We did not assess the methodology SBA used or the appropriateness of its decision to resolve and remove these hold codes.

However, our evaluation of *SBA's Eligibility and Forgiveness Reviews of Paycheck Protection Program Loans Made to Borrowers With Treasury's Do Not Pay Data Matches* (Report Number 24-06), which documented the use of similar hold codes, found that SBA did not always appropriately resolve the hold codes. We will assess the appropriateness of SBA's removal of hold codes for the 3,015 loans when SBA provides sufficient evidence to close the recommendation in this report.

Beginning in August 2020, SBA used a new automated screening process to identify potential PPP non-compliance issues with eligibility and fraud. The automated screening used 19 rules that reflect known and suspected fraud and abuse patterns to identify issues, such as fictitious or inactive businesses. This process included

steps to screen loan information provided by lenders through ETran against the entire loan database and publicly available information. This process flagged 348,494 PPP applications that SBA ultimately did not approve.

**SBA's PPP automated  
screening process flagged  
348,494  
applications that SBA  
ultimately did not approve**

Although SBA's automated screening process identified potential PPP issues, SBA did not fully leverage that information to reduce the risk of potentially ineligible and fraudulent borrowers obtaining 7(a) loans. This occurred because SBA did not implement policies and procedures to identify issues across its various loan programs. In addition, SBA did not implement an automated screening process for 7(a) because SBA viewed the unresolved COVID-19 loan compliance issues as low risk for the 7(a) loan program. According to SBA:

- The 7(a) program has more controls in place than PPP and COVID-19 EIDL,
- Lenders have more at stake due to the lower guaranty percentages on 7(a) loan programs, and
- Lenders are required to adhere to Know Your Customer and Bank Secrecy Act requirements.

According to the U.S. Government Accountability Office, federal program managers should design and implement a strategy with specific control activities to mitigate assessed fraud risks and collaborate to help ensure effective implementation.<sup>1</sup> These control activities could include the use of data analytics to identify potential fraud through data mining and data matching techniques. In addition, effective internal controls require that quality information is communicated across all levels of the entity to achieve objectives and address risks.<sup>2</sup>

We discussed the 7(a) loan program and COVID-19 related hold codes with SBA's Fraud Risk Management Board, which serves as the designated anti-fraud entity responsible for oversight and coordination of SBA's fraud risk prevention, detection, and response activities. The board identified hold codes and identity theft as prevalent fraud risks for the 7(a) loan program.

Because SBA did not review all instances of potential fraud across the 7(a) loan program and related pandemic loans, it missed opportunities to mitigate fraud risk and promote program integrity. In addition, SBA reduced its ability to hold fraudulent borrowers accountable and increased the risk that fraudulent or ineligible borrowers could obtain loans and assistance from various other loan programs. If SBA leveraged data across loan programs, it could have further ensured that borrowers for the 5,044 loans totaling approximately \$4.5 billion met eligibility requirements, thereby reducing the risk of potential fraud and financial loss.

During our review on August 1, 2023, SBA implemented a screening process through ETran to check 7(a) loan applications for eligibility, which included screening for PPP and COVID-19 EIDL hold codes prior to loan approval. The screening occurs when lenders enter borrower information into ETran. SBA then uses third-party databases to validate eligibility information. If the screening returns an error code for eligibility, the lender must work with SBA to clear the code by providing support documentation. Once the code is cleared, the lender can continue processing the 7(a) loan.

If implemented effectively, SBA's screening process through ETran should reduce the risk of ineligible borrowers receiving 7(a) loans. We will continue to monitor the capabilities of this screening process. However, to reduce the impact of potential fraud and promote program

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<sup>1</sup> GAO-15-593SP, *A Framework for Managing Fraud Risks in Federal Programs* (July 2015).

<sup>2</sup> GAO-14-704G, *Standards for Internal Controls in the Federal Government* (September 2014).

integrity, SBA should take immediate action to address the identified 5,044 approved and disbursed 7(a) loans, totaling approximately \$4.5 billion where the borrowers had related PPP loans or COVID-19 EIDLs with an applicable unresolved hold code.<sup>3</sup>

## Recommendations

To ensure eligibility requirements were met and reduce the risk of potential fraud, we recommend the Administrator direct the Associate Administrator for the Office of Capital Access to:

**Recommendation 1:** Review and appropriately resolve hold codes related to the 5,044 7(a) loans to determine impact on 7(a) eligibility and seek remedy or repayment of all 7(a) loans deemed ineligible.

## Evaluation of Agency Response

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SBA management provided formal comments to the draft report, which we considered when preparing this final report. Management partially agreed with the recommendation, stating they have already resolved hold codes related to 3,015 of the 5,044 loans and they will review hold codes related to the remaining 2,029 7(a) loans. See Appendix 2 for management's comments in their entirety.

## Summary of Actions Necessary to Close the Recommendation

The following section summarizes the status of our recommendation and the actions necessary to close it.

### Recommendation 1

To ensure eligibility requirements were met and reduce the risk of potential fraud, we recommend the Administrator direct the Associate Administrator for the Office of Capital Access to review and appropriately resolve hold codes related to the 5,044 7(a) loans to determine impact on 7(a) eligibility and seek remedy or repayment of all 7(a) loans deemed ineligible.

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<sup>3</sup> SBA stated it resolved hold codes for 3,015 of the 5,044 7(a) loans. We will assess the appropriateness of SBA's removal of these hold codes prior to closing the recommendation.

**Status: Resolved**

SBA management partially agreed with the recommendation, stating they already resolved hold codes for 3,015 of the 5,044 loans. Management stated they will review open and unresolved hold codes related to the remaining 2,029 7(a) loans to determine if the potential issue identified by the open hold code impacts 7(a) eligibility. If there is a potential impact to 7(a) eligibility, management will ensure they address the potential issue. In subsequent correspondence, SBA provided a target completion date of May 1, 2025.

We recognized in the report that SBA stated it resolved applicable hold codes for 3,015 of the 5,044 7(a) loans after they were approved and disbursed. We sampled 133 of the 3,015 loans and found that the hold codes were removed for 132 of them. However, we did not assess the appropriateness of SBA's decision to resolve and remove these hold codes because the related information was not readily available in SBA's systems.

We stated in the report that we will assess the appropriateness of SBA's removal of hold codes for the 3,015 loans during the audit follow-up process. To satisfy the intent of this recommendation, SBA should provide clear and sufficient evidence to show it appropriately resolved hold codes related to the 3,015 7(a) loans and this had no impact on 7(a) eligibility. Management must also review the remaining 2,029 loans to ensure eligibility requirements were met and provide clear and sufficient evidence to support its review decisions.

We consider this recommendation resolved and will close it when management provides clear and sufficient evidence they have reviewed and appropriately resolved hold codes related to the 5,044 7(a) loans to determine impact on 7(a) eligibility and seek remedy or repayment of all 7(a) loans deemed ineligible.

# Appendix 1: Scope and Methodology

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This report presents the results of our inspection of the U.S. Small Business Administration's (SBA) process for approving 7(a) loans. The SBA's Office of Inspector General (SBA OIG) conducted this inspection to assess SBA's process for approving 7(a) loans with related unresolved Coronavirus Disease 2019 (COVID-19) pandemic loan compliance issues. Our scope of work included approved and disbursed 7(a) loans for borrowers who had approved Paycheck Protection Program (PPP) and COVID-19 Economic Injury Disaster Loans (EIDL) with unresolved hold codes during the 7(a) loan approval process.

To answer our objective, we reviewed policies, procedures, and guidance related the approval of 7(a) loans with related unresolved COVID-19 pandemic loan compliance issues.

We interviewed SBA personnel from various offices in the Office of Capital Access, including the Office of Financial Program Operations, and the Office of Performance and Systems Management, to gain an understanding of related processes, procedures, and system controls.

Further, we analyzed data for the 7(a), PPP, and COVID-19 EIDL programs from October 1, 2019 to May 2023 to identify the number and amount of 7(a) loans with related unresolved COVID-19 pandemic loan compliance issues. We also analyzed the PPP and COVID-19 EIDL data to identify loans with unresolved hold codes.

We statistically sampled 133 of 3,015 7(a) loans that SBA indicated had the related PPP and COVID-19 EIDL hold codes resolved after the 7(a) loan was approved and disbursed. We reviewed whether hold codes were resolved after the 7(a) loan was approved and disbursed and projected our results using a 95 percent confidence level.

We conducted this inspection in accordance with the Council of the Inspectors General on Integrity and Efficiency's Quality Standards for Inspection and Evaluation. These standards require that we adequately plan and perform the evaluation to obtain sufficient and appropriate evidence to provide a reasonable basis for our findings and conclusions based on our objective. We believe that the evidence provides a reasonable basis for our conclusions based on our objective.

## Use of Computer-Processed Data

We relied on data from SBA’s electronic loan application system (ETran). We performed limited testing on data extracts to ensure the data was complete and met the scope parameters of this inspection. We also reviewed a data reliability assessment from a recent prior audit that used ETran data. As a result, we believe that the data are sufficiently reliable to support our findings.

## Prior Audit Coverage

Report Number	Report Title	Date
SBA OIG Report 23-09	<i>COVID-19 Pandemic EIDL and PPP Loan Fraud Landscape</i>	June 27, 2023
SBA OIG Report 23-05	<i>White Paper 7(a) Loan Program During SBA’s Response to the Covid-19 Pandemic</i>	March 21, 2023
SBA OIG Report 22-13	<i>SBA’s Handling of Potentially Fraudulent Paycheck Protection Program Loans</i>	May 26, 2022

## Appendix 2: Agency Response

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SBA RESPONSE TO THE INSPECTION REPORT





U.S. SMALL BUSINESS ADMINISTRATION  
WASHINGTON, DC 20416

**To:** Hannibal “Mike” Ware  
Inspector General  
U.S. Small Business Administration

**From:** Jihoon Kim  
Director  Digitally signed by Ji KIM  
Date: 2024.04.29 14:02:50  
-04'00'  
Office of Financial Program Operations  
Office of Capital Access

**Date:** May 1, 2024

**Subject:** Response to OIG Draft Report - 7(a) Loan Approval for Borrowers with  
Unresolved COVID-19 Pandemic Loan Compliance Issues – Project 23011

We appreciate the role the Office of Inspector General (OIG) plays in working with management in ensuring that our programs are effectively managed, and for the feedback provided in this draft report. We offer the following comments to the draft and Recommendations:

SBA acknowledges the importance of determining whether a 7(a) applicant is eligible. In an effort to ensure eligibility, as well as in response to lessons learned from the Paycheck Protection Program (PPP), SBA implemented a new preapproval screening process utilizing SBA’s Risk Mitigation Framework for all 7(a) loan applications, both delegated and non-delegated, as of August 1, 2023. This is the first time in the Agency’s history that SBA has instituted such a review on 7(a) loans. As a part of this process, SBA is screening 7(a) loan applications to identify Borrowers with unresolved hold codes on COVID-19 Pandemic loans to prevent 7(a) loan approval until all COVID-19 hold codes are resolved.

**Recommendation 1** – Review and appropriately resolve hold codes related to the 5,044 7(a) loans to determine impact on 7(a) eligibility and seek remedy or repayment of all 7(a) loans deemed ineligible.

**SBA Response:** SBA partially agrees. SBA has already resolved hold codes on COVID-19 Pandemic loans related to 3,015 of these loans and will review hold codes related to the remaining 2,029 7(a) loans. Where hold codes remain open and unresolved, SBA will review those loans to determine if the potential issue identified by the open hold code impacts 7(a)

eligibility. If there is a potential impact to 7(a) eligibility, SBA will enter a Chron comment to ensure the potential issue is addressed.