

# WHITE PAPER: RISK AWARENESS AND LESSONS LEARNED FROM PRIOR AUDITS OF ECONOMIC STIMULUS LOANS

April 3, 2020





# EXECUTIVE SUMMARY

## RISK AWARENESS AND LESSONS LEARNED FROM PRIOR AUDITS OF ECONOMIC STIMULUS LOANS

Report  
No. 20-11

April 3,  
2020

### Why We Did This

We prepared this memorandum to provide the Small Business Administration (SBA) information regarding lessons learned and risks identified in prior audits and reviews that SBA should consider to ensure program integrity and mitigate the risk of financial loss for COVID-19 related loans.

The President signed the Coronavirus Aid, Relief, and Economic Security (CARES) Act into law on March 27, 2020. The Act contains several provisions intended to provide economic relief to our nation's small businesses. One of the Act's largest provisions created the Paycheck Protection Program under section 7(a) of the Small Business Act. This program provides \$349 billion in fully guaranteed SBA loans, which can be forgiven if used properly, for small businesses to cover payroll, rent, utility payments, and other limited uses. SBA's 7(a) loan program is the Agency's primary method of facilitating capital to eligible small businesses. SBA offers guarantees on loans made by participating lenders to help expand capital to small businesses that face challenges getting loans through conventional financing methods." Another significant provision of the CARES Act provides \$17 billion for SBA to pay 6 months of principal and interest payments for current SBA loans.

SBA's 7(a) loan is a deferred participation loan made between the lender and SBA, with the lender providing the funding to an eligible small business. SBA will honor its guaranty on the 7(a) loan if the lender demonstrates it originated, serviced, closed and liquidated the loan according to SBA requirements. As of December 31, 2019, the total unpaid principal balance of SBA 7(a) loans was approximately \$95.4 billion.

### What We Reviewed

The Office of Inspector General (OIG) regularly conducts audits and inspections that evaluates management controls and assesses the program integrity, efficiency, and effectiveness of the 7 (a) loan program. We compiled findings from those audits and reviews that identified significant issues and relevant risk.

### Identified Areas of Risk

Our review of prior audits and reviews of economic stimulus loan programs identified areas of risk in SBA's 7(a) loan program. Specifically, delays in promulgating regulations caused confusion among program participants about economic stimulus loan program requirements. In addition, we found SBA did not require program participants to submit documentation, which resulted in inappropriate or unsupported loan approvals. Further, we determined that SBA should establish proper controls, such as clear and consistent guidance and training for new stimulus programs before disbursing funds. The controls should also ensure that program requirements are updated. Finally, inaccurate or unreliable data did not allow for proper measurement of economic stimulus loan program performance.

While SBA has improved controls related to existing loan programs, we note several risk areas that may present SBA with challenges while issuing and administering requirements under the COVID-19 related 7(a) stimulus loan programs.

### Key Considerations for SBA

In summary, to ensure program integrity and the timeliness of loans to eligible small businesses and to mitigate the risk of financial loss SBA should:

- Issue clear requirements and ensure timely communication to lending partners
- Establish and monitor performance measures
- Establish proper internal controls
- Establish a quality assurance plan to prevent and detect improper payments
- Track program data to support accurate measurement and reporting



# Office of Inspector General

## U.S. Small Business Administration

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**DATE:** April 3, 2020

**TO:** Jovita Carranza  
Administrator

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

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

**SUBJECT:** Risk Awareness and Lessons Learned From Prior Audits of Economic Stimulus Loans

We prepared this memorandum to provide the Small Business Administration (SBA) information regarding risks identified from prior audits and reviews, in addition to lessons learned, that SBA should consider in managing and mitigating the risk of financial loss for loan programs funded as a result of the Coronavirus (COVID-19) pandemic.

### Background

Like other nations, the United States is dealing with the devastating effects of the COVID-19 pandemic, which has significantly impacted countless small businesses across the country. Temporary business closings and layoffs could have a lasting negative impact on local economies if these entities don't survive. The President signed the Coronavirus Aid, Relief, and Economic Security (CARES) Act into law on March 27, 2020, to provide economic relief to our nation's small businesses.<sup>1</sup> One of the Act's largest provisions created the Paycheck Protection Program under section 7(a) of the Small Business Act. This program provides \$349 billion in fully guaranteed SBA loans, which can be forgiven if used properly, for small businesses to cover payroll, rent, utility payments, and other limited uses. Another significant provision provides \$17 billion for SBA to pay 6 months of principal and interest payments for existing 7(a), 504, and 7(m) loans.

Increased guaranties from SBA reduces the risk to lenders, who, as a result, may not exercise due diligence in originating loans, thereby increasing the risk of potential financial losses to SBA. In addition, increased loan volume, loan amounts, and expedited loan processing timeframes may make it more difficult for SBA to identify red flags in loan applications. Therefore, we are providing SBA with key risks and lessons learned from past large-scale stimulus packages for its consideration. Without sufficient controls in place, SBA's programs suffer increased vulnerability to fraud and unnecessary losses when SBA and its lending partners expedite loan transactions to provide quick relief. The most recent large-scale SBA-administered stimulus is the combination of "The American Recovery and Reinvestment Act of 2009 (ARRA) and the Small Business Jobs Act of 2010 (JOBS Act). We refer to these acts collectively in this analysis as the Recovery Act.

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<sup>1</sup> Public Law 116-136.

## Applicable Federal Statutes, Regulations, and Guidelines

Section 7(a) of the Small Business Act empowers SBA administrator to make loans to any small business concern. These powers are subject to restrictions, limitations, and provisions as defined in the Act.

Title 13, Part 120 in the Code of Federal Regulations contains the requirements for SBA's business loan programs.

SBA Standard Operating Procedures (SOP) 50 10 5 (K) provides specific policies and procedures governing 7(a) business loan programs including Standard 7(a), the Preferred Lenders Program, SBA Express, and the Agency's Pilot Loan Programs.

The CARES Act contains provisions related to SBA's loan programs. The Act requires SBA to implement these provisions, which include:

- **Section 1102:** creates the Paycheck Protection Program under section 7(a) of the Small Business Act, which has a covered period from February 15 through June 30, 2020. This program provides \$349 billion for SBA loans—with a 100-percent guarantee—to cover payroll, rent, utility payments, and other limited uses. The Paycheck Protection Program waives many standard 7(a) requirements, including the associated fees, consideration of credit elsewhere, collateral, and personal guarantees. In addition, these loans will have deferred payments for 6 to 12 months.
- **Section 1106:** provides the requirements related to the forgiveness of the Paycheck Protection Program loans under section 1102.
- **Section 1112:** provides \$17 billion for SBA to pay 6 months of principal, interest, and expense payments for existing 7(a), 504, and 7(m) loans starting on the next payment due or on the first payment due date of any such loans made between March 27 and September 27, 2020.

## Prior Audit Findings

In fulfilling our responsibility to oversee past stimulus programs, including the Supplemental Terrorist Activity Relief (STAR) and the Recovery Act, we issued 27 reports and memorandums that included 89 recommendations. In addition, other entities responsible for oversight, including the U.S. Government Accountability Office (GAO) and congressional committees, issued reports on SBA's implementation and oversight of past stimulus programs. Following are some examples of the significant findings and relevant risk from the prior audits and reviews. We restricted our review to stimulus packages issued since fiscal year 2000.

### Stimulus Program Implementation

Prior audits and reviews determined that SBA did not implement key stimulus loan programs within statutory deadlines. In addition, SBA did not implement clear guidance for lending partners. These findings demonstrate that to ensure program integrity and effectively mitigate the risk of financial loss, SBA must implement stimulus loan programs in a timely manner, provide lending partners with clear requirements, and ensure public communication from SBA officials is appropriate and consistent with the established requirements.

[Office of Inspector General \(OIG\) report 6-09: Audit of SBA's Administration of the Supplemental Terrorist Activity Relief \(STAR\) Loan Program, December 2005.](#)

In this report, we found that SBA did not implement adequate internal controls and oversight of the STAR loan program to ensure that only eligible borrowers obtained STAR loans. SBA directed loan officers not to question the lenders' justifications for these loans. Further, to promote the program and encourage lender participation, senior SBA officials made several public statements that broadened the scope of eligibility for the program and provided assurances that SBA would not second guess lender eligibility justifications.

[GAO Report 10-298R: SBA's Economic Stimulus Provisions, January 2010.](#)

GAO found SBA experienced challenges implementing the America's Recovery Capital (ARC) Loan Program. The report stated that emergency rulemaking authority required SBA to issue regulations within 15 days of ARRA enactment for the program; SBA did not meet the statutory deadline. GAO identified several factors that may have contributed to SBA's delay in implementing these administrative provisions, including challenges related to the creation of new and complex programs. Some market participants said that while interest in the ARC loan program among many potential small business borrowers appeared to be high, there was significant confusion about the program's eligibility requirements. Market participants GAO interviewed also cited that some lenders were uncertain about the definition of a viable business, as defined by SBA regulations, and how to determine immediate financial hardship. SBA subsequently issued revised guidance for determining borrower eligibility under the ARC loan program.

### **Stimulus 7(a) Loan Approvals**

These findings demonstrate SBA's need to provide lending partners with clear requirements and to clearly communicate the need to originate, close, and service loans according to program requirements to ensure program integrity and effectively mitigate the risk of financial loss.

[OIG report ROM 11-07: Origination and Closing Deficiencies Identified in 7\(a\) Recovery Act Loan Approvals, September 2011.](#)

In this report, we identified documentation deficiencies in 24 (or 40 percent) of the 60 7(a) stimulus loans reviewed, resulting in inappropriate or unsupported loan approvals. Based on the sample results, we estimated that at least 1,996 of the loans in the universe were not originated and closed in compliance with SBA's policies and procedures, resulting in at least \$869.5 million in inappropriate or unsupported loan approvals. The projected volume of inappropriate or unsupported loan approvals demonstrates the inherent risk of these loans and the importance of careful review by SBA.

[OIG report ROM 11-03: America's Recovery Capital Loans Were Not Originated and Closed in Accordance with SBA's Policies and Procedures, March 2011](#)

In addition, in this report, the OIG identified material origination and closing deficiencies in fifty-six, or 47 percent, of the 120 7(a) stimulus loans reviewed, resulting in inappropriate loan approvals of approximately \$1.8 million. The documentation in the loan files was inadequate. Based on the sample results, we estimated that 2,228 of the 7(a) stimulus loans were not originated and closed in compliance with SBA's policies and procedures, resulting in approximately \$66.5 million in inappropriate loan approvals.

## **Stimulus 7(a) Loan Purchases**

We also identified findings regarding loan purchases that demonstrate SBA's need to communicate clear guidance to lenders and to provide adequate training to loan purchase center staff. Ensuring that lenders know the program requirements and providing training to staff will minimize the risk of improper payments due to erroneous purchases resulting from improper documentation provided by SBA 7(a) lenders.

[OIG report 12-11R: High-Dollar Early-Defaulted Loans Require an Increased Degree of Scrutiny and Improved Quality Control at the National Guaranty Purchase Center, March 2012](#)

We found that SBA and its lenders originated, closed, and purchased 11 of the 25 sampled loans according to SBA rules and regulations and commercially prudent lending standards. We identified material deficiencies, however, in 14 of the 25 early-defaulted loans selected for audit. Of these 14 loans, we identified material deficiencies in 10 loans and SBA identified material deficiencies in the remaining 4 loans. These deficiencies resulted in questioned costs or recoverable guaranty payments totaling approximately \$10.7 million. We noted that loan specialists did not always review high-dollar, early-defaulted loans with the level of scrutiny necessary to identify all material deficiencies.

[OIG report 6-09: Audit of SBA's Administration of the Supplemental Terrorist Activity Relief \(STAR\) Loan Program, December 2005](#)

In this report, we found that SBA did not ensure that only eligible borrowers obtained stimulus loans. The lender files did not contain sufficient information to demonstrate that borrowers were adversely affected as required by SBA loan program policies and procedures. As a result, eligibility could not be determined for 50 of the 59 (or 85 percent) of the loans reviewed. We recommended that SBA provide more definitive guidance to its purchase centers to determine what constituted an inadequate adverse situation, thereby making the loan eligible for stimulus provisions.

After we issued our report, the Majority Staff of the United States Senate Committee on Small Business and Entrepreneurship conducted its review of the STAR loan program (["Small Business Administration's Supplemental Terrorist Activity Relief Loan Program, September 6, 2006"](#)). The report found that only 26 percent of the loan files reviewed contained adequate documentation demonstrating recipient eligibility to receive a STAR loan. Of the files reviewed by committee staff, 74 percent contained either questionable, inadequate, or no documentation.

## **Stimulus Data Reliability and Program Reporting**

Prior reports found SBA did not ensure that data from Recovery Act investments was reliable. The report findings demonstrate the need for SBA to establish and continuously monitor specific outcome-oriented performance measures, modify existing loan systems to track key stimulus program information at the loan level, and implement internal controls to ensure the integrity of the recorded data to support accurate program measurement and reporting. Without reliable and specific program measurements, SBA cannot ensure program integrity, nor can it confidently measure the performance of stimulus 7(a) loan programs.



[OIG report ROM 10-04: Review of Controls Over Job Creation and Retention Statistics Reported by SBA under the American Recovery and Reinvestment Act of 2009, December 2009](#)

We found SBA did not ensure that data from ARRA investments was reliable. Specifically, SBA may have overstated its reported number of jobs created or retained by at least 16 percent. The errors that made up the overstatement were statistical outliers, negative job numbers, and jobs that were double counted for businesses that received multiple loans. The report found these errors occurred because SBA did not establish reasonableness checks and did not have the necessary system controls and lender guidance.

[OIG report ROM 10-15: Review of SBA's Job Creation Data Under the Recovery Act, April 2010](#)

In this report, we found SBA did not ensure that program performance was accurately reported. Certified Development Companies (CDCs) reported job creation and retention statistics consistent with 504 program guidance. SBA did not define or provide lenders guidance on how jobs retained were to be measured in the 7(a) program, however, lenders were generally reporting all existing jobs at the applicant's business as jobs retained. As a result, SBA's reporting of 7(a) job retention was unclear and misleading. The risk of confusion was compounded by the fact that "jobs created/retained" for the 7(a) and 504 loan programs were reported side by side, even though they were not comparable.

## **SBA's Improvements**

SBA addressed the recommendations included in the issued reports, and we closed the recommendations after review of the supporting documentation provided. In addition, after we reported on the Recovery Act, SBA improved its processes and the underlying internal controls. These improvements include, but are not limited to:

- Updating loan program requirements
- Providing training to loan specialists
- Enhancing loan review checklists to determine lender compliance
- Modifying production standards for loan specialists to evaluate complex early defaulted loans
- Developing and implementing a quality control program for all its loan centers to verify and document compliance with the loan process, from origination to closeout
- Reducing improper payments and improving the accuracy of improper payment reporting

Although SBA addressed recommendations from these reports, actions SBA had taken may have since been revised because of program changes over time. SBA must reevaluate the current effectiveness of its internal controls to avoid a recurrence of these issues and to mitigate the risk of financial loss for COVID-19 related 7(a) stimulus loan programs.

## **Key Points to Consider When Administering Stimulus Loan Programs**

In summary, to ensure program integrity, the timeliness of loans to eligible small businesses, and to mitigate the risk of financial loss SBA should:

- Issue clear requirements and ensure timely communication to lending partners
- Establish and monitor specific outcome-oriented performance measures

- Ensure public communication from SBA officials is appropriate and consistent with the established requirements
- Establish proper controls in the loan approval phase to ensure eligibility of participants and to mitigate the risk of loan default
- Establish a quality assurance plan to prevent and detect improper payments
- Oversee the program to ensure it is implemented as intended and that program goals and objectives are met
- Modify existing loan systems to track stimulus program data to support accurate program measurement and reporting

## **Fraud Hotline**

SBA OIG also aggressively investigates allegations of fraud, waste, abuse, or mismanagement. Please report fraud, waste, abuse, or mismanagement of Federal funds involving SBA programs, operations, or personnel to the SBA OIG hotline. To submit a complaint, please visit <https://www.sba.gov/about-sba/oversight-advocacy/office-inspector-general/office-inspector-general-hotline> or call 1-800-767-0385.

## **Disclaimer**

This White Paper contains findings from prior audits and reviews. It is intended solely to provide risk information from those prior audits that SBA should consider to ensure program integrity and to mitigate lending risk for COVID-19 related loans. It is not an audit performed under Generally Accepted Government Auditing Standards and is not an inspection, evaluation, or review performed under the CIGIE Quality Standards for Inspection and Evaluation.

If you have any questions, please contact me at 202-205-6586 or Andrea Deadwyler, Assistant Inspector General for Audits, at 202-205-6616.

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