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SMALL BUSINESS ADMINISTRATION

Observations on the Disaster Loan Program

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Accountability * Integrity * Reliability

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Madam Chair and Members of the Committee:

I am pleased to be with you today at this roundtable to discuss the role of the Small Business Administration's (SBA) Disaster Loan Program in responding to the September 11, 2001, terrorist attacks, general performance measures for the program, and the effects of SBA's program to sell loans to private investors on disaster loans and their borrowers. As you know, the effects of the September 11 attacks were felt not only in New York but also around our country, with the economic damage occurring in states as far west as California. The unique nature of the attacks and the government's response required SBA to make unprecedented efforts to expand its disaster lending coverage and to be flexible in its efforts to serve those needing assistance. Notwithstanding SBA's extraordinary performance in responding to the September 11 attacks, our work showed that the Disaster Loan Program's performance measures do not fully or adequately reflect SBA's actual performance. In reviewing SBA's loan sales program, which includes disaster loans, we identified three areas needing improvement: tracking borrower inquiries and complaints; sales budgeting and accounting, which affect the reliability of SBA financial statements and budget information; and reporting on the operational benefits of the loan sales.

My remarks today will focus on SBA's (1) response to the September 11 terrorist attacks; (2) performance plans and measures for its Disaster Loan Program; and (3) loan asset sales program, which involves selling disaster and other loans.[1] My comments are based on our recent reports on SBA's Disaster Loan Program (*Small Business Administration: Response to September 11 Victims and Performance Measure for Disaster Lending*, GAO-03-385, Jan. 29, 2003) and loan asset sales program (*Small Business Administration: Accounting Anomalies and Limited Operational Data*

[1]For information on assistance provided to small businesses in the Lower Manhattan area after September 11 by SBA and other government agencies, please see U.S. General Accounting Office, *September 11: Small Business Assistance Provided in Lower Manhattan in Response to the Terrorist Attacks*, GAO-03-88 (Washington, D.C.: Nov. 1, 2002).

Make Results of Loan Sales Uncertain, GAO-03-87, Jan. 3, 2003).[2] Both are available on our Web site: www.gao.gov.

Summary

The nature of the September 11 attacks and subsequent government actions presented SBA's Disaster Loan Program with new and difficult challenges. Specifically, small businesses in both the declared disaster areas and around the nation suffered economic injury. SBA sought to respond to the concerns of small businesses in the months following September 11 by extending eligibility for economic injury loans nationwide—a marked change from earlier disasters that affected primarily businesses in one geographic location. In addition, SBA modified both the terms and lending practices of its Disaster Loan Program—for example, by reducing the amount of documentation some borrowers needed to provide. Congress supported these efforts with supplemental appropriations that allowed SBA to offer larger loans to a relatively broad population of victims. By the end of fiscal year 2002, the agency had worked with individuals and businesses in all 50 states, the District of Columbia, and the U.S. territories, approving 9,700 loans totaling $966 million.

We found that SBA had adapted its Disaster Loan Program to respond to the needs of September 11 victims but that SBA's performance measures did not provide congressional decision makers with an accurate description of the program's performance. For example, two of SBA's six performance measures assessed only one discrete step in the loan application and disbursement processes—the application process. In addition, some output measures[3] had not kept up with SBA's actual progress in assisting disaster victims. Further, we identified features in SBA's description of its Disaster Loan Program in the 2002 and 2003 performance plans that made assessing the agency's progress in attaining

[2]Also see April 29, 2003, testimony before the Subcommittee on Government Efficiency and Financial Management, Committee on Government Reform, U.S. House of Representatives. U.S. General Accounting Office, *Small Business Administration: Loan Accounting and Other Financial Management Issues Impair Accountability*, GAO-03-676T (Washington, D.C.: Apr. 29, 2003).

[3]According to Office of Management and Budget (OMB) guidance, outputs are the level of activity that can be produced or provided over a given period of time or by a specific date. Outcomes are the intended results, effects, or consequences that occur from carrying out program activities. OMB, *Preparation and Submission of Strategic Plans, Annual Performance Plans, and Program Performance Reports*, Circular No. A-11, Part 6. (Washington, D.C: June 2002).

its strategic goals difficult. For example, although SBA guidance recommended that program goals be outcome oriented, SBA's 2003 performance goal was output oriented.

Our review of SBA's five loan sales from August 1999 to January 2002 revealed that 85 percent of the $4.4 billion in loans sold were disaster assistance home and business loans. SBA established some policies to protect borrowers whose loans were sold. For example, disaster loans less than 2 years old were not sold because they typically required more servicing and sometimes had to be increased to cover exigencies, such as revised physical damage estimates. In trying to determine how borrowers reacted to having their loans sold, we found that SBA relied on borrower inquiries and complaints to determine whether purchasers of the loans were using prudent loan servicing practices. However, information on borrowers' reactions was incomplete because SBA did not have a comprehensive process to capture the inquiries and complaints it receives. Moreover, we found serious issues in SBA's budgeting and accounting for the loans sold, as well as the remainder of the portfolio. For example, SBA incorrectly calculated the accounting losses on the loan sales and lacked reliable financial data to determine the overall financial impact of the sales. In addition, there were significant unexplained declines in the subsidy allowance for the disaster program. We discussed these issues with SBA's auditor who subsequently withdrew its "clean" financial statement audit opinions for fiscal years 2000 and 2001 and disclaimed an opinion for 2002. SBA is continuing to work on resolving its accounting and financial reporting problems. Finally, our analysis of the operational benefits from loan sales suggested that some benefits that SBA reported, such as reductions in servicing and workload volume, either had not yet materialized or were overstated.

Background

When disasters such as floods, tornadoes, or earthquakes strike, federal, state, and local government agencies coordinate to provide assistance to disaster victims. SBA, through its Disaster Loan Program, is part of this effort. SBA provides loans to households and businesses without credit available elsewhere at a maximum rate of 4 percent and up to a 30-year term. For households or businesses with credit available elsewhere, SBA provides loans at a maximum rate of 8 percent and, for businesses, up to a 3-year term. Business loans are available up to $1.5 million,[4] loans for

[4]Even if a business receives a loan to cover both physical damage and economic injury, the total loan amount generally cannot exceed $1.5 million.

physical damage to homes are available up to $200,000, and loans for the repair or replacement of personal property are available up to $40,000.

Like other federal programs, SBA's Disaster Loan Program follows performance measurement guidelines under the Government Performance and Results Act (GPRA) of 1993.[5] GPRA requires agencies to set multiyear strategic goals in their strategic plans and corresponding annual goals in their performance plans, measure performance toward the achievement of those goals, and report on their progress in their annual performance reports.[6] Annual performance plans are sent to Congress soon after the transmittal of the President's budget and provide a direct linkage between an agency's long-term goals and mission and day-to-day activities. Related annual performance reports describe the degree to which performance goals have been met. Guidance from the Office of Management and Budget (OMB) indicates that performance plans should include measures of outcomes—intended results—when the outcomes can be achieved during the fiscal year covered by the plan. Otherwise, the guidance recognizes that the performance plans will predominantly include measures of outputs (program activities) rather than outcomes.

In 1999, SBA began a loan asset sales program, at the direction of OMB, to reduce the amount of debt the agency owned and serviced. OMB is interested in increasing loan asset sales in order to improve the management of loan assets and to transfer loan servicing responsibilities to the private sector. Our review focused on SBA's first five loan sales through January 2002 in which 110,000 loans with an outstanding balance of $4.4 billion were sold. Approximately 85 percent of the dollar volume of loans SBA sold were disaster assistance loans made directly by SBA, most of which have below-market borrower interest rates. The remaining 15 percent were mostly defaulted 7(a) loans, made by SBA's lending partners (primarily banks).

[5]P.L. 103-62, GPRA 1993.

[6]OMB provides guidance on developing these plans in "Preparation and Submission of Strategic Plans, Annual Performance Plans, and Annual Program Performance Reports," Circular No. A-11, Part 6 (Washington, D.C: June 2002).

SBA Expanded and Changed the Terms of Its Disaster Loan Program in Response to the September 11 Attacks

In the weeks and months following the terrorist attacks, SBA and Congress faced the challenge of responding to the lingering effects of the attacks and subsequent federal actions on small businesses throughout the country. SBA responded first in Lower Manhattan, then expanded its response as additional parts of the New York City and Pentagon areas were designated disaster areas. Ultimately, SBA helped small businesses around the country with disaster lending. In response to the concerns expressed by small businesses, SBA and Congress modified the program, expanding eligibility for economic injury loans to small businesses around the country, providing translators for applicants, modifying the size standards for small businesses, expediting the loan approval and disbursement processes, and providing larger loans.

SBA's Response Covered Small Businesses Nationwide

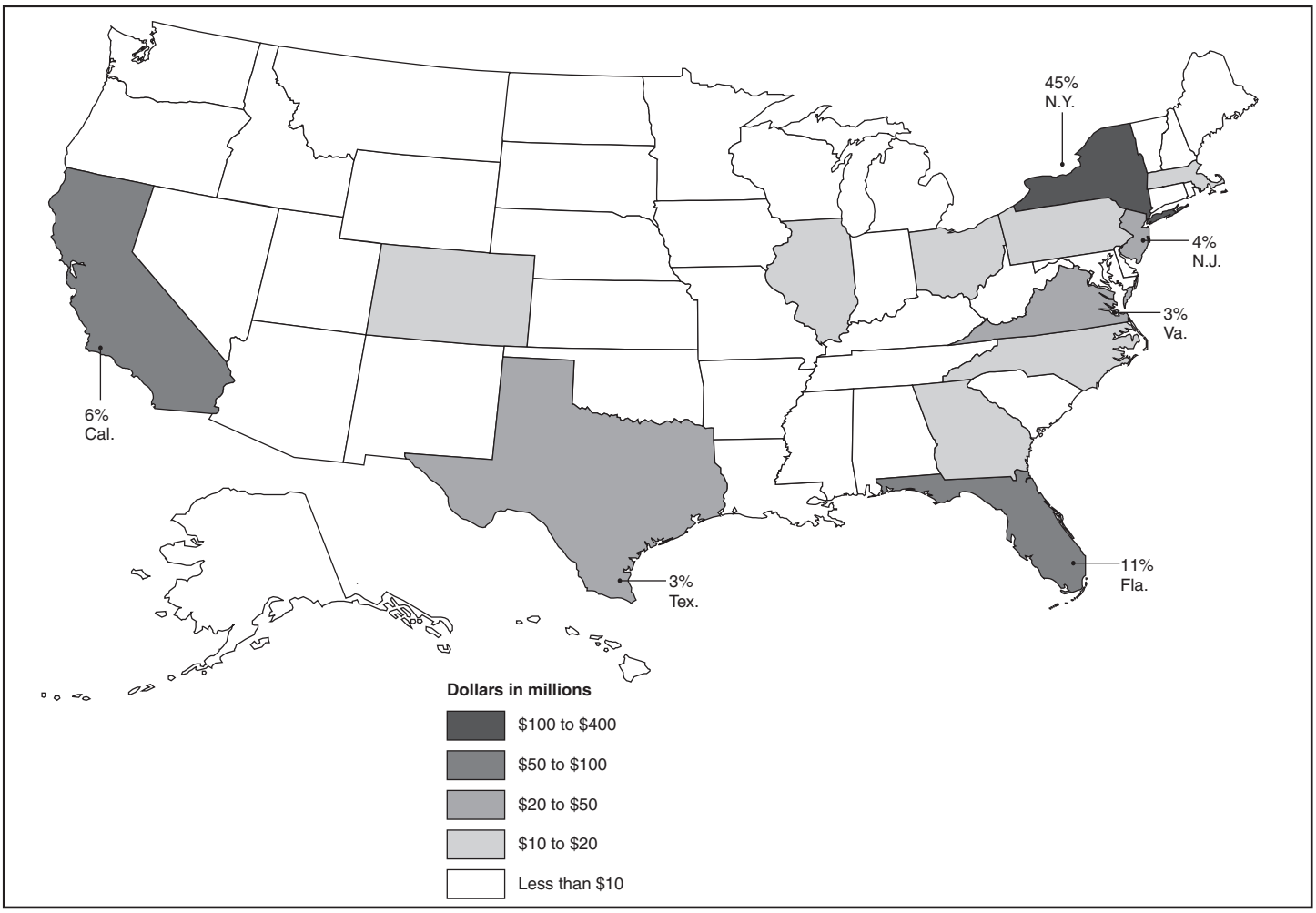
SBA's response to the terrorist attacks began on September 11, when SBA officials arrived in Lower Manhattan to begin coordinating the agency's efforts. The initial disaster area in New York City and New Jersey eventually expanded to include additional counties in Connecticut, Massachusetts, New Jersey, New York, and Pennsylvania. Maryland, Virginia, and parts of the District of Columbia were also declared disaster areas for SBA purposes. As the United States began to deploy military personnel in response to the terrorist attacks, small businesses nationwide affected by the loss of employees called up as military reservists were eligible to apply for a disaster loan under the Military Reservist Economic Injury Disaster Loan (EIDL) program.[7] Small businesses across the nation that were adversely affected by the lingering effects of the attacks and subsequent government action, such as airport closings and the precipitous drop in tourism, were also eligible to receive disaster loans under SBA's Expanded EIDL program. In essence, the entire country was deemed a disaster area.

More than half the loans went to small businesses outside the area of the attack sites in New York City and at the Pentagon, with businesses in Florida and California receiving the second and third largest share of loans (see fig. 1). Loans ranged from $300 to $1.5 million, with $50,000 as the most frequently disbursed amount (11 percent of all loans). Businesses outside the immediate sites of the attacks generally received slightly more than those close by, in part because they did not have access to the

[7]The Military Reservist EIDL program is available to small businesses whenever the government calls military reservists to duty, not just during federally declared disasters.

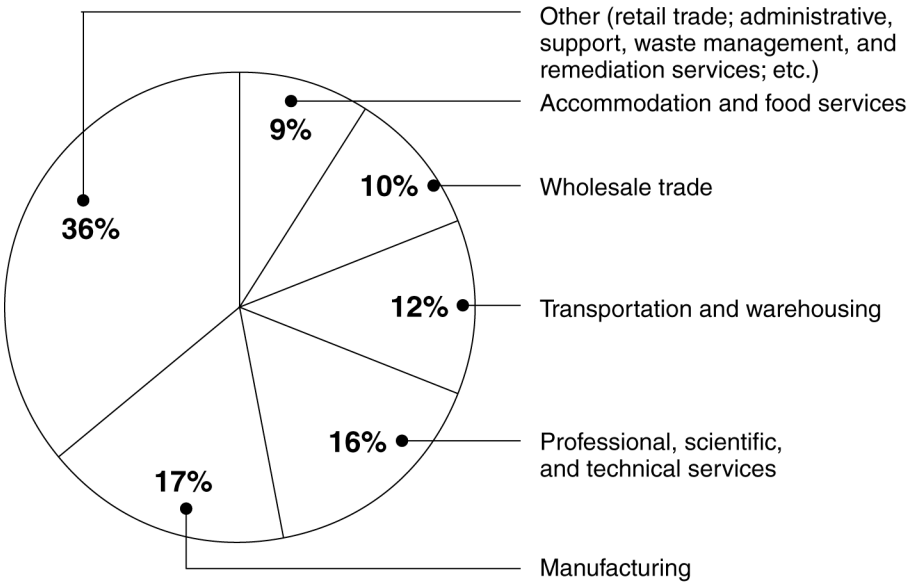
resources available in New York City. The loans were spread among industries, with no single type of business accounting for most of the funds (see fig. 2). The manufacturing sector received the most funds, followed by professional, scientific, and technical services; transportation and warehousing; wholesale trade; and accommodation and food services.

Figure 1: Geographic Distribution of SBA September 11 Loan Disbursements



Source: GAO analysis of SBA data.

Figure 2: SBA September 11 Business Loan Disbursements, By Industry



Source: GAO analysis of SBA data.

SBA and Congress Modified the Disaster Loan Program in Response to Complaints from Small Businesses

In the months after the terrorist attacks, small business owners affected by the terrorist attacks presented a number of concerns to Congress about SBA's Disaster Loan Program. SBA officials regarded these comments as valuable feedback and worked with Congress to make several modifications to the program for September 11 victims:

- First, in October 2001, SBA issued regulations to make economic injury disaster loans available to small businesses nationwide, an unprecedented change to the Disaster Loan Program, according to SBA officials. SBA's Expanded EIDL program enabled businesses outside the declared disaster areas to apply for loans to cover "ordinary and necessary" operating expenses that could not be met because of the attacks or related actions of the federal government between September 11 and October 22, 2001.

- Second, SBA printed informational packets in languages such as Spanish and Chinese; provided multilingual staff at its offices who could speak Mandarin Chinese, Croatian, Arabic, and Spanish; and was prepared to send employees with additional language capabilities to New York City.

- Third, in February 2002, SBA modified the size standards for all September 11 loan applicants, allowing borrowers to take advantage of recent inflation-based adjustments.[8] In addition, in March 2002, SBA increased the size threshold for travel agencies adversely affected by the attacks from $1 million in annual revenues to $3 million.

- Fourth, to expedite loan processing, loan officers streamlined their needs analysis, calculating economic injury loans using the applicant's annual sales and gross margin. By the end of fiscal year 2002, SBA was processing September 11 business loans, on average, in 13 days compared with 16 days for disaster assistance business loans processed in fiscal year 2001. To further expedite disbursement to those in the World Trade Center and Pentagon disaster areas, SBA decreased the amount of documentation needed to disburse up to $50,000.

- Fifth, in January 2002, Congress approved supplemental appropriations for SBA of $150 million, raised the maximum loan amount from $1.5 million to $10 million, and deferred payments and interest for 2 years.[9] Congress also created the Supplemental Terrorist Activity Relief (STAR) program to provide assistance to small businesses affected by the terrorist attacks through SBA's 7(a) loan guaranty program, which is not part of the Disaster Loan Program. Under the STAR program, SBA reduced the fee charged to lenders on new 7(a) loans from 0.50 percent of the outstanding balance of the guaranteed portion of the loan to 0.25 percent. As of the end of fiscal year 2002, SBA had guaranteed about 4,700 STAR loans for $1.8 billion.

Some small businesses affected by the terrorist attacks maintained that SBA's underwriting criteria—for example, collateral requirements—were too restrictive. They testified that SBA had withdrawn their applications because they would not use their homes as collateral. They argued that it was too risky to use their homes as collateral, especially since the survival of their businesses was uncertain. SBA, however, did not change its underwriting criteria for September 11 victims. SBA officials said that the

[8]In January 2002, SBA increased the revenue-based thresholds for determining the size of businesses by the rate of inflation. In February 2002, SBA retroactively applied the inflation-adjusted size standards to all businesses applying for September 11 loans, allowing more businesses to seek assistance.

[9]*Emergency Supplemental Appropriations for Recovery and Response to Terrorist Attacks on the United States Act*, 2002 P.L. 107-117 (Emergency Supplemental Act of 2002).

agency makes every effort to approve each application by applying more lenient credit standards than private lenders. However, the officials said that they adhered to their credit standards to minimize losses and program costs.

SBA data indicate that the 52 percent rate for withdrawing and declining September 11-related loan applications was not out of line when compared with other disasters or with private lenders. The primary reasons SBA identified for withdrawing September 11 loan applications was a lack of Internal Revenue Service (IRS) records to corroborate applicants' income, and applicants' failure to provide additional information SBA had requested. SBA officials said that the most common reasons for declining September 11 loan applications were inability to repay the loan and unsatisfactory credit. According to SBA, these were also the primary reasons for withdrawing or declining nearly two-thirds of all SBA disaster loan applications in fiscal year 2001.

SBA officials believed that many of the complaints about the disaster program resulted from the mismatch between victims' expectations of SBA's disaster program and the nature of the program. SBA officials told us that they tried to minimize public confusion about the nature of the assistance available from SBA by working closely with the media and public officials to provide accurate information about the Disaster Loan Program.

SBA's Disaster Program Performance Measures Do Not Capture the Scope of the Agency's Efforts

The six performance indicators SBA currently uses to measure the Disaster Loan Program are

- field presence within 3 days of a declaration,[10]
- loans processed within 21 days,
- customer satisfaction rate,
- homes restored to predisaster condition,

[10]Federal assistance, including all types of SBA disaster loans, is available once the President declares that a major disaster or emergency situation exists. Governors may request a disaster declaration from SBA if damage is minor or moderate and a declaration from the Department of Agriculture if losses are confined to agricultural production. SBA offers only economic injury loans in these last two situations.

- businesses restored to predisaster condition, and
- initial loan disbursement within 5 days of receiving closing documents.

We identified several problems with these measures. For example, several are output measures that did not reflect the actual progress being made. Some are proxies that did not accurately represent what was being measured. There is a lack of measures for intermediate or end outcomes, and features in SBA's description of the Disaster Loan Program in its performance plans made assessing the program difficult. Several of the limitations we found had been identified in previous GAO or SBA Inspector General reports and had not been corrected.[11]

Three Output Measures Do Not Capture Progress

Officials from SBA's Disaster Area Offices (DAO) questioned whether the three output measures—establishing a field presence within 3 days of a disaster declaration, processing loan applications within 21 days, and disbursing initial loan amounts within 5 days of receiving the closing documents—were appropriate indicators of timely service to disaster victims since they did not, for example, capture recent program improvements. SBA has had a 98 percent success rate in meeting the target for establishing a field presence each fiscal year since 1998. Officials from the area offices said that improvements in planning, interagency coordination, and technology enabled them to have staff on site within 1 day of a disaster declaration. According to DAO staff, delays in establishing a field presence generally occurred because SBA was waiting for decisions from state officials.

SBA data and comments from DAO officials suggested that the second output measure—processing loan applications within 21 days of receipt—did not reflect improvements in past performance. For example, SBA aimed for an 80 percent success rate for fiscal year 2001, but the actual time required for processing averaged 13 days in fiscal year 2001 and fell to 12 days in fiscal year 2002. The average time required to process the

[11]See U.S. General Accounting Office, *Managing for Results: Opportunities for Continued Improvement in Agencies Performance Plans*, GAO/GGD-99-215 (Washington, D.C.: July 20, 1999); *Small Business Administration: Status of Achieving Key Outcomes and Addressing Major Management Challenges*, GAO-01-792 (Washington, D.C.: June 22, 2001); and *Final Audit Report—Results Act Performance Measurement for the Disaster Assistance Program*, Small Business Administration, Office of the Inspector General, Audit Report 1-06 (Feb. 15, 2001).

September 11 business loans was also about 13 days. DAO officials attributed their faster processing times to several agencywide improvements.

DAO staff also suggested that another measure—the 5-day target for making initial disbursements once closing documents are received—did not reflect past performance and was a low threshold. Before 2002, SBA had an internal goal of ordering disbursements within 3 days of receiving closing documents. When SBA included this measure in the performance plan, the disbursement target was increased to 5 days to accommodate weekends and holidays, because SBA's system for tracking disaster loan processing could not distinguish between workdays and other days. Accustomed to the stricter 3-day standard, staff were able to meet the 5-day standard with ease.

In commenting on a draft of our report, SBA indicated that the output measures were established based on what was determined to be a reasonable level of service in an average year, taking into account the amount of resources required. Because disasters cannot be predicted, officials did not think it would be feasible to adjust production levels based on a single year's performance. Even with some program improvements, they believed it would be very difficult and costly to maintain such levels during periods of multiple major disasters. Although SBA acknowledged that a basis for modifying some output measures might exist, the officials believed that the modifications should be based on an average level of projected activity that takes into consideration some permanent improvements that have been made to the program.

Two "Outcome" Measures Actually Assessed Outputs

SBA officials indicated that three measures—number of homes restored to predisaster condition, number of businesses restored to predisaster condition, and customer satisfaction—were used to assess the effect, or outcomes of lending to disaster victims. But these "outcome" measures also had limitations. First, while the restoration of homes and businesses was a stated outcome in SBA's strategic and performance plans, SBA did not actually measure the number of homes and businesses restored. Instead, SBA reported on the number of home loans approved as a proxy measure for the number of homes restored to predisaster condition. However, these measures assessed what are actually program outputs (loans approved) rather than stated outcomes (homes and businesses restored). Such proxy measures, then, were likely to have overestimated the number of homes and businesses restored because borrowers might cancel the loan. According to SBA, about 10 percent of the loans approved

for September 11 victims were cancelled by borrowers. Third, these indicators used annual figures that were affected by factors outside of SBA's control, such as the number of disasters that occurred during a given fiscal year. A more useful indicator would be the percentage of homes and businesses receiving loans that were restored each year to pre-disaster conditions.

To measure customer satisfaction, SBA used the results of its survey of successful loan applicants. (SBA also used this survey to evaluate the impact of the program.) But the survey methodology had significant limitations. For example, it measured the satisfaction of only a portion of the customers that the disaster loan program serves. Every DAO director we interviewed indicated that all disaster victims were SBA customers and that a broader population should be surveyed. In 2001, we and the SBA Inspector General made the same suggestion to SBA. As we indicated then, the survey method SBA had been using was likely to produce positively skewed responses. SBA headquarters officials indicated that they were resistant to surveying those who were denied loans because they presumed that the applicants' responses would be negative.

Some Measures Did Not Assess Intermediate or End Outcomes

Recommendations from SBA's Inspector General, and guidance from us and within SBA, have encouraged the use of outcome measures for this program. But we found that only one of the performance measures SBA was using—customer satisfaction—had the potential to assess a stated outcome of the Disaster Loan Program. The other intended outcomes, which could have been measured annually or biannually, such as jobs retained or housing restored, were not measured.

In addition, SBA had stopped using intermediate outcome measures it had used in the past—loan currency and delinquency rates—to assess the quality of disaster loans. It also had not measured another potential intermediate outcome from the underwriting process—having appropriate insurance. As one DAO official suggested, having coverage such as flood insurance potentially reduces the number of loans required in some disaster-prone areas. As we have reported previously, such insurance can reduce disaster assistance costs and could reduce the effect of a disaster on its victims.[12]

[12]U.S. General Accounting Office, *Disaster Assistance: Information on Federal Costs and Approaches for Reducing Them*, GAO/T-RECD-98-139 (Washington, D.C.: Mar. 26, 1998).

SBA headquarters staff said that while they recognized some of these shortcomings, they had limited ability to develop and use better outcome measures. The staff indicated that the very nature of disaster lending was unpredictable, making it difficult to set performance targets for intermediate or end outcomes. One SBA official said that the agency is reluctant to measure and report intermediate or end outcomes that are outside its control. Other DAO officials indicated that conducting some end outcome measurement methodologies would be expensive—for instance, on-site inspections of a sample of homes and businesses to assess restoration.

We made two recommendations designed to help SBA improve its performance measures for disaster lending. First, we recommended that SBA revise the performance measures to include more outcome measures; assess more significant outputs, such as service to applicants or loan underwriting; report achievements that can be compared over several years, such as percentages; and include performance targets that encourage process improvement rather than maintaining past levels of performance. Second, we recommended that SBA revise and expand its current research to improve its measures and evaluate program impact. To improve its current measures, we suggested that SBA conduct research, such as surveying DAO staff and reviewing relevant literature to identify new outcome measures that could be tested. To evaluate its program impact, SBA needs to ensure that its survey covers all disaster loan applicants and to employ other methods, such as periodic analyses of regional statistics, to assess the economic impact of the program on local communities. SBA generally agreed with our recommendations and said it is addressing our concerns. As of this month, SBA had distributed a customer service survey to help evaluate the Disaster Loan Program's impact and was developing a broader survey. We will follow up with SBA regarding the status of their efforts.

SBA's Performance Plans Had Limitations

We identified several features of the description of the Disaster Loan Program in the 2002 and 2003 performance plans that make it difficult to assess whether SBA is making progress in attaining its strategic goal. First, between 2002 and 2003, the program's performance goal changed from an outcome-oriented goal (helping families recover from disasters) to an output-oriented goal (streamlining disaster lending) without the required explanation. GPRA requires agencies to explain why they change performance goals, and OMB generally recommends that agencies use goals that are outcome-oriented.

Second, the 2002 and 2003 performance plans do not define the linkages between each program output and each intermediate or end outcome. The plans do not explain how the outputs (disaster loans) are related to the performance indicators (field presence, customer satisfaction, and application processing time frames). Third, the plans do not explain how the performance measures or indicators are related to either program outcomes or outputs. Fourth, performance indicators are added to or dropped from the plans without explanation, making it difficult to understand how and if SBA expects to improve or sustain its loan processing performance.

The performance plans also contain incomplete or inaccurate information on some performance indicators. For example, despite OMB and SBA guidance, validation and verification information on field presence and loan processing measures is omitted, making it difficult to assess the quality of performance data. In addition, the 2003 performance plan indicates that data on the number of homes restored to predisaster condition are based on on-site inspections of homes. However, SBA officials indicated that they use a proxy measure—the number of original home loans approved—as the actual source of data for homes restored to predisaster condition.

We recommended revising the section of the performance plan that covers the Disaster Loan Program to establish direct linkages between each output and outcome and the associated performance measure; accurately describe proxy measures as either outcome or output measures; accurately describe the validation and verification of performance measures; and explain additions, deletions, or changes from the previous year's goals and measures. SBA also agreed with this recommendation. SBA informed us this month that it has undertaken a long-term review of the strategic plan with the aim of revising the performance goals and measures and linking performance to the new plans and goals. We will monitor SBA's progress in implementing this initiative.

Loan Assets Sales Affect Disaster Loan Borrowers and the Loan Program

A large portion—85 percent in the first 5 sales—of the loans sold are disaster loans previously serviced by SBA. SBA's program to sell disaster loans that it makes directly to borrowers and subsequently services results in private investors owning and servicing the loans over their remaining terms. It was difficult for us to determine the reaction of borrowers whose loans were sold because of incomplete records at SBA. We identified numerous errors in SBA's accounting for the loan sales, including unexplained declines in SBA's loss allowance account for disaster loans.

Until corrected, these errors mean that SBA's subsidy estimates and reestimates for the disaster loan program cannot be relied upon. The operational benefits from selling loans that SBA has claimed may be overstated.

Information on How Selling Disaster Loans Affects Borrowers Is Incomplete

SBA built in some safeguards to protect borrowers when their loans are sold. But, because SBA's process for documenting and tracking borrower inquiries and complaints has weaknesses, we could not determine how many borrowers had actually contacted SBA with complaints or concerns about the loan sales.

Borrowers have little control over what happens to their loans if SBA decides to sell them. However, SBA has some policies intended to protect the integrity of the programs that provided the loans. SBA's programs, including servicing disaster loans after they are made, are designed to help the borrower recover from a disaster. To protect this public policy goal, SBA's loan sales agreements with purchasers require certification that the investors are qualified to purchase and service the loans and will follow prudent loan servicing practices. The loan sales agreement also prevents purchasers from unilaterally changing the terms and conditions of the loans. In addition, SBA does not sell some disaster loans, including those issued to borrowers currently residing in a federally declared disaster area and those that are less than 2 years old. According to SBA, more servicing is typically required in the first 2 years of a disaster loan—such as changes due to revised physical damage estimates.

Nevertheless, we were not able to validate the way in which borrowers reacted to the loan sales because SBA could not provide a reliable estimate or information on the number of borrowers who had contacted them about their sold loans. Complete and reliable information on borrower complaints is important because SBA officials told us that when a borrower complained about a servicing action they contacted purchasers to collect additional information and determine whether a purchaser was breaching the borrower protections. One reason why SBA's tracking system is ineffective is that borrowers with questions or complaints can call or write to several different SBA offices, or to a representative of Congress. Some SBA field office officials told us that SBA does not provide them with clear guidance on how to respond to or document such complaints. Officials from seven district offices, three servicing centers, and two disaster area offices told us that they had received calls and letters from borrowers who had concerns about loans that had been sold. But the methods for documenting inquiries and complaints varied across

offices, except for congressional letters, which were consistently forwarded to SBA headquarters. In August 2001, SBA began providing a toll-free number for borrowers to call with questions or complaints about loan sales. Borrowers were informed about the toll-free number in a letter telling them how to contact the new owner of their loan. However, field office staff did not receive any guidance regarding the purpose and use of the toll-free number.

Though we were unable to determine how many borrowers have contacted SBA about their sold loans, we reviewed 133 of the 155 written inquiries and complaints documented at headquarters, along with SBA's written responses, to identify the types of questions and problems borrowers may have when their loans are sold. Our analysis showed that almost half (65) were inquiries and concerns about their loans being sold, requests to buy their own loans, or pleas not to have their loans sold. However, 47 of the borrowers complained about a purchaser's servicing action. For example, some letters involved disagreements or frustration with servicing decisions, such as refusing to subordinate or release collateral,[13] or imposing a fee to complete a servicing action such as subordination. Another 18 letters were from borrowers who wanted to defer payments or change the amount of their monthly payments because of financial problems, and felt they were not getting appropriate treatment from the purchasers of their loans.

To address these weaknesses in the loan sales program, we recommended that SBA develop procedures for documenting and processing inquiries and complaints from borrowers, and then provide guidance to the field offices about implementing them. SBA reported to Congress in March 2003 that it would soon issue a procedural notice to its field offices providing a uniform process for handling borrower inquiries and complaints. SBA stated that it also intends to establish an e-mail account for use by all employees to record and forward borrower comments to the asset sales team at headquarters, establish a database to track borrower comments, and enhance a tracking system used for residential borrower inquiries at a servicing center. We will follow up with SBA to monitor its implementation of our recommendations.

[13]"Subordination" occurs when a lender allows a new or existing loan to take a superior lien to another loan. For example, a borrower with an SBA disaster home loan may want SBA or a lender to subordinate the disaster loan to a new or refinanced home mortgage.

SBA's Accounting for Loan Sales and the Remaining Portfolio Was Flawed

During our review, we found errors that we believe could have significantly affected the reported results in the budget and financial statements for fiscal years 2000 and 2001. Because of errors we identified, SBA's auditor withdrew its clean audit opinions for those years and issued disclaimers of opinion. Moreover, because of these and other financial management issues, the auditor has disclaimed an opinion on SBA's financial statements for 2002. Although this roundtable is not intended to explore the intricacies of accounting, I will briefly comment on our findings, which are fully discussed in the report and testimony cited previously.[14]

SBA incorrectly calculated the accounting losses on the loan sales and lacked reliable financial data to determine the overall financial impact of the sales. Further, because SBA did not analyze the effect of loan sales on its remaining portfolio, its reestimates of loan program costs for the budget and financial statements cannot be relied upon. In addition, SBA could not explain significant declines in its loss allowance account for disaster loans. Until SBA corrects these errors and determines the cause of the precipitous decline in the loss allowance account, the subsidy estimates and reestimates for the disaster loan program cannot be relied on. These errors and the lack of key analyses also mean that congressional decision makers are not receiving accurate financial data to make informed decisions about SBA's budget and the level of appropriations the agency should receive.

We recommended that, before doing more loan asset sales, SBA correct the accounting and budgeting errors and misstatements. And that SBA's Inspector General, with SBA's independent auditors, should assess the impact of the identified errors and determine if the prior audit opinions need to be revised. SBA is working to respond to these recommendations and, as we noted above, the auditor has withdrawn the previously issued clean audit opinions because they could not be relied upon. We will be monitoring SBA's continuing efforts to resolve these issues.

[14] GAO-03-87 and GAO-03-676T.

Loan Sales Have Reduced SBA's Loan Servicing Volume, but Other Operational Benefits May Be Overstated

SBA reported that loan asset sales had benefited the agency's operations by reducing loan servicing, and that this reduction in loan servicing volume should help allocate resources to other areas necessary to achieving SBA's mission and help the agency to manage its loan portfolio more effectively. Though we found that loan servicing volume had declined for SBA disaster home loan centers, the effect on regular business loans was less clear. Furthermore, despite these reductions in loan servicing volumes, SBA had not yet redeployed staff to more mission-critical activities, such as lender oversight and business outreach. We found that loan sales have mostly reduced the servicing workloads for disaster assistance loans. They have had less impact on servicing workloads for 7(a) business loans, because lenders did not always consent to sell these loans. Because the reduction in loan servicing has involved disaster assistance loans, it was unclear to what extent loan sales would help the agency realign its workforce in the district offices that primarily serve small businesses.

SBA has also reported that the loan sales have prompted borrowers to pay their loans in full, revealed inconsistencies in the application of the agency's servicing procedures, and highlighted weaknesses in its information system. We found some support to show that the loan sales had produced portfolio management efficiencies. But we also found that some of the benefits SBA had reported began before the loan sales program, or could have been caused by other factors. For example, borrowers of disaster loans who refinanced their homes while lower interest rates were available often paid off their disaster loans, even though their disaster loans had low interest rates.

To provide Congress and SBA with a better understanding of the impact of loan sales on SBA's operations, we recommended that SBA conduct a more comprehensive evaluation of the loan sales' impact on the agency and the cost savings from the sales. SBA recently stated that it will conduct such an evaluation.[15] We will follow up with SBA as it addresses our recommendation.

Madam Chair, Members of the Committee, this concludes my prepared statement. I would be happy to answer any questions at this time.

[15]Hector V. Barreto, Administrator, Small Business Administration, Letter to The Honorable Susan Collins, Chair, Committee on Government Affairs, U.S. House of Representatives, March 7, 2003.

Contacts and Acknowledgments

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