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United States General Accounting Office
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Accounting and Information
Management Division

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November 30, 1999

The Honorable Stephen Horn
Chairman, Subcommittee on Government
Management, Information and Technology
Committee on Government Reform
House of Representatives

The Honorable Christopher Bond
Chairman
Committee on Small Business
United States Senate

Subject: The Small Business Administration: Loan Origination and Debt Collection Processes

This letter summarizes the information provided during October 14 and October 18, 1999, briefings to your offices. You had asked us to determine the extent to which the Small Business Administration (SBA) has established (1) adequate loan origination procedures and consistently obtains the required documents and data necessary for determining whether loan applicants comply with the program's statutory, regulatory, and eligibility requirements and have any outstanding, delinquent federal debt and (2) a systematic process for identifying and collecting delinquent debts, including a prompt referral of delinquent debts to the Department of the Treasury for offset and cross-servicing programs.

As agreed, we reviewed three of SBA's loan programs: the 7(a) Loan Guaranty Program, the Disaster Home Loan Program, and the Disaster Business Loan Program. The 7(a) Loan Guaranty Program, one of SBA's primary programs, serves small business borrowers who lenders believe otherwise would not be able to secure financing on reasonable terms. Private sector lenders are given authority to determine eligibility and to approve loans without prior SBA review for over 70 percent of 7(a) loans. Under the program, SBA provides guarantees of up to 80 percent on loans made by participating lenders. The Disaster Home Loan Program provides disaster assistance through direct loans to victims of federally declared disasters, while the Disaster Business Loan Program provides such assistance to qualified businesses affected by federally declared disasters. Together, these three programs comprise about 73 percent of SBA's direct and guaranteed loan portfolio as of July 31, 1999.

loan applicants. In our June 1998 report,[2] we identified problems with lender oversight of the 7(a) Loan Guaranty Program. According to SBA officials, since that work was conducted, SBA has implemented an oversight program for preferred lenders and has developed and begun to implement oversight for other 7(a) Loan Guaranty Program delivery methods. Lender reviews for these other loan delivery methods were scheduled to begin during the first quarter of fiscal year 2000.

In our work on debt collection for the Disaster Home Loan Program and our review of a recent SBA Office of Inspector General report on debt collection for the 7(a) Loan Guaranty and Disaster Business Loan programs, we found that SBA has established procedures to guide its in-house collection of disaster and 7(a) guaranteed loans that are consistent with DCIA requirements. These procedures include periodically sending notices of delinquency, periodically contacting borrowers, and providing opportunities for loan restructuring. Referral to Treasury for offset and cross-servicing are two methods that are to be used when others fail.

With the exception of referral to Treasury for offset and cross-servicing, SBA's internal procedures for collecting delinquent disaster loans and 7(a) guaranteed loans were consistently applied. However, limited use was made of referral to Treasury for administrative offset, and delays existed in transferring delinquent loans to Treasury for cross-servicing. For example, for delinquent Disaster Home loans we examined, we found loans that were between 260 and 1,163 days delinquent that had not been transferred to Treasury for cross-servicing.

According to SBA officials, delays in the referral of delinquent debt to Treasury for administrative offset occurred with the Disaster Home Loan Program because SBA's automated systems were not properly identifying loans eligible for offset, and those that were identified could not be processed at Treasury because the SBA and Treasury computer systems were not compatible. With regard to the 7(a) Loan Guaranty and Disaster Business Loan programs, SBA officials stated that referrals for administrative offset were not occurring because SBA did not have an automatic process for identifying eligible loans. Rather, loan officers were referring individual cases as they came to their attention. SBA officials told us that they (1) worked with Treasury to correct the compatibility problems for the Disaster Home Loan Program, (2) corrected the problems that were causing the Disaster Home Loan Program's automated system to not properly identify loans eligible for offset, and (3) have fully implemented an automated offset referral system for the 7(a) Loan Guaranty and Disaster Business Loan programs. SBA officials told us they have not yet tested these systems to ensure that they are working effectively.

With regard to transferring delinquent loans to Treasury for cross-servicing, SBA officials stated they have an understanding with Treasury that SBA will not transfer loans more than 180 days delinquent for cross-servicing if SBA is still actively pursuing collection. In a letter dated March 26, 1999, SBA formally requested from

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[2] *Small Business Administration: Few Reviews of Guaranteed Lenders Have Been Conducted* (GAO/GGD-98-85, June 1998).

We conducted our work from April 1999 through October 1999 in accordance with generally accepted government auditing standards. We requested comments on a draft of our briefing slides from SBA officials, who generally agreed with the information and the recommendations in the slides. We incorporated their comments as appropriate.

We are sending copies of this letter to the Honorable Jim Turner, Ranking Minority Member, Subcommittee on Government Management, Information and Technology, House Committee on Government Reform; the Honorable John F. Kerry, Ranking Minority Member, Senate Committee on Small Business; the Honorable Aida Alvarez, the Administrator of the Small Business Administration; the Honorable Lawrence H. Summers, the Secretary of Treasury; and the Honorable Jacob J. Lew, the Director of the Office of Management and Budget. Copies will also be made available to others upon request.

If you have any questions about this letter or the briefings, please contact me at (202) 512-9508 or Shirley Abel, Assistant Director, at (202) 512-9516. Key contributors to this assignment were Carol Browder and Julia Duquette.

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Linda M. Calbom
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Enclosure

(913877)

GAO Accounting and Information Management Division

Briefings to the Subcommittee on Government Management, Information, and Technology, House Committee on Government Reform and the Senate Committee on Small Business

The Small Business Administration's Loan Origination and Debt Collection Processes

October 14, 1999
and October 18, 1999

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Contents

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Objectives

To determine the extent to which SBA has established:

(1) adequate loan origination procedures and consistently obtains the required documents and data necessary for determining whether loan applicants comply with the program's statutory, regulatory, and eligibility requirements and have any outstanding, delinquent federal debt and

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Objectives

(2) a systematic process for identifying and collecting delinquent debts, including a prompt referral of delinquent debts to Treasury for cross-servicing and offset programs.

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Background

- 7(a) Loan Guaranty Program
    - Is one of SBA's primary programs, with 182,646 loans totaling $22.5 billion outstanding as of July 31, 1999.
    - Provides loans to small businesses unable to secure financing in the commercial marketplace without SBA's guarantee.
    - Uses a variety of loan delivery methods.

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Background

- Has delegated loan approval authority to the lenders for over 70 percent of 7(a) loan approvals.

- Uses lender oversight as the primary internal control.

Background

- Disaster Assistance Program - Homes and Personal Property

  - 204,455 loans totaling $3.3 billion outstanding as of July 31, 1999.

  - Provides disaster assistance through direct loans to victims of federally declared disasters.

  - Proceeds may be used to restore primary residences or repair or replace clothing, furniture, cars, etc.

Background

- Disaster Assistance Program - Businesses

  - 69,784 loans totaling $3.6 billion outstanding as of July 31, 1999.

  - Provides disaster assistance through direct loans to qualified businesses that suffer physical or economic injury resulting from federally declared disasters.

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Background

- Proceeds may be used to replace or repair business property or to pay recurring operating expenses during business interruptions.

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Overview of Applicable DCIA Requirements

- The DCIA was enacted in April 1996 to facilitate collection of delinquent non-tax debt owed to the federal government. DCIA provides that:

  - An entity with outstanding debt with any federal agency (other than IRS) in a delinquent status generally cannot obtain federal financial assistance in the form of a loan. Disaster programs are exempt from this requirement.

  - Agencies shall take appropriate steps to collect delinquent debt.

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Overview of Applicable DCIA Requirements

- Agencies shall notify Treasury of debt that is more than 180 days delinquent for administrative offset.

- Agencies shall transfer debt that is more than 180 days delinquent to Treasury for cross-servicing.

- Certain debts are exempt from referral to Treasury.

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Scope and Methodology

- Loan Origination
  - Focused on 7(a) loans guaranteed between October 1, 1998 and March 31, 1999.
  - Reviewed applicable SBA policies and procedures.
  - Discussed lender oversight with SBA officials.

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Scope and Methodology

- Selected and reviewed a nationwide statistical sample of 99 loans to determine if documentation in the SBA loan files supported applicant eligibility.

- Did not go to lender locations to review lender files or reperform the lenders' underwriting procedures.

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Scope and Methodology

- Delinquent Debt Collection
  - Disaster Home Loan Program
    - Reviewed disaster home loans that were more than 180 days delinquent as of March 31, 1999.
    - Reviewed applicable SBA policies and procedures.
    - Discussed delinquent loan collection procedures with SBA officials.

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Scope and Methodology

- Selected and reviewed a nationwide statistical sample of 99 delinquent loans to determine whether SBA:

  - took appropriate steps to recover delinquent debt,
  - referred debt delinquent more than 180 days to Treasury for offset, and
  - transferred debt delinquent more than 180 days to Treasury for cross-servicing.

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Scope and Methodology

- Delinquent Debt Collection
  - 7(a) and Disaster Business Loan Programs
    - Relied on the SBA OIG's July 1999 audit that included a statistical sample of 88 loans.
    - Reviewed the SBA OIG's audit workpapers and determined that we could rely on the results of the audit.

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Scope and Methodology

- Obtained and incorporated agency comments as appropriate.

- Conducted review in accordance with generally accepted government auditing standards between April and October 1999.

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Findings--Loan Origination

- SBA has established adequate internal procedures and consistently documents those procedures to determine whether loan applicants comply with eligibility requirements and have any outstanding, delinquent federal debt.
  - Depending on type of loan delivery system, these procedures require SBA to maintain different types of documentation. For example,
    - Loans that are approved by SBA district offices require extensive documentation.
    - Low documentation loans that are approved by lenders require only a one-page application.

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Findings--Loan Origination

- Required documentation was available in SBA's loan files in 97 of 99 cases.
  - In 1 case, a low documentation loan was approved even though the borrower had a 1989 bankruptcy, counter to SBA policy for low documentation loans.
  - In 1 case, the borrowers were married and although the husband's criminal history statement was signed, the wife's was not.

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Findings--Loan Origination

- SBA and lenders consistently screened loan applicants for any outstanding delinquent federal debt using credit reports, but did not use the required Credit Alert Interactive Voice Response System (CAIVRS).[1]
  - Use of CAIVRS to screen for outstanding delinquent federal debt is required by OMB Circular A-129.

[1]CAIVRS is an automated database, maintained by the Department of Housing and Urban Development (HUD), that identifies individuals who are delinquent on federal debts.

Findings--Loan Origination

- According to SBA officials, SBA does not use CAIVRS because its computer link with CAIVRS has never worked properly and obtaining CAIVRS information for each loan by telephone is too time-consuming. As a result, loan officers rely on credit reports.

  - The law requires federal agencies to report delinquent debt to credit reporting bureaus before discharging the delinquent debt.

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Findings--Loan Origination

- Since the lender, not SBA, makes the decision on creditworthiness in most cases, lender oversight by SBA is essential to ensure adequate screening of loan applicants.
    - In our June 1998 report,[1] we identified problems with 7(a) lender oversight and recommended that SBA establish a mechanism for ensuring that regular periodic reviews of lender compliance are conducted.

[1] Small Business Administration: Few Reviews of Guaranteed Lenders Have Been Conducted (GAO/GGD-98-85).

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Findings--Loan Origination

- According to SBA officials since that work was conducted, SBA has implemented an oversight program for preferred lenders and has developed and begun to implement an oversight program for other loan delivery methods, including policies and procedures. Lender reviews for the other loan delivery methods will begin in the first quarter of fiscal year 2000.

Findings--Debt Collection

- Disaster Home Loan Program
  - SBA has established internal procedures to guide its in-house collection activities that are consistent with DCIA requirements.
    - Delinquent borrowers are to receive periodic notices of delinquency and telephone calls.
    - Delinquent borrowers are to be given opportunities to restructure loans and defer payments as necessary.

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Findings--Debt Collection

- Foreclosure, litigation, wage garnishment, and referral to Treasury for cross-servicing and offset are to be used when other methods fail.

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Findings--Debt Collection

- With the exception of referral to Treasury for offset and cross-servicing, SBA's internal collection procedures were consistently applied in 95 of 99 cases.
  - In 2 cases, borrowers received only initial delinquency notices.
  - In 2 cases, internal procedures were initially applied, but no follow-up efforts had been made in approximately 1 year.

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Findings--Debt Collection

- Limited use was made of referral to Treasury for administrative offset.
  - Of the 56 loans in our sample that met the criteria for referral to Treasury for administrative offset, only 12 had been referred.

GAO Findings--Debt Collection

- According to SBA officials, SBA's automated systems–which should identify loans eligible for offset and refer them to Treasury–were not working properly. Also, SBA officials stated that compatibility issues existed between SBA's and Treasury's computer systems and that SBA has actively worked with Treasury to address and correct these problems.

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Findings--Debt Collection

- Serious delays existed in transferring delinquent loans to Treasury for cross-servicing.
    - Of the 56 loans in our sample that were eligible for cross-servicing, the transfer process had not been initiated for 21.
        - These 21 loans were between 260 and 1,163 days delinquent.[3]

[3]The average number of days delinquent was 545.

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Findings--Debt Collection

- The 35 loans in the transfer process were not transferred following DCIA's required 180 day time frame.
  - These 35 loans were between 247 and 1,188 days delinquent.[4]

[4]The average number of days delinquent was 474.

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Findings--Debt Collection

- According to SBA officials, SBA has an understanding with Treasury that it will not transfer loans more than 180 days delinquent for cross-servicing if SBA is still actively pursuing collection.

- SBA has formally requested from Treasury an exemption from transfer for cross-servicing of SBA loans more than 180 days delinquent that are not otherwise specifically exempted from transfer. The request is still pending.

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Findings--Debt Collection

- Once SBA identifies a loan as uncollectible, the required charge-off processes may take several months before the loan can be transferred to Treasury for cross-servicing.

    - Charge-off procedures include determining the borrower's financial condition, documenting collection efforts, including efforts to compromise the debt, and performing an asset search. SBA must also ensure that the debt is still legally enforceable.

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Findings--Debt Collection

- SBA sends a 60-day "due process" notice to the borrower stating that the loan may be transferred to Treasury if not paid. The loan is transferred to Treasury after this 60-day period.

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Findings--Debt Collection

- 7(a) and Disaster Business Loan Programs.
  - SBA OIG had similar findings:
    - With the exception of referral to Treasury for offset and cross-servicing, SBA's internal collection procedures were consistently applied in 81 of 88 sample cases.
    - Of the 88 loans in the OIG's sample, 22 were eligible but had not been referred for offset or cross-servicing.

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Findings--Debt Collection

- In its response to the SBA OIG's findings, SBA officials stated that 14 of the 22 cases had either been referred to Treasury or were exempt from referral subsequent to the OIG's review. The remaining 8 should have been referred but were not.

- According to SBA officials, the 7(a) and Disaster Business Loan systems did not automatically identify loans eligible for offset and refer them to Treasury. Loan officers were manually identifying and referring individual cases as they came to their attention.

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Findings--Debt Collection

- According to SBA officials, during August 1999, SBA fully implemented an automated administrative offset referral system for its 7(a) and Disaster Business Loan programs.

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Recommendations

- In order to comply with DCIA requirements, we recommend that SBA :

    - test SBA's systems to verify they are working effectively to identify and refer eligible Disaster Home, Disaster Business, and 7(a) loans to Treasury for administrative offset as soon as they become more than 180 days delinquent.

GAO Recommendations

- Develop procedures that will allow uncollectible loans to be identified and transferred to Treasury for cross-servicing within the required time frames or for those loans on which they are still actively pursuing collection at the 180-day mark, promptly after suspending collection efforts.

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