

GAO

Report to the Administrator, Small
Business Administration

August 2004

SMALL BUSINESS ADMINISTRATION

SBA Followed Appropriate Policies and Procedures for September 11 Disaster Loan Applications





Highlights of [GAO-04-885](#), a report to the Administrator, Small Business Administration

Why GAO Did This Study

The Small Business Administration (SBA) played a key role in assisting small businesses affected by the September 11, 2001 terrorist attacks by providing over \$1 billion in disaster loans to businesses that sustained physical damage or economic injury. Small businesses in the immediate areas of the attacks and others nationwide that suffered related economic injury were eligible to apply for disaster loans. SBA declined or withdrew about half of these loan applications. SBA's disaster loans are direct federal government loans provided at a subsidized interest rate.

In response to concerns that more small businesses impacted by September 11 could have benefited from SBA's disaster loans, GAO conducted a review of its Disaster Loan Program. Specifically, GAO addressed the following questions: (1) Are the disaster program policies consistent with the law and the overall mission of SBA's Disaster Loan Program? (2) What were SBA's underwriting policies and criteria for September 11 Economic Injury Disaster Loans (EIDL) and how did they compare with those applied by nonprofit lenders that were active in New York City after September 11? (3) Did SBA correctly apply its policies and procedures in its disposition of September 11 EIDLs?

GAO makes no recommendations in this report.

www.gao.gov/cgi-bin/getrpt?GAO-04-885.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Davi M. D'Agostino at (202) 512-8678 or dagostinod@gao.gov.

SMALL BUSINESS ADMINISTRATION

SBA Followed Appropriate Policies and Procedures for September 11 Disaster Loan Applications

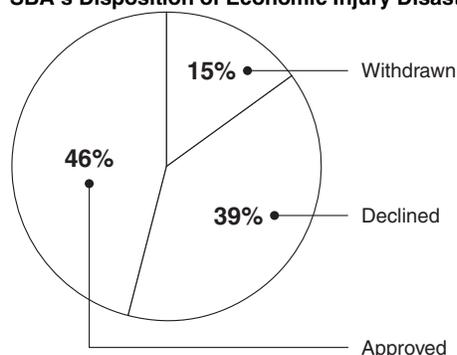
What GAO Found

SBA's policies and procedures for providing EIDLs are consistent with the Small Business Act: applicants must have suffered substantial economic injury as a result of a declared disaster, and SBA must determine that they are not able to obtain credit elsewhere. The act addresses some loan terms, such as length of maturity, but it does not specify underwriting criteria for SBA to follow. However, SBA's regulations contain underwriting criteria such as assessing an applicant's ability to repay the loan and obtaining collateral.

SBA's underwriting requirements for September 11 EIDLs generally followed program guidelines and were similar to those of selected nonprofit organizations in New York City. Small businesses that were eligible to apply for SBA assistance were expected to meet standard requirements for documentation, creditworthiness, repayment ability, collateral, and character. These requirements are generally consistent with best practices published by lending industry experts and guidance issued by federal regulators. Changes made to address the unusual circumstances of the September 11 disaster were to eligibility and loan terms and not to loan underwriting criteria. The three nonprofit organizations in New York City that made September 11 disaster loans had requirements similar to SBA, but the nonprofits had some additional flexibility to address the needs of their small business constituents.

GAO found that SBA followed its policies and procedures in making decisions for September 11 EIDLs. All of the files in our random, representative sample of declined or withdrawn applications contained documentation and analysis to support the SBA's determination. GAO's review of this sample also indicated that SBA followed its procedures for processing applications—such as supervisory review and notifying applicants of its decision and their right to have the application reconsidered. GAO's review of a small sample of approved loans also indicated that SBA followed its policies and procedures.

SBA's Disposition of Economic Injury Disaster Loan Applications for September 11



Source: GAO.

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Abbreviations

EIDL	Economic Injury Disaster Loan
FEMA	Federal Emergency Management Agency
IRS	Internal Revenue Service
SBA	Small Business Administration

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United States Government Accountability Office
Washington, D.C. 20548

August 31, 2004

The Honorable Hector V. Barreto
Administrator
Small Business Administration

Dear Mr. Barreto:

The Small Business Administration (SBA) played a key role in assisting small businesses affected by the September 11, 2001 terrorist attacks. SBA provided approximately \$1.1 billion in disaster loans to businesses that were physically damaged or had suffered a substantial economic injury as a result of the attacks. Small businesses in the declared disaster areas surrounding the World Trade Center and the Pentagon, as well as others nationwide that had suffered economic injuries directly related to the events of September 11, were eligible to apply for disaster loans. SBA required eligible applicants to document the extent of their losses and provide enough financial information for SBA to determine repayment ability. SBA declined or withdrew those loan applications that its loan officers determined did not meet its underwriting criteria. SBA's disaster loans are direct federal government loans provided at a subsidized interest rate.

In previous work, we reported that SBA had declined or withdrawn about half of approximately 24,000 post-September 11 applications for disaster loans nationwide.¹ In response to concerns that more small businesses impacted by September 11 could have benefited from these loans, we conducted a review of SBA's Disaster Loan Program. Specifically, we addressed the following questions: (1) Are the disaster program policies consistent with the law and the overall mission of SBA's Disaster Loan Program? (2) What were SBA's underwriting policies and criteria for September 11 Economic Injury Disaster Loans (EIDL) and how did they compare with those applied by nonprofit lenders that were active in New York City after September 11? (3) Did SBA correctly apply its policies and procedures in its disposition of September 11 EIDLs?

To determine whether SBA's program policies are consistent with the law and overall mission of SBA's Disaster Loan Program, we reviewed the law

¹GAO, *Small Business Administration: Response to September 11 Victims and Performance Measures for Disaster Lending*, [GAO-03-385](#) (Washington D.C.: Jan. 29, 2003).

related to the program as well as SBA's regulations and operating procedures. To determine SBA's underwriting policies and criteria for September 11 EIDLs, we analyzed SBA's policies and procedures for approving, declining, and withdrawing disaster loans, and changes in its policies and the law made after September 11. We discussed the provisions of the law and SBA's policies and procedures with SBA officials. We also analyzed the underwriting policies and procedures of three selected nonprofit lenders that provided loans to small businesses in New York after September 11 and discussed the lenders' policies with officials of the respective organizations. In addition, we compared SBA's underwriting requirements with best practices for managing credit risk during the loan-making process of industry and banking regulators. To determine whether SBA correctly applied its policies in the disposition of September 11 EIDL applications, we reviewed a representative random sample of declined and withdrawn September 11 EIDL application files drawn from all disaster area offices,² and a small sample of application files for approved September 11 loans. The representative sample of declined and withdrawn files allowed us to project to the universe of about 12,000 declined and withdrawn EIDLs, but the small sample of approved loans did not allow us to project to the universe of all approved loans, and we discuss only the disposition of the 27 approved loans we reviewed. Appendix I contains a detailed description of our scope and methodology. We conducted our work between May 2003 and June 2004 in Atlanta, GA; New York, NY; and Washington, D.C. in accordance with generally accepted government auditing standards.

Results in Brief

The SBA Disaster Loan Program's policies and procedures are consistent with the law and the program's overall mission of helping businesses, among others, recover from disasters.³ The Small Business Act authorizes SBA to make low-interest loans to small businesses that have suffered a

²SBA's four disaster area offices are located in California, Georgia, New York, and Texas, and serve the entire continental United States and U.S. territories.

³SBA's Office of Disaster Assistance defines its mission as helping people recover from disasters and rebuild their lives by providing affordable, timely, and accessible financial assistance to homeowners, renters, and businesses. This report addresses only economic injury disaster loans SBA provided to businesses, although SBA also provides loans to businesses for physical damage from disasters.

substantial economic injury as the result of a disaster.⁴ The act states that no loan for economic injury shall be extended unless SBA finds that the applicant is not able to obtain credit elsewhere, but it does not specifically address underwriting criteria. For example, the act does not specify that EIDLs must be of such sound value or so secured as to provide reasonable assurance of repayment, as it does for SBA's general business loans. Additionally, the act does not specifically address the issue of collateral for EIDLs, whereas it specifies that SBA not require collateral for physical disaster business loans of \$10,000 or less. However, SBA's regulations for its Disaster Loan Program do specify underwriting criteria for EIDLs. Under its disaster program regulations, SBA generally requires collateral for EIDLs over \$5,000, but it will not decline a loan if an applicant lacks adequate collateral if there is a reasonable assurance that the applicant can repay the loan.

SBA's underwriting policies and criteria for September 11 EIDLs generally followed program guidelines, although notable exceptions were made for this disaster, and were generally similar to those of the selected nonprofit organizations we reviewed. Applicants eligible for SBA's program were expected to meet established requirements for documentation, creditworthiness, repayment ability, collateral, and, as determined by SBA, appropriate character.⁵ These requirements are generally consistent with best practices published by lending industry experts and guidance issued by federal regulators. With the Defense Appropriations Act of 2002, Congress increased the statutory loan limit and the deferral periods for repayment and SBA increased business size standards for eligible borrowers.⁶ The maximum loan amount was increased from \$1.5 million to \$10 million, and SBA's standard 4-month deferral period was increased to 2 years for borrowers in the immediate areas of the disaster. Also, SBA took action so that businesses nationwide—not just those in the immediate area

⁴Although the Small Business Act does not define substantial economic injury for EIDLs, SBA regulations define it as economic harm to a business concern that results in its inability to meet its obligations as they mature or pay its ordinary and necessary operating expenses. 13 C.F.R. §123.300 (a) (1) (2003).

⁵By statute, SBA is required to deny assistance to persons convicted during the past year of committing a felony during and in connection with a riot or civil disorder. Pub. L. No. 90-448 § 1106(e) (1968). According to SBA officials, SBA uses specific program guidelines to make a character determination on each loan applicant with a prior arrest or conviction. SBA's procedure is documented in the Standard Operating Procedure 50-30.

⁶See Pub. L. No. 107-117 §§ 202, 203, 115 Stat. 2297 (Jan. 10, 2002).

of the disaster—were able to apply for EIDLs if they had suffered economic injury as a result of the terrorist attacks and subsequent federal actions, such as closing airports.⁷ In addition, applicants in the expanded area were required to provide a statement linking their economic injury claims to the September 11 disaster. The three nonprofit organizations that we selected for comparison generally provided financial and technical assistance to businesses in New York City that suffered losses as a result of September 11. All of these organizations had requirements that were similar to SBA's for documentation, creditworthiness, and repayment ability. Unlike SBA, all had limited requirements for collateral, and none used character as a factor in determining eligibility for assistance.

Our review of a representative sample of declined and withdrawn September 11 EIDLs and a small sample of approved loans indicated that SBA followed its own policies and procedures in making determinations on these loan applications. We reviewed a sample of 99 declined and withdrawn loan application files to determine whether SBA made its determinations correctly. For all of the 99 files, SBA's policies and procedures justified its decisions to decline or withdraw the applications. SBA's primary reason for declining September 11 loan applications overall was its determination that the applicant lacked repayment ability. In making such determinations, SBA looked at whether the applicants had the cash flow to make payments on the loan based on their pre-disaster financial performance. The primary reason SBA withdrew loan applications was the applicant's failure to file and pay federal income tax for 1 or more years. Outside the designated September 11 disaster area, the primary reason SBA declined applications was the applicants' failure to establish a direct link between the events of September 11 or related federal actions and the applicants' business downturn. In all of the 99 files, we found that SBA had notified the applicants in writing of its reasons for declining or withdrawing loan applications, problems with the applications and the means of correcting any deficiencies, and each applicant's right to have the loan application reconsidered by SBA. Our review of a small sample of 27 approved loan application files indicated that SBA also followed its policies and procedures in approving these loans. SBA had denied or withdrawn 8 of these 27 applications prior to approving them.

⁷The Small Business Administration promulgated regulations dealing specifically with EIDLs relating to the September 11, 2001, terrorist attacks. See 13 C.F.R. Part 123, Subpart G (2003).

For these eight approved loans, the applicants addressed deficiencies identified by SBA, such as failure to file for federal income taxes.

We provided a draft of this report to SBA and received written comments from the Associate Administrator For Disaster Assistance. SBA's letter is reprinted in appendix II. SBA agreed with the findings in this report.

Background

When a disaster occurs, staff from SBA's Disaster Loan Program, the Federal Emergency Management Agency (FEMA), and other government agencies work together to assess the damage to the affected area and aid household and business disaster victims. Either the President or the SBA Administrator may issue a disaster declaration. When the President issues a disaster declaration, FEMA specifies the immediate disaster area and SBA determines which contiguous counties are eligible for federal assistance.⁸ When SBA issues a disaster declaration, it specifies the immediate disaster area and any contiguous counties that are eligible for assistance. Unlike FEMA, which can provide some grants to residents in the area of a disaster, SBA provides loans to households and businesses affected by disasters. Once a disaster is declared, officials from one of SBA's four Disaster Area Offices—located in California, Georgia, New York, and Texas—arrive at the disaster site and begin assisting victims. These officials provide information about the disaster loan process, distribute loan applications, and assist victims, if requested, in completing applications. In response to the September 11 terrorist attacks, SBA disaster program officials from around the country provided assistance to the New York Disaster Area Office, which was the office primarily responsible for providing assistance.

Depending on the nature of the disaster, SBA can provide businesses hurt by a disaster with fixed-rate, low-interest loans to address physical

⁸According to SBA officials, most requests for disaster declarations come from the governor of the affected state, who can ask for a presidential disaster declaration or an SBA administrative declaration, depending on the severity of the disaster. A presidential declaration makes many federal programs available, including SBA loans; an SBA declaration makes only SBA loans available.

property damage and economic injuries.⁹ These low-interest loans are subsidized by taxpayers through federal appropriations, and if the loans are not repaid, the subsidy cost for disaster loans increases. SBA provides loans to cover physical damage to both small and large businesses, enabling them to repair or replace damaged real property, machinery, equipment, fixtures, and inventory to begin restoring the property to its pre-disaster condition. SBA provides EIDLs only to eligible small businesses, allowing them to meet necessary financial obligations that could have been met if the disaster had not occurred and to maintain necessary working capital during the period that business activities are affected by the disaster. For most disasters, SBA has primarily assisted businesses with physical disaster loans. However, given the nationwide economic impact resulting from the terrorist attacks of September 11, 2001, EIDLs became SBA's primary form of assistance. Of the approximately 24,000 September 11 disaster loan applications, SBA approved about 11,000, totaling \$1.1 billion. Over 10,000 of these loans, amounting to \$1 billion, were for EIDLs.

Under its statutory authority to provide economic injury disaster loans to small businesses, SBA has established policies and procedures for determining whether an applicant qualifies for a loan and the likely viability of the loan, using pre-disaster financial information from the applicant. SBA loan officers determine whether applicants meet agency criteria. SBA loan officers may determine that applicants do not meet these criteria for one or more of the following reasons:

- lack of repayment ability;
- unsatisfactory history on an existing or previous SBA loan;
- unsatisfactory history on a federal obligation, such as taxes;
- unsatisfactory credit history;
- unsatisfactory debt payment history;

⁹For physical and economic injury disaster loans made after October 1, 1982, to businesses that cannot obtain credit elsewhere, the maximum interest rate is 4 percent per annum. For businesses with credit available elsewhere, SBA provides loans for physical damage at a maximum rate of 8 percent with a 3-year term; economic injury loans are not available to businesses with credit available elsewhere. See 15 U.S.C. § 636(c)(5) (2000 & Supp. 2003).

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- economic injury not substantiated;
 - business activity not eligible;
 - not a small business;
 - credit available elsewhere (for instance, from a commercial financial institution);
 - recovery available from other sources, such as an insurance settlement;
 - failure to maintain required flood insurance on an SBA loan;
 - not a qualified business;
 - refusal to pledge collateral;
 - no direct link established between the business downturn and the disaster (for September 11 EIDLs only); and
 - outstanding judgment for a federal debt.

When SBA does not receive all the required information or documentation from an applicant, it withdraws the loan application. SBA also withdraws applications when the Internal Revenue Service (IRS) has no record that the applicant has filed income tax returns for 1 or more years¹⁰ or because of an unresolved character issue (for example, an applicant's criminal activity). Additionally, an applicant may request that SBA withdraw its application. After SBA declines or withdraws an application, the applicant has 6 months to request reconsideration. SBA explains its reason(s) for not approving the loan and the process for reapplying in correspondence to the applicants.

In addition to SBA, several nonprofit organizations (nonprofits) in New York City offered economic relief to small businesses in the area affected by the events of September 11. The nonprofits that we contacted to discuss their September 11 programs typically provide economic and technical support to small, entrepreneurial, and nontraditional businesses such as

¹⁰In processing loan files, SBA requests 3 years of an applicant's business federal tax transcripts and 1 year of the principal's personal federal tax returns directly from the IRS.

street vendors and taxi drivers, in New York City and generally receive funding from private and public sources. Funding for their September 11 programs came from these sources as well as from federal grants allocated to support such programs. All three nonprofits received grants from the September 11th Fund and raised additional capital with the help of private banks and partner organizations.¹¹ Two of the three nonprofits reported that they provided both grants and loans to small businesses, but all provided working capital loans to help businesses meet short-term obligations such as rents, salaries, and accounts payable. These working capital loans were expected to help businesses weather expected recovery periods of between 3 and 6 months. One nonprofit offered only low-interest working capital loans of up to \$150,000, while another reported providing \$900,000 in grants and \$3.1 million in low-interest loans. The third nonprofit reported providing \$7.1 million in grants and no-interest loans, \$12.4 million in low-interest loans, and \$4 million in wage subsidies.

Small businesses in New York were also assisted by \$3.5 billion in Community Development Block Grant funding appropriated by Congress. Congress earmarked at least \$500 million of this funding to compensate small businesses, nonprofits, and individuals for their economic losses. This assistance included grants to compensate small businesses for some of their losses, as well as payments to attract and retain small businesses in an effort to revitalize the affected areas.¹²

¹¹The September 11th Fund was established on the day of the terrorist attacks by The New York Community Trust and United Way of New York City. Grants from the fund enable cash assistance, counseling, and other services to individuals and families, small businesses, and community organizations affected by the disaster. The fund, which continues to operate, makes grants directly to nonprofit organizations and agencies with the expertise to meet a wide range of needs in a timely manner, as well as those that were directly affected by the disaster.

¹²We have discussed federal assistance in response to the September 11 terrorist attacks in several other reports. See GAO, *September 11: Small Business Assistance Provided in Lower Manhattan in Response to the Terrorist Attacks*, [GAO-03-88](#) (Washington, D.C.: Nov. 1, 2002); GAO, *Disaster Assistance: Information on FEMA's Post 9/11 Public Assistance to the New York City Area*, [GAO-03-926](#) (Washington, D.C.: Aug. 29, 2003); and GAO, *September 11: Overview of Federal Disaster Assistance to the New York City Area*, [GAO-04-72](#) (Washington, D.C.: Oct. 31, 2003).

The SBA Disaster Loan Program's Policies and Procedures Are Consistent with the Law and the Program's Overall Mission

SBA's policies and procedures for providing EIDLs are consistent with the Small Business Act. The agency's policies and procedures are consistent with the two requirements specific to EIDLs. These requirements are that applicants must have suffered a substantial economic injury as a result of a covered disaster and that SBA must find that the applicant is not able to obtain credit elsewhere. The act addresses some loan terms, such as length of maturity, but it does not specify underwriting criteria for SBA to follow. However, SBA's regulations do contain underwriting requirements such as assessing an applicant's ability to repay the loan, credit history, and the availability of collateral, as well as other requirements.

The Small Business Act Provides Little Specific Guidance on How SBA Should Manage Its Disaster Loan Program, Particularly in Providing EIDLs

The law provides for SBA to make loans to small business concerns that have suffered a substantial economic injury as a result of a covered disaster, provided that SBA finds that an applicant is not able to obtain credit elsewhere.¹³ Although the law does not define substantial economic injury for EIDLs, SBA's regulations define it as economic harm to a business concern that results in its inability to meet its obligations as they mature or to pay its ordinary and necessary operating expenses. SBA may provide an EIDL if it determines that an applicant has suffered a substantial economic injury resulting from a disaster described in the act. For EIDLs, the act describes four disaster scenarios: (i) a major disaster, declared by the President of the United States; (ii) a natural disaster, as determined by the Secretary of Agriculture; (iii) a disaster declared by SBA; and (iv) if no disaster was declared under scenarios (i) through (iii), certification to SBA by the Governor of a State that eligible concerns have suffered economic injury as a result of a disaster and are in need of financial assistance which is not available on reasonable terms in the stricken area.¹⁴

Although the act specifies some terms for EIDLs, it does not specify underwriting requirements. For example, the law states that the loans should not exceed \$1,500,000, unless the applicant is a major source of employment in the impacted area or have more than a 30-year maturity

¹³The law excludes agricultural enterprises from eligibility to receive a disaster loan.

¹⁴15 U.S.C. § 636(b)(2)(A)-(D).

period.¹⁵ It also provides some specific interest rate requirements, based on the year of the disaster. However, it does not specify underwriting criteria for EIDLs. The act does not specify that EIDLs should be of sound value or secured to provide reasonable assurance of repayment, as it does for SBA's general business loans. Additionally, the act does not specifically address the issue of collateral for EIDLs, whereas it specifies that SBA not require collateral for physical disaster business loans in the amount of \$10,000 or less.

SBA's Regulations Specify Underwriting Criteria and Other Requirements for Disaster Loan Applicants

SBA's regulations for EIDLs contain underwriting criteria that require, among other things, a reasonable assurance of repayment, satisfactory credit and character, and generally, collateral.¹⁶ The regulations state that SBA must have reasonable assurance that all disaster loan applicants can repay their loans from their personal or business cash flow. The regulations also state that SBA is prohibited from lending to businesses with an associate who is incarcerated, on probation, on parole, or who has been indicted for a felony or a crime of moral turpitude.¹⁷ The regulations do not elaborate on satisfactory credit, however, as discussed later, SBA's policies and procedures address these issues. For EIDLs greater than \$5,000, SBA regulations require that applicants provide collateral, although SBA will not decline a loan if the applicant lacks a particular amount of collateral, as long as it has reasonable assurance that the applicant can repay the loan. However, SBA may decline or cancel a loan where the applicant refuses to pledge available collateral when requested by SBA. SBA regulations also specify eligibility requirements for the types of businesses that may obtain an EIDL. The regulations exclude the following types of small businesses:

- businesses engaged in lending, speculation, or investment;
- nonprofits and charities;
- consumer or marketing cooperatives;

¹⁵Under certain circumstances, SBA may suspend payment of principal and interest for up to 5 years. As discussed elsewhere in this report, Congress increased the limitation on loan amounts and provided a deferral of the repayment period for loans resulting from the September 11, 2001 attacks.

¹⁶13 C.F.R. §§ 123.6, 123.11 (2003).

¹⁷13 C.F.R. § 120.110(n) (2003).

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- businesses deriving more than one-third of gross annual revenue from gambling activities;
 - loan packagers that earn more than one-third of gross annual revenue from packaging SBA loans;
 - businesses principally engaged in teaching, counseling or indoctrinating religion or religious beliefs; and
 - businesses primarily engaged in political or lobbying activities.¹⁸

SBA amended its regulations in October 2001, expanding eligibility to small businesses outside the declared disaster area, applicable only to September 11 EIDLs. SBA made this change in recognition that the September 11 disaster had a widespread economic impact, beyond the boundaries of the declared disaster areas in New York and Virginia. Under the new section of the regulations, SBA agreed to provide EIDLs to businesses outside of the declared disaster area if they could show that they suffered a substantial economic injury as a direct result of the destruction at the World Trade Center or the damage to the Pentagon, or any related federal actions (such as the suspension of air travel) taken between September 11, 2001, and October 22, 2001.¹⁹ The regulations specify that loss of anticipated profits or a drop in sales is not considered substantial economic injury for purposes of an EIDL under these provisions.²⁰ Other than this change to expand EIDL eligibility nationwide, SBA's general regulatory requirements for disaster loans, which we discuss more fully later in this report, applied to September 11 EIDLs.

¹⁸13 C.F.R. § 123.301. Also, SBA EIDL assistance may not be provided to the following business concerns: concerns with a principal convicted, during the past year, of a felony during and in connection with a riot or civil disorder or other declared disaster; concerns with a principal presently incarcerated, or on probation or parole following conviction of a serious criminal offense; concerns engaged in illegal activities; government-owned entities (except for a business owned or controlled by a Native American tribe); concerns which present live performances of a prurient sexual nature or which derive more than *de minimus* gross revenue through the sale of products or services, or the presentation of any depictions or displays of a prurient sexual nature; concerns with a principal who owns more than 50 percent of the business and who is more than 60 days late on a child support order, unless the principal divests all interest in the business. See *ID*, and 12 U.S.C. § 633(e), (f) (2000).

¹⁹13 C.F.R. § 123.600.

²⁰13 C.F.R. § 123.601(a)(2).

SBA's Underwriting Criteria Followed Program Guidelines and Best Practices and Were Similar to Those of Nonprofits Offering Disaster Loans

SBA's underwriting policies and criteria for September 11 EIDLs generally followed established guidelines, even with the exceptions that were made for this disaster, and were similar to those of selected nonprofits in New York City. Small businesses that were eligible to apply for SBA loans were expected to meet standard requirements for documentation, creditworthiness, repayment ability, collateral, and appropriate character, as determined by SBA.²¹ We found that SBA's lending activities followed best practices for private lending, as set out by industry experts. As we reported previously,²² modifications to SBA's Disaster Loan Program were made to address the unusual circumstances surrounding the September 11 disaster and to respond to the concerns of affected small businesses. However, the changes that were made were to eligibility and terms, not to loan underwriting criteria. Finally, the three nonprofits that we reviewed had requirements that were similar to SBA's for documentation, creditworthiness, and repayment ability, but their requirements differed for collateral and appropriate character.

SBA EIDL Requirements for September 11 Generally Followed Program Guidelines

SBA used the same requirements for September 11 EIDLs as it would for any other disaster. In accordance with the guidelines of the Disaster Loan Program, SBA required small business applicants to provide the following:

- personal financial statements for all principals with at least 20 percent interest in the business and each general partner;
- business tax records for the 3 most recent tax years and 1 year of personal tax records;
- balance sheets and operating statements dated within 90 days of application; and
- monthly sales figures beginning 3 years before the disaster and continuing through the most current month available.

²¹According to SBA officials, SBA follows the requirements of the Office of Management and Budget Circular A-129, Managing Federal Credit Programs, which, among other issues, prescribes policies and procedures for extending credit such as screening applicants, documenting loans, and collateral requirements.

²²GAO-03-385.

Applicants were also required to undergo the standard credit analysis required for the EIDL program. Since EIDLs are available only to small businesses unable to obtain credit elsewhere, SBA administers its own test to determine whether applicants are able to qualify for private funds under reasonable terms and conditions, or if the applicant has the financial capacity to recover without federal assistance. September 11 loan applications were processed using SBA's "credit elsewhere" test, a combination of two formulas that looks at cash flow for debt servicing and available net worth. Loan officers then used information provided in the credit reports, balance sheets, and tax records to determine repayment ability, based primarily on pre-disaster financial performance. SBA required that EIDLs of more than \$5,000 be secured by personal guaranties from all business principals and by the "best available collateral."²³ SBA officials stated that the best available collateral typically would be business or personal real estate, since real estate is the only asset that will likely maintain its value over the life of a 30-year SBA loan.²⁴ In some cases, SBA accepted other business property as collateral for smaller September 11 EIDLs, if it was the best available, according to SBA officials.

Finally, Disaster Loan Program guidelines require that SBA make a character determination on all loan applicants in order to determine eligibility for federal loans. By statute, SBA is required to deny loans to persons convicted during the past year of a felony committed during a riot or civil disorder and in connection with another declared disaster.²⁵ SBA uses specific program guidelines to make a character determination on each loan applicant who has a prior arrest, indictment, or conviction or is on parole or probation. Applicants are required to provide information on any previous arrests or convictions.

SBA's Program Policies Were Generally Consistent with Good Lending Practices

SBA's guidelines for its Disaster Loan Program generally coincide with best practices published by lending industry experts and guidance issued by federal regulators. As stated previously, modifications that were made specifically for the September 11 disaster did not affect the administration of the program or underwriting criteria for EIDLs made to small businesses

²³Personal guaranties were not required for sole proprietorships, because the sole proprietor is individually obligated under the note.

²⁴30 years is the maximum term for an SBA disaster loan.

²⁵P. L. No. 90-448 § 1106(e) (1968).

nationwide. Disaster Loan Program requirements include specific and clearly stated criteria and processes for analyzing credit and determining repayment ability. Operating procedures for the program also detail internal control and supervisory review directives.

According to experts, “a cornerstone of safe and sound banking is the design and implementation of written policies and procedures related to identifying, measuring, monitoring, and controlling credit risk. Such policies should be clearly defined, consistent with prudent banking practices and relevant regulatory requirements, and adequate for the nature and complexity of the bank’s activities.”²⁶ Further, in order to be effective, credit policies must be communicated throughout the organization, implemented through appropriate procedures, and monitored and periodically revised to take into account changing internal and external circumstances. We compared SBA’s policies and procedures with industry best practices and regulatory guidance for extending credit. SBA’s policies and procedures for its Disaster Loan Program in general and EIDLs in particular are presented in SBA’s standard operating procedures and related program memoranda. Underwriting criteria are clearly defined, with specific formulas for SBA’s loan officers to use in evaluating credit risk for each loan applicant. Industry standards also specify the importance of a comprehensive analysis of a borrower’s ability to repay the loan and requiring a borrower to pledge collateral. SBA’s requirements for loan guaranties and collateral and its analysis of applicants’ cash flow to determine repayment ability are in line with industry guidance on mitigating lender risk in individual credit transactions. Modifications that were made to eligibility and terms for September 11 EIDLs were communicated throughout the agency in program memoranda. SBA provided applications for the expanded program nationwide through its resource partners.²⁷ Our review of September 11 loan files also indicated that SBA complied with its procedures for supervisory review of all loan decisions.

²⁶Principles for the Management of Credit Risk: Basel Committee on Banking Supervision, September 2000.

²⁷Some of SBA’s resource partners are Small Business Development Centers (SBDC).

Congress and SBA Approved Modifications in Key Areas of the Disaster Program

With the Defense Appropriations Act of 2002, Congress approved notable modifications for this disaster that changed the terms for September 11 EIDLs for small businesses. These included increasing the maximum loan limit from \$1.5 million to \$10 million and raising the maximum repayment deferral period.²⁸ SBA's policy of a 4-month deferral period was increased to 2 years, by legislation, for businesses in the immediate areas of the disaster. EIDLs granted in the immediate areas of the disaster also did not accrue interest during the 2-year deferral period.

By regulation, borrowers in the immediate disaster areas receiving economic injury loans also had 2 years from the date of approval to apply for additional funds or a modified loan, and borrowers in the expanded area had 1 year.²⁹ Borrowers would thus have sufficient time to assess additional disaster-related damage that had not been detected or reported at the time of the initial application.

Under its regulatory authority, SBA expanded eligibility for the September 11 disaster to businesses nationwide that were directly affected by the terrorist attacks and subsequent federal actions such as airport closures that resulted in business disruptions across the country.³⁰ The expanded program also addressed the needs of small businesses that depended on other businesses and industries whose operations were suspended or disrupted because of the disaster. Businesses in the expanded areas were required to provide an economic injury statement. Applicants needed to make a direct link between the economic downturn affecting their business and the events of the disaster in order to qualify for loans under the expanded program.³¹

²⁸The \$10 million loan limit also included loans to businesses with joint economic injury and physical disaster claims.

²⁹13 C.F.R. § 123.20 and 13 C.F.R. § 123.606.

³⁰66 Fed. Reg. 53329 (Oct. 22, 2001).

³¹SBA developed standard eligibility criteria and a sample question and answer form for the Expanded EIDL Program to help loan officers determine whether businesses qualified for loans. The criteria stated that a general decline in business since September 11 was not in itself enough to establish eligibility. The downturn had to be the direct result of the destruction of the World Trade Center, damage to the Pentagon, or related federal actions. The program did not cover a decline in revenue due to public reaction in the wake of the disaster.

SBA made other accommodations for September 11 applicants, including increasing the size limits for eligible businesses, expediting loan processing, and providing translators to help non-English speaking applicants. As we noted in a previous report, small business owners had complained to Congress about some facets of the Disaster Loan Program.³² These complaints prompted SBA and the Congress to modify the program. First, because of the immediate and devastating effect on the travel industry nationwide, SBA increased the business size standards for travel agencies and certain other travel-related businesses.³³ Applications that were pending or had been previously declined or withdrawn solely on the basis of the size of the business were automatically reconsidered, and SBA adjusted the size determination date to the application acceptance date instead of the date of the disaster. For travel agencies and other travel businesses, the size standard was increased from \$1 million to \$3 million in annual receipts, allowing larger businesses to qualify. Second, in an effort to improve efficiency in processing the large number of EIDL requests for September 11, particularly under the expanded program, SBA developed an expedited process for reviewing loan applications. Under the expedited process, applicants that did not qualify based on eligibility criteria or pre-disaster credit and repayment issues were declined early in the review process. Loan officers were required to inform these applicants about the abbreviated process, and applicants could ask to be reconsidered and could submit additional documentation to justify their request. According to SBA officials, expedited processing also allowed it to provide quick loan approval to businesses within the declared disaster area in operation at the time of application up to a maximum amount of \$200,000 and those that were not in operation because of the events of September 11, up to \$350,000. Expedited processing allowed businesses outside of the declared disaster area meeting certain basic requirements to receive quick approval for loan amounts up to \$50,000.³⁴ Third, in direct response to complaints from small business owners in New York City with limited proficiency in English, SBA made efforts to provide loan application documents in languages other than English, including Spanish and Asian languages, and to provide multilingual personnel at New York City application centers. One SBA small business development center representative told us that

³²GAO-03-385, see pages 10-15 and appendix III.

³³67 Fed. Reg. 11874 (Mar.15, 2002).

³⁴Basic requirements were adequate repayment ability, satisfactory credit, and a verifiable federal tax return showing that the business had operated for at least 12 months.

although this initiative was positive, interpreters who were not familiar with business and financial jargon still faced limitations in communicating adequately with some small business owners.

Nonprofit Lenders in New York City Had Similar Requirements for Disaster Loans

Three nonprofits in New York City that made September 11 disaster loans had requirements similar to SBA's, but the programs had some additional flexibility to address the needs of their small business constituents (fig. 1). One of the nonprofits reported ineligibility for SBA loans or not meeting SBA's requirements as one of its own criteria for application acceptance. Another reported that its program was geared, in particular, toward small businesses that had not qualified for significant loans from SBA or other recovery loan programs. The existence of these nonprofit lenders provided alternative economic injury assistance to small businesses in New York City.

Figure 1: SBA's Underwriting Criteria Compared with Those of Three Nonprofit Lenders

Lender	Loan application requirements						
	Business and/or personal financial statements/documents	Business and/or personal tax records	Credit reports	Demonstrated repayment ability	Collateral to secure loan (over \$5,000 for SBA)	Character determination	
SBA's Disaster Loan Program: Economic Injury Disaster Loan	●	●	●	●	●	●	
ACCION New York: American Dream Fund	●	●	●	●	○	○	
Alliance for Downtown New York: Lower Manhattan Small Business & Workforce Retention Project	●	●	●	●	○	○	
Renaissance Economic Development Corporation: Chinatown Recovery Loan Program	●	●	●	●	○	○	

- No requirement
- Limited requirement
- Requirement

Source: GAO.

Like SBA, the nonprofits we spoke with had requirements for documentation, creditworthiness, and repayment ability. All three nonprofits required that applicants provide business financial statements, business and personal tax records, credit reports, and a number of other documents. One nonprofit requested, among other documents, corporate bank statements, a business plan, insurance statements, and receipts and invoices for expenses related to September 11. The same nonprofit required that applicants commit to remaining in New York City and asked for a current executed commercial lease. Another nonprofit said that commitment to rebuilding in the area was a factor in the decisionmaking process but did not include this factor in its eligibility requirements. Like SBA, the nonprofits used credit reports and business financial statements to determine an applicant's level of past debt, management of past credit,

and likelihood of repaying the disaster loan.³⁵ All of the nonprofits reported that credit and repayment histories played an important role in the decisionmaking process, but two of the nonprofits emphasized that applicants were not declined solely on the basis of the information provided in credit reports. One nonprofit considered the direct impact of the disaster on a business's ability to manage its recent credit, and another reported that it made allowances for special circumstances such as illness and divorce if applicants provided documentation and could show a pattern of good faith efforts to address delinquencies.

Unlike SBA, all of the nonprofits had limited requirements for collateral and reported that collateral was only requested on a case-by-case basis. One nonprofit reported that collateral was not required, but was accepted in lieu of a guaranty or cosigner for applicants who had been approved with less than satisfactory pre-disaster credit. In such cases, collateral would be accepted, even if it was not enough to secure the entire loan and would be considered "psychological collateral." Another nonprofit reported that collateral was typically required when a business had a limited operating history or highly unpredictable and inconsistent cash flow, and offered unsecured loans up to \$250,000. The third nonprofit reported that business collateral was required on a case-by-case basis but provided no further details. Two of the nonprofits indicated that they required personal guaranties, with one specifying that owners with 20 percent or more interest in the business would need to provide some guarantee. The third nonprofit indicated that it also determined whether to ask for personal guaranties on a case-by-case basis.

None of the nonprofits had a requirement similar to SBA's for appropriate character for their September 11 programs. One of the nonprofits indicated that an applicant's character was called into question if a written or verbal account was inconsistent with the documentation provided.

³⁵Personal credit reports are available from one of three credit-reporting bureaus in the United States—Equifax, Experian, and TransUnion. A typical consumer credit report provides an overall credit rating, credit history detail, and records of any bankruptcies, liens, and judgments filed against an individual. Besides requesting personal credit reports for each principal of an applicant business, SBA also requested business credit reports from Dun & Bradstreet, which provide information on company structure, an overall business credit rating, and records of any bankruptcies, liens, and judgments.

SBA Followed Its Own Policies and Procedures in Making Determinations on September 11 Economic Injury Disaster Loans

In our review of SBA's September 11 EIDL application files, we found that SBA followed its own policies and procedures in determining whether to provide loans to prospective borrowers. Our review of a representative random sample of applications SBA declined or withdrew showed that all of the 99 files contained the documentation and analysis needed to support the determination. We also found that SBA followed its procedures for processing loan applications, such as conducting supervisory reviews of loan decisions, and made its determinations and notified applicants in a timely manner. Our review of a small random sample of approved loans also indicated that SBA followed its policies and procedures in granting loans.

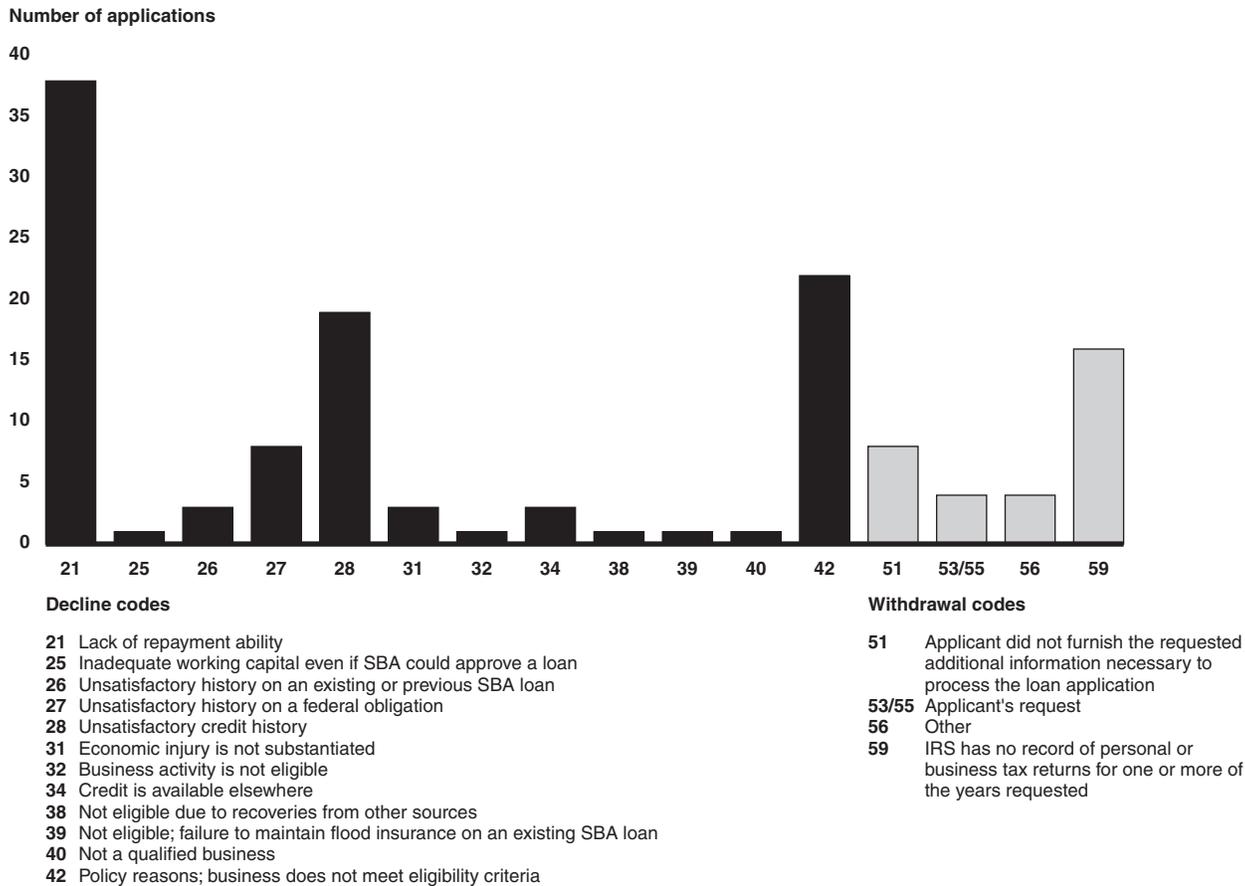
SBA Followed Its Policies and Procedures in Declining and Withdrawing Its September 11 Economic Injury Disaster Loan Applications

In all of the 99 loan files we reviewed in our representative random sample, SBA correctly declined 70 and withdrew 29 of the applications. Overall, SBA declined September 11 loan applications primarily because it determined that the applicants were unlikely to be able to repay the loan. While SBA can cite several reasons for declining a loan, it gave lack of ability to repay as at least one of the reasons for declining 38 of the 70 declined loan applications that we reviewed. In these cases, SBA concluded that the applicants' income was insufficient to repay a disaster loan, given existing debts and expenses, based on the analysis that loan officers conducted using financial information provided by the applicant. Our analysis of the universe of September 11 EIDLs revealed that SBA declined 4,513 applications, or more than half of all declined applications for lack of repayment ability. For the 34 declined Expanded EIDL applications in our sample, SBA declined 18 applications, or about half, because the applicants failed to establish a direct link between their business downturn and the events of September 11 or related federal actions, as SBA required of applicants outside of the declared disaster areas. In the universe of Expanded EIDLs, SBA declined 4,186 applications and 1,975 were declined for this reason. For example, a small business in an airport that lost revenue during the period in which air travel was suspended would have been eligible for an SBA September 11 Expanded EIDL. However, a business that simply showed losses after September 11 would not be eligible for a loan.

SBA withdrew loan files primarily because the applicants had not filed federal income tax returns. Of the 29 withdrawn loan applications in our sample, SBA withdrew 16 for this reason. Following its usual procedures, SBA requested the most recent 3 years of business tax records and 1 year of

personal tax records directly from IRS. According to a senior SBA official, SBA has a special arrangement with IRS for obtaining federal tax documentation for disaster loan applicants. IRS dedicates staff to processing these requests, and the IRS staff work the same hours as the SBA loan officers in order to provide the needed information as the loans are processed. IRS provides SBA with transcripts of available returns or a notification that no records could be found. SBA withdraws an application if IRS has no record of the applicant's tax return for at least a year and will also generally withdraw an application when missing or incomplete information prevents the loan officer from making a determination. Figure 2 provides additional information on the reasons SBA declined and withdrew loan applications in our sample. Our analysis of the universe of September 11 EIDLs revealed that SBA withdrew 1,294 applications, or about 38 percent of all withdrawn applications, because IRS had no record of tax returns for the applicants for 1 or more years.

Figure 2: Reasons SBA Declined and Withdrew September 11 Loan Applications in Our Sample



Source: GAO.

Note: SBA may decline or withdraw a loan application for more than one reason. The bars represent the frequency with which the decline and withdrawal codes were cited in the loan applications we reviewed.

We found technical errors in 2 of the 99 files we reviewed, although the facts presented in the application files showed that SBA would not have granted the loan, even if the errors had not been made. SBA declined one application because the applicant owed federal income taxes and lacked repayment ability, even though the applicant was a nonprofit and therefore ineligible for an EIDL. SBA notified another applicant that it was declining the application for policy reasons because the applicant was a subsidiary of a foreign company and had no revenues in the United States. According to

an SBA official, SBA's policies and procedures suggest that the application could have also been declined for lack of repayment ability.

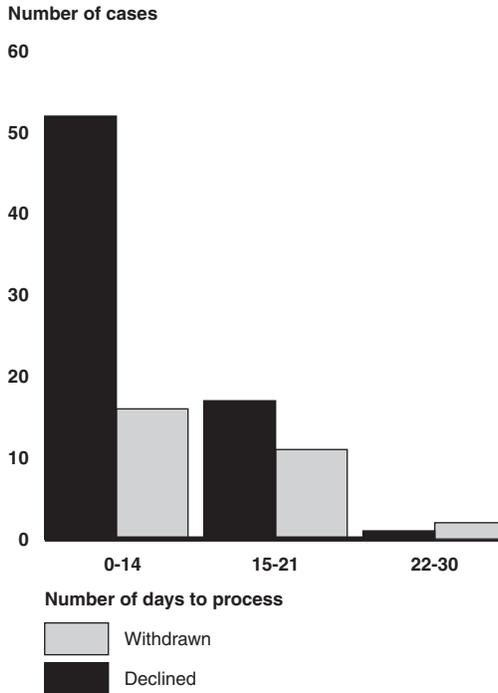
SBA Followed Its Procedures for Processing Declined and Withdrawn Loan Applications

In our review of declined and withdrawn loan files, we found that SBA followed its policies and procedures for conducting supervisory reviews of loan decisions and notifying applicants of the decisions and that the agency generally processed applications in a timely manner. In all of the 99 declined and withdrawn files that we reviewed, an SBA supervisory loan officer signed the loan officer's report, which documents how the loan officers came to the decision on the application.³⁶ On many of the loan officer's reports, the supervisory loan officer made some notations assessing the loan officer's analysis of the application. Additionally, all of the files contained correspondence to the applicant documenting SBA's decision that clearly described SBA's reasons for declining or withdrawing the application, the deficiencies in the application and additional documentation required (if applicable), and the applicant's right to have the application reconsidered. We also found that SBA generally processed the loan applications in a timely manner, as defined in SBA procedures. At the time SBA processed the September 11 loans, its benchmark was to process loan applications within 21 days. For most of the files that we reviewed, SBA made a decision within 14 days of the application date (fig. 3).³⁷ Our analysis of the universe of all September 11 EIDLs found that SBA processed declined files in an average of 11 days and withdrew files in an average of 13 days.

³⁶In addition to supervisory reviews of loan decisions, SBA also conducts an annual quality assurance review in each of its area offices to assess whether loan officers are following SBA's policies and procedures in making loan decisions. SBA reviews a randomly chosen sample of loan files as a part of this review.

³⁷In a previous report, [GAO-03-385](#), we found that SBA's average time for processing September 11 business loans was about 13 days. Thus, SBA was exceeding its own performance measure. We recommended that, to better demonstrate its program performance, SBA revise performance measures related to the disaster program. SBA has made several appropriate changes to its measures, as reported in its fiscal year 2003–2008 strategic plan, but it has not substantially changed its performance goal for processing EIDL applications. For example, its goal for fiscal year 2004 is to process 85 percent of EIDL applications within 20 days.

Figure 3: SBA's Processing Times for Declined and Withdrawn Loan Application Files in Our Sample



Source: GAO.

SBA Also Followed Its Own Procedures for Approving September 11 Loans

Based on our review of a small sample of loan files, SBA also followed its own policies and procedures in approving September 11 disaster loans.³⁸ However, this sample was not representative and cannot be projected to the universe of September 11 EIDLs. In our review of 27 approved loan files, we found that they contained all of the financial documentation and underwriting analysis required to approve the loans, according to SBA's policies and procedures. However, we did find an error in one of the approved loan files. In this case, an applicant had stated on his application that he was the sole proprietor of his business and not a U. S. citizen. Under

³⁸SBA's Office of Inspector General (OIG) is conducting a more extensive review of approved September 11 loans to determine whether the loans were underwritten, disbursed, and administered according to SBA's standard operating procedures. The OIG is also reviewing a sample of loans that have already defaulted.

these circumstances, SBA was supposed to request that the applicant provide proof that he was a non-citizen national or qualified alien.³⁹ Based on evidence in the file, the applicant had not provided proof of his alien status. As with our review of the declined and withdrawn files, the approved loans all showed evidence of supervisory review.

Of the 27 approved loan files we reviewed, SBA had initially declined or withdrawn eight. In these eight files, applicants had deficiencies similar to those of the declined or withdrawn loan files we reviewed but were able to address the deficiencies and reapply. For example, the applicants whose files had been withdrawn because of income tax issues reapplied after filing and paying federal income taxes, allowing SBA to approve the loans. In one of the approved loan files we reviewed, SBA withdrew the application for failure to file for federal income taxes. After the applicant filed federal tax returns, SBA then declined the application for lack of repayment ability and unsatisfactory history on a federal obligation, or failure to pay federal income taxes. After setting up a payment plan with the IRS and reducing expenses, the applicant reapplied and SBA approved the loan. In another approved loan file, SBA initially declined the application because the applicant had not substantiated the economic injury. Based on SBA's analysis of the applicant's documentation, the business would be able to meet its financial obligations without a loan. However, the applicant provided further documentation to show that it had lost contracts because of the September 11 disaster and that the loss of business would have a negative effect on the firm over time. The additional documentation allowed SBA to approve the loan.

Observations

Although SBA is not required to maintain specific underwriting criteria for its Disaster Loan Program under the provisions of the Small Business Act, we think that SBA's policies are generally consistent with good lending policies as reflected in industry best practices and regulatory guidance, and, when properly applied, should help maintain the integrity of the program. SBA's underwriting procedures evaluate applicants' credit risk and analyze their ability to repay the loan. These procedures, along with requiring collateral to secure the loans, help ensure that SBA fulfills its

³⁹SBA instituted this procedure to comply with Pub. L. 104-193, Title IV of the Personal Responsibility and Work Opportunity Reconciliation Act of 1996, which prohibits providing a federal public benefit to persons who are not United States citizens, non-citizen nationals, or qualified aliens.

mission in providing loans that will assist small businesses in recovering from disasters. By assessing repayment ability, SBA can more effectively use its resources to assist small businesses that are more likely to be able to repay the loan, thus limiting the loan program's cost to the government, and therefore the taxpayer.

Agency Comments

We provided a draft of this report to SBA and received written comments from the Associate Administrator For Disaster Assistance. SBA's letter is reprinted in appendix II. SBA agreed with the findings presented in this report. In addition, SBA provided technical comments, which we incorporated into this report as appropriate.

We will provide this report to appropriate congressional committees. In addition, this report will be available at no charge on our web site at <http://www.gao.gov>.

Please contact me at (202) 512-8678 or dagostinod@gao.gov or Katie Harris, Assistant Director at (202) 512-8415 or harrism@gao.gov if you or your staff have any questions about this report. Key contributors to this report were Bernice Benta, Gwenetta Blackwell-Greer, Diane Brooks, Jackie Garza, Fred Jimenez, and Carl Ramirez.

Sincerely yours,



Davi M. D'Agostino
Director, Financial Markets and
Community Investment

Scope and Methodology

To determine whether Economic Injury Disaster Loan (EIDL) program policies are consistent with the law and overall mission of SBA's Disaster Loan Program, we reviewed the Small Business Act and SBA's related regulations. We determined what the provisions of the law require of SBA in its operation of the program as well as SBA's regulations and operating procedures. We discussed our views on the laws, regulations, and operating procedures with appropriate SBA officials.

To compare SBA's underwriting policies and criteria for September 11 EIDLs with nonprofit lenders active in New York City after the disaster, we reviewed SBA's policies and criteria for approving, declining, and withdrawing disaster loans, and amendments made after September 11. We also compared SBA's underwriting requirements with industry best practices and banking regulators' guidance for managing credit risk during the lending process. We spoke with officials of nonprofit organizations (nonprofits) that provided loans to small businesses in New York City after September 11,¹ and reviewed their underwriting policies and criteria. We requested specific information on their loan programs to answer questions regarding (1) eligibility requirements for each nonprofits' program, (2) type of documentation that was required to accompany a loan application, (3) actual limits and terms associated with available loans, and (4) factors that each nonprofit considered in making the decision to approve or decline an application. We reviewed this information within each of the four categories and compared it with SBA's EIDL policies and criteria applicable to post-September 11 lending.

To determine whether SBA correctly applied its policies in the disposition of September 11 EIDL applications, we reviewed a representative random sample of declined and withdrawn September 11 EIDL application files across all disaster area offices, and a small sample of loan application files for approved September 11 EIDLs. We developed a data collection instrument containing key factors we identified in SBA's standard operating procedures and reviewed each loan application file to determine whether there was evidence that the appropriate policies and criteria had been applied in determining the disposition of each application. The representative sample of declined and withdrawn files allowed us to project to the universe of about 12,000 declined and withdrawn EIDLs. The small sample of approved loans did not allow us to project to the universe

¹These nonprofits were identified during our previous work on assistance provided to small businesses in New York City after September 11. See [GAO-03-88](#), pp. 21-24.

of all approved loans, and we discuss the disposition only of the files that we reviewed.

We sampled from the original population of all 24,041 September 11 disaster loan applications.² We selected a probability sample using a design that was stratified by SBA's four disaster area offices and whether or not the loan application was declined or withdrawn. We also selected a smaller simple random sample from among all of the accepted loan applications, as a check to see how the loan files differed from those withdrawn or declined. We assessed the reliability of SBA's database, the Automated Loan Control System, and found it acceptable for our purposes. Additional details about our sampling methodology follow.

The sampling unit was the paper copy of a loan application file. The sample sizes were estimated at the 95 percent level of confidence for a desired precision of 6 percent. The sample size was estimated using a formula appropriate for estimating an attribute in a stratified design.³ Within the universe, some older application files had already been shredded. Under SBA's procedures, declined and withdrawn files that have been inactive for 2 years may be shredded. To account for this, the sample size was increased slightly within each of the eight strata, in case one of these files appeared in the random sample. However, none of the files in our sample had been shredded—SBA was able to provide us with all of the files we requested. Between the eight strata, a sample size of 103 was proportionally allocated and then selected. The strata allocation and final disposition of the sample are shown in Table 1.

Table 1: Disposition of Loan Application Sample by SBA Disaster Area Office

Stratum	Sample	Out of scope files	Adjusted sample
New York – Declined	44	2	42
New York – Withdrawn	21	2	19
Georgia – Declined	13	0	13

²The number of applications in SBA's universe of September 11 disaster loans was as of January 30, 2004, when SBA provided us with the data.

³Cochran, William, *Sampling Techniques: Third Edition* (New York, New York: John Wiley and Sons, 1977).

(Continued From Previous Page)

Stratum	Sample	Out of scope files	Adjusted sample
Georgia – Withdrawn	4	0	4
Texas – Declined	5	0	5
Texas – Withdrawn	2	0	2
California – Declined	10	0	10
California – Withdrawn	4	0	4
Total	103	4	99

Source: GAO.

In our loan application file reviews, we found that 4 of the 103 loan application files sampled were physical injury disaster loans files, not EIDL applications, and we excluded them as out of our study’s scope. In the entire original population of 13,171 declined or withdrawn applications, we found 808 corresponding out of scope records. In addition, there were 223 files that SBA indicated had been shredded. Therefore, the final study population that we analyzed and to which our data collection instrument sample is projected is 12,140.

Our confidence in the precision of the results from this sample is expressed in 95-percent confidence intervals. The 95-percent confidence intervals are expected to include the actual results for 95 percent of the samples of this type. We calculated confidence intervals for our study results using methods that are appropriate for probability samples of this type. For all of the percentages presented in this report, we are 95-percent confident that the results would have obtained, had we studied the entire population, are within plus or minus 6 or fewer percentage points of our results, unless otherwise noted.

We located and reviewed all 99 declined or withdrawn sampled files. We also reviewed 27 of the 30 approved loans in our nonprobability sample. SBA reported that three of the files in our sample were not readily available because the loans had been paid in full by the borrower, and the loan files had been placed in storage. To ensure accuracy of our file reviews, two GAO analysts reviewed each of the loan files. Based on the reviews of documentation in the files, we entered information into an automated data collection instrument. We also conducted basic checks on the programming and analysis of the file review data.

Appendix I
Scope and Methodology

We conducted our work in Atlanta, GA; New York, NY; and Washington, D.C., between May 2003 and June 2004 in accordance with generally accepted government auditing standards.

Comments From Small Business Administration



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

JUL 29 2004

Davi M. D'Agostino
Director
Financial Markets and Community Investment
United States Government Accountability Office
441 G Street, N.W.
Washington, DC 20548

Dear Ms. D'Agostino:

We appreciate the recognition in this report of the exceptional performance of the U.S. Small Business Administration (SBA) in our underwriting practices and procedures in response to the September 11, 2001, terrorist attacks.

SBA disaster loans are the primary form of Federal assistance for non-farm, private sector disaster losses. For this reason, the disaster loan program is the only form of SBA assistance not limited to small businesses. By providing disaster assistance through low interest loans which are repaid to the Treasury, SBA's disaster loan program helps reduce Federal disaster costs compared to other forms of assistance, such as grants.

Because SBA utilizes taxpayer funds to lend to disaster victims, it is our responsibility as a creditor to establish a reasonable assurance that all disaster loans can and will be repaid. Accordingly, our decisions are based on a balance between our role as a provider of disaster assistance and our responsibility to protect the government's interest as a creditor. In assessing the ability of each business to repay a disaster loan, we look at the business' pre-disaster performance based on financial data from the applicant and Federal tax returns. By using these financial records to establish normal pre-disaster performance, we avoid penalizing a business because of the adverse economic impact of the disaster itself.

Be assured, the SBA was committed to assisting small businesses with their working capital losses that were a direct impact of the tragic events of September 11. SBA worked hard to approve each application and we incurred risks private lenders cannot. Nevertheless, in lending taxpayer funds, we must adhere to fundamental credit standards.

SBA IS AN EQUAL OPPORTUNITY EMPLOYER AND PROVIDER



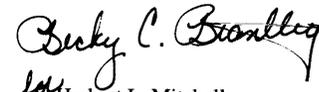
**Appendix II
Comments From Small Business
Administration**

Davi M. D'Agostino

Page 2

We appreciate the opportunity to provide clarifying comments and have included our specific requests for clarification and/or changes within the attachment herein.

Sincerely,


for
Herbert L. Mitchell
Associate Administrator
For Disaster Assistance

Attachment

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