

# SBA'S HANDLING OF POTENTIALLY FRAUDULENT PAYCHECK PROTECTION PROGRAM LOANS

REPORT NUMBER 22-13 | May 26, 2022





# EXECUTIVE SUMMARY

Report 22-13

May 26, 2022

## SBA'S HANDLING OF POTENTIALLY FRAUDULENT PAYCHECK PROTECTION PROGRAM LOANS

### What OIG Reviewed

The Coronavirus Aid, Relief, and Economic Security (CARES) Act established the Paycheck Protection Program (PPP), an \$813.7 billion program that provided fully guaranteed SBA loans for eligible small businesses, individuals, and nonprofits adversely impacted by the pandemic. PPP loans can be forgiven if used as required by the law.

From the start of the program, the U.S. Small Business Administration (SBA) Office of Inspector General (OIG) was called on to investigate cases of suspected fraud. As of December 2021, PPP fraud Hotline complaints exceeded 54,000.

Our objective was to assess SBA's handling of potentially fraudulent PPP loans. To accomplish our objective, we reviewed SBA processes, procedures, and guidance for handling PPP loans and interviewed key SBA officials.

### What OIG Found

SBA did not have an organizational structure with clearly defined roles, responsibilities, and processes to manage and handle potentially fraudulent PPP loans across the program. In addition, the agency did not establish a centralized entity to design, lead, and manage fraud risk.

This problem occurred because the agency did not establish a sufficient fraud risk framework at the start of and throughout PPP implementation. Management stated this was partly due to the speed of the delivery of PPP and the continuous and rapid discovery of different kinds of fraud schemes.

In addition, lenders were not always clear on how to handle PPP fraud or recover funds obtained fraudulently from the PPP that remained in the borrower's account. SBA did not provide lenders sufficient specific guidance to effectively identify, track, address, and resolve potentially fraudulent PPP loans.

These control gaps weakened SBA's ability to actively prevent and reduce fraud and increased the risk of fraudulent and ineligible applicants receiving PPP loans and loan forgiveness.

During our review, SBA established a Fraud Risk Management Board. As a result, we are not making a recommendation regarding a centralized entity to manage fraud risk.

### What OIG Recommended

To better mitigate fraud, we recommend SBA establish clearly defined and detailed roles, responsibilities, and processes and provide lenders formal guidance for managing and handling potentially fraudulent loans.

### Agency Response

SBA management generally agreed with the findings and agreed with both recommendations. Management plans to document the roles, responsibilities, and processes for all SBA offices responsible for managing and handling potentially fraudulent PPP loans. Management also plans to consolidate its existing guidance to lenders regarding fraud and provide new guidance as appropriate.




# Office of Inspector General

U.S. Small Business Administration

**Date:** May 26, 2022

**To:** Isabella Casillas Guzman  
Administrator

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

**Subject:** SBA's Handling of Potentially Fraudulent Paycheck Protection Program Loans

This report presents the results of our inspection on *SBA's Handling of Potentially Fraudulent Paycheck Protection Program Loans*. We considered management's comments on the draft of this report when preparing the final report. Management agreed with the recommendations.

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

cc: Patrick Kelley, Associate Administrator, Office of Capital Access  
John Miller, Deputy Associate Administrator, Office of Capital Access  
Arthur Plews, Chief of Staff  
Therese Meers, Acting General Counsel, Office of General Counsel  
Michael Simmons, Attorney Advisor, Office of General Counsel  
Katherine Aaby, Associate Administrator, Office of Performance, Planning, and Chief Financial Officer  
Tonia Butler, Director, Internal Controls, Office of Chief Financial Officer

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## Introduction

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This report presents the results of our inspection of the U.S. Small Business Administration's (SBA) handling of potentially fraudulent Paycheck Protection Program (PPP) loans. The scope of this inspection covers SBA roles and responsibilities, processes, procedures, and guidance for handling potentially fraudulent PPP loans from March 2020 to July 2021.

## Background

The President signed the Coronavirus Aid, Relief, and Economic Security (CARES) Act into law on March 27, 2020. Section 1102 of the Act provided \$349 billion to create the Paycheck Protection Program (PPP) under Section 7(a) of the Small Business Act. PPP provided fully guaranteed SBA loans for certain eligible small businesses, individuals, and nonprofit organizations that can be forgiven if loan proceeds were used as required by the law. Eligible expenses include payroll, rent, utility payments, and for other limited uses.

On April 24, 2020, the President signed the Paycheck Protection Program and Health Care Enhancement Act to add \$310 billion to the PPP, totaling \$659 billion for the program. Round one of PPP lending closed on August 8, 2020 with 5.2 million PPP loans approved, totaling \$525 billion.

On December 27, 2020, the Economic Aid to Hard-Hit Small Businesses, Nonprofits, and Venues Act through the Consolidated Appropriations Act, 2021 extended the program through March 31, 2021 to continue assistance under the PPP for small businesses financially affected by the ongoing Coronavirus Disease 2019 (COVID-19) pandemic. The Economic Aid Act provided an additional \$147.5 billion in program funding, which increased the total program funding to \$806.5 billion.

On March 11, 2021, the American Rescue Plan Act of 2021 provided an additional \$7.2 billion to the PPP, which increased the total program funding to \$813.7 billion. On March 30, 2021, the President signed the PPP Extension Act of 2021, which allowed SBA to continue accepting new applications until May 31, 2021.

## Unprecedented Fraud Levels

Since the beginning of the program, the Office of Inspector General (OIG) has investigated an unprecedented number of fraud complaints from various sources, including the OIG Hotline, financial institutions, and other law enforcement agencies. OIG continues to receive complaints and launch investigations.

Since March 2020, the Department of Justice has publicly announced charges in numerous fraud-related cases. OIG and other law enforcement agencies have identified systemic patterns of potential fraud, including false attestations on loan documents, inflation of payroll, falsified tax documentation, identity theft, and misuse of proceeds. Our investigative activities and case load continue to increase.

Additionally, based on our previous work and analysis of SBA's loan data as of August 2020, we identified more than 70,000 loans totaling over \$4.6 billion in potentially fraudulent PPP loans. These figures stem from three OIG projects that highlighted indicators and red

flags for potential fraud, including duplicate loans, businesses created after the February 15, 2020 cutoff date, and loans that match Do Not Pay data sources.<sup>1</sup>

These loans can only be considered potentially fraudulent because OIG has not completed a document-by-document review of loan files to confirm or resolve the suspicious activity; however, our investigations have substantiated an unprecedented level of fraud activity. We are working to identify the full extent of PPP fraud.

SBA was mandated by Congress to implement the program 15 days after enactment of the CARES Act. The CARES Act also allowed SBA to rely on borrower self-certifications regarding operating status and true and accurate information, rather than verification of supporting documentation provided by borrowers. Speed became the highest priority in complying with the mandate. As of May 31, 2021, SBA had processed 11.8 million guaranteed PPP loans, totaling \$799.8 billion, through about 5,460 private lenders.

As of December 2021, PPP fraud OIG Hotline complaints exceeded 54,000 in comparison to the 52 complaints received in all of 2019 for SBA's 7(a) guaranteed loan program. From April to October 2020, financial institutions filed more than 21,000 suspicious activity reports related to PPP loans with the Financial Crimes Enforcement Network.

Because PPP lending is closed to new applications, SBA's challenge is to effectively handle potentially fraudulent PPP loans to reduce the risk of financial loss and ensure only eligible borrowers receive forgiveness in accordance with program requirements. In February 2022,<sup>2</sup> we reported that SBA changed its process to review loans in June 2021, prioritizing by risk level instead of the order the forgiveness application was submitted.

SBA also made changes to allow certain loans to be retroactively reviewed for fraud and eligibility after they have been forgiven. We expressed concerns about the affect this change will have on SBA's ability to recover funds for forgiven loans later determined to be ineligible.

## **How PPP Works**

To get a PPP loan, borrowers submitted applications which included good faith certifications of information required in the application. The borrowers submitted these applications to lenders to approve PPP loan requests using the lender's delegated authority.

If approved, the lender submitted the borrower's application information to SBA electronically to be assigned an SBA loan number. Once SBA issued a loan number, the lender disbursed the approved loan amount to the borrower.

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<sup>1</sup> SBA OIG Flash Report 21-09, *Duplicate Loans Made Under the Paycheck Protection Program*, March 15, 2021; SBA OIG Inspection Report 21-07, *Inspection of SBA's Implementation of the Paycheck Protection Program*, January 14, 2021; and SBA OIG Management Alert Report 21-06, *Paycheck Protection Program Loan Recipients on the Department of Treasury's Do Not Pay List*, January 11, 2021.

<sup>2</sup> SBA OIG Report 22-09, *SBA's Paycheck Protection Program Loan Review Processes*, February 28, 2022.

To have loans forgiven, borrowers must complete and submit the PPP loan forgiveness application to the lender. The lender then has 60 days to review the application and make a loan forgiveness decision to SBA.

The lender may deny the loan forgiveness amount in full or in part. Once SBA receives the lender's decision, SBA is required to remit the appropriate forgiveness amount to the lender within 90 days.

## **Results**

SBA did not have an organizational structure with clearly defined roles, responsibilities, and processes to manage and handle potentially fraudulent PPP loans. In addition, the agency did not establish a centralized entity to design, lead, and manage fraud risk because the agency did not establish a sufficient fraud risk framework. Management stated this was partly due to the speed of the delivery of PPP and the continuous and rapid discovery of different kinds of fraud schemes.

In addition, lenders were not always clear on how to handle PPP fraud or recover funds obtained fraudulently from the PPP that remained in the borrower's account. This occurred because SBA did not provide lenders sufficient specific guidance to effectively handle potentially fraudulent PPP loans. According to SBA officials, there was a significant increase in lenders requesting specific guidance from SBA to ensure they met agency requirements and handled fraud appropriately. However, SBA officials said lenders already had industry regulations for fraud, which could have served as guidance for handling PPP fraud.

These gaps weakened SBA's ability to actively reduce and combat fraud and increased the risk of fraudulent and ineligible applicants receiving PPP loans and loan forgiveness.



## **Finding 1: SBA Did Not Establish Clearly Defined Roles, Responsibilities, and Processes to Manage Potentially Fraudulent PPP Loans**

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SBA did not have an organizational structure with clearly defined roles, responsibilities, and processes to manage and handle potentially fraudulent PPP loans across the program. In addition, the agency did not establish a centralized entity to design, lead, and manage fraud risk as recommended in the Government Accountability Office's (GAO) *A Framework for Managing Fraud Risks in Federal Programs*.<sup>3</sup>

### **Roles and Responsibilities**

The *Standards for Internal Control in the Federal Government* recommends management establish an organizational structure, assign responsibility, and delegate authority to key roles to achieve program objectives. Management should create documented processes and policies for the organization's internal controls.<sup>4</sup>

SBA did not clearly designate points of contacts for handling various aspects of fraud in the program and define their roles and responsibilities. The agency did not establish a centralized entity to ensure a consistent and effective approach to managing, coordinating, and leading efforts to handle potentially fraudulent PPP loans.

We found SBA's Office of Capital Access and Office of General Counsel were in supportive roles and involved in only a portion of the fraud risk effort. Within the Office of Capital Access and Office of General Counsel, SBA developed general roles and responsibilities for each of its offices that were not specific to the PPP.

During our meetings with each SBA office, we learned the following information about the roles of the program offices:

- The Office of Financial Assistance, in coordination with the Office of General Counsel and the Department of the Treasury, updated regulations, policies, and procedures for the PPP. Also, during PPP implementation, SBA coordinated with the Department of the Treasury to issue interim final rules and frequently asked questions.
- The Office of Performance Systems Management developed, monitored, and maintained systems such as E-Tran, which supports the 7(a) loan program, including the PPP.
- The Office of Financial Program Operations identified, tracked, and referred instances of PPP fraud to OIG. The office's support contractor performed automated screenings and manual reviews of PPP loans.
- The Office of Credit Risk Management monitored lenders and was mainly a liaison between the lenders that reported PPP fraud and other SBA offices, such as the Office of Financial Program Operations, the Office of General Counsel, and OIG.

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<sup>3</sup> GAO-15-593SP, *A Framework for Managing Fraud Risks in Federal Programs*, July 2015.

<sup>4</sup> GAO-14-704G, *Standards for Internal Control in the Federal Government*, September 2014.



- The Office of General Counsel provided legal services to all SBA offices, including the Office of Capital Access. The Office of General Counsel was only involved in handling PPP fraud when meeting an office's request to provide legal advice or assistance.

## Processes

None of the Office of Capital Access suboffices had sufficient written guidance outlining the process to identify, address, and resolve potentially fraudulent PPP loans. The written guidance in place was either highly general or not specific to the program office's role in the PPP.

For example, SBA officials referred us to Interim Final Rules, Frequently Asked Questions, Standard Operating Procedures, and the PPP Loan Review Plan as the written guidance relating to SBA's handling of potentially fraudulent PPP loans. However, these documents just contained general statements on SBA preventing fraud, waste, and abuse within the PPP.

In addition, SBA officials could not provide detailed written documentation describing how officials within the offices of Capital Access and General Counsel were to handle potentially fraudulent PPP loans. SBA did not clearly document officials' involvement in leading, designing, and managing fraud risk activities to ensure a consistent and effective approach to handling potentially fraudulent PPP loans.

Officials told us they were not provided sufficient guidance on their specific roles and responsibilities in handling potentially fraudulent PPP loans. This occurred because SBA had not established a centralized entity to manage the program consistently.

The PPP Loan Review Plan provided an overview of SBA's loan review processes, including overall processes for the office's support contractor. However, the loan review plan was not a comprehensive fraud risk framework. The plan did not specify the roles and responsibilities of all SBA officials involved in handling PPP fraud and related procedures.

For example, the loan review plan says if SBA determined a borrower was ineligible, the agency could seek repayment of the outstanding PPP loan balance or pursue other available remedies. However, the plan did not specifically outline the processes for how SBA would seek repayment and did not provide specifics on the other available remedies.

SBA officials within the Office of Capital Access's program offices were not always clear on the roles and processes of other offices. For example, an Office of Financial Assistance official told us they did not have formal internal processes for handling potentially fraudulent PPP loans and referred us to the Office of Financial Program Operations. When we met with the Office of Financial Program Operations, an official told us the PPP guidance does not address fraud and referred us back to Office of Financial Assistance for formal processes.

Because instructions were minimal, SBA officials we interviewed said they developed their own informal and ad hoc processes to deal with potential fraud as it occurred. According to SBA officials within the various OCA offices, each office had their own informal process regarding their involvement with handling potentially fraudulent PPP loans.

These conditions occurred because SBA did not establish a sufficient fraud risk framework at the start and throughout PPP implementation. SBA officials told us they did not formalize roles and responsibilities and establish sufficient written processes to handle potential fraud because they had to launch the PPP 15 days after enactment and the immediate problem of constantly having to combat rapidly evolving fraud schemes.

The absence of a sufficient fraud risk framework did not allow for the mitigation of fraud risk or the establishment of controls to decrease fraud risk. Without a sufficient fraud framework, the agency increased the risk of fraudulent and ineligible applicants receiving PPP loans, which is evident in the unprecedented increase in government-wide investigative activities and audit results stemming from the PPP.

Our investigations have substantiated an unprecedented level of fraud activity. Our analysis of PPP loan data as of August 2020 identified more than 70,000 potentially fraudulent PPP loans totaling more than \$4.6 billion. Additionally, we received over 54,000 PPP related OIG Hotline complaints.

In February 2022, we reported SBA made changes to its loan review process in June 2021.<sup>5</sup> In part, the changes allowed SBA to forgive certain loans before reviewing the loans for eligibility and fraud. We expressed concerns regarding the impact this change will have on SBA's ability to recover funds for forgiven loans later determined to be ineligible.

When implementing controls for PPP forgiveness or similar programs in the future, SBA must develop written processes that are clear, comprehensive, and complete to effectively mitigate fraud and help ensure only eligible borrowers receive funds or loan forgiveness.

## **Actions to Reduce Fraud Risks**

During the implementation of PPP, SBA implemented or initiated action on all of the OIG recommendations to strengthen internal controls and reduce fraud risks.<sup>6</sup> For example, SBA required verification that businesses were established before the mandated date and that loan applicants were not included on Treasury's Do Not Pay data sources.

In October 2020, SBA developed and implemented its loan review plan to establish guidelines for loan and forgiveness reviews. SBA made significant changes to this plan in June 2021. SBA also used a contractor's automated review tool and the PPP Platform to analyze loans for fraud and eligibility.

In March 2021, GAO recommended that SBA conduct and document a fraud risk assessment for the PPP and develop a strategy that outlines specific actions to monitor and manage fraud risks in the PPP on a continuous basis.<sup>7</sup>

Although the PPP ended May 31, 2021, SBA hired a contractor in June 2021 to conduct a fraud risk assessment. The contractor's report, dated October 29, 2021, identified known and emerging fraud vulnerabilities, aligned the vulnerabilities to fraud risks, incorporated

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<sup>5</sup> SBA OIG Report 22-09, *SBA's Paycheck Protection Program Loan Review Processes*, February 28, 2022.

<sup>6</sup> SBA OIG Memorandum, "Key Recommendations Based on Lessons Learned from Prior COVID-19 Economic Injury Disaster and Paycheck Protection Program Loan Programs," December 23, 2020.

<sup>7</sup> GAO-21-387, *COVID-19: Sustained Federal Action is Crucial as Pandemic Enters Its Second Year*, March 2021.

SBA's mitigation strategies to date, and provided risk response recommendations to support addressing the accepted fraud risks.

As of March 10, 2022, GAO's recommendations remained open. We will continue to monitor SBA's actions related to the contractor's identified risks, which we have reported in our past reports.

Additionally, to be effective and avoid operating in a pay-and-chase environment, the Office of Management and Budget recommends Executive Offices prioritize efforts to prevent improper payments from occurring.<sup>8</sup> The reason for this is not only to avoid the improper payment but also to avoid expending resources to try and recover the overpayment. Building a strong control environment is essential because fraudulent activities can occur at any time during the life cycle of PPP loans, from origination to forgiveness and repayment. Additionally, establishing procedures to mitigate fraud would set a solid foundation for similar future programs.

On February 24, 2022, SBA established a Fraud Risk Management Board, nearly a year after the PPP ended May 31, 2021. According to the charter, the board will serve as the designated antifraud entity responsible for oversight and coordination of SBA's fraud risk prevention, detection, and response activities.

If effective, this action should address our concern about the agency not establishing a centralized entity to design, lead, and manage fraud risk. We are not making a recommendation regarding this matter. However, we will continue to monitor the activities of the fraud risk board to reduce fraud risks and develop effective antifraud controls.

## **Recommendation**

We recommend the Administrator direct the Associate Administrator of the Office of Capital Access to:

1. Establish clearly defined and detailed roles, responsibilities, and processes for all SBA offices and officials responsible for managing and handling potentially fraudulent PPP loans to reduce the risk of ineligible applicants receiving PPP forgiveness and the risk of fraud and financial loss in the PPP and when implementing similar future programs.

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<sup>8</sup> Office of Management and Budget Memorandum M-21-19, "Transmittal of Appendix C to OMB Circular A-123, Requirements for Payment Integrity Improvement," March 5, 2021.

## **Finding 2: SBA Did Not Provide Comprehensive Fraud Guidance to Lenders**

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Lenders were not always clear on how to handle PPP fraud or recover funds obtained fraudulently from the PPP that remained in the borrower's account. This occurred because SBA did not provide lenders specific and sufficient guidance to effectively identify, track, address, and resolve potentially fraudulent PPP loans.

SBA informed lenders to refer potentially fraudulent PPP loans to OIG. The methods SBA used to inform lenders included informal emails, phone calls, and SBA-written guidance with a link to the SBA OIG Hotline complaint portal. However, SBA stated it did not provide specific guidance to lenders because it believed that lenders already had industry regulations regarding fraud, which could serve as guidance for handling PPP fraud.

Because of the size and scope of the PPP and delegated authority given to lenders, specific guidance would have better prepared lenders to handle the large volume of fraudulent loans they received. Federal internal control standards recommend management implement internal controls by documenting responsibilities and providing guidance.<sup>9</sup>

Consequently, the agency had a responsibility to issue sufficient and specific guidance to the lenders. GAO recommended that agencies develop and implement a strategy with specific control activities to reduce fraud risks and collaborate to help ensure effective implementation. This included developing, documenting, and communicating an antifraud strategy focusing on preventive control activities and establishing collaborative relationships with stakeholders.<sup>10</sup>

SBA established a publicly available PPP webpage for lender information and resources, which included general guidance and documents SBA issued on PPP, such as Interim Final Rules, Frequently Asked Questions, Letters from the SBA Administrator, Lender Notices, and lender and borrower forms. However, none of the references provided specific guidance to lenders for handling PPP fraud.

Instead, SBA informally advised individual lenders that investigating potential fraud, filing a petition to recover any funds seized on PPP loans, and recovering the funds was the lender's responsibility and obligation.

According to SBA officials, there was a significant increase in lenders requesting specific guidance from SBA to ensure they met agency requirements and handled fraud appropriately. To address the increase in lender inquiries, SBA officials said they informally emailed and called individual PPP lenders.

However, with the significant increase in volume and various types of lender inquiries SBA received, SBA managers should have provided formal and consistent guidance to ensure lenders had the information they needed to handle fraud.

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<sup>9</sup> GAO-14-704G, *Standards for Internal Control in the Federal Government*, September 2014.

<sup>10</sup> GAO-15-593SP, *A Framework for Managing Fraud Risks in Federal Programs*, July 2015.

For example, from May 2020 through August 7, 2021, the Office of General Counsel received at least 2,800 inquiries from PPP lenders. The PPP lenders included online lenders, called financial technology lenders or fintechs, that generally had less experience with SBA and dealing with fraud.

PPP lenders requested guidance from the agency on how to

- report evidence of systemic fraud in the PPP,
- identify whether a particular pattern was fraud required to be reported to OIG,
- handle fraudulent PPP applicants rejected for a loan,
- determine whether the lenders were required to report fraudulent applicants,
- handle the large volume of fraudulent applications lenders were receiving,
- handle flagged PPP loans,
- handle PPP loans in bankruptcy that involve false certifications and fraud,
- act on borrowers indicted for fraud,
- recover fraudulently obtained funds from PPP loans still remaining in the borrower's account as well as funds the borrower had withdrawn,
- handle seized funds from PPP loans,
- continue servicing the loan, such as whether a lender can apply for forgiveness or request a purchase guaranty when the borrower has been charged with fraud.

## **Lenders Turned to OIG**

Before the PPP, OIG investigative agents had little to no historical interaction with lenders in the regular SBA 7(a) guaranteed loan program. However, OIG also received a high volume of requests for guidance from lenders and financial institutions on how to handle potentially fraudulent PPP loans.

OIG has received inquiries from lenders requesting guidance on how to

- handle flagged PPP loans,
- flag a street address suspected of PPP fraud,
- return remaining funds for potentially fraudulent PPP loans,
- report individuals suspected of committing fraud on PPP loans,
- handle deposits from potentially fraudulent PPP loans,
- handle the remaining unspent funds that a borrower received from a potentially fraudulent PPP loan.

In March 2021, our Investigations Division in coordination with the U.S. Secret Service Office of Investigations issued an alert to financial institutions about PPP fraud indicators, suspicious activity report filings, returning potentially fraudulent PPP funds, and reporting fraudulent activities to law enforcement.

SBA should have provided lenders specific guidance from the onset to identify, track, address and resolve potentially fraudulent loans. Establishing strong upfront controls helps ensure lenders know how to effectively handle fraud.

Working with lenders is essential because they work directly with borrowers and have the delegated authority to process and service the loans that SBA ultimately guarantees or forgives using taxpayer funds.

Because SBA did not provide specific guidance to lenders, they were faced with uncertainty on how to resolve issues they were uncovering. The lack of specific guidance for lenders increased the risk of guaranteeing and forgiving PPP loans for potentially fraudulent and ineligible applicants.

Providing lenders with specific guidance on addressing PPP fraud could establish a solid foundation for addressing fraud in similar programs in the future.

## **Recommendation**

We recommend the Administrator direct the Associate Administrator of the Office of Capital Access to:

2. Provide lenders formal guidance to effectively and consistently handle potentially fraudulent PPP loans and ensure lenders have sufficient guidance when implementing similar future programs.

## **Analysis of Agency Response**

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SBA management provided formal comments to the draft report, which are included in Appendix C. Management generally agreed with the findings and agreed with both recommendations. Management provided implementation dates for the recommendations in separate correspondence, and its proposed actions will resolve both recommendations. We considered management's comments when preparing this final report.

### **Summary of Actions Necessary to Close the Recommendations**

The following section details the status of our recommendations and the actions necessary to close them.

#### **Recommendation 1**

Establish clearly defined and detailed roles, responsibilities, and processes for all SBA offices and officials responsible for managing and handling potentially fraudulent PPP loans to reduce the risk of ineligible applicants receiving PPP forgiveness and the risk of fraud and financial loss in the PPP and when implementing similar future programs.

#### **Status: Resolved**

SBA management agreed with the recommendation, stating that it will document the roles, responsibilities, and processes for all SBA offices and officials responsible for managing and handling potentially fraudulent PPP loans. SBA management stated that although SBA agrees with the recommendation, it does so with the belief that much has already been done in that regard during the last two years.

Management stated SBA can detect potential fraud at any point in the PPP lifecycle. At origination, up-front lender procedures, compliance checks, and hold codes helped detect fraud. All PPP loans have passed through SBA's automated screening tool, aggregate review tool, and machine learning tool prior to forgiveness being granted. As loans pass through each of these tools, they are flagged for indications of potential fraud, which are manually reviewed by third-party fraud experts and referred to the SBA's Office of Financial Program Operations and OIG if necessary.

SBA's Office of General Counsel (OGC) also took an active role in handling PPP fraud by assisting the Department of Justice and OIG on PPP civil and criminal cases and advising and informing lenders on numerous fraud issues. OGC worked with the U.S. Secret Service to seize fraudulent accounts and provide witnesses in many PPP prosecutions.

Although SBA management stated that the procedures and actions referenced above helped detect and combat fraud, as noted in the report, SBA did not establish clearly defined roles, responsibilities, and processes to manage and handle potentially fraudulent PPP loans across the program.

The absence of a sufficient fraud risk framework increased the risk of fraudulent and ineligible applicants receiving PPP loans, pushing SBA into a pay-and-chase environment. This is evident, as noted in the report, in the unprecedented increase in government-wide investigative activities and audit results, stemming from the PPP. We also recognized actions SBA subsequently took to reduce the fraud risks.



SBA plans to complete final action on this recommendation by September 30, 2022. This recommendation can be closed when SBA provides evidence that they have established clearly defined and detailed roles, responsibilities, and processes for all SBA offices and officials responsible for managing and handling potentially fraudulent PPP loans. The defined roles, responsibilities, and processes should also serve as a foundation for future similar stimulus programs.

## **Recommendation 2**

Provide lenders formal guidance to effectively and consistently handle potentially fraudulent PPP loans and ensure lenders have sufficient guidance when implementing similar future programs.

### **Status: Resolved**

SBA management agreed with the recommendation, stating that the agency will work to consolidate its existing guidance on fraud and add any new guidance to lenders as appropriate. SBA will ensure lenders have sufficient guidance when implementing similar future programs.

SBA management identified a PPP Interim Final Rule, three SBA procedural notices, two SBA standard operating procedures, and other information as guidance for handling potentially fraudulent PPP loans. OCA developed a system of hold codes that included fraud, which was designed to prevent loan approval or granting forgiveness for loans suspected of being fraudulent. SBA management stated this was effective because many lenders held up loan forgiveness decisions until suspicion was cleared.

SBA management stated that once fraud was detected by either lenders or SBA officials, the requirement was clear that the case had to be referred to OIG. There is a system for dealing with fraudulent activity through the Bank Secrecy Act and other regulatory agencies. The nature of the PPP program required that assistance be given to small businesses as quickly as possible. Given the enormous magnitude of the PPP, it also required delegating the responsibility for making these loans to the lenders, who were responsible for their underwriting.

Although SBA management stated that the guidance and controls referenced by SBA were helpful in detecting and combating fraud, as noted in the report, the guidance was not specific and sufficient for lenders to effectively and consistently identify, track, address, and resolve potentially fraudulent PPP loans. SBA informed lenders that they should refer cases of fraud when detected. However, lenders were not always clear on how to handle PPP fraud, including recovering funds in borrower accounts that were obtained fraudulently.

SBA has responsibility for overseeing the PPP and reducing the risk of financial loss. The agency should ensure lenders have sufficient guidance to handle and resolve potentially fraudulent activity. SBA should provide information on the type of fraud lenders are finding and best practices for detecting and reporting that fraud to SBA and OIG. Specifically, SBA should instruct lenders on how to document and report the return of funds from the financial institution. This should include the reason for the return and any findings of fraud found by the financial institution and lender. In addition, SBA should provide instructions for lenders to report notice of seizures, forfeitures, and restitution to the SBA. The

instructions would help SBA properly flag loans for potential fraud and account for the loan balance. This would help determine if there are any funds due to the SBA if the loan had been forgiven or guaranteed purchased.

Management plans to complete final action on this recommendation by September 30, 2022. This recommendation can be closed when SBA provides evidence that it has provided lenders formal guidance to effectively and consistently handle potentially fraudulent PPP loans and ensure lenders have sufficient guidance when implementing similar future programs.

## Appendix A: Objective, Scope, and Methodology

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Our objective was to assess SBA’s handling of potentially fraudulent PPP loans. We defined handling as identifying, tracking, addressing, resolving, referring, and reporting. To meet our objective, we reviewed relevant federal regulations, policies, procedures, and guidance, including the following:

- CARES Act
- PPP and Health Care Enhancement Act
- PPP Flexibility Act of 2020
- Extending Authority for Commitments for the PPP and Separating Amounts Authorized for other 7(a) loans
- Economic Aid to Hard-Hit Small Businesses, Nonprofits, and Venues Act
- American Rescue Plan Act of 2021
- PPP Extension Act of 2021
- PPP Interim Final Rules
- SBA criteria including Standard Operating Procedures (SOP), such as SOP 50-10-6, Lender and Development Company Loan Programs, and SOP 50-57-2, 7(a) Loan Servicing and Liquidation, PPP Frequently Asked Questions, Notices, and PPP Loan Review Plan
- GAO-15-593SP, *A Framework for Managing Fraud Risks in Federal Programs*
- GAO-14-704G, *Standards for Internal Control in the Federal Government*

In addition, we interviewed SBA officials from the Office of General Counsel and officials from various offices within the Office of Capital Access, including the Office of Credit Risk Management, Office of Financial Assistance, Office of Financial Program Operations, and Office of Performance Systems Management to understand SBA’s processes for handling fraudulent PPP loans.

We sought to understand each office’s involvement, any processes or criteria in place based on that involvement, and whether any system is maintained by that office to track PPP fraud. We obtained a walkthrough from the Office of Financial Program Operations support contractor to understand the contractor’s role in the PPP loan review process, including automated screenings and manual reviews.

Our scope of work covered SBA roles and responsibilities, processes, procedures, and guidance for handling PPP loans from March 2020 to July 2021.

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

## **Use of Computer-Processed Data**

We did not rely on computer-processed data for the purposes of this report.

## Appendix B: Prior Audit Coverage

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Report	Title	Date
<a href="#">22-09</a>	<i>SBA'S Paycheck Protection Program Loan Review Processes</i>	February 28, 2022
<a href="#">21-19</a>	<i>Small Business Administration's Implementation of Recommended Controls and the Economic Aid Act</i>	August 12, 2021
<a href="#">21-09</a>	<i>Duplicate Loans Made Under the Paycheck Protection Program</i>	March 15, 2021
<a href="#">21-07</a>	<i>Inspection of SBA's Implementation of the Paycheck Protection Program</i>	January 14, 2021
<a href="#">21-06</a>	<i>Paycheck Protection Program Loan Recipients on the Department of Treasury's Do Not Pay List</i>	January 11, 2021
N/A	"Key Recommendations Based on Lessons Learned from Prior COVID-19 Economic Injury Disaster and Paycheck Protection Program Loan Programs" ( <a href="#">Memorandum</a> )	December 23, 2020

## **Appendix C: Management Comments**

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SBA RESPONSE TO INSPECTION REPORT

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



TO: Hannibal “Mike” Ware, Inspector General  
The Office of Inspector General (OIG)

FROM: Patrick Kelley  
Associate Administrator, Office of Capital Access

SUBJECT: Response to OIG Draft Report entitled “SBA’s Handling of Potentially Fraudulent Paycheck Protection Program Loans”

DATE: May 2, 2022

Thank you for providing the Office of Capital Access (OCA) the opportunity to respond to OIG’s Draft Report entitled, “SBA’s Handling of Potentially Fraudulent Paycheck Protection Program Loans,” dated April 1, 2022. The OIG’s audit objective for this draft report was to assess SBA’s handling of potentially fraudulent PPP loans. The OIG defined “handling” as identifying, tracking, addressing, resolving, referring, and reporting.

**OIG Recommendation 1** – We recommend the Administrator direct the Associate Administrator of the Office of Capital Access to establish clearly defined and detailed roles, responsibilities, and processes for all SBA offices and officials responsible for managing and handling potentially fraudulent PPP loans to reduce the risk of ineligible applicants receiving PPP forgiveness and the risk of fraud and financial loss in PPP and when implementing similar future programs

**SBA Response:** SBA concurs with this recommendation and will document the roles, responsibilities, and processes for all SBA offices and officials responsible for managing and handling potentially fraudulent PPP loans.

The Office of Capital Access (OCA) has the following comments with respect to the OIG recommendation 1:

Although SBA concurs with this recommendation, it does so with the belief that much has already been done in that regard over the course of the last two years, as noted below. It is also important to remember that the COVID-19 Pandemic posed a national health and economic crisis of historic proportions equivalent to events in the country’s history such as the Great Depression. As a result, the initial focus had to be on providing financial assistance as quickly as possible to respond to the crisis rather than carefully reviewing PPP loans as is done in the



making of regular 7(a) loans. In short, great speed was needed in delivering this economic assistance to small businesses to keep the economy afloat.

For example, as noted below, lenders were allowed to rely on borrower certifications that they were eligible for the programs. All lenders were delegated complete authority to oversee the making of these loans by the CARES Act.

SBA has the ability to detect potential fraud at any point in the PPP lifecycle. At origination, up-front lender Bank Secrecy Act/Know Your Customer/Anti-Money Laundering procedures (required for both federally-regulated lenders and non-bank lenders in the first PPP Interim Final Rule posted on April 2, 2020), SBA's up-front Compliance Checks (added for loan applications received after January 11, 2021), and Hold Codes (to prevent approval of certain Second Draw Loans without further review) helped detect potential fraud before a PPP loan number was assigned. All PPP loans have passed through SBA's automated screening tool, aggregate review tool, and machine learning tool prior to forgiveness being granted. As loans pass through each of these tools, they are flagged for indicia of potential fraud. Loans flagged for indicia of potential fraud are manually reviewed by third-party fraud experts and, if necessary, referred to SBA staff in OFPO for further review. If after a complete manual review, OFPO staff are unable to rule out fraud, the loan is referred to the OIG.

In May 2020, SBA Headquarters sent guidance to its loan servicing centers instructing them to report any indicia of PPP fraud to a central point of contact within the OFPO team. Since the early months of PPP, this central point of contact has been collecting potential fraud tips from inside SBA, from lenders, whistleblowers, victims of identity theft, and from external agencies such as the OIG, the Department of Justice (DOJ), the U.S. Secret Service and the Federal Bureau of Investigation (FBI), and ensuring that any associated loans are flagged with Hold Codes in SBA's CAFS. Since May 2020, there has been a structure in place for a dedicated team within SBA to field potential fraud tips and report potential fraud to external agencies. Even before this time, from the onset of the CARES Act and PPP, SBA has been working closely with and continues to work closely with these investigative agencies, continues to utilize CAFS to flag suspect loans with Hold Codes, and regularly shares CAFS data with the OIG and other law enforcement agencies.

We also note that SBA made approximately 11.4 million PPP loans, which by statute are 7(a) loans. The 70,000 PPP loans identified by OIG as potentially fraudulent, combined with the 54,000 PPP inquiries to the OIG Hotline, equates to approximately one percent of the PPP loans made by SBA. Although the volume of inquiries OIG received through the Hotline may have been unprecedented, the volume of PPP loans made by SBA was also unprecedented. By way of contrast, in a normal fiscal year, for example FY 2019, SBA guaranteed only 51,907 7(a) loans.

SBA's Office of General Counsel (OGC) also took an active role in handling PPP fraud. Immediately upon the implementation of the PPP program, a senior attorney in the Office of Litigation was assigned to assist the Department of Justice and OIG on PPP civil and criminal cases. The attorney also advised lenders on numerous fraud issues, as did the head of that Office and other attorneys there. Those attorneys also gave presentations on PPP fraud to the FDIC, to

the Federal Bar Association and had a widely attended conference call with members of the Bank Policy Institute (BPI) in order to answer a number of questions regarding forgiveness.

OGC also brought in the U.S. Secret Service (USSS), which had over 3,000 agents and seizure authority to help seize fraudulent accounts. Subsequently, OIG negotiated an agreement with the USSS for joint referrals. Two other attorneys in the Office of Litigation worked on nothing but asset seizures after OGC set up a system for the recovery of these funds with OCA and the CFO. Since that time, OGC has filed petitions for remission in thousands of cases. OGC has also been responsible for providing witnesses in many of the prosecutions involving the PPP program.

**OIG Recommendation 2** – We recommend the Administrator direct the Associate Administrator of the Office of Capital Access to provide lenders formal guidance to effectively and consistently handle potentially fraudulent PPP loans and ensure lenders have sufficient guidance when implementing similar future programs.

**SBA Response:** SBA concurs with this recommendation and will work to consolidate its existing guidance on fraud and add any new guidance to lenders as appropriate. SBA will ensure lenders have sufficient guidance when implementing similar future programs.

OCA has the following comments with respect to the OIG recommendation 2:

In April 2020, the Financial Crimes Enforcement Network (FinCEN) provided guidance about the obligations financial institutions have to follow existing guidance concerning reporting suspicious activity under Bank Secrecy Act (BSA) rules. Financial institutions were directed to contact FinCEN with concerns. FinCEN's guidance can be found here: [The Financial Crimes Enforcement Network Provides Further Information to Financial Institutions in Response to the Coronavirus Disease 2019 \(COVID-19\) Pandemic | FinCEN.gov](#).

FinCEN also provided additional guidance regarding PPP BSA requirements throughout the PPP program. See, <https://www.fincen.gov/sites/default/files/shared/Consolidated%20COVID-19%20Notice%20508%20Final.pdf>

The first PPP Interim Final Rule posted on April 2, 2020 (85 FR 20811), set forth the following responsibilities for PPP lenders when underwriting PPP loans:

b. What do lenders have to do in terms of loan underwriting?

Each lender shall:

- i. Confirm receipt of borrower certifications contained in Paycheck Protection Program Application form issued by the Administration;
- ii. Confirm receipt of information demonstrating that a borrower had employees for whom the borrower paid salaries and payroll taxes on or around February 15, 2020;
- iii. Confirm the dollar amount of average monthly payroll costs for the preceding calendar year by reviewing the payroll documentation submitted with the borrower's application; and
- iv. Follow applicable BSA requirements:

I. Federally insured depository institutions and federally insured credit unions should continue to follow their existing BSA protocols when making PPP loans to either new or existing customers who are eligible borrowers under the PPP. PPP loans for existing customers will not require re-verification under applicable BSA requirements, unless otherwise indicated by the institution's risk-based approach to BSA compliance.

II. Entities that are not presently subject to the requirements of the BSA, should, prior to engaging in PPP lending activities, including making PPP loans to either new or existing customers who are eligible borrowers under the PPP, establish an anti-money laundering (AML) compliance program equivalent to that of a comparable federally regulated institution.

Depending upon the comparable federally regulated institution, such a program may include a customer identification program (CIP), which includes identifying and verifying their PPP borrowers' identities (including e.g., date of birth, address, and taxpayer identification number), and, if that PPP borrower is a company, following any applicable beneficial ownership information collection requirements. Alternatively, if available, entities may rely on the CIP of a federally insured depository institution or federally insured credit union with an established CIP as part of its AML program. In either instance, entities should also understand the nature and purpose of their PPP customer relationships to develop customer risk profiles. Such entities will also generally have to identify and report certain suspicious activity to the U.S. Department of the Treasury's Financial Crimes Enforcement Network (FinCEN). If such entities have questions with regard to meeting these requirements, they should contact the FinCEN Regulatory Support Section at [FRC@fincen.gov](mailto:FRC@fincen.gov). In addition, FinCEN has created a COVID-19-specific contact channel, via a specific drop-down category, for entities to communicate to FinCEN COVID-19-related concerns while adhering to their BSA obligations. Entities that wish to communicate such COVID-19-related concerns to FinCEN should go to [www.FinCEN.gov](http://www.FinCEN.gov), click on "Need Assistance," and select "COVID19" in the subject drop-down list.

Each lender's underwriting obligation under the PPP is limited to the items above and reviewing the "Paycheck Protection Application Form." Borrowers must submit such documentation as is necessary to establish eligibility such as payroll processor records, payroll tax filings, or Form 1099-MISC, or income and expenses from a sole proprietorship. For borrowers that do not have any such documentation, the borrower must provide other supporting documentation, such as bank records, sufficient to demonstrate the qualifying payroll amount.

Additionally, SBA's Form 3507, "CARES Act Section 1102 Lender Agreement – Non-Bank and Non-Insured Depository Institution Lenders," requires non-bank, non-insured lenders to attest to compliance with their BSA obligations and agree to service and liquidate all covered loans made under the Paycheck Protection Program in accordance with PPP Loan Program Requirements. The Agreement further states that all servicing actions are the responsibility of the lender, which must follow accepted standards of loan servicing employed by prudent lenders.

SBA issued several Procedural Notices to provide PPP lenders with guidance on Hold Codes and Compliance Checks, as follows: SBA Procedural Notice 5000-20092, "Revised SBA Paycheck Protection Platform Procedures for Addressing Hold Codes on First Draw PPP Loans and Compliance Check Error Messages on First Draw PPP Loans and Second Draw PPP Loans" and SBA Procedural Notice 5000-808216, "Second Notice of Revised Procedures for Addressing Hold Codes and Compliance Check Error Messages on PPP Loans."

Additionally, SBA created a Declaration of Identity Theft to request that SBA review an outstanding PPP loan for identity theft. [Declaration of Identity Theft \(sba.gov\)](https://www.sba.gov/declaration-of-identity-theft)

Because PPP loans are 7(a) loans, SBA employees and lenders are also required to follow SBA's SOPs with regard to suspected fraud or illegal activity, including referral to OIG (SOP 50 10 6, Lender and Development Company Programs and SOP 50 57 2, 7(a) Loan Servicing and Liquidation). SBA also reminded employees and lenders to report fraud, waste, or abuse in Procedural Notice 5000-812316, "SBA Guaranty Purchases and Lender Servicing Responsibilities for PPP Loans."

Under the Agency's long-standing regulations (13 CFR 120.197) and policies (SOP 50 10 6, Part 1, Section A, Chapter 1, Para. C.4.), all 7(a) loans (of which PPP is a subset) with indications of fraud are required to be reported to OIG. Furthermore, lenders were counseled by both OCA and OIG that if they saw any suspicious activity with respect to PPP loans, they were to report it to OIG. In conjunction with that, OCA developed a system of Hold Codes that included fraud, which was designed to prevent loan approval or granting forgiveness for loans with that suspicion. This was very effective in that many lenders even held up submission of forgiveness decisions to SBA for loans with that designation until the suspicion was cleared up.

Despite the above, the draft audit report asserts that with the significant increase in the volume of lenders' inquiries, "SBA managers should have provided formal and consistent guidance to ensure lenders had the information they needed to handle fraud." On close analysis, however, this general statement loses its validity. As noted above, once fraud was detected by either lenders or SBA officials, the requirement was clear that the case had to be referred to OIG. There already existed a regulatory scheme for dealing with fraudulent activity as lenders participating in the PPP Program were subject to the requirements for detecting fraud under the Bank Secrecy Act and other regulatory requirements promulgated by their regulators and FinCen at Treasury. Moreover, as noted above, the nature of the PPP program required that this assistance to small businesses be accomplished as quickly as possible. Given the enormous magnitude of the PPP program, it also required that the responsibility for making these loans was delegated to the lenders, who were responsible for their underwriting.