

**MANAGEMENT ADVISORY REPORT ON
THE TRANSFER OF OPERATIONS TO
THE NATIONAL GUARANTY PURCHASE CENTER
Herndon, Virginia**

REPORT NUMBER 4-39

The findings in this report are the conclusions of the Office of Inspector General's Auditing Division based on testing of SBA operations. The findings and recommendations are subject to review, management decision, and corrective action in accordance with existing Agency procedures for follow-up and resolution. This report may contain proprietary information subject to the provisions of 18 USC 1905 and must not be released to the public or another agency without permission of the Office of Inspector General.



U.S. SMALL BUSINESS ADMINISTRATION
OFFICE OF INSPECTOR GENERAL
WASHINGTON, D.C. 20416

MANAGEMENT ADVISORY
REPORT

Issue Date: August 31, 2004

Report Number: 4-39

To: Stephen D. Galvan
Chief Operating Officer

Ronald E. Bew
Associate Deputy Administrator for Capital Access

From: *1st original signed*
Robert G. Seabrooks
Assistant Inspector General for Auditing

Subject: Management Advisory Report on the Transfer of Operations to the National Guaranty Purchase Center

Attached is a copy of the subject management advisory report. The purpose of the review was to determine if the National Guaranty Purchase Center (Center) is properly staffed and controlled to ensure the efficiency and effectiveness of operations based on concerns regarding staffing levels and the ability to meet workload demands while maintaining quality purchase decisions and liquidation actions. The report contains two findings and eleven recommendations. Based on the response from the Office of Capital Access, we revised recommendation 1F to ensure that the statuses of all loan files are tracked. We also added recommendation 1G to address the discrepancy between SBA's Loan Accounting System and the Center's records. The responses received from the Office of Capital Access and the Chief Operating Officer are synopsisized in the report and included as Attachment 2 and 3, respectively.

The findings in this report are the conclusions of the Office of Inspector General's Auditing Division. The recommendations are subject to review and implementation of corrective action in accordance with existing Agency procedures for audit follow-up.

Please provide your management decision for each recommendation addressed to you within 30 days from the date of this report using the attached SBA Forms 1824, Recommendation Action Sheet.

Should you or your staff have any questions, please contact Garry Duncan, Director, Credit Programs Group, at (202) 205-7732.

Attachments

**MANAGEMENT ADVISORY REPORT ON
THE TRANSFER OF OPERATIONS TO
THE NATIONAL GUARANTY PURCHASE CENTER
Herndon, Virginia**

Objective

The objective of the review was to determine if the Center is properly staffed and controlled to ensure the efficiency and effectiveness of operations. Fieldwork was conducted at the Small Business Administration (SBA) Central Office in Washington, D.C. and the Center in Herndon, Virginia, from March 2004 to June 30, 2004. We reviewed the Center's purchase activities from March 13, 2004 through June 25, 2004 and liquidation activities from March 13, 2004 through May 12, 2004. During the review, we met with SBA officials in the Office of Capital Access (OCA) and the Center, reviewed planning documentation provided by OCA officials, and analyzed the Center workload and productivity. Since our review was limited in scope, we did not perform steps necessary to assess the quality of purchase and liquidation decisions made by the Center.

Background

In 1983, SBA implemented the Preferred Lenders Program which allows certain lenders to process, service, and liquidate SBA guaranteed loans with reduced oversight by SBA. The primary control used by SBA to assess PLP lender compliance and ensure taxpayers are not paying for improper PLP loans is the guaranty purchase process, which is generally initiated by the lender after a PLP loan defaults. Since 1983, there has been a significant growth in PLP loans. In fiscal years (FY) 2001 and 2002, PLP loans represented 55 percent of the total dollars of 7(a) loans approved. Due to the limited oversight of PLP loans, this growth has increased the risk of the 7(a) loan program and the importance of the guaranty purchase process.

In FY 2003, SBA approved 67,306 Section 7(a) loans and purchased guaranties for 5,978 loans with unpaid principal balances totaling \$704 million. Additionally, SBA processed 694 guaranty repairs and withdrawals totaling \$27.2 million and 28 denials totaling \$4.7 million. SBA anticipates approving 90,000 loans in FY 2004, so the number of purchases, repairs, and denials would be expected to increase accordingly.

Centralizing loan liquidation and purchase activities was part of SBA's overall transformation plan. According to GAO, when SBA initially planned and implemented its transformation, it gave some attention to practices important to successful organizational transformation. However, after the Chief Operating Officer left the agency shortly after initiating pilot projects related to transformation, it was not evident who was responsible for implementing the transformation.¹ SBA officials told us that transformation planning took place at the most senior levels of the Agency and OCA did not always participate in the final plans for the transformation effort.

¹ GAO-04-76, Report to Congressional Requesters, "Progress Made, But Transformation Could Benefit from Practices Emphasizing Transparency and Communication," issued October 2003.

On September 10, 2003 SBA notified 171 district office employees of the creation of the Center and informed them that they were going to be reassigned to the Center or an understaffed district office in the near future. Each employee was offered a \$25,000 buy-out to avoid reassignment. SBA then solicited volunteers for relocation to the Center in November 2003 and in December 2003, sent reassignment letters to 60 district office employees. Employees began reporting to the Center in January 2004.

From September 2003 to January 2004, district office loan officers were required to perform loan activities and prepare loan files for shipping to the Center. Shipping was to occur in phases between January 5, 2004 and February 9, 2004. However, many of the loan officers who were supposed to perform this work in the district offices were leaving the agency, resulting in insufficient loan officer staffing to handle the loan activity. Therefore, the shipping phases were accelerated and, rather than shipping files to the Center over a period of a month or so, all files were shipped to the Center by mid January.

In January 2004, SBA established the Center in Herndon, Virginia to: (i) centralize and improve 7(a) guaranty purchase and loan liquidation activities² previously performed in 76 district and branch offices; and (ii) allow district and branch offices to concentrate on SBA marketing and outreach efforts.

The Center began processing guaranty purchase requests and liquidation actions on March 13, 2004, although it opened for business two months earlier. Understaffing and the need to complete logistical requirements caused the delay.

² Excluding Section 504 and SBA Express actions

AUDIT RESULTS

The National Guaranty Purchase Center was established without a thorough analysis of how best to accomplish centralization of guaranty purchase and liquidation actions being conducted by field activities. A significant backlog of purchase requests and liquidation actions developed because appropriate staffing levels were not assigned, and file control processes were not adequately developed, prior to the establishment of the Center in January 2004. In April 2004, OCA management assigned 18 Headquarters staff to assist with the purchase backlog, and eight summer interns were hired to assist loan officers in locating and filing loans. As of June 25, the increased staffing was alleviating the backlog. There were, however, unresolved issues about loan file tracking, and workload levels and long-term staffing needs.

Also, production reports were inadequate and unverifiable. As a result, SBA management did not have the necessary information for assessing performance and making informed decisions regarding resources.

We also noted that: (i) while SBA established an Oversight Council for the Center, the Council lacked a Center representative; and (ii) SBA used a questionable practice of recording lender purchase request withdrawals as “Paid in Full” in the SBA Loan Accounting System.

Finding 1 A Lack of Planning Led to Inadequate Staffing and Control Over Loan Files

Initial inadequate staffing and improper control over loan files at the Center was caused by a lack of planning. There was no documented evidence that SBA:

- Performed an analysis of staffing requirements to meet anticipated production levels.
- Performed a risk assessment to identify potential weaknesses and determine critical success factors for centralization.
- Planned for the receipt and control of loan files.

As a result, the Center was understaffed and unable to meet demand for purchase and liquidation actions. Also, there was no assurance that all loan files were properly classified, inventoried, and controlled.

Reorganization Criteria

General Accounting Office (since changed to the Government Accountability Office) (GAO) Standards for Internal Control in the Federal Government provide that effective management of an organization’s workforce – its human capital – is essential to achieve results. Only when the right personnel for the job are on board and are provided the right training, tools, structure, incentives, and responsibilities, is operational success possible.

GAO’s Internal Control Management and Evaluation Tool provides that management should ensure that the agency has the appropriate number of employees so that managers and supervisors have time to carry out their duties and responsibilities, employees do not have to

work excessive overtime or outside the ordinary workweek to complete assigned tasks, and managers and supervisors are not fulfilling the roles of more than one employee.

GAO Report Number GAO-03-669, entitled “Implementation Steps to Assist Mergers and Organizational Transformations,” states that dedicating a strong and stable implementation or integration team that will be responsible for the transformation’s day-to-day management is important to ensuring that it receives focused, full time attention needed to be sustained and successful. The report further states that the mission and strategic goals of a transformed organization must become the focus of the transformation, define the culture, and serve as the vehicle for employees to unite and rally around. The mission and strategic goals must be clear to employees.

The GAO Standards state that internal control covers all aspects of an agency’s operations (programmatic, financial, and compliance). Office of Management and Budget (OMB) Circular A-123, “Management Accountability and Control,” states that internal control includes processes for planning, organizing, directing, and controlling program operations. Internal control provides reasonable assurance that the objectives of the agency are being achieved with regards to the effectiveness and efficiency of operations, reliability of reports, and compliance with applicable laws and regulations. One standard of internal control is risk assessment, which is a preventative process that allows management to: (i) identify potential weaknesses that impede the ability to accomplish program and operating objectives; and (ii) identify critical success factors. A precondition to risk assessment is the establishment of clear and consistent objectives.

Poor planning and a lack of a risk assessment was a major cause of Center problems

A lack of planning for the transfer of the guaranty purchase and liquidation processes to a centralized location in Herndon, Virginia appears to be the primary cause for the problems and deficiencies discussed in the following sections of the report. We found no evidence that SBA conducted an analysis prior to the establishment of the Center to support estimated staffing and production levels. Further, SBA initiated a pilot project in Santa Ana, California in March 2003, to test the feasibility of centralizing the loan liquidation and guaranty purchase processes previously performed in three district offices. SBA, however, began planning for a national centralized purchase center before the pilot results were known and accordingly, the results of the pilot were not used in the planning process.

Per a GAO report³, SBA officials stated that the Agency performed a workload analysis of the Santa Ana pilot. GAO was told that the 7(a) liquidation and purchase guaranty process could be done by 40 employees in a Center as opposed to 266 district office employees. Our analysis indicates that this statement was invalid and unsupported. When results of the pilot were compiled, an analysis of staffing levels or number of hours to complete a purchase review or liquidation was not determined. Therefore, the pilot results did not support the Agency’s position that a staff of 40 loan officers was sufficient to operate the Center. Based on discussions with a senior SBA official, it appears that the proposed staffing level of 40 loan officers was

³ Small Business Administration – Progress Made, but Transformation Could Benefit from Practices Emphasizing Transparency and Communication (GAO-04-76) October 2003

driven by budget constraints rather than the results of the pilot project. Without any workload analysis, SBA could not be assured the Center would be adequately staffed to complete the guaranty purchase and liquidation workload.

SBA's leadership and implementation team for the entire SBA transformation, including centralization of the liquidation and purchase activities, changed from time-to-time and a day-to-day manager for the transformation effort was not formally designated. Accordingly, responsibility was passed between several program offices and there was little accountability for the transformation efforts. Additionally, there was no finalized written plan prepared for the transformation. SBA's overall transformation plan remained in draft and the planning documents for the transfer of operations to the Center were generally unorganized and incomplete.

While objectives were established for the transfer of operations to the Center, a risk assessment was not performed. GAO's Internal Control Management and Evaluation Tool suggests that risk identification should take place as part of short term and long term forecasting and strategic planning. It further suggests that consideration should be given to risks arising from the changing needs or expectations of Congress, agency officials, and the public and that risks resulting from business, political, and economic changes should be identified. Also, it suggests that risks associated from downsizing of agency operations and personnel should be considered.

Inadequate staffing

Appropriate staffing levels were not assigned prior to the establishment of the Center. Beginning in January 2004, loan officers and senior managers were required to unpack, classify, and file loan files. Consequently, they were not able to begin processing loans until March 2004. GS-12, 13, and 14 loan officers also performed support duties such as opening and sorting mail, answering phones, addressing Information Resources Management needs, and entering loans into tracking systems. In addition, the Center did not have sufficient administrative support staff or Loan Service Assistants (LSA). As a result, the Center staff was unable to keep up with the demand for guaranty purchase requests. Only 56 percent of new purchase requests received between June 1 and June 25, 2004, were completed.

Further, only 13 percent of 7,798 loan liquidation files requiring action had been assigned to a loan officer as of May 12, 2004. The staffing level of ten loan officers appeared inadequate to meet the demand for liquidation actions. Center personnel stated that they were unable to meet demand and were simply reacting to lender requests. The Center estimates that an experienced loan officer can complete a maximum of 300 liquidation cases per year. Using this estimate, at least 26 loan officers will be needed to meet the May 12, 2004, liquidation processing demand.

Center officials estimated that a 25 percent reduction in productivity could be attributed to the lack of support staff, or staff assigned to other duties. An analysis of available documentation and production reports showed that the current production rate would have to increase by more than 25 percent to meet the demand for purchase and liquidation actions.

Eight interns were hired for the summer to help organize the file room and assist loan officers by locating and filing loans. The interns, however, cannot perform all necessary support functions. Moreover, we found no evidence of a plan in place to hire needed staff.

Effect of lack of staff

The backlog of new purchase requests continued to grow at an increasing rate until June 18, 2004, because the Center was unable to meet requests with existing staffing levels. This may have resulted in additional interest payments to lenders for purchase delays and delays in receiving recovery on repair and denial actions. Additionally, all required liquidation actions were not performed. The Center's inability to meet its liquidation action demands timely may result in reduced recoveries to SBA from increased liquidation expenses and dissipating collateral if SBA is not regularly monitoring liquidations and timely approving liquidation plans, offers in compromise, collateral releases, and care and preservation of assets held as collateral.

Additionally, it may result in defacto approvals of liquidation plans submitted by certified lenders that could be inadequate, illegal, or costly. SOP 50 51 2, Loan Liquidation and Acquired Property, requires certified lenders to submit liquidation plans to SBA prior to commencement of liquidation for loans with principal balances greater than \$50,000. SBA must approve, deny, or modify the submitted plans within 10 days or the plan is deemed approved. The dollar value of loans approved via the Certified Lenders Program equaled four percent of the total dollar value of 7(a) loans approved in FY 2003.

SBA officials hope to increase production levels with the current staff level in order to meet demand. For example, they stated that loan officers should be completing an average of two purchase reviews per day. The desire to increase production appears to be arbitrary and without reasonable basis. We found no documentation that an analysis was performed which showed production could be increased with the current staffing levels without certain costs, such as low quality reviews resulting in material errors and mistakes. In the case of purchase reviews, such mistakes and errors can lead to erroneous and improper guaranty payments.

Based on an analysis of Center records for 10 workdays in June, loan officers were completing approximately 1.7 purchases per day. Experienced loan officers indicated that SBA's expectation of two purchase reviews per loan officer per day is unreasonable. One former SBA loan officer stated that it takes, on average, two days to perform a quality purchase review. Also, SBA Headquarter officials estimated that liquidation loan officers could complete 500 to 600 liquidation cases per year. Again, we found no basis for this estimate. A Center staff member and an experienced former SBA loan officer stated this estimate was unreasonably high.

New purchase requests received after March 13, 2004

According to the Center's June 1 through June 25, 2004, purchase production report, 56 percent of new purchase requests were resolved (see discussion of production report deficiencies in Finding 2). During this period, the report showed that an average of 101 new requests were received per week. This projects to 5,050 requests annually. As of June 25, there were 650 purchase requests awaiting an initial review and 39 requiring a legal review. Daily production

reports covering 10 workdays in June showed a weekly average of 11 loan officers processing purchase requests. Therefore, in order to meet the projected annual demand, the loan officers would need to complete an average of 1.8 reviews per day which is slightly more than actual production of 1.7 reviews, as shown on the daily production reports. This excludes supervisory and attorney reviews, which are not tracked.

The figures, however, do not tell the complete story. Purchase requests are classified as resolved after they have been paid (in full or part), denied, or withdrawn. A complete purchase review is required for regular purchase requests prior to purchase. However, 57 percent (401/703) of the purchase requests reported as resolved as of June 25, 2004, were actually secondary market loans which, in accordance with regulations, do not require a full purchase review to be completed prior to purchase. Thus, because secondary market purchase⁴ requests were reported as resolved prior to a purchase review, production levels were overstated. Further, as of June 25, 2004, 77 percent (310/401) of the secondary market purchase requests still had not been reviewed after the guaranty was purchased even though SOP 50 50 4, Loan Servicing, states that post purchase reviews will be performed within 10 days after purchase. Accordingly, it appears additional staff is also needed to ensure post purchase reviews are completed timely.

Based on the above, it appears that additional loan officers, supervisors and attorneys would be needed to ensure guaranty purchase reviews are completed timely and at an acceptable level of quality. Furthermore, additional staffing may also be necessary to meet demand as the annual number of guaranteed loans increases. According to SBA's FY 2005 Performance Budget Submission, 67,306 Section 7(a) loans were approved in fiscal year FY 2003, but SBA anticipates approving 90,000 Section 7(a) loans in FY 2004.

Backlog purchase requests received before March 13, 2004

The Center did not begin to process purchase requests until March 13, 2004, although staff and loan files began arriving in January 2004. Consequently, when processing began, there was a backlog of 1,039 guaranty purchase requests. To help resolve the backlog, a team of 18 employees from SBA Central Office were temporarily assigned to the Center. Originally, SBA had hoped to resolve the backlog by June 11, 2004, but as of June 25th there were still 607 backlogged purchase requests with demand dates prior to March 13, 2004. The backlog team was resolving an average of 43 purchase requests (including supervisory and legal review) per week.

The cause for the delay appeared to be the understaffing of supervisors and attorneys reviewing backlogged purchase requests. Daily purchase production reports (not including supervisory and legal reviews) for a ten day period in June showed an average of 10 loan officers processed purchase requests at a rate of 2.3 per day, which equates to 115 purchase reviews per week. Accordingly, since the backlog team as a whole only resolved 43 purchases on average per week, it appears there are not enough supervisors and attorneys to keep up with the loan officers' weekly production. Although daily production was not tracked for these reviews, the

⁴ Loans sold on the secondary market are backed by the full faith and credit of the United States. Therefore, upon default, secondary market loans must be purchased by SBA if the lender refuses to do so. SBA's procedures require a "post-purchase" review to determine whether a loan was properly originated and serviced by the lender.

legal staff had a backlog of 242 purchase cases as of June 25th, which represented 40 percent (242/607) of the total purchase backlog. Furthermore, based on an analysis of available information, the legal backlog was growing at an average rate of 40 purchase cases per week.

Control and accountability of transferred loan files

The Center did not have sufficient controls in place for the receipt of loan files shipped from district offices. Although shipping directives were prepared and provided to each district and branch office, there was no planning for the receipt, control, inventory, classification, and filing of loan files once they began to arrive in January 2004. The Center did not have the necessary bar coding equipment in place when it opened and the new facility was not complete, including a file room for storing the loan files. These problems were compounded when district office shipping phases were condensed, causing files to arrive much sooner than planned. Consequently, the entire Center staff, including managers and loan officers, was required to unpack, classify, and inventory loan files.

According to OMB Circular A-123, transactions should be promptly recorded, properly classified, and accounted for in order to prepare timely accounts and reliable financial and other reports. Furthermore, it states management controls must provide reasonable assurance that assets are safeguarded against waste, loss, unauthorized use, and misappropriation. Access to resources and records should be limited to authorized individuals, and accountability for the custody and use of resources should be assigned and maintained.

To gain improved control, loan files were scanned into an Inventory Tracking System. This System, however, could not be reconciled to the liquidation and purchase tracking systems. As of May 15, 2004, there were 13,045 files in the Inventory Tracking System; 2,163 of those files had not been recorded in the Center's purchase and liquidation tracking databases. Additionally, 715 files shown to belong to the Center per the Loan Accounting System (LAS) had not been entered into the Inventory Tracking System. According to an SBA official, (1) the Inventory Tracking System does not track servicing actions and accordingly, would not reconcile to the purchase and liquidation tracking databases, and (2) loans coded to the Center in the LAS does not guaranty they were shipped and received by the Center. As a result, the Center cannot track the status of all loans in its inventory and all loans coded to the Center per the LAS cannot be accounted for.

Additionally, prior to the establishment of the Center's purchase and liquidation tracking databases, the Center manually classified loans received on an Excel spreadsheet. We were informed that these loans were only processed when a lender made an inquiry as to the status of the loan. According to Center officials, sufficient personnel were not available to process these files. Therefore, as of May 23, 2004, there were 965 purchase files, and as of May 12, 2004, there were 6,816 liquidation files requiring action that had not been recorded in the Center's purchase and liquidation tracking systems and, accordingly, were not being processed.

Until recently, the Center also did not have controls in place over the removal of loan files. Loan officers were responsible for locating and replacing their own loan files. This led to misplaced files and a loss of productivity for the loan officers, who had to search for missing

files. Summer interns were hired to maintain control over the file room and be responsible for removing and re-filing all files. Additionally, a system to check files out has been established. It is unclear, however, how these controls will be maintained when the interns leave at the end of the summer.

Conclusion

We found that the lack of planning by SBA led to inadequate initial staffing and improper control over loan files at the Center. When the identified deficiencies are addressed, however, centralization could result in consistency and a more uniform quality of actions and decisions in the guaranty purchase and liquidation processes. Statistics show that centralization also could provide more reasonable assurance that improper payments will be reduced because there has been an increase in the number of denials and lender withdrawals of purchase requests at the Center.

Recommendations

We recommend that the Associate Deputy Administrator for Capital Access, in coordination with the General Counsel, take the following actions:

- 1.A Determine the appropriate number of loan officers, supervisors, and attorneys to be assigned to the Center by (i) establishing the elements of quality for the purchase and liquidation action review process, (ii) determining how much time it takes to complete a quality review at each level (loan officer, supervisor and attorney), and (iii) computing the staff levels needed to complete the estimated annual purchase and liquidation action workloads at an acceptable level of quality.
- 1.B Determine and assign the additional supervisors and attorneys needed to meet the demand of purchase reviews processed by the Backlog Team Loan Officers to ensure the timely resolution of these purchase requests with demand dates prior to March 13, 2004.

We recommend that the Associate Deputy Administrator for Capital Access take the following actions:

- 1.C Ensure manually classified loan files requiring action that have not been recorded in the Center's purchase and liquidation tracking systems are processed timely.
- 1.D Determine the appropriate number of support staff and Loan Servicing Assistants needed to ensure loan officers are not required to perform tasks outside of their normal responsibilities to maintain an acceptable level of productivity.
- 1.E Develop written policies and procedures for the receipt, control, and tracking of loan files.

- 1.F Track the status of all loan files in the Center's inventory.
- 1G. Determine the locations of all loan files coded to the Center per LAS and not entered into the Center's Inventory Tracking System and either properly account for them in the Center's inventory or revise the LAS codes to reflect the actual locations of the loan files.
- 1.H Perform an internal control assessment of the Center to ensure compliance with GAO's standards for internal control in the Federal Government and a comprehensive risk assessment to identify and analyze risks to determine how they should be managed.

Management's Response

General comments

The Associate Deputy Administrator for Capital Access (ADA/CA) stated that the National Guaranty Purchase Center is a true success story and the outcome is a significant accomplishment towards the overall transformation of the new SBA. The ADA/CA noted that the Office of Capital Access (OCA) was not surprised by the findings and was well aware of issues raised in the draft report. OCA's primary focus was to "touch" all the files and address the purchase backlog in order to demonstrate to SBA's customers, the lenders, that SBA was addressing their purchase requests in a timely fashion. The ADA/CA stated that they look forward to addressing the audit recommendations in the final report.

Specific comments are discussed below and the entire response (consolidated) is included as Attachment 2. The specific comments are arranged on the order of the related section in the draft report.

Specific Comments to Finding 1

Poor planning and a lack of risk assessment was a major cause of Center problems

The Office of Capital Access (OCA) stated they have consistently made planning and staffing of the Center a priority and that the development of the Center was only one component of SBA's overall transformation plan. Furthermore, the planning documents for the overall transformation were developed at the most senior levels of the Agency and OCA did not always participate in the final plans of the transformation effort.

Inadequate staffing

OCA noted that they knew some areas of the Center would need additional staffing and described some of the actions recently taken to relieve the loan officers from performing duties outside their normal responsibilities. For example, five new employees have been hired to assist the loan officers and there is a plan in place to hire and contract additional support staff and loan

services assistants. OCA stated that the contractors should be in place when the summer interns leave for school.

OCA also explained that a manual spreadsheet was developed to quickly classify over 13,000 loan files received by the Center in order to determine which loans needed priority treatment. The spreadsheet was scrubbed and used to populate the liquidation action tracking database. They believed that inquiries from lenders were much more comprehensive sources of information for prioritizing the liquidation workload and updating the liquidation action tracking database. According to OCA, when the database was fully implemented, it contained 2,454 liquidation actions.

Effect of lack of staff

OCA stated that recent reports show that the processing of liquidation and guaranty purchase actions are exceeding incoming requests. They also stated that there was no evidence that SBA had been untimely in reviewing offers in compromises, collateral sales and releases, etc. Additionally, OCA stated that the Center has made great efforts to make the PLP lenders aware that they have a responsibility to take unilateral actions without seeking SBA's approval and this effort has cut the incoming volume of liquidation actions. According to OCA, liquidation plans received now are immediately assigned to loan officers and reviewed per the SOP. The Center is currently developing a system to quickly identify liquidation plans submitted by CLP lenders to ensure those plans are reviewed within 10 days.

OCA stated that we incorrectly concluded that the Center attempted to increase production at the expense of quality and that there is no evidence that increased production has led to material errors in purchase reviews. OCA explained that purchase requests are not processed by loan officers until they contain sufficient information to make a purchase decision and therefore, a performance goal of two purchases per day was reasonable.

New purchase requests received after March 13, 2004

OCA stated that as of July 2004, the permanent Center staff was exceeding the incoming purchase requests on a continuing basis. According to OCA, as daily production began to exceed the new requests, staff was redirected to perform secondary market post-purchase reviews. OCA stated that secondary market purchase requests averaged 25 percent of the total number of cases received between June 7th and July 23rd and therefore, our conclusion that 57 percent of the purchases resolved as of June 25th were secondary market purchases was high. Additionally, they stated that the Center's reports were never intended to overstate production and were developed to track guaranty purchases. Post purchase reviews were simply not part of the information requested by Headquarters. OCA also indicated that the increase in 7(a) loan approvals for FY 2004 should not affect the Center because SBA anticipates that approximately 55 percent of the loans originated in FY 2004 will be SBA Express loans which will not be sent to the Center for liquidation or purchase actions.

Backlog purchase requests received before March 13, 2004

OCA acknowledged that additional Headquarters staff and attorneys were detailed to assist with the purchase backlog. They further stated the backlog has been fully resolved and the remaining caseload of approximately 500 cases will be considered work-in-progress. It is SBA's goal to maintain a work-in-progress of 500 cases.

Control and accountability of transferred loan files

OCA stated that the filing system had been ordered but had not been installed when the Center began receiving files due to construction delays. They stated that the Inventory Tracking System had been shipped to the Center prior to staff arriving. Additionally, a bar code scanner was in full operation when the files began arriving in January 2004.

OCA clarified that the Inventory Tracking System is used to track loan files only and does not track any servicing actions. Therefore, it does not reconcile to the liquidation and purchase tracking systems. Additionally, OCA stated that loans coded to the Center in the Loan Accounting System do not guaranty they were shipped and received by the Center.

OCA reiterated that the manual classification Excel spreadsheet, correspondence, and inquiries from lenders were used to populate the liquidation tracking database, indicating that all necessary actions are being tracked in the liquidation tracking database. OCA also stated that the Center currently has a file room and file handling procedures in place.

Recommendations

OCA generally agreed with recommendations 1A, 1B, 1E, and 1G (now 1H) and described actions that have been taken or are planned to address these recommendations. OCA disagreed with recommendation 1C, stating that all files received by the Center are immediately scanned into the Inventory Tracking System. They also disagreed with recommendation 1D, stating that they believe the current permanent staff of 50 professionals plus the contract staff of 8 individuals and the attorneys is sufficient to perform at an acceptable level of service. Furthermore, OCA disagreed with recommendation 1F, stating that they believe they have the proper tools and tracking system in place to account for the files maintained at the Center. Recommendation 1G was added to the final report as a result of OCA's response and accordingly, OCA did not have the opportunity to comment on this recommendation.

OIG's Analysis of Management's Response:

General comments:

OCA took exception to some of the points and/or conclusions discussed in the draft report, however, did not provide any supporting documentation or evidence to support their positions.

Comments specific to Finding 1:

Poor planning and a lack of risk assessment was a major cause of Center problems

A section was added to the Background section of our report to explain that centralization is only part of SBA's overall transformation and that OCA did not always participate in the final plans of the transformation effort.

Inadequate staffing

Regarding management's comments on liquidation actions, it does not seem likely that only 2,454 actions were required on 13,000 plus loan files received by the Center. According to Center records reviewed by the auditors, as of May 12, 2004, there were 6,816 loans on the manual classification spreadsheet that required one or more liquidation actions by SBA (such as plan review and approval, litigation action, regular monitoring, or wrap-up and charge off) that were not recorded in the Center's liquidation action tracking database. Further, we do not agree with OCA that lender inquiries are a more comprehensive source of information for prioritizing the workload and updating the liquidation action tracking database. Prior audits have shown that lenders do not always communicate liquidation actions unless they are actively monitored by SBA. For example, it was discovered during one audit of an early default SBA guaranteed loan that the lender had liquidated the collateral but did not provide SBA with its portion of the liquidation proceeds. Consequently, we do not believe it is reasonable to rely on lender inquiries to update the liquidation database.

Based on our analysis of the spreadsheet and discussions with Center personnel, it does not appear that all required liquidation actions have been entered into the tracking database. Therefore, we do not believe the Center has reliable information on the number of loans in liquidation that require action by SBA.

Effect of lack of staff

Although production reports issued by the Center subsequent to the completion of our field work appear to indicate that the permanent staff is meeting or exceeding demand, we believe this may not be the case based on a number of mitigating factors. The number of incoming purchase requests significantly decreased since June which, according to SBA officials, is common during summer months. Additionally, we were told that the Headquarter officials temporarily assigned to the Center to resolve the backlog cases began to review new purchases during this period. The production reports, however, did not note the injection of the temporary staff into the new purchase review process and therefore, do not reflect the true production level that can be expected from the permanent staff on a regular basis. Also, since it does not appear that all liquidation actions were entered into the liquidation tracking database, the actual number and type of liquidation action requests received from lenders cannot be determined. Therefore, SBA has no assurance that all action requests submitted to the center are timely reviewed, such as offers of compromise and collateral sales and releases.

Finally, we did not draw the conclusion, as indicated in management's response, that the Center attempted to increase production at the expense of quality or that increased production led to material errors in purchase reviews. Rather, we concluded in the draft report that SBA officials desired to increase production with existing staff without performing an appropriate workload analysis to determine if production could be increased without certain costs, such as low quality reviews, material errors or mistakes that could lead to improper and erroneous guaranty purchase payments. Without a proper workload study or staffing analysis coupled with a quality assurance program, the reasonableness of the two purchases per day performance goal is not supportable.

New purchase requests received after March 13, 2004

As discussed above, we do not believe recent production reports accurately reflect the production level that can be expected on a regular basis from the permanent staff at the Center. Furthermore, because secondary market post purchase reviews are a normal part of the Center's activities, shifting resources from regular purchase reviews to the post purchase backlog is only a temporary solution and may not be possible on a regular basis with existing staff levels. When incoming purchase requests begin to increase after the summer lull and the temporary staff has returned to Headquarters, additional staff may be needed to perform the required post purchase reviews in order to maintain the production levels. Also, the 57 percent figure cited in the report, which represents secondary market purchases, was derived from the total number of new purchase requests "*resolved*" as of June 25, 2004. Thus, it would not necessarily correlate to the percentage of secondary market purchase requests received on a weekly basis. Secondary market purchases are *resolved* quicker than regular purchases because a complete and thorough purchase review is not required prior to the guaranty payment. A secondary market purchase is considered *resolved* by the Center when the guaranty payment is made. As a consequence, lumping secondary market purchases in with other purchase requests that have been subject to the full guaranty purchase review process is misleading to someone who takes "*resolved*" to mean fully reviewed and processed.

Finally, SBA statistics show that loans originated through the Preferred Lenders Program are also increasing in FY 2004. Accordingly, it is reasonable to expect the number of purchase requests received at the Center will increase in the future.

Backlog purchase requests received before March 13, 2004

Although the backlog was significantly reduced in the weeks subsequent to the completion of our field work, we believe it is incorrect to consider the backlog "fully resolved" until all purchase requests received prior to March 13, 2004, are completed. As of August 6, 2004, there were 78 backlogged purchase requests still being processed.

Control and accountability of transferred loan files

Based on OCA's response, we modified the report by deleting the statement that the Center did not have an Inventory Tracking System in place when it opened. We also revised the section of our report on the inventory tracking system not reconciling to the purchase and

liquidation tracking databases. Based on OCA's response and further analysis, we concluded that the Center cannot track the status of 2,163 loans in its inventory and that 715 loans coded to the Center per the LAS cannot be located.

As described in the preceding section captioned "Inadequate Staffing", we question the reliability of the liquidation action tracking system. We continue to believe there are additional recorded in the Excel spreadsheet used for manual classification, which require SBA action and are not recorded in the purchase and liquidation tracking databases.

Recommendations

The actions taken or planned by SBA management to address recommendations 1A, 1B, 1E and 1G (now 1H) are responsive to these recommendations. Based on management comments, recommendation 1C was revised to specifically refer to the manually classified files requiring action that are not being processed. OCA's response to recommendation 1D is not responsive to our recommendation. The fact that they believe the proposed staff level is sufficient does not address our recommendation to determine the appropriate number of support staff and LSAs. A proper workload analysis will be necessary to ensure the proposed staffing level is appropriate. Recommendation 1F was revised to recommend that the status of all loan files in the Center's inventory be tracked. Recommendation 1G was added to the report to recommend that all loan files coded to the Center per the LAS and not entered into the Center's Inventory Tracking System be located and properly coded.

Finding 2 Center Production Reports Needed Improvement

The production reports used by the Center did not capture all data needed to accurately determine productivity. Consequently, management did not have the information necessary to effectively manage Center operations nor to determine resources needed to accomplish its mission.

According to GAO's Standards for Internal Control in the Federal Government, information should be recorded and communicated in a form and within a timeframe that enables management to carry out their responsibilities. Additionally, the standards state that program managers need operational data to determine whether they are meeting their agencies' strategic and annual performance plans and are accountable for effective and efficient use of resources. OMB Circular A-123 further provides that transactions should be promptly recorded, properly classified, and accounted for in order to prepare timely accounts and reliable financial and other reports.

Purchase production reports

The design of the Center's reports did not accurately reflect guaranty purchase production, thus making it appear that production was higher than it actually was. Problems with the production reports included:

- Specific information on initial receipt of files, supervisory review, and legal analysis was not captured. Consequently, the report did not accurately track the status of purchase requests from initial receipt through the various levels of review.
- Production information on post purchase reviews (loans purchased by SBA from the secondary market) was not tracked. All purchases from the secondary market require a post purchase review. The Center's purchase production report showed secondary market purchases as "resolved" when the purchase request was processed for payment even though purchase reviews would not be accomplished until sometime in the future.
- Historical data and weekly production information were combined which made it difficult to analyze changes in inventory from week to week. Historical information should be maintained separately as a means to identify the Center's annual workload.
- Report data could not be traced to source documentation due to difficulty in mapping the purchase information to the Guaranty Purchase Tracking System (GPTS). The GPTS has a large number of status codes such as "Approval Recommendation," "Legal Concur Approval Recommendation," "Demand Canceled," "Demand Withdrawal", etc. According to a Center official, it is difficult to crosswalk each of the codes in the GPTS to the purchase production report. Additionally, if a purchase demand is cancelled in GPTS and re-entered, the loan is recorded twice.

Liquidation actions

The Center established a system to separately track each individual liquidation action performed. The system, however, did not track the number of liquidation actions received and resolved by the Center each week. Accordingly, the Center was not tracking actual productivity related to liquidation actions.

Conclusion

As a result of the above deficiencies, the productivity of the Center could neither be accurately measured nor did management have information necessary to make informed decisions regarding resource needs.

Recommendation

- 2.A We recommend that the Associate Deputy Administrator for Capital Access develop purchase and liquidation production reports to meet management's needs and track the necessary production data to report work in process. A suggested report format is provided in Attachment 1.

SBA Management's Response

OCA stated that the Center's reports reflected information that was requested by Headquarter officials to address the purchase backlog and were designed to track the number of

purchases received, reviewed, sent to legal, checked for final approval and purchased. OCA does not believe the reports were misleading because they were designed to track a different aspect than the number of total purchases completely resolved. OCA stated they are in the process of reviewing and revising existing reports to include all facets of production, including post purchase reviews of secondary market loans. They stated that Center personnel are working with the Office of the Chief Information Officer to improve the GPTS information and make it more responsive for management reporting and that new updates have been made continuously since the Center opened. In response to recommendation 2A, OCA stated that Center management and Headquarters are continually revising the reports and agreed to review the suggested reporting format for inclusion into existing reports.

OIG's Analysis of Management's Response

OCA generally agreed with finding 2 and their comments and planned actions were responsive.

Other Matters:

The Oversight Council Should Include a Center Representative

In June 2004, a council was established to perform oversight of the Center. The council is comprised of senior SBA management officials but did not include a representative from the Center. During our review, we found that Headquarters officials were not fully knowledgeable about the operations and conditions at the Center. Additionally, the Headquarters and Center officials did not always agree on some issues, such as production expectations and staffing needs. OMB Circular A-123 states that a Senior Management Council generally includes both line and staff management and is useful for assessing and monitoring deficiencies in management controls.

Guaranty Purchase Requests Withdrawn by Lenders are Recorded in the Loan Accounting System as "Paid in Full"

A "paid in full" status in the LAS indicates that a lender was successful in awarding a loan to a borrower who did not default and paid the loan in full. We found, however, that guaranty purchase requests withdrawn by lenders are also recorded as "paid in full." Accordingly, LAS data cannot be relied upon to assess lender and borrower performance history. Users of this data would be misled to believe that lenders who have withdrawn purchase requests as a result of loan origination deficiencies have successfully awarded "paid in full" loans. Similarly, users would be misled to believe that the borrowers who defaulted on these loans paid them in full. Additionally, by recording withdrawn loans as "paid in full," SBA's data does not accurately reflect the number of loans appropriately awarded to small businesses.

Recommendations

- 3.A. We recommend that the Chief Operating Officer require a representative of the National Guaranty Purchase Center to be present at Oversight Council meetings.

- 3.B. We recommend that the Associate Deputy Administrator for Capital Access ensure withdrawals of purchase guaranties are accurately reflected in the Loan Accounting System and not shown as “paid in full” loans.

SBA Management’s Response

The Chief Operating Officer concurred with recommendation 3A and will include a Center representative in all future oversight meetings. His response is included in its entirety as Attachment 3.

OCA stated that changes to the mainframe LAS would be needed to implement recommendation 3B and that the feasibility of making these changes would be explored. They further explained that loans classified as paid-in-full because of cancellation or denial are coded in the system to record these classifications and consequently, data are available for these categories.

OIG’s Analysis of Management’s Response

The Chief Operating Officers comment is responsive to recommendation 3A.

Regarding OCA’s response to recommendation 3B, it is unclear if the specific classifications can be extrapolated for analysis and reporting purposes. Accordingly, we continue to support the recommendation until it can be demonstrated that the costs of properly classifying loans in the LAS outweigh the benefits.

Sample Work in Process Production Report for the National Guaranty Purchase Center

Note: This report is provided as an example. The numbers used below are for illustration purposes only. The format should be revised, as necessary, to meet the needs of Management.

Initial Receipt of Files--Work in Process		
	Reporting Period	
	# 1	# 2
Activity	Number of Files	Number of Files
Beginning Inventory	1,252	1,197
Purchase Requests Received	102	99
Inventory Adjustment (Explain)	11	(2)
Files Forwarded for Review		
Pre-Purchase	(115)	(123)
Secondary Market	(50)	(48)
Lender Withdrawals	(3)	(2)
Ending Inventory	1,197	1,121
Inventory Adjustment: Adjustment is net of files received in prior reporting period but not recorded in inventory and files returned for regular servicing as a result of a workout.		

Pre Purchase Review Process		
Pre Purchase Review--Work in Process		
	Reporting Period	
	# 1	# 2
Activity	No. of Files	No. of Files
Beginning Inventory	101	137
Files Transferred for Purchase Review	115	123
Files Returned by Supervisor	1	0
Files Returned by Legal Staff	1	2
Purchases Resolved by Loan Officers	(81)	(90)
Ending Inventory	137	172



Secondary Market Purchase Process		
Secondary Market Purchase Requests--Work in Process		
	Reporting Period	
	# 1	# 2
Activity	No. of Files	No. of Files
Beginning Inventory	110	82
Purchases Requests Received	50	48
Secondary Market Purchase Requests Approved for Payment	(78)	(87)
Inventory Adjustments	0	0
Ending Inventory	82	43



Attachment 1

Supervisory Pre Purchase--Work In Process		
Activity	Reporting Period	
	# 1	# 2
	No. of Files	No. of Files
Beginning Inventory	52	28
Purchases Resolved by Loan Officers	81	90
Purchases Resolved by Supervisors	(98)	(87)
Purchase Decisions Returned to Loan Officers	(1)	0
Purchases Withdrawn by Lenders	(6)	0
Ending Inventory	28	31

Denver Finance Center Secondary Market Purchases--Work in Process		
Activity	Reporting Period	
	#1	#2
	No. of Files	No. of Files
Beginning Inventory	97	125
Secondary Market Purchase: Requests for Payment Approved	78	87
Payments to Lenders	(50)	(48)
Ending Inventory	125	164



Legal Staff Pre Purchase Review-- Work in Process		
Activity	Reporting Period	
	# 1	# 2
	No. of Files	No. of Files
Beginning Inventory	105	106
Recommendations to Purchase Guaranty Received from Loan Officer Supervisors	98	87
Recommendations to Accept Decision to Purchase Guaranty	(89)	(84)
Recommendations to Deny Guaranty Purchase Request	(2)	0
Recommendations to Repair Guaranty Purchase Request	(5)	(1)
Recommendations Returned to Loan Officers	(1)	(2)
Ending Inventory	106	106

Post Purchase Review--Work in Process (Secondary Market Purchases)		
Activity	Reporting Period	
	# 1	# 2
	No. of Files	No. of Files
Beginning Inventory	97	89
Secondary Market Purchase Requests Paid and Pending Review	50	48
Purchase Reviews Returned by Legal Staff	2	0
Purchase Reviews Returned by Loan Officer Supervisors	1	0
Purchases Resolved by Loan Officers	(61)	(87)
Ending Inventory	89	50

Supervisory Post Purchase--Work In Process		
Activity	Reporting Period	
	Number of files	Number of files
Beginning Inventory	77	58
Purchases Resolved by Loan Officers	61	87
Purchases Resolved by Supervisors	(79)	(92)
Purchase Decisions Returned to Loan Officers	(1)	(0)
Purchases Withdrawn by Lenders	(0)	(0)
Ending Inventory	58	53



Attachment 1

Legal Staff Post Purchase Review-- Work in Process		
	Reporting Period	
	# 1	# 2
Activity	No. of Files	No. of Files
Beginning Inventory	98	113
Post Purchase Files from Loan Officer Supervisors	79	92
Guaranteed Purchase Payment Correct	(62)	(87)
Recommendations Returned to Loan Officers	(2)	0
Recommendation to Deny	0	0
Recommendation to Repair	0	0
Ending Inventory	113	118

Date: August 6, 2004

To: Robert G. Seabrooks,
Assistant Inspector General for Auditing

From: Ronald E. Bew
Associate Deputy Administrator for Capital Access

Subject: Response to Draft Audit on Transfer of Operations to the National Guaranty
Purchase Center

In response to the draft audit on the "Transfer of Operations to the National Guaranty Purchase Center", I offer the following comments.

Herndon is a true success story and the outcome is a significant accomplishment towards the overall transformation of the NEW SBA. As of July 30, 2004, Herndon has processed 2,321 guaranty purchases and completed 2,862 liquidation actions. Secondly, we met with the Inspector General and the Deputy Inspector General prior to the beginning of this audit and requested that the audit be delayed for two months. The reason behind our request was due to the fact that construction for the facility was not complete, the process of setting up production reports was ongoing, and there was a larger than anticipated backlog. The findings of this report are not surprising, we were well aware of the issues that were raised. However, our primary focus was to "touch" all the files and address the purchase backlog as directed by the Administrator. This "touch" was to demonstrate to our customer, the lenders, that we were addressing their purchase requests and not delaying action as some cases were up to three years old. To date, we have received very few lender complaints and we have successfully centralized a major function within the 7(a) loan guaranty program. We are now moving into the phase where we address many of the recommendations such as work-in-process reporting.

The specific comments regarding the draft audit are contained in bold in the attached draft audit. We look forward to addressing the recommendations in the final audit.

Background

Note that the Agency is experiencing tremendous growth with the SBA Express loan program and to-date SBA Express represents approximately 55% of the number of 7(a) loans approved during FY 2004. Under SBA Express, lenders are required to liquidate all collateral prior to purchase and the SBA Express purchase requests will not be processed by the National Guaranty Purchase Center (Center) in Herndon. This activity is taking place in Little Rock and Sacramento Service Centers.

Finding 1 A Lack of Planning Led to Inadequate Staffing and Control over Loan Files

Poor planning and a lack of a risk assessment was a major cause of Center problems

SBA initial estimate was that the minimum number of employees needed to staff the National Guaranty Purchase Center was 40 professional loan officers. The staffing of the Center also included attorneys and necessary support personnel. This estimate was revised to a minimum of 50 professional staff, 3 permanent administrative staff, 8 contract support staff and a combination of permanent and detailed attorneys.

The Office of Capital Access and the Office of Financial Assistance have consistently made the planning and staffing of the Center a priority. The development of the Center and the centralization of the liquidation and guarantee purchase functions are only one component of SBA's overall transformation plan. The planning documents for the transformation itself were developed at the most senior levels of the Agency and Capital Access or Financial Assistance did not always participate in the final plans of the transformation effort.

Inadequate staffing

As a start up operation, the Agency knew that some areas would need additional staffing. Plans were developed early in February and March of 2004 regarding the need for additional staffing, especially support staff. Staffing alternatives were explored including volunteers and in May, 2004, additional volunteers were added to the professional staff as well as the hiring of summer interns for the file and mailroom. In addition, the Office of the Chief Information Officer has detailed a full time Information Resource Manager to coordinate the set-up and maintenance of the computers and the telephone system. Currently the Center has a GS-12 loan officer staffing the Lender Hot-Line. This number is featured on the lenders web page and is used in all letters sent to lenders. A portion of the calls received may be able to be routed to others but a professional will always be needed in this function to provide guidance to lenders calling for assistance. The Center is also awaiting the installation of a switchboard when all employees are finally situated in their assigned spaces. This will occur when the headquarters team leaves in early August. The incoming loan files and purchase packages are now being handled by interns. They open, classify and distribute all mail in packages. Letters, which can contain checks from lenders or Colson Services are opened by Administrative staff and are entered into the field cashing system. The package function will be transitioned to a contractor when the interns leave in the fall. The Herndon Oversight Committee has recently approved the hiring of contractors to staff the support functions for the Center.

During the exit meeting, we discussed that it appears that the 7,730 liquidation files requiring action was derived by combining two separate databases. Early in February and March of 2004, a manual excel spreadsheet program was developed to track the classification of loan files into different categories. The loan officers quickly reviewed each of the 13,000 plus loan files and made a determination of the status of the loan. This process was done specifically as a triage function to determine which loans needed priority treatment. Following the classification process, the Center developed the Herndon Action Tracking System (HATS) to track the liquidation and portfolio management actions. Loans and actions from the initial database were scrubbed and used to populate the HATS database. HATS was also populated by correspondence and inquiries from the lenders. Their requests for actions were entered and given priority treatment when appropriate. Information contained in some of the loan files was very outdated and thus, the classification was performed quickly in an effort to identify those files containing purchase requests, compromises, etc. A much more comprehensive source of information was the lending community. Their phone calls, emails and faxes were used to help prioritize the workload and to update the information in HATS. When HATS was fully implemented it contained 2,454 liquidation actions populated from the above sources. All these actions were assigned to loan officers and are tracked by Center Management. HATS is the only database being used by the Center to monitor liquidation and portfolio management actions and reports can be generated by loan officer, type of action, date received, etc. HATS is currently being utilized by Center management to assist in making management and resource decisions. In addition, the benchmark caseload level for lender-serviced liquidation cases per loan officer will be reviewed in the center environment and adjusted appropriately.

The addition of support staff has been a major component in the increase in productivity. A review of the recent information in HATS shows the liquidation backlog has been reduced to a manageable portfolio of approximately 40-50 actions per loan officer. Center management monitors these reports to ensure staff is allocated appropriately.

In late May of 2004, the Agency, through its summer intern program hired eight (8) interns to provide support for the mail and file room functions. In addition, over the past 2 months the Center has hired five (5) new employees at the GS-7 level and has four more offers pending. These new hires are currently providing support that could be categorized as Loan Service Assistants (LSA). Their training will include numerous tasks of an operational nature previously performed by the loan officers and are a factor in the increased productivity by the loan officers in purchase and liquidation functions. In addition, there was a staffing plan prepared in mid-March that detailed the need for additional support staff and LSA's. At present, the Herndon Oversight Committee has approved the staffing plan and the contracting out of the support function currently staffed by the interns. The contractors should be in place when the interns leave for school.

Effect of lack of staff

The recent reports reflect that both liquidation and guaranty purchase actions are exceeding the incoming requests.

In reviewing the information in HATS and the email and phone logs, we find no evidence that SBA has not been timely in reviewing offers in compromises, collateral sales and releases, etc. Historically, numerous PLP lenders sent in documents requesting the SBA's acknowledgment or concurrence. The Center has made great efforts to make the PLP lenders aware that they have a responsibility to take unilateral actions without providing notice or seeking the SBA's approval. This effort has cut the incoming volume substantially and allows more time for the loan officers to deal with the CLP lenders who do require SBA involvement for more actions. The Center also has a loan officer and a new hire working on the reimbursement of CPC expenses to the lenders.

In using data pulled from HATS, the Center has approved 498 out of a total of 626 liquidation plans submitted to the Center from January 1, 2004 through July 27, 2004. While there may have been some liquidation plans approved by default early in the Center start up phase, the plans being received now are immediately assigned to loan officers and reviewed per the SOP. The Center is currently developing a system to quickly identify the liquidation plans made under the Certified Lenders Program to ensure that those plans are reviewed within the 10 day timeframe. As indicated, the loans approved through this program represent a small percentage of SBA's portfolio.

This statement is incorrect. We can not state strongly enough that the Center has never attempted to increase production at the expense of quality. There is no evidence to support the contention made in this report that the increase in production has lead to material errors and mistakes during the purchase review and that erroneous and improper guaranty payments have been made. The approval process starts with a recommendation by the loan officer, is forwarded to the attorneys for concurrence and then to a senior loan officer for final approval. The attorneys assigned to the Center and those recently detailed in from the district offices have all commented on the high quality of the loan officer reviews and recommendations. Any cases that are returned by the attorneys for additional clarification are reviewed by team leaders or supervisors.

The Center currently has three loan officers reviewing the incoming purchase packages for completeness. Lenders sending demand letters with no additional documentation are notified immediately that they will need to provide certain documentation before their request will be processed. Purchase packages are not forwarded to the loan officers until they are substantially complete and ready for review. This step has allowed the loan officers to concentrate on those packages that contain sufficient information to make a decision regarding purchase, repair or denial. For the period from 7/13/04-7/26/04 the Center permanent staff averaged 2.2 purchases per day per person. The number of guarantees purchased exceeded the number of new request for the same period by 54. Also, the 2 purchases per day performance goal is reviewed in terms of a longer time period, such as 10 purchases per week. This approach recognizes that some purchases will take more time and some will be relatively straightforward and can be processed quicker.

New purchase requests received after March 13, 2004

As of July 2004, the permanent Center staff has been exceeding the incoming purchase requests on a continuing basis. This will allow loan officers to complete the post-purchase

reviews that stem from the secondary market purchases. At present there are three employees working full time on post-purchase reviews and over 100 cases have been completed to date.

Currently the Secondary Market Team has three (3) loan officers doing post-purchase reviews. They have completed over 100 cases since the Center opened and a plan is in place for completing the remaining post-purchase reviews. The figure of 57 percent used in the report is high given the percentage of secondary market loans received by the Center for the past seven (7) weeks (June 7-July 23, 2004), the secondary market requests averaged 25.4 percent of the total number of cases received. The reports referenced were never intended to overstate production. As we have stated on numerous occasions, the reports were developed specifically to track the purchase of the guarantee by the SBA. The Agency was under intense pressure from the lending community to process the older as well as the incoming purchase requests in a timely fashion. OCA and OFA management requested reports that showed requests backlogged, new purchases received, purchases processed, concurred by legal and scheduled for payment. The post-purchase reviews were not deliberately excluded but were simply not part of the information requested by headquarters. Post-purchase reviews have always been prioritized and have been performed on loans with large CPC expense requests. As daily production began to exceed the new requests, staff was redirected to post-purchase reviews and over 100 cases have now been completed.

As stated above, SBA is anticipating that approximately 55 percent of the new loans originated in FY 2004 will be made through the SBA Express loan program. Those loans will not be sent to the Herndon Center for portfolio management actions of purchase.

Backlog purchase requests received before March 13, 2004

As was previously stated, with a start up operation the Agency knew that some areas would need additional staffing. Plans were developed early in February and March of 2004 regarding the need for additional staffing, especially support staff, etc. We detailed additional Headquarters staff and once a backlog was in place in the legal review and final approval process, we placed additional resources including attorneys that were detailed from the Office of General Counsel to assist with the approval process. This backlog has been fully resolved. The remaining caseload of approximately 500 cases will be considered a work in progress and as of the date of this response we are below that goal. Additionally, the Headquarters staff detailed to Herndon will report back to Headquarter in early August.

Control and accountability of transferred loan files

The filing system had been ordered but due to construction delays had not been installed when the Center started to receive files. The file inventory tracking system (MasterTrak) had been researched prior to staff being moved to Herndon and the software located and shipped to the Center. A bar code scanner was ordered, shipped and put into full operation in January, 2004 at the time the files arrived. It is true that everyone associated with the Center assisted in checking in the files but it also allowed all personnel to get a better understanding of where the loans were coming from and the volume being received.

The MasterTrak Inventory Tracking System was evaluated and chosen as the software. OFA is familiar with this software as it is used in the other SBA Servicing Centers and we believe one of the software's strengths is the labeling feature that uses bar coding for the loan files. In fact, other Servicing Centers assisted the Herndon Center by printing colored bar coded labels for some incoming files until a color printer could be installed in the Center. As the Agency already owned licenses for MasterTrak this was deemed the most cost effective and quickest way to get the file inventory system operational in Herndon. It is unclear what records cannot be reconciled to MasterTrak as the case files have been in the system of record for the loan files since they started arriving in Herndon.

The Inventory Tracking System is used to track loan files only. It is not designed to track any servicing actions and thus, does not reconcile with the Herndon Action Tracking System (HATS) or the Guaranty Purchase Tracking System (GPTS). Also, loans shown coded to the Center (0350) in LAS does not guarantee that they were shipped and received by the Center. Again, there is no method to reconcile systems that do not track the same information.

Early in February and March of 2004, a manual excel spreadsheet program was developed to track the classification of loan files into different categories. The loan officers quickly reviewed each of the 13,000 plus loan files and made a determination of the status of the loan. This process was done specifically as a triage function to determine which loans needed priority treatment. Following the classification process, the Center developed the Herndon Action Tracking System (HATS) to track the liquidation and portfolio management actions. Loans and actions from the initial database were scrubbed and used to populate the HATS database. HATS was also populated by correspondence and inquiries from the lenders. Their requests for actions were entered and given priority treatment when appropriate. Information contained in the loan files can be very outdated and thus, the classification was performed quickly in an effort to identify those files containing purchase requests, compromises, etc. A much more comprehensive source of information was the lending community. Their phone calls, emails and faxes were used to help prioritize the workload and to update the information in HATS.

The Center currently has File Room procedures and file handling procedures in place. They were developed when staff became available to relieve the loan officers of the necessity of finding and returning their own loan files.

Recommendations

- 1.A. The Center is currently re-evaluating the overall process to determine the best allocation of staff to the different functions within the Center.
- 1.B. Additional staff is already in place and the backlog of cases prior to March 13, 2004, is in the process of being eliminated by a target date of early August.
- 1.C. All files received by the Center are immediately scanned into the MasterTrak Inventory System. We continually searching for lost or misplaced files and scan files when located.

- 1.D.** We believe that the current permanent staff of 50 professionals plus the contract staff of 8 individuals and the attorneys assigned to the Herndon Center is sufficient to perform an acceptable level of service.
- 1.E.** File Room procedures were distributed on July 20, 2004 and are being followed by Center staff.
- 1.F.** We believe we have the proper tools and tracking system in place to account for the files maintained in Herndon. We also understand that we need to perform periodic sweeps of the file room to account for the cases.
- 1.G.** Management will review this issue and take appropriate steps to ensure compliance with this recommendation.

Finding 2 Center Production Reports Needed Improvement

As previously stated, the reports in place were designed for the specific purpose of tracking the number of purchases received from all sources and on an on-going basis how many needed to be reviewed, sent to legal for concurrence, checked for final approval and finally purchased. We are in the process of reviewing existing reports and revising the report to include all facets of production, including post purchase reviews of secondary market loans. And, the reports provided to senior management in headquarters reflected the information that was requested on addressing the purchase backlog.

As previously stated, we acknowledge this point; however, we believe that the information provided was not misleading but rather, were designed to track a different aspect than the number of total purchased completely resolved.

We don't believe that historical production reports were difficult to analyze or understand; however, some of the files reviewed were very old and thus older information from the district offices was needed.

Herndon Center personnel are working continuously with OCIO staff to improve the GPTS information and make it more responsive for management reporting. New updates to the system have been made continuously since the Center opened.

Recommendation 2.A.

Center Management and Headquarters are continually revising the management reports maintained by the Center. The suggested reporting format will be reviewed for inclusion into existing reports.

Recommendation 3.B.

Changes to the mainframe loan accounting system would be needed to implement this recommendation. The feasibility of making these changes will be explored. However, loans classified as PIF because of cancellation of guaranty (voluntary release) or denial of liability are coded in the system to record these classifications and consequently data are available for these categories.



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

OFFICE OF THE ADMINISTRATOR

DATE: August 16, 2004

TO: Robert G. Seabrooks
Assistant Inspector General for Auditing

FROM: Stephen D. Galvan */s/ Original Signed*
Chief Operating Officer

SUBJECT: Draft Management Advisory Report on the Transfer of Operations to the
National Guaranty Purchase Center

The subject draft audit report on the operations of the National Guaranty Purchase Center had one recommendation for the Chief Operating Officer. It stated:

- 3.A. We recommend that the Chief Operating Officer require a representative of the National Guaranty Purchase Center to be present at Oversight Council meetings.

The Chief Operating Officer concurs with this recommendation and will include a representative in all future Oversight Council meetings.



REPORT DISTRIBUTION

<u>Recipient</u>	<u>No. of Copies</u>
Associate Administrator for Financial Assistance	1
Associate Administrator for Field Operations	1
General Counsel.....	3
Deputy General Counsel	1
United States Government Accountability Office	1
Office of the Chief Financial Officer Attention: Jeff Brown	1