

**AUDIT OF SBA'S
IMPLEMENTATION OF THE IMPROPER
PAYMENTS INFORMATION ACT**

JUNE 21, 2006

REPORT NUMBER 6-25

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

AUDIT REPORT
Issue Date: June 21, 2006
Report Number: 6-25

To: Jennifer E. Main
Chief Financial Officer

From: /S/ **Original Signed**
Debra S. Ritt
Assistant Inspector General for Auditing

Subject: Audit of SBA's Implementation of the Improper
Payments Information Act

We have completed an audit of the implementation of the improper payments program at the Small Business Administration (SBA). Our audit identified one finding and three recommendations.

BACKGROUND

The Improper Payments Information Act (IPIA) of 2002, Public Law No. 107-300, requires all Federal agencies to: (1) conduct annual reviews of their programs and activities and identify those that are susceptible to erroneous payments, (2) estimate the amount of erroneous payments in susceptible programs, and (3) report the results to Congress along with action plans for erroneous payment reduction. IPIA defines improper payments as any payment that should not have been made or that was made in an incorrect amount (including overpayments and underpayments) under statutory, contractual, administrative, or other legally applicable requirements; and includes any payment to an ineligible recipient, any payment for an ineligible service, any duplicate payment, any payment for services not received and any payment that does not account for credit for applicable discounts.

In 2003, the Office of Management and Budget (OMB) issued Memorandum 03-13, *Implementation Guidance for the Improper Payments Information Act of 2002*, which instructs agencies on implementation of an erroneous payment identification and reporting program. The memorandum clarifies that erroneous payment estimates in susceptible programs must be statistically valid. Moreover, OMB's revised Circular A-123, *Management's Responsibility for Internal Control*, effective 2006, identifies the IPIA as one of the statutory requirements that should be considered in an agency's internal control framework.

OMB, in Circular A-11, *Preparation and Submission of Budget Estimates*, Section 57, identified that SBA's four credit programs were susceptible to erroneous payments. The Circular further required SBA to estimate and report erroneous payments, and implement erroneous payment reduction plans. The programs identified are the Section 504 Certified Development Company (CDC) Program, the Section 7(a) Guarantied Loan Program, and the Small Business Investment Companies (SBIC) Program which are run by SBA's Office of Capital Access (OCA); and the Disaster Assistance Loan Program which is run by the Office of Disaster Assistance (ODA). Overall responsibility for erroneous payment reporting in SBA falls within the Office of the Chief Financial Officer (OCFO).

OBJECTIVES, SCOPE AND METHODOLOGY

The audit objective was to determine whether SBA has developed an erroneous payment identification, reporting and reduction program that is in compliance with the IPIA and whether management could rely on the existing erroneous payment activities to provide several of the basic components of an effective internal control program required by OMB Circular A-123.

To accomplish this objective, we interviewed program managers in SBA's four credit programs identified by OMB as susceptible to erroneous payments. Additionally, we reviewed the improper payment risk assessment activities in SBA's non-credit payment programs. Furthermore, we reviewed annual performance reports and performed independent analyses of program results. We also consulted with OMB officials regarding selected aspects of the process for initial implementation of the erroneous payment requirement. Fieldwork was performed at SBA Headquarters in Washington, DC; with subsequent audit revisions based on the OMB guidance and OCFO discussions through May 1, 2006. Our audit was conducted in accordance with generally accepted Government Auditing Standards.

AUDIT RESULTS

SBA can improve its compliance with Federal guidance on the improper payment act requirements for the four major SBA programs identified in OMB Circular A-11. Improvements are needed because the Agency has not fully documented detailed procedures for its erroneous payment processes. As a result, the current program does not consistently satisfy all elements of a comprehensive program to manage and reduce erroneous payments.

Finding 1: SBA did not Establish Uniform Procedures for Risk Assessment and Reporting for Key Program Areas

SBA did not establish uniform Agency-wide processes and procedures for the full range of erroneous payment risk assessment and reporting activities. Each SBA program was allowed to establish its own risk assessment process using the IPIA and the OMB Memorandum 03-13 as guidance. As a result of the lack of uniform and documented procedures, each SBA program office developed their own procedures and did not consistently identify high risk areas of vulnerability in relation to improper payments.

OMB Memorandum 03-13 requires an agency to review programs susceptible to erroneous payments, estimate annual amounts, develop a plan to reduce erroneous payments and report on erroneous amounts and progress made in reducing them.

For FY 2004, SBA reported on four programs identified as risk susceptible. Those four programs are 504 Certified Development Companies, 7(a) guaranteed loans, disaster loans, and Small Business Investment Companies. We identified issues with three of four of the programs' risk assessments and improper payment reports.

504 Certified Development Companies – Although SBA management performed an improper payment review for its 504 CDC loan program and deemed it to be a low risk process, the scope and type of review was not formally documented and reporting details for the program were not fully supported. Specifically, risk assessments were not documented and transaction analyses were not performed to support the low risk conclusion. As a result, SBA could not provide assurance that necessary corrective actions were taken to reduce or prevent improper payments in the 504 CDC loan program.

7(a) Guaranteed Loans – SBA had started the implementation of a comprehensive review program to satisfy FY 2005 improper payments reporting requirements for the guaranty purchase process. However, the 7(a) guaranteed loan program did not maintain complete risk assessment documentation for its improper payment review in FY 2004 and did not adequately identify the precise reasons for improper payments in the program.

Small Business Investment Companies – The SBIC program did make an estimate of its improper payments, but that estimate did not utilize statistical sampling procedures as required by OMB guidance.

As a result, SBA program offices did not consistently identify high-risk areas of vulnerability in relation to improper payments, and did not maintain documentation to support whether their programs were susceptible to significant improper payments. Without a complete assessment to identify risks of erroneous payments, any corrective actions planned by SBA's credit-programs to reduce erroneous payments may not address the true systemic causes of erroneous payments in these programs.

Management's Response:

Management generally agreed with our audit finding and recommendations. Management noted that the IPIA establishes a \$10 million threshold for improper payment reporting and requested that we modify our recommendation to identify improper payment risks only to those programs where the possibility of improper payments exceeds \$10 million. We have modified recommendation 1A accordingly.

Management also noted that Appendix C to OMB Circular A-123, *Management's Responsibility for Internal Control* will supercede OMB Memorandum 03-13 as IPIA implementation guidance and suggested that we modify our recommendation to cite the circular. We agree, but note that the appendix is now only in draft form and has not yet been finalized. We have modified recommendation 1C to include the use of OMB Circular A-123 Appendix C as IPIA guidance when it is published and becomes effective.

Recommendations: We recommend that the Chief Financial Officer:

- 1A** Require that systematic annual risk assessments be conducted and documented on all SBA programs and activities as appropriate to identify improper payment risks that would possibly exceed OMB's \$10 million threshold for improper payment reporting.
- 1B** Instruct all SBA program offices required to report on their improper payment activities to submit complete improper payment estimation and reduction reports that adequately address all of the elements required by OMB Memorandum 03-13; and all the elements of Appendix C to OMB Circular A-123 when it is published and becomes effective.
- 1C** Develop Procedural Notices or Standard Operating Procedures to be used as internal guidance as appropriate when changes to IPIA requirements are issued by OMB for the erroneous payment estimation and reporting process.

* * *

The findings included in this report are the conclusions of the Office of Inspector General's Auditing Division. The findings and recommendations are subject to review, management decision, and corrective action by your office in accordance with existing Agency procedures for audit follow-up and resolution.

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Should you or your staff have any questions, please contact Jeffrey R. Brindle, Director, Information Technology and Financial Management Group at (202) 205-[FOIA Ex. 2].



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

Date: JUN 9 2006

To: Robert G. Hultberg
Acting Assistant Inspector General for Audit

From: Jennifer Main [FOIA Ex. 6]
Chief Financial Officer

Subject: Audit of SBA's Implementation of the Improper Payments Information Act

This memorandum provides the SBA's comments on the OIG draft audit report dated May 15, 2006 on SBA's implementation of the Improper Payments Information Act. We think the report is much improved from the original version circulated last fall and appreciate your responsiveness to our comments. Overall we generally agree with your findings and recommendations. However, we have a few specific comments we would like to make.

As you know, the Improper Payment Information Act established a \$10 million threshold for the IPIA requirements. Your recommendation 1.A. is for OCFO to:

“Require that systematic annual risk assessments be conducted and documented on all SBA programs and activities as appropriate to identify improper payment risks.”

OCFO's assessments have consistently found that the SBA's programs, except for the four major credit programs currently reported under IPIA guidelines, are so small that they couldn't possibly generate \$10 million annually of improper payments. Moreover, we have never had any evidence or indication (through audits or other sources) that any of SBA's non-credit programs have improper payment levels that begin to approach the \$10 million annual threshold.

We believe it is appropriate to conduct the annual risk assessments on SBA's smaller programs in a summary manner using the risk assessment form provided by OMB that SBA has used in past years. This provides appropriate documentation and the cost of the effort is commensurate with the significantly lower level of improper payment risk in these programs. We believe this approach is consistent with OMB's Memorandum 03-13 guidance that improper payment efforts should focus on programs which the Agency has identified as susceptible to significant erroneous payments.

We request that you modify your recommendation 1.A. to recognize the \$10 million IPIA threshold by adding the language in bold as follows:

SBA IS AN EQUAL OPPORTUNITY EMPLOYER AND PROVIDER

OIG Recommendation 1.A:

Require that systematic annual risk assessments be conducted and documented on all SBA programs and activities as appropriate to identify improper payment risks **that would possibly exceed the OMB's threshold for improper payment reporting.**

Relative to your recommendation 1.B on the completeness of SBA's improper payment reporting, the OMB's Circular A-123 Appendix C will supersede OMB memorandum 03-13 so you may want to modify your recommendation to cite this circular. Otherwise, we concur with this recommendation.

We concur with your recommendation 1.C on the documentation of SBA's Improper Payment program. We are currently developing an SOP on SBA's internal controls and we will include a chapter on Improper Payments in this SOP.

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