



U.S. Small Business Administration
Washington, D.C. 20416

**OFFICE OF
INSPECTOR GENERAL**

January 15, 2002

The Honorable Fred Thompson
Ranking Minority Member
Committee on Governmental Affairs
United States Senate
SD-511 Dirksen Senate Office Building
Washington DC 20510

Dear Mr. Chairman:

In your letter dated June 26, 2001, you asked for the Small Business Administration (SBA) Office of Inspector General's (OIG) assessment of SBA's efforts to identify and reduce the level of erroneous payments. My response to your letter was delayed pending the issuance of SBA's December 14, 2001, answer to your request as to the level of erroneous payments and actions taken by the Agency to reduce these payments. You asked that we use the five general components of internal control as discussed in GAO's Internal Control Standards for the Federal Government and its recently published guidance on erroneous payments.

In its response, the Agency acknowledged that it does not have estimates of the amount of improper payments made in the last 2 years in the Section 7(a) Business Loan, Section 504 Certified Development Company (CDC), Small Business Investment Company (SBIC), and Disaster Assistance Programs. We concur with this assessment and are committed to work with the Agency to develop processes to identify such estimates.

Our assessment of the Agency's response is based on our audit, inspection, and investigative efforts in recent years and pertains solely to SBA's efforts in regards to erroneous payments. Our responses follow the questions you posed and are discussed below.

Control Environment

What does your agency plan to do to "creat(e) a culture of accountability that provides a positive and supportive attitude toward improvement and the achievement of established program outcomes" as GAO suggests?

Agency Response

The control environment for the Agency's four major credit programs includes

- Implementation of OMB Guidelines
- Loan Program Risk Assessment
- Goaling
- Internal Controls
- Lender Audits and Reviews

OIG Assessment

SBA's control environment, as it pertains to erroneous payments, needs improvement. Currently, guidelines for identification of some erroneous payments either are inadequate or non-existent. For example,

- There are no procedures requiring the identification of Section 7(a) loan applicants who are ineligible due to prior defaulted loans; and
- Loan origination and defaulted loan review procedures are not adequate to properly detect many lender and borrower errors.

Also, SBA managers involved in the Section 7(a) and SBIC programs have indicated a need for more staff to facilitate prevention and detection of erroneous payments. The "goaling" element within SBA's control environment consists of performance targets included in the annual budget submissions. These performance targets do not address erroneous payment detection or prevention. The establishment of an erroneous payment "goal" with appropriate performance indicators in the annual plan would better serve the Agency.

Risk Assessment

To what extent are improper payments in your agency the result of agency error, a need for improved oversight and monitoring, inadequate eligibility controls, fraud, or other causes? What is the amount of improper payments your agency has made in the last two years?

If you do not yet know the nature and extent of your agency's improper payments, what is your agency doing to find out?

Agency Response

SBA stated in its letter that it does not have estimates of the amount of improper payments made. The Agency stated that it will estimate improper payments for:

- The Section 7(a) program based on the results of the purchase decision reviews,

- The Section 504 program based on a review of the control points for cash movement in this system,
- The SBIC program after developing and implementing a measure for erroneous payments, and
- The disaster program using the Quality Assurance Reviews.

The Agency also stated that the newly established Office of Lender Oversight (OLO) is a key component in the effort to improve credit programs management and to assess and evaluate program risk.

OIG Assessment

The Agency has not assessed the risk of erroneous payments and, therefore, cannot state to what extent improper payments are due to Agency error, inadequate oversight and monitoring, inadequate controls, or fraud. We noted that SBA's initiatives generally are designed to detect erroneous payments as opposed to preventing them. SBA's increased dependence on lender loan origination indicates a need for more controls to prevent erroneous payments.

The measures proposed by the Agency to estimate erroneous payments for the Section 7(a) and 504 programs will understate the risk because these methods are limited to only those loans that are in defaulted or liquidation status. Our audits have shown that ineligible or otherwise improper loans may not default and, therefore, would not be detected by the proposed methods. For the Section 7(a) and 504 programs, a better estimating method would be to use the results of the lender and CDC reviews done by the Preferred Lender Program review team and the district offices. These error rates could be projected for the entire portfolio.

For the SBIC program, findings identified during the annual examinations would serve as a method for estimating the level of improper payments. The Quality Assurance Reviews proposed by the Disaster Assistance program could provide a reasonable measure of improper payments if the reviews are done at least yearly for each area office and are done on a statistical basis that will allow projection to the entire year's production.

Control Activities

What efforts are underway at your agency to design and implement a plan for significantly reducing the amount of, and the potential for making, improper payments?

Agency Response

To address the issue of erroneous payments, SBA stated that it is

- Improving measurement of improper payments
- Developing risk management and program oversight tools
- Relying on OIG oversight; and
- Conducting lender reviews and examinations.

OIG Assessment

As previously stated, the efforts proposed by SBA will result in an understatement of the level of erroneous payments. Additionally, these efforts do not address reducing the amount of erroneous payments. The adoption of our proposed methods would provide a more realistic estimate of the amount of erroneous payments made yearly. SBA then needs to develop a goal for an acceptable level of erroneous payments and a methodology to achieve this goal that focuses on preventive measures.

Information and Communication

How does this plan address security and privacy concerns related to the information needed to carry out the plan?

Agency Response

SBA stated that it currently collects information to ensure that lenders and borrowers fulfill eligibility criteria and follow program regulations, and as a rule, security and privacy concerns are addressed when establishing the legislation or program regulations. The Agency stated that it does not currently see a need for more information.

OIG Assessment

SBA's proposed efforts to identify the extent of erroneous payments do not appear to have a negative impact on the security and privacy of applicants or lenders.

Monitoring

How will you track and report on your progress? Do you, or will you, "establish agency-specific goals and measures for reducing improper payments?" Will you provide your estimates of improper payments in your annual financial statements or in some other transparent way?

Agency Response

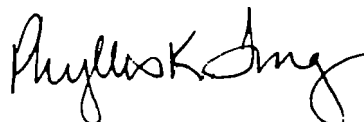
SBA stated that it is developing measures for the Section 7(a), Section 504, disaster, and SBIC programs and will report on targets and estimates of erroneous payments in its budget submission and in the Annual Performance and Accountability Report.

OIG Assessment

Our concerns about the Agency's proposed measures have been discussed above. Assuming appropriate measures are developed, the reporting of these measures, along with targets and estimates, in the cited documents would appear to be sufficient to allow external entities to monitor the Agency's progress.

We appreciate the opportunity to present our views on this important issue. Should you or your staff have questions concerning our response, please do not hesitate to contact Peter McClintock, Deputy Inspector General, or me at 202-205-6586. A similar letter is being sent to Senator Joseph Lieberman.

Sincerely,

A handwritten signature in black ink that reads "Phyllis K. Fong". The signature is written in a cursive, flowing style.

Phyllis K. Fong
Inspector General