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Opportunities To Improve Financial Management And Reduce Costs Of Loan Administration B-114835

Small Business Administration

UNITED STATES
GENERAL ACCOUNTING OFFICE

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JULY 11, 1973

UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D C 20548

DIVISION OF FINANCIAL AND
GENERAL MANAGEMENT STUDIES

B-114835

The Honorable Thomas S Kleppe
Administrator, Small Business Administration

Dear Mr Kleppe

This is our report on opportunities to improve financial management and reduce costs of loan administration in the Small Business Administration

We have discussed the findings contained in this report with your responsible management officials For the most part, corrective actions on deficiencies presented in the report have been taken or promised

Copies of this report are being sent today to the Chairmen of the Senate and House Committees on Appropriations and Government Operations, the Senate Committee on Banking, Housing, and Urban Affairs, the House Committee on Banking and Currency, and the Director, Office of Management and Budget

Sincerely yours,

D L Scantlebury

D L Scantlebury
Director

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ABBREVIATIONS

GAO General Accounting Office

SBA Small Business Administration

GENERAL ACCOUNTING OFFICE
REPORT TO THE ADMINISTRATOR
SMALL BUSINESS ADMINISTRATION

OPPORTUNITIES TO IMPROVE FINANCIAL MANAGEMENT AND REDUCE COSTS OF LOAN ADMINISTRATION
Small Business Administration
B-114835

D I G E S T

WHY THE REVIEW WAS MADE

The Budget and Accounting Procedures Act of 1950 requires the head of each executive agency to observe the accounting principles and standards prescribed by the Comptroller General in establishing and maintaining accounting systems The act also requires GAO to review from time to time the executive agencies' accounting systems

The Small Business Administration (SBA) had 242,085 loans valued at over $3 7 billion outstanding at June 30, 1972 GAO reviewed SBA's accounting system for loans and financial management aspects of its loan administration activities

FINDINGS AND CONCLUSIONS

The loan accounting system was being operated largely without the benefit of adequate comprehensive accounting instructions For example, instructions for recording cash receipts and expenditures, adjusting individual loan accounts, processing computer-rejected transactions, and processing chargeoffs of uncollectible loan accounts were inadequate and incomplete (See p 5)

SBA had many opportunities to improve financial management and to reduce costs of its loan administration activities For example

--SBA mailed a statement to a borrower each time it received monthly payments At GAO's suggestion, SBA changed its mailings from a monthly to a yearly basis The new procedure will save about $250,000 annually in computer and mailing cost: (See p 6)

--SBA required banks to report unnecessary information each month when remitting SBA's share of loan collections By changing its procedures and reducing the amount of information required for its accounting system, SBA could save more than $100,000 annually in data processing costs (See p 7.)

--SBA did not verify fees retained by banks for servicing participating loans As a result SBA had no assurance that the banks' computations of servicing fees, which exceeded $1 6 million in fiscal year 1972, were correct (See p. 10)

RECOMMENDATIONS

GAO made a number of recommendations to SBA with the objective of improving the policies and procedures applicable to the loan accounting system and loan administration activities (See pp 8, 9, 10, 11, and 12)

AGENCY ACTIONS

For the most part, corrective actions on deficiencies presented in the report have been taken or promised

CHAPTER 1

INTRODUCTION

The Budget and Accounting Procedures Act of 1950 requires GAO to review from time to time the accounting systems of the executive agencies The Small Business Administration's (SBA's) accounting principles and standards and accounting systems design were approved by the Comptroller General in December 1968 and August 1970, respectively

SBA had 242,085 loans valued at over $3 7 billion outstanding at June 30, 1972 SBA makes loans directly to borrowers and in participation with lending institutions and guarantees certain loans A brief description of each type of loan follows

Direct loans--These loans are made wholly by SBA with no participation by lending institutions SBA services all direct loans, which includes arranging for the loan, recording borrowers' liens, maintaining custody of collateral, receiving collections on loans, and following up on delinquent payments

Participating loans--SBA and lending institutions make these loans jointly, with each financing an agreed percentage of the loans Either SBA or the lending institution may service the loans, depending on the loan agreement Lending institutions which service participating loans charge SBA a servicing fee, when SBA services participating loans, it does not charge the banks a servicing fee

Guaranty loans--These loans are made wholly by lending institutions and guaranteed in part by SBA The institution may call on SBA to purchase that portion of the loan it guarantees when default by the borrower continues for 90 days Lending institutions service all guaranteed loans

The SBA headquarters office in Washington, D C , is responsible for administering SBA's various loan programs SBA has 10 regional and approximately 70 field offices which process loan applications and approve and service loans

The Accounting Operations Division, Office of Budget and Finance, Washington, D C , operates the SBA loan accounting system The Office of Data Management, Washington, D C , and the Financial Operations Division, Denver, operate supporting automatic data processing systems The Office of Budget and Finance directs the Denver operation

Our review of SBA's accounting system for loans and financial management aspects of its loan administration activities covered the period of January 1972 through March 1973 and included

- --Examining selected cash receipt and disbursement transactions
- --Reviewing accounting manuals, reports, loan records, and related files
- --Reviewing SBA procedures for verification of loan account balances
- --Testing the procedures used by SBA in determining its reserves for doubtful accounts
- --Interviewing cognizant officials responsible for various loan administration activities and accounting operations.

Our objective was to identify matters requiring attention and improvement rather than to evaluate the total accounting and loan administration system

Our review was made at SBA headquarters in Washington, D C , the Financial Operations Division in Denver, and the SBA disaster office in Los Angeles

CHAPTER 2

OPPORTUNITIES TO IMPROVE FINANCIAL MANAGEMENT AND REDUCE COSTS OF LOAN ADMINISTRATION

SBA's loan accounting system was being operated largely without the benefit of adequate comprehensive accounting instructions as described in title 2 of the GAO Manual for Guidance of Federal Agencies

SBA had many opportunities to improve its financial management and reduce costs of its loan administration activities On December 15, 1972, the Director, Office of Budget and Finance, established a task force to review all budget and finance operations to determine how the functions could be accomplished most economically

NEED FOR FORMULATING ADEQUATE ACCOUNTING INSTRUCTIONS

Over 40 employees of the Accounting Operations Division were operating with manuals which did not include adequate detailed instructions for the day-to-day operations of the loan accounting system Some of the important loan functions they performed were

--recording cash receipts and disbursements,

--making adjustments to individual loan accounts,

--following up on transactions rejected by the computer, and

--processing chargeoffs of loans

We believe the lack of detailed instructions could result in ineffective and inefficient operations For example, the Liquidations Unit, Accounting Operations Division, did not have detailed operating instructions and personnel assigned to the unit were (1) manually preparing thousands of documents which duplicated information reported on computer printouts, (2) unnecessarily auditing computer printouts and borrowers' history files, and (3) unnecessarily filing thousands of documents After we informed SBA of this situation, it promptly acted to discontinue preparation of almost 15,000 documents and filing of about 22,500 documents annually

We suggested to SBA officials that detailed loan accounting procedures for the day-to-day operations of the Accounting Operations Division be devised and issued

Subsequent to our review, SBA issued improved procedures We were informed that after these new procedures are implemented, three employee positions in the Liquidations Unit will be eliminated This action will save an estimated $50,000 annually

ABOUT $250,000 WILL BE SAVED ANNUALLY BY PROVIDING BORROWERS WITH A STATEMENT ANNUALLY INSTEAD OF MONTHLY

SBA sent a statement of account to a borrower each time it received a monthly payment on a loan it serviced Based on data available in May 1972, we estimated that, if SBA continued this practice, 180,000 statements would have been issued monthly in fiscal year 1973

The statement showed the application of a borrower's payment to principal, interest, and escrow and the new principal balance It did not, however, show cumulative interest payments for the year Therefore, to compute interest deductions for income tax purposes, the borrower had to save all the statements received and add the amounts of interest reported monthly to determine the total for the year As a result, SBA annually received about 3,000 requests from borrowers for the total interest paid during the year To answer these requests SBA prepared annually a voluminous computer listing showing the amount of interest paid by borrowers

We questioned the need for sending monthly statements to borrowers and suggested to SBA officials that an annual statement, which would show the total interest paid and could be used for income tax purposes, be issued instead SBA concurred with our suggestion, and borrowers were subsequently notified that only annual statements would be issued

We estimate that $250,000 will be saved annually, principally in mailing and computer processing costs, from implementing our suggestion The savings will increase as SBA's loan portfolio increases Savings will result also from the elimination of the yearend computer listing and from a sharp reduction in the number of borrowers' requests for the annual interest paid The borrower will benefit because the annual statement will show the total amount of interest paid during the year for use in preparing his income tax return

ANNUAL SAVINGS IN EXCESS OF $100,000 COULD BE REALIZED THROUGH REDUCTION OF REPORTING REQUIREMENTS IMPOSED ON BANKS AND IMPROVED DATA PROCESSING PROCEDURES

An excessive amount of information on about 13,500 monthly collections for participating loans is being reported by banks and recorded in SBA's loan accounting system By changing its procedures and reducing the amount of information required for its accounting system, SBA could save more than $100,000 annually in data processing costs

Banks which participate with SBA in financing a loan normally collect the borrower's payments When remitting SBA's share of the collection, each bank submits to SBA a report which shows how the collection has been distributed between the bank and SBA The report includes information on how much of the payment was applied to principal and interest, the bank's and SBA's interest rates, opening and closing loan balances, and the bank's servicing fee SBA personnel keypunch this information and record it in the loan accounting system

In our opinion, much of the information reported was unnecessary SBA officials said that information on the bank's share of a remittance was not used and that the requirement for the banks to report and SBA to process such information could be eliminated.

Most of the information on SBA's share of the collection, which is reported by banks and processed by SBA, could be eliminated For example, information such as SBA's interest rate and the opening and closing loan balances is either already available in its files or can be computed

The only information SBA needs from the banks is

--The amount of the remittance

--The date the payment was received by the bank for computing the amount of interest paid by the borrower

--The amount of the service fee retained by the bank for verifying whether the fee charged is correct

The Chief, Data Management Branch, Denver, said that the cost to process a collection from the direct loan program is $0 075, whereas it costs approximately $0 75 to process each report from a bank on remittances from the participating loan program He also said that the main reasons for the difference in costs are

1 Substantially less data is required and processed for direct loan collections than for participating loan collections

2 In the direct loan program, SBA sends a prepunched card containing loan identification data to the borrower The borrower in turn sends the card with his remittance to SBA Use of a prepunched card reduces the cost of keypunching and other data processing costs In the participating loan program, a prepunched card is not used

If SBA (1) reduces the amount of information required for participating loan remittances to that needed by SBA and (2) sends prepunched cards containing loan identification data to banks to be used when sending SBA's share of participating loan collections, the cost to process participating loan collections would approximate the cost to process direct loan collections Resulting annual savings in data processing costs would exceed $100,000 The costs incurred by participating banks would also be reduced since the reporting requirements imposed on them would be reduced significantly

Recommendation

We recommend that the Administrator, SBA, take action to (1) record only the minimum amount of information required in the accounting system pertaining to participating loan collections and (2) use a prepunched remittance card in lieu of the report that is now prepared by banks

Agency action

An SBA official said that a study would be made to determine (1) what information SBA has a valid need for and (2) the feasibility of using a prepunched card

NEED FOR SBA TO STUDY THE ADVISABILITY OF CHARGING A FEE ON SBA-SERVICED PARTICIPATING LOANS

When a bank services a participating loan, SBA pays the bank a servicing fee for each collection made on its share of the loan Using rates prescribed by SBA, the fee is computed on SBA's share of the unpaid principal balance At June 30, 1972, about 13,500 bank-serviced participating loans were outstanding Servicing fees paid to banks during fiscal year 1972 totaled about $1 6 million

When SBA services a loan in which a bank participates, SBA does not charge a servicing fee At June 30, 1972, about

4,800 SBA-serviced participating loans were outstanding Based on the same fee structure that is used to pay banks, we estimate that SBA would have realized more than $115,000 in fiscal year 1972 if a servicing fee had been collected on the banks' share of the unpaid principal balance

An SBA official said that, if banks were required to pay SBA a servicing fee, many banks might elect not to participate in SBA loans. We noted, however, that SBA had not made a study to determine what adverse effect, if any, the charging of a servicing fee would have on SBA's participating loan program

Recommendation

We recommend that the Administrator, SBA, examine the advisability of having banks pay fees when SBA services participating loans

Agency action

The Director, Office of Loan Administration, said that SBA will examine into the advisability of having banks pay a servicing fee when SBA services participating loans

OPPORTUNITIES TO REDUCE THE NUMBER OF REPORTS PERTAINING TO LOANS

As of August 1972 the Office of Data Management was required to prepare about 85 different reports pertaining to SBA loans We believe that SBA has an opportunity to reduce requirements for reports by strengthening its procedures to review the need for reports

In reviewing various aspects of loan accounting activities, we noted several instances where reports either were not needed or their frequency could be reduced Examples follow

1 A report showing the details of loan receivable accounts was prepared monthly Because of the large volume of detail included in the report, we inquired as to its use The Chief, Accounting Branch, advised us that the report was no longer being used on a monthly basis The frequency of the report was subsequently changed to every 3 months We again questioned the need for the report, and SBA officials agreed to make it an annual report The change will save about $4,800 annually.

2 In making the annual study to determine the needed provision for losses on loans receivable for fiscal year 1971, the Accounting Operations Division required a number of reports Our review of the study disclosed that several of the

reports were not needed or used For example, a 291-page detailed report of business and economic opportunity loans was not used in the study We informed SBA officials of this, and they eliminated several reports for the 1972 study

It is the Office of Budget and Finance policy to review each request for a report on loans and to annually review the need for, and distribution of, reports

In our opinion the procedures used in the initial and annual review of report requirements could be strengthened In the initial review of the requests for reports, justifications for the reports are not included in the request and evaluations are not made of the need for the reports In the 1972 annual review, where the report recipient indicated on a questionnaire that a report was necessary, the review team did not generally evaluate the need for the report

Recommendation

We recommend that the Administrator, SBA, require that (1) recipients of reports provide justification for the need for reports in connection with the initial and annual review of report requirements and (2) the justification for reports tc be evaluated

Agency action

The Assistant Administrator for Administration advised us that more effective procedures for reviewing the need for reports will be used when recently installed computer equipment becomes operational

NEED FOR VERIFICATION OF SERVICING FEES WITHHELD BY BANKS

Banks generally compute and retain fees from collections made for participating loans which they service SBA was not verifying the validity of the amount of fees retained by banks, and, as a result, SBA had no assurance that the banks' computations of servicing fees, which exceeded $1 6 million in fiscal year 1972, were correct

At June 30, 1972, there were about 13,500 loans serviced by banks SBA procedures provide that, where a bank-serviced participating loan has been fully disbursed, the computer will automatically verify every 10th collection reported by banks, including servicing fees withheld The Chief, Data Automation Branch, Denver, said that these procedures were not implemented because not enough data on these loans was stored in the Denver computer to make this verification The Director, Data Management Division, Washington, however, said that missing elements of data needed to automate the verification process could be obtained from the master file in Washington and sent to Denver

To insure that banks are not deducting excessive fees, SBA should verify whether the fees retained by banks are correct

Recommendation

We recommend that the Administrator, SBA, take the necessary steps to implement effective verification procedures for fees withheld by banks for servicing participating loans

Agency action

The Director, Office of Budget and Finance, informed us that appropriate action will be taken to implement verification procedures

NEED FOR PERIODIC REVIEW OF PROCEDURES FOR CHARGING OFF UNCOLLECTIBLE LOANS

The amount of SBA loans determined to be uncollectible increased from $31 million in fiscal year 1971 to about $54 million in fiscal year 1972 In several instances, current payments were being made on loans which SBA field offices had erroneously determined to be uncollectible

We brought these cases to the attention of SBA officials and suggested that the Internal Audit Division review the adequacy of procedures for determining the uncollectibility of loans Subsequently, a review was made at four field installations

The major findings from the review were that

--Data in the files and the reports recommending the chargeoff of uncollectible loans differed

--Loans were determined to be uncollectible without first being reviewed by legal counsel

--The basis for conclusions that the cost of further efforts to collect a loan would exceed the amount of recoveries needs to be documented

In a memorandum dated March 16, 1973, the Associate Administrator for Operations sent a copy of the internal audit report to all regional directors and instructed them to make a thorough evaluation of loan chargeoff procedures in their respective district offices and to forward to his office the results of the evaluations for all offices under their jurisdiction

Recommendation

We recommend that the Administrator, SBA, require periodic reviews of the adequacy of procedures for determining the uncollectibility of loans

Agency action

The Director, Internal Audit Division, stated that periodic reviews will be performed subject to the approval by the Assistant Administrator for Administration

OTHER MATTERS ABOUT WHICH SBA HAS TAKEN OR WILL TAKE CERTAIN ACTIONS

SBA has taken or will take the actions indicated below on other matters which we brought to its attention

--A study would be made of the efficiency and effectiveness of sending 15-day delinquent notices to borrowers, including a comparison of benefits of issuing 30-day notices in lieu of present 15-day delinquency notices

--A study would be made to determine the feasibility of having banks compute SBA's fees for guaranty loans remaining under the periodic fee arrangement to reduce processing costs

--Procedures for computing the provision for losses on three types of loans were revised