U.S. Small Business Administration

SBA

Your Small Business Resource

Office of the Inspector General Reports

Office of the Inspector General Audit Follow-up

Summary of OIG Follow-up

Throughout the year, the OIG conducts audits of the SBA's processes, procedures and programs, and makes recommendations for improvement. Many of these recommendations are not material, relative to their dollar impact on the SBA's financial and administrative operation, but are very beneficial to the SBA's management. Program management has the option to agree or disagree with OIG recommendations. If agreement cannot be reached, the issue can be raised to a higher level by the OIG. Once both management and the OIG agree with a recommendation, it becomes a "management decision." The manager also develops a specific action plan and provides a target date for completion as part of the "management decision.' The corrective action is referred to as a "final action."

The OCFO is responsible for monitoring the final actions and reporting on their status of implementation. To track and report these to management, the OCFO maintains a database and provides a status report available on the SBA intranet page. This is updated as corrective actions are completed. Program offices also provide regular updates on final action status that are used to update the database.

The OCFO continues to take aggressive steps to improve management's attention to these issues, resulting in 183 final actions during FY 2008. Of these final actions, 15 were monetary and 168 were non-monetary.

The following two charts depict the SBA's monetary final action activity: audit recommendations with disallowed or questioned costs, and audit recommendations with funds put to better use. The status of all audit recommendations is reconciled with the OIG to ensure actions are posted promptly and accomplished in accordance with the agreed-upon target dates. Please refer to Appendix 4 Table III, for the detail of Final Action Activity, which lists each report and analysis of the decisions.

Table I

Final Action On Audit Recommendations With Disallowed / Questioned Costs
October 1, 2007 – September 30, 2008

	Number of Recommendations	Disallowed Costs (Rounded to Thousands)
A. Recommendations with management decisions on which final action had not been taken at the beginning of the period.	15	$ 29,595
B. Recommendations on which management decisions were made during the period.	4	$ 15,917
C. Total recommendations pending final action during period.	19	$ 45,509
D. Recommendations on which final action was taken during the period.		
1. Recoveries:		
(a) Collections and Offsets	3	$ 326
(b) Property	0	$ 0
(c) Other	0	$ 0
2. Write-Offs	9	$ 37,757
3. Total	12	$ 38,083
E. Recommendations needing final action at the end of the period.	7	$ 7,429

Table II

Final Action On Audit Recommendations With Funds Put To Better Use October 1, 2007 – September 30, 2008		
	Number of Recommendations	**Funds to be Put to Better Use** (Rounded to Thousands)
A. Recommendations with management decisions on which final action had not been taken at the beginning of the period.	2	$ 436
B. Recommendations on which management decisions were made during the period.	3	$ 36,400
C. Total recommendations pending final action during period.	5	$ 36,836
D. Recommendations on which final action was taken during the period.		
1. Value of recommendations implemented (completed).	2	$ 436
2. Value of recommendations that management concluded should not or could not be implemented or completed.	1	$ 29,200
3. Total	3	$ 29,636
E. Recommendations needing final action at the end of the period.	2	$ 7,200

U.S. SMALL BUSINESS ADMINISTRATION

OFFICE OF INSPECTOR GENERAL

Report No. 09-02

Fiscal Year 2009 Report on the Most Serious Management and Performance Challenges Facing the Small Business Administration

October 20, 2008

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

October 20, 2008

MEMORANDUM

TO: Sandy K. Baruah
Acting Administrator

FROM: Peter L. McClintock
Acting Inspector General

SUBJECT: Fiscal Year 2009 Report on the Most Serious Management and Performance Challenges Facing the Small Business Administration

In accordance with the Reports Consolidation Act of 2000, we are providing you with the Office of Inspector General (OIG) Fiscal Year (FY) 2009 Report on the Most Serious Management and Performance Challenges Facing the Small Business Administration (SBA). This report represents our current assessment of Agency programs and/or activities that pose significant risks, including those that are particularly vulnerable to fraud, waste, error, mismanagement, or inefficiencies. The Challenges are not presented in order of priority, as we believe that all are critical management or performance issues.

Our report is based on specific OIG, Government Accountability Office, and other official reports, as well as our general knowledge of SBA's programs and operations. Our analysis generally considers those accomplishments that SBA reported as of September 30, 2008.

The Agency has continued to make progress in resolving the Management Challenges, as illustrated by the large number of color scores that have improved since last year (see table below). SBA has continued to improve the security of its information systems by improving the tracking of security weaknesses, performing periodic service continuity testing, centralizing and implementing a process to track IT security training, and improving technical training for individuals with significant information security duties. The Agency has also made good progress in addressing its human capital management issues and lender oversight duties. Finally, the Agency completed the remaining recommended action for one of the Challenges in last year's report: "SBA needs to continue updating its system of directives to provide proper guidance and control over its operations" (formerly Challenge 9). Thus, this Challenge has now been eliminated.

Within each Management Challenge there are a series of "recommended actions" to resolve the Challenge. Each recommended action is assigned a color "status" score. The scores are as follows: Green for Implemented; Yellow for Substantial Progress; Orange for Some Progress; and Red for No

Progress. An upwards arrow in the color box indicates that the color score improved over last year's report. As part of the OIG's continuing evaluation of the Management Challenges, certain Challenges have been updated or revised.

Actions that were scored Green last year, and which remained Green this year, have been moved up to the "history bar," which is located above the action items. The history bar helps to show any progress that the Agency has made on the Challenge over the past four fiscal years (or as long as the Challenge has existed, if shorter) by reporting the number of actions that moved to Green each year.

Following is a summary of the FY 2009 report on the Agency's Most Serious Management and Performance Challenges.

		Status Score				
	Topic	Green	Yellow	Orange	Red	Improved[1]
1	Small Business Contracts	1	1	2		1
2	IT Security	2	4			3
3	Human Capital		3			
4	Loan Guaranty Purchase	2	1	1		2
5	Lender Oversight	4	2	4		4
6	8(a) BD Program	1	3	1	1	3
7	SBIC Program	1	4			3
8	Loan Agent Fraud	1				1
	TOTAL	12	18	8	1	17

We would like to extend our appreciation to SBA's management and staff for their cooperation in providing us with the information needed to complete this report, and their efforts to make progress in addressing these Challenges. We would especially like to thank you and Deputy Administrator Carranza for the commitment you have demonstrated in promoting agency actions to address the Management Challenges. The Agency's considerable progress this past year reflects the emphasis that the Agency has placed on resolving the Management Challenges.

Please let me know if you have any questions.

Attachment

cc: Deputy Administrator

[1] "Improved" refers to a recommended action that showed progress this year over last year's score (as denoted by an "up" arrow). Challenge 3, Human Capital, was revised in the OIG FY 2008 Management Challenges Report and, consequently, none of the actions in that report were graded with a color. Since the "Improved" column only records improvement in the color score from last year's report, it does not show progress in this Challenge during FY 2008. Nonetheless, earning three "Yellow" scores on this Challenge represents a significant achievement for the Agency.

Table of Contents

Page

Challenge 1. Procurement flaws allow large firms to obtain small business awards and agencies to count contracts performed by large firms towards their small business goals 1

Challenge 2. Information systems security needs improvement 2

Challenge 3. Effective human capital strategies are needed to enable SBA to successfully carry out its mission and become a high-performing organization 3

Challenge 4. SBA's National Guaranty Purchase Center needs better controls over the 7(a) loan guaranty purchase process 4

Challenge 5. SBA needs to further strengthen its oversight of lending participants 5

Challenge 6. The 8(a) program needs enhanced business development processes, objectively defined eligibility standards, upgraded training and information systems, improved graduation procedures, and better oversight of contractor compliance with program regulations 6

Challenge 7. Insufficient and outdated SBA controls continue the excessive risk of the SBIC program 7

Challenge 8. Effective tracking and enforcement would reduce financial losses from loan agent fraud 8

Appendix: Relevant Reports 9

Challenge 1. Procurement flaws allow large firms to obtain small business awards and agencies to count contracts performed by large firms towards their small business goals.

The Small Business Act establishes a Governmentwide goal that 23 percent of the total value of all prime contract awards for each fiscal year (FY) be awarded to small businesses. As the advocate for small business, the Small Business Administration (SBA) should strive to ensure that only small firms obtain small business awards and that procuring agencies accurately report contracts awarded to small businesses when representing its progress in meeting small business contracting goals.

However, Office of Inspector General (OIG) audits and other governmental studies have shown widespread misreporting by procuring agencies; many contract awards recorded as going to small firms have actually been performed by larger companies. While some contractors may misrepresent or erroneously calculate their size, most incorrect reporting results from errors made by government contracting personnel. Noted errors include acceptance of questionable size self-certifications and misapplication of small business contracting rules. Also, it is unclear whether contracting officers always review the on-line certifications that contractors enter into the governmental Online Representations and Certifications Application (ORCA) prior to awarding contracts. SBA needs to do more to: (1) ensure that contracting personnel are adequately trained on small business procurement procedures and are reviewing ORCA data prior to awarding contracts, and (2) encourage greater accuracy in Federal small business contracting reports.

The Agency also needs to address a loophole within General Services Administration Multiple Awards Schedule (MAS) contracts that contain multiple industrial codes. Currently, a company awarded such a contract can identify itself as small on individual task orders awarded under that contract even though it does not meet the size criteria for the applicable task. Thus, agencies may obtain small business credit for using a firm classified as small, when the firm is not small for specific orders under such a MAS contract.

While more remains to be done, SBA made some progress on this challenge as it: (1) conducted some training on behalf of requesting agencies; (2) added language in the Federal Acquisition Regulations to require contracting personnel to check size in ORCA; and (3) coordinated with the Office of Management and Budget (OMB) on a directive that requires agencies to certify the accuracy of their FY 2008 procurement data in the Federal Procurement Data System (FPDS), including data on small business procurements.

Challenge History Fiscal Year (FY) Issued: 2005	Actions Accomplished (Green Status) during Past 4 FYs			
			06-0	07-0
Remaining Recommended Actions for FY 2009				**Status at end of FY 2008**
1. Develop and take steps to provide reasonable assurance that agencies are providing adequate basic and continuing education training to contracting personnel on small business contracting procedures.				Orange
2. Develop and implement a program that promotes accurate contractor certifications and ensures that contracting personnel review contractor certifications.				Yellow
3. Develop and implement a plan that ensures that Federal agencies accurately report the number of contracts they award to small businesses.				Green
4. Issue regulations that require firms to meet the size standard for each specific order they receive under a GSA schedule and Governmentwide Acquisition Contract (GWAC) and show that the regulations are being followed.				Orange

Green-Implemented Yellow-Substantial progress Orange-Limited Progress Red-No progress

54

Challenge 2. Information systems security needs improvement.

The confidentiality, integrity, and availability of SBA's information systems are vital to the continued successful operation of the Agency. While information technology (IT) can result in a number of benefits, such as information being processed more quickly and communicated almost instantaneously, it can also increase the risk of fraud, inappropriate disclosure of sensitive data, and disruption of critical operations and services. SBA's computer security program operates in a dynamic and highly decentralized environment and requires management attention and resources as weaknesses are identified.

In FY 2008, SBA continued to improve the security of its information systems. SBA centralized administration of its network accounts, strengthened controls over access granted to contractors, established an Enterprise Change Control Board (ECCB), and standardized change control requests. SBA implemented standard baseline configurations for its Windows operating system servers and implemented end user encryption tools. Additionally, SBA improved the tracking of security weaknesses, performed periodic service continuity testing, centralized and implemented the tracking of IT security training, and demonstrated that technical training for individuals with significant security duties has improved. SBA is also to be commended for implementing 28 of 40 OIG audit recommendations. To show further progress, SBA will need to: (1) implement a process to more timely mitigate system risks that are identified as "medium" and "high" and ensure all security weaknesses identified in risk assessments are included in the Plan of Actions and Milestones; (2) identify and remove unnecessary accounts from the general support systems and major applications; and (3) identify users of the Loan Accounting System who have incompatible system access rights, demonstrate the full deployment of end user security controls at the program office level, and address open OIG audit recommendations.

Challenge History Fiscal Year (FY) Issued: 1999	Actions Accomplished (Green Status) during Past 4 FYs			
	04-4	05-2	06-2	07-2
Remaining Recommended Actions for FY 2009				**Status at end of FY 2008**
1. Access controls are in place and operating effectively.				Yellow
2. System software controls are in place and operating effectively. *(Previously action #3)*				Yellow ↑
3. Segregation of duty controls are in place and operating effectively. *(Previously action #4)*				Yellow
4. Service continuity controls are in place and operating effectively. *(Previously action #5)*				Green ↑
5. The Plan of Actions and Milestones (POA&M) accurately reports all computer security weaknesses and corrective actions. *(Previously action #7)*				Yellow
6. SBA ensures adequate and up-to-date computer security program training. *(Previously action #8)*				Green ↑

Green-Implemented Yellow-Substantial progress Orange-Limited Progress Red-No progress

55

Challenge 3. Effective human capital strategies are needed to enable SBA to successfully carry out its mission and become a high-performing organization.

Between 2001 and 2006, SBA's staffing (excluding Disaster) decreased by more than 25 percent while virtually all of its programs grew significantly. For example, the number of loans made to small businesses doubled and the Agency's oversight responsibilities over government contracting to small businesses increased as the value of these Federal contracts rose by more than 50 percent. In response to budget cuts, SBA restructured key Agency operations, reengineered its largest loan programs, and downsized personnel through attrition and directed transfers. While these actions transformed the way SBA does business, the Agency did not adequately analyze priorities and allocate resources consistent with those priorities and its new business processes. As a result, there was no assurance that sufficient resources—in terms of both number of staff and the knowledge and skills possessed by staff—were available and appropriately deployed to perform critical functions. For example, audits showed that inadequate staffing of key functions resulted in limited oversight of lenders and inadequate monitoring of 8(a) program requirements.

The 2002, 2004, and 2006 Federal Human Capital Surveys (FHCS), which were administered by the Office of Personnel Management (OPM), illustrated SBA's serious human capital challenges. These surveys measured Federal employees' perceptions about how effectively agencies have managed their workforces. For example, in the 2006 survey, positive responses to 36 of 80 questions were far below the government-wide average, and 7 items trended significantly downward since the previous survey. Out of 36 agencies, SBA ranked near the bottom on all four human capital indices: Leadership and Knowledge Management (33rd); Results-Oriented Performance Culture (32nd); Talent Management (35th); and Job Satisfaction (34th). SBA's scores were particularly low related to the adequacy of job-related knowledge and skills, the reasonableness of workload, sufficiency of information needed to go a good job, and employee morale.

SBA's current leadership has emphasized transparency and communication in implementing a "reform agenda" to prioritize agency goals, align resources with identified goals, and assess results. It has also been proactive in addressing the results of the FHCS, and an interim employee survey in 2007 showed substantial improvement in many areas. However, human capital management continues to be a significant challenge for SBA, requiring ongoing attention and commitment by senior leadership.

Challenge History Fiscal Year (FY) Issued: 2001 (Revised 2007)	Actions Accomplished (Green Status) during Past 4 FYs			
	04-1	05-0	06-0	07-0
Remaining Recommended Actions for FY 2009				**Status at end of FY 2008**
1. Allocate appropriate staffing toward Agency priorities – perform an analysis of Agency priorities and develop, communicate, and implement a comprehensive plan (including responsibilities, metrics, and timeframes) for allocating appropriate staffing (in terms of staffing levels and requisite knowledge, skills, and abilities) toward those priorities.				Yellow
2. Take steps to correct problems identified by the Federal Human Capital Survey (FHCS) – develop, communicate, and implement a corrective action plan (including priorities, responsibilities, metrics, and timeframes) to address the underlying causes of SBA's poor results on the FHCS.				Yellow
3. Plan for the future of SBA – develop and implement an effective succession planning program to ensure that there are qualified staff available to perform SBA's mission-critical functions and meet identified priorities for the foreseeable future.				Yellow

Green-Implemented Yellow-Substantial progress Orange-Limited Progress Red-No progress

57

Challenge 4. SBA's National Guaranty Purchase Center needs better controls over the 7(a) loan guaranty purchase process.

The majority of loans made under the 7(a) loan-guaranty program are made with little or no review by SBA prior to loan approval because SBA has delegated most of the credit decisions to lenders originating these loans. SBA's review of lender requests for guaranty purchases on defaulted loans is, therefore, the Agency's primary tool for assessing lender compliance on individual loans and protecting SBA from making erroneous purchase payments. However, OIG audits of early defaulted loans and SBA's guaranty purchase process have shown that reviews made by the National Guaranty Purchase Center (NGPC) have not consistently detected lender failures to administer loans in full compliance with SBA requirements and prudent lending practices, resulting in improper payments.

SBA has taken actions to correct many of the deficiencies identified by the OIG, such as reengineering the 7(a) loan guaranty purchase process to improve the efficiency of the program, increasing the staffing level at the NGPC, and issuing revised Standard Operating Procedures (SOPs) for lender loan processing. SBA has also developed a comprehensive operations manual for the NGPC and trained individuals responsible for making purchase decisions. Further, the Agency developed and implemented a statistical sampling methodology to identify improper payments in accordance with OMB requirements. While improvements have been made, additional actions are needed to strengthen guaranty purchase decisions and effectively reduce improper payments, such as ensuring corrective actions are taken when deficiencies in the purchase review process are identified. Also, the Agency needs to implement policies and procedures that are required in recommended action 4 below, including: (1) review of the entire lender loan file for early-defaulted loans; (2) verification of financial information; (3) identification of collateral at loan inception and after loan default; and (4) verification of borrower equity injections.

Challenge History Fiscal Year (FY) Issued: 2001	Actions Accomplished (Green Status) during Past 4 FYs			
	04-0	05-2	06-0	07-0
Remaining Recommended Actions Needed for FY 2009				**Status at end of FY 2008**
1. Devote adequate resources to the purchase process.				Green
2. Determine the level of improper payments for the entire loan portfolio in compliance with the Improper Payments Information Act of 2002 and OMB guidance.				Green
3. Establish a process to identify and address the risks of improper payments.				Orange
4. Implement effective policies and procedures governing the guaranty purchase process.				Yellow

Green-Implemented Yellow-Substantial progress Orange-Limited Progress Red-No progress

58

Challenge 5. SBA needs to further strengthen its oversight of lending participants.

Since its inception in 1953, SBA has loaned or guaranteed billions of dollars to finance and spur investment in small business concerns and over the years has shifted from being an organization that processes loans to one that relies on program participants to originate, service and liquidate loans. This reliance requires an effective participant oversight program to monitor participant noncompliance with SBA policies and procedures and take corrective action when material noncompliance is detected.

The Agency expanded its oversight process by establishing a Loan and Lender Monitoring System (L/LMS) that identifies potential and actual financial risks at the portfolio, lender, and loan levels. L/LMS uses internal and external information to develop credit scores for each loan, aggregates the scores by lender, and produces ratings that measure the level of lender risk. In September 2007, the rating categories were rescaled to reflect statistical groupings of raw lender scores and their associated purchase rates. In addition to the L/LMS, the Agency established the responsibilities, authorities, and staffing levels of the Office of Credit Risk Management (OCRM), established Portfolio Analysis and Lender Oversight committees to assess the portfolio and individual lender performance, commenced on-site reviews of participants with large SBA guaranteed loan portfolios, and established a corrective action process for lenders requiring improved performance. OCRM also issued guidance for on-site participant reviews, including fees to be charged to support the oversight process. However, OIG audit efforts disclosed weaknesses in the oversight process, most notably in the areas of: establishing acceptable levels of risk; assigning lender risk ratings; conducting onsite reviews; staffing oversight functions; setting guidance for the oversight process; and correcting unacceptable lender performance.

To enhance the oversight program, among other things, the Agency needs to: (1) revise the lender rating process to ensure that it accurately reflects each lender's risk to SBA; (2) expand the onsite reviews to include medium size lenders; (3) revise the onsite review and examination process to appropriately assess the compliance risk posed by lenders; (4) issue and abide by guidance designed to achieve the objectives of the lender oversight process; and (5) develop specific performance measures that address the deficiencies noted in the lender corrective action plans.

Challenge History Fiscal Year (FY) Issued: 2001	Actions Accomplished (Green Status) during Past 4 FYs			
	04-7(A)-7 04-504-7	05-7(A)-0 05-504-3	06-7(a)-2 06-504-1	07-7(a)-0 07-504-1

Remaining Recommended Actions for FY 2009	Status at end of FY 2008	
	7(a)	504
1. Implement a process that effectively assesses the level of financial risk of the portfolio, of participants, and of loans.	Green ↑	Green ↑
2. Improve the process for reviewing lenders and Certified Development Companies (CDCs) for compliance risks.	Yellow	Yellow
3. Provide adequate personnel resources for the Office of Credit Risk Management.	Green ↑	Green ↑
4. Implement guidance providing for effective oversight of lending programs *(Previously action #5)*	Orange	Orange
5. Ensure that effective corrective actions are implemented, monitored, and result in improvement in the performance of participants with unacceptable performance. *(Previously action #6)*	Orange	Orange

Green-Implemented Yellow-Substantial progress Orange-Limited Progress Red-No progress

60

Challenge 6. The 8(a) program needs enhanced business development processes, objectively defined eligibility standards, upgraded training and information systems, improved graduation procedures, and better oversight of contractor compliance with program regulations.

The SBA 8(a) Business Development (BD) program was created to assist eligible small disadvantaged business concerns to compete in the American economy through business development. An applicant firm must: (1) be a small business; (2) be unconditionally owned and controlled by one or more socially and economically disadvantaged individuals who are of good character and Citizens' of the United States; and (3) demonstrate potential for success.

Previously, the Agency had not placed adequate emphasis on business development to enhance the ability of 8(a) firms to compete, and did not adequately ensure that only 8(a) firms with economically disadvantaged owners in need of business development remained in the program. Companies that were "business successes" were allowed to remain in the program and continue to receive 8(a) contracts, causing fewer companies to receive most of the 8(a) contract dollars and many to receive none. The Agency was also challenged by an information system that impaired its ability to effectively manage the program.

The Agency has strengthened its internal controls to reasonably ensure that the business development needs of individual firms in the 8(a) BD program are identified and that assistance is provided to meet those needs. A new innovative Business Development Management Information System (BDMIS) has been implemented for the program that will automate the certification and annual review process, thus allowing for more timely and effective reviews. The system will also be able to perform internal analytics, create reports, and track business development activities. In addition, the Agency has modified existing procedures to enhance its ability to detect whether 8(a) firms are complying with regulatory requirements when they perform contracts.

Although SBA has made some improvements, many challenges remain. In particular, the Agency needs to develop clear and objective criteria for determining "economic disadvantage".

61

Challenge History Fiscal Year (FY) Issued: 2003	Actions Accomplished (Green Status) during Past 4 FYs			
	04-0	05-0	06-1	07-1
Remaining Recommended Actions for FY 2009				**Status at end of FY 2008**
1. Develop and implement a plan, including SOP provisions, which ensures that the 8(a) BD program identifies and addresses the business development needs of program participants on an individualized basis.				Orange
2. Develop and implement Regulations and SOP provisions to ensure that participants are graduated once they reach the levels defined as business success.				Yellow ↑
3. Establish objective and reasonable criteria that effectively measures "economic disadvantage", and implement the new criteria.				Red
4. Provide sufficient financial and analytical training to business development specialists (BDS) to enable them to evaluate a company's business profile and competitive potential.				Yellow
5. Determine data needs to support and manage the BD program and implement a management information system (MIS) that will support the program mission and objectives, provide useful information, and enable SBA to measure program results.				Green ↑
6. On a regular basis, conduct surveillance reviews of procuring agencies to ensure they are effectively monitoring and enforcing compliance with specified 8(a) BD regulations on the contracts they administer *(Previously action #7)*.				Yellow ↑

Green-Implemented Yellow-Substantial progress Orange-Limited Progress Red-No progress

62

Challenge 7. Insufficient and outdated SBA controls continue the excessive risk of the SBIC program.

The Small Business Investment Company (SBIC) Program is designed to stimulate and supplement the flow of private equity capital and long-term debt to small business concerns. SBA uses both guaranteed debt (debentures) and equity interest (participating securities) to provide government-backed financing to SBICs. No new participating security SBICs have been licensed since funding for this program ended on September 30, 2004. As of September 2008, SBA had about $9.5 billion of such financings at risk. The financial performance of participating security SBICs between FY 1993 and FY 2008 is estimated to have resulted in as much as $2 billion in losses to the Federal Government. Government Accountability Office (GAO) and OIG audits attributed these losses to the structure of the participating security funding process, and the lack of focus on limiting costs when liquidating SBICs. The audits determined that: (1) the subsidy model underestimated the cost of the program; (2) SBA's profits were not proportional to its investments in the participating security SBICs; (3) insufficient incentives existed to encourage participating security SBICs to repay principal debt as quickly as possible; (4) SBA allowed too much time for financially troubled SBICs to attempt rehabilitation; (5) better performance goals and indicators were needed to show how well and how timely recoveries were maximized for liquidated SBICs; (6) SOPs for SBIC operations and liquidations were outdated; and (7) existing guidance did not provide a systematic approach for estimating the level of financial risk, implementing restrictive operations, transferring capitally-impaired SBICs to liquidation status, liquidating SBICs with participating securities, and monitoring the liquidation of SBIC receiverships.

To address this Management Challenge, the Agency developed a new subsidy estimation methodology, issued revised SOPs for SBIC operations and SBIC Liquidations, revised contracts for receivership agents, and filled staff vacancies. Additional actions needed include demonstrating: (1) that SBICs are transferred timely into liquidation status in accordance with revised guidance; (2) that quarterly risk assessments are performed and documented; and (3) that financially troubled participating security SBICs are placed timely into restrictive operations status. The Agency also must issue performance goals and indicators for the SBIC liquidation process and implement procedures for liquidation of participating security SBICs and monitoring of SBICs in receivership.

63

Challenge History Fiscal Year (FY) Issued: 2004	Actions Accomplished (Green Status) during Past 4 FYs			
	04-2	05-0	06-1	07-1
Remaining Recommended Actions for FY 2009				**Status at end of FY 2008**
1. Develop systematic criteria and implement a timely approach for transferring SBICs to liquidation status. *(Previously action #2)*				Yellow
2. Revise SOP 10 06 to include a process to perform and document quarterly risk assessments, including an analysis of repayment potential, and recommended actions. *(Previously action #3)*				Green ↑
3. Incorporate into SOP 10 06 a requirement for the timely and consistent implementation of restrictive operations. *(Previously action #4)*				Yellow
4. Develop and implement performance goals and indicators that address the efficiency, cost-effectiveness, and timeliness of the SBIC liquidation process. *(Previously action #5)*				Yellow ↑
5. Develop and implement procedures, to be included in a revised version of SOP 10 07 that address the liquidation of participating security SBICs and SBA monitoring of the liquidation of SBICs in receivership. *(Previously action #6)*				Yellow ↑

Green-Implemented Yellow-Substantial progress Orange-Limited Progress Red-No progress

64

Challenge 8. Effective tracking and enforcement would reduce financial losses from loan agent fraud.

For years, OIG investigations have revealed a pattern of fraud in the 7(a) business loan guaranty program by loan packagers and other for-fee agents. Fraudulent schemes have involved hundreds of millions of dollars. Yet, SBA oversight of loan agents is limited, putting taxpayer dollars at risk. The Agency could reduce this risk if it established effective loan agent disclosure requirements, a database or equivalent means to track loan agent involvement with its loans, and a more effective agent enforcement program.

In response to this Challenge, SBA proposed to revise its E-Tran system (which is designed to collect loan data electronically from participating lenders) to collect information on loan agent involvement. However, after further examination, the Agency concluded that this process had limitations that would not address the problem due to limitations in the E-Tran system and communication issues between lender personnel involved in loan decisions and those performing E-Tran data entry, and because many lenders were not using E-Tran. Late in FY 2007, SBA proposed a new approach to address the Challenge. The Agency intends to integrate the collection of data from the Form 159 (which asks for information about loan agents) into the Form 1502 process. The Form 1502 is an electronically-submitted report that lenders submit to SBA's Fiscal and Transfer Agent (FTA) to describe the status of all SBA-guaranteed loans in their portfolios. This method of capturing the data is superior to using the E-Tran system because the 1502 is first submitted after the initial loan disbursement, so a lender should be aware of and able to report on loan agent activity, and because it is submitted by all 7(a) lenders. In FY 2008, the OIG consolidated three actions from this Challenge into the revised recommended action #1 below. SBA made no progress on this action during FY 2008, in part due to a protest of the award of the FTA contract to what would have been a new vendor.

In FY 2007, the Agency made progress by issuing its Lender Oversight SOP and by previously revising the guaranty purchase checklist (which lists the records that lenders need to provide when requesting SBA to pay a guaranty) to include the submission of the Form 159. The Agency must also make certain that it captures loan agent information electronically and links it to individual loans. SBA could then identify patterns of loan agent fraud and assess the various risks that loan agents present to the SBA's portfolio of guaranteed loans. SBA also needs to establish a more effective enforcement program to deter fraudulent loan agent activity.

Challenge History Fiscal Year (FY) Issued: 2000	Actions Accomplished (Green Status) during Past 4 FYs			
	04-0	05-0	06-0	07-1
Remaining Recommended Actions for FY 2009				**Status at end of FY 2008**
1. Develop an effective method of disclosing and tracking loan agent involvement in the SBA business loan programs. *(Previously actions #1, 3, and 4)*				New
2. Review loans for irregularities that could indicate loan agent fraud and abuse, and show that SBA is promptly and effectively exercising its regulatory authority to deter loan agent misconduct when warranted. *(Previously action #6)*				Green
3. Implement procedures for enforcement actions against loan agents for improper and fraudulent conduct.				New

Green-Implemented Yellow-Substantial progress Orange-Limited Progress Red-No progress

69

Appendix: Relevant Reports

Most of the SBA OIG reports listed can be found at: www.sba.gov/ig/igreadingroom.html.

Challenge 1:

- SBA Advocacy, Analysis of Type of Business Coding for the Top 1,000 Contractors Receiving Small Business Awards in FY 2002, December 2004.
- The Center for Public Integrity, The Big Business of Small Business: Top defense contracting companies reap the benefits meant for small businesses, September 29, 2004.
- The Center for Public Integrity, The Pentagon's $200 Million Shingle: Defense data shows billions in mistakes and mislabeled contracts, September 29, 2004.
- SBA OIG, Audit of SBA's Administration of the Procurement Activities of Asset Sale Due Diligence Contracts and Task Orders, Report #4-16, March 17, 2004, pp. 8-9.
- GAO, Contract Management: Reporting of Small Business Contract Awards Does Not Reflect Current Business Size, GAO-03-704T, May 7, 2003.
- The Small Business Committee, U.S. House of Representatives Hearing, Are Big Businesses Being Awarded Contracts Intended for Small Businesses? Testimony of Mr. Fred C. Armendariz, Associate Deputy Administrator, SBA, May 7, 2003.
- The Small Business Committee, U.S. House of Representatives Hearing, Are Big Businesses Being Awarded Contracts Intended for Small Businesses? Testimony of Mr. Felipe Mendoza, Associate Administrator, Office of Small Business Utilization, U.S. General Services Administration, May 7, 2003.
- SBA OIG, SBA Small Business Procurement Awards Are Not Always Going to Small Businesses, Report #5-14, February 24, 2005.
- SBA OIG, Review of Selected Small Business Procurements, Report #5-16, March 8, 2005.

Challenge 2:

- SBA OIG Audit of SBA's FY 2007 Financial Statements, Report #8-03, November 15, 2007.
- SBA OIG, Audit of Controls Over Access to Employee Emails by SBA Managers, Report #8-02, October 19, 2007.
- SBA OIG, Results of KPMG Vulnerability Assessment, Report #7-16, March 6, 2007.
- SBA OIG, FISMA Independent Evaluation for FY 2006, Report #7-14, February 9, 2007.
- SBA OIG, Memorandum Advisory Report on SBA's Protection of Sensitive Information, Report #7-13, February 9, 2007.
- Audit of SBA OIG, Audit of SBA's Financial Statements for FY 2006, Report #7-03, November 15, 2006.
- SBA OIG, FISMA Independent Evaluation for FY 2005, Report #6-01, October 7, 2005.
- SBA OIG, Memorandum Advisory Report on SBA Needs to Implement a Viable Solution to its Loan Accounting System Migration Problem, Report #5-29, September 30, 2005.
- SBA OIG, Audit of SBA's Information System Controls for FY 2004, Report #5-12, February 24, 2005.
- SBA OIG, Audit of SBA's Exchange Email System, Report #4-42, September 10, 2004.
- SBA OIG, Audit of Selected SBA General Support Computer Operating Systems, Report #4-41, September 10, 2004.
- SBA OIG, Audit of SBA's Information System Controls for FY 2003, Report #4-19, April 29, 2004.
- SBA OIG, Audit of SBA's Information System Controls for FY 2002, Report #3-20, March 31, 2003.

Challenge 3:

- SBA OIG, Non-Native Managers Secured Millions of Dollars from 8(a) Firms Owned by Alaska Native Corporations through Unapproved Agreements that Jeopardize the Firms' Program Eligibility, Report #8-14, August 7, 2008
- OPM, 2006 Federal Human Capital Survey (FHCS), http://www.fhcs2006.opm.gov/
- SBA OIG, Audit of Two 8(a) Sole-Source Contracts Awarded to Contractors in SBA's Mentor Protégé Program, Report #7-19, March 30, 2007
- SBA OIG, Management Advisory Report on the Transfer of Operations to the National Guaranty Purchase Center, Report #4-39, August 31, 2004
- GAO, Small Business Administration: Progress Made, but Transformation Could Benefit from Practices Emphasizing Transparency and Communication, GAO-04-076, October 2003
- OMB, The President's Management Agenda and OMB's Human Capital Scorecard, http://www.results.gov/agenda/fiveinitiatives.html http://www.results.gov/agenda/departmentupdates12.html
- GAO, Results Oriented Cultures: Implementation Steps to Assist Mergers and Organizational Transformations, GAO-03-699, July 2003
- GAO, Small Business Administration: Workforce Transformation Plan is Evolving, GAO-02-931T, July 16, 2002
- SBA OIG, Modernizing Human Capital Management, Report #2-20, May 31, 2002
- GAO, Small Business Administration: Current Structure Presents Challenges for Service Delivery, GAO-02-17, October 2001
- GAO, Small Business Administration: Steps Taken to Better Manage its Human Capital, but More Needs to be Done, GAO/T-GGD/AIMD-00-256, July 20, 2000
- SBA OIG, A Framework for Considering the Centralization of SBA Functions, November 1996

Challenge 4:

- SBA OIG, Audit of Six SBA Guaranteed Loans, #8-18, September 8, 2008
- SBA OIG, Audit of Loan Classifications and Overpayments on Secondary Market Loans, #8-09, March 26, 2008
- SBA OIG, Audit of UPS Capital Business Credit's Compliance with Selected 7(a) Lending Requirements, #8-08, March 21, 2008
- SBA OIG, Audit of the Guarantee Purchase Process for Section 7(a) Loans at the National Guaranty Purchase Center, Report #7-23, May 8, 2007
- SBA OIG, Audit of an SBA Guaranteed Loan, Report #7-17, March 12, 2007
- SBA OIG, Audit of an SBA Guaranteed Loan, Report #7-15, February 12, 2007
- SBA OIG, Audit of an SBA Guaranteed Loan, Report #7-10, January 16, 2007
- SBA OIG, Audit of an SBA Guaranteed Loan, Report #7-09, January 9, 2007
- SBA OIG, Audit of an SBA Guaranteed Loan, Report #7-07, December 29, 2006
- SBA OIG, Audit of an SBA Guaranteed Loan, Report #7-06, December 28, 2006
- SBA OIG, Audit of an SBA Guaranteed Loan, Report #7-05, December 20, 2006
- SBA OIG, Audit of an SBA Guaranteed Loan, Report #7-02, October 23, 2006
- SBA OIG, Audit of Deficiencies in OFA's Purchase Review Process for Backlogged Loans, Report #6-35, September 29, 2006
- SBA OIG, Survey of the Quality Assurance Review Process, Report #6-26, July 12, 2006
- SBA OIG, Audit of SBA's Implementation of the Improper Payments Information Act, Report #6-25, June 21, 2006

- SBA OIG, Audit of an SBA Guaranteed Loan, Report #6-22, May 17, 2006
- SBA OIG, Audit of an SBA Guaranteed Loan, Report #6-17, March 20, 2006
- SBA OIG, Audit of an SBA Guaranteed Loan, Report #6-16, March 20, 2006
- SBA OIG, Audit of an SBA Guaranteed Loan, Report #6-14, March 2, 2006
- SBA OIG, Audit of an SBA Guaranteed Loan, Report #5-26, September 28, 2005
- SBA OIG, Audit of an SBA Guaranteed Loan, Report #5-21, July 15, 2005
- SBA OIG, Management Advisory Report on the Transfer of Operations to the National Guaranty Purchase Center, Report #4-39, August 31, 2004
- SBA OIG, Audit of an Early Defaulted Loan, Report #4-38, August 24, 2004
- SBA OIG, Audit of an Early Defaulted Loan, Report #4-33, July 30, 2004
- SBA OIG, Audit of an Early Defaulted Loan, Report #4-28, July, 9, 2004
- SBA OIG, Audit of an Early Defaulted Loan, Report #4-25, June 22, 2004
- SBA OIG, Audit of an Early Defaulted Loan, Report #4-06, January 8, 2004
- SBA OIG, Audit of an Early Defaulted Loan, Report #3-38, September 22, 2003
- SBA OIG, Audit of an Early Defaulted Loan, Report #3-30, June 19, 2003
- SBA OIG, Audit of an Early Defaulted Loan, Report #3-27, May 22, 2003
- SBA OIG, Audit of the Guaranty Purchase Process, Report #3-15, March 17, 2003
- SBA OIG, Audit of an Early Defaulted Loan, Report #3-07, January 23, 2003
- SBA OIG, Audit of an Early Defaulted Loan, Report #2-32, September 30, 2002
- SBA OIG, Audit of an Early Defaulted Loan, Report #2-30, September 24, 2002
- SBA OIG, Audit of an Early Defaulted Loan, Report #2-23, August 7, 2002
- SBA OIG, Audit of an Early Defaulted Loan, Report #2-15, March 29, 2002
- SBA OIG, Improvements are Needed in Small Business Lending Company Oversight Process, Report #2-12, March 21, 2002
- SBA OIG, Audit of an Early Defaulted Loan, Report #2-03, February 27, 2002
- SBA OIG, Audit of an Early Defaulted Loan, Report #2-05, February 27, 2002
- SBA OIG, Audit of an Early Defaulted Loan, Report #1-10, March 9, 2001
- GAO, Major Management Challenges and Program Risks, GAO-01-260, January 2001
- SBA OIG, Audit of an Early Defaulted Loan, Report #0-10, April 23, 2000
- SBA OIG, Audit of an Early Defaulted Loan, Report #0-12, March 28, 2000
- SBA OIG, Audit of an Early Defaulted Loan, Report #0-05, February 14, 2000

Challenge 5:

- SBA OIG, SBA's Oversight of SBA Supervised Lenders, Report #8-12, May 9, 2008
- SBA OIG, UPS Capital Compliance with Selected 7(a) Lending Requirements, Report #8-08, March 21, 2008
- GAO, Small Business Administration: Additional Measures Needed to Assess 7(a) Loan Program's Performance, GAO-07-769, July 13, 2007
- SBA OIG, SBA's Oversight of Business Loan Center, LLC, Report #7-28, July 11,2007.
- SBA OIG, SBA's Use of the Loan and Lender Monitoring System, Report #7-21, May 2, 2007.
- SBA OIG, Audit of the Office of Lender Oversight Corrective Action Process, Report #7-18, March 14, 2007.
- GAO, Small Business Administration: Improvements Made, But Loan Programs Face Ongoing Management Challenges, GAO-06-605T, April 6, 2006
- SBA OIG, SBA's Administration of the Supplemental Terrorist Activity Relief (STAR) Loan Program, Report #6-09, December 23, 2005

- GAO, Small Business Administration: New Service for Lender Oversight Reflects Some Best Practices, But Strategy for Use Lags Behind, GAO-04-610, June 8, 2004
- GAO, Continued Improvements Needed in Lender Oversight, Report #03-90, December 2002
- SBA OIG, Impact of Loan Splitting on Borrowers and SBA, Advisory Memorandum Report #2-31, September 30, 2002
- SBA OIG, Improvements needed in SBLC Oversight, Advisory Memorandum Report, #2-12, March 20, 2002
- SBA OIG, Preferred Lender Oversight Program, Report #1-19, September 27, 2001
- SBA OIG, SBA Follow-up on SBLC Examinations, Report #1-16, August 17, 2001

Challenge 6:

- SBA OIG, Audit of Two 8(a) Sole –Source Contracts Awarded to Contractors in SBA's Mentor Protégé Program, Report #7-19, March 30, 2007.
- SBA OIG, Audit of Monitoring Compliance with 8(a) Business Development Regulations During 8(a) Business Development Contract Performance, Report #6-15, March 16, 2006.
- SBA OIG, Business Development Provided by SBA's 8(a) Business Development Program, Report #4-22, June 2, 2004.
- SBA OIG, SACS/MEDCOR: Ineffective and Inefficient, Report #4-15, March 9, 2004.
- SBA OIG, Section 8(a) Program Continuing Eligibility Reviews, Report #4-3-H-006-021, September 30, 1994.

Challenge 7:

- SBA OIG, Audit of SBIC Liquidations Process, Report #5-22, July 28, 2005
- SBA OIG, The SBIC Program: At Risk for Significant Losses, Report #4-21, May 24, 2004
- OMB, Small Business Administration: PART Assessment on the SBIC Program, February 2, 2004
- SBA OIG, FY 2003 Financial Statement Audit in the SBA FY 2003Performance and Accountability Report, January 30, 2004, pp. 230-60
- SBA OIG, Audit of SBIC Oversight, Report #3-33, July 1, 2003
- GAO, Small Business: Update on SBA's Small Business Investment Company Program, GAO/RCED-97-55, February 1997
- GAO, Small Business Administration: SBA Monitoring Problems Identified in Case Studies of 12 SBICs and SSBICs, GAO/OSI-96-3, April 1996
- GAO, Small Business Administration: Better Oversight of SBIC Programs Could Reduce Federal Losses, GAO/T-RCED-95-285, September 28, 1995
- GAO, Small Business Administration: Inadequate Oversight of Capital Management Services, Inc.-An SSBIC, GAO/T-OSI-95-19, August 7, 1995
- GAO, Small Business Administration: Prohibited Practices and Inadequate Oversight in SBIC and SSBIC Programs, GAO/OSI-95-16, May 28, 1995
- GAO, Small Business Administration: Inadequate Oversight of Capital Management Services, Inc.-An SSBIC, GAO/OSI-94-23, March 1994
- SBA OIG, Audit Report on the Small Business Investment Company (SBIC) Liquidation Function, Report #3-2-E-004-031, March 31, 1993

Challenge 8:

- SBA OIG, Applicant Character Verification in SBA's Business Loan Program, Report #3-43, April 5, 2001
- SBA OIG, Summary Audit of Section 7(a) Loan Processing, Report #0-03, January 11, 2000
- SBA OIG, Loan Agents and the Section 7(a) Program, Report #98-03-01, March 31, 1998
- SBA OIG, Fraud Detection in SBA Programs, Report #97-11-01, November 24, 1997
- SBA OIG, Operation Cleansweep Memorandum, August 21, 1996

74

Agency Response to the OIG Report on Management Challenges

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

Date: **November 13, 2008**

To: **Peter McClintock**
Acting Inspector General

From: **Jovita Carranza**
Deputy Administrator 11/13/8

Subject: FY 2009 OIG-Identified Major Management Challenges

On October 20, 2007, the OIG published a report, entitled: "FY 2009 Report on the Most Serious Management Challenges Facing the Small Business Administration." Each Inspector General publishes annually in the Agency Financial Report (AFR) a list and assessment of major Agency management challenges based on cost to taxpayer, visibility, impact on overall management, and other subjective factors. SBA's eight major challenges fall into two major categories:

1. Those that pose risk of losing taxpayers' money (i.e., guarantee purchase process, lender oversight, loan agent fraud, SBIC program risk); and
2. Those that pose risk of delivering inefficient programs (i.e., human capital, IT security, contracting loopholes, 8(a) program).

One of my primary functions as Deputy Administrator is to ensure that SBA exercises cost-effective stewardship over its resources and offers transparent and accountable service to its customers. To increase our focus on improved risk management through increased compliance and oversight, the Administrator launched his Initiative #9 early in 2007 and advanced two key objectives:

1. Create a strong program management integrity and control culture beginning with a clear "tone from the top" about the importance of transparency, accountability, and efficiency; and
2. Ensure an effective tracking and reporting process for demonstrating progress in improving management and reducing opportunities for waste, fraud, and abuse.

SBA appreciates the cooperation and work done by the OIG in helping the Agency to address these challenges. Instituting sound internal management processes lead to reduced government risk; lower cost to the taxpayer; and reduced potential for waste, fraud and abuse. The Agency concurs with the FY 2008 Report that reflects improvements gained from a more serious monitoring process and a more consistent focus on addressing the challenges. In addition to reducing the number of red ("no progress" ratings) from 22 to 1 since 2004, the report also reflects the following tangible results:

1. Improved ratings in all 8 rated challenges (i.e., in 20 of the 39 existing recommended actions).
2. Achieved 12 green or "fully successful" ratings out of 39 actions.
3. Reduced the number of recommended actions from 53 to 39, down from 136 in FY 2004.

Only through our continued collaboration with the OIG can we create the high performing organization that the Congress asks, the President demands, and the taxpayers expect. Thank you and your staff for your continued help in improving our management environment.