

U.S. SMALL BUSINESS ADMINISTRATION

OFFICE OF INSPECTOR GENERAL

Report No. 6-02

*FY 2006 Report
on the Most Serious Management Challenges
Facing the Small Business Administration*

October 14, 2005



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

**OFFICE OF
INSPECTOR GENERAL**

October 14, 2005

MEMORANDUM

TO: Hector V. Barreto
Administrator

FROM: Peter L. McClintock
Acting Inspector General

SUBJECT: SBA's Top Management Challenges for Fiscal Year 2006

In accordance with the Reports Consolidation Act of 2000, we are providing the Office of Inspector General's (OIG) Report on the Most Serious Management Challenges Facing the Small Business Administration (SBA) in Fiscal Year (FY) 2006. This document represents our current assessment of Agency programs 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 issues facing the Agency.

Our report is based on specific OIG, Government Accountability Office (GAO), or other official reports, as well as our general knowledge of SBA's programs and operations. Our analysis considers actions reported by the Agency as of September 16, 2005, as well as certain actions brought to our attention as of September 30, 2005.

The OIG has eliminated two Challenges from the FY 2005 Report. These two Challenges are: former Challenge #1—"SBA needs to improve its managing for results processes and performance data;" and former Challenge #8—"SBA needs to enforce its rules to deter firms receiving small business set-aside, 8(a), or small disadvantaged business price evaluation preference contracts from passing through large portions of the procurement to other firms."

This year's report contains one new Challenge—Challenge #1—that states that "Flaws in the procurement process allow large firms to receive small business awards and agencies to receive small business credit for contracts performed by large firms." This Challenge was published in February 2005 as Challenge #12. Challenge #11 from last year's report, entitled "The current practices of the SBIC program place too much risk on taxpayer money" has been renumbered as Challenge #8.

For FY 2006 the OIG has implemented a fourth score color—"orange"—which denotes that the Agency has made some progress on a particular "action needed" item in a Challenge. For example, if the challenge involves establishing a new process, a "red" score indicates no progress in developing the document (e.g., an SOP procedure); an "orange" signifies that a credible document had been drafted; and a "yellow" indicates that the document has been cleared and issued. To achieve "green," the Agency would need to show that it is effectively implementing the process. For some "actions needed" this means that the Agency has moved up from a "red" score to an "orange" one. In other cases where the prior color was "yellow," the "orange" color reflects a more accurate status for the action. In these cases, the status will not show downward arrows if a "yellow" score has been reclassified.

While Agency progress on a number of the challenges has been encouraging, much more remains to be done. By their nature, these challenges require continued long-term commitment and effort by the Agency.

We would like to extend our appreciation to SBA's management and staff for their courtesy and cooperation in providing us with the information needed to complete this report in a timely manner.

This report will be incorporated into the SBA's FY 2005 Performance and Accountability Report, as required by law. Please contact me at (202) 205-6586, should you have any questions.

Attachment

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Challenge 1: Flaws in the procurement process allow large firms to receive small business awards and agencies to receive small business credit for contracts performed by large firms.

The Small Business Act establishes a Government-wide procurement goal that 23 percent of the total value of all prime contract awards for each fiscal year 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 agencies only receive small business credit for awards to small firms.

Studies by the Government Accountability Office (GAO), SBA’s Office of Inspector General (OIG), and SBA’s Office of Advocacy found that agencies are counting contracts performed by large firms towards their small business procurement goals. One recurring problem arises with size certifications on multi-year contracts. Firms receiving contracts certify whether they are small when they respond to a solicitation. For contracts through the General Services Administration’s (GSA) Multiple Awards Schedule (MAS) Program and other GSA multiple award contracts (MAC), these small business certifications are valid until contract renewal (i.e., up to 5 years), even if the firm outgrows its small business status. For all other contracts containing option years, including Government-Wide Acquisition Contracts (GWAC), the procuring office is not required to have the contractor re-certify it is small when exercising each option. Thus, the contractor retains its small business status for the life of the contract (e.g., 20 years) even if it outgrows its small business status. Several years ago, SBA proposed a new regulation, but has not finalized it.

Another problem with the MAS Program is that GSA classifies firms as small for a contract even though the firms may not be small for all of the contract’s goods or services. Thus, agencies may obtain small business credit for using a firm classified as small even if the firm is not small for all of the procured goods or services. This is contrary to SBA regulations, which require that a contractor meet the size standard for each product or service for which it submits an offer (13 CFR § 121.407).

Large companies also improperly receive small business contracts due to errors by contracting personnel. For example, contracting personnel, possibly due to a lack of familiarity with small business procedures, have accepted questionable size self-certifications. Moreover, contracting personnel do not always require companies to self-certify their size when responding to a solicitation. Instead, to determine size status, they inappropriately rely on governmental databases with (possibly inaccurate) small business information. A new database, Online Representations and Certifications Application (ORCA), partially addresses the problem by allowing contractors to maintain current and accurate information.

Challenge History Fiscal Year (FY) Issued: 2005	Actions Accomplished (Green Status) during Past 4 FYs		
	N/A		
Remaining Actions Needed for FY 2006			Status Oct. 2005
1. Issue a final rule stating that a firm that receives a multi-year contract must annually certify that it continues to be a small business for the specified size standard(s), and that procuring agencies cannot continue to receive small business credit after the firm becomes large.			Orange
2. Develop and take steps to provide reasonable assurance that GSA follows SBA regulations (13 CFR § 121.407) so that a firm must meet the size standard for each product or service for which it submits an offer.			Orange↑
3. Develop and take steps to provide reasonable assurance that agencies are requiring offerors to self-certify their size for small business contracts.			Yellow↑
4. Develop and take steps to provide reasonable assurance that agencies are providing adequate training to contracting personnel on small business contracting procedures.			Orange↑

Green-Implemented Yellow-Substantial progress Orange-Some progress Red-No progress

Challenge 2. SBA faces challenges in financial management and reporting, which affect its ability to provide reliable, timely, and accurate financial information.

Various laws and regulations place significant responsibilities on Federal financial managers to assess whether they are effectively and efficiently managing public resources. Since FY 2002, the OIG, GAO, and external auditors have all noted weaknesses in SBA’s financial management and reporting controls that result in SBA being unable to produce reliable, timely, and accurate financial information. SBA has responded by making sound financial management and reporting a top priority, and has taken the necessary steps to make improvements. These efforts have focused primarily on improving SBA’s models for estimating subsidy costs, improving controls over financial statement preparation, and correcting accounting errors in prior periods related to loan sales and subsidy cost allowances.

The results of SBA’s FY 2004 financial statement audit indicate that significant progress has been made. However, SBA must still overcome material weaknesses in the areas of financial management and reporting and credit reform modeling. It must also ensure it complies with laws and regulations related to its financial management and reporting responsibilities, and ensure that it can implement new reporting and internal control requirements in an effective and timely manner. Additions to, and changes in the “actions needed” are due to new Circular A-123 requirements from OMB.

Challenge History Fiscal Year (FY) Issued: 2003	Actions Accomplished (Green Status) during Past 4 FYs			Status at end of FY 2005
	02-N/A	03-0	04-0	
Remaining Actions Needed for FY 2006				
1. SBA produces timely financial statements and other financial information in accordance with prevailing requirements and accounting standards.				Yellow↑
a. SBA maintains strong internal control over the financial reporting process to avoid submitting financial statements with misclassifications and errors.				Yellow
b. SBA ensures its financial reporting responsibilities can be accomplished under SBA’s normal operations and practices.				Yellow (New)
2. SBA’s financial management controls and quality assurance (QA) procedures over financial reporting achieve their objectives:				Yellow (New)
a. SBA redesigns or adds to its existing financial management controls and/or QA procedures, based upon thorough review and analysis, to ensure the related control objectives can be met.				Yellow (New)
b. SBA ensures financial management controls and QA procedures are being performed as required and by individuals with the skills and abilities necessary to perform the procedures.				Yellow (New)
3. SBA maintains effective control over the subsidy re-estimation process.				Yellow
a. SBA produces reasonable estimates that can be developed, internally reviewed, and audited in a timely manner consistent with the Agency’s financial reporting deadlines.				Yellow
b. SBA’s financial systems provide data that are accurate, complete, and in sufficient detail for use in the subsidy estimate and re-estimate models.				Yellow
c. SBA refines its quality assurance and review procedures over the subsidy re-estimation process and demonstrates that these procedures are sufficient and working effectively.				Yellow
4. SBA demonstrates it has procedures in place to identify and implement new reporting and internal control requirements (such as those listed below) while fulfilling its current responsibilities for reporting and maintaining effective internal control.				Yellow (New)
a. Closing package, special-purpose financial statements and intra-governmental reporting.				Yellow (New)
b. Cash held outside of Treasury and accounting for trust funds standards.				Yellow (New)
c. OMB Circular A-123 “Management’s Responsibility for Internal Control.”				Yellow (New)
d. Improper Payments Information Act of 2002—erroneous/improper payments reporting.				Yellow (New)

Green-Implemented Yellow-Substantial progress Orange-Some progress Red-No progress

Challenge 3. 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 information systems do not have the necessary controls to fully ensure its security.

The Chief Information Officer is responsible for all facets of enforcing computer security, enterprise architecture, and systems development standards for SBA’s 20 major information systems. The Agency’s commitment of direct resources to maintain computer security, maintain SBA systems, provide technical support staff, and develop security training has stabilized at a level below what is generally necessary for an entity the size of SBA. This continues to hamper a computer security program that already lacks sufficient controls to fully protect SBA’s systems. Due to the long-term nature of maintaining an adequate security program, completion of final actions on a number of the recommendations is not scheduled until the FY 2006 time frame or beyond. The OIG will be performing further audit work to evaluate the Agency’s ongoing efforts in its information security program. Additions to, and changes in, the “actions needed” are due to new Federal Information Security Management Act (FISMA) requirements from OMB.

Challenge History Fiscal Year (FY) Issued: 1999	Actions Accomplished (Green Status) during Past 4 FYs				Status at end of FY 2005
	01-2	02-2	03-5	04-4	
Remaining Actions Needed for FY 2006					
<i>SBA needs to improve its Information Technology general and application control environment.</i>					
1. Entity-wide security program controls are in place and operating effectively.					Orange↑
2. Access controls are in place and operating effectively.					Red↓
3. Application software development and program change controls are in place and operating effectively.					Yellow
4. System software controls are in place and operating effectively.					Red
5. Segregation of duty controls are in place and operating effectively.					Yellow
6. Service continuity controls are in place and operating effectively.					Orange
<i>SBA needs to fully comply with the Federal Information Security Management Act</i>					
7. The SBA Certification and Accreditation (C&A) process is in compliance with NIST 800-37.					Yellow (New)
8. The Plan of Actions and Milestones (POA&M) accurately reports on all computer security weaknesses and corrective actions.					Yellow
9. The POA&M prioritizes IT Security weaknesses to ensure that significant weaknesses are addressed and receive appropriate resources.					Green↑
10. SBA timely mitigates audit and system risk assessment weaknesses.					Red (New)
11. Procedures and practices for reporting security incidents are in place and operate effectively.					Yellow↓
12. SBA has assessed risks to operations and assets under its control, maintained security plans, and performed security test and evaluation procedures.					Green↑
13. SBA ensures adequate and up-to-date computer security program training.					Yellow

Green-Implemented Yellow-Substantial progress Orange-Some progress Red-No progress

Challenge 4. Maximizing program performance requires that SBA fully develop, communicate, and implement a human capital management/transformation strategy.

As small business practices, products, and needs changed in the last decade, SBA began to make significant changes in the structure of its workforce by delegating more authority to lenders, centralizing loan functions, and reducing staff. For several years SBA has had a Human Capital Management Plan that deals primarily with specific Office of Human Capital Management (OHCM) activities. It has not provided a comprehensive SBA transformation strategy and generally lacks specific strategies and milestones for moving SBA to the new vision posed in SBA's FY 2003-2008 Strategic Plan. This lack of a documented transformation strategy impedes accountability.

Nevertheless, in the last few years, OHCM has made significant progress in providing the Agency with the support and tools it needs for transforming SBA. By their nature many of these tools require substantial time to implement.

OHCM efforts, however, are only one part of the Agency's effort to resolve the human capital challenge and transform the Agency. The overall responsibility for transforming the Agency belongs to SBA as a whole. Because the Agency did not develop a comprehensive transformation plan, problems have occurred, for example, in establishing of the National Guaranty Purchase Center (NGPC) in Herndon, Virginia. SBA did not inform or make employees aware of major workforce changes that would affect them until after the changes had been implemented. The Agency has now drafted, and plans to issue to employees, a transformation strategy. The lack of employee involvement in the decision-making process or timely communication of a transformation strategy can breed uncertainty and mistrust, resulting in poor employee morale and reduced commitment and productivity. The FY 2004 Government-wide employee survey revealed substantial morale problems in SBA.

Challenge History Fiscal Year (FY) Issued: 2001	Actions Accomplished (Green Status) during Past 4 FYs				Status at end of FY 2005
	01-0	02-0	03-0	04-1	
Remaining Actions Needed for FY 2006					
1. Develop, communicate to all employees, and implement a Human Capital Plan that (1) is structured along the lines of the <i>Human Capital Assessment and Accountability Framework</i> (released jointly by the OMB, the Office of Personnel Management and the GAO) and (2) contains clear customer service standards.					Yellow
2. Communicate to all employees and incorporate into the Human Capital Plan a transformation strategy that aligns with SBA's FY 2003-2008 Strategic Plan.					Orange↑
3. Identify and analyze the knowledge, skills, abilities, and other characteristics that SBA employees will need to perform successfully over the next five years and complete a gap analysis.					Orange
4. Establish and implement competency models reflecting the core competencies that will be needed in the next five years.					Yellow
5. Establish and implement an evaluation control mechanism to ensure that all employees have received the appropriate training and have the necessary skills.					Yellow
6. Develop and implement a comprehensive succession planning process for all staff levels, including regular evaluations of the effectiveness/impact of various components of the process.					Orange
7. Make substantial progress in SBA's workforce transformation to meet the needs of SBA's FY 2003-2008 Strategic Plan.					Yellow

Green-Implemented Yellow-Substantial progress Orange-Some progress Red-No progress

Challenge 5. SBA’s National Guarantee Purchase Center needs better controls over the business loan purchase process.

SBA’s guaranty purchase process is the primary tool for assessing lender compliance on a loan-by-loan basis, and protecting SBA from making erroneous guaranty purchase payments. Until recently, there have been few changes in the guaranty purchase process since 1983, when the majority of Section 7(a) loan applications and all credit-worthiness decisions were reviewed by SBA prior to loan approval. At the same time, the Preferred Lenders Program (PLP), which permits lenders to make credit decisions with minimal or no SBA oversight, has grown significantly. In FY 2004, the \$7 billion in PLP loan approvals represented 52 percent of the total dollar value of Section 7(a) loan approvals. OIG audits of early defaulted loans and SBA’s guaranty purchase process, however, have shown that lenders have not always originated, serviced, and liquidated loans in full compliance with SBA requirements or prudent lending practices, and SBA’s guaranty purchase reviews did not consistently detect these non-compliances, resulting in improper payments. In the fourth quarter of FY 2003, SBA discontinued the quarterly Guaranty Purchase Review (GPR) quality assurance program designed to monitor the guaranty purchase decision making process and assess the level of improper payments. The Improper Payments Information Act of 2002 requires SBA to assess risk, and measure and monitor improper payments.

SBA has taken actions to correct many of the deficiencies identified, such as formalizing the revised purchase procedures in SBA Policy Notice 5000-831 by incorporating the procedures into Standard Operating Procedures (SOPs) on loan servicing and loan liquidation, developing training modules, and training individuals responsible for making purchase decisions. SBA also centralized the 7(a) loan guaranty purchase process to improve the efficiency of the program and in the first quarter of FY 2004 re-established a quality assurance review program to replace the discontinued GPR program. While we agree that centralization will strengthen the process, an OIG management advisory report on the transfer of operations to the Guaranty Purchase Center questioned the reasonableness of the 85 percent reduction in the guaranty purchase review staff and showed that additional actions are needed to strengthen the process and achieve an effective operation for reducing improper payments.

Challenge History Fiscal Year (FY) Issued: 2001	Actions Accomplished (Green Status) during Past 4 FYs				Status at end of FY 2005
	01-1	02-2	03-4	04-0	
Remaining Actions Needed for FY 2006					
<i>Top management provides a positive and supportive attitude toward the guarantee purchase process.</i>					
1. Management establishes an organizational culture where deny and repair actions are used when appropriate.					Green ↑
2. Adequate resources are devoted to the purchase process.					Red
3. Adequate training is provided.					Green ↑
<i>SBA identifies level of improper payments and analyzes risks associated with loan guarantee purchases.</i>					
4. SBA periodically determines actual or potential risks of erroneous payments.					Orange
5. SBA determines level of improper payments for the entire loan portfolio in compliance with the Improper Payments Information Act of 2002.					Yellow↑
<i>Policies and procedures provide guidance to ensure consistency and accuracy in the purchase process.</i>					
6. SBA has clear guaranty purchase procedures that provide for consistent interpretation.					Yellow
7. Current guidance describes adequate documentation needed to make purchase decisions.					Yellow
<i>SBA manages the guarantee purchase to reduce improper payments and resolve programmatic problems.</i>					
8. SBA implements a quality assurance system that allows SBA to make progress in achieving established goals for reducing improper payments.					Yellow↑
9. Problems identified by the audits and reviews are resolved timely.					Yellow

Green-Implemented Yellow-Substantial progress Orange-Some progress Red-No progress

Challenge 6. SBA needs to continue improving lender/participant oversight.

As the largest gap lender for small businesses, SBA necessarily takes more risk than a conventional lender. Since its inception in 1953, SBA has loaned or guaranteed billions of dollars to finance and spur investment in small business concerns, and has shifted over the years from an organization that processed loans to one that relies on program participants to originate and service loans. This reliance requires an effective participant oversight program to mitigate the increased risk of financial loss to SBA and participant noncompliance with SBA policies and procedures.

To improve its oversight, the Agency established a Lender Monitoring System (LMS) to identify the potential and actual financial risk by both lender and loan, and for the entire portfolio. The LMS uses internal and external information to develop a risk rating for each loan and lender. In addition, the Agency issued a strategic plan for lender oversight that identified the responsibilities and authorities of the Office of Lender Oversight (OLO) and established the Oversight and Portfolio Analysis committees. OLO also issued draft guidance for on-site lender reviews. The effectiveness of the new policies and programs will be assessed during up-coming audits. Overall, OLO is making progress in implementing a risk-based process to evaluate effectively its lenders and loan portfolio. However, the Agency needs to issue regulations and SOPs for lender oversight, and to move enforcement authority from the Office of Financial Assistance to OLO to avoid potential conflicts of interest. This Management Challenge has been revised to reflect the Agency’s progress and to modify the action items to emphasize implementation of the OLO strategic plan and an effective oversight program.

Challenge History Fiscal Year (FY) Issued: 2001	Actions Accomplished (Green Status) during Past 4 FYs				
	01-7(A)-5 01-SBIC-5 01-504-1	02-7(A)-0 02-SBIC-0 02-504-0	03-7(A)-3 03-SBIC-2 03-504-4	04-7(A)-7 04-504-7	
Remaining Actions Needed for FY 2006				Status at end of FY 2005	
				7(a)	504
<i>SBA analyzes risks associated with achieving objectives.</i>					
1. SBA implements a systematic process that effectively assesses the level of compliance risk of the loan portfolio, each loan, and each lender on a recurring basis.				Yellow↓	Green
<i>Policies and procedures provide guidance to ensure consistency among organizational components.</i>					
2. SBA issues and implements regulations and SOPs providing for effective oversight of its lending programs, including procedures for lender reviews and periodic evaluations of participant performance and retention.				Orange	Orange
3. SBA provides guidance and training for new participants and those who demonstrate an unacceptable level of compliance.				Yellow↓	Yellow↓
4. SBA issues and implements an SOP containing formal training programs for SBA personnel and SBA contractors participating in the lender oversight process.				Orange	Orange
5. SBA develops and implements a plan for lender oversight.				Yellow↓	Green
<i>Monitoring of performance occurs and findings of audits and other reviews are promptly resolved.</i>					
6. SBA performs standardized and periodic reviews of participants to evaluate risk levels.				Yellow↓	Green
7. There is an effective system for tracking the results of the periodic reviews of participants and the effectiveness of the corrective actions taken.				Yellow	Yellow
8. Each lending partner’s status is periodically re-evaluated based on the results of the financial and compliance risk assessments and the periodic reviews.				Yellow↓	Green

Green-Implemented Yellow-Substantial progress Orange-Some progress Red-No progress

Challenge 7: The Section 8(a) Business Development (BD) program needs to be modified so more firms receive access to business development, standards for determining economic disadvantage are clear and objective, and more eligible firms receive contracts.

SBA has not placed adequate emphasis on business development to enhance 8(a) firms’ ability to compete, and does not adequately ensure that only 8(a) firms with economically disadvantaged owners in need of business development remain in the program. Contracting opportunities are also not equitably distributed to 8(a) participants. Based on FPDS data for FY 2003, 50 percent of the value of 8(a) contracts went to 1.2 percent of the 8(a) firms, and almost 80 percent of the firms received no Federal contract benefit. Additionally, the program’s primary database is ineffective and inefficient, and does not contain the information needed to successfully manage the program. An ever-changing Federal contracting arena has created an environment in which reengineering of the 8(a) BD program is needed.

In its report of actions taken during FY 2005, SBA advised that it had done the following:

- Notified participants, SBA field staff, and officials at other agencies that the 8(a) BD program is a business development program;
- Provided business development training and refocused the 7(j) training component;
- Defined business success in a change to the 8(a) participation agreement;
- Requested all district offices to graduate firms who completed their program term and substantially achieved their targets, objectives and goals;
- Aggressively enforced the business mix requirements to encourage 8(a) firms to obtain non-8(a) contracts;
- Collaborated with other agencies to unbundle large contracts and distribute them to many 8(a) firms;
- Set limits for “economic disadvantage” elements and funded a study to further define this term;
- Required business opportunity specialists to complete at least four training courses;
- Provided training and automated tools to business opportunity specialists;
- Completed a study of the data needed to support and manage the 8(a) BD program;
- Completed the first phase of the new management information system (MIS); and
- Requested funding to complete the final phase of the MIS.

Although these actions demonstrate some progress, more needs to be done.

Challenge History Fiscal Year (FY) Issued: 2003	Actions Accomplished (Green Status) during Past 4 FYs			Status at end of FY 2005
	03-0	04-0		
Remaining Actions Needed for FY 2006				
1. Refocus the 8(a) BD program to emphasize business development.				Yellow
2. Develop criteria defining “business success.”				Yellow↑
3. Graduate participants once they reach those levels defined as “business success.”				Red
4. Ensure that a few companies do not receive most of the 8(a) contracts.				Orange
5. Redefine “economic disadvantage” using objective, quantitative, qualitative, and other criteria that effectively measure capital and credit opportunities.				Orange↑
6. Provide sufficient financial and analytical training to business opportunity specialists to enable them to evaluate a company’s business profile and competitive potential.				Orange
7. Determine data needs to support and manage the program and implement a management information system that will support the program mission and objectives, provide useful information, and enable SBA to measure program results.				Orange

Green-Implemented Yellow-Substantial progress Orange-Some progress Red-No progress

Challenge 8. The current practices of the SBIC program place too much risk on taxpayer money.

The Small Business Investment Company (SBIC) Program, which was designed to stimulate and supplement the flow of private equity capital and long-term debt to small business concerns, uses both guaranteed debt (debentures) and equity interest (participating securities) to facilitate the program, and had about \$12.5 billion at risk as of September 30, 2004. The financial performance of the program for FY 1993 to FY 2004 resulted in about \$2 billion in higher cost to the Federal Government than originally anticipated, which the Agency concluded was due to economic conditions, and the commercial terms of the participating securities.

Various GAO and OIG audits attributed the program’s unanticipated costs to the structure of the SBIC program, the funding process, and the lack of focus on limiting costs when liquidating SBICs. The audits determined that: (a) the subsidy model underestimated the cost of the program; (b) SBA’s “profits” were not proportional to its investments in the participating security SBICs; (c) insufficient incentives existed to encourage participating security SBICs to repay principal debt as quickly as possible; (d) SBA allowed too much time for financially troubled SBICs to attempt rehabilitation; (e) better performance goals and indicators were needed to show how well and how timely recoveries were maximized for liquidated SBICs; (e) the SOPs for SBIC operations and liquidations were outdated, and; (f) the 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 the Management Challenge, program officials have developed a new estimation methodology, have drafted (but not implemented) a revised SOP for SBIC operations and are filling personnel vacancies. No new participating security SBICs will be licensed since funding for this program ended September 30, 2004. New “actions needed” were added as a result of a recently published OIG audit of the SBIC liquidation process. To address these actions, the Agency is hiring a consultant to review the entire liquidation process and will be revising the current SOP on SBIC liquidations.

Challenge History Fiscal Year (FY) Issued: 2004	Actions Accomplished (Green Status) during Past 4 FYs			Status Oct. 2005
	04-2			
Remaining Actions Needed for FY 2006				
1. Develop reasonable subsidy estimates.				Yellow
2. Provide documented analysis justifying the capital impairment percentages.				Red↓
3. Develop more systematic criteria and implement a more timely approach for transferring SBICs to liquidation status.				Orange
4. Revise SOP 10 06 to include a process to perform and document quarterly risk assessments, including an analysis of repayment potential, and recommended actions.				Orange
5. Codify in SOP 10 06 a requirement for the timely and consistent implementation of restrictive operations.				Orange
6. Develop and implement performance goals and indicators that address the efficiency, cost-effectiveness, and timeliness of the SBIC liquidation process.				Orange (new)
7. Develop and implement effective controls for liquidating participating security SBICs.				Yellow
8. Develop and implement detailed operating procedures addressing how SBA personnel should monitor the liquidation of SBICs in receivership.				Orange (new)
9. Revise SOP 10 07 to define the term “SBA-investor” and to discuss SBA’s role as an investor as it pertains to liquidation actions.				Orange (new)

Green-Implemented Yellow-Substantial progress Orange-Some progress Red-No progress

Challenge 9. Preventing loan agent fraud requires additional measures.

OIG investigations have revealed a pattern of fraud in the business loan 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 and a database to track loan agent involvement.

Agency efforts to track loan agents have been limited and ineffective. SBA has begun to implement its E-Tran system, which is designed to collect loan data electronically from lenders who *voluntarily* participate. An October 2004 notice required that, for all E-Tran loans, lenders identify whether a loan agent was involved and provide the agent’s name and address. However, the Agency does not require disclosure of sufficient information to track agents’ activity. Further, the data fields have caused confusion among lenders, there are data quality problems, and, thus far, relatively few lenders have signed up to use E-Tran (although some large lenders use the system). SBA is also not yet certain how, or whether, it will obtain loan agent information from lenders not participating in E-Tran.

SBA needs to ensure that *both* the E-Tran system’s data fields and a modified SBA Form 159 (a compensation agreement) require lenders to disclose whether a loan agent has participated in the loan, as well as provide sufficient loan agent information to be able to track agents’ activity. This could include: the agent’s name and company, address, company tax identification number, agent’s date and place of birth, and a government-issued (non-Social Security number) identification number. Lenders also need to maintain a copy of the agent’s identification on file. The Agency has made progress by developing a new requirement that lenders submit the Form 159 to SBA when seeking a guaranty purchase (although the Agency needs to issue a formal notice to make this official). However, it must also take steps to compile the data from this form with E-Tran data in a database linking loan agents to individual loans in order to identify potential patterns of fraud. In addition, although SBA has enforcement authority under 13 C.F.R. Part 103, it needs to adopt procedures to accomplish an effective agent enforcement system. For greater clarity, the single “action needed” in last year’s report has been expanded into five actions.

Challenge History Fiscal Year (FY) Issued: 2000	Actions Accomplished (Green Status) during Past 4 FYs			
	01-0	02-0	03-0	04-0
Remaining Actions Needed for FY 2006				Status at end of FY 2005
<i>Systematically identify all loan agents, track their association with individual loans, and enforce relevant regulations.</i>				
1. Ensure that both the E-Tran system’s data fields and a modified SBA Form 159 <u>require</u> disclosure of agent involvement and sufficient loan agent identity information to track agent participation.				Orange (New)
2. Compile loan agent information obtained through E-Tran in a database that can link loan agents with individual loans, and establish a means of collecting similar data from lenders not using E-Tran so that the data is also compiled in such a database.				Orange (New)
3. Provide guidance to lenders to ensure they enter correct loan agent data consistently.				Yellow (New)
4. Require that lenders provide the Form 159 at the time of guaranty purchase.				Orange (New)
5. Implement effective procedures to (1) review loans for irregularities that could indicate loan agent fraud and abuse, (2) refer potential criminal violations to the OIG, and (3) undertake timely and effective enforcement action when warranted.				Orange (New)

Green-Implemented Yellow-Substantial progress Orange-Some progress Red-No progress

Challenge 10. SBA needs to update its system of directives to provide proper guidance and control over its operations.

SBA’s system of directives—used to instruct its staff and resource partners on the policies and procedures necessary to conduct Agency-related activities—needs to be revised. This critical system is the primary means for managing billions of dollars in financing and other programs. Yet, the Agency continues to rely upon expired policy and procedural notices which conflict with existing SOPs. In other cases, obsolete directives are neither cancelled nor updated. Without corrective actions, SBA employees and program participants may continue to exhibit confusion about applicable procedures and may not interpret Agency requirements consistently. The resulting uncertainty can waste time and money, delay services to small businesses, create a negative public image, and produce unforeseen consequences.

The overall directives system needs to be overhauled. As recommended by the OIG, SBA formed a working group to develop a plan for revising the directives system’s structure. The plan was finalized in November 2003. It called for SBA to complete, by July 2005, a review of all directives in existence as of October 1, 2003, in order to ensure that any backlog of obsolete or draft directives is cleared out, and that all applicable expired notices are incorporated into SOPs. However, this was not accomplished.

In addition, in 2003, the working group produced a draft policy notice to revise the clearance procedures for future directives. Although the notice was cleared by most SBA offices, it has not been issued. Consequently, the Chief of Staff at the time issued an executive memorandum directing offices to incorporate all relevant temporary directives pertaining to permanent policy changes into their SOPs by March 30, 2004. To date, however, only a few revised SOPs have been issued. In FY 2005, the working group revised the SOP governing directives management and placed it in the Agency clearance process. The OIG’s review of this SOP, however, determined that it did not adequately address the problems with the directives management system. In addition, in late FY 2005, the Agency issued a notice requesting program managers to update their SOPs. For greater clarity, the single “action needed” in last year’s report has been expanded into four actions.

Challenge History Fiscal Year (FY) Issued: 2004	Actions Accomplished (Green Status) during Past 4 FYs			Status at end of FY 2005
	04-0			
Remaining Actions Needed for FY 2006				
<i>Fully implement a revision of SBA’s directives system.</i>				
1. Issue a revised SOP governing directives management, including effective clearance procedures.				Orange (New)
2. Complete the current effort to update all SOPs and incorporate relevant temporary directives.				Orange (New)
<i>Keep the directives system current.</i>				
3. Implement a regular review mechanism to maintain SOPs so that they are up-to-date.				Red (New)
4. Make all SOPs available electronically on SBA’s Web site and update changes promptly.				Yellow (New)

Green-Implemented **Yellow**-Substantial progress **Orange**-Some progress **Red**-No progress

Appendix 1: 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 2004 Financial Statements Management Letter*, Report #5-13 February 23, 2005
- SBA OIG, *Audit of SBA's FY 2004 Financial Statements*, Report #5-05, November 15, 2004
- *Small Business Administration: Model for 7(a) Program Subsidy Had Reasonable Equations, but Inadequate Documentation Hampered External Reviews*, GAO-04-9, March 31, 2004
- SBA OIG, *Audit of SBA's FY 2003 Financial Statements Management Letter*, Report #4-17, March 23, 2004
- SBA OIG, *Audit of SBA's FY 2003 Financial Statements*, Report #4-10, January 30, 2004
- SBA OIG, *Audit of SBA's FY 2002 Financial Statements Management Letter*, Report #3-24, April 14, 2003
- SBA OIG, *Audit of SBA's FY 2002 Financial Statements*, Report #3-06, January 30, 2003
- GAO, *Accounting Anomalies and Limited Operational Data Make Results of Loan Sales Uncertain*, GAO-03-87, January 2003
- SBA OIG, *Audit of SBA's Oversight of the Fiscal Transfer Agent for the Section 7(a) Loan Program*, Report #03-08, January 30, 2003
- SBA OIG, *Audit of SBA's FY 2001 Financial Statements Management Letter*, Report #2-17, April 12, 2002
- SBA OIG, *Audit of SBA's FY 2001 Financial Statements*, Report #2-04, February 27, 2002.
- SBA OIG, *Audit of SBA's FY 2000 Financial Statements Management Letter*, Report #1-15, August 15, 2001
- SBA OIG, *Audit of SBA's FY 2000 Financial Statements*, Report #1-08, February 28, 2001

Challenge 3:

- SBA OIG, *Audit of SBA's Informs System*, Report 5-25, September 25, 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, *Memorandum Advisory Report on Consolidation of SBA's Systems Subject to the Federal Information Security Management Act*, Report 5-19, May 20, 2005.

- SBA OIG, *Audit of SBA's Continuity of Operations Program*, Report 5-17, March 30, 2005.
- SBA OIG, *Audit of SBA's Information System Controls*, Report 5-12, February 24, 2005.
- SBA OIG, *Independent Evaluation of SBA's Computer Security Program*, Report 5-02, October 7, 2004.
- 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*, Report #4-19, April 29, 2004.
- SBA OIG, *Audit of SBA's Loan Application Tracking System*, Report #4-18, April 5, 2004.
- SBA OIG, *Enforcement of SBA Information Technology Enterprise Architecture During Development of the Disaster Credit Management System*, Report #4-14, March 2, 2004.
- SBA OIG, *Monitoring of SBA's Implementation of its Disaster Credit Management System*, Report #3-39, September 24, 2003.
- SBA OIG, *Independent Evaluation of SBA's Computer Security Program*, Advisory Memorandum Report #3-37, September 17, 2003.
- SBA OIG, *Audit of SBA's Acquisition, Development and Implementation of its Joint Accounting and Administrative Management System*, Report #3-32, June 30, 2003.
- SBA OIG, *Audit of SBA's Information System Controls*, Report #3-20, March 31, 2003.
- SBA OIG, *SBA's Implementation of its Critical Infrastructure Protection Program, Phase III*, Report #3-03, January 10, 2003.

Challenge 4:

- 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/fiveinitatives.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.
- OIG, *A Framework for Considering the Centralization of SBA Functions*, November 1996.

Challenge 5:

- SBA OIG, *Audit of an Early Defaulted Loan*, Report #5-26, September 28, 2005
- SBA OIG, *Audit of an Early Defaulted 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 6:

- 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 7:

- 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 8:

- 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 2003 Performance 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.
- OIG, *Audit Report on the Small Business Investment Company (SBIC) Liquidation Function*, Report # 3-2-E-004-031, March 31, 1993.

Challenge 9:

- 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.

Challenge 10:

- SBA OIG, *Audit of SBIC Oversight*, Report #3-33, July 1, 2003.
- SBA OIG, *Problems with SBA's Directives System*, Advisory Memorandum #3-28, May 22, 2003.
- SBA OIG, *Guaranty Purchase Processing: Directors' Survey Responses and Loan Officers' Survey Responses*, Report #3-16, March 18, 2003.
- SBA OIG, *Audit of the Guaranty Purchase Process*, Report #3-15, March 17, 2003.
- SBA OIG, *The Microloan Program: Moving Toward Performance Management*, Report #3-26, May 13, 2003.
- SBA OIG, *Standard Operating Procedure 00-11*, Memorandum, December 17, 2002.
- SBA OIG, *Travel of SBA's Former Regional Administrator*, Report #2-22, August 7, 2002.