

U.S. SMALL BUSINESS ADMINISTRATION

OFFICE OF INSPECTOR GENERAL

**Report No. 7-01**

*FY 2007 Report  
on the Most Serious Management Challenges  
Facing the Small Business Administration*

October 16, 2006



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

OFFICE OF  
INSPECTOR GENERAL

October 16, 2006

MEMORANDUM

TO: Steven C. Preston  
Administrator

FROM: Eric M. Thorson  
Inspector General  
<Original signed by>

SUBJECT: SBA's Top Management Challenges for Fiscal Year 2007

In accordance with the Reports Consolidation Act of 2000, we are providing you with the Office of Inspector General's (OIG) Report on the Most Serious Management Challenges Facing the Small Business Administration (SBA) in Fiscal Year (FY) 2007. This report 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, or 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, 2006.

Within each Management Challenge is a series of "action items" showing the actions recommended by the OIG to resolve that particular Challenge. Each action item is assigned a color status score, except that the OIG did not assign a color score to new actions in this report unless we notified the Agency of the new action by midyear. 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; a downwards arrow indicates that the color score worsened. As part of the OIG's continuing evaluation of the Management Challenges, certain action items have been revised (revisions, other than minimal revisions, are indicated by "Revised Action").

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. This 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 FY 2007 report on the ten Management Challenges.

	Topic	Status Score				Change in Status	
		Green	Yellow	Orange	Red	Improved <sup>1</sup>	Worsened <sup>2</sup>
1	Small Business Contracts			3			
2	Financial Reporting	4	2			4	
3	IT Security		8	2	1	4	
4	Human Capital		4	2		1	
5	Loan Guaranty Purchase		1	4		1	2
6	Lender Oversight	3	5	4	2	6	
7	8(a) BD Program	1		2	3	1	1
8	SBIC Program	1	1	4	1	2	1
9	Loan Agent Fraud		2	3	1	2	1
10	Policies and Procedures	1	3			3	

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 2006 Performance and Accountability Report, as required by law. Please contact me at (202) 205-6586, should you have any questions.

Attachment

---

<sup>1</sup> "Improved" refers to an action item that showed progress this year over last year's score.

<sup>2</sup> "Worsened" refers to an action item that showed regression this year from last year's score.

## 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. SBA faces significant challenges in financial management and reporting, which affect its ability to provide reliable, timely, and accurate financial information .....	2
Challenge 3. Information systems security needs improvement .....	3
Challenge 4. Maximizing program performance requires that SBA fully develop, communicate, and implement a human capital management/transformation strategy .....	4
Challenge 5. SBA’s National Guaranty Purchase Center needs better controls over the business loan purchase process .....	5
Challenge 6. SBA needs to effectively implement its participant oversight plan .....	6
Challenge 7. The Section 8(a) Business Development (BD) program needs to be modified so more firms receive business development assistance, standards for determining economic disadvantage are clear and objective, and SBA ensures that firms follow 8(a) regulations when completing contracts .....	7
Challenge 8. The current practices of the SBIC program place too much risk on taxpayer money .....	8
Challenge 9. Preventing loan agent fraud requires additional measures .....	9
Challenge 10. SBA needs to continue its efforts to update its system of directives to provide proper guidance and control over its operations.....	10
Appendix. Relevant Reports .....	11

**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 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.

Large companies improperly obtain small business contracts due to a variety of problems. In some cases, improper awards result from errors by contracting personnel, such as accepting questionable size self-certifications, unfamiliarity with small business contracting procedures, or miscoding a business as small in Federal databases. Although a new database, Online Representations and Certifications Application (ORCA), allows contractors to maintain current certification information electronically, questions remain as to whether contracting officers are required to review on-line certifications prior to awarding contracts. Some contractors obtain small business contracts for which they are not eligible by misrepresenting their size or by not diligently verifying whether they meet size criteria. SBA needs to do more to ensure that government contracting personnel receive adequate training on small business procurement procedures, promote contractor accuracy, and encourage greater accuracy in Federal agency small business contracting reports.

SBA also needs to work to close regulatory loopholes that allow agencies to take credit for meeting their small business procurement goals even though contracts are performed by large firms. For example, multiple award contracts, such as the General Services Administration Multiple Awards Schedule (MAS) Program and Government Wide Acquisition Contracts (GWACs), are structured so that a company's size is only relevant when admitted to the initial contract, not for the task orders issued under the contract. Task orders can be issued under these contracts for many years after the contract is awarded. In 2003, SBA proposed a regulation requiring companies to certify as to their size on an annual basis, but it now appears that a rule with a one-year certification requirement will not be issued. If this is the case, the OIG will reevaluate the matter to assess whether the Agency should take other steps to address this problem.

The Agency also needs to address another loophole with MAS contracts that contain multiple industrial codes. In being awarded such a contract, a company can identify itself as small even though it does not meet the size criteria for every industrial code. Thus, agencies may obtain small business credit for using a firm classified as small even if the firm is not small for the specific goods or services procured through a particular task order under such a MAS contract.

Challenge History Fiscal Year (FY) Issued: 2005	Actions Accomplished (Green Status) during Past 4 FYs			
				05-0
<b>Remaining Actions Needed for FY 2007</b>				<b>Status at end of FY 2006</b>
1. Develop and take steps to provide reasonable assurance that agencies are providing adequate basic and continuing education training to all contracting personnel on small business contracting procedures.				Orange
2. Develop and implement a program that promotes accurate contractor certifications, and which ensures that contracting personnel review contractor certifications.				Orange (Revised Action)
3. Develop and implement a plan that ensures that Federal agencies accurately report the number of contracts they award to small businesses.				New
4. Issue regulations to ensure that firms must meet the size standard for each order it receives under a GSA schedule contract.				Orange (Revised Action)

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

**Challenge 2. SBA faces significant 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 2005 financial statement audit demonstrate that SBA made significant progress addressing a material weakness over financial management and reporting. SBA’s financial management and reporting controls, however, continue to need improvement in the areas of funds management, financial accounting transactions, review of account balances, financial statement preparation and quality assurance. The Agency 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. The “Actions Needed” were revised for this report to consolidate related action items and to emphasize the importance of internal control on effective financial management and reporting.

Challenge History Fiscal Year (FY) Issued: 2003	Actions Accomplished (Green Status) during Past 4 FYs			Status at end of FY 2006
	03-0	04-0	05-0	
<b>Remaining Actions Needed for FY 2007</b>				
<i>SBA demonstrates its financial management and reporting controls achieve their objectives, and produces timely financial statements and other financial information in accordance with prevailing requirements and accounting standards.</i>				
1. SBA submits financial reports that are free of misclassifications and errors and receives an unqualified audit opinion on its annual financial statements.				Yellow (Revised Action)
2. SBA submits accurate financial reports by established deadlines and does so without negatively affecting the timing or efficiency of other Agency operations.				Green↑
3. SBA evaluates its financial controls to identify deficiencies in their design or operation which prevent achieving objectives and implements corrective actions, and corrective actions result in no reportable conditions.				Yellow (Revised Action)
<i>SBA maintains effective control over the subsidy re-estimation process.</i>				
4. SBA produces reasonable estimates that can be developed, internally reviewed, and audited in a timely manner consistent with the Agency’s financial reporting deadlines.				Green↑
5. SBA’s financial systems provide data that are accurate, complete, and in sufficient detail for use in the subsidy estimate and re-estimate models.				Green↑
6. SBA refines its quality assurance and review procedures over the subsidy re-estimation process and demonstrates that these procedures are sufficient and working effectively.				Green↑

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

### Challenge 3. Information systems security needs improvement.

The confidentiality, integrity, and availability of SBA’s 19 major 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.

The level of resources the Agency has committed to manage computer security, maintain SBA systems, provide technical support staff, and administer security training is below what is generally necessary for an entity the size of SBA. This continues to weaken 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 OIG recommendations is not scheduled until FY 2007 or later. 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			
	02-2	03-5	04-4	05-2
<b>Remaining Actions Needed for FY 2007</b>				<b>Status at end of FY 2006</b>
1. Entity-wide security program controls are in place and operating effectively.				Yellow↑
2. Access controls are in place and operating effectively.				Orange↑
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.				Yellow↑
7. The SBA Certification and Accreditation (C&A) process is in compliance with NIST 800-37.				Yellow
8. The Plan of Actions and Milestones (POA&M) accurately reports all computer security weaknesses and corrective actions.				Yellow
9. SBA timely mitigates audit and system risk assessment weaknesses.				Orange↑
10. Procedures and practices for reporting security incidents are in place and operate effectively.				Yellow
11. SBA ensures adequate and up-to-date computer security program training.				Yellow

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

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

As SBA’s budget has decreased and small business practices, products, and needs have changed over the last decade, SBA began to make significant revisions in the structure of its workforce by delegating more authority to lenders, centralizing loan functions, and reducing staff. Although SBA issued a Human Capital Management Plan that dealt primarily with specific Office of Human Capital Management (OHCM) activities, this plan did not adequately address the significant changes in the Agency’s workforce because it lacked a comprehensive SBA transformation strategy and specific strategies and milestones for moving SBA to the new vision posed in SBA’s FY 2003-2008 Strategic Plan. For example, key program functions have been transferred from the District Offices to service centers without clarifying the new role and appropriate staffing of the District Offices.

In September 2006, OHCM issued a revised Strategic Human Capital (SHC) Plan that is linked to the Agency’s FY 2003-2008 Strategic Plan. The OHCM has also drafted an Accountability Plan, but has not yet implemented this plan. The Office of Personnel Management’s (OPM) *Human Capital Assessment and Accountability Framework (HCAAF)* guidance on developing human capital plans states that human capital management decisions should be guided by data-driven, results-oriented planning and accountability systems that align human capital strategies with Agency mission, goals, and objectives. In light of continuing changes to SBA’s structure and workforce, an effective accountability system will be critical for the successful management of SBA’s human capital in the coming years. However, resolving the human capital challenge and transforming SBA is more than just an OHCM challenge. The Agency has drafted but has yet to issue a comprehensive transformation strategy. Issuance of this transformation strategy would help agency employees understand how their role fits into SBA’s strategic plan and reduce employee uncertainty and cynicism, thereby improving morale and productivity (the FY 2005 Government-wide employee survey revealed substantial morale problems in SBA). SBA also needs to make progress in identifying and addressing employee training needs and in developing succession plans in order to achieve satisfactory productivity and continuity of operations.

Challenge History Fiscal Year (FY) Issued: 2001	Actions Accomplished (Green Status) during Past 4 FYs			
	02-0	03-0	04-1	05-0
<b>Remaining Actions Needed for FY 2007</b>				<b>Status at end of FY 2006</b>
1. Develop, communicate to all employees, and implement a Human Capital Plan that is structured along the lines of OPM’s HCAAF and includes appropriate metrics and accountability system for assessing the Agency’s management of human capital.				Yellow (Revised Action)
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.				Yellow↑
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

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



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

The majority of loans made under the section 7(a) loan-guaranty program are made with little or no review by SBA prior to loan approval because SBA has delegated credit decisions to lenders on these loans. SBA’s review of lender requests for guaranty purchase on defaulted loans is, therefore, the primary tool for assessing lender compliance on a loan-by-loan basis and protecting SBA from making erroneous guaranty purchase payments. However, OIG audits of early defaulted loans and SBA’s guaranty purchase process have shown that the reviews by the SBA National Guaranty Purchase Center 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 issuing revised Standard Operating Procedures (SOP) 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 2005 re-established a quality assurance review program (an earlier program ended in FY 2003). While we agree that centralization will strengthen the process, an OIG management advisory report on the transfer of operations to the National Guaranty Purchase Center questioned the reasonableness of the 85 percent reduction in the guaranty purchase review staff and emphasized that additional actions are needed to strengthen the guarantee purchase decisions and effectively reduce improper payments.

Challenge History Fiscal Year (FY) Issued: 2001	Actions Accomplished (Green Status) during Past 4 FYs				Status at end of FY 2006
	02-2	03-4	04-0	05-2	
<b>Remaining Actions Needed for FY 2007</b>					
1. Adequate resources are devoted to the purchase process.					Orange↑
2. SBA determines level of improper payments for the entire loan portfolio in compliance with the Improper Payments Information Act of 2002 and OMB guidance.					Orange↓
3. SBA establishes controls to identify risks of improper payments and establishes procedures for addressing these risks.					Orange (Revised Action)
4. SBA implements a quality assurance system that allows SBA to make progress in achieving established goals for reducing improper payments.					Orange ↓
5. Policies and procedures provide guidance to ensure consistency and accuracy in the purchase process.					Yellow

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

## Challenge 6. SBA needs to effectively implement its participant oversight plan.

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.

The Agency improved its oversight process by establishing a Lender Monitoring System (LMS) that identifies potential and actual financial risks at the portfolio, lender and loan levels. The LMS uses internal and external information to develop credit scores for each loan, aggregates the scores by lender, and produces ratings that measure lender loan portfolio performance. In addition, the Agency has identified the responsibilities and authorities of the Office of Lender Oversight (OLO), provided resources to support the oversight mission, and established the Portfolio Analysis and Lender Oversight committees to assess the portfolio and individual lender performance. OLO also issued guidance for on-site lender reviews, including fees to be charged to support the oversight process. The effectiveness of the new policies and the on-site review process will be assessed in the future. To further improve the oversight program, among other things, the Agency needs to issue regulations and a Standard Operating Procedure governing OLO, commence on-site reviews of section 504 entities, develop performance standards for lender ratings, expand the number of lenders with unsatisfactory ratings discussed by the Lender Oversight Committee, and ensure that deficiencies identified during on-site reviews are corrected. This Management Challenge was revised in October 2005 to reflect the Agency's progress and to modify the action items to emphasize implementation of the OLO strategic plan and the effectiveness of its oversight program.

Challenge History Fiscal Year (FY) Issued: 2001	Actions Accomplished (Green Status) during Past 4 FYs				
	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	05-7(a)-0 05-504-3	
<b>Remaining Actions Needed for FY 2007</b>				<b>Status at end of FY 2006</b>	
				<b>7(a)</b>	<b>504</b>
1. SBA has implemented a process that effectively assesses the level of financial risk of the portfolio, of participants, and of loans.				Yellow (New)	Yellow (New)
2. SBA provides guidance and training for new participants and those who demonstrate an unacceptable level of compliance.				Green↑	Green↑
3. SBA has implemented a program of reviews of lenders and Certified Development Companies (CDC) for compliance risks.				Yellow↑ (Revised Action)	Yellow↑ (Revised Action)
4. Adequate personnel resources have been provided for the participant oversight program.				Orange (New)	Orange (New)
5. A formal training program has been prepared and implemented for SBA and contractor personnel.				Green↑	Yellow↑
6. SBA has issued and implemented guidance providing for effective oversight of lending programs.				Red (Revised Action)	Red (Revised Action)
7. SBA ensures that appropriate corrective action is implemented and monitored for participants with unacceptable performance.				Orange (Revised Action)	Orange (Revised Action)

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

**Challenge 7. The Section 8(a) Business Development (BD) program needs to be modified so more firms receive business development assistance, standards for determining economic disadvantage are clear and objective, and SBA ensures that firms follow 8(a) regulations when completing 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. Allowing companies that are "business successes" to remain in the program and continue to receive 8(a) contracts can be a reason why a few companies receive most of the 8(a) contract dollars and many receive none. Based on FY 2005 FPDS-NG data, 50% of the dollars obligated against 8(a) contracts went to 1.7 percent of the 8(a) firms and over 70% of the eligible firms received no FY 2005 8(a) contract benefit at all. (This obligated contract figure excludes amounts awarded to firms that had left the 8(a) program before FY 2005.) Additionally, the program's primary database is ineffective and inefficient, and does not contain the information needed to successfully manage the program.

Finally, while SBA delegated its 8(a) BD contract execution authority to 26 Federal procuring agencies starting in 1998, it has not conducted any surveillance reviews to ensure that agencies were effectively monitoring compliance with 8(a) BD regulations on awarded contracts. Neither SBA nor delegated procuring agencies monitored 8(a) BD contracts to ensure SBA regulations have been followed. Therefore companies could violate 8(a) BD regulations and Federal officials would be unaware of the violations. An ever-changing Federal contracting arena has created an environment in which reengineering of the 8(a) BD program is needed.

Challenge History Fiscal Year (FY) Issued: 2003	Actions Accomplished (Green Status) during Past 4 FYs			Status at end of FY 2006
		03-0	04-0	
<b>Remaining Actions Needed for FY 2007</b>				
1. Develop and implement a plan, including Standard Operating Procedure (SOP) provisions, which ensure that the 8(a) BD program identifies the business development needs of the program participants on an individualized basis and provides assistance to meet those needs.				Red (Revised Action)
2. Develop criteria defining "business success."				Green↑
3. Develop and implement SOP provisions to ensure that participants are graduated once they reach those levels defined as "business success."				Red (Revised Action)
4. Redefine "economic disadvantage" using objective, quantitative, qualitative, and other criteria that effectively measure capital and credit opportunities, and implement the new definition.				Red↓
5. Provide sufficient financial and analytical training to business development specialists (BDS) to enable them to evaluate a company's business profile and competitive potential.				Orange
6. Determine data needs to support and manage the 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.				Orange
7. Revise the partnership agreements with the procuring agencies so they are specifically required to (1) monitor 8(a) BD companies compliance with program requirements, and (2) take steps to ensure that contracting officers and technical representatives are adequately advised of their responsibilities concerning 8(a) compliance.				New
8. Develop and implement SOP provisions to ensure that SBA regularly reviews efforts by procuring agencies to effectively monitor and enforce compliance with specified 8(a) BD regulations on the contracts they administer.				New

Green-Implemented Yellow-Substantial progress Orange-Limited 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 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. As of September 30, 2006, SBA had about \$10.5 billion of such financings at risk. 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 Government Accountability Office 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: (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) Standard Operating Procedures (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 capially 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, 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 on 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		
		04-2	05-0
<b>Remaining Actions Needed for FY 2007</b>			<b>Status at end of FY 2006</b>
1. Develop reasonable subsidy estimates.			Green↑
2. Provide documented analysis justifying the capital impairment percentages (CIP).			Yellow↑
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
7. Develop and implement procedures, that are included in a revised SOP 10 07, to address the liquidation of participating security SBICs and SBA’s monitoring of the liquidation of SBICs in receivership..			Red↓ (Revised Action)

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

## Challenge 9. Preventing loan agent fraud requires additional measures.

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 and a database or equivalent means to track loan agent involvement.

Agency efforts to track loan agents have been limited and ineffective. In response to this Challenge, SBA revised its E-Tran system, which is designed to collect loan data electronically from lenders who *voluntarily* participate, so that lenders can indicate whether a loan agent was involved with a loan. However, the OIG has learned that lenders are confused by the E-Tran requirement to identify the “source” of the loan, and that the system is not accurately capturing loan agent involvement. Further problems with the system result from the lack of clear procedures to ensure that the lending official that is working with a borrower transmits loan agent information to the person that is entering data into E-Tran. In addition, the Agency does not capture sufficient identifying information about the loan agents that are being recorded on E-Tran. These flaws need to be addressed before the Agency can rely on E-Tran as an effective means of tracking loan agent activity.

Although the Agency has advised that a majority of loans are now being processed through E-Tran, SBA is also not yet certain how, or whether, it will capture, in a searchable database, loan agent information from the large number of lenders that are still not participating in E-Tran. The Agency has made progress by 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, which asks for information about loan agents. However, the Agency needs to formally issue this checklist to make this official. In order to establish effective loan agent tracking, SBA must also develop some system to capture loan agent information electronically and link it to individual loans. Such a system would enable the Agency to identify patterns of loan agent fraud and assess the various risks that loan agents present to the SBA’s portfolio of guaranteed loans, regardless of whether or not a lender uses E-Tran. 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.

Challenge History Fiscal Year (FY) Issued: 2000	Actions Accomplished (Green Status) during Past 4 FYs			
	02-0	03-0	04-0	05-0
<b>Remaining Actions Needed for FY 2007</b>				<b>Status at end of FY 2006</b>
1. Ensure that the E-Tran system’s data fields <u>require</u> disclosure of agent involvement and sufficient loan agent identity information to track agent participation.				Orange
2. Ensure that SBA Form 159 or another SBA form <u>requires</u> disclosure of agent involvement and sufficient loan agent identity information to track agent participation.				Yellow↑
3. Provide guidance to lenders to ensure they enter correct loan agent data consistently.				Orange↓
4. Compile loan agent information obtained from lenders <b>not using E-Tran</b> in a database or equivalent means that can link loan agents with individual loans.				Red (Revised Action)
5. Formally issue the guaranty purchase checklist to require that lenders submit the Form 159 to SBA at the time the Agency purchases a loan.				Yellow↑
6. Implement effective procedures to (1) review loans for irregularities that could indicate loan agent fraud and abuse, and (2) undertake timely and effective enforcement action against loan agents when warranted.				Orange

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

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

SBA’s system of directives—used to implement policies and procedures that govern agency programs — needs to be revised. Agency rules require that all long-term policies and procedures be implemented through permanent directives known as Standard Operating Procedures (SOPs). Yet, a number of Agency program offices have issued dozens of temporary notices to manage their programs either in lieu of SOPs or that even conflict with existing SOPs, and continue to rely upon these notices even after they have expired. In other cases, obsolete directives (some dating back to the 1970s) have been neither cancelled nor updated even though they apply to programs that no longer exist or that have been substantially altered. The result is an often incoherent and inefficient system that generates confusion and uncertainty in both SBA employees and resource partners that rely on these directives, leads to uneven and potentially arbitrary application of policies and procedures, and which reduces the effectiveness of the agency’s internal controls system.

In particular, the SOPs governing SBA’s multi-billion dollar business loan programs have not been updated for over six years despite the introduction of new lending programs and a significant number of policy and procedural changes. Specifically, the SOP that governs decisions on making guaranteed loans (SOP 50 10) has not been updated since 2000, is over 700 pages long (including appendixes), and contains many sections that are not actually related to making such loans. This SOP often provides outdated and confusing guidance to SBA employees that administer the small business loan programs and lenders participating in those programs.

Recently, the Agency has made some progress in resolving these issues. In FY 2005, SBA revised the SOP that governs the Directives Management System to implement more coherent directive clearance procedures and to require program managers, on an annual basis, to either certify that their SOPs were current or implement appropriate revisions. The Agency has also made many of the SOPs available to employees through an internal website, an improvement over the previous system where a number of SOPs were only available in paper copy. This website, however, continues to identify SOPs dating back to the 1970s and 1980s that are not available electronically, and which, by all appearances, are obsolete. The Agency also needs to ensure that current versions of relevant SOPs are available to the public through [www.sba.gov](http://www.sba.gov) since many of the SOPs on that website are out of date.

Challenge History Fiscal Year (FY) Issued: 2004	Actions Accomplished (Green Status) during Past 4 FYs			
			04-0	05-0
<b>Remaining Actions Needed for FY 2007</b>				<b>Status at end of FY 2006</b>
1. Issue a revised SOP governing directives management, including effective clearance procedures.				Green↑
2. Complete the current effort to update all SOPs and incorporate relevant temporary directives.				Yellow↑
3. Update SOP 50-10 so that it contains current and clear guidance and is applicable only to loan making policies.				New
4. Implement a regular review mechanism to maintain SOPs so that they are up-to-date.				Yellow↑
5. Make current versions of all SOPs available electronically on SBA’s internal and publicly available Web sites and delete obsolete SOPs.				Yellow

Green-Implemented Yellow-Substantial progress Orange-Limited 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](http://www.sba.gov/ig/igreadingroom.html).

### Challenge 1:

- House Small Business Committee Democratic Staff, *Scorecard VII: Faulty Accounting by Administration Results in Missed Opportunities for Small Business*, July 26, 2006
- SBA OIG, *Review of Selected Small Business Procurements*, Report #5-16, March 8, 2005
- SBA OIG, *SBA Small Business Procurement Awards Are Not Always Going to Small Businesses*, Report #5-14, February 24, 2005
- SBA Office of 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?* Testimonies of Mr. Fred C. Armendariz, Associate Deputy Administrator, SBA, and Mr. Felipe Mendoza, Associate Administrator, Office of Small Business Utilization, U.S. General Services Administration, May 7, 2003

### Challenge 2:

- SBA OIG, *Audit of SBA's FY 2005 Financial Statements Management Letter*, Report #6-10, January 18, 2006
- SBA OIG, *Review of the 1502 Reporting Process*, Report #6-07, December 9, 2005
- SBA OIG, *Audit of SBA's FY 2005 Financial Statements*, Report #6-04, November 15, 2005
- *SBA Disaster Loan Program: Accounting Anomalies Resolved but Additional Steps Would Improve Long-Term Reliability of Cost Estimates*, GAO-05-409, April 14, 2005
- 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 Information System Control for FY 2005*, Report #6-08, December 22, 2005
- SBA OIG, *FISMA Independent Evaluation*, Report #6-01, October 7, 2005

- 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 for FY 2004*, 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 for FY 2003*, 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 for FY 2002*, Report #3-20, March 31, 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
- SBA OIG, *A Framework for Considering the Centralization of SBA Functions*, November 1996

#### **Challenge 5:**

- 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 6:**

- GAO, *Small Business Administration Improvements Made, But Loan Programs Face Ongoing Management Challenges*, Report #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 7:**

- 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 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
- SBA 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