

U.S. SMALL BUSINESS ADMINISTRATION

OFFICE OF INSPECTOR GENERAL

Report No. 5-01

*FY 2005 Report  
on the Most Serious Management Challenges  
Facing the Small Business Administration*

OCTOBER 15, 2004



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

**OFFICE OF  
INSPECTOR GENERAL**

October 15, 2004

MEMORANDUM

TO: Hector V. Barreto  
Administrator

FROM: Harold Damelin  
Inspector General

SUBJECT: SBA's Top Management Challenges for Fiscal Year 2005

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) 2005. We have provided our current assessment of Agency programs or activities that pose significant risks, including those that are particularly vulnerable to fraud, waste, error, or mismanagement. 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. Our analysis considers actions reported by the Agency as of August 16, 2004, as well as certain actions brought to our attention as of September 30, 2004.

This year's report contains one new challenge—Challenge 11. It deals with the need to make substantial changes in the Small Business Investment Company (SBIC) program to reduce the substantial risk to taxpayers, as set forth in an OIG report issued in May 2004.

Recently, at your direction, the Agency has focused more attention on the Management Challenges by, among other things, placing them on the Management Board agenda and assigning overall responsibility to the Chief Operating Officer. As a result, SBA has made progress on many of the challenges, especially on Challenge 1—managing for results. While this is encouraging, much more remains to be done. By their nature, these challenges require continued long-term commitment and effort by the Agency.

This report will be incorporated into the SBA's FY 2004 Performance and Accountability Report, as required by law. Please contact me at (202) 205-6586, should you have any questions.

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**Challenge 1. SBA needs to improve its managing for results processes and performance data.**

The Agency made substantial progress toward implementing actions to address this challenge last year. Budget and performance integration, an integral part of the President’s Management Agenda (PMA) and whose underpinnings include the Government Performance and Results Act (GPRA), is an increasingly important and demanding activity for SBA. During the past year, the Agency continued to work toward implementing performance-based management processes devised to meet the requirements of the PMA and GPRA. These processes include planning for, and analysis of, performance measurement data and reporting of programmatic results and accountability.

To better manage its results processes and performance data, SBA created the Office of Analysis, Planning and Accountability (OAPA) to coordinate and support the work of program offices and others across the Agency that have performance measurement and reporting responsibilities. Through training and outreach to program offices, OAPA works to build capacity among program staff to develop performance measures that better measure program outcomes. OAPA also serves as the key resource to advise management in meeting the requirements of the PMA, GPRA and related initiatives.

Despite the SBA’s progress toward improving its managing for results processes, SBA’s capacity to report quality data continues to present a challenge. Recognizing that SBA needs to improve the quality of its data, the Agency is requiring program offices to complete a “Validation of Data Used in Performance Measure” table for each performance indicator that will be used in the FY 2004 Performance and Accountability Report. Information from these tables will assist the Agency in determining whether performance outcomes are regularly measured and reflect results attributable to Agency programs.

Actions Needed	Progress
<b><i>Top management provides positive and supportive attitude toward performance-based management focused on managing for results.</i></b>	
Top management provides leadership to coordinate the Agency’s managing for results program and commits sufficient resources to support the leadership effort.	Green↑
Strategic plan is ratified and reflects top management’s vision and direction.	Green
<ul style="list-style-type: none"> <li>• Appropriate Agency program goals and objectives are established.</li> </ul>	Green
<ul style="list-style-type: none"> <li>• Appropriate performance measures and indicators are established.</li> </ul>	Green
<ul style="list-style-type: none"> <li>• Program managers support SBA’s strategic plan, performance goals, and objectives.</li> </ul>	Green↑
<ul style="list-style-type: none"> <li>• Training programs are provided to managers and others responsible for implementing the performance results requirement.</li> </ul>	Green↑
Management provides adequate resources to support processes necessary to have an effective performance-based and results-driven operation.	Green↑
<b><i>SBA analyzes risks associated with achieving objectives.</i></b>	
SBA periodically assesses the risk that it may not achieve its goals.	Green↑
Performance outcomes are regularly measured and reflect results attributable to Agency programs and services delivered.	Yellow
<b><i>Policy and procedures provide guidance to ensure consistency among organizational components.</i></b>	
Policies and guidelines for developing performance goals, objectives and measures, and verifying and validating data are published.	Green
<b><i>Information is recorded and communicated to management and others who need it to fulfill their oversight and stewardship responsibilities.</i></b>	
Managers have and use operational and financial data to assess their progress in meeting Agency goals and to ensure accountability for effective and efficient use of resources.	Yellow

Green-Implemented Yellow-Progress being made Red-Not implemented/no substantial progress

**Challenge 2. SBA faces significant challenges in financial management and reporting, which affects 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. During FYs 2002 and 2003, the OIG, GAO, and SBA’s external auditor all noted significant internal control weaknesses that resulted in the Agency being unable to produce reliable, timely, and accurate financial information, including its annual financial statements and the results of past loan asset sales.

The Agency has taken steps to improve its financial management and reporting. These efforts have been focused primarily on improving the Agency’s models for estimating subsidy costs, improving controls over financial statement preparation, and correcting accounting errors related to loan sales and subsidy cost allowances. FY 2004 is the first full reporting cycle for which these improvements have been placed into operation and preliminary reviews of these actions indicate that significant progress has been made. However, as of the cut-off date of this report, the external auditor and OIG have not fully assessed whether the corrective actions will result in SBA overcoming its financial management and reporting challenges.

Actions Needed	Progress
<b><i>SBA’s financial reporting process provides complete, reliable, and timely financial management information.</i></b>	
The Office of the Chief Financial Officer (OCFO) produces complete, reliable, and timely financial statements that are prepared in accordance with OMB Bulletin No. 01-09, Form and Content of Agency Financial Statements.	Red
<ul style="list-style-type: none"> <li>SBA’s core financial system is able to provide complete, reliable, timely, and consistent financial management information.</li> </ul>	Red
<ul style="list-style-type: none"> <li>SBA meets all deadlines for financial reporting.</li> </ul>	Yellow↑
<ul style="list-style-type: none"> <li>SBA documents all aspects of its financial reporting process.</li> </ul>	Yellow
<ul style="list-style-type: none"> <li>SBA maintains strong internal control over the financial reporting process to avoid submitting financial statements with misclassifications and errors.</li> </ul>	Yellow
<b><i>SBA maintains proper accounting for, and accountability of, the Master Reserve Fund (MRF).</i></b>	
SBA fully accounts for the MRF in accordance with all Federal accounting regulations.	Yellow
SBA utilizes statistically valid tools to measure the financial position of the MRF.	Yellow
<b><i>SBA maintains control over all aspects of the loan accounting and budgeting processes.</i></b>	
SBA revises the approach to estimate cash flows for the disaster loan program.	Yellow
SBA adheres to the requirements of Federal Financial Accounting and Auditing Technical Release No. 3.	Yellow
SBA properly accounts for loan asset sales in accordance with all Federal accounting and budget regulations.	Yellow
<ul style="list-style-type: none"> <li>SBA investigates and corrects all known errors made in the accounting and budget records from previous loan sales.</li> </ul>	Yellow
<ul style="list-style-type: none"> <li>SBA performs the necessary analysis to assess the effects of loan sales on the subsidy re-estimates to determine whether cash flow assumptions in SBA’s subsidy rate model predict future loan performance.</li> </ul>	Yellow
<ul style="list-style-type: none"> <li>SBA performs the necessary analysis to determine and correct any unexplained decline in the subsidy allowance account.</li> </ul>	Yellow
SBA utilizes a well-documented and tested automated methodology for accumulating cash flows necessary for subsidy calculations.	Yellow
SBA fully implements quality assurance procedures over the subsidy re-estimation process.	Yellow

Green-Implemented Yellow-Progress being made Red-Not implemented/no substantial 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 can result in a number of benefits, such as information being processed more quickly and communicated almost instantaneously, it can also increase 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 38 major information systems. The Agency’s commitment of direct resources to improve computer security, provide technical staff support, and develop security training has continued to decline. This has further weakened a computer security program that already lacks sufficient controls to fully protect SBA’s systems. Due to the long-term nature of implementing a security program, completion of final action on some of the recommendations is not scheduled until the FY 2005 to 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.

Actions Needed	Progress
<b><i>SBA needs to improve its Information Technology general and application control environment.</i></b>	
Entity-wide security program controls are in place and operating effectively.	Red↓
Access controls are in place and operating effectively.	Yellow
Application software development and program change controls are in place and operating effectively.	Yellow
System software controls are in place and operating effectively.	Red↓
Segregation of duty controls are in place and operating effectively.	Yellow
Service continuity controls are in place and operating effectively.	Yellow
Application authorization controls are in place and operating effectively.	Green↑
Application completeness controls are in place and operating effectively.	Green↑
Application accuracy controls are in place and operating effectively.	Green↑
Application integrity of processing and data file controls are in place and operating effectively.	Green↑
<b><i>SBA needs to fully comply with the Federal Information Security Management Act (FISMA).</i></b>	
Material weaknesses in SBA’s computer security program are being addressed and corrected.	Yellow
The SBA Plan of Actions and Milestones (POA&M) accurately reports on all computer security weaknesses and corrective actions.	Yellow
The SBA Administrator has clearly set forth FISMA responsibilities and authorities.	Green
SBA complies with its the Capital Asset and Investment Control Program.	Green
The SBA Administrator ensures that the computer security program is practiced throughout the life-cycle of each agency system.	Yellow↑
SBA integrates its information security program with its critical infrastructure program.	Green
SBA has identified its critical operations and assets and further defined the interdependencies and interrelationships of those operations and assets.	Yellow
Procedures and practices for reporting security incidents are in place and operate effectively.	Green
SBA has assessed risks to operations and assets under its control, maintained security plans and performed security test and evaluation procedures.	Yellow
SBA has adequately maintained an agency-wide information security program.	Yellow
SBA ensures adequate and up-to-date computer security program training.	Yellow↓
SBA integrates security into capital planning and investment control.	Yellow

Green-Implemented Yellow-Progress being made Red-Not implemented/no substantial 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 have changed in the last decade, SBA has made major modifications in its delivery of goods and services and has begun making significant changes in the structure of its workforce. To respond to these external and internal changes, SBA developed a Human Capital Management Plan. This plan, however, deals primarily with specific Office of Human Capital Management (OHCM) activities instead of providing a comprehensive workforce transformation strategy. For example, the Human Capital Management Plan 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.

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

OHCM efforts, however, can be only one part of the Agency’s effort to resolve the human capital challenge and transform the workforce. The overall responsibility for transforming the Agency belongs to SBA as a whole. Because the Agency did not develop a comprehensive transformation plan, problems occurred in establishing of the National Guaranty Purchase Center (NGPC) in Herndon, Virginia. A recent OIG review found that the NGPC was established without a thorough analysis of how best to accomplish centralization of guaranty purchase and liquidation actions that were being conducted in the field. Lack of planning led to inadequate staffing and program deficiencies. SBA has never released a transformation strategy or made employees aware of major changes that will affect them until after the changes have already been implemented. Moreover, the Agency has yet to publish a report on the changes that have been instituted. The lack of Agency employee involvement in the decision-making process and timely communication of a transformation strategy can breed uncertainty and mistrust, resulting in poor employee morale and reduced commitment and productivity.

Actions Needed	Progress
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 Office of Management and Budget, the Office of Personnel Management and the General Accounting Office) and (2) contains clear customer service standards.	Yellow
Communicate to all employees and incorporate into the Human Capital Plan a workforce transformation strategy that aligns with SBA’s FY 2003-2008 Strategic Plan.	Red
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
Establish and implement competency models reflecting the core competencies that will be needed in the next five years.	Yellow
Develop and implement an evaluation process for regular assessments of Agency skills.	Green↑
Establish and implement an evaluation control mechanism to ensure that all employees have received the appropriate training and have the necessary skills.	Yellow
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.	Yellow
Make substantial progress in SBA’s workforce transformation to meet the needs of SBA’s FY 2003-2008 Strategic Plan.	Yellow

Green-Implemented Yellow-Progress being made Red-Not implemented/no substantial progress

**Challenge 5. SBA 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 had 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 approval. At the same time, the Preferred Lenders Program (PLP), which permits lenders to make credit decisions with little or no SBA oversight, has grown significantly. In FY 2003, the \$5.8 billion in PLP loans represented 52 percent of the total dollar value of Section 7(a) loans. OIG audits of early defaulted loans showed that lenders did not always originate loans in full compliance with SBA’s credit 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 (erroneous) payments. The Improper Payments Act of 2002 requires SBA to assess risk and develop information to measure and monitor improper payments.

SBA has taken actions to correct many of the deficiencies identified, such as issuing a policy notice strengthening purchase procedures, developing training modules, and training a limited number of individuals responsible for making purchase decisions. SBA also recently centralized the 7(a) loan guaranty purchase process to improve the efficiency of the program and plans to re-establish a quality assurance program to replace the discontinued GPR program. The field offices are no longer involved in the purchase process. While we agree that centralization will strengthen the process, a recent 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 further strengthen the process and make it an effective operation for reducing the level of improper payments.

Actions Needed	Progress
<b><i>Top management provides a positive and supportive attitude toward the guarantee purchase process.</i></b>	
Management establishes an organizational culture where deny and repair actions are used when appropriate.	Yellow
<ul style="list-style-type: none"> <li>• Adequate resources are devoted to the purchase process.</li> </ul>	Red↓
<ul style="list-style-type: none"> <li>• Adequate training is provided.</li> </ul>	Yellow
<b><i>SBA identifies level of improper payments and analyzes risks associated with loan guarantee purchases.</i></b>	
SBA periodically determines actual or potential risks of erroneous payments.	Yellow
SBA determines level of improper payments for the entire loan portfolio in compliance with the Improper Payments Information Act of 2002.	Red↓
<b><i>Policies and procedures provide guidance to ensure consistency and accuracy in the purchase process.</i></b>	
SBA has clear guaranty purchase procedures, that provide for consistent interpretation.	Yellow
Current guidance describes adequate documentation needed to make purchase decisions.	Yellow
Lenders are informed of required documentation to submit with the guaranty purchase request.	Green
Goals are established for reducing erroneous payments.	Green
<b><i>SBA manages the guarantee purchase to reduce improper payments and resolve programmatic problems.</i></b>	
SBA implements a quality assurance system that allows SBA to make progress in achieving established goals for reducing improper payments.	Red↓
Problems identified by the audits and reviews are resolved timely.	Yellow
Information on all loans with identified guaranty purchase issues are flagged in the Delinquent Loan Collection System (DLCS).	Green

Green-Implemented Yellow-Progress being made Red-Not implemented/no substantial progress



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

SBA is the largest gap lender for small business entrepreneurs in the United States. As a gap lender, 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. In its business loan programs, SBA has shifted over the years from an organization that processed loans to one that relies on program participants to implement its credit programs and services. This reliance results in less oversight by SBA, thereby increasing the risk of financial loss and noncompliance with policies and procedures. An effective participant oversight program is critical for ensuring that participant activities serve Agency objectives and comply with all policies and procedures.

To improve its oversight, the Agency has established a Lender Monitoring System to identify the level of potential and actual financial risk by both lender and loan that allows the assessment of overall program risk. The on-site and off-site lender review process has been revised to focus on those lenders who present the greatest risk to SBA. Also, the Agency has issued its strategic plan for lender oversight, and is developing new guidance for lender reviews. The effectiveness of the new programs will be assessed this year. Overall, the Office of Lender Oversight (OLO) appears to be making progress in implementing a risk-based process to evaluate effectively its lenders and loan portfolio.

Actions Needed	Progress	
	7(a)	504
<b><i>Top management provides a positive and supportive attitude toward lender oversight.</i></b>		
The Agency establishes an OLO to implement and manage the oversight of lending partners.	Green	Green
SBA has a plan for lender oversight.	Green↑	Green↑
Training programs exist for implementing the participant oversight process.	Green↑	Green↑
Senior management provides adequate resources for the lender oversight program.	Green	Green
<b><i>SBA analyzes risks associated with achieving objectives.</i></b>		
A systematic process exists to estimate the level of financial risk on a per loan and participant basis.	Green↑	Green↑
A systematic process exists to estimate the level of compliance risk on a per loan and participant basis.	Green	Green
Overall program risk is independently reassessed on a recurring basis.	Green↑	Green↑
<b><i>Policies and procedures provide guidance to ensure consistency among organizational components.</i></b>		
Policy and program guidance for lender reviews exists.	Yellow	Yellow
SBA provides guidance and training for new participants and those who demonstrate an unacceptable level of compliance.	Green	Green
Uniform policies and procedures have been established for periodic evaluations of participant performance and retention.	Yellow	Yellow
<b><i>Information is recorded and communicated to management and others who need it to fulfill their oversight and stewardship responsibilities.</i></b>		
SBA has an automated loan monitoring system to capture useful information and effectively monitor risk.	Green↑	Green↑
There is effective communication among SBA's internal units.	Yellow↓	Yellow↓
<b><i>Monitoring of performance occurs and findings of audits and other reviews are promptly resolved.</i></b>		
Standardized and periodic reviews of lending activities that address risk are performed.	Green↑	Green↑
Systems tracking review results and recommendations are implemented.	Yellow	Yellow
The status of each lending partner is periodically reevaluated based on the results of the estimates of financial and compliance risk.	Green↑	Green↑

**Green**-Implemented **Yellow**-Progress being made or improvements implemented but not evaluated as of this date

**Red**-Not implemented/no substantial 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. In FY 2002, 50 percent of the value of 8(a) contracts went to approximately 2 percent of the 8(a) firms, and over half 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.

SBA needs to:

- Emphasize business development so 8(a) firms can compete in the American economy;
- Develop, implement, and enforce criteria defining “business success”;
- Develop new standards for determining economic disadvantage in order to effectively measure diminished capital and credit opportunities—the definition of success included in the law;
- Ensure a more equitable distribution of contracting opportunities to program participants;
- Provide sufficient training to staff responsible for evaluating firms; and
- Determine data needs to support and manage the program, and implement a system that will support the program mission and objectives and enable the Agency to measure program results.

SBA has taken the following actions to address the weaknesses in the 8(a) BD Program:

- Issued a 7(j) grant, whereby the grantee will provide workshops for 8(a) and other firms to develop Individualized Business Development Plans, including training in, and assistance with, obtaining needed business development;
- Tasked the Associate Administrator for BD, via SBA’s FY 2004 Performance Scorecard, to work with Federal agencies so they will distribute their contracts more equitably to 8(a) firms;
- Issued an 8(a) BD Program Standard Operating Procedure, which is expected to be further refined over the next year in order to incorporate improvements recommended by OIG; and
- Drafted a report detailing the program’s data needs. The electronic 8(a) application, which is the front end of a new management information system, is now in the testing phase. Implementation of the entire system is scheduled for 2006.

Actions Needed	Progress
Refocus the 8(a) BD program to emphasize business development.	Yellow
Develop criteria defining “business success.”	Red
Graduate participants once they reach those levels defined as “business success.”	Red
Develop a mechanism that ensures contracting opportunities are more equitably distributed to 8(a) BD program participants.	Yellow
Redefine “economic disadvantage” using objective, quantitative, qualitative, and other criteria that effectively measure capital and credit opportunities.	Red
Provide sufficient financial and analytical training to business opportunity specialists to enable them to evaluate a company’s business profile and competitive potential.	Yellow
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.	Yellow(New)

Green-Implemented Yellow-Progress being made Red-Not implemented/no substantial progress

**Challenge 8. SBA needs to enforce its rules to deter firms receiving small business set-aside, 8(a), or small disadvantaged business (SDB) price evaluation preference contracts from passing through large portions of the procurement to other firms.**

While SBA has rules restricting the amount of a contract that a company receiving a small business set-aside contract, 8(a) contract, or SDB price evaluation preference may subcontract or “pass through” to other firms, these rules have not been fully adhered to. OIG audits found that large companies received substantial financial benefit through small business set-aside contracts. For example, there were contracts for computer equipment where 80 percent or more of the contract costs were realized by large computer manufacturers. Therefore, the SBA’s mission to help small businesses was not being fully realized and the intended purpose of set-aside contracts was not being met.

SBA has issued regulations that (1) include a new standard for value-added resellers and (2) address the definition of manufacturing. These regulations were effective January 28, 2004, and June 21, 2004, respectively. If existing and recently issued regulations are properly administered and enforced, they should preclude agencies from counting a procurement as a small business procurement when participants make only minor (or no) modifications to the products of large and other manufacturers. After the new regulations have been in effect for at least a year, we will determine whether this challenge has been resolved.

Action Needed	Progress
Tighten the definition of “manufacturing” to preclude the practice of making only minor modifications to the products of large and other manufacturers.	Yellow

**Green**-Implemented **Yellow**-Progress being made **Red**-Not implemented/no substantial progress

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

Fraud in the business loan program continues to be a problem, with loan packagers and other for-fee agents frequently playing a role with limited, or no, oversight by SBA. Although the loans involving fraudulent loan agent schemes that have been identified thus far represent a small percentage of SBA’s total portfolio, they have involved hundreds of millions of dollars. Due to the fact that SBA does not have an effective mechanism for ensuring disclosure of loan agents, or a database containing such information, the scope of the problem is unknown. Without corrective measures, the Agency leaves itself vulnerable to potential risk. If SBA systematically identified loan agents, it could track loan agents’ association with individual loans in order to identify patterns of potentially fraudulent behavior and prevent further harm. Several years ago, SBA drafted a modification to an existing compensation agreement (SBA Form 159) in order to gather identification information from loan agents. Unfortunately, this effort was never completed.

A previous “action needed” item that was identified in the FY 2004 OIG report on management challenges stated that loan agents should be *required* to provide SBA with the information and releases necessary to conduct criminal background checks. The OIG has eliminated this action item for now, but reserves the right to reinstate it at a future point.

Regarding the remaining “action needed,” SBA has begun to implement its E-Tran system, which is designed to collect loan data electronically from lenders who *voluntarily* participate. The Agency has reserved data fields for names and addresses of loan packagers and brokers. However, it is not clear whether lenders will provide the names of individual loan agents, their firms’ names, or—as was shown in one case—just the names of the lender’s own employees. Other than an individual’s name, data fields for the most definitive identifiers—date of birth, place of birth, and Social Security Number—have not been reserved. Thus far, relatively few lenders have signed up to use E-Tran, although some are large lenders. In addition, there is evidence of early data quality problems. The Agency is also not yet certain how it will obtain loan agent information from lenders that do not participate in E-Tran. According to the Chief Operating Officer, SBA will ask for loan agents’ identifying information on a *voluntary* basis, and obtain Office of Management and Budget approval and public comments for this new information collection. The Agency will also work with banks (and presumably other lenders) to ensure that E-Tran information is valid and reliable, and will solve existing E-Tran data quality problems. Nevertheless, unless SBA requires disclosure of basic loan agent information, e.g., name and address of the company and names of the individuals involved, and compiles this information in a database, it will not be able to make substantial progress in this area. In addition, SBA should seek voluntary disclosure of each loan agent’s Social Security Number, date of birth, place of birth, and the tax identification number of his/her firm.

Action Needed	Progress
SBA systematically identifies all loan agents and tracks their association with individual loans. This process would include requesting the provision of loan agents’ personal identifiers on a voluntary basis and maintaining this data in an electronic database.	Red

Green-Implemented Yellow-Progress being made Red-Not implemented/no substantial 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—is breaking down. This system is critical because it is the primary means for managing billions of dollars in loan guarantees and other financing, as well as a variety of other programs. Expired Policy and Procedural Notices continue to be used, while drafts of proposed Standard Operation Procedures (SOP) are sometimes used prior to undergoing Agency clearance procedures. In other cases, directives that have become obsolete are not updated. Unless corrective actions are taken, SBA employees and participants in SBA programs will continue to exhibit confusion about applicable procedures and interpret Agency requirements in an inconsistent manner. In addition, the resulting uncertainty can waste time and money, delay service delivery to small businesses, create a negative public image, and produce unforeseen consequences.

The overall directives system needs to be significantly 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 calls 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.

In addition, SBA had circulated internally a draft policy notice to revise the clearance procedures for future permanent and temporary directives. Although the notice was cleared by most SBA offices, it was never issued. Consequently, the Chief of Staff at the time issued an executive memorandum directing offices to put into clearance SOP revisions and incorporate all relevant temporary directives pertaining to permanent policy changes into their SOPs by March 30, 2004. Some directives were hastily placed into clearance, with a corresponding decrease in quality. The process has since slowed.

Nonetheless, according to SBA officials, program offices continue to revise their SOPs to incorporate outstanding temporary directives. The working group is completing the new SOP that governs directives management. This SOP was scheduled to be ready for clearance on September 30, 2004. Moreover, the working group plan has recommended that any new SBA program should have an SOP in place within ten months of the program’s effective date. Finally, SOPs not previously available on SBA’s Web site are being scanned in electronically to make them more accessible to users.

Action Needed	Progress
Fully implement a revision of SBA’s directives system, including revising out-of-date directives and implementing an ongoing periodic review mechanism to ensure they are kept up-to-date.	Yellow
<span style="color: green;">Green</span> -Implemented <span style="color: yellow;">Yellow</span> -Progress being made <span style="color: red;">Red</span> -Not implemented/no substantial progress	

**Challenge 11. The current structure and oversight practices of the SBIC program place too much risk on taxpayer money.**

SBIC program officials estimate that, given the rapidly mounting losses in the portfolio, the cumulative cost of the program to the Federal Government is projected to be almost \$2 billion on an outstanding portfolio of \$5 billion. Although the venture capital industry is designed to assume substantial risk in support of new and growing businesses, the structure of the SBIC program and funding process has contributed significantly to losses in recent years. SBA’s “profits” are not proportional to the investment that the agency makes in SBICs, and insufficient incentives exist to encourage SBICs to pay back principal debt to SBA as quickly as possible. Moreover, the subsidy model underestimates the cost of the program, with the technical assumptions more optimistic than actual performance.

Over the last 10 to 15 years, GAO and the OIG have found that SBA’s policy of allowing extensive time for financially troubled SBICs to attempt rehabilitation has allowed SBIC assets to decrease and reduced SBA’s potential for recovery. SBA’s policy of allowing capially-impaired SBICs to charge significant management fees and the way SBA applies distributable gains from SBICs also contribute to program losses. The SOP for the SBIC program has not been revised since March 1989, and existing guidance does not provide a systematic approach for estimating the level of financial risk, ensuring the implementation of restrictive operations, transferring capially impaired SBICs to liquidation status, or liquidating SBICs receiving participating securities.

According to program officials, actions are being taken which will strengthen the assessment and management of financial and regulatory risks inherent in the program. A new SOP is in the clearance process. SBA has also submitted a legislative proposal to Congress to increase its fees and share of profit earnings, and improve the program’s ability to limit risk and prevent major avoidable program losses. It has not been passed by the Congress as yet. Although such legislation would be helpful, the Agency should act to limit program losses without waiting for legislative revisions. For example, while capially impaired participating securities SBICs have been transferred to liquidation, timely actions have not been initiated to commence their liquidation. Officials should continue to pursue legislative reforms and implement procedures to bring about effective and timely liquidation of capially impaired SBICs.

Actions Needed	Progress
Revise the subsidy model estimation methodology to develop more realistic technical assumptions.	Yellow↑
Submit and pursue legislative proposals that will more effectively protect the Federal Government’s financial interest, by appropriately increasing fees and SBA’s share of profit earnings, and by placing SBA in a more favorable position for maximizing recoveries.	Green↑
Develop and implement management fee policies that will slow the erosion of assets of capially impaired SBICs.	Green↑
Provide documented analysis justifying the need for the: (1) concept of forbearance, (2) forbearance periods, and (3) capital impairment percentages.	Yellow↑
Implement more systematic criteria and a more timely approach for transfers to liquidation.	Yellow
Develop and implement an effective control process for liquidating participating securities.	Red
Include in a revised SOP the items recommended in the OIG’s FY 2003 SBIC audit to:	Yellow
<ul style="list-style-type: none"> <li>• perform and document quarterly risk assessments, including an analysis of repayment potential, and recommended actions, and</li> </ul>	Yellow
<ul style="list-style-type: none"> <li>• ensure the timely and consistent implementation of restrictive operations.</li> </ul>	Yellow

Green-Implemented Yellow-Progress being made Red-Not implemented/no substantial 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:

- GAO, *Status of Achieving Key Outcomes and Addressing Major Management Challenges*, Report # GAO-01-792, June 2001.
- SBA OIG, *Results Act Performance Measurement for the Section 8 (a) Minority Small Business and Capital Ownership Development Program*, Report # 1-11, March 27, 2001.
- SBA OIG, *Results Act Performance Measurement for the Disaster Assistance Program*, Report # 1-06, February 15, 2001.
- SBA OIG, *Results Act Performance Measurement for the Section 7(a) Business Loan Program*, Report # 1-01, December 4, 2000.
- SBA OIG, *Advisory Memorandum: Data Issues Regarding the Processing Centers*, Report #00-09-01, September 28, 2000.
- SBA OIG, *Coordination and Performance Measurement in SBA's Entrepreneurial Development Programs*, Report #00-09-02, September 28, 2000.
- SBA OIG, *Results Act Performance Measurement for the Surety Bond Guarantee Program*, Report #0-26, September 25, 2000.
- SBA OIG, *Results Act Performance Measurement for the Small Business Investment Company*, Report #0-25, September 6, 2000.
- SBA OIG, *Audit of SBA's FY 2003 Financial Statements, Management Letter*, Report #4-17, March 23, 2004

### Challenge 2:

- *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 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/departmentsupdates12.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, *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.
- SBA OIG, *Business Loan Guarantee Purchases*, Report #7-5-H-011-026, September 30, 1997.

### **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, *NOAA Computer Workstation Contracts*, Report #87H002017, June 18, 1998.

### **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.

### **Challenge 11:**

- 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.