

U.S. SMALL BUSINESS ADMINISTRATION

OFFICE OF INSPECTOR GENERAL

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

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

**OFFICE OF
INSPECTOR GENERAL**

December 30, 2003

MEMORANDUM

TO: Hector V. Barreto
Administrator

FROM: Harold Damelin
Inspector General

SUBJECT: SBA's Top Management Challenges for Fiscal Year 2004

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) 2004. 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 – we believe that all are critical management issues facing the Agency.

Our report is based on specific OIG, General Accounting Office (GAO), or other official reports, as well as our general knowledge of SBA's programs. Our analysis considers Agency actions through December 1, 2003.

This year's report contains one new challenge, which deals with the need for SBA to update its directives system in order to provide proper guidance and controls over Agency operations. In addition, Challenge 9 has been updated to focus on fraud committed by loan agents.

While SBA has made progress on many of the challenges, much remains to be done. By their nature, the top challenges require long-term commitment and attention by the Agency. We have only recently seen a rising level of attention placed on some of the challenges. While this is encouraging, SBA needs to continue to expand its efforts to address these critical issues.

This report will be incorporated into the SBA's FY 2003 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 Government Performance and Results Act of 1993 (GPRA) was passed in order to improve Federal program effectiveness and public accountability by promoting a new focus on results, service quality, and customer satisfaction. Reliable performance data that measures the results of SBA programs and the related costs of delivering those results are the cornerstone of an effective performance-based results-driven organization. However, SBA has not fully implemented performance-based management processes that use cost information to monitor and manage program activities and ensure that intended results are achieved efficiently and effectively. For example, OIG audits and inspections found that SBA's performance measures had not been well defined and had not been properly integrated into the Agency's budget submissions and the management and operation of the Agency. In addition, SBA could not ensure the accuracy and reliability of its performance data for major Agency programs.

The OIG believes that the Agency has made progress toward this challenge in the last year. SBA has recently adopted a revised Strategic Plan, developed output and outcome measures, and implemented a mechanism – an Intranet application, “SBA Execution Scorecard” – to report on the status of measuring its performance. However, the Agency needs to make greater efforts in verifying and validating data and ensuring that its resources are monitored and aligned with its recently adopted Strategic Plan.

Actions Needed	Progress
<i>Top management provides positive and supportive attitude toward performance-based management focused on managing for results.</i>	
Top management provides leadership to coordinate the Agency's managing for results program and commits sufficient resources to support the leadership effort.	Yellow
Strategic plan is ratified and reflects top management's vision and direction.	Green
• Appropriate Agency program goals and objectives are established.	Green
• Appropriate performance measures and indicators are established.	Green
• Program managers support SBA's strategic plan, performance goals, and objectives.	Yellow
• Training programs are provided to managers and others responsible for implementing the performance results requirement.	Yellow
Management provides adequate resources to support processes necessary to have an effective performance-based and results-driven operation.	Yellow
<i>SBA analyzes risks associated with achieving objectives.</i>	
SBA periodically assesses the risk that it may not achieve its goals, and results are used to redirect performance to enhance the successful attainment of goals.	Yellow
Performance outcomes are regularly measured and reflect results attributable to Agency programs and services delivered.	Yellow
<i>Policy and procedures provide guidance to ensure consistency among organizational components.</i>	
Policies and guidelines for developing performance goals, objectives, and measures, and verifying and validating data, are published.	Green
<i>Information is recorded and communicated to management and others who need it to fulfill their oversight and stewardship responsibilities.</i>	
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, OIG, GAO, and SBA’s external auditor all noted an increased number of material 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; however, these efforts have been focused primarily on improving controls over financial statement preparation. SBA still needs to develop and implement improvements to other aspects of its financial management, including accounting for loan asset sales, the disaster subsidy estimate process, and accounting for the Master Reserve Fund (MRF).

The Office of the Chief Financial Officer (OCFO) had actions in process or completed as of December 1, 2003, that were aimed at overcoming this challenge. Although preliminary reviews of these actions indicate that significant progress has been made, the December 1st cut-off date for this report did not allow the external auditor and OIG to fully assess whether the corrective actions will result in SBA overcoming its financial management and reporting challenges.

Actions Needed	Progress
<i>SBA’s financial reporting process provides complete, reliable, and timely financial management information.</i>	
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"> • SBA’s core financial system is able to provide complete, reliable, timely and consistent financial management information. 	Red
<ul style="list-style-type: none"> • SBA meets all deadlines for financial reporting. 	Red
<ul style="list-style-type: none"> • SBA documents all aspects of its financial reporting process. 	Yellow
<ul style="list-style-type: none"> • SBA maintains strong internal control over the financial reporting process to avoid submitting financial statements with misclassifications and errors. 	Yellow
<i>SBA maintains proper accounting for and accountability of the MRF.</i>	
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
<i>SBA maintains control over all aspects of the loan accounting and budgeting processes.</i>	
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"> • SBA investigates and corrects all known errors made in the accounting and budget records from previous loan sales. 	Yellow
<ul style="list-style-type: none"> • 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. 	Yellow
<ul style="list-style-type: none"> • SBA performs the necessary analysis to determine and correct any unexplained decline in the subsidy allowance account. 	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 also increases the risk of fraud, inappropriate disclosure of sensitive data, and disruption of critical operations and services. SBA's information systems do not have the necessary controls to fully ensure their security.

The Chief Information Officer (CIO) is responsible for all facets of enforcing computer security, enterprise architecture, and systems development standards for SBA's 38 major information systems. While the Agency has corrected a number of information security vulnerabilities, its commitment of direct resources to improve computer security, provide technical staff support, and develop security training has been declining. The continuing strain on computer security resources may ultimately result in further weakening of a computer security program that already lacks sufficient controls to fully protect SBA's systems. Also, because of the long-term nature of implementing a security program, completion of final action on some of the recommendations is not scheduled until the FY 2004 to FY 2005 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
<i>SBA's information systems have the necessary general and application controls to fully protect their security.</i>	
Entity-wide security program controls are in-place and operating effectively.	Yellow
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.	Yellow
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.	Yellow
Application completeness controls are in-place and operating effectively.	Yellow
Application accuracy controls are in-place and operating effectively.	Yellow
Application integrity of processing and data file controls are in-place and operating effectively.	Yellow
<i>SBA fully complies with the Federal Information Security Management Act (FISMA).</i>	
Material weaknesses in SBA's computer security program are being addressed and corrected.	Yellow
The SBA's 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 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.	Red
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 operates effectively.	Green
SBA has assessed risks to operations and assets under its control, maintains security plans and performs security tests 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.	Green
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 progress in providing the Agency with the support and tools it needs for transforming SBA's workforce and SBA is making some progress in this transformation. However, employees have not been made aware of major changes that will affect them until after the changes have already been implemented. The lack of Agency employee involvement in the decision-making process and the 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 which (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.	Red
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 process reviews did not consistently detect these non-compliances, resulting in improper payments. Several OIG audits showed that certain lender errors continued to go undetected because SBA did not obtain and review the lenders’ entire loan file during the guaranty purchase review process. The most prevalent lending errors involved repayment ability, equity injection, use of loan proceeds, and collateral. Also, since SBA did not use statistical sampling techniques to select the loans for the quarterly Guaranty Purchase Reviews (GPRs), the results were not reliable for tracking and estimating the level of erroneous 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. However, additional actions are needed to further strengthen the guaranty purchase process and reduce the level of erroneous payments.

Actions Needed	Progress
<i>Top management provides a positive and supportive attitude toward the guaranty purchase process.</i>	
Management establishes an organizational culture where deny and repair actions are used when appropriate.	Yellow
• Adequate resources are devoted to the purchase process.	Yellow
• Adequate training is provided.	Yellow
<i>SBA analyzes risks associated with loan guaranty purchases.</i>	
SBA periodically determines actual or potential risks of erroneous payments.	Yellow
SBA determines level of erroneous payments for the entire loan portfolio.	Yellow
<i>Policies and procedures provide guidance to ensure consistency and accuracy in the purchase process.</i>	
SBA has clear guaranty purchase procedures, which 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
<i>Information is recorded and communicated to those who need it to ensure proper guaranty purchase decisions.</i>	
SBA has a system for sharing information among field offices regarding the basis and justification for repairs, denials, and withdrawals of loan guarantees.	Green
Field offices track the number of guaranty repairs/denials/withdrawals and the information is readily available centrally.	Green
Information is captured on erroneous payments and is accurate.	Yellow
<i>The guaranty purchase process is properly monitored.</i>	
A quality assurance system provides appropriate feedback to improve the purchase process.	Green
Progress in achieving established goals for reducing erroneous payments is monitored.	Yellow
Results of the GPRs, audits, and other reviews are provided to field offices timely and accurately.	Green
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 preeminent 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 program, 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 increases 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 established an Office of Lender Oversight (OLO); completed multiple cycles of PLP reviews and reviews of selected non-PLP lenders; revised the review process for Section 504 Certified Development Companies; conducted safety and soundness examinations of the non-depository Small Business Lending Companies (SBLC); and, implemented a loan monitoring system and risk-based review process to evaluate participants and program risk for its business loans. The effectiveness of the new programs will be assessed this year. Overall, OLO appears to be addressing the elements of its strategic plan and making progress in addressing the actions needed, as described below.

Actions Needed	Progress		
	7(a)	SBIC	504
<i>Top management provides a positive and supportive attitude toward lender oversight.</i>			
The Agency establishes on OLO to implement and manage the oversight of lending partners.	Green	N/A	Green
SBA has a plan for lender oversight.	Yellow	Yellow	Yellow
Training programs exist for implementing the participant oversight process.	Yellow	Yellow	Yellow
Senior management provides adequate resources for the lender oversight program.	Green	Green	Green
<i>SBA analyzes risks associated with achieving objectives.</i>			
A systematic process exists to estimate the level of financial risk on a per loan/investment and participant basis.	Yellow	Yellow	Yellow
A systematic process exists to estimate the level of compliance risk on a per loan/investment and participant basis.	Green	Yellow	Green
Overall program risk is independently reassessed on a recurring basis.	Yellow	Yellow	Yellow
<i>Policies and procedures provide guidance to ensure consistency among organizational components.</i>			
Policy and program guidance for lender reviews exists.	Yellow	Yellow	Yellow
SBA provides guidance and training for new participants and those who demonstrate an unacceptable level of compliance.	Green	Yellow	Green
Uniform policies and procedures have been established for periodic evaluations of participant performance and retention.	Yellow	Yellow	Yellow
<i>Information is recorded and communicated to management and others who need it to fulfill their oversight and stewardship responsibilities.</i>			
SBA has an automated loan monitoring system to capture useful information and effectively monitor risk.	Yellow	Yellow	Yellow
There is effective communication among SBA's internal units.	Green	Green	Green
<i>Monitoring of performance occurs and findings of audits and other reviews are promptly resolved.</i>			
Standardized and periodic reviews of lending activities that address risk are performed.	Yellow	Yellow	Yellow
Systems tracking review results and recommendations are implemented.	Yellow	Yellow	Yellow
<ul style="list-style-type: none"> • The status of each lending partner is periodically reevaluated based on the results of the estimates of financial and compliance risk. 	Yellow	Yellow	Yellow

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 program needs to be modified so that more participating companies receive access to business development and standards for determining economic disadvantage are clear and objective, so that more eligible companies receive 8(a) contracts.

The Section 8(a) Business Development program (8(a) BD program) does not help the largest number of 8(a) companies in need of business development. The primary vehicle to assist 8(a) companies is through contracts with Federal agencies. In FY 2002, 50 percent of the dollar value of 8(a) contracts went to approximately 2 percent of the 8(a) companies, and over half of the companies received no Federal contract benefit. SBA has not placed sufficient emphasis on business development activities to enhance the ability of 8(a) BD participants to compete for contracts and does not adequately ensure that only companies that are owned by economically disadvantaged entrepreneurs and in need of business development remain in the program. In addition, an ever-changing Federal contracting arena, coupled with other socio-economic factors, has created an environment where reengineering of the 8(a) BD program is needed.

SBA needs to:

- Emphasize business development so that the program fulfills its statutory purpose of providing assistance to 8(a) companies so they 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, and
- Provide sufficient training to staff responsible for evaluating companies.

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

- Started a process that will ultimately have 8(a) BD firms attend workshops to develop Individualized Business Development Plans, including training in and assistance with planning to obtain needed business development;
- Tasked the Associate Administrator for Business Development, via the FY 2004 Performance Scorecard, with working with Federal agencies to get them to distribute their contracts more equitably to 8(a) BD firms; and
- Drafted an 8(a) BD Program Standard Operating Procedure (SOP), which is expected to be further refined in FY 2004 in order to incorporate improvements recommended by OIG.

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

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

Challenge 8. SBA needs to clarify its rules intended to deter Section 8(a) Business Development participants from passing through procurement activity to non-Section 8(a) Business Development firms.

The 8(a) BD program is intended to be used exclusively for business development purposes in order to help small businesses owned by "socially" and "economically" disadvantaged persons compete on an equal basis in the mainstream of the American economy. While SBA has rules that restrict the amount of a contract that an 8(a) BD firm may “pass through” to a non-Section 8(a) BD firm, these rules are not fully adhered to. OIG audits found that many non-8(a) BD companies received substantial financial benefit through the 8(a) BD program. 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 the program was not being met.

SBA has taken action to address this issue by developing a proposed regulation that includes a new standard for value-added resellers. This regulation is in the final approval phase. SBA is also developing a size regulation final rule that will modify Sections 121 and 134 of 13 CFR. Among other issues, this rule should address the definition of manufacturing. These proposed changes, if properly administered, could resolve this management challenge. After the proposed changes are implemented, we will determine whether this issue 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. Although the loans involving 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. Without corrective measures, the Agency leaves itself vulnerable to additional risk. Fraud could be reduced by systematically identifying loan agents, obtaining necessary background information, and tracking their association with individual SBA loans. The OIG believes that the statutory framework already exists for SBA to take these preventive measures and has requested a confirming legal opinion from the Agency’s Office of General Counsel (OGC).

Several years ago, the Agency 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. If the Agency systematically identified loan agents and obtained necessary background information, including criminal background checks, it would have access to information on prior criminal activity that could indicate an individual’s propensity to engage in fraudulent activities. In addition, SBA could track loan agents’ association with individual loans in order to identify patterns of potentially fraudulent behavior and prevent further harm to the Agency. SBA has made no progress on this management challenge since it was first issued by the OIG in 1998.

Actions Needed	Progress
Within Privacy Act constraints, SBA requires all loan agents to provide the Agency with the information and releases necessary to conduct criminal background checks.	Red
SBA systematically identifies all loan agents and tracks their association with individual loans. This process would include maintaining identifying data on loan agents 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 (New).

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 SOPs are sometimes used ahead of time. In other cases, directives are simply obsolete. Unless corrective actions are taken, 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. Moreover, according to Agency officials, SOPs previously not on SBA’s Web site are now being scanned in electronically to make them more accessible to employees. In addition, SBA circulated internally a draft policy notice to revise the clearance procedures for future permanent and temporary directives and recently began revising the SOP governing directives management. The new SOP is scheduled to be ready for clearance on September 30, 2004. Finally, the plan 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.

The Agency is in the early stages of actually revising its entire directives system but, if SBA maintains its current momentum on the directives issue, it is likely that by December 2004 it will have made measurable progress.

Actions 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 kept up-to-date.	Yellow
Green -Implemented Yellow -Progress being made Red -Not implemented/no substantial progress	

Additional Information

Since this is a newly issued challenge, the following additional information is being included to further illustrate the problems related to this challenge:

- SBA made \$7.6 million in erroneous payments when it honored the guaranties on a sample of defaulted loans reviewed by the OIG. The Agency’s review process for purchasing defaulted guaranteed loans did not detect numerous lender errors and non-compliances, largely because of the lack of adequate guidance. Agency procedures have not been significantly revised since 1983, while the number of loans made by lenders authorized to make credit decisions without SBA oversight has increased dramatically. Moreover, a survey of SBA loan officers found that most respondents indicated that the SOP needed to be strengthened.
- Since 1992’s major legislative changes, the outstanding leverage held by Small Business Investment Companies (SBICs) had increased from \$805 million to \$4 billion by the end of FY 2001. Yet, existing procedures are outdated and do not effectively minimize program risk. The SOP on oversight and regulation of SBICs has not been revised since 1989, well before the new legislation was enacted. As of December 2003, a revised SOP had not been finalized.

- Although an SOP for the Microloan Program has been in draft over the last 10 years, it has never been issued. Moreover, the guidance on which program staff and participants rely is inadequate.
- In response to lenders and field staff seeking guidance as to whether to comply with a Policy Notice after its expiration date, SBA district office, program, and legal staff offered differing interpretations. The notice instructed SBA employees not to verify the citizenship status of naturalized citizens and had an expiration date of June 1, 2002. Such inconsistency can result in confusion, ineffective service to small businesses, and reduced programmatic accountability.
- SBA regulations did not prohibit a Regional Administrator (RA) from self-authorizing travel. Consequently, the Agency had no independent official determining whether the RA's travel expenses were necessary. Had the new – but as yet unissued – SOP covering travel been in effect at the time, this situation likely would not have occurred. An OIG audit recommended that the Agency issue the new SOP, to include requiring another official to authorize RAs' travel, as well as obtain reimbursement from the RA for unallowable travel payments.
- District offices are supposed to review Section 8(a) firms' business plans annually. A Procedural Notice on the annual review process had an expiration date of May 1, 1996. According to one official, while the notice technically is not in effect, it is still being used until a new SOP is issued. Consequently, the program is using an old directive that may be functionally obsolete.
- A draft SOP for small purchases, grants, and cooperative agreements was prepared in August 1998. Staff members have been directed to follow the draft SOP even though it has not been cleared by SBA offices or formally issued with an effective date. Thus, Agency employees are making official decisions based on a document that technically has no official authority and could be significantly changed.

Appendix 1: Relevant Reports

Most of the SBA OIG reports listed can be found at: 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*, Audit Report # 1-11, March 27, 2001.
- SBA OIG, *Results Act Performance Measurement for the Disaster Assistance Program*, Audit Report # 1-06, February 15, 2001.
- SBA OIG, *Results Act Performance Measurement for the Section 7(a) Business Loan Program*, Audit Report # 1-01, December 4, 2000.
- SBA OIG, *Advisory Memorandum: Data Issues Regarding the Processing Centers*, Inspection Report #00-09-01, September 28, 2000.
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