SMALL BUSINESS ADMINISTRATION

OFFICE OF INSPECTOR GENERAL

FY 2002

AGENCY MANAGEMENT CHALLENGES

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

OFFICE OF
INSPECTOR GENERAL

January 16, 2002

MEMORANDUM

TO: Hector V. Barreto
Administrator

FROM: Phyllis Fong
Inspector General

SUBJECT: FY 2002 Update of the Most Serious Management Challenges

I am pleased to submit the Office of Inspector General's (OIG) report on the most serious management challenges facing the Small Business Administration (SBA) in FY 2002. In accordance with the Reports Consolidation Act of 2000, we are providing it to SBA for inclusion in the Agency's FY 2001 Performance and Accountability Report. As with previous Congressional requests for Agency challenges, we have given our current assessment of Agency programs or activities that pose significant risks, including those that are particularly vulnerable to fraud, waste, error, or mismanagement. Our report is based on specific OIG, General Accounting Office, or other official reports, which are referenced in the individual sections, and our general knowledge of SBA programs

The current list updates the ten challenges we submitted last year. The first four focus on Agencywide issues that are critical to SBA's goal of modernizing the Agency—managing for results, modernizing SBA's information systems for loan monitoring and financial management, improving information systems security, and managing human capital. Other challenges are more program specific.

This year we have further developed the "Actions Needed" sections, half of which are based on the Federal internal control model, and made them more specific in order to clarify the issues. In an attempt to reach a common understanding on what is needed to address the challenges, we developed them with substantial input from SBA officials. The Agency's comments helped us ensure all points of view were given careful consideration and the narrative discussions are factually accurate.

This year OIG has also added a scoring system for the “Actions Needed” section of the report. It evaluates the status of SBA management actions as of the end of December. The system is as follows.

1–Action has been implemented
2–Progress is being made
3–The action has not been implemented/no substantial progress is being made

SBA made substantial progress on the FY 2001 managing for results challenge by developing the needed guidance, procedures, and surveys. The focus of this challenge for FY 2002 has since shifted, however, to implementing and using the guidance developed; progress in these areas is limited.

The Agency appears to be making some progress on five other challenges. These include improving information security controls, modernizing information systems, implementing human capital management strategies, business loan guarantee purchase controls, and improving lender oversight.

There has been no measurable progress in addressing the challenge on preventing loan agent and borrower fraud, or on the three Section 8(a) Business Development (BD) Program challenges—access to business development and contracts, clearer standards for economic disadvantage, and pass-through procurement activity. Except for some updating and clarification, the Section 8(a) BD challenges remain essentially the same as in previous years. In our view, the problems identified in these challenges limit the program’s potential for developing minority businesses because the Agency does not give sufficient emphasis to business development assistance, some participants continue to receive benefits after they are no longer qualified for the program, and many benefits pass through to large businesses.

During FY 2001, OIG and the Office of the Chief Financial Officer (OCFO) worked together to develop a periodic reporting and assessment process for tracking SBA progress in addressing these issues. The OCFO has developed a database of this progress and assessment information for internal Agency use. OIG will continue to work with the Administration, SBA program managers, and the OCFO to focus attention on these critical issues.

If you or your staff have any questions, please do not hesitate to call me or Peter McClintock, Deputy Inspector General, at (202) 205-6586.

Attachment

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

Summary **-** *SBA needs to develop effective outcome measures, ensure that its performance data are accurate and reliable, and establish systems to manage for results. The Agency has taken steps to identify more program outcomes, improve performance measures, and increase the accuracy of its data. SBA still needs to implement the Agencywide guidance issued in July 2001 for preparing more effective performance goals and indicators, and ensuring that standards and procedures for data verification, validation, client surveys, and other methods to obtain outcome information are fully implemented.*

Actions Needed	Progress
Top management provides positive and supportive attitude toward performance based management focused on managing for results.	
• Top management provides leadership to coordinate the Agency's managing for results program and has designated sufficient resources to support the leadership effort.	2
• Strategic plan is ratified and reflects top management's vision and direction.	3
-- Appropriate Agency program goals and objectives are established.	3
-- Appropriate performance measures and indicators are established.	2
-- Program managers support SBA's strategic plan, performance goals, and objectives.	3
-- Training programs are provided to managers and others responsible for implementing the performance results requirement.	3
• Management provides adequate resources to support processes necessary to have an effective performance-based and results-driven operation.	2
SBA analyzes risks associated with achieving objectives.	
• 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.	2
• Performance outcomes are regularly measured and reflect results attributable to Agency programs and services delivered.	3
Policy and procedures provide guidance to ensure consistency among organizational components.	
• Policies and guidelines for developing performance goals, objectives, and measures, and for verifying and validating data are published.	1

Information is recorded and communicated to management and others who need it to fulfill their oversight and stewardship responsibilities.	
• Managers have and use operational and financial data to assess their progress in meeting Agency goals, and ensure accountability for effective and efficient use of resources.	2
• Performance data are verified and validated.	3
Monitoring of performance occurs and findings of relevant audits and other reviews are promptly resolved.	
• Top level review and tracking of major Agency achievements occurs, and comparisons are made to plans, goals, and objectives.	2
• Feedback process is used to improve performance goals, measures, and accuracy of data.	2

Legend:
1–Implemented
2–Progress being made
3–Not implemented/no substantial progress

Background

SBA has three major goals: (1) Help small businesses succeed, (2) help businesses and families recover from disasters, and (3) improve internal SBA management. To comply more fully with the Government Performance and Results Act (GPRA), SBA needs to develop appropriate outcome measures, improve the accuracy and completeness of its data, and institute managing for results processes throughout the organization. SBA reports that it is moving away from output measures, has identified outcome goals and targets of performance, and improved its reporting of results.

The Senate Governmental Affairs Committee identified three "key outcomes" in SBA's FY 2000 Performance Report and asked GAO to evaluate how well SBA performed during FY 2000. GAO found that in SBA's FY 2000 Performance Report its reported progress in achieving its outcomes is mixed. GAO had difficulty assessing SBA's progress due to weaknesses in its performance measures and data. GAO was unable to assess SBA's strategies for achieving its outcomes because SBA's plan and report lack either an explanation of how the strategies relate to the outcomes or a discussion regarding strategies for the outcome. Specifically, GAO determined the following.

- Planned outcome - Assist small businesses to become self-reliant and successful in the competitive marketplace. SBA's success in achieving this outcome is mixed. SBA's performance indicators provide little performance information on the self-reliance and success of small businesses or on SBA's contributions to this outcome. Because of the lack of explanation in the plan and report regarding how SBA's strategies for this outcome relate to helping small businesses succeed, GAO was unable to assess whether the strategies are clear and reasonable.

- Planned outcome - Ensure that businesses and families recovering from disasters receive timely assistance. SBA reported that it met its FY 2000 goal of providing timely service to disaster victims, yet GAO has concerns about the quality of SBA's performance measures.

- Planned outcome - Ensure that more eligible small businesses participate in SBA programs and become more successful. SBA's reported success varied in achieving the portion of this outcome regarding having more eligible small disadvantaged businesses participate in its programs.

It was not possible for GAO to determine SBA's progress in helping more eligible small disadvantaged businesses become more successful because SBA has not developed performance measures that assess the success of its key programs in this area. GAO indicated that SBA has discussed its strategies for this outcome as a part of its outcome of helping businesses succeed.

A team of analysts from the Mercatus Center at George Mason University also ranked the FY 2000 Performance Reports of the 24 Chief Financial Officers Act agencies. Rankings were based on whether (1) Agency accomplishments were reported in a transparent fashion, (2) the report focused on documenting the Agency's tangible public benefits, and (3) there was evidence of forward-looking leadership that uses performance information to devise strategies for improvement. SBA received 36 out of a possible 60 points, ranking it 8th of the 24 Agencies.

OIG audits and inspections have focused on SBA's implementation of performance measurement requirements and the reliability of the performance data for major Agency programs. The five audits completed to date have found that SBA's performance measures and data accuracy could be improved. For example, the Surety Bond Guaranty (SBG) audit found that the program's performance data were reliable but recommended improvements in data collection and presentation. A Section 7(a) GPRA audit, however, found that some of the program's performance data are not reliable, due primarily to an absence of effective validation and verification strategies and methods. Moreover, loan quantity indicators used are not a valid measure of output because they measure loans approved rather than actual loans made or disbursed.

The Disaster Assistance GPRA audit found the disaster home loan currency and delinquency rates were misleading because they excluded a large portion of disaster loans and the indicator for effective field presence was not consistently applied. The Section 8(a) GPRA audit found that data concerning the fiscal year the program participant left the program were accurate; however, some performance data were unreliable or incorrectly described.

An FY 2000 OIG inspection of SBA loan processing centers found some uncertainty in the Office of Financial Assistance concerning what constitutes adequate data verification. An inspection of SBA's Office of Entrepreneurial Development (OED) found inconsistencies in counting clients in its small business counseling and technical assistance programs that appeared to overstate the efforts of some service providers. A common unit of measurement was needed. In addition, although it is difficult to attribute outcome measures such as a small business' increased sales or hiring to OED efforts, SBA needed to develop outcome measures to determine the intermediate or long term results of OED services.

Action Taken

- The Agency published Guidelines for Performance Indicators and Data Quality on July 20, 2001. The guidance provides SBA program managers with a context and logical framework for developing useful performance goals and measures. The guidance discusses the balanced score card and the importance of addressing the cost of delivering services.

- SBA has issued the final guidance on how to count OED clients served and client counseling and training sessions. In another OED effort, the University of Michigan surveyed clients of the Service Corps of Retired Executives, Women's Business Centers, and One Stop Capital Shops. Business Information Centers have conducted their own annual client survey.

- ODA has developed a standard definition of effective field presence and issued this guidance to field staff to ensure consistent application.

- SBA has indicated it has conducted risk assessment sessions using the COSO internal control framework throughout SBA and that all offices have completed the internal control checklist and other assessment efforts.

Reports

SBA OIG, *Results Act Performance Measurement for the Small Business Investment Company*, Audit Report #0-25, September 6, 2000.

SBA OIG, *Results Act Performance Measurement for the Surety Bond Guarantee Program*, Audit Report #0-26, September 25, 2000.

SBA OIG, *Results Act Performance Measurement for the Section 7(a) Business Loan Program*, Audit Report # 1-01, December 4, 2000.

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 8 (a) Minority Small Business and Capital Ownership Development Program,* Audit Report # 1-11, March 27, 2001.

SBA OIG, *Coordination and Performance Measurement in SBA's Entrepreneurial Development Programs,* Inspection Report #00-09-02, September 28, 2000.

SBA OIG, *Advisory Memorandum: Data Issues Regarding the Processing Centers,* Inspection Report #00-09-01, September 28, 2000.

U.S. Senate, Governmental Affairs Committee, *Summary of FY 1999 Performance Report Information: Small Business Administration*, June 2000.

George Mason University, Mercatus Center, *Performance Scorecard: Which Federal Agencies Inform the Public*, May 16, 2001.

GAO, *Status of Achieving Key Outcomes and Addressing Major Management Challenges*, Report # GAO-01-792, June 2001.

Significant Open Recommendations

Management has agreed with OIG audit recommendations and issued guidance, but the guidance needs to be fully implemented.

Challenge 2. SBA faces significant challenges in modernizing its major loan monitoring and financial management systems.

Summary *- SBA implemented the Joint Accounting and Administrative Management System (JAAMS) on October 9, 2001. JAAMS is a software acquisition project intended to improve SBA's financial management systems. The previous accounting and financial management system used by SBA was becoming obsolete, and the service provider was planning to shut down the system. SBA had plans to modernize and update its loan information system–Loan Monitoring System (LMS). LMS was initially planned to include a new loan financial tracking system as a replacement to SBA's Loan Accounting System, as well as a loan monitoring, portfolio analysis, and lender oversight system. LMS is on hold awaiting decisions on its future. SBA has made some progress, but needs to formulate and implement sound procedures for system development and software acquisition for all its systems under development.*

Actions Needed	**Progress**	
	JAAMS	LMS
Top management provides a positive and supportive attitude toward adherence to Information Technology (IT) capital investment methodology.		
• Top management designates an official or advisory board to oversee IT capital investment projects, and these projects adhere to the requirements of the Information Technology Management Reform Act (known as the Clinger-Cohen Act of 1996).	1	1
• Employees are trained in fulfilling their responsibilities for managing IT capital investment projects.	2	2
• Management provides adequate resources to support system development projects.	2	2
Top management identifies risks associated with IT capital investment projects.		
• IT projects have risk management programs designed to identify potential risks to the projects and possible risk mitigation plans to minimize identified risks.	2	2
Policies and procedures provide guidance to employees to ensure an effective system development and acquisition process.		
• Policies and procedures are established to define processes for investment selection, control, and evaluation.	1	1
• Procedures provide a systematic process for architecture development and maintenance, and target dates for implementation of the maintenance process.	2	2
• Agencywide use of SBA's Systems Development Methodology (SDM) is institutionalized and enforced.	2	3

• Policies, procedures, and processes address areas such as requirements management, project planning, project tracking and oversight, software quality assurance, configuration management, acquisition planning, solicitation, contract tracking and oversight, product evaluation, and transition to support.	2	2
• Policies and procedures mandate effective communication of project progress to project participants, stakeholders, and SBA management.	2	2
• Policies and procedures ensure that systems are adequately documented and tested before those systems are implemented.	2	2
• Proper evaluation of prototype software and documentation is defined by procedure before the prototypes are put into production. Specifically for LMS, a decision is made to consider whether the software should be separated from LMS and implemented, separated from LMS and further modified to meet mission needs, or held in suspense until all LMS requirements and plans have been completed.	N/A	3

Legend:
1–Implemented
2–Progress being made
3–Not implemented/no substantial progress

Background

SBA needs to ensure that its planned systems for loan monitoring and lender oversight are developed, integrated, and implemented efficiently and effectively, so that intended objectives are achieved and risks are minimized. These risks relate primarily to a wide range of functional and regulatory requirements, including systems security, data integrity, electronic records management, and cost control.

In 1998, SBA initiated the Systems Modernization Initiative (SMI) for modernizing its major information systems. SMI included JAAMS and LMS, as well as other systems development efforts. In 2001 SBA eliminated SMI as an initiative. SBA began implementing JAAMS in FY 2000. JAAMS capabilities for financial management and administrative activities, including accounting, budgeting, and financial reporting, were implemented in October 2001. JAAMS capabilities for contract and grants management, human resources, and payroll have not been implemented and are on hold at this time.

SBA's systems to capture and summarize information needed to provide the Agency with data for loan monitoring are not as efficient and technologically advanced as they could be. To support its credit programs, SBA began to develop LMS to address challenges such as higher levels of lending activity, increased lender authority and responsibility, outsourcing of loan servicing, credit reform, and loan asset sales. Development of LMS was stopped in FY 2001 pending decisions on its future. A recently completed GAO review of LMS concluded that the development and implementation of software was not consistent with the Small Business Reauthorization Act of 1997, and SBA's agreement with the House Committee on Small Business not to acquire hardware or software before completing systems development planning for LMS.

While SBA has taken some steps in establishing required policies in the Office of the Chief Information Officer (OCIO), SBA has no Standard Operating Procedure (SOP) which covers the broad areas of systems development or acquisition. Such an SOP should include policies, procedures, and processes needed to address areas such as requirements management, project planning, project tracking and oversight, software quality assurance, configuration management, acquisition planning, solicitation, contract tracking and oversight, product evaluation, and transaction support. Additionally, a comprehensive SOP would be a framework for aiding other SBA offices as they begin the process of managing new systems.

Action Taken

- SBA has taken steps to strengthen and institutionalize its "Information Technology (IT) Planning and Investment Control Process," to improve selection and control of IT projects in a portfolio environment, and to improve formulation of the IT budget. This should help the Agency meet the requirements of the Clinger-Cohen Information Technology Management Reform Act.

- To address past criticisms and help support its strategic goals, OCIO recently developed and has started implementing SDM. SDM is a set of procedures and quality controls intended to reduce risks in the development of new information systems and ensure that new systems function as intended by owners and stakeholders. SDM needs to be codified in an SBA SOP.

- The Agency has completed an IT architecture document and established procedures for its maintenance. The IT architecture document needs to be codified in an SBA SOP.

- SBA has developed configuration management procedures. However, these procedures need to be codified in an SBA SOP.

Reports

GAO, *Loan Monitoring System: SBA Needs to Evaluate Use of Software*, GAO-02-188, November 30, 2001.

SBA OIG, *Advisory Memorandum Report: Developing the Loan Monitoring System,* Audit Report #A1-03, February 23, 2001.

GAO, *Financial Management: Status of Financial Management Issues at the Small Business Administration*, GAO/AIMD-00-263, August, 29, 2000.

GAO, *Information Technology Management: SBA Needs to Establish Policies and Procedures for Key IT Processes*, GAO/AIMD-00-170, May 31, 2000.

GAO, *SBA Loan Monitoring System: Substantial Progress Yet Key Risks and Challenges Remain,* GAO/AIMD-00-124, April 25, 2000.

SBA OIG, *SBA's Proposed Systems Development Methodology*, Audit Report #0-15, March 30, 2000.

Significant Open Recommendations

SBA has accepted all significant recommendations in this area. Continued efforts, however, are needed to implement them into day-to-day operations.

Challenge 3. Information systems security needs improvement.

Summary - *SBA operations depend heavily on the Agency's information systems, and the security of those systems is critical. The Agency has made a substantial commitment of resources for enhancing computer security, providing technical staff support, and developing security training. SBA needs to fully implement its Agencywide systems security program to include assessing risks, establishing and updating policies and controls, promoting awareness, and evaluating security effectiveness.*

Actions Needed	Progress
SBA needs to fully implement and maintain an ongoing information security program aimed at understanding and reducing its information security risks. This program should include assessing risks, implementing appropriate policies and controls, promoting awareness, and monitoring and evaluating policy and control effectiveness.	
• The Chief Information Officer (CIO), in conjunction with appropriate program offices, develops and implements procedures for monitoring, assessing, and measuring security program effectiveness.	2
• The CIO develops procedures to require review and approval of all proposed changes to server configurations.	2
• The CIO, in conjunction with appropriate program offices, identifies and eliminates incompatible duties, responsibilities, and functions.	2
• The CIO, in conjunction with appropriate program offices, develops a disaster recovery and contingency test plan and expedites a review for storing backup and recovery tapes.	2
SBA needs to complete planning and assessment activities to protect its critical infrastructure as required by Presidential Decision Directive (PDD) 63.	
• The CIO develops a multi-year funding plan.	1
• The CIO includes infrastructure assurance functions in the strategic planning and performance measurement framework.	1
• The Chief Information Assurance Officer coordinates physical infrastructure protection efforts with the General Services Administration.	2
SBA needs to comply with the Government Information Security Reform Act (GISRA).	
• The CIO completes risk assessments and security plans for SBA's high-priority and cyber-based systems. Once the vulnerabilities are identified in the risk assessments, the system owner should accept, correct, or mitigate the risk to SBA systems.	2

• The CIO completes a formalized management control process to formally act on risks identified from risk assessments. The management control process includes a schedule to correct identified deficiencies, dates for completion, and funding requirements.	3
• The CIO develops a program to perform Security Test & Evaluation (ST&E) reviews on all of SBA's high-priority computer systems.	3
• The CIO identifies Agency personnel who should be required to undertake security training as end-users, Designated Security Officers (DSO), Information Resource Managers (IRM), and back-up personnel; and requires those individuals to take the course on DSO/IRM security training.	2
SBA's UNIX computer servers need to be more secure and meet Federal and Agency security standards.	
• SBA remedies a number of security vulnerabilities identified in the audit of SBA's UNIX servers. These include password vulnerabilities, non-review of system audit logs and configuration files, and a lack of adequate system patching.	2

Legend:
1–Implemented
2–Progress being made
3–Not implemented/no substantial progress

Background

SBA's programs and activities depend heavily on computerized systems. The Agency is engaged in several initiatives, such as paperless loan applications, use of digital signatures, expanded internet access, and electronic data interchange, that will increase its reliance on such systems. While information technology can result in a number of benefits, such as information being processed quickly and communicated almost instantaneously, it also increases the risk of fraud, inappropriate disclosure of sensitive data, and disruption of critical operations and services.

In 1997, the General Accounting Office (GAO) designated information security as a Governmentwide high risk area because of growing evidence indicating that controls over computerized operations were not effective and risks were increasing. The FY 2000 audit of SBA's financial statements and the FY 2001 audit of SBA's implementation of PDD 63 disclosed that significant progress had been made in SBA's computer security program. Additionally, the FY 2001 audit of SBA's Computer Security Program for GISRA found that SBA generally maintains a satisfactory information security program for its high priority financial management and general support systems. However, improvements are still needed in the areas of entity-wide security program planning, segregation of duties, computer security testing, computer access controls, and disaster recovery and contingency planning. Also, improvements in physical security (such as better coordination with the General Services Administration) are needed to ensure the protection of SBA's physical infrastructure.

Action Taken

Examples of actions SBA has taken since 1999 include:

- Eliminated the "Material Weakness" finding in computer security in FY 2001;

- Committed over $1.2 million in personnel and contract support to enhance the Agency's computer security program;

- Issued an updated computer security policy document that incorporated security policies covering the latest Agency technology, including client servers, e-mail, and the Internet;

- Documented the computer security program and produced guidance documents and templates for the performance of computer security functions within the Agency;

- Completed Certification and Accreditation reviews for 38 of the most sensitive systems;

- Developed a security training program; and

- Continued work on developing critical infrastructure protection and security plans required by PDDs 63 and 67.

Reports

SBA OIG, *Audit of SBA's UNIX Operating Systems*, Audit Report #1-21, September 28, 2001.

SBA OIG, *Audit of SBA's Computer Security Program,* Advisory Memorandum Report #A1-06, September 28, 2001.

SBA OIG, *Audit of SBA's FY 2000 Information Systems Controls,* Audit Report #1-12, March 27, 2001.

SBA OIG, *Audit of SBA's Planning and Assessment for Implementing Presidential Decision Directive 63, Phase III,* Audit Report #1-09, March 26, 2001.

Significant Open Recommendations

All of the audit reports listed above include a number of specific recommendations aimed at implementing an Agencywide information systems security program. As described above under Action Taken, the Agency has taken a number of steps to improve its information systems security program. 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 2002 to FY 2004 time frame. The OIG will be performing further audit work to evaluate the Agency's ongoing efforts at establishing an information security program.

Challenge 4. Maximizing program performance requires that SBA fully develop and implement its human capital management strategies.

Summary - *The nature and scope of SBA's work has changed significantly, requiring a different set of skills in the Agency's workforce. SBA has begun to take the steps necessary to better manage its human capital activities, but needs to do more. The Agency must define what the future SBA will look like. The Office of Human Resources, in partnership with the program and district offices, should then develop a comprehensive human capital strategy that will identify SBA's current and future human capital needs, including the size of the workforce and skill gaps; its deployment across the organization; the knowledge, skills, and abilities needed for the Agency to pursue its missions; and an effective succession planning process.*

Actions Needed	**Progress**				
	CA	ED	GC	MA	DA
Develop and implement a comprehensive human capital strategy that encompasses human capital policies, programs, and practices to guide the Agency and that	◄		3		►
is linked to SBA's strategic goals,	◄		3		►
includes major human capital objectives,	◄		3		►
identifies the milestones and resources needed to implement the strategy, and	3	3	3	3	3
establishes results-oriented performance measures for human capital objectives.	◄		3		►
The human capital strategy should include the following:					
• Identification of the knowledge, skills, abilities, and other characteristics SBA employees will need to perform successfully in the new business environment**.**	◄		3		►
-- Management has analyzed the tasks that need to be performed by SBA today.	2	2	2	2	2
-- Management has analyzed the tasks that need to be performed for SBA's core competencies in the new business environment, completed a gap analysis, and linked the needed tasks to SBA's strategic plan.	3	3	3	3	3
-- Competency models or other means of identifying and defining specific tasks required for job positions have been established and implemented.	2	2	2	3	2
-- An evaluation process for regular assessments of Agency skills has been developed and implemented.	◄		3		►
• An estimate of the number of employees with the identified skills who will be needed in the new business environment.	3	3	3	3	*

<table>
<tr><td>• Adequate training for all employees to perform their jobs well</td><td colspan="5">2</td></tr>
<tr><td>-- There are appropriate orientation and training programs to meet the needs, and minimize skills gaps/imbalances, of all employees–especially those in the core competencies.</td><td>2</td><td>2</td><td>3</td><td>3</td><td>2</td></tr>
<tr><td>-- An evaluation/control mechanism is established and implemented to ensure that all employees have received appropriate training and have the necessary skills.</td><td colspan="5">3</td></tr>
<tr><td>• A comprehensive succession planning process for the Agency, including forecasting SBA's future executive resource needs at both headquarters and in the field.</td><td colspan="5">2</td></tr>
<tr><td>-- The human capital plan includes an analysis of attrition rates, retirement eligibility, and retirement rates for senior managers.</td><td colspan="5">2</td></tr>
<tr><td>-- The Agency has defined the types of leaders it wants through written descriptions of roles, responsibilities, attributes, and leadership competencies, has established broad performance expectations for them, and has implemented them.</td><td colspan="5">2</td></tr>
<tr><td>-- The District Director development program is reestablished and continued with periodic evaluations of its impact and effectiveness.</td><td colspan="5">2</td></tr>
<tr><td>-- The Senior Executive Service Candidate Development Program is reinstated and periodic evaluations of its impact and effectiveness conducted.</td><td colspan="5">3</td></tr>
<tr><td>-- A recruitment, retention, and development plan for lower and middle levels which has explicit links to skill needs the Agency has identified is developed and implemented.</td><td colspan="5">3</td></tr>
</table>

Legend:
(An arrow is used to indicate SBA wide responsibility)
1–Implemented
2–Progress being made
3–Not implemented/no substantial progress
CA–Capital Access
ED–Entrepreneurial Development
GC–Government Contracting/8(a)Business Development
MA–Management & Administration
DA–Disaster Assistance
* Because each disaster is unique, it is not possible to estimate the number of employees needed until the disaster occurs.

Background

Managing and investing in human capital has emerged as a critical issue throughout the Federal Government. Human capital management is especially important for SBA. Over the last decade, small business practices, products, and needs have been transformed and SBA has made major changes in its delivery of goods and services. SBA now uses public-private partnerships to perform the loan origination, servicing, and liquidation functions that SBA personnel formerly handled. At the same time, SBA has decreased its workforce by more than 20 percent and increased the number of Section 7(a) and Section 504 loan approvals from 20,609 in FY 1991 to 48,170 in FY 2001.

To accomplish its vision of "a modernized SBA" capable of adapting to changes in the economy and small business needs, SBA has determined that it must (1) change its core functions to include business outreach, marketing, and improved partner relationship management through outsourcing and increased use of technology; (2) improve internal controls and external program oversight; (3) upgrade and modernize its information systems; (4) use the Internet and e-commerce to increase accessibility to customers when and where they need assistance; and (5) prepare its workforce for the future–especially through training and relocation–to put customers first, make effective use of partnerships and technology, and achieve results.

SBA’s human capital strategy should be closely linked to the goals and objectives of the Agency’s Strategic Plan. Under its FY 2001-2006 Strategic Plan goal of “Modernizing the SBA,” a key objective is “investing in our personnel to create a motivated, creative, competent and productive workforce.” Strategies include: (1) Improving workforce skills by retraining approximately 1,700 personnel; (2) changing workforce deployment, using some workforce relocation; (3) providing succession planning and leadership training; (4) conducting annual personnel surveys; and (5) improving human resource management and information systems.

While SBA has identified some steps to better manage its human capital activities and foster a performance culture, the Agency is still in the early stages of examining its workforce needs. Its efforts and results in workforce planning, leadership, and talent development are limited. In FY 2000, a preliminary staffing analysis of SBA headquarters was conducted. Its emphasis, however, was on current, as opposed to future, needs. The FY 2002 Performance Plan provides for transforming the workforce as an indicator for improving SBA management but does not provide any specifics–goals, objectives, measures, or milestones–for accomplishing that objective.

To develop a comprehensive human capital strategy, the Agency must first define what the future SBA will look like. Identifying and prioritizing the skill sets needed; fully developing an analysis of the skill gaps, including overlapping functions and programs; and implementing a comprehensive strategy will require a collaborative relationship between Agency management, the Office of Human Resources, program offices, and the field. As GAO noted in a January 2001 report, if the Agency does not implement its human capital strategies, "SBA’s attempt to redesign its business processes and transform its workforce is potentially at risk."

Action Taken

SBA has indicated that it will establish a steering committee “to reposition the Agency to allow it to be more responsive to its target market.”

SBA has reported the following actions.

- In FY 2000, completed a workload and staffing analysis of Headquarters.

- Developed competency models for Marketing & Outreach Specialists, Public Information Officers, Lender Oversight and Business Development, and adopted a leadership competency model. With the exception of Business Development, training has begun with the other competencies. A draft program for procurement occupations has been developed.

- To estimate the number of employees in need of skills training, and based on projections that shifts in SBA's human capital needs will likely result in a need for fewer employees, but more personnel with new technology skills, SBA is using: (a) "gap analysis" to compare the skill sets that SBA employees currently possess to the competency models developed; (b) interviews with Associate Deputy Administrators regarding their vision for the future of their organizations; and (c) surveys such as the FY 2000 Agencywide training assessment survey.

- Initiated two developmental programs for succession planning: the Senior Executive Service Candidate Development Program (SESCDP) and the District Director Candidate Development Program. The SESCDP is currently on hold.

- Continued to monitor the developmental progress of the 1998 Presidential Management Interns (PMI), most of whom have graduated, and hired a PMI for the Office of Capital Access.

- Shifted the training focus slightly from emerging functions to fundamental skills training, such as the core skills for carrying out the Agency's mission—business basics and leadership.

  -- More than 135 senior managers and 165 mid-level managers have received leadership training thus far.

  -- SBA offers courses in Practical Personnel Solutions for managing human resources; business basics courses in Commercial Credit Analysis, Advanced Commercial Credit Analysis, Resolution of Problem Commercial Credits, Advanced Resolution of Problem Commercial Credits, Train the Trainer, and Marketing and Outreach; and courses for SBDC Project Officers and Contracting Officers Technical Representatives.

  -- In the area of personnel and administrative basics, training is being offered for Administrative Officers and in retirement planning.

  -- SBA is in the process of developing technology-based training systems to enhance the delivery of skills training using "on-demand," web-based delivery. With sufficient funding, SBA plans to use distance learning techniques.

Reports/Testimony

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.

GAO, *Major Management Challenges and Program Risks: Small Business Administration*, GAO-01-260, January 2001.

GAO, *Small Business Administration: Status of Achieving Key Outcomes and Addressing Major Management Challenges*, GAO-01-792, June 2001.

U.S. Senate, Committee on Governmental Affairs, *Government at the Brink*, Volumes I and II, June 2001.

GAO, *Small Business Administration: Current Structure Presents Challenges for Service Delivery*, GAO-02-17, October 2001.

Significant Open Recommendations

No OIG formal audit or inspection recommendations have been made on this issue.

Challenge 5. SBA needs better controls over the business loan purchase process.

Summary *- OIG audits have shown that SBA field offices do not consistently follow Agency requirements when purchasing guarantees from lenders after loan defaults, resulting in purchases that may not be justified and unnecessary expenditures for the Agency. In response to this concern, SBA reports that it has instituted a guaranty purchase review (GPR) process, implemented a guaranty repair tracking system, established an early warning system, and is in the process of improving procedures and training. The Agency needs to ensure that the guaranty is denied or reduced when a lender fails to comply with SBA requirements by continuing to update and implement changes to improve the guaranty purchase process based on the results of the guaranty purchase reviews. Responsibility for taking actions to improve the purchase process is shared by the Office of Financial Assistance (OFA) and the Office of Field Operations (OFO) with the assistance of the Office of General Counsel.*

Actions Needed	Progress
Top management provides a positive and supportive attitude toward the guarantee purchase process.	
• Management establishes an organizational culture where deny and repair actions are used when appropriate.	2
• Adequate training is provided.	3
SBA analyzes risks associated with loan guarantee purchases.	
• SBA periodically determines actual or potential risks of improper guaranty purchases.	2
• SBA determines level of improper payments for the entire loan portfolio.	3
Policies and procedures provide guidance to ensure consistency and accuracy in the purchase process.	
• SBA has clear guaranty purchase procedures, which provide for consistent interpretation.	2
• Current guidance describes adequate documentation needed to make purchase decisions.	3
• Lenders are informed of required documentation to submit with the guaranty purchase request.	2
• Goals are established for reducing improper guaranty purchases.	3
Information is recorded and communicated to those who need it to ensure proper guarantee purchase decisions.	
• SBA has a system for sharing information among field offices regarding the basis and justification for repairs, denials, and withdrawals of loan guarantees.	3
• Field offices track the number of guaranty repairs/denials/withdrawals and the information is readily available centrally.	1
• Information is captured on improper payments and is accurate.	2

The guarantee purchase process is properly monitored.	
• A quality assurance system provides appropriate feedback to improve the purchase process.	2
• Progress in achieving established goals for reducing improper purchases is monitored.	3
• Results of the GPRs, audits, and other reviews are provided to field offices timely and accurately.	2
• Problems identified by the audits and reviews are resolved timely.	2
• Information on all loans with identified guaranty purchase issues are flagged in the Delinquent Loan Collection System.	2

Legend:
1–Implemented
2–Progress being made
3–Not implemented/no substantial progress

Background

A 1997 audit and an on-going audit of business loan guaranty purchases found that SBA did not consistently apply its procedures when purchasing guarantees. Inappropriate purchase activities may result from unclear guidelines or inconsistent application of these guidelines. In addition, OIG believes that inappropriate purchases may occur because of a possible conflict between the competing goals of maintaining good relationships with lenders to increase loan volume, and fully or partially denying a guaranty when the lender has not complied with SBA requirements. The 1997 audit found 17 of 58 (29 percent) of the decisions either were not supported by sufficient documentation to make an informed decision or resulted in paid guaranties when information in the file suggested that the guaranty should have been partially or fully denied. A statistical projection of the audit results indicated that an estimated $102.9 million in purchases were not supported by sufficient documentation at the time the decision was made, and guaranties totaling up to $16.2 million should not have been honored. The current audit, which focuses on loan guarantees purchased from a particular lender, found that the guarantees on 23 of 140 loans purchased by SBA should have been denied in full or part.

Several audits of early defaulted loans have also shown that lenders did not originate the loans in accordance with SBA requirements or prudent lending practices. The most prevalent lender errors involved equity injection, use of proceeds, collateral, and repayment ability.

Action Taken

The GPR was instituted in FY 2000 as a means to improve the guaranty purchase process. Since GPR's initiation, SBA has reviewed approximately 300 guaranty loan purchase decisions in FYs 2000 and 2001. Of the 300 loans reviewed, 48 purchase decisions were questioned and forwarded to OFA for final determination on whether OFA agrees with the GPR teams or the field offices. While the GPR efforts should help improve the guaranty purchase process, the current OIG review of the guaranty purchase process has identified several potential weaknesses.

- *Training for Individuals Reviewing Guaranty Purchases*. Training for individuals reviewing guaranty purchase requests consists of personal experience and on-the-job training by individuals already reviewing purchase requests. The Agency had not developed a training course for individuals responsible for reviewing and recommending actions on guarantee purchase requests. Although a training module is planned, it is not scheduled for completion until June 30, 2003.

- *Sample Selection*. The GPR program was designed to review a random sample of 10 percent of all guaranty loan purchases (up to 300 per year) processed by field offices, including loans identified by OIG as potentially problematic for purchase. The samples selected for GPR reviews have been restricted to loans purchased and charged off within the same 6-month period. Past audits have shown that loans are often charged off well beyond the 6-month period and sometimes take several years before charge off occurs, due to such factors as the amount of collateral attached to the loan and the time it takes to liquidate the collateral. OIG believes the selection process in effect restricts the universe of purchased loans and may limit the lender deficiencies examined by the GPR team. SBA has captured improper payment information using the sample of purchased loans examined during the GPR process. The level of improper payments is not projected to reflect the level of improper payments for the entire loan portfolio.

- *Loans Identified with Potential Purchase Problems*. Loans identified with a guaranty purchase issue are required to be flagged in the Guaranty Repair Tracking System (GRTS). However, not all potentially problematic loans have been entered into the system. For example, loans identified as having a potential guaranty issue during safety and soundness examinations of the Small Business Lending Companies (SBLC) have not been entered. Consequently, loans may be inappropriately excluded from GPRs.

- *Review Limitations*. The GPR team limits its review to the loan files assembled during the purchase review performed in the district offices and uses the existing purchase procedures to conduct its reviews. Also, risk based procedures have not been developed to request lender files during guaranty purchase reviews either by the field offices or the GPR teams to ensure that the purchase of the guaranty is warranted and any lender noncompliance is identified. Past audits have found information in lender files, such as internal correspondence, that indicated lenders did not comply with origination, servicing, or liquidation policies and procedures.

- *Delinquent Loan Collection System*. This system was modified to flag problem loans identified by OIG audits and other oversight reviews such as the Preferred Lender Program and SBLC safety and soundness examinations. Although field office personnel have been instructed on the proper procedures for flagging a loan with an identified potential guaranty purchase issue, not all loans are appropriately flagged.

- *Guaranty Repair Tracking System*. This automated system was implemented in December 2000 with coding enhancements implemented in August 2001. The GRTS was developed to permit Agencywide tracking of lender performance relating to guarantee purchases. Although the system provides monthly paper reports of loans with repairs, denials, and withdrawals, the information is provided only to the headquarters offices. Electronic reports are scheduled to be available to field offices around the end of CY 2001 to assist them in making guarantee purchase decisions.

- *Standard Operating Procedures*. SBA has issued several notices on the GPR and the guaranty repair tracking system. The notices were provided to advise SBA personnel of the GPR and provide instructions on the use of GRTS. The guaranty purchases procedures in Standard Operating Procedure (SOP) 50 50, "Loan Servicing," are being revised to incorporate any policies and procedures needing clarification in light of findings from the GPR and will be incorporated into SOP 50 51, "Loan Liquidation." Since this effort is in the initial stage, we do not have sufficient information to comment on the adequacy of the proposed revisions. OIG will review the proposed revised procedures during the clearance process and will consider the information obtained during the current audit of the guaranty purchase process.

- *Tracking GPR Results*. OFO established a tracking system to follow up on purchases when the review teams disagreed with the actions of the field offices. The system was developed to enable the Agency to track the actions and provide trend data for policy changes and staff training. OIG does not have sufficient information at this time to comment on the adequacy of the tracking system. The tracking system will be evaluated as part of OIG's current audit of the guarantee purchase process.

Reports

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

SBA OIG, *Vincent R. Forshan Medical Corporation,* Audit Report #0-12, March 28, 2000.

SBA OIG, *Dixieland Events/TA Mingo Farms,* Audit Report #0-05, February 14, 2000.

SBA OIG, *Roshni Foods,* Audit Report #0-10, April 23, 2000.

SBA OIG, *MVP Sports Cafe,* Audit Report #1-10, March 9, 2001.

GAO, *Major Management Challenges and Program Risks,* GAO-01-260, January 2001.

Significant Open Recommendations

Management has agreed to take action on all prior OIG audit recommendations, but has not completed the actions.

Challenge 6. SBA needs to continue improving lender oversight.

Summary - *An effective lender oversight program is critical for ensuring lender activities serve Agency objectives and comply with all rules and procedures. The Agency established an Office of Lender Oversight (OLO); completed the third-cycle Preferred Lender Program (PLP) reviews; started the fourth-cycle of PLP reviews, initiated reviews of selected non-PLP lenders; completed the third cycle of safety and soundness examinations of the non-depository Small Business Lending Companies (SBLC); and implemented a review process that ensures all lenders are reviewed periodically and consistently. Congress stopped additional funding and froze existing funds available for the development of a loan monitoring system because of significant changes in scope and dramatic cost increases in the systems modernization initiative. To have an effective oversight program, the Agency needs to develop and implement the loan monitoring system.*

Actions Needed	**Progress**		
	7(A)	**SBIC**	**504**
Top management provides a positive and supportive attitude toward lender oversight.			
• The Agency establishes OLO to implement and manage the oversight of lending partners.	1	1	1
• SBA has a plan for Lender Oversight.	1	2	3
• Training programs exist for implementing the participant oversight process.	2	3	3
• Senior management provides adequate resources for the lender oversight program.	2	2	3
SBA analyzes risks associated with achieving objectives.			
• A systematic process exists to estimate the level of financial risk on a per loan/investment and participant basis.	2	1	2
• A systematic process exists to estimate the level of compliance risk on a per loan/investment and participant basis.	1	2	2
• Overall program risk is independently reassessed on a recurring basis.	3	3	3
Policies and procedures provide guidance to ensure consistency among organizational components.			
• Policy and Program Guidance for Lender Reviews exists.	1	2	2
• SBA provides guidance and training for new participants and those who demonstrate an unacceptable level of compliance.	2	2	3
• Uniform policies and procedures have been established for periodic evaluations of participant performance and retention.	2	2	2
Information is recorded and communicated to management and others who need it to fulfill their oversight and stewardship.			
• SBA has an automated loan monitoring system to capture useful information and effectively monitor risk.	2	2	2
• There is effective communication among SBA's internal units.	3	1	3

Monitoring of performance occurs and findings of audits and other reviews are promptly resolved.			
• Standardized and periodic reviews of lending activities that address risk are performed.	1	1	2
• Systems tracking review results and recommendations are implemented.	2	1	3
• The status of each lending partner is periodically reevaluated based on the results of the estimates of financial and compliance risk.	2	2	2

Legend:
1–Implemented
2–Progress being made
3–Not implemented/no progress being made

Background

SBA is the preeminent gap lender for entrepreneurs in the United States. As a gap lender, SBA necessarily takes more risk than the conventional lender. Since its inception in 1953, SBA has loaned or guaranteed billions of dollars in loans and investments to small business concerns. To control risk, SBA established a lender oversight function that encourages greater discipline in loan underwriting and servicing. OLO will, where a need is indicated, assist lenders in improving the discipline associated with lending to higher risk small business and optimize the relationship between taxpayer cost and mission-based risk through the use of portfolio management mechanisms. Also, OLO is responsible for coordinating all headquarters and field office lender reviews and non-depository lenders' and SBLCs' safety and soundness examinations; evaluating new programs and changes to existing programs to assess potential risk to SBA; and working with other financial regulatory bodies to leverage SBA resources. The Associate Administrator for Lender Oversight is a member of the Agency's Risk Management Committee, which is supposed to meet on a regular basis, and a key member of the working group responsible for the design and implementation of a loan monitoring system.

Actions Taken

The Agency has made some progress toward implementing an effective oversight program, and additional improvements are in process. However, significant improvements need to be made to ensure consistent and appropriate oversight of SBA's lending partners and to assess risk in SBA's portfolio. We used the Federal internal control model to assess the progress made and to determine whether additional improvements are needed for the three most significant credit programs. Our review showed progress in the areas of risk identification and communications, and mixed results in the areas of control environment, policies and procedures, and monitoring.

- *Control Environment*

  -- The Agency has established OLO and developed a strategic plan to address oversight of lenders for each credit program. While many of the elements of the strategic plan have been implemented for the Section 7(a) program, most of the plan's elements have not been implemented for the Small Business Investment Companies (SBIC) and Section 504 programs. Personnel have been added to OLO but additional resources are needed to implement all aspects of the strategic plan. Many district offices claim that they do not have sufficient personnel to conduct the required reviews of lenders and Certified Development Companies (CDCs).

- *Risk Identification*

  -- The Agency recently established processes to estimate the level of financial risk for each lender. However, scores in the lender evaluation worksheet indicating high financial risk can be offset by non-financial factors, thereby allowing a lender with an unsatisfactory financial risk score to receive a satisfactory overall rating.

  -- The systematic processes for estimating lender compliance risk have been implemented for the Section 7(a) program, although some improvements are needed. For the Section 504 program, compliance risk is not properly ascertained due to inappropriate questions used during reviews. The SBIC program has a rating system for measuring compliance risk on a per SBIC basis, but the system is not used. SBIC compliance risk is subjectively determined.

  -- SBA does not periodically combine per participant financial and compliance ratings to determine overall financial and compliance ratings for each program. Combined ratings would allow SBA to identify the overall level of risk for each program and to identify program trends.

- *Policies and Procedures*

  -- SOP 50 50 4, Loan Policy and Program Oversight Guide, provides policies and procedures for lender oversight and provides procedures for periodic reviews of Sections 7(a) and 504 participants. The SOP is generally effective for the Section 7(a) program, but needs to be revised to better reflect the activities of CDCs in the Section 504 program. Lender oversight policies and procedures for the SBIC program would be improved by finalizing the revision to SOP 10 06, Oversight and Regulation of SBICs.

  -- For the Section 7(a) program, recurring training is provided to SBA personnel conducting lender reviews, to lenders attending National Association of Government Guaranteed Lenders conferences, and during district office-sponsored events. Training for the Section 504 program is provided to CDCs at National Association of Development Companies conferences. Training is provided to SBICs when they enter the program and on an as needed basis. Recurring training has not been provided to SBA personnel for the Section 504 and SBIC programs.

  -- Uniform policies and procedures for evaluation of participant performance have been established for each program. The evaluations are used to determine whether the participants will be retained in the program, provided remedial training, or removed from the program. Each of the procedures includes substantial subjective criteria in the evaluation process which can result in non-uniform decisions concerning lender status.

- *Communications*

  -- The Agency has not made substantial progress toward implementing a comprehensive loan monitoring system (LMS). Congress stopped funding to develop the LMS due to scope changes and cost increases. OLO is part of a steering committee formed to address this matter.

  -- The Partner Information Management System (PIMS) has been implemented to allow automated identification of lending partners for the Section 7(a) program. The Lender Analysis and Management Program (LAMP) identifies all CDCs within the Section 504 program. The SBIC program maintains an automated system with information about each licensed SBIC.

  -- During our audit of PLP oversight, we noted that not all lenders were selected for review because information in the Sacramento Loan Processing Center database was not used by the Kansas City Review Branch to select lenders for review. This problem should be corrected by the PIMS database. Also, district offices claim to receive little, if any, direction from headquarters. No communication problems have been noted in the SBIC program**.**

- *Monitoring*

  -- Periodic reviews of participants and loans/investments have been established for each program. However, additional effort is needed to fully develop a system to track review results and recommendations for the Sections 7(a) and 504 programs. The SBIC program has a system to track review results and recommendations.

  -- Periodic reevaluations of participant status are done for each program, but the procedures need to be reviewed for effectiveness. Both the PLP and SBAExpress Lender Program evaluations place too little emphasis on whether a lender achieves financial performance benchmarks. The monitoring process for the Section 504 program needs to be reviewed to ensure the CDCs are properly evaluated and that the evaluations are done consistently. For the SBIC program, the effectiveness of periodic reevaluations would be improved if standard criteria were established to measure SBIC compliance.

Reports

- SBA OIG, *Preferred Lender Oversight Program*, Audit Report # 1-19, September 27, 2001.

- SBA OIG, *SBA Follow-up on SBLC Examinations*, Audit Report # 1-16, August 17, 2001.

- SBA OIG, *Identification of Possible Ineligible Borrowers*, Advisory Memorandum Report #A1-02, January 11, 2001.

Significant Unresolved Recommendations

After audit reports are issued, program officials are required to provide a formal management decision for each recommendation in the report. Recommendations for which a formal management decision either has not been received or is in disagreement with the recommendation are considered unresolved. Current unresolved recommendations from the PLP oversight report recommended that the Associate Administrators for Lender Oversight and Financial Assistance:

1-C. Require sample sizes to include at least one loan from recent approvals, one in liquidation status, and one in past-due or delinquent status, where applicable.

2-A. Request that all applicable sections of the annual review checklist be completed for each loan reviewed.

2-B. Review the annual review process scoring system to include an assessment of lender performance benchmarks.

Also, there are unresolved recommendations from the followup audit on SBLC examinations, which recommended that the Associate Deputy Administrator for Capital Access:

1-A. Develop and implement formal procedures for the SBLC examination followup process and ensure that appropriate corrective actions are taken in a timely manner.

1-B. Develop and promulgate internal control standards for the SBLC program similar to those for non-SBLC lenders subject to financial institution regulators. At a minimum this standard should address the following areas:

- Identifying problem loans,
- Classifying loans according to risk, and
- Establishing allowance accounts that reasonably reflect the potential for loan losses.

Challenge 7. More participating companies need access to business development and contracts in the Section 8(a) Business Development program.

Summary *- The Agency needs to give greater emphasis to business development assistance and ensure a more equitable distribution of contracting opportunities to program participants. The bulk of the dollar value of Section 8(a) Business Development (BD) contracts goes to a relatively small number of companies in the program.*

Actions Needed	Progress
Refocus the Section 8(a) BD program to emphasize business development.	3
Develop criteria defining "business success."	3
Graduate participants once they reach those levels defined as "business success."	3
Develop a mechanism that ensures contracting opportunities are more equitably distributed to Section 8(a) BD program participants.	3

Legend:
1–Implemented
2–Progress being made
3–Not implemented/no substantial progress

Background

The purpose of the Section 8(a) BD program is to assist eligible small disadvantaged business concerns to compete in the American economy through business development. A small number of Section 8(a) BD program participants obtain significant contract awards, while others receive little or no contract benefit. This occurs, in part, because SBA has not placed sufficient emphasis on business development activities to enhance the ability of Section 8(a) BD participants to compete for contracts. In addition, an ever-changing Federal contracting arena, coupled with other socio-economic factors, has created an environment where reengineering of the Section 8(a) BD program is needed.

The Federal Acquisition Streamlining Act of 1994 streamlined the Federal Government's $200 billion a year acquisition system and dramatically changed the way the Government buys its goods and services. The Federal Government is seeing an increase in larger contracts that often are not suitable for small businesses to perform as prime contractors. Agencies are also using streamlined procurement practices such as multiple award contracts, Governmentwide acquisition contracts, Federal supply schedules, and credit card purchases. At the same time, the Section 8(a) BD program contract mechanisms have not been modernized to work with the new acquisition methods authorized by procurement reform.

During FY 2000, when almost 6,400 companies participated in the Section 8(a) BD program, 50 percent ($2.7 billion) of the dollar value of the contracts and modifications went to just 219 companies. Each of the top 10 companies (in terms of dollar value of Section 8(a) BD contracts and modifications) received an average of $60 million in Section 8(a) BD contracts and modifications in FY 2000, with one company receiving over $136 million (2.5 percent of the total). At least 3,500 Section 8(a) BD companies were not awarded any contracts or modifications during the same period. Program officials note, however, that the Section 8(a) BD Program does not guarantee every participating firm will receive a contract during each year of its participation. These officials reported that approximately 70 percent of Section 8(a) firms have received at least one contract during their tenure in the program, which can extend up to 9 years.

Action Taken

- Management has drafted a proposal to redesign the Section 8(a) BD Program. It is waiting the Administrator's review. According to program officials, it will refocus the Section 8(a) BD Program's efforts and resources on business development activities and will coordinate the delivery of other SBA counseling, training, and technical assistance services to Section 8(a) BD participants.

Reports

SBA, *Performance and Accountability Report Fiscal 2000.*

Significant Open Recommendations

SBA identified concentration of contracts as a material weakness in its FY 2000 Performance and Accountability Report. There are no open OIG recommendations relating to this challenge.

Challenge 8. SBA needs clearer standards to determine economic disadvantage.

Summary - *New standards for determining economic disadvantage should be established to effectively measure diminished capital and credit opportunities–the definition included in the law. The Agency should (1) redefine "economic disadvantage" using objective, quantitative, qualitative, and other criteria that effectively measure capital and credit opportunities; and (2) provide sufficient training to SBA staff responsible for evaluating companies.*

Actions Needed	Progress
Redefine "economic disadvantage" using objective, quantitative, qualitative, and other criteria that effectively measure capital and credit opportunities.	3
Provide sufficient financial and analytical training to business opportunity specialists to enable them to evaluate a company's business profile and competitive potential.	3

Legend:
1–Implemented
2 -Progress being made
3–Not implemented/no substantial progress

Background

The Small Business Act requires that participants be socially and economically disadvantaged, and defines "economic disadvantage" as "diminished capital and credit opportunities compared to owners of similar businesses that are not disadvantaged." SBA, however, has not adequately determined what constitutes diminished capital and credit opportunities. Section 8(a)(6)(A) of the Small Business Act states that "[i]n determining the degree of diminished credit and capital opportunities, the Administration shall consider, but not be limited to, the assets and net worth of such socially disadvantaged individual[s]." According to SBA regulations, when considering diminished capital and credit opportunities, SBA is to review such factors as personal income, personal net worth, and the fair market value of all assets. SBA is also to compare the financial condition of the company with other small businesses in the same primary industry classification. While SBA obtains information on a number of factors when determining economic disadvantage, such as comparisons with Robert Morris Associates figures for businesses, it relies primarily on the net worth of the individual. Net worth by itself, however, does not show whether an individual has diminished capital and credit opportunities.

SBA regulations allow individuals with a net worth of up to $750,000 (after excluding the equity in their home and Section 8(a) Business Development (BD) business) to remain in the program and be classified as economically disadvantaged. The $750,000 limit appears to have been set without the use of empirical data. Further, an SBA review found that many Agency employees did not possess the range of skills required to conduct financial analyses. Participants may therefore receive benefits for which they do not qualify.

According to SBA officials, defining and implementing standards for determining economic disadvantage of the individual has been time consuming and ineffective in accomplishing its intended goal of ensuring that adequate Government resources were afforded to developing firms. Economic disadvantage was always difficult to define and often failed at its task of helping to redirect resources. SBA officials believe that in the post-Federal Acquisition Streamlining Act/Federal Acquisition Reform Act era, economic disadvantage is dated, ineffective, and largely inapplicable to the essential goal of the Section 8(a) BD program, which is the development of firms.

Action Taken

- Management has agreed to develop appropriate guidance for SBA employees. This guidance will require a more in-depth review of economic disadvantage factors for Section 8(a) BD owners once certain conditions are met and detail what must be reviewed in these instances. In developing this guidance, Agency officials will determine whether SBA will need to seek statutory changes to ensure that SBA can effectively determine economic disadvantage. The Deputy Associate Deputy Administrator for Government Contracting/Business Development stated that by March 31, 2002, the guidance should be issued and the decision made whether to seek statutory changes that may be deemed to be required.

Reports

SBA OIG, *Section 8(a) Program Continuing Eligibility Reviews*, Audit Report #4-3-H-006-021, September 30, 1994.

Significant Open Recommendations

The September 1994 audit report contained one outstanding recommendation to modify the criteria used for determining one aspect of economic disadvantage. While various recommendations have been made and implemented which address segments of economic disadvantage, SBA has not clarified the definition of economic disadvantage using objective, quantitative, qualitative, and other criteria that effectively measure capital and credit opportunities.

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Challenge 9. 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.

Summary *- SBA's rules, while restricting the amount of a contract that a Section 8(a) Business Development (BD) firm may pass through to a non-Section 8(a) firm, allow many non-participating companies to receive substantial financial benefit. SBA intends to include value-added resellers as a legitimate industry under the North American Industry Classification System. SBA needs to tighten the definition of "manufacturing" to preclude the pass-through practice of making only minor modifications to the products of other manufacturers.*

Action Needed	Progress
Tighten the definition of "manufacturing" to preclude the practice of making only minor modifications to the products of other manufacturers.	3

Legend:
1–Implemented
2–Progress being made
3–Not implemented/no substantial progress

Background

The Section 8(a) BD program is intended to be used exclusively for business development purposes to help small businesses owned by "socially" and "economically" disadvantaged persons compete on an equal basis in the mainstream of the American economy. To ensure that the business development aspects of the program accrue to its participants, SBA has rules to restrict the amount of a Federal contract that may be performed by a non-participant. Nevertheless, OIG audits have found that many non-Section 8(a) BD companies benefit from the program.

An SBA rule requires that supply contracts be filled either by the manufacturer of the end product or by a company that meets SBA's criteria for a "non-manufacturer." SBA's definition of a manufacturer, however, has been interpreted to allow a small business to make only a minor modification to a finished product manufactured by another company. The product that is manufactured by the non-Section 8(a) BD company is considered to be a "basic material" for the new product. Therefore, the Section 8(a) BD company is credited with creating a new product. This occurs frequently with computer equipment, and OIG audits have found instances where 80 percent or more of the contract costs are realized by large computer manufacturers. Agency officials stated that a company providing such work should be classified as a "Value Added Reseller" instead of a "Manufacturer." Typically, according to these officials, these procurements require the contractor to "modify" or "add value" to a finished product by enhancing its functionality and features.

A June 1998 OIG audit report recommended that SBA "provide definitive guidance and definitions to evaluate the manufacturing criteria at 13 CFR 121.406." The Agency agreed with the recommendation and stated that it planned to solicit comments from the business community and have specific discussions with businesses in computer-related industries. As of October 2001, SBA still had not clarified the manufacturing criteria.

Action Taken

- The Office of Government Contracting/Business Development (GC/BD) has put into clearance a proposed rule to establish an industry category and size standard for Information Technology (IT) Value Added Resellers. This action will ensure that small businesses supplying IT products to the Federal Government as nonmanufacturers will perform significant value added services of at least 15 percent of total contract value or supply the product of a small manufacturer. Implementation of this rule will not tighten the definition of "manufacturing," but will allow nonmanufacturing companies to be classified as Value Added Resellers.

- Additionally, GC/BD has agreed to review the existing regulations and minimize the subjectivity in the manufacturing criteria.

Reports

SBA OIG, *Audit of the Administration of the Section 8(a) Program Work Performance Requirements*, Audit Report #3-2-C-002-033, March 31, 1993.

SBA OIG, *Audit of the National Oceanic and Atmospheric Administration Computer Workstation Contract*, Audit Report #8-7-002-017, June 18, 1998.

Significant Open Recommendations

The 1998 report recommendation to provide specific guidance and definitions to evaluate manufacturing criteria has not been implemented. See **Action Taken** for the status of the steps being taken to implement the recommendation.

Challenge 10. Preventing loan fraud requires additional measures, including new regulations and funding.

Summary – *OIG studies have demonstrated that fraud in the business loan program could be reduced by obtaining criminal background information on prospective borrowers and on loan packagers and other for-fee agents. Specific statutory authority exists to perform background checks on prospective borrowers. OIG believes that the statutory framework already exists for SBA to require background checks of loan packagers and other for-fee agents.*

Actions Needed	Progress
Within Privacy Act constraints, SBA requires all loan agents to provide the Agency with the information necessary to conduct criminal background checks.	3
SBA informs loan agents that SBA will conduct criminal background checks on them and that they are subject to future OIG reviews.	3
SBA systematically identifies all loan agents and tracks their association with individual loans. This process would include maintaining identifying data and background information on loan agents.	3
SBA obtains sufficient funding to identify and track loan agents systematically.	3*
SBA changes its policy to advise all prospective borrowers that they may be subject to criminal background checks.	3*
SBA obtains sufficient funding to enable the Agency and OIG to perform criminal background checks on prospective borrowers and loan agents in a timely manner.	3

Legend:
1–Implemented
2–Progress being made
3–Not implemented/no substantial progress
*– "Action Needed" revised due to new developments

Background

OIG studies have demonstrated that obtaining additional background information from loan agents and prospective loan borrowers could reduce the incidence of fraudulent loans. While the fraud identified thus far is a small percentage of SBA's total portfolio, the dollar amounts are significant.

A. <u>Loan Agents</u> - Loan agents provide referral and loan application services to prospective borrowers or lenders for a fee. Some agents, particularly loan packagers, have been involved in a variety of fraudulent schemes, such as submitting false tax returns or other financial data, charging the borrower excessive fees, using fictitious names on SBA forms, exaggerating their ability to obtain loan approval, acting in illegal collusion with officials of lending institutions, conspiring with borrowers to submit false loan packages, and performing other illegal acts.

These schemes, which have been used by various agents, have resulted in borrower defaults causing loan purchases by SBA and, ultimately, losses to the taxpayers.

Over the past 5 years ending September 30, 2001, in the business loan program, OIG has initiated criminal investigations potentially involving more than $100 million in loan applications handled by approximately 20 loan agents. There are hundreds of potential individual subjects in these investigations. Allegations involving loan agents continue to be reported to OIG. Moreover, because the Internet allows ready access to a national audience, dishonest loan agents can expand the scope of their fraudulent activities. At the same time, the Agency may not have adequate staff to monitor loan agent activity.

A March 1998 OIG inspection report identified efficient ways to reduce fraud by loan packagers and other loan agents. If SBA conducted criminal background checks on loan agents, the Agency would have access to information on prior criminal activity that could indicate an individual's propensity to engage in fraudulent activities.

SBA and OIG have agreed that it would be helpful if the Agency maintained a database linking loans to individual packagers and other agents. With such data available on an automated basis, when SBA identifies a circumstance of potential fraud, the Agency would be able to identify other loans packaged by the same individual and thus would be able to locate more readily other loans where similar fraud may have occurred. Therefore, as part of the Agency's systems modernization effort, data elements will be included that will identify any loan agent involved in a loan application.

Action Taken

- In FY 2001, SBA submitted a legislative proposal specifically to authorize criminal background checks of loan agents; require loan agents and prospective borrowers to provide personal identifiers (including Social Security Numbers) needed by the National Crime Information Center (NCIC) database operated by the FBI; and mandate the use of the NCIC. The Senate Small Business Committee voted to include the proposal in SBA's Reauthorization Bill for FY 2001. The conference committee, however, adopted the House version that did not contain the proposal.

- SBA plans to establish a loan agent tracking system that is tied to the development of a Partner Information Management System (PIMS). PIMS is to be incorporated into the Loan Monitoring System (LMS). The first phase of PIMS was completed on June 30, 2000. SBA Form 159, which contains information on loan agents, was being revised to clarify the requirements for agents to notify SBA of their loan participation. In view of the need for new regulations, the form may need to be further revised to include additional loan agent identification data.

- SBA expects the loan agent criminal background check system to be operational 6 months after appropriate authorization (statutory, regulatory, or administrative) is in place, if adequate staff resources are available.

Report

SBA OIG, *Loan Agents and the Section 7(a) Program,* Inspection Report #98-03-01, March 31, 1998.

Significant Open Recommendations

Within current authority and Privacy Act constraints, SBA needs to require loan agents to provide sufficient information to conduct criminal background checks. This could take place through revised compensation agreements (the Form 159 referred to earlier) or statements of personal history. In some cases fingerprinting may be necessary. If additional authority is later desired, then a legislative initiative could be pursued.

B. <u>Borrowers in Business Loan Programs</u>: OIG work has shown that borrowers who do not disclose their criminal histories have higher rates of default on SBA loans than those who either disclose their records or have no criminal histories. SBA currently performs criminal history checks, but only if prospective borrowers voluntarily disclose past criminal violations. As a result, the Agency does not always identify individuals with criminal histories and this may result in higher losses to SBA.

Past OIG studies have revealed problems with the accuracy of the criminal history information provided by loan applicants on SBA Form 912, *Statement of Personal History*. To determine the extent of the problem, OIG initiated proactive investigations called Operations Cleansweep, Cleansweep II, and Cleansweep III. Operation Cleansweep showed that almost 12 percent of the defaulted loans involved borrowers who failed to disclose their criminal records. A number of audits have also documented misrepresentation by borrowers of their criminal histories. An audit of 240 loans found that 8 percent of the 429 borrowers sampled failed to disclose their criminal records.

After Cleansweep II, OIG estimated, based on a lending level of about $11 billion per year, that the potential loss to the Government stemming from these false certifications could exceed $27 million. Cleansweep III revealed that 5.9 percent of the applicants did not disclose their criminal record on the loan applications they submitted to SBA, which affected approximately 9.1 percent of the loans that were submitted. This means that, on average, nearly 1 out of every 11 loans guaranteed by SBA contained a false statement by one or more borrowers. The sample further revealed that loans in which applicants lie about their criminal record are 1.3 times as likely to become nonperforming and result in the purchase of the guaranty by SBA. A total of 36,872 business loans were approved and disbursed in FY 1999. Extrapolating the sample results (i.e., one-quarter of a fiscal year's worth of loan approvals) to a full year indicates potential guaranty losses of $56,951,855. To avoid significant losses, SBA needs to advise all prospective borrowers that they may be subject to criminal background checks.

Both Congress and previous SBA Administrators have expressed support for a more rigorous check of an applicant's criminal history. The Small Business Reauthorization Act of 1997 (Public Law 105-135) authorized an expanded check on criminal histories of loan applicants. Subtitle D-Miscellaneous Provisions, Section 231, Subsection B, Background Checks, states that “[p]rior to the approval of any loan made pursuant to this subsection * * * the Administrator may verify the applicant’s criminal background, or lack thereof, through the best available means, including, if possible, use of the NCIC computer system at the Federal Bureau of Investigation.”

While useful, the law does not mandate a criminal background check on loan applicants and, as previously stated, SBA’s current policy is to require background checks only if an individual voluntarily discloses a past criminal record. Verification of the criminal history of business loan applicants would allow SBA to: (1) Detect fraudulent applications early in the process, so they may be referred for appropriate criminal and/or civil action; (2) reduce the Government’s losses by preventing fraudulent loans from being disbursed; and (3) provide a heightened level of deterrence through increased enforcement actions. OIG believes that there is no more effective or efficient method available to achieve these goals without seriously disrupting the flow of the loan process. OIG previously estimated that the start-up cost for initiating such a verification program for all applicants would be approximately $1 million.

Action Taken

- As noted previously, in FY 2001, SBA submitted a legislative proposal to specifically authorize criminal background checks of loan agents; require loan agents and prospective borrowers to provide personal identifiers (including Social Security Numbers) needed by the NCIC database operated by the FBI; and mandate the use of the NCIC. The Senate Small Business Committee voted to include the proposal in SBA’s Reauthorization Bill for FY 2001. The conference committee, however, adopted the House version that did not contain the proposal.

Reports

SBA OIG, *Fraud Detection in SBA Programs*, Inspection Report #97-11-01, November 24, 1997.

SBA OIG, *Summary Audit of 7(a) Loan Processing*, Audit Report #0-03, January 11, 2000.

SBA OIG, *Applicant Character Verification in SBA’s Business Loan Program*, April 5, 2001.

SBA OIG, *Operation Cleansweep Memorandum,* August 21, 1996.

Significant Open Recommendations

For the past several years, SBA pursued legislation that would have strengthened and expanded its statutory authority to conduct criminal history checks on 100 percent of loan applicants. (This was most recently recommended in April 2001.) The proposed legislation was not passed. Recently OIG has determined that SBA needs to refocus its efforts by changing its policy regarding criminal background checks for prospective borrowers, based on current authority. Specifically, SBA needs to inform all prospective borrowers that they are subject to a possible criminal background check. OIG plans to perform periodic criminal background checks on a sample of borrowers and, based on the results, will determine whether a wider effort is warranted. Implementation of this new approach during FY 2003 is expected to cost approximately $500,000. Results may indicate a need for increased future funding.