



**U.S. SMALL BUSINESS ADMINISTRATION  
OFFICE OF INSPECTOR GENERAL  
Washington, DC 20416**

July 12, 2006

**ADVISORY MEMORANDUM No. 6-26**

TO: James E. Rivera  
Associate Administrator for Financial Assistance

**/S/ Original Signed**

FROM: Debra S. Ritt  
Assistant Inspector General for Auditing

SUBJECT: Survey of the Quality Assurance Review Process

The purpose of this memorandum is to alert you to several issues identified during our survey of the Quality Assurance Review (QAR) process at the National Guaranty Purchase Center (Center).

In September 2004, the Center developed a Quality Assurance (QA) plan to review the quality of the guaranty purchase approval process. The QAR process is designed to provide SBA with valid reviews, independent of the purchase approval process to ensure (1) the proper interpretation and consistent implementation of SBA's policies and procedures, and (2) that competent, consistent and accurate guaranty purchase decisions are made by the Center, thereby minimizing any losses the Agency might otherwise have experienced.

The objective of the survey was to gain an overview of the QAR process and determine if it is effective in the identification of improper purchases and guaranty purchase process areas needing improvement. Our survey was performed from August 2005 to March 2006 in Herndon, Virginia. We identified the following issues which we believe require corrective action to improve the Center's QAR process.

**1. Implementation of the Center's Quality Assurance Plan has not been Achieved**

Our survey disclosed that while the Center was reviewing loan purchase decisions, it was not examining an adequate volume of loans in the high-risk categories identified in the plan. Further, only one senior staff member was assigned to the QAR process on a part-time basis. The priority for the Center at the time of our survey was to ensure compliance with the Improper Payments Information Act of 2002. Consequently, the QAR process was being used to estimate the level of improper payments for the 7(a) loan program rather than to identify purchase process areas in need of improvement.

According to the QA plan, quality assurance reviews should be performed by a QC team composed of several Center staff members and oversight should be provided through a senior staff member accountable for the overall performance and direction of the QC team. The QC team is required to review the quality of the guaranty purchase process by conducting:

- A complete review of 3 to 5 percent of all 7(a) loans approved for purchase by Center staff,
- Post-purchase reviews of 3 to 5 percent of previously purchased secondary market loans,
- Reviews of no less than 5 percent of all Preferred Lender Program (PLP) “Early Default” loans recommended for purchase by Center staff, and
- Reviews that target loans recommended for purchase with unpaid principal balances in excess of \$250,000.

Finally, the QC team leader should ensure all Center staff and lenders requesting guaranty purchases are represented in the reviews.

Despite these requirements, we found that only one senior staff member was assigned to the QAR process on a part-time basis. The Center was also not reviewing a sufficient number of loans in the specific loan categories identified in the Center’s QA Plan.

Under the process in place at the time of our survey, 10 loans were systematically selected each month from an Excel spreadsheet obtained from the Office of the Chief Information Officer and reviewed by one QC team member during the following month. These reviews accounted for approximately 4 percent of the Center’s annual pre and post purchase reviews (120 reviews per year out of approximately 3,000 pre and post purchase reviews completed annually). However, the Center’s practice of systematically sampling 10 loans for review each month did not ensure that the required percentage of PLP “Early Default” loans were reviewed, loans with unpaid principal balances in excess of \$250,000 were targeted, or that all Center staff and lenders requesting guaranty purchases were represented in the samples. While the number of loans reviewed may have been sufficient to assess compliance with the Improper Payments Information Act of 2002, the sample did not adequately cover the high-risk loan categories identified in the QA plan. Consequently, the Center was unable to ensure with any degree of reliability that guaranty purchase decisions made by Center staff were complete, consistent and accurate.

We noted that procedures for selecting representative samples of all loans purchased at the center as well as the high-risk loan categories were not included in the QA plan. Without documented procedures for sample selection, there is no assurance that representative samples will be selected.

## **2. QAR Checklist is Incomplete**

Although the QAR checklist identifies 18 areas that must be reviewed and designated as “Acceptable, Deficient, or Not Applicable” during a quality assurance review, it does not include all areas that require evaluation during the original purchase review process, such as (1) adverse changes in the borrower’s financial condition, (2) significant changes in loan terms, (3) legal pleadings (including bankruptcy filings), (4) evidence of insurance, and (5) assignment of life insurance. Consequently, purchase review deficiencies in these areas may not be identified during the QAR process.

## **3. Procedures to Address Identified Deficiencies must be Developed**

The QA plan does not document all steps to be taken when a deficiency is identified during a quality assurance review. The QA plan provides that:

*“When guaranty purchase deficiencies are found, the QC Team will notify the Center’s staff recommending purchase approval and a resolution will be determined prior to the actual purchase of the loan. In cases where the QC team finds deficiencies in post purchase reviews, the QC team and the Center staff will determine if recovery of purchase funds is appropriate.”*

*“Monthly reports... will be provided to the Center Director to detail deficiencies found by the QC reviews. Where numbers of deficiencies found by the QC team warrant further scrutiny, the QAR sample percentages may be increased and/or the Center Director may take action as deemed necessary to improve the guaranty approval process.”*

The QA plan, however, does not prescribe procedures for determining when and how purchase reviewers will be notified of deficiencies, how necessary training will be provided, and whether revisions to the guaranty purchase process will be implemented to ensure areas requiring improvement are adequately addressed.

## **Recommendations**

We recommend that the Associate Administrator for Financial Assistance:

1. Determine the level of staffing needed to fully implement all aspects of the QA plan to ensure the QAR process effectively identifies improper purchases and areas of the purchase process needing improvement.
2. Consult a statistician to develop procedures for selecting samples of all loans purchased at the Center and specific loan categories to be tested in the QA plan.
3. Update the QAR checklist to include all items required to be evaluated during the original purchase review.

4. Develop procedures to be followed when a deficiency is identified during a quality assurance review to (1) notify purchase reviewers of the deficiency, (2) provide training, and (3) implement revisions to the guaranty purchase process as necessary.
5. Revise the QA plan as necessary and fully implement the QAR Process.

**SBA Management Comments**

We conducted an exit conference with the Center Director and Deputy Director on May 23, 2006 to discuss our findings and recommendations. They concurred with our findings and recommendations and stated they are in the process of revising the QA plan.

Please provide us with your management decisions on our recommendations within 30 days of the date of this report using the attached SBA Form 1824, *Recommendation Action Sheet*.

If you have any questions, please contact Stephen Seifert, Director, Credit Programs Group, at 703-487-[FOIA Ex. 2].