



**U.S. SMALL BUSINESS ADMINISTRATION  
OFFICE OF INSPECTOR GENERAL  
WASHINGTON, D.C. 20416**

**Final Report Transmittal**  
Report Number: 17-03

**DATE:** November 14, 2016

**TO:** Maria Contreras-Sweet  
Administrator, Small Business Administration

Tami Perriello  
Associate Administrator for Performance Management and  
Chief Financial Officer, Small Business Administration

**FROM:** Hannibal M. Ware /s/  
Deputy Inspector General

**SUBJECT:** *Independent Auditors' Report on SBA's FY 2016 Financial Statements*

We contracted with the independent certified public accounting firm KPMG LLP (KPMG) to audit the U.S. Small Business Administration's (SBA) consolidated financial statements for fiscal year (FY) 2016, ending September 30, 2016. This audit is an annual requirement of the Chief Financial Officers' Act of 1990, and was conducted in accordance with *Generally Accepted Government Auditing Standards*; the Office of Management and Budget Bulletin No. 15-02, *Audit Requirements for Federal Financial Statements*, as amended; and the U.S. Government Accountability Office's *Financial Audit Manual* and *Federal Information System Controls Audit Manual*.

The attached independent auditors' report presents an unmodified opinion on SBA's consolidated financial statements for FY 2016. Specifically, KPMG reported that:

- The financial statements were fairly presented in all material aspects in conformity with U.S. generally accepted accounting principles.
- There were no material weaknesses in internal control.
- There is a significant deficiency related to controls over the completeness and accuracy of data for SBA's Secondary Market Guarantee credit reform model; and
- There is also a significant deficiency related to SBA's information technology security controls, which has been identified in the past.

Details regarding KPMG's conclusions are included in Exhibit I to this report. Within 30 days of this report, KPMG expects to issue a separate letter to SBA management regarding other, less significant matters that came to its attention during the audit.

We reviewed a copy of KPMG's report and related documentation and made necessary inquiries of their respective representatives. Our review was not intended to enable us to express—and we do not express—an opinion on SBA's financial statements, KPMG's conclusions about the effectiveness of internal controls, or its conclusions about SBA's compliance with laws and regulations. However, our review disclosed no instances where KPMG did not comply, in all material respects, with *Generally Accepted Government Auditing Standards*.

We provided a draft of KPMG's report to SBA's Chief Financial Officer, who concurred with its findings and recommendations and agreed to implement the recommendations. The Chief Financial Officer's comments are attached as Exhibit II to this report.

We appreciate the cooperation and assistance of SBA and KPMG. Should you or your staff have any questions, please contact me at (202) 205-6586 or Jeffrey R. Brindle, Director of the Information Technology and Financial Management Group at (202) 205-7490.

cc: Nick Maduros, Chief of Staff  
Melvin F. Williams, Jr., General Counsel  
Martin Conrey, Attorney Advisor, Legislation and Appropriations  
LaNae Twite, Director, Office of Internal Controls

Attachment



KPMG LLP  
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## Independent Auditors' Report

Inspector General  
United States Small Business Administration:

### Report on the Financial Statements

We have audited the accompanying consolidated financial statements of the U.S. Small Business Administration (SBA), which comprise the consolidated balance sheets as of September 30, 2016 and 2015, and the related consolidated statements of net cost, and changes in net position, and combined statements of budgetary resources for the years then ended, and the related notes to the consolidated financial statements.

### ***Management's Responsibility for the Financial Statements***

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

### ***Auditors' Responsibility***

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America, in accordance with the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, and in accordance with Office of Management and Budget (OMB) Bulletin No. 15-02, *Audit Requirements for Federal Financial Statements*. Those standards and OMB Bulletin No. 15-02 require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### ***Opinion on the Financial Statements***

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the U.S. Small Business Administration as of September 30, 2016 and 2015, and its net costs, changes in net position, and budgetary resources for the years then ended in accordance with U.S. generally accepted accounting principles.



## **Other Matters**

### *Required Supplementary Information*

U.S. generally accepted accounting principles require that the information in the Management's Discussion and Analysis, Required Supplementary Information, and Required Supplementary Stewardship Information sections be presented to supplement the basic consolidated financial statements. Such information, although not a part of the basic consolidated financial statements, is required by the Federal Accounting Standards Advisory Board who considers it to be an essential part of financial reporting for placing the basic consolidated financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic consolidated financial statements, and other knowledge we obtained during our audits of the basic consolidated financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

### *Other Information*

Our audits were conducted for the purpose of forming an opinion on the basic consolidated financial statements as a whole. The Message from the Administrator, Other Information and information on pages 37 to 40 is presented for purposes of additional analysis and is not a required part of the basic consolidated financial statements. Such information has not been subjected to the auditing procedures applied in the audits of the basic consolidated financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

## **Other Reporting Required by Government Auditing Standards**

### ***Internal Control Over Financial Reporting***

In planning and performing our audit of the consolidated financial statements as of and for the year ended September 30, 2016, we considered SBA's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the consolidated financial statements, but not for the purpose of expressing an opinion on the effectiveness of SBA's internal control. Accordingly, we do not express an opinion on the effectiveness of SBA's internal control. We did not test all internal controls relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act of 1982.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that have not been identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. We did identify certain deficiencies in internal control, described in Exhibit I that we consider to be significant deficiencies:

- (1) Improvement Needed in Controls over the Completeness and Accuracy of Secondary Market Guarantee Model Data, and
- (2) Improvement Needed in Information Technology Security Controls



### ***Compliance and Other Matters***

As part of obtaining reasonable assurance about whether SBA's consolidated financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests of compliance disclosed no instances of noncompliance or other matters that are required to be reported herein under *Government Auditing Standards* or OMB Bulletin No. 15-02.

We also performed tests of its compliance with certain provisions referred to in Section 803(a) of the Federal Financial Management Improvement Act of 1996 (FFMIA). Providing an opinion on compliance with FFMIA was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests of FFMIA disclosed no instances in which SBA's financial management systems did not substantially comply with (1) Federal financial management systems requirements, (2) applicable Federal accounting standards, and (3) the United States Government Standard General Ledger at the transaction level.

### ***SBA's Responses to Findings***

SBA's responses to the findings identified in our audit are described in Exhibit II. SBA's responses were not subjected to the auditing procedures applied in the audit of the consolidated financial statements and, accordingly, we express no opinion on the responses.

### ***Purpose of the Other Reporting Required by Government Auditing Standards***

The purpose of the communication described in the Other Reporting Required by *Government Auditing Standards* section is solely to describe the scope of our testing of internal control and compliance and the result of that testing, and not to provide an opinion on the effectiveness of SBA's internal control or compliance. Accordingly, this communication is not suitable for any other purpose.

**KPMG LLP**

Washington, D.C.  
November 14, 2016

**U.S. Small Business Administration**

## Significant Deficiencies

**(1) Improvement Needed in Controls over the Completeness and Accuracy of Secondary Market Guarantee Model Data**

During FY 2016, the U.S. Small Business Administration (SBA) management identified a significant error for an account balance in one of the data files, provided by a fiscal transfer agent (FTA), which is used as an input for the Secondary Market Guarantee year-end financial statement subsidy reestimate calculation. The error related to securities erroneously included in the FTA data file (meant to comprise of cash available) that were already included in a second reestimate data input file prepared by SBA based on trustee information. Ultimately, this error occurred because SBA did not perform complete reconciliations between the two datasets. Neither SBA management nor the FTA has been able to identify which securities or transactions the duplication relates to, but determined the error was not the result of normal cut-off or timing differences. Furthermore, we believe that a similar reconciliation difference existed in prior periods. This matter was corrected prior to the end of FY 2016, and as such, the Liability for Loan Guaranty balance as of September 30, 2016, is fairly presented. However, the FY 2016 Statement of Net Cost, while presented fairly, includes costs associated with the error that should have been recorded in the prior year.

The following criteria were considered with respect to the matter described in the preceding paragraph:

- U.S. Government Accountability Office's, *Standards for Internal Control in the Federal Government*, Section OV4.01, Service Organizations
- Federal Financial Accounting and Auditing Technical Release 6, *Preparing Estimates for Direct Loans and Loan Guarantee Subsidies*, paragraph 35
- Office of Management and Budget (OMB) Circular No. A-129, *Policies for Federal Credit Programs and Non-Tax Receivables*, Section III.B.1.b.iii, Outsourcing Programmatic Functions to Contractors

**Recommendations:**

To enhance the existing reconciliation controls and documentation related to the Secondary Market Guarantee reestimate process, we recommend the Director of the Office of Financial Analysis and Modeling:

1. Establish and document the precision level used for evaluating reconciling differences to timely prevent and/or detect material misstatements.
2. Document the assessment of any differences identified during the performance of this reconciliation control at each phase of the reestimate process and the potential impact on the financial statements, using the established level of precision.

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## Significant Deficiencies

**(2) Improvement Needed in Information Technology Security Controls**

During the FY 2016 financial statement audit, we found that SBA continued to implement corrective actions on some of the prior year information technology (IT) findings; however, a number of conditions persisted in FY 2016 that limited SBA's ability to effectively manage its information system risks. As a result, collectively, these conditions continue to present a significant deficiency in SBA's internal control environment.

In an effort to provide additional clarity to SBA management with respect to the corrective actions required, we enhanced our prior year recommendations where issues persisted in FY 2016, and issued additional recommendations for the new control deficiencies identified. In the sections below, we distinguish between recurring conditions and related recommendations, and those that were newly identified in FY 2016. We have omitted some technical details from the conditions and recommendations due to the sensitivity of the information. These details were communicated to management in Notices of Findings and Recommendations throughout the audit.

The following criteria were considered with respect to the matter described in the preceding paragraph:

- National Institute of Standards and Technology (NIST) Special Publication 800-53, *Security and Privacy Controls for Federal Information Systems and Organizations*, (Revision 4)
- Federal Information Processing Standards (FIPS) Publication 200, *Minimum Security Requirements for Federal Information and Information Systems*
- SBA Standard Operating Procedure (SOP) 90 47 3, *Information System Security Program*

We have summarized the IT control deficiencies that we noted during the FY 2016 audit below, and have organized them by the following general IT control objectives: logical access controls, system configuration management, and contingency planning.

*Logical Access Controls*

An integral part of the effectiveness of an organization's security program management efforts should be to ensure that logical access controls provide reasonable assurance that IT resources, such as data files, application programs, and IT-related facilities/equipment, are protected against unauthorized modification, disclosure, loss, or impairment.

Our audit found that the following control deficiencies identified in prior year(s) persisted in FY 2016:

- Account authorization processes were not implemented in accordance with SBA policy.
- User accounts were not recertified in accordance with SBA policy.
- The principle of "least privilege" for user/service accounts with administrator privileges was not enforced.
- The employee exit clearance and contractor off-boarding processes were not standardized to ensure that access to SBA's systems was timely removed upon separation.
- Processes for consistently and effectively reviewing audit logs were not implemented.

Our audit identified the following new control deficiency in FY 2016:

- Segregation of duties was not enforced for one system.

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## Significant Deficiencies

Recommendations – Logical Access Controls:

To address the repeat and new control deficiencies listed in the section above, we recommend that the Chief Information Officer (CIO) coordinate with SBA program offices to:

3. Implement and monitor procedures to ensure that access is appropriately granted to employees and contractors, consistent with the conditions on their access forms after all approvals have been obtained.
4. Improve SBA's access recertification processes by taking the following actions:
  - o Implement procedures to ensure that user access, including user accounts and associated roles, is reviewed on a periodic basis consistent with the nature and risk of the system, and any necessary account modifications are performed when identified;
  - o Implement effective procedures to ensure that accounts are independently reviewed for appropriateness in accordance with SBA policy.
5. Grant elevated privileges per business needs only, and enforce the concept of least privilege or implement mitigating controls to ensure that activities performed using privileged accounts (including service accounts) are properly monitored.
6. Improve SBA's administration of logical system access by taking the following actions:
  - o Implement an effective off-boarding process, and periodically verify that controls to remove logical access for separated employees are implemented and operating as designed;
  - o Establish a process for the identification and removal of separated contractors to help ensure that logical access is timely removed upon contractor separation; and
  - o Timely remove access to general support systems and major applications (including development and test environments) when employees and contractors are terminated.
7. Improve SBA's information system logging and auditing program, by taking the following actions:
  - o Review and rationalize current audit and logging activities and capabilities to determine their effectiveness in addressing risks to systems and data;
  - o Implement and enforce consistent and effective creation of audit records, capturing relevant auditable events, auditing (i.e., manual or automated review of audit records) for specified events, and automated alerting on specified events across SBA's infrastructure using a risk-based approach; and
  - o Retain sufficient evidence of the audit log review.
8. Enforce segregation of duties policies and procedures or implement mitigating controls in order to minimize the risk of unauthorized activity and other relevant security events.

*System Configuration Management*

The primary focus of an organization's system configuration management process should be to control the security configuration of its infrastructure including servers, databases, network equipment, security appliances, and security services. Without such controls, there is a risk that security features could be inadvertently, or deliberately, omitted or turned off, introducing risk into the IT environment.



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Significant Deficiencies

Our audit noted that although improvements have been made, the following prior year control deficiency persisted in FY 2016:

- Numerous critical, high and medium-risk configuration and patch management vulnerabilities were noted in certain systems.

Recommendation – System Configuration Management:

To address the repeat system configuration management condition above, we recommend that the:

9. CIO coordinate with SBA program offices to address the existing configuration and patch management vulnerabilities noted during our assessment to be in compliance with SBA policies. In addition, implement procedures to ensure the consistent implementation and monitoring of SBA approved security configuration baselines across SBA's workstations, servers, databases, network devices, and other security relevant appliances.

*Contingency Planning*

The focus of an organization's contingency planning program should be to provide reasonable assurance that information resources are protected and the risk of unplanned interruptions is minimized. Without such controls, there is a risk that data may be lost or that critical operations may not resume in a timely manner.

Our audit noted that the following prior year control deficiencies persisted in FY 2016:

- Incremental or full backups for one of the systems were not retained in accordance with SBA policies.

Recommendation – Contingency Planning:


To address the repeat contingency planning conditions above, we recommend that the:

10. CIO coordinate with SBA program offices to ensure that incremental and full backups for all systems, including related support infrastructure, are configured and retained in accordance with SBA policies.

## CFO Response to Draft Audit Report on FY 2016 Financial Statements

**DATE:** November 14, 2016

**TO:** Hannibal M. Ware, Deputy Inspector General

**FROM:** Tami Perriello, Associate Administrator for Performance Management and Chief Financial Officer 

**SUBJECT:** Draft Audit Report on FY 2016 Financial Statements

The Small Business Administration has received the draft Independent Auditors' Report from KPMG that includes the auditors' opinion on the financial statements and its review of the Agency's internal control over financial reporting and compliance with laws and regulations. The independent audit of the Agency's financial statements and related processes is a core component of SBA's financial management program.

We are pleased that the SBA has again received an unmodified audit opinion with no material weaknesses from the independent auditor. We believe these results accurately reflect the quality of the Agency's financial statements and our continuous improvements in accounting, budgeting and reporting processes. We are proud that the results of our efforts have been confirmed.

The audit report includes a continuing significant deficiency in SBA's information technology controls. The SBA invested heavily over the past year to improve controls over the information technology environment and will continue to work on improvements in IT security, specifically in logical access controls, configuration management, and contingency planning.

The SBA reported to the auditor that significant differences between balances of available cash and investments existed in data inputs to the Secondary Market Guarantee program model. During FY 2016, SBA worked with its fiscal transfer agent to reconcile those differences and corrected amounts were used for reestimates presented in the financial statements. KPMG notified us that although we had identified and corrected the problem for FY 2016, the amounts in question, and timing, constituted a significant deficiency in internal control which is reported for this fiscal year. The SBA has improved controls over the data inputs to the model and required its fiscal transfer agent to reconcile daily to the trustee account. We believe our controls are effective and will prevent future differences in model data inputs for this program. In accordance with the auditor's recommendations, we will be establishing a precision level and documentation methodology to ensure that the controls continue to be effective.

We appreciate your efforts and those of your colleagues in the Office of the Inspector General, as well as those of KPMG. The independent audit process continues to provide us with new insights and valuable recommendations that will further enhance SBA's financial management practices. We remain committed to excellence in financial management and look forward to making more progress in the coming year.