



**U.S. SMALL BUSINESS ADMINISTRATION  
OFFICE OF INSPECTOR GENERAL**

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**ADVISORY MEMORANDUM  
REPORT NO. 12-07**

**DATE:** March 8, 2012

**To:** Jonathan I. Carver  
Chief Financial Officer

**SUBJECT:** The SBA's Improper Payment Review and Reporting for its Contracting Activities did not Comply with IPERA and IPIA Requirements During FY 2011

**Summary**

This advisory memorandum presents issues that we identified during our review, the *Small Business Administration's (SBA) Compliance with the Improper Payments Elimination and Recovery Act of 2010 (IPERA)*<sup>1</sup>. We are issuing a separate report that summarizes the SBA's overall compliance with IPERA. However, due to the significance of our findings related to the agency's contracting activities, we are issuing this advisory memorandum to enable SBA's senior management to immediately take corrective action. We determined that the SBA did not comply with IPERA and Improper Payments Information Act (IPIA) requirements. The issues pertain to the SBA's planning, execution, and reporting of the improper payments for its contracting activities during Fiscal Year (FY) 2011. Specifically, we found that the:

- personnel responsible for developing the test plan and performing the improper payments review did not have training in contracting practices;
- test plan was inadequate to detect improper payments;
- IPERA review did not capture significant payment errors;
- publishing of an 89 percent improper payment rate was incomplete;
- improper payment rate was not reported in accordance with the Office of Management and Budget (OMB) guidance; and
- SBA management did not develop or publish a *Corrective Action Plan* and a *Payment Recapture Audit Plan*.

Without addressing the root cause(s) of its improper payments, the agency remains at significant risk for future improper payments.

Our objective was to assess the extent to which SBA's planning, execution, and reporting of the improper payments for its contracting activities complied with criteria established by IPIA, IPERA, and the Office of Management and Budget (OMB). To perform our review, we sampled 5 of 134 payments

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<sup>1</sup> The Improper Payments Elimination and Recovery Act of 2010 (IPERA) amends the Improper Payments Information Act of 2002 (IPIA). Even though IPERA amends IPIA, the authorizing legislation is still named IPIA. OMB guidance applies to both IPERA and IPIA.

reviewed by the SBA for its contracting activities. We conducted our review, in accordance with *Government Auditing Standards* prescribed by the Comptroller General of the United States, from September 2011 to January 2012.

We provided a draft of this report to SBA's management for comment. In their comments (see Appendix I), management provided numerous comments but did not specifically state whether it agreed or disagreed with the audit findings and recommendations. We found management's comments to be unresponsive to four of five of our recommendations.

## **Background**

An improper payment is any payment that should not have been made or that was made in an incorrect amount under statutory, contractual, administrative, or other legally applicable requirements. Guidance for IPIA and IPERA requires agencies to conduct improper payment reviews for all programs and activities susceptible to significant improper payments<sup>2</sup> and to annually report their improper payment results to the President and Congress. For FY 2011, the SBA performed a risk assessment of its contracting activities which revealed that the program was highly susceptible to improper payments. In accordance with OMB guidance<sup>3</sup>, SBA personnel performed an improper payment review of 134 payments, valued at \$29,330,644, that were made between April 5, 2010 and March 31, 2011. The results of the SBA's review, as published in its *Agency Financial Report (AFR) FY 2011*, revealed a significant improper payments rate of 89 percent. The Office of Inspector General (OIG) assessed the SBA's improper payments review in accordance with the requirements set forth by IPIA, IPERA, and OMB guidance.

## **Results**

### **The SBA's Test Plan Placed the Agency at Risk for not Detecting Improper Payments**

The SBA's improper payments test plan for its contracting activities was inadequate and did not provide reasonable assurance of detecting improper payments within the program. The personnel that developed the test plan and performed the agency's improper payment review did not have contracting backgrounds and had limited contract training. This may have resulted in the development of inadequate test plan steps for identifying improper payments. We determined that 11 of the 16 steps within the improper payments test plan were ineffective and additional steps were required. For example, the test plan did not include a step to review the 10 required items of a proper invoice<sup>4</sup>. In addition, SBA personnel did not review indefinite delivery / indefinite quantity<sup>5</sup> (IDIQ) contracts for associated task orders<sup>6</sup>. These conditions occurred because reviewing personnel did not understand that task orders execute IDIQ contracts and that invoices must be held to the terms of both the IDIQ contract and its task orders. Further, reviewing personnel did not adequately execute all steps within

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<sup>2</sup> Generally, a program is deemed susceptible to significant improper payments if the program has improper payments greater than \$10 million and over 2.5 percent of all payments made under that program, or if the program has more than \$100 million in estimated improper payments.

<sup>3</sup> Memorandum M-11-16, *Issuance of Revised Parts I and II to Appendix C of OMB Circular A-123*.

<sup>4</sup> Federal Acquisition Regulation Part 32.905, *Payment Documentation and Process*, describes the 10 required items of a proper invoice.

<sup>5</sup> Indefinite delivery/indefinite quantity contracts are used to acquire supplies and services when the exact time and quantity is unknown at the time of the award.

<sup>6</sup> Task orders are contracts for services that execute orders under an indefinite delivery/indefinite quantity contract.

the test plan. Specifically, they did not determine whether payments were sent to the appropriate bank account for the contractor because they did not realize they should have validated the bank account established in the Central Contractor Registration database. These conditions resulted in improper payments being overlooked as payments that did not comply with Federal Acquisition Regulations and the Prompt Payment Act<sup>7</sup>. To mitigate the risk of not detecting improper payments, the agency should develop a more robust test plan and provide contracting training to reviewing personnel.

### **Test Plan and Training Inadequacies Limited Reviewing Personnel’s Ability to Identify Improper Payments**

As part of our review, we selected a sample of 5 of the 134 payments reviewed by the SBA for its contracting activities. From our sample we determined that the SBA correctly identified all five payments as improper; however, the SBA did not identify the following errors within the 5 contract payments we reviewed:

- An underpayment of \$90,784.95 to one vendor;
- Outstanding late payment interest penalties of \$4,265.97 owed to three different vendors;
- A payment of \$28,572.90 for items not authorized for procurement by the contract;
- A payment of \$74,893.51 for services not authorized by the contract;
- A payment of \$869,821.23 submitted to a bank account not validated in the CCR for the vendor;
- An invoice billed at different rates than specified in the contract; and
- An invoice payment that exceeded the contract award limit of \$1 million per order.

These errors were undetected because the test plan was not sufficiently detailed to guide reviewing personnel in the identification of improper payments. In addition, reviewing personnel did not have adequate government contract training and were inexperienced in contracting. While the agency found and reported an 89 percent improper payment rate, it may have understated its improper payment rate because reviewing personnel did not identify several significant payments errors and related opportunities for correcting those errors. With an improved test plan and contract training, reviewing personnel may have been better equipped to identify the additional improper payment errors that we identified.

### **The SBA’s Improper Payment Rate Published for FY 2011 was Incomplete**

In the *AFR FY 2011*, the agency published an improper payment rate “that could reach 89 percent” for its contracting activities. However, the SBA inappropriately classified FY 2011 as a “test” (test measure) and stated that it will begin reporting improper payments for contracting activities in its FY 2012 AFR due in November 2012. Guidance issued by OMB does not provide for a one year adjustment period to become acclimated to IPERA. Nor did the SBA obtain a waiver from OMB exempting the agency from officially reporting the improper payments of its contracting activities for FY 2011. According to the SBA’s *AFR FY 2011*, “the SBA will take lessons learned from the test in FY 2011 to refine the measurement process and report improper payment estimates in the FY 2012 AFR.” It appears that the SBA attempted to diminish its responsibility for officially reporting the improper payment rate of its contracting activities during FY 2011.

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<sup>7</sup> The Prompt Payment Act requires Federal agencies to pay their bills on a timely basis, to pay interest penalties when payments are made late, and to take discounts only when payments are made by the discount date.

For example, despite OMB requirements the SBA:

- excluded the 89 percent improper payment rate for its contracting activities from the *Improper Payment Reduction Outlook* table;
- did not prepare a *Corrective Action Plan* that addresses the root cause of the improper payments; and
- did not prepare a *Payment Recapture Audit Plan* to recover overpayments.

***The SBA Did Not Include Its 89 Percent Improper Payment Rate within the Improper Payment Reduction Outlook Table as Required by OMB***

The agency did not report the improper payment details of its contracting activities within the *Improper Payment Reduction Outlook* table published in its *AFR FY 2011*. According to OMB guidance, agencies must report the programs or activities that are susceptible to significant improper payments in a table titled *Improper Payment Reduction Outlook*. This table was included within the SBA's *AFR FY 2011*<sup>8</sup> but inaccurately reported that most of the payment disbursement details were "not applicable." Most notably, the agency reported that all improper payment categories were "not applicable." Instead, the agency called its FY 2011 review a "test measurement" and stated that it planned to wait until FY 2012 before reporting the improper payments of its contracting activities. In addition, OMB guidance does not recognize a test measurement as an exception to the mandatory requirement for agencies to annually report their improper payments within the *Improper Payment Reduction Outlook* table and the SBA did not obtain a waiver of reporting requirements from OMB. Therefore, we determined that the SBA was not compliant with IPERA and IPIA reporting requirements for its contracting activities in FY 2011.

Based on language in the *AFR FY 2011*, it appears that the SBA has taken the position that they are not required to comply with all OMB requirements for IPERA. Further, instead of identifying the root causes of SBA's excessive improper payment rate, the SBA plans on refining their measurement for FY 2012. Any program or activity that is susceptible to a significant improper payment must develop a *Corrective Action Plan* and a *Payment Recapture Audit Plan* to address the root cause.

***The SBA did not Develop Corrective Action and Payment Recapture Audit Plans as Required by the OMB***

The SBA did not develop or publish a *Corrective Action Plan* and a *Payment Recapture Audit Plan* for the improper payments of its contracting activities in its *AFR FY 2011*. Guidance issued by OMB requires agencies to publish a *Corrective Action Plan* for each root cause of improper payments for every program or activity reviewed in the *AFR*. It also requires agencies to implement corrective actions that prevent and reduce improper payments. Agencies are also required to submit a single *Payment Recapture Audit Plan* that describes their current and planned payment recapture efforts. Further, OMB guidance directs agencies to determine whether the Payment Recapture Audit program is cost effective. In circumstances when a Payment Recapture Audit program is not cost effective, the agency must notify OMB and the agency Inspector General of this decision and include any analyses used by the agency to reach this decision. The SBA did not provide its rationale for not developing or publishing a *Corrective Action Plan*, and the SBA's *AFR FY 2011* did not provide an analysis to support the agency's

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<sup>8</sup> The *AFR FY 2011* includes the *Improper Payment Reduction Outlook table* on p. 116. The table footnotes that SBA will refine its FY 2011 test results and report a measurement in FY 2012.

determination that the *Payment Recapture Audit Plan* was not cost effective. The OIG requested copies of the SBA's *Corrective Action Plan* and the *Payment Recapture Audit Plan* for its contracting activities on several occasions, however, neither document was provided. The SBA also did not obtain a written waiver from OMB to exempt the contracting activity from complying with OMB guidance. Moreover, the SBA did not provide rationale for not obtaining a written waiver from OMB.

## Conclusion

Despite publishing an extremely high improper payment rate of 89 percent in its AFR FY 2011, the SBA may not have identified all improper payments due to the test plan and training inadequacies. In addition, the SBA may not have identified all root causes of improper payments in its contracting programs. Making improvements to the test plan and providing contract training to personnel responsible for preparing the plan and performing the review should improve the SBA's detection of improper payments within its contracting activities.

The SBA classified its FY 2011 improper payment rate as a test measure and therefore, did not fully comply with OMB reporting requirements. In addition, the SBA did not submit a *Corrective Action Plan* and a *Payment Recapture Audit Plan* for its contracting activities that were susceptible to significant improper payments. Without addressing the root cause of SBA's improper payments the agency remains at high risk for future improper payments that exceed the allowable 2.5 percent of activity outlays and \$10 million in payments<sup>9</sup>. Ultimately, an excessive improper payment rate could result in a transfer of authority for agency funds<sup>10</sup>. According to OMB guidance, agencies that do not comply with IPIA and IPERA reporting requirements must submit a plan to the Senate Homeland Security and Government Affairs Committee and the House Committee on Oversight and Governmental Reform describing the actions that the agency will take to become compliant within 90 days of the issuance of this memorandum.

## Recommendations

With regard to contracting activities, we recommend that the Chief Financial Officer:

1. Develop and implement a more robust test plan that provides reasonable assurance of detecting improper payments within the program during FY 2012.
2. Determine the underlying causes of the contracting activities improper payments for the FY 2011 IPERA review and develop and implement a robust *Corrective Action Plan* and a *Payment Recapture Audit Plan* for the improper payments of its contracting activities for FY 2011 or obtain a written waiver from OMB.
3. Provide contract training to the SBA personnel responsible for developing the test plan and performing the agency's improper payment review to ensure the detection of improper payments.

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<sup>9</sup> OMB M-11-16, *Issuance of Revised Parts I and II to Appendix C of OMB Circular A-123*, defines significant improper payments as gross annual improper payments (i.e., the total amount of overpayments plus underpayments) in the program exceeding (1) both 2.5 percent of program outlays and \$10,000,000 of all program or activity payments made during the fiscal year reported or (2) \$100,000,000.

<sup>10</sup> OMB M-11-16, *Issuance of Revised Parts I and II to Appendix C of OMB Circular A-123*, states that the Director of OMB may exercise reprogramming or transfer authority for programs or activities that are non-compliant for two consecutive years.

4. Develop procedures to annually review the SBA's *Corrective Action Plan* to determine if actions are sufficient.
5. Submit to the Senate Homeland Security and Government Affairs Committee and the House Committee on Oversight and Governmental Reform within 90 days of this memorandum a plan that includes:
  - a. Measurable milestones for becoming compliant with IPERA;
  - b. Designation of an accountable senior agency official; and
  - c. The establishment of an accountability mechanism, describing the actions the agency will take to become compliant.

## **Agency Comments and Office of Inspector General Response**

On February 2, 2012, we provided a draft of this report to SBA's Office of the Chief Financial Officer (OCFO) for comment. On February 17, 2012, management submitted formal comments, which are contained in their entirety in Appendix I. While management provided numerous comments, it did not specifically state whether it agreed or disagreed with the audit findings and recommendations; and we found management's comments to be unresponsive to four of five of our recommendations. We summarized management's comments and our evaluation of them below.

### **Management Comments**

Management provided a five page response, the bulk of which provided background information and its justification for its abbreviated approach and reporting of its improper payment review. Much of the discussion was a reiteration of the statements they provided during the audit that are addressed in the findings.

Among other things, management asserted that the root cause for the FY 2011 improper payments was due to the fact that "all but four of the contracts reviewed were dated prior to the transfer of the acquisition function to the OCFO, and we found incomplete files and contracts not executed properly in the transferred files." Management also stated "we found that the errors were primarily due to lack of adequate documentation or errors on the documentation itself – not errors in payment amounts or payment for undelivered goods or services. In an effort to avoid misleading the public, the [AFR] narrative stated that had the measurement reflected payments made in inaccurate amounts or non-compliance with contract terms, the improper payment rate would be 3%."

### **OIG Response**

While we recognize the challenges the SBA faced in conducting its review, the OIG was required to conduct a statutory review in accordance with OMB guidance, which we did. That guidance did not allow for exceptions, or abbreviated reporting by agencies. While the OIG understands that the procurement function, prior to transferring to the CFO, had significant deficiencies — as noted by management's reference to incomplete files and improper contracts — this condition did not exempt the SBA from adhering to the IPERA requirements. In fact, incomplete files and improper contracting are significant "red flags" that internal controls, to assure proper payments, were lacking. Without proper internal controls, the SBA had no assurance that its payments were proper.

## **Recommendation 1**

### ***Management Comments***

Management stated its test plan was adequate as evidenced by its use that resulted in a “staggering” improper payment rate of 89%, and their consultation about their test plan with the Acquisition Division Manager and OIG. Management stated, however, that it would enhance the test plan by incorporating suggested changes and comments provided by the OIG.

### ***OIG Response***

While management stated it would enhance their test plan by incorporating suggested changes and comments from the OIG, we believe management should also reassess the plan using other knowledgeable contracting personnel and their own reassessment of their process. While OIG has observations, it is not the OIG’s role to develop their plan and the agency should consider its adequacy based on its thorough analysis of it.

While the agency did not specifically disagree with our recommendation, we believe there needs to be more specificity in their planned activities. We will address this in the audit follow-up process.

## **Recommendation 2**

### ***Management Comments***

Management stated that it could not determine the true root cause; however, it suggested the root cause was due to a lack of complete files and improper contracting practices. It further stated that it developed a high-level *Corrective Action Plan* published in the *AFR FY 2011* (page 115). Further, the response stated that they submitted a *Payment Recapture Audit Plan* on September 15, 2011, establishing that a payment recapture audit was not cost effective. Lastly, the FY 2011 assessment helps to establish a baseline for future testing, and a more formal, comprehensive *Corrective Action Plan* will be developed.

### ***OIG Response***

Management did not publish a *Corrective Action Plan* or a *Payment Recapture Plan* in its *AFR FY 2011* as required by IPIA and IPERA guidance. In addition, it did not provide an analysis to support management’s assertion that a payment recapture audit was not cost effective. While its comments recognize the need to develop underlying causes and a more comprehensive plan for corrective action, management did not provide specific steps or timeframes for implementation. We will address this in the audit follow-up process.

## **Recommendation 3**

### ***Management Comments***

Management did not respond to the recommendation.

***OIG Response***

We will pursue resolution within the audit follow-up process.

**Recommendation 4**

***Management Comments***

Management did not address the recommendation with any specificity. Management stated that it will develop a more comprehensive plan in the future and publish it in the AFR in future years.

***OIG Response***

We will pursue resolution within the audit follow-up process.

**Recommendation 5**

***Management Comments***

Management stated that it would, within 90 days of the date of the final version of this memorandum, submit a plan, to the Senate Homeland Security and Government Affairs Committee and the House Committee on Oversight and Government Reform, as outlined within the OIG recommendation.

***OIG Response***

The agency concurs with the recommendation.

**Actions Required**

Please provide your management decision for each recommendation on the attached SBA Forms 1824, *Recommendation Action Sheet*, within 30 days from the date of this advisory memorandum. Your decision should identify the specific action(s) taken or planned for each recommendation and the target date(s) for completion.

We appreciate the courtesies and cooperation of the Small Business Administration during this review. If you have any questions concerning this memorandum, please call me at (202) 205-7390 or Riccardo R. Buglisi, Director, Business Development Programs Group at (202) 205-7489.

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/S/ original signed  
John K. Needham  
Assistant Inspector General for Auditing



## Appendix I. Management Comments



### U.S. SMALL BUSINESS ADMINISTRATION OFFICE OF THE CHIEF FINANCIAL OFFICER

February 17, 2012

To: John K. Needham  
Assistant Inspector General for Auditing

Subject: Advisory Memorandum dated February 2, 2012, Project 11010  
The SBA's Improper Payment Review and Reporting for its Contracting Activities

The Office of the Chief Financial Officer (OCFO) supports the purpose of the Improper Payments Elimination and Recovery Act of 2010 (IPERA) and is working to comply with all aspects of the act. We appreciate this opportunity to reply to your observations and draft recommendations noted in the draft Advisory Memorandum dated February 2, 2012, which outlines compliance issues noted in your review.

Before delving into specifics, we thought it useful to provide some background.

- SBA's Contracting area did not meet the requirements for reporting improper payments before the Improper Payment Elimination and Recovery Act of July 2010.
- Due to the limited amount of outlays (\$133.4 million for the improper payment period), SBA determined that recapture audits were not cost effective.
- SBA admitted in the FY 2011 Agency Financial Report that contracting activities suggest a higher than acceptable improper payments rate.
- The high rate of contracting improper payments was generally due to documentation errors, not due to payments errors or non-receipt of goods or services.
- If the improper payments measurement reflected payments made in inaccurate amounts or non-compliance with contract terms, the improper payments rate would be 3% or \$4.5 million.
- SBA is using its FY 11 test, to refine its measurement process for reporting improper payments in a category, which will be reported in the FY 2012 Agency Financial Report.
- SBA has taken several corrective actions, with further corrective actions planned, to reduce the contracting improper payments rate. For instance, SBA is providing and improving COTR training, enhancing the Contract Management System interface with the financial system, developed a "Review Checklist" and conducting a review of all active contract files to identify missing documents and correct documentation errors, re-instituted legal reviews and expanded legal staff, enhanced training and intake checklist for invoices, and is revising the Standard Operating Procedures for Contracting.
- SBA will continue to cooperate with Office of Inspector General staff in creating test plans and in conducting testing.
- SBA has revised the corrective action plan for contracting improper payments.
- SBA takes seriously its responsibility for reducing and eliminating improper payments, and has implemented or is implementing Governmentwide improper payments guidance and best practices (provided on the Office of Federal Financial Management's Improper Payments website at [www.whitehouse.gov/omb/financial\\_fia\\_improper/](http://www.whitehouse.gov/omb/financial_fia_improper/)).

- SBA provides trained and qualified staff, contractors and resources to its improper payments office. The Director, Office of Internal Controls, reports directly to the Chief Financial Officer. SBA's Senior Assessment Team meets monthly, and SBA complies with the Governmentwide internal controls requirements and guidance.
- Trained internal control reviewers are not required to be subject matter experts in every area that they review. Instead, they are expected to have expertise in how to review and test internal control measures to make sure they are effective, efficient, and achieve results.
- SBA participates in the President's Campaign to Cut Waste and continues to make advances in program efficiencies in its programs.

We offer the following responses to your specific observations and recommendations:

**Observation: The SBA's Test Plan Placed the Agency at Risk for not Detecting Improper Payments.**

Recommendation #1: Develop and implement a more robust test plan that provides reasonable assurance of detecting improper payments within the program during FY2012.

Management Response: FY 2011 marks the first annual improper payments review under IPERA, and as noted in the AFR, the OCFO is committed to improving its improper payments measurement and related business processes. The 2011 test plan was developed by a trained auditor and reviewed by the Deputy Chief Financial Officer (a trained external auditor) in conjunction with the Denver Finance Center's Manager of the Acquisition Division. In another measure to ensure that the plan was acceptable, we requested a review by staff from the Office of Inspector General (OIG), and we made subsequent revisions based on their recommendations.

Using this test plan, the estimated improper payment rate was 89%, a staggering rate that suggests the test plan was not "ineffective" or put the Agency at risk for undetected improper payments, as noted in the Advisory Memorandum. In addition, the examples cited regarding 11 of 16 steps of the test plan may have added clarity, but none materially changed a step. Nothing was recommended to be deleted and the only addition recommended was the Federal Acquisition Regulation (FAR) 10 required items of a proper invoice, of which some items were already in the test plan. With that said, we will enhance our test plan by making the changes suggested by the OIG. We will also ask that the Manager of the Acquisition Division review and approve the final test plan as suggested in discussions with the OIG.

**Observation: Test Plan and Training Inadequacies Limited Reviewing Personnel's Ability to Identify Improper Payments.**

Recommendation #3: Provide contract training to the SBA personnel responsible for developing the test plan and performing the agency's improper payment review to ensure the detection of improper payments.

Management Response: The OCFO is committed to the detection and elimination of improper payments. As such, management engaged relevant stakeholders such as OMB and the OIG early and often throughout the course of this first-ever IPERA review over contracting. The review team is led by a certified internal auditor who is qualified to conduct the review over improper payments.

The review at the Denver Finance Center was conducted in consultation with the agency's procurement team that is required to maintain annual training certification on Federal contracting laws and regulations.

The sampled 5 payments selected by the OIG for review were detected as improper payments by the review team and were reported in the 89% improper payment rate. Consistent with the OIG findings, the team also found multiple issues with each payment of the OIG sample and subsequently reported the entire payment as improper. Moreover, only 13 of the 134 payments reviewed were identified by the review team as without issue; therefore, if the improper payment rate was understated as asserted in the Advisory Memorandum, the amount would not be significant.

To respond specifically to the differences noted in the OIG review, we noted the following:

- **An underpayment of \$90,784.95 to one vendor.** The contract was split funded between loan funds and S&E funds, and partial payment was made through the loan system on 9/22/10. We have attached a copy of the confirmation to this memorandum.
- **Outstanding late payment interest penalties of \$4,265.97 owed to three different vendors.** We agree with the OIG on two vendor interest payments but found a discrepancy with one of the vendors: The OIG found a \$75.54 difference; however, we paid \$1,178.07 in interest, which we believe to be accurate. We will pay the remaining two vendors the interest due.
- **A payment of \$28,572.90 for items not authorized for procurement by the contract.** We agree this was an error at the time of initial payment, however a later invoice removed the need for any recovery. We will flag the payment as unauthorized and review under the ratification process to determine further action.
- **A payment of \$74,893.51 for services not authorized by the contract.** We agree this was an error at the time of payment. However, the payment was for services provided and accepted. We will flag the payment as unauthorized and review under the ratification process to determine further action.
- **A payment of \$869,821.23 submitted to a bank account not validated in the CCR for the vendor.** We have validated that the account that received the payment was for the correct vendor, just not the vendor's account reflected in the CCR. We will evaluate ways to assure update of agency records when the vendor changes banking information in the CCR.
- **An invoice billed at different rates than specified in the contract.** The contract is a firm fixed price contract and we paid less than the firm fixed price. As we go through the contract close-out process, will confirm with the vendor that there is no outstanding balance due.
- **An invoice payment that exceeded the contract award limit of \$1 million per order.** We are still researching this particular award to confirm that no subsequent modifications change the per order limit. Based on our finding will use this example to reinforce training with our contracting officers.

**Observations: The SBA's Improper Payment Rate Published for FY2011 was Incomplete; The SBA Did not Include Its 89 Percent Improper Payment Rate within the Improper Payment Reduction Outlook Table as Required by OMB.**

Management Response: We believe the improper payment rate of 89% was fairly presented in the narrative of SBA's Annual Financial Report (AFR), consistent with the OMB guidance presented in the revised Parts I and II to Appendix C of OMB Circular A-123<sup>11</sup> and Circular A-136, which allows annotation either by a note or "N/A," and where there is no measurement provided, the indication of a date by which a measurement is expected. Including the extraordinarily high rate without explanation within Table 1 would have been misleading to the public, as it implies that SBA paid for goods and/or services never received or performed or that the SBA paid the wrong amounts – neither is accurate in any instance. Without access to the former procurement team, we could not determine the true root cause; however, based on the resources available, we found that the errors were primarily due to lack of adequate documentation or errors on the documentation itself – not errors in payment amounts or payment for undelivered goods or services. In an effort to avoid misleading the public, the narrative stated that had the measurement reflected payments made in inaccurate amounts or non-compliance with contract terms, the improper payment rate would be 3%.

As allowable under OMB guidance and presented in the AFR, the agency determined contracting to be a high-risk program that we will reassess and modify the review methodology once it is determined within this coming year. Thus, the rate was excluded, as discussed with SBA's Inspector General and with OMB, which confirmed the risk assessments to identify programs susceptible to significant improper payments (step 1) and the statistical sample to report improper payment estimates (step 2) do not have to be completed in the same year. The sentence extracted from the AFR in your memorandum, "the SBA will take lessons learned from the test in FY2011 to refine the measurement process and report improper payment estimates in the FY2012 AFR" was written with the knowledge that the estimated error rate provided to our statistician to calculate the sample size was too low and as a result our precision was not within IPERA guidelines. With the information we have now after the 2011 test results, we will be able to refine our measurement process, which may likely result in a higher sample size to reach the precision required by IPERA in order to provide a more accurate improper payment rate. All but four of the contracts reviewed were dated prior to the transfer of the acquisition function to the OCFO, and we found incomplete files and contracts not executed properly in the transferred files.

**Observation: The SBA did not Develop Corrective Action and Payment Recapture Audit Plans as Required by the OMB.**

Recommendation #2: Determine the underlying causes of the contracting improper payments for the FY2011 IPERA review and develop and implement a robust Corrective Action Plan and a Payment Recapture Audit Plan for the improper payments of its contracting activities for FY2011 or obtain a written waiver from OMB.

Recommendation #4: Develop procedures to annually review the SBA's Corrective Action Plan to determine if actions are sufficient.

Management Response: The SBA identified the root cause, as described above, and it developed a high-level Corrective Action plan published in the AFR (page 115) that identifies steps taken to

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<sup>11</sup> Transmitted via OMB Memorandum 11-16, April 14, 2011

implement improvements in contracting. It is important to note that the FY 2011 assessment helps to establish a baseline for future testing, and a more formal, comprehensive Corrective Action Plan will be developed as we determine and refine remedial action and their appropriate timelines. Until that time, we aim to send an initial plan for your review in response to your final report. It is estimated that a more formal plan as outlined in the A-136 will be published in the AFR in future years.

SBA did develop and submit a Payment Recapture Audit Plan to OMB on 9/15/11 and copied OIG staff on the email. In the plan was our justification that a payment recapture audit was not cost effective. SBA has not received comment on its assessment regarding the establishment of a payment recapture program. Communications have suggested that OMB is not issuing “waivers,” given that the responsibility is upon the agencies to make that determination. Management has concluded it will not establish such a program given it is not cost-effective. Further, it is not accurate to say we did not include our justification in the AFR as it is discussed in the Recapture of Improper Payments section (page 117).

Recommendation #5: Submit to the Senate Homeland Security and Government Affairs Committee and the House Committee on Oversight and Governmental Reform within 90 days of this memorandum a plan that includes:

- a. Measurable milestones for becoming compliance with IPERA;
- b. Designation of an accountable senior agency official; and
- c. The establishment of an accountability mechanism, describing the actions the agency will take to become compliant.

Management Response: Within 90 days of the date of your final version of the memorandum, we will submit to the Senate Homeland Security and Government Affairs Committee and the House Committee on Oversight and Governmental Reform the items listed in point a, b, and c above, per the IPERA guidance.

Thank you again for this opportunity to provide comments on your draft memorandum on improper payment compliance for contracts. Please contact us if you have any questions or need additional information.

Sincerely,

Jonathan Carver  
Chief Financial Officer  
Chief Acquisition Officer