



U.S. SMALL BUSINESS ADMINISTRATION  
OFFICE OF INSPECTOR GENERAL  
AUDITING DIVISION

**AUDIT REPORT**

**Issue Date:** November 15, 2007

**Number:** 8-03

**To:** Steven C. Preston  
Administrator

Jennifer Main  
Chief Financial Officer

**From:** Debra Ritt, [Exemption 6]  
Assistant Inspector General for Auditing

**Subject:** Audit of SBA's FY 2007 Financial Statements

Pursuant to the Chief Financial Officer's Act of 1990, attached are the *Independent Auditors' Report* and accompanying reports on internal control and compliance with laws and regulations issued by KPMG LLP for the fiscal year ending September 30, 2007. The audit was performed under a contract with the Office of Inspector General (OIG) and in accordance with *Generally Accepted Government Auditing Standards*; Office of Management and Budget's (OMB) Bulletin 07-04, Audit Requirements for Federal Financial Statements, the Government Accountability Office (GAO)/President's Council on Integrity and Efficiency (PCIE) *Financial Audit Manual* and GAO's *Federal Information System Controls Audit Manual*.

The KPMG report concluded that SBA's consolidated financial statements presented fairly, in all material respects, the financial position of SBA as of and for the years ended September 30, 2007 and 2006. It also presented fairly, in all material respects, SBA's net costs, changes in net position, and combined statements of budgetary resources for the years then ended.

With respect to internal control over financial reporting, KPMG reported a significant deficiency related to Information Technology security controls, but did not consider this deficiency to be a material weakness. Details regarding this significant deficiency are discussed more in Exhibit 1 of the *Independent Auditors' Report*.

KPMG's test for compliance with certain laws, regulations, contracts and grant agreements determined that the Agency does not fully comply with the Debt Collection Improvement Act (DCIA) of 1996 because SBA does not consistently follow Treasury guidelines when referring delinquent debts for collection. Details regarding the auditor's conclusion are included in the Compliance and Other Matters section of the *Independent Auditor's Report*. The auditors did not report any other instances or matters regarding noncompliance.

We provided a draft of KPMG's report to SBA's Chief Financial Officer (CFO), who concurred with its findings and recommendations and agreed to implement the recommendations. The CFO is pleased that SBA has received an unqualified audit opinion with no reported material weaknesses and believes these results accurately reflect the quality of the Agency's financial statements and its improved accounting, budgeting and reporting processes. The CFO also acknowledged that SBA was not in compliance with the DCIA, and outlined Agency plans to improve standard operating procedures.

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 the SBA's financial statements, KPMG's conclusions about the effectiveness of internal control, 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 appreciate the cooperation and assistance of SBA and KPMG. Should you or your staff have any questions, please contact me at [Exemp 2] or Jeffrey R. Brindle, Director, Information Technology and Financial Management Group at (202) 205- [Exemption 2]

Attachments



KPMG LLP  
2001 M Street, NW  
Washington, DC 20036

### **Independent Auditors' Report**

Office of Inspector General  
U.S. Small Business Administration:

We have audited the accompanying consolidated balance sheets of the U.S. Small Business Administration (SBA) as of September 30, 2007 and 2006, and the related consolidated statements of net cost, changes in net position, and combined statements of budgetary resources (hereinafter referred to as "consolidated financial statements") for the years then ended. The objective of our audits was to express an opinion on the fair presentation of these consolidated financial statements. In connection with our fiscal year 2007 audit, we also considered SBA's internal controls over financial reporting and tested SBA's compliance with certain provisions of applicable laws, regulations, contracts, and grant agreements that could have a direct and material effect on these consolidated financial statements.

#### **SUMMARY**

As stated in our opinion on the consolidated financial statements, we concluded that SBA's consolidated financial statements as of and for the years ended September 30, 2007 and 2006, are presented fairly, in all material respects, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 16 to the consolidated financial statements, SBA changed its method of reporting the reconciliation of budgetary resources obligated to the net cost of operations in fiscal year 2007.

Our consideration of internal control over financial reporting resulted in the following condition being identified as a significant deficiency:

- Improvement needed in management's information technology security controls.

However, we did not consider this significant deficiency to be a material weakness.

The results of our tests of compliance with certain provisions of laws, regulations, contracts, and grant agreements disclosed one instance of noncompliance with the following law that is required to be reported under *Government Auditing Standards*, issued by the Comptroller General of the United States, and Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*:

- Debt Collection Improvement Act of 1996 (DCIA)

The following sections discuss our opinion on SBA's consolidated financial statements; our consideration of SBA's internal control over financial reporting; our tests of SBA's compliance with certain provisions of applicable laws, regulations, contracts, and grant agreements; and management's and our responsibilities.



## **OPINION ON THE FINANCIAL STATEMENTS**

We have audited the accompanying consolidated balance sheets of SBA as of September 30, 2007 and 2006, and the related consolidated statements of net cost, changes in net position, and the combined statements of budgetary resources for the years then ended.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of SBA as of September 30, 2007 and 2006, and its net costs, changes in net position, and budgetary resources for the years then ended in conformity with U.S. generally accepted accounting principles.

As discussed in Note 16 to the consolidated financial statements, SBA changed its method of reporting the reconciliation of budgetary resources obligated to the net cost of operations in fiscal year 2007.

The information in the Management Discussion and Analysis, Required Supplementary Stewardship Information, and Required Supplementary Information sections is not a required part of the consolidated financial statements, but is supplementary information required by U.S. generally accepted accounting principles and OMB Circular No. A-136, *Financial Reporting Requirements*. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of this information. However, we did not audit this information, and accordingly, we express no opinion on it.

## **INTERNAL CONTROL OVER FINANCIAL REPORTING**

Our consideration of the internal control over financial reporting was for the limited purpose described in the Responsibilities section of this report and would not necessarily disclose all deficiencies in the internal control over financial reporting that might be significant deficiencies or material weaknesses.

A control deficiency 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 misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects SBA's ability to initiate, authorize, record, process, or report financial data reliably in accordance with U.S. generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of SBA's consolidated financial statements that is more than inconsequential will not be prevented or detected by SBA's internal control over financial reporting. A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by SBA's internal control.

In our fiscal year 2007 audit, we consider the deficiency described in Exhibit I to be a significant deficiency in internal control over financial reporting, and we believe that the significant deficiency described in Exhibit I is not a material weakness. Summaries of the status of the prior year material weakness and reportable conditions, and management's response to our findings are included as Exhibits III, IV, and V, respectively.

We also noted certain additional matters that we reported to SBA's management in a separate letter dated November 14, 2007.



## COMPLIANCE AND OTHER MATTERS

Our tests of compliance with certain provisions of laws, regulations, contracts, and grant agreements, as described in the Responsibilities section of this report, exclusive of those referred to in the *Federal Financial Management Improvement Act of 1996* (FFMIA), disclosed one instance of noncompliance that is required to be reported herein under *Government Auditing Standards* or OMB Bulletin No. 07-04, and is described below.

**Debt Collection Improvement Act of 1996 (DCIA).** During our testwork, we noted that SBA did not consistently follow Treasury guidelines when referring delinquent debts for collection. Specifically, we noted that 47 of 140 delinquent debt referral transactions tested were not referred timely or were coded improperly in SBA's Loan Accounting System. Of the 47 exceptions noted, 41 of the items were referred only to the Treasury Offset Program (TOP), when the DCIA requirement is to refer delinquent debts to both the TOP and the Treasury Servicing Program. As a result, management did not refer approximately 24,000 delinquent debts for Treasury cross-servicing. SBA management believes that the issue stems from outdated standard operating procedures and a lack of clear instructions to field offices regarding the referral of delinquent debt to Treasury. SBA management stated it has established revised protocols that will provide clear instructions to field offices to use in the future regarding how to properly refer charge-offs to the TOP and Treasury Servicing program in accordance with DCIA. In regards to the remaining 6 items noted as exceptions above, the referral to Treasury for servicing did not occur within 180 days of delinquency as required by DCIA. According to SBA management, efforts are under way to address this situation.

The results of our tests of compliance as described in the Responsibilities section of this report, exclusive of those referred to in FFMIA, disclosed no other instances of noncompliance or other matters that are required to be reported herein under *Government Auditing Standards* or OMB Bulletin No. 07-04.

The results of our tests of FFMIA disclosed no instances in which SBA's financial management systems did not substantially comply with the three requirements discussed in the Responsibilities section of this report.

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## RESPONSIBILITIES

**Management's Responsibilities.** The United States Code Title 31 Section 3515 and 9106 require agencies to report annually to Congress on their financial status and any other information needed to fairly present their financial position and results of operations. To meet these reporting requirements, SBA prepares and submits financial statements in accordance with OMB Circular No. A-136.

Management is responsible for the consolidated financial statements, including:

- Preparing the consolidated financial statements in conformity with U.S. generally accepted accounting principles
- Preparing the Management Discussion and Analysis (including the performance measures), Required Supplementary Information, and Required Supplementary Stewardship Information



- Establishing and maintaining effective internal control
- Complying with laws, regulations, contracts, and grant agreements applicable to SBA, including FFMIA.

In fulfilling this responsibility, management is required to make estimates and judgments to assess the expected benefits and related costs of internal control policies.

**Auditors' Responsibilities.** Our responsibility is to express an opinion on the fiscal year 2007 and 2006 consolidated financial statements of SBA based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Bulletin No. 07-04. Those standards and OMB Bulletin No. 07-04 require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of SBA's internal control over financial reporting. Accordingly, we express no such opinion.

An audit also includes:

- Examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements
- Assessing the accounting principles used and significant estimates made by management
- Evaluating the overall consolidated financial statement presentation.

We believe that our audits provide a reasonable basis for our opinion.

In planning and performing our fiscal year 2007 audit, we considered SBA's internal control over financial reporting by obtaining an understanding of the SBA's internal control, determining whether internal controls had been placed in operation, assessing control risk, and performing tests of controls as a basis for designing our auditing procedures for the purpose of expressing our opinion on the consolidated financial statements. We limited our internal control testing to those controls necessary to achieve the objectives described in *Government Auditing Standards* and OMB Bulletin No. 07-04. We did not test all internal controls relevant to operating objectives as broadly defined by the *Federal Managers' Financial Integrity Act of 1982*. The objective of our audit was not to express an opinion on the effectiveness of SBA's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the SBA's internal control over financial reporting.

As part of obtaining reasonable assurance about whether SBA's fiscal year 2007 consolidated financial statements are free of material misstatement, we performed tests of SBA's 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 SBA financial statement amounts, and certain provisions of other laws and regulations specified in OMB Bulletin No. 07-04, including certain provisions referred to in FFMIA. We limited our tests of compliance to the provisions described in the preceding sentence, and we did not test compliance with all laws,



regulations, contracts, and grant agreements applicable to SBA. However, providing an opinion on compliance with laws, regulations, contracts, and grant agreements was not an objective of our audit, and accordingly, we do not express such an opinion.

Under OMB Bulletin No. 07-04 and FFMIA, we are required to report whether SBA's financial management systems 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. To meet this requirement, we performed tests of compliance with FFMIA Section 803(a) requirements.

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SBA's response to the findings identified in our audit report is presented in Exhibit V. We did not audit SBA's response, and accordingly, we express no opinion on it.

This report is intended solely for the information and use of SBA's management, SBA's Office of Inspector General, OMB, the U.S. Government Accountability Office, and the U.S. Congress, and is not intended to be, and should not be, used by anyone other than these specified parties.

**KPMG LLP**

November 14, 2007

**U.S. Small Business Administration**  
Significant Deficiency

**Introduction**

The internal control deficiency discussed in this report and the U.S. Small Business Administration's (SBA) progress toward correcting it are discussed in the context of SBA's organizational structure and its ability to obtain funding to take corrective action. Exhibit I herein describes the control deficiencies, which collectively resulted in the significant deficiency reported below, for the year ended September 30, 2007, and our recommendations thereon. The status of prior year compliance and internal control deficiencies are reported in Exhibits II, III, and IV, respectively, and SBA management's response is presented in Exhibit V.

***(1) Improvement Needed in Management Information Technology Security Controls***

During fiscal year 2007, we noted that SBA made progress in several areas in its efforts to address prior year Information Technology (IT) internal control deficiencies. Despite these improvements, deficiencies continue to exist in the areas of security access controls, software program changes, and end user computing.

**Security Access Controls**

Integral to an organization's security program management efforts, technical security access controls for systems and applications should 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.

A summary of the security access control deficiencies we identified during the fiscal year 2007 SBA financial audit follow:

- There are no procedures documented for the sanctions process against the personnel not compliant with existing SBA security policies.
- The Office of the Chief Information Officer personnel/management (collectively referred to herein as OCIO) does not maintain enough storage capacity for the server audit logs.
- OCIO does not retain the logs long enough to allow for a sufficient review.
- OCIO does not have formal day-to-day operating procedures documented for data center employees, which include segregation of critical functions.



**U.S. Small Business Administration**

**Significant Deficiency**

Recommendations – security access controls:

We recommend that:

1. OCIO implement a formal sanctioning policy for those personnel and contractors who do not complete the required annual computer security training program.
2. OCIO allocate a larger storage space for audit logs.
3. OCIO retain audit logs for longer periods (at least a week) to enable sufficient management review.
4. OCIO develop and implement specific policies and procedures outlining the day-to-day actions performed by data center employees.

**Software Program Changes**

The primary focus of an organization's software change/configuration management program is on controlling the software changes made to systems and applications in operation. Without such controls, there is a risk that security features could be inadvertently or deliberately omitted or turned off, or that processing irregularities or malicious code could be introduced into the IT environment.

A summary of the software program change control deficiencies we identified during the fiscal year 2007 SBA financial audit follow:

- The configuration baselines for the Disaster Credit Management System (DCMS) have not been updated with information from the last change to system settings.
- The configuration baselines for the LAS do not contain a date indicating when it was last updated.

Recommendations – software program changes:

We recommend that:

5. OCIO inform application service providers of policies and procedures for regularly updating DCMS configuration baselines and dates for major applications and general support systems.
6. OCIO create policies that mandate documentation of all noncompliance with established SBA LAS configuration benchmarks and require management approval.

**U.S. Small Business Administration**  
Significant Deficiency

**End User Computing**

End user computing tools/programs (e.g., spreadsheets and other user-developed programs) present the need for a unique set of general control needs within an organization. By its nature, end user computing brings the development and processing of information systems closer to the user. While this environment may not typically be subjected to the same level of rigor and structure as an IT general controls environment, we believe policies and procedures in this area are important to the overall IT environment. During our review, we noted that the Office of the Chief Operating Officer (COO) has not documented policies and program offices have not documented procedures for end user computing, specifically enforcing access controls over critical end user programs.

Recommendations – end user computing:

We recommend that:

7. COO develop and implement policies for end user computing, specifically enforcing user-level access controls over existing programs and data objects.
8. All program offices identify critical end user programs and develop end user computing procedures in accordance with end user policies.

## U.S. Small Business Administration

## Status of Prior Year Noncompliance

Fiscal Year 2006 Noncompliance	Fiscal Year 2007 Status of Noncompliance
<p data-bbox="183 497 800 621"><b>Federal Financial Management Improvement Act of 1996 (FFMIA)</b> – FFMIA requires Federal agencies to be in substantial compliance with the criteria listed below:</p> <ul data-bbox="183 653 800 863" style="list-style-type: none"><li data-bbox="183 653 800 716">• Federal financial management systems requirements</li><li data-bbox="183 741 800 772">• Federal accounting standards</li><li data-bbox="183 804 800 863">• U.S. Standard General Ledger (USSGL) at the transaction level</li></ul> <p data-bbox="183 894 800 1018">During fiscal year 2006, our tests indicated instances in which SBA’s information systems did not substantially comply with the first criteria listed above regarding Federal financial management systems requirements.</p>	<p data-bbox="839 497 1450 590">The results of our tests of compliance with FFMIA in fiscal year 2007 disclosed no instances in which SBA is in substantial noncompliance with FFMIA.</p>

**U.S. Small Business Administration**  
Status of Prior Year Material Weakness

<b>Fiscal Year 2006 Finding</b>	<b>Fiscal Year 2007 Status of Finding</b>
<p>During fiscal year 2006, we reported a material weakness in internal control related to SBA's financial reporting process.</p>	<p>During fiscal year 2007, SBA made significant operational improvements over the controls centered on funds management, financial accounting, and account balance reviews. Additionally, SBA enhanced its procedures to identify areas of risk in its financial systems and reporting processes to better assess whether financial information is adequately reported in the financial statements and note disclosures.</p> <p>Therefore, in fiscal year 2007, this matter was closed.</p>

**U.S. Small Business Administration**  
Status of Prior Year Reportable Conditions

Fiscal Year 2006 Findings <sup>1</sup>	Fiscal Year 2007 Status of Findings
1. Improvement needed over budgetary controls surrounding obligations	<p>During fiscal year 2007, SBA made significant, overall operational improvements over budgetary controls centered on travel vouchers and undelivered orders, financial accounting, and account balance reviews. In addition, our testwork did not identify any significant misstatements in the amounts reported.</p> <p>Therefore, this matter was closed in fiscal year 2007.</p>
2. Improvement needed in management information technology security controls	<p>During our review of SBA's information technology (IT) general and application controls, we noted improvements in formalizing policies and procedures over granting users emergency access, formalizing continuity of operations plan (COOP), and documenting reviews of remote users. However, we continued to identify opportunities for SBA to improve its internal controls. The control deficiencies that continue to exist are in the following areas: security access controls, software program changes, and end user computing.</p> <p>Therefore, in fiscal year 2007, the presentation of the issue was modified to reflect current year operations, and we continue to report a significant deficiency in internal controls as it relates to IT systems and their impact on the consolidated financial statements. See Exhibit I for additional information.</p>

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<sup>1</sup> Effective for periods ending on or after December 15, 2006, Statement of Auditing Standards (SAS) No. 112 replaces SAS No. 60 and establishes new criteria for evaluating internal control deficiencies. Under SAS No. 60, the auditor must evaluate identified control deficiencies and determine whether those deficiencies, individually or in combination, are significant deficiencies or material weaknesses. Further, the auditor must communicate, in writing, significant deficiencies and material weaknesses (including those identified in prior audits but not yet remediated) to management and those charged with governance.



U.S. SMALL BUSINESS ADMINISTRATION  
WASHINGTON, D.C. 20416

**CFO Response to Draft Audit Report on FY 2007 Financial Statements**

**DATE:** November 14, 2007

**TO:** Debra Ritt, Assistant IG for Auditing

**FROM:** Jennifer Mann, Chief Financial Officer

**SUBJECT:** Draft Audit Report on FY 2007 Financial Statements

The Small Business Administration is in receipt of the draft Independent Public Accountant report from KPMG that includes the auditor's opinion on the financial statements and review of the Agency's internal control over financial reporting and compliance with laws and regulations. The IPA audit of the Agency's financial statements and related processes is a core component of SBA's financial management program.

We are very pleased that the SBA has received an unqualified audit opinion from the independent auditor with no reported material weaknesses. We believe these results accurately reflect the quality of the Agency's financial statements and our improved accounting, budgeting and reporting processes. As you know, the SBA has worked hard over the past several years to address the many findings from our independent auditors. Our core financial reporting data and processes have improved substantially and we are proud that the results of our efforts have been confirmed by the independent auditor.

The IPA's report includes a finding that during the year the Office of Capital Access was not in compliance with the Debt Collection Improvement Act, which requires agencies to refer outstanding receivables that are delinquent over 180 days to Treasury for cross-servicing. The OCA was referring loans for Treasury offset, but through a loan system coding error one of SBA's servicing offices was not referring the same loans for cross-servicing. Out of date instructions to SBA's loan servicing offices and an incomplete standard operating procedure on loan servicing contributed to the servicing office's misunderstanding of the proper procedure for recording charged off loans.

Upon discovering this Treasury referral issue, SBA portfolio management officials worked with the OCIO to immediately refer the backlog of 24,000 loans for \$1.3 billion. This referral action was completed by July 15, 2007. A mitigation plan is in place to ensure that this error does not occur in the future. In addition, the SBA reminded all servicing centers of the procedures for processing charge-off actions, including Treasury

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referrals, that have been in effect since August 26, 1999. This reminder was provided to all servicing offices by August 30, 2007.

SBA's portfolio management office currently has a project underway to revise the SOP on loan liquidation to address more completely the Treasury referral procedures for charged off loans. This project is due for completion by December 12, 2007. As a follow up to this action SBA's portfolio management office is monitoring samples of monthly charged off loans to ensure that the loans have been correctly classified for Treasury referral. As a final step, the portfolio management officials will follow up with any servicing center that has incorrectly classified charged off loans for Treasury referral.

We appreciate all of 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 continue to be committed to excellence in financial management and look forward to making more progress in the coming year.