




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

Final Report Transmittal
Report Number: 18-03

DATE: November 14, 2017

TO: Linda E. McMahon
Administrator

FROM: Hannibal "Mike" Ware 
Acting Inspector General

SUBJECT: Independent Auditors' Report on SBA's FY 2017 Financial Statements

We contracted with the independent certified public accounting firm KPMG LLP (KPMG) to audit the U.S. Small Business Administration's (SBA's) consolidated financial statements for fiscal year (FY) 2017, ending September 30, 2017. 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. 17-03, *Audit Requirements for Federal Financial Statements*; 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 2017. 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 monitoring controls over the Secondary Market Guaranty Program;
- there is also a significant deficiency related to SBA's information technology security controls, which has been identified in the past; and
- there is one instance of noncompliance with laws and regulation related to the Debt Collection Improvement Act of 1996.

Details regarding KPMG's conclusions are included in the "Compliance and Other Matters" section and Exhibit I of 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 of 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: Allie Leslie, Deputy Administrator
Mary Anne Bradfield, Chief of Staff
Timothy Gribben, Chief Financial Officer and Associate Administrator for
Performance Management
Pradeep Belur, Senior Advisor to the Administrator
Christopher M. Pilkerton, General Counsel
Martin Conrey, Attorney Advisor, Legislation and Appropriations
LaNae Twite, Director, Office of Internal Controls

Attachment



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Independent Auditor's Report

Acting 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, 2017 and 2016, and the related consolidated statements of net cost, 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 accounting principles generally accepted in the United States of America; 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.

Auditor's 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 the Office of Management and Budget (OMB) Bulletin No. 17-03, *Audit Requirements for Federal Financial Statements*. Those standards and OMB Bulletin No. 17-03 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 auditor's 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, 2017 and 2016, and its net costs, changes in net position, and budgetary resources for the years then ended in accordance with accounting principles generally accepted in the United States of America.



Other Matters

Interactive Data

Management has elected to reference to information on websites or other forms of interactive data outside the *Agency Financial Report* to provide additional information for the users of its financial statements. Such information is not a required part of the basic consolidated financial statements or supplementary information required by the Federal Accounting Standards Advisory Board. The information on these websites or the other interactive data has not been subjected to any of our auditing procedures, and accordingly we do not express an opinion or provide any assurance on it.

Required Supplementary Information

Accounting principles generally accepted in the United States of America 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 38 to 41 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, 2017, 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 identified the following deficiencies in internal control, described in Exhibit I, that we consider to be significant deficiencies:

- (1) Improvement Needed in Monitoring Controls over the Secondary Market Guaranty Program
- (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 disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* or OMB Bulletin No. 17-03. Specifically, our audit results noted noncompliance with the *Debt Collection Improvement Act of 1996* (DCIA or Act) which is described below at Exhibit II:

The DCIA gave the U.S. Department of the Treasury (Treasury) significant responsibilities for collecting delinquent debts, Government-wide. The Act requires Federal agencies to transfer their nontax delinquent debt to Treasury. During our test work over loan charge-offs, we noted that the SBA did not properly or timely refer obligors (i.e., eligible principal borrowers, co-borrowers, and/or guarantors) to the Treasury for offset or cross-servicing as required by DCIA. Similar instances of noncompliance with the Act were reported in prior years.

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 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 Response(s) to Findings

SBA's response to the findings identified in our audit is described in the accompanying Exhibit III. SBA's response was not subjected to the auditing procedures applied in the audit of the consolidated financial statements and, accordingly, we express no opinion on the response.

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 the SBA's internal control or compliance. Accordingly, this communication is not suitable for any other purpose.

KPMG LLP

Washington, DC
November 14, 2017

U.S. Small Business Administration

Significant Deficiencies

(1) Improvement Needed in Monitoring Controls over the Secondary Market Guaranty Program

During the Fiscal Year (FY) 2017 financial statement audit, management determined that the prepaid principal to be distributed to pool investors by its fiscal transfer agent (FTA), as part of SBA's 7(a) Secondary Market Guaranty (SMG) Program, was not being executed in accordance with program policy changes that were published in Federal Register Notice 69 FR 56472, dated September 2004. The changes in the Notice were to apply to loan pools with an issue date on or after October 1, 2004. While SBA management appropriately self-identified this matter, there was not sufficient visibility into the FTA's system and processes regarding the application of prepayments, in order to ensure that SBA's policy change was properly implemented in the FTA's system.

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

- GAO-14-704G, *Standards for Internal Control in the Federal Government* (Green Book) Sections OV4.01 and OV4.02, 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 Circular No. A-129, *Policies for Federal Credit Programs and Non-Tax Receivables*

Recommendations:

We recommend that the Associate Administrator for Capital Access:

1. In consultation with the Chief Financial Officer, enhance SBA's complementary controls regarding the SMG program and relevant processes at the FTA. This process should be refined to include a more thorough review and analysis of the FTA's systems and data used for the liability for loan guaranty reestimate.
2. Monitor and perform procedures over their service organization's attestation report regarding user control considerations. This assessment should be performed annually.

(2) Improvement Needed in Information Technology Security Controls

During the FY 2017 financial statement audit, we found that the SBA continued to implement corrective actions on some of the prior year findings; however, a number of conditions persisted in FY 2017 that reduced 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 2017, and issued additional recommendations for the new control deficiencies that we identified. In the sections below, we distinguish between recurring conditions and related recommendations, and those that were newly identified in FY 2017. We have omitted some technical details from the conditions and recommendations due to the sensitivity of the information. These details were formally 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 information technology (IT) control deficiencies that we noted during the FY 2017 audit below, and have organized them by the following general IT control objectives: logical access controls, and system configuration management.

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 2017:

- Account authorization processes were not implemented in accordance with SBA policy.
- User accounts were not recertified in accordance with SBA policy.
- 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 2017:

- Administrator privilege escalations were not monitored for one general support system.

Recommendations – Logical Access Controls:

We recommend that the Chief Information Officer (CIO) coordinate with SBA program offices to:

3. Continue to 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. Continue to implement access recertification 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.
5. Continue to enforce the concept of least privilege for privileged accounts or implement mitigating controls to ensure that activities performed using privileged accounts are properly monitored.
6. Continue to improve SBA's administration of logical system access by taking the following actions:
 - Implement an effective off-boarding process, and periodically verify that controls to remove logical access for separated employees are implemented and operating as designed;
 - Establish a process for the identification and removal of separated contractors to help ensure that logical access is timely removed upon contractor separation; and
 - Timely remove access to general support systems and major applications (including development and test environments) when employees and contractors are terminated.
7. Continue to improve SBA's information system logging and auditing program, by taking the following actions:
 - Review and rationalize current audit and logging activities and capabilities to determine their effectiveness in addressing risks to systems and data;
 - 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
 - Retain sufficient evidence of the audit log review.

System Configuration Management Controls

An integral part of the effectiveness of an organization's security program management efforts should be to ensure that application change management controls provide reasonable assurance that program changes implemented to the applications are appropriate and authorized.

Our audit identified the following new control deficiency in FY 2017:

- Application change management controls were not consistently implemented in accordance with SBA policy.

Recommendation – System Configuration Management Controls:

We have issued the following recommendation to address the new control deficiency listed in the section above.

We recommend that the CIO coordinate with SBA program offices to:

8. Enhance application change management controls to ensure approval documentation is maintained in accordance with SBA policy.

U.S. Small Business Administration

Non-Compliance with Debt Collection Improvement Act of 1996

Noncompliance with the Debt Collection Improvement Act of 1996

The *Debt Collection Improvement Act of 1996* (DCIA) assigned the U.S. Department of the Treasury (Treasury) the responsibility for collecting delinquent debts, government-wide. The DCIA requires Federal agencies to transfer their nontax debt over 120 days delinquent to Treasury. During our testwork over loan charge-offs, we noted SBA did not refer obligors (i.e., eligible principal borrowers, co-borrowers, and/or guarantors) to the Treasury for offset or cross-servicing at the time of charge-off, as required by the DCIA. Similar instances of noncompliance with the DCIA were reported in prior years. The SBA's noncompliance with the DCIA was the result of untimely entering of charge-offs at loan centers and a systematic update that resulted in the elimination of certain liable obligors.

We recommend the Associate Administrator of the Office of Capital Access:

9. Perform a comprehensive root cause analysis of system protocols to identify, quantify, and remediate all defective, system coding problems that may cause untimely referral of loans in accordance with the DCIA.
10. Work with the loan servicing center directors and assess processes to timely enter charge-offs within a reasonable timeline, to ensure compliance with the DCIA.



CFO Response to Draft Audit Report on FY 2017 Financial Statements

DATE: November 14, 2017

TO: Hannibal M. Ware, (Acting) Inspector General

FROM: Timothy Gribben, Chief Financial Officer and
Associate Administrator for Performance Management

SUBJECT: FY 2017 Financial Statement Audit

A handwritten signature in blue ink that reads "Tim Gribben".

The Small Business Administration has reviewed 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 continued efforts to further improve our accounting, budgeting, and reporting processes. As you know, the SBA has worked hard in past years to address the findings from our independent auditor.

The audit report includes a continuing significant deficiency in SBA's information technology security controls and a new significant deficiency related to monitoring controls over our Secondary Market Guarantee Program. The auditor also reported that the SBA is not compliant with the Debt Collection Improvement Act of 1996 related to timely referral of charged-off loans to the Department of the Treasury for its tax refund offset and collection programs. The SBA appreciates the recommendations from the auditors, and we look forward to working with you to continue to improve financial management in our Agency. Our response to the findings and recommendations follows.

Exhibit I, Significant Deficiencies Related to Internal Control Over Financial Reporting

1. Improvement Needed in Monitoring Controls over the Secondary Market Guarantee Program

Management concurs. The SBA self-identified and reported this matter to the auditors. In FY 2018, we will continue to enhance complementary monitoring and user controls over the program and the relevant processes at our fiscal transfer agent.

2. Improvement Needed in Information Technology Security Controls

Management concurs. A new CIO onboarded in October 2016, and under her leadership the Office of the CIO moved aggressively to increase governance and oversight, stabilize and modernize SBA's network and systems, address security deficiencies, and improve its cybersecurity posture. In FY 2018, the SBA will pursue additional policies and monitoring activities to address deficiencies in logical access controls and system configuration management.

Exhibit II, Noncompliance with Debt Collection Improvement Act of 1996

The SBA's noncompliance with the DCIA was the result of untimely entering of some charge-offs at a loan center and a systematic update that resulted in the elimination of certain liable obligors. While both situations have been addressed, the SBA will continue to monitor processes and procedures to ensure compliance with DCIA.

Conclusion

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 directly support our efforts to 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.