SBA's Lender Loan Reporting Process has Systemic Reporting Issues and Data Control Weaknesses

U.S. Small Business Administration
Office Of Inspector General
Washington, D.C. 20416

DATE: February 23, 2012

TO: Jeanne Hulit
Associate Administrator for Capital Access

Paul T. Christy
Chief Operating Officer

SUBJECT: SBA's Lender Loan Reporting Process has Systemic Reporting Issues and Data Control Weaknesses

This report presents the results of our *Audit of Control and Security of SBA's Fiscal Transfer Agent and Reporting Process*. Our audit objective was to determine the adequacy of SBA's controls and oversight over the development, security, and operation of certain information technology systems and processes performed by Colson Services Corporation.

We request you provide your management decision for each recommendation on the attached SBA Form 1824, Recommendation Action Sheet, by March 26, 2012 (30 days after final report date). Your decision should identify the specific actions taken or planned for each recommendation and the target dates for completion.

We appreciate the courtesies and cooperation of the Office of the Capital Access and Office of Chief Information Officer during this audit. If you have any questions concerning this report, please call me at (202) 205-7390 or Jeffrey Brindle, Director, Information Technology and Financial Management Group at (202) 205-7490.

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

What OIG Audited

Since 1989, Colson Services Corporation has performed certain functions for SBA in the 7(a) loan program and more recently in the 504 loan program. These functions include processing certain automated transactions and developing new information technology systems. Our audit objective was to determine the adequacy of SBA's controls and oversight over the development, security, and operation of certain information technology systems and processes performed by Colson Services Corporation (Colson).

We reviewed Colson's performance and SBA's oversight of:

- the processing of lenders' loan reports on the status and balance of all SBA 7(a) loans, using SBA Form 1502, Guaranty Loan Status and Remittance Report, including error corrections;
- the design, development, and SBA oversight of the 504 First Mortgage Loan Pooling (FMLP) system;
- the security and independent audit requirements of Colson's systems; and
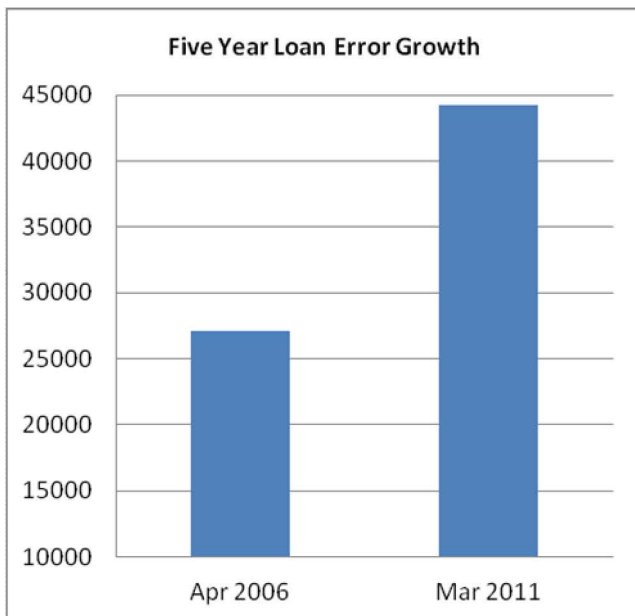- guaranty fee collection and reconciliations.

What OIG Found

SBA's Lender Loan Reporting process had systemic reporting issues and data control weaknesses that resulted in an estimated $956 million overstatement of unpaid loan balances with an estimated $5.2 million effect on program subsidy. Lenders frequently did not report the status and balance of their loans to Colson. Less than one percent of SBA lenders were responsible for over half of identified errors and omissions. Further, Colson and SBA systems perform different error checking routines, making error correction untimely and labor intensive. The loan error volume grew by 63.5 percent from April 2006 to March 2011, reaching 44,327 errors.

The SBA provided limited oversight of the 504 FMLP system development and did not ensure it met SBA's quality standards.

We also found that SBA systems were being operated by Colson without ensuring their compliance with Federal security requirements.

Finally, secondary market late penalty fee collection needs improvement. The SBA was due $2.5 million in late penalty fees, most of which are at least 180 days outstanding.

Figure 1. Loan Error Growth from April 2006 to March 2011

OIG Recommendations

We made 11 recommendations, the most significant being to: 1) correct loan balances contributing to the $5.2 million subsidy overstatement; 2) collect $2.5 million in outstanding late penalty fees; 3) ensure that system development projects adhere to SBA quality standards for systems development projects; and 4) ensure that systems are authorized to operate prior to being put into production. Management agreed with our recommendations except for the recommendation to collect the $2.5 million in outstanding late penalty fees.

Actions Taken

The SBA initiated a special project to address weaknesses in the 1502 reporting process prior to issuance of a draft of this report.

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Introduction

This audit examines the Small Business Administration's (SBA's) oversight of information technology systems and fee recovery processes employed by one of its contractors, Colson Services Corporation (Colson). Colson provides services to assist the SBA's administration of its business loan programs. The audit identified data control weaknesses, concerns with SBA's oversight of system development for a new program, areas of improvement in certain fee collection processes, and other internal control weaknesses.

Objectives

Our audit objective was to determine the adequacy of SBA's controls and oversight over the development, security, and operation of certain information technology systems and processes performed by Colson.

Background

Colson has been SBA's Fiscal Transfer Agent (FTA)[1] for the SBA's 7(a) guaranty loan program through successive contracts since 1989. Colson also acts as the Central Servicing Agent (CSA) for the SBA's 504 Development Company Program. Colson is compensated by the collection of fees (e.g., issuance, service, transfer, origination, etc) that it earns on various program-related transactions. The FTA earns additional revenue from its role as an intermediary between lenders that sell the guaranteed portions of SBA-backed loans (either as individual guarantees or in loan pools) to investors on SBA's secondary market. Colson earns float interest from this role. Float interest is earned by receiving interest between the date payments are received from lenders and the date payments are made either to the investors (known as "registered holders") or to the SBA's Master Reserve Fund[2].

To ensure the integrity of the guaranteed loan portfolio, the SBA mandates that lenders with outstanding 7(a) loans report the status and balance of all SBA 7(a) loans in their portfolio using SBA Form 1502: Guaranty Loan Status and Remittance Form[3]. The SBA requires the submission of this form, even when there are no payment activities from the borrowers for the subject month. Since 1996, Colson has collected the Form 1502 data from lenders on the SBA's behalf. To facilitate the processing of this data, at the beginning of each month, Colson receives an SBA file to establish the population of loans expected to be reported during the month. The information Colson receives from lenders is then compared to SBA data using a series of edit checks (i.e. error checks) to ensure accuracy and completeness.

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[1] The FTA's principal duties are to facilitate the settlement of the first sale of a loan; record current and all prior registered holders (investors) of a loan; track loan payment histories; collect payments from lenders on sold loans; remit payments to investors; forward all servicing requests from a lender to the investor and forward the response back to the lender; notify SBA of delinquent loans; and handle SBA and lender repurchases from the investor.

[2] The Master Reserve Fund was created to facilitate operation of loan pooling in SBA's 7(a) secondary market program by holding both the principal paid from borrowers and due to investors, as well as accumulated interest earnings.

[3] This form also serves as the medium for lender submission of 7(a) loan program guarantee fees and payments for loans sold on the secondary market.

Colson notifies lenders of discrepancies identified by the edit checks so revisions can be made. Near the 20th of each month, Colson transmits loan information to the SBA to update the Loan Accounting System (LAS). During the same month, the FTA transmits additional information to the SBA as lenders correct identified reporting errors or submit 1502 updates. Prior to using any of the loan data from Colson, the SBA runs a series of edit checks to ensure that the information is valid. The loan data is then updated into the SBA's Electronic Loan Information Processing System (ELIPS). The SBA's ELIPS is the system of record for loan accounting and subsidy calculations.

Multiple OIG audits and other reviews conducted between 2005 and 2011 identified the need for the Agency to:

- implement consistent edit check criteria with Colson;
- identify and address lenders that had consistent 1502 reporting errors;
- develop and enforce penalties on lenders who do not report on their loans; and
- provide adequate training to lenders.

In 2007, the SBA re-solicited the FTA contract and, in response to previous OIG recommendations, included contract provisions to improve the quality of 1502 data and reporting. Upon contract award in 2008, responsibility for 1502 data error correction was transferred from SBA field offices and servicing centers to the FTA.

The SBA's implementation of provisions of the American Recovery and Reinvestment Act[4] required modifications to Colson systems and operations as SBA's FTA for the 7(a) Loan Program and CSA for the 504 Development Company Program. Specifically, section 503 of the American Recovery and Reinvestment Act authorized SBA to place a Federal guaranty on a pool of first mortgages associated with loans made under its 504 Development Company Program. In June 2010, the SBA modified its CSA contract with Colson for $2 million to include development of an SBA system to service 504 first mortgage loan pools. This application is referred to as the 504 First Mortgage Loan Pooling System.

Review of Internal Controls

The SBA's Standard Operating Procedures[5] provides guidance on the implementation and maintenance of effective systems of internal control as required by Federal Managers Financial Integrity Act of 1982. Accordingly, the Office of Management and Budget (OMB) Circular A-123[6], provides further guidance for effective systems of internal control to improve the accountability and effectiveness of Federal programs and operations by establishing, assessing, correcting, and reporting on internal controls. Circular A-123 also provides that processes for conducting management's assessment of the effectiveness of internal controls over financial reporting should be based on widely recognized internal control standards.

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[4] On February 17, 2009, in response to the economic crisis, the American Recovery and Reinvestment Act was enacted, establishing new SBA programs as well as changes to existing SBA programs.
[5] SBA SOP 00 02: *Internal Control Systems*
[6] OMB Circular A-123, "Management's Responsibility for Internal Control."

We identified internal control weaknesses as they relate to the audit objective. Specifically, the Office of Capital Access (OCA) did not adequately ensure that 7(a) loan transactions exchanged between Colson and the SBA received consistent system edits and related error correction procedures. In addition, OCA management did not adequately address previous OIG audit and external consultant recommendations intended to improve the quality of 1502 data and reporting. Further, the SBA was not compliant with its system development guidance and did not adhere to Federal security requirements relating to system authorizations.

We will provide a copy of the final report to the senior officials responsible for internal controls in the Office of the Chief Financial Officer and Office of Capital Access.

Nature of Limited or Omitted Information

No information has been omitted due to confidentiality or sensitivity, nor were there limitations to information on this audit.

Results

Finding: SBA Management has not Adequately Addressed Systemic Data Control Weaknesses within the 1502 Reporting Process

Between October 2010 and March 2011, a monthly average of 42,000 loans, or approximately 13% of the 320,000 active 7(a) loans, did not have their outstanding balance and status updated in SBA's ELIPS. Approximately 20,000 of these loans were not updated for this entire six-month period.

Over the past five years, the number of loans in error per month increased from approximately 27,000 to 44,327 loans[7]. This occurred because some lenders did not report all of their loans, some reports contained unresolved errors, and edit checks used by the SBA and Colson were not consistent. Further, Colson was not effectively complying with its contractual requirement to correct errors and the SBA was not enforcing the requirement. As a result, 7(a) loan unpaid principal balances and subsidy re-estimates have been overstated and fees due to the SBA may not be collected. Specifically, a consultant performed a study on behalf of the Office of the Chief Financial Officer, which determined that the unpaid principal balance of the SBA's 7(a) portfolio was overstated by $956 million. Because of overstating the amount of unpaid loans in its portfolio by nearly $1 billion, the SBA's estimate of the money needed to subsidize projected losses in the program was overstated by $5.2 million[8] as of April 2011[9].

Lenders omit loans from the Form 1502 Report

Lenders did not report about 17,000 loans each month (four to five percent of the approximately 320,000 loans in the active 7(a) loan portfolio) to Colson via the SBA Form 1502.

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[7] Monthly loans in error include unreported loans.
[8] The estimates disclosed in the consultant's study as being based on term loans included both term loans and loans with revolving lines of credit.
[9] Annually, under the Credit Reform Act, SBA must assess the adequacy of its loan subsidy balances. Consequently the $5.2 million subsidy cost overstatement may result in excess funds being transferred from the 7(a) subsidy loan program account as well as overstate SBA's lending costs.

Loans that are not reported by lenders may overstate the loan balance and adversely affect SBA fee collections. For loans not sold on the secondary market, the ongoing guaranty fee is remitted with the Form 1502 every month an interest payment is received. Therefore, if a lender does not report the status of an unsold loan and remit the fee on the Form 1502, Colson cannot determine whether or not an interest payment was made to the lender and thus, whether the ongoing guarantee fee is due to the SBA.

Between October 2010 and March 2011, 20 lenders consistently did not report some or all of their loans on the Form 1502[10]. In March 2011, these 20 lenders[11], which represent less than 1-percent of lenders reporting to Colson, were responsible for 53-percent of the 15,533 unreported loans.

Lenders report loans incorrectly on the Form 1502

Approximately four to five percent of the remaining active 7(a) loans that are reported monthly by lenders to Colson contained at least one error. These errors included reporting loans that were paid in full or purchased and reporting outstanding loan balances that exceeded the loan approval amount. On average, Colson, in coordination with SBA lenders, corrected only 10-percent of the loans in error prior to submitting the 1502 information to the SBA. Between October 2010 and March 2011, 17 lenders[12] had consistent 1502 reporting errors. In March 2011, these 17 lenders, which represent less than 1-percent of lenders reporting to Colson, were responsible for 48-percent of the loans with reporting errors identified by Colson[13]. If an error is not corrected, the current loans status and outstanding balance is not updated in ELIPS, thereby resulting in inaccurate data.

SBA and Colson do not use the same edit check criteria

Inconsistent business rules used by the SBA and Colson systems to perform edit (i.e., error) checks on 1502 data resulted in an unresolved backlog of erroneous data. Between October 2010 and March 2011, twelve error conditions identified by the SBA's system accounted for 96-percent of the total errors affecting 7(a) loans. However, because Colson used different business rules to check for errors, the FTA was unable to identify and address many of the errors noted by the SBA.[14] Further the SBA did not provide Colson with the information or requirements necessary to correct the errors. We performed limited sampling of errors in 1502 data[15] and found that Colson either did not or was unable to take corrective action for seven SBA edit checks, which accounted for approximately 35% of monthly SBA identified 1502 errors.[16]

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[10] These 20 lenders did not report at least 100 loans on the Form 1502 for each month.
[11] See Appendix II for the list of lenders that did not consistently report their loans on the Form 1502.
[12] Eleven of these lenders also did not consistently report some or all of their loans to Colson.
[13] See Appendix III for the list of lenders that had consistent Form 1502 reporting errors.
[14] For a detailed breakdown of errors affecting SBA loans see Appendix IV: Summary Table of 1502 Errors.
[15] For details on our sampling methodology see Appendix I: Scope and Methodology.

[16] For detailed information on our sample results see Appendix V: Sample of SBA Loans in Error and Appendix VI: SBA 1502 Edits Not Effectively Utilized by Colson.

The OMB Circular A-123, requires controls to ensure that transactions are properly authorized and processed accurately and that data is valid and complete. It also requires that controls, such as edit checks, be established within Agency systems to verify inputs and outputs. Further, this guidance requires agencies to continuously monitor the effectiveness of internal control. Circular A-123 also provides that personnel should be responsible for periodic reviews, reconciliations or comparisons of data and periodic assessments should be integrated as part of management's continuous monitoring of internal control.

To correct deficiencies in the 1502 reporting process that were identified by the OIG in 2005 and subsequent internal control reviews, the SBA included provisions within the FTA contract to improve the quality of 1502 data and reporting. These requirements included:

- the implementation of a daily electronic loan information exchange with SBA, and
- the requirement for Colson to resolve 99-percent of the correctable errors identified by SBA edit criteria, or 97-percent of the affected loan accounts within one month.

The SBA did not enforce these provisions, however, since it did not provide Colson with system business rules necessary to support them. Additionally, SBA management directed Colson's efforts towards other program priorities. These priorities included systems development and modifications necessary to enact SBA programs established in the American Recovery and Reinvestment Act. Finally, management stated that staffing shortages within the Office of Financial Assistance contributed to these ongoing 1502 deficiencies.

Conclusion

Agency management had not adequately addressed systemic control weaknesses that prevent the updating of loans in ELIPS. As a result, 1502 error rates had increased from previous years. This put the quality and reliability of SBA's 7(a) portfolio data at risk, overstated subsidy estimates, and exposed the SBA to potential financial losses from uncollected ongoing guarantee fees. Specifically, a consultant performed a study on behalf of the Office of the Chief Financial Officer that determined that the unpaid principal balance of SBA's 7(a) portfolio was overstated by $956 million. This created an estimated $5.2 million subsidy re-estimate overstatement as of April 2011, which may result in excess funds being transferred from the 7(a) subsidy loan program account to the 7(a) financing account and overstate SBA's lending costs.

Management Actions Taken and In Process

In response to our findings, the SBA has initiated a special project to address identified weaknesses in the 1502 reporting process.

Recommendation(s)

In order to improve the conditions affecting SBA's 1502 reporting process, we recommend that the Associate Administrator, Office of Capital Access:

1. Research and correct loans that have not been reported within the ELIPS for a significant length of time (i.e. 6 months or more) which contribute to subsidy overstatements currently estimated at $5.2 million.

2.   Utilize the lender exception detail reports to identify and address lenders that consistently do not report loans and issue corrective action plans.
3.   Utilize the lender exception detail reports to identify lenders with consistent 1502 errors and develop training programs that will significantly reduce their error rates.
4.   Identify SBA business rules that affect most loans and provide them in a useable format that Colson can integrate into relevant systems.
5.   Develop a plan to oversee and enforce FTA contractual requirements for the daily electronic loan information exchange and error correction.

Agency Comments

Recommendation 1
The SBA fully agreed with our recommendation. The OCA has initiated a project team to develop and implement a lender outreach program focused on changing lender behavior. The goal of this program is to develop greater lender awareness and connect greater lender compliance with program privileges by establishing an enforcement role within the SBA's Office of Credit Risk Management (OCRM). The SBA's proposed actions are responsive to recommendation 1.

Recommendation 2
The SBA fully agreed with our recommendation. The lender exception detail reports have been circulated to OCRM each month since August 2010 to focus attention on those lenders repeatedly identified with unreported or incorrect and unresolved reporting errors. The SBA's proposed actions are responsive to recommendation 2.

Recommendation 3
The SBA fully agreed with our recommendation. The SBA has a plan in place to build greater awareness within the lender community on proper completion of the Form 1502. The SBA is utilizing exception reports to identify lenders and researching Agency resources that could best address corrective efforts with these lenders. The SBA's proposed actions are responsive to recommendation 3.

Recommendation 4
The SBA fully agreed with our recommendation. The SBA 1502 process improvement project includes consolidating SBA validation codes at Colson. Development and implementation is underway and the Agency expects results by the first quarter of calendar year 2012. The SBA's proposed actions are responsive to recommendation 4.

Recommendation 5
The SBA fully agreed with our recommendation. The SBA has incorporated oversight functions into their improvement project and technical team meetings between the FTA and SBA systems information staff are underway. The SBA's proposed actions are responsive to recommendation 5.

Finding: The SBA did not Provide Adequate Oversight of the First Mortgage Loan Pooling System Development

The SBA's oversight of the Colson 504 First Mortgage Loan Pooling (FMLP) system development project was not adequate to ensure that the project met the standards in SBA's System Development Method (SDM)[17]. Specifically, the SBA did not provide adequate project management and oversight, which would include the review, approval, and retention of project documentation and deliverables. SBA officials overseeing the project cited a lack of awareness of the SDM requirements as the reason for these omissions.

The SBA procedures[18] require the SBA's SDM or its equivalent to be used on all information technology (IT) system development projects. The SBA's SDM is a phased approach that requires the sponsoring official to assign a project manager who is accountable for ensuring that phase deliverables are completed, reviewed, and approved before moving forward to a successive phase. This helps ensure that key issues are identified and addressed as early as possible, and limits major modifications to the original project.

The SBA also did not participate in system acceptance testing as required by the SDM. Per the SDM, system acceptance testing emphasizes the proper functioning of the system from the user's point of view and demonstrates whether the program meets the user's written set of measurable objectives[19]. The SDM provides classes of system acceptance testing that should be executed prior to system implementation including: requirements validation tests, functional tests, operational tests, interface tests and security tests.

Conclusion

Because SBA management did not provide required project oversight or participate in system acceptance testing, the SBA does not have adequate assurance that the FMLP system fulfills the program's needs. Additionally, SBA management does not have adequate assurance that Colson performed all system development activities specified in the contract. Finally, there is an increased risk that SBA would be unable to migrate, operate, and maintain the system in a new environment as system documentation has not been obtained by the SBA.

Recommendation(s)

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

6. Retrieve and archive all FMLP system development documentation.
7. Conduct a post implementation review of the FMLP project deliverables to ensure Colson adhered to its SDLC and that all project documentation and deliverables meet acceptable quality standards.

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[17] The SBA SDM provides a structured and integrated approach to acquiring IT solutions including planning, developing and operating those solutions.

[18] SOP 90-47 (2): *Automated Information Systems Security Program*

[19] The primary focus of the tests should be on translation errors, which are errors made in the process of transforming objectives and requirements of the system into design specifications and , finally, into an operational system.

We recommend that the Associate Administrator, Office of Capital Access in coordination with the Chief Information Officer:

8.   Ensure that all future internal and external OCA system developments adhere to SBA SDM standards for project management and development.

Agency Comments

Recommendation 6
The SBA fully agreed with our recommendation. The SBA will work retrieving and archiving FMLP system documentation. The SBA's proposed actions are responsive to recommendation 6.

Recommendation 7
The SBA fully agreed with our recommendation. The SBA will conduct a post implementation review of the FMLP system. The SBA's proposed actions are responsive to recommendation 7.

Recommendation 8
The SBA fully agreed with our recommendation. However, the SBA did not propose actions that were fully responsive to the recommendation. Specifically, the SBA did not provide details on the measures it will take to ensure that all future internal and external OCA system developments adhere to SBA SDM standards for project management and development.

Finding: The SBA Did Not Ensure that Colson's Operation of SBA Systems Met Federal Security Requirements

Colson was operating SBA-owned systems without SBA ensuring their compliance with Federal security requirements. Specifically, since 2007, the SBA had not assessed or authorized Colson's FTA system operations in accordance with regulatory requirements. Additionally, the SBA did not complete a system control assessment and authorization prior to deployment of the FMLP system, which was a significant change to the existing Colson 504 loan servicing system.

The OMB guidance[20] requires that major system applications be authorized to operate prior to being put into production and system security controls to be reviewed at least every three years. Additional guidance from the National Institute for Standards and Technology (NIST)[21] details the authorization process and further requires systems to be re-assessed when significant changes are made to an existing system or unplanned applications are introduced. The goal of the system controls assessment and authorization process is to evaluate security controls of a system, determine the risk posed by operating the system, authorize a system for operation, and monitor controls after a system is placed into production. This process is an important element of the Agency's IT security and risk management.

Due to an oversight by SBA management, the FTA system was not reassessed or reauthorized for operation when the previous authorization expired in 2007. Additionally, due to the need to introduce new statutorily mandated programs, the SBA focused on implementing the FMLP system and originating and servicing 504 first mortgage loan pools rather than completing the system authorization.

Conclusion

The SBA has allowed Colson to operate SBA systems without adequate knowledge of all system risks and vulnerabilities. As a result, management did not ensure system security was commensurate with the risk and magnitude of the harm resulting from the unauthorized access, use, disclosure, disruption, modification, or destruction of information.

Recommendation(s)

We recommend that the Associate Administrator, Office of Capital Access, in coordination with the Chief Information Officer:

9. Complete the review of security controls and authorization of Colson FTA and CSA systems.
10. Ensure that currently operated systems are authorized for operation and meet the requirements of applicable NIST guidance and that any new system meets this requirement before becoming operational.

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[20] OMB Circular A-130 Appendix III "Security of Federal Automated Information Resources"
[21] NIST 800-37, Rev.1 "Guide for Applying the Risk Management Framework to Federal Information Systems"

Agency Comments

Recommendation 9
The SBA fully agreed with our recommendation and completed the review, authorization, and accreditation of the FTA and CSA systems hosted by Colson on August 3, 2011.

Recommendation 10
The SBA fully agreed with our recommendation. However, the SBA did not propose actions that were fully responsive to the recommendation. Specifically, the SBA did not provide details on how it will ensure that new systems are authorized for operation and meet the requirements of applicable NIST guidance before becoming operational.

Over the last five years, Colson, as SBA's FTA, has collected approximately $798 million of ongoing guarantee fees from lenders. Limited testing of Colson's collection activities determined that controls were generally effective. However, we determined that improvement is needed regarding the collection of secondary market late penalty fees from lenders. Specifically, $2.5 million in secondary market late penalty fees were due to the SBA and were not collected within reasonable timeframes.

The SBA's Standard Operating Procedures [22]require lenders to complete and sign SBA Form 1086: Secondary Participation Guarantee Agreement for each SBA 7(a) guaranteed loan they sell to investors on the secondary market. The form requires lenders to remit payments on secondary market loans to the FTA by the third calendar day of every month, or the next business day if the third is not a business day. When payments on secondary market loans are not submitted to Colson by the time they are due to the investor, Colson will pay the investor from a trust fund[23] established for that purpose. For any payment not received by the FTA on the second business day after the due date, the lender is subject to the following late payment penalties:

- a late payment penalty to SBA (collected by FTA), which is the greater of $100 or five-percent of the unremitted amount (subject to a maximum penalty of $5,000 per month);
- a late payment penalty to FTA equal to the interest on the unremitted amount at the rate provided in the Note, less the rate of Lender's servicing fee; and
- a late payment penalty to FTA calculated at a rate of twelve-percent per annum, on the unremitted amount.

The form also states that failure by the lender to pay such penalty and collection fees within ten business days of receipt of a bill for such fees may constitute a significant violation of the rules and regulations of the secondary market. Finally, the form states that the FTA and the SBA reserve the right to withhold these penalty fees from settlement of any future guaranteed interest sale, or any payment made by the SBA or FTA to the lender.

While Colson has billed lenders approximately $8 million in late penalty fees over the last five years, unpaid amounts have increased from $1.7 million in 2006 to approximately $3 million in 2011. We determined that SBA's portion of these outstanding penalty fees was approximately $2.5 million, most of which exceeded 180 days. Management was not adequately monitoring outstanding secondary market late penalty fees due to a lack of resources within OFA needed to collect small outstanding amounts.

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[22] SOP 50 10 5(C): *Lender and Development Company Loan Programs*
[23] The Master Reserve Fund

Conclusion

Because the SBA did not dedicate resources to collect these outstanding amounts, approximately $2.5 million in funds were not collected.

Recommendation(s)

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

11.   Collect the $2.5 million in secondary market late penalty fees by either billing lenders or offsetting against any guarantee purchase amounts.

Agency Comments

Recommendation 11
The SBA did not agree with our recommendation to collect the $2.5 million in secondary market late penalty fees. The SBA does not view the outstanding penalty fees as a material item in the context of total fees collected that requires the dedication of limited staff resources and time to collect. The OIG believes that the $2.5 million in secondary market late penalty fees is an outstanding amount owed to the Agency that should be collected through direct billing or offset.

AGENCY COMMENTS AND OFFICE OF INSPECTOR GENERAL RESPONSE

On October 12, 2011, we provided a draft of this advisory memorandum to the Associate Administrator for Capital Access and the Chief Information Officer. On January 9, 2012, the Office of Inspector General received SBA's final comments. The Acting Associate Administrator for Capital Access generally agreed with all of the recommendations. A summary of management's comments and our response follows.

Agency Comments

Management agreed that SBA's Lender Loan Reporting process had systemic reporting issues and stated that it has made improving the process a top priority for the OCA and has already resolved two of the eleven recommendations. Management, however, was concerned that our references to the $5.2 million subsidy re-estimate overstatement did not clearly identify this value as an estimate and included enough context. Management also stated that the audit report did not adequately disclose whether the analysis conducted in 2006 included unreported loans.

OIG Response

In response to the Agency's comments, we added additional language in the executive summary to clarify that the $5.2 million subsidy amount was an estimated figure. We also revised the report to provide additional information regarding the composition of loans used to derive the estimate. Additionally, the OIG added language within the report to disclose that the analysis of loan errors conducted in 2006, which identified approximately 27,000 loans in error, included unreported loans.

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 report. 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 audit. If you have any questions concerning this report, please call me at (202) 205-7390 or Jeff Brindle, Director, IT and Financial Management Group at (202) 205-7490.

Appendix I: Scope and Methodology

To accomplish our objective we reviewed contractor performance and SBA's oversight of contracts with Colson Services Corporation (Colson) for Fiscal Transfer Agent (FTA) and Central Servicing Agent (CSA) services. For the FTA contract, we reviewed activities related to 1502 data collection, error correction and reconciliation, guaranty fee collection and reconciliation, secondary market transactions, SBA Form 159 data collection, and summary and variance reporting requirements. For the CSA contract, we reviewed SBA's oversight of the design and development of the FMLP system. Finally, we reviewed the security and independent audit requirements of Colson's systems including system Certification and Accreditations, Statement of Accounting Standards 70 (SAS 70) reports for Colson and its parent and SBA's Plans of Action and Milestones covering Colson system vulnerabilities.

Our audit methodology consisted of interviews with program officials and Colson personnel, review and analysis of SBA contracts with Colson, as well as relevant reports and system documentation. Additionally, we performed analytical procedures on data extracts obtained from Colson and the SBA for the period of October 2010 through March 2011 and conducted limited sampling of 1502 report errors.

We conducted this audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Sampling

Our analysis of SBA error conditions affecting 7(a) loans identified that 12 error codes were responsible for approximately 96-percent of the total errors each month. In order to further understand the conditions that result in "errors" identified by SBA, we selected a judgmental sample of 36 loans, 3 per error code, that were affected by these 12 errors. This sample was sufficient to identify whether the error was the result of an unreported loan, a condition that Colson had knowledge of but was unable to correct, or exclusive to SBA edit criteria.

To select our judgmental sample, we performed a series of data queries to select and insert records into new monthly tables from an extract of SBA's 1502 data. The table of records for the month of March 2011 was selected and sorted by the error and the first three loans affected by a singular error from the top 12 error codes were selected for our sample. Sampling only loans with a single error code was performed to facilitate the isolation and identification of the condition resulting in the error. Loans affected by error codes 1044 and 1196 were only observed in combination with other error codes. In response, we sampled loans with error code combinations of '1044, 1006' and '1042, 1196' as these combinations were the most common in both instances. This sample was then submitted to Colson requesting that the following information be provided:

1. Whether the loan was reported on the 1502 by the lender during the month.
2. Whether the loan was reported on the 1502 by the lender and identified in error by Colson.
3. Whether the identified error(s) on a given loan were corrected by Colson prior to the final 1502 data submission to SBA.

For the results of this test, see Appendix V: Sample of SBA Loans in Error.

Appendix II: Lenders Not Reporting at Least 100 Loans between October 2010 – March 2011

Table 1. Lenders Not Reporting at Least 100 Loans between October 2010 - March 2011

LENDER NAME	Loans Not Reported Oct-10	Loans Not Reported Nov-10	Loans Not Reported Dec-10	Loans Not Reported Jan-11	Loans Not Reported Feb-11	Loans Not Reported Mar-11
BANCO POPULAR DE PUERTO RICO	221	218	242	245	240	246
BANCO POPULAR NORTH AMERICA	1,550	104	104	100	1,421	100
BRANCH BANKING & TRUST CO.	116	111	118	127	135	146
CAPITAL ONE FSB	271	272	273	300	304	300
CHARTER ONE BANK N.A.	178	158	167	542	178	187
CITIZENS BANK	1,372	1,395	1,391	1,383	1,415	1,409
CITIZENS BANK PENNSYLVANIA	279	292	296	305	314	319
CITIZENS BANK OF MASSACHUSETTS	188	192	193	190	375	387
CITIZENS BANK OF RHODE ISLAND	114	116	113	115	116	113
DORAL FEDERAL SAVINGS BANK	104	104	104	104	104	103
FIRST COMMONWEALTH BANK	131	125	124	120	114	111
HSBC BANK USA	220	241	244	249	253	253
HUNTINGTON NATIONAL BANK	101	105	121	100	130	127
INNOVATIVE BANK	229	414	369	515	495	675
JPMORGAN CHASE BANK, NA	527	489	522	529	558	324
MANUFACTURERS & TRADERS TRUST	254	200	219	206	216	200
SOVEREIGN BANK MID ATLANTIC	101	1,833	100	104	1,894	1,922
TD BANK, N.A.	508	491	491	505	508	511
WASHINGTON MUTUAL BANK, FA	115	131	125	126	329	124
WELLS FARGO BANK N.A.	392	417	434	633	676	735
TOTAL	**6,971**	**7,408**	**5,750**	**6,498**	**9,775**	**8,292**

Source: Colson Services Corporation

Appendix III: Lenders Reporting at Least 100 Loans in Error between October 2010 – March 2011

Table 2. Lenders Reporting at Least 100 Loans in Error between October 2010 - March 2011

LENDER NAME	Loans Reported In Error Oct-10	Loans Reported In Error Nov-10	Loans Reported In Error Dec-10	Loans Reported In Error Jan-11	Loans Reported In Error Feb-11	Loans Reported In Error Mar-11
BANCO POPULAR DE PUERTO RICO	142	157	129	138	160	164
BANCO POPULAR NORTH AMERICA	157	118	197	182	202	144
BANK OF AMERICA N.A.	610	1,139	722	864	885	871
CAPITAL ONE FSB	843	766	823	815	836	299
CHARTER ONE BANK N.A.	199	183	190	177	208	206
CITIZENS BANK	736	755	825	788	833	845
CITIZENS BANK PENNSYLVANIA	435	433	441	440	445	444
CITIZENS BANK NA	175	172	165	145	169	170
CITIZENS BANK NEW HAMPSHIRE	273	274	292	298	304	320
CITIZENS BANK OF CONNECTICUT	104	108	110	100	115	111
CITIZENS BANK OF MASSACHUSETTS	479	478	486	521	447	459
CITIZENS BANK OF RHODE ISLAND	239	237	248	269	254	264
FIRST CITIZENS F/K/A TEMECULA	168	167	173	171	136	169
JPMORGAN CHASE BANK, NA	208	181	176	205	182	144
MANUFACTURERS & TRADERS TRUST	258	279	242	244	214	216
PNC BANK, NATIONAL ASSOCIATION	319	212	217	345	204	767
WELLS FARGO BANK N.A.	351	340	307	883	298	289
TOTAL	5,696	5,999	5,743	6,585	5,892	5,882

Source: Colson Services Corporation

Appendix IV: Summary Table of 1502 Errors

Table 3. Summary of 1502 Errors

SBA Error Code	SBA Error Code Text	Oct-10 39,326 loans	Nov-10 41,233 loans	Dec-10 39,969 loans	Jan-11 43,863 loans	Feb-11 43,107 loans	Mar-11 44,286 loans	Total	% of Total Errors
1006	Lender not reported	17,544	19,403	17,828	22,336	22,994	19,559	119,664	32%
1044	Guarantee Report status code is mandatory	11.239	13,759	12,559	15,805	15,218	13,421	82,001	22%
1030	Outstanding Balance cannot decrease as Principal Payment is 0	8,875	8,923	9,096	8,707	7,759	11,855	55,215	15%
1037	If Guaranty Service Status Code is 1,2,3,4 Current Loan Status must be 1 or 2	7,821	7,490	7,585	7,031	6,845	6,978	43,750	12%
1042	Outstanding Balance plus Total Amount Undisbursed cannot exceed Current Loan Approval Amount	2,699	2,699	2,677	2,732	2,559	3,133	16,499	4%
1029	Loan has been Purchased	1,113	1,215	1,484	1,273	1,358	1,691	8,134	2%
1196	Outstanding Balance must be less than or equal to Current Loan Approval Amount	1,406	1,371	1,342	1,415	1,320	1,306	8,160	2%
1048	First Disbursement Date cannot be null when Loan Disbursed Indicator is Y	783	951	1,033	1,203	935	1,064	5,969	2%
1050	Total Amount Undisbursed must be 0 for a loan in Liquidation	1,092	1,135	1,020	963	894	1,004	6,108	2%
1011	Current loan status must be 1 (Approved – Fully Undisbursed) , 2 (Disbursed – Regular Servicing) or 3 (Disbursed – In-Liquidation)	552	985	1,091	805	1,013	1,089	5,535	1%
1033	If Guaranty Service Status Code is 9 or 0, Total Amount Undisbursed must equal Current Loan Approval Amount	720	784	744	879	1,070	765	4,962	1%
1035	If Guaranty Service Status Code is 1,2,3,4 Outstanding Balance must be greater than 0	757	670	716	774	598	621	4,136	1%
Remaining Errors		2,775	2,986	2,849	2,529	2,776	2,636	16,551	4%
Total Errors		57,376	62,371	60,024	66,452	65,339	65,122	376,684	

Source: SBA 1502 Data Warehouse information

Appendix V: Sample of SBA Loans in Error

Table 4. Sample of SBA Loans in Error

Sample Item	SBA Loan Number	SBA Error Code	SBA Error Message(s) for loans in error	Loan reported on 1502 by lender to Colson	Loan reported on 1502 and identified in error by Colson	Error Corrected by Colson
1	1689785006	1006	Lender not reported			
2	1720975003	1006	Lender not reported			
3	1943406000	1006	Lender not reported			
4	2041145004	1011	Current loan status must be 1 (Approved – Fully Undisbursed) , 2 (Disbursed – Regular Servicing) or 3 (Disbursed – In-Liquidation)	X		
5	4327845007	1011	Current loan status must be 1 (Approved – Fully Undisbursed) , 2 (Disbursed – Regular Servicing) or 3 (Disbursed – In-Liquidation)	X	X	
6	9347654002	1011	Current loan status must be 1 (Approved – Fully Undisbursed) , 2 (Disbursed – Regular Servicing) or 3 (Disbursed – In-Liquidation)	X		
7	[Ex. 4, 6]	1029	Loan has been Purchased	X		
8	[Ex. 4]	1029	Loan has been Purchased	X		
9	[Ex. 4]	1029	Loan has been Purchased	X		
10	1803545009	1030	Outstanding Balance cannot decrease as Principal Payment is 0	X	X	
11	2256355005	1030	Outstanding Balance cannot decrease as Principal Payment is 0	X		
12	9147504009	1030	Outstanding Balance cannot decrease as Principal Payment is 0	X		
13	3607465000	1033	If Guaranty Service Status Code is 9 or 0, Total Amount Undisbursed must equal Current Loan Approval Amount	X		
14	4313825000	1033	If Guaranty Service Status Code is 9 or 0, Total Amount Undisbursed must equal Current Loan Approval Amount	X		
15	4341205010	1033	If Guaranty Service Status Code is 9 or 0, Total Amount Undisbursed must equal Current Loan Approval Amount	X		
16	2191446002	1035	If Guaranty Service Status Code is 1,2,3,4 Outstanding Balance must be greater than 0	X	X	
17	4197205004	1035	If Guaranty Service Status Code is 1,2,3,4 Outstanding Balance must be greater than 0	X	X	
18	6507933003	1035	If Guaranty Service Status Code is 1,2,3,4 Outstanding Balance must be greater than 0	X	X	
19	1999106003	1037	If Guaranty Service Status Code is 1,2,3,4 Current Loan Status must be 1 or 2	X		
20	6206544007	1037	If Guaranty Service Status Code is 1,2,3,4 Current Loan Status must be 1 or 2	X		
21	6586044000	1037	If Guaranty Service Status Code is 1,2,3,4 Current Loan Status must be 1 or 2	X		
22	1919076008	1042	Outstanding Balance plus Total Amount Undisbursed cannot exceed Current Loan Approval Amount	X	X	

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Sample Item	SBA Loan Number	SBA Error Code	SBA Error Message(s) for loans in error	Loan reported on 1502 by lender to Colson	Loan reported on 1502 and identified in error by Colson	Error Corrected by Colson
23	4241145008	1042	Outstanding Balance plus Total Amount Undisbursed cannot exceed Current Loan Approval Amount	X	X	X
24	4382135009	1042	Outstanding Balance plus Total Amount Undisbursed cannot exceed Current Loan Approval Amount	X	X	
25	1771774006	1044, 1006*	Guarantee Report status code is mandatory; Lender not reported			
26	1864765009	1044, 1006*	Guarantee Report status code is mandatory; Lender not reported			
27	1951005002	1044, 1006*	Guarantee Report status code is mandatory; Lender not reported			
28	1847505010	1048	First Disbursement Date cannot be null when Loan Disbursed Indicator is Y	X		
29	3476615007	1048	First Disbursement Date cannot be null when Loan Disbursed Indicator is Y	X		
30	4075825004	1048	First Disbursement Date cannot be null when Loan Disbursed Indicator is Y	X		
31	[Ex. 4]	1050	Total Amount Undisbursed must be 0 for a loan in Liquidation	X		
32	[Ex. 4, 6]	1050	Total Amount Undisbursed must be 0 for a loan in Liquidation	X		
33	[Ex. 4, 6]	1050	Total Amount Undisbursed must be 0 for a loan in Liquidation	X		
34	1397645008	1196, 1042*	Outstanding Balance plus Total Amount Undisbursed cannot exceed Current Loan Approval Amount; Outstanding Balance must <= Current Loan Approval Amount	X	X	
35	1431805002	1196, 1042*	Outstanding Balance plus Total Amount Undisbursed cannot exceed Current Loan Approval Amount; Outstanding Balance must <= Current Loan Approval Amount	X	X	
36	4514505005	1196, 1042*	Outstanding Balance plus Total Amount Undisbursed cannot exceed Current Loan Approval Amount; Outstanding Balance must <= Current Loan Approval Amount	X	X	

Source: SBA 1502 Data Warehouse information and supplemental information provided by Colson Services Corporation

This appendix provides the results of a sample of SBA identified 1502 errors on 36 loans and whether Colson Services Corporation identified the loans as: 1) not reported by lenders, 2) reported in error by lenders, or 3) corrected by Colson Services Corporation.

Appendix VI: SBA 1502 Edits not Effectively Utilized by Colson

Table 5. SBA 1502 Edits not Effectively Utilized by Colson

SBA Edit Check	Error Message	Percent of Total SBA Errors
1011	Current loan status must be 1 (Approved – Fully Undisbursed), 2 (Disbursed – Regular Servicing) or 3 (Disbursed – In-Liquidation)	1%
1029	Loan has been purchased	2%
1030	Outstanding balance cannot decrease as principal payment is 0	15%
1033	If guaranty service status code is 9 or 0, total amount undisbursed must equal current loan approval amount	1%
1037	If guaranty service status code is 1,2,3 or 4, current loan status must be 1 or 2	12%
1048	First disbursement date cannot be null when loan disbursed indicator is Y	2%
1050	Total amount undisbursed must be 0 for a loan in liquidation	2%
Total		**35%**

Source: SBA 1502 Data Warehouse information and supplemental information provided by Colson Services Corporation

Appendix VII: Use of Computer-Processed Data and Prior Coverage

Use of Computer-Processed Data and Prior Coverage

We were provided several documents and reports containing computer-processed data. The majority of these were Microsoft Excel documents created by Colson to support contractual requirements for their FTA responsibilities. These reports included summarized lender 1502 exception reports, 7(a) Monthly Dashboard reports, and outstanding secondary market late penalty fee reports.

We were also provided SBA 1502 Data Warehouse information for the period covering October 2010 through April 2011. We conducted detailed data analyses of 1502 records to determine common errors and error counts and compared them to summary reports generated by SBA to monitor loan records that do not update in ELIPS. We performed limited tests of these reports and 1502 Warehouse information and determined that the data was reasonably complete, authentic and accurate.

Prior Coverage

Multiple audits and reviews have been conducted between 2005 and 2011 related to the 1502 loan reporting process and SBA's oversight of Colson operations. The SBA OIG reports and other review reports used in this audit include:

SBA OIG Reports
- Review of the 1502 Reporting Process, December 9, 2005, Report Number 06-07.
- Loan Classifications and Overpayments on Secondary Market Loans, March 26, 2008, Report Number 08-09.
- Audit of SBA's FY 2010 Financial Statements – Management Letter, December 15, 2010, Report Number 11-05.

SBA OIG reports can be accessed at http://www.sba.gov/office-of-inspector-general.

Other Reports
- Kearney & Company: Summary of the 1502 Project, August 24, 2006
- FI Consulting: 1502 Reporting Process Analysis, August 13, 2010
- FI Consulting: 1502 Reporting Process Analysis, July 14, 2011

Appendix VIII: Agency Comments

RESPONSE TO "AUDIT OF CONTROL AND SECURITY OF SBA'S FISCAL TRANSFER AGENT"

Improving the 1502 process is a top priority for the Office of Capital Access (OCA). The OCA is leading an intra-agency team to identify core issues and improvement opportunities to remedy lender loan reporting in the 7(a) program. These should be resolved upon execution of the project plan over the next six months.

OCA has reviewed the Office of Inspector General ("OIG") draft report titled "Audit of Control and Security of SBA's Fiscal Transfer Agent" dated October 13, 2011 (the "audit")[24].
In discussions that we have had with the OIG, we understand that the OIG's reference to a report prepared for the CFO by an outside third party contractor (referred to from this point as the "CFO contractor report")[25], was only to determine the financial impact of reported errors on the subsidy estimates. We believe reference to the CFO contractor report as a means to develop a numerical point estimate should be disclosed in the audit so that the reader knows is aware of the limited use of the analysis and can determine on their own if other aspects of the analysis have merit. The objective of the audit is to determine the adequacy of SBA's controls and oversight over the development, security, and operation of certain information technology systems and processes performed by the agency's procured contractor serving as the Fiscal Transfer Agent (FTA) for SBA's secondary market for SBA 7(a) loans and as Central Servicing Agent (CSA) for SBA's 504 loan program.

OIG has issued eleven recommendations following its review, three of which require input from the Office of Chief Information Officer. The comments below address the report contents in general and recommendations for action that have been made to the Associate Administrator for Capital Access.

OCA's response to the audit is coordinated with the format of the audit report so, for example, comments to statements made in the "Executive Summary" of the audit can be found under the header "Executive Summary" in this document.

RESPONSE TO RECOMMENDATIONS

Executive Summary

In the Executive Summary, the OIG stated that it found that the lender loan reporting process had issues and weaknesses that resulted in a $956 million overstatement of unpaid loan balances with a $5.2 million effect on subsidy estimates.

> *Response: The summary purports to disclose the overstatement as a matter of fact instead of the CFO contractor report estimate.*

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[24] In this document, the term "audit" shall refer both to the draft audit report and the audit activity underlying the report.
[25] Small Business Administration 1502 Reporting Process Analysis, 14 July 2011 by FI Consulting.

The subsequent statement that the overstatement results in a $5.2 million effect on subsidy estimates lacks context unless it is compared with the re-estimate total provided in the same CFO contractor report $26.24 million. This results in a 0.54% impact on the overall subsidy estimate.

We would expect this disclosure to be contained in the audit.

<u>Response to Specific Recommendations</u>

Seven of the eleven recommendations center on improving lender reporting behavior, introducing daily data transfers, and aligning business validation rules that exist separately at the SBA and at Colson Services Corp, our fiscal and transfer agent. The OCA is leading an intra-agency team to identify core issues and improvement opportunities to remedy lender loan reporting in the 7(a) program. These should be resolved upon execution of the project plan over the next six months.

Two of the eleven have been resolved separate from the report, and three others require input from information systems development staff.

First Finding - SBA Management has not Adequately Addressed Systemic Data Control Weaknesses within the 1502 Report Process

The statement is made in the second paragraph that "...Colson is not complying with its contractual requirement to correct errors..."

Response: The fiscal and transfer agent contract with Colson sets performance measures based on correctable errors that are received back from lenders issued exception notices. If lenders do not respond to lender exception notifications, Colson remains obligated to return all accounts received at the beginning of a monthly report cycle. In this report cycle framework, it is not possible for Colson to adjust incorrect account information arbitrarily.

OCA has also investigated the differences in what Colson deems as a correct account, and what SBA considers as remaining in error. We have engaged SBA stakeholders in developing uniform validation rules that will be implemented in 2012 to eliminate this divergence from occurring.

This exercise has been initiated by SBA and Colson within the last 90 days, and SBA is tracking this as a priority project in Capital Access.

In addition, the finding is based on increases in the number of unreported and uncorrected data errors related to SBA loan balances in the 7(a) program.

Response: The analysis of loan error increases considers two discrete points in time and establishes a ratio accordingly. The audit does not disclose whether the analysis conducted in 2006 included unreported loans as they are now in 2011. Nor does the audit look at the change in the portfolio composition and the flow of accounts in and out of the portfolio between the two time periods. To that end, SBA presents the following

Loan Error Rate Increase			
March 2011 Loans in Error			44,327
April 2006 Loans in Error			27,111
Reported Increase in Loan Error Rate			63.5%
Number of Loans in Portfolio at Sep 30 2005:			265773
FY	# of Loan Approvals	Loans Removed from Active Portfolio	# of Loans Outstanding
2006	97,291	70,204	292,860
2007	99,607	71,459	321,008
2008	69,437	71,050	319,395
2009	41,289	61,122	299,562
2010	47,000	62,384	284,178
		336,219	
Number of Loans in Portfolio at Sep 30 2010:			276,746
Total Number of Accounts in Portfolio that			276,746
Involved Change in Status, 2006 - Apr 2011			336,219
Total Accounts That Impacted Active Portfolio			612,965
Loan Error Rate - Revised			7.23%

When viewed in this context, the loan error rate is 7.23%, not 63.5%, and should be the baseline for process improvement. OCA respectfully disagrees with this element of the finding as presented.

Response to Recommendations
1. Research and correct loans that have not been reported within the Electronic Loan Information Processing System (ELIPS) for a significant length of time (i.e. 6 months or more) which contribute to subsidy overstatements currently estimated at $5.2 million.

Response: The Office of Capital Access has initiated a project team to develop and implement a lender outreach program focuses on changing lender behavior in order to comply with reporting standards. The goal is to develop greater lender awareness of loan reporting impact on SBA stakeholders, connect greater lender compliance with program privileges (PLP authority, secondary market participation, waiver from SBA right of offset) by establishing an enforcement role within the Office of Credit Risk Management (OCRM) for those lenders with repeated errors in Form 1502 report filings.

2. Utilize the lender exception detail reports to identify and address lenders that consistently do not report loans and issue corrective action plans.

Response: These reports have been circulated to OCRM each month since August 2010 to focus attention on those lenders repeatedly identified with unreported or incorrect and unresolved reporting errors. We expect risk-based reviews to include corrective action recommendations to improve lender loan reporting.

3. Utilize the lender exception detail reports to identify lenders with consistent 1502 errors and develop training programs that will significantly reduce their error rates.

Response: As mentioned above, we have a plan in place to build greater awareness within the lender community on proper completion of the Form 1502. We utilize the exception report to identify lenders, and are looking into which Agency resource could best address corrective efforts with these lenders.

4. Identify SBA business rules that affect most loans and provide them in a useable format that Colson can integrate into relevant systems.

Response: Our 1502 process improvement project includes consolidating SBA validation codes at Colson. Development and implementation is underway and we expect to see results by the first quarter of calendar year 2012.

5. Develop a plan to oversee and enforce FTA contractual requirements for the daily electronic loan information exchange and error correction.

Response: This effort is incorporated into our improvement project with technical team meetings between the FTA and SBA systems information staff underway.

Second Finding - SBA did not Provide Adequate Oversight of the First Mortgage Loan Pooling System Development

Response to Recommendations
6. Retrieve and archive all FMLP system development documentation.

Response: SBA will work on retrieving and archiving this documentation.

7. Conduct a post implementation review of FMLP project deliverables to ensure Colson adhered to its SLDC and all project artifacts meet acceptable quality standards.

Response: SBA agrees and will conduct a post implementation review.

8. Ensure that all future internal and external OCA system developments adhere to SBA SDM standards for project management and development.

Response: SBA agrees.

Third Finding - SBA Did Not Ensure That Colson's Operation of SBA Systems Met Federal Security Requirements

The reports states that systems owned by SBA and operated by Colson were operating without SBA ensuring the system compliance with Federal security requirements.

> *Response: SBA has worked hand-in-hand with the Office of the Chief Information Officer since early 2011 to obtain system security accreditation and authorization. This authorization and accreditation was secured for these systems in August 2011. This extensive effort included the system elements associated with the FMLP program was being completed at the same time of this review. We would recommend the report reflect this as a subsequent event that has been addressed. OCA agrees with the finding and has since corrected the finding.*

<u>Response to Recommendations</u>

9. Complete the review of security controls and authorization of Colson FTA and CSA systems.

Response: The review, authorization and accreditation of the FTA and CSA systems hosted by Colson were completed August 3, 2011.

10. Ensure that currently operated systems are authorized for operation and meet the requirements of applicable NIST guidance and that any new system meets this requirement before becoming operational.

Response: SBA agrees.

Fourth Finding – SBA has not Adequately Enforced Collection of Secondary Market Late Penalty Fees

The draft report estimates that over the last five years, SBA has not collected $2.5 million in late fees through Colson.

> *Response: This estimate of uncollected fees should be viewed in the context of all fees collected in the 7(a) program over this same period. See below:*

Fee Collection	
Reported Collection Deficiency	2,500,000
Total Fees Collected, FY2006 - March 2011	798,000,000
Fees Oustanding / Fees Collected	0.313%

OCA considers the recommendation to devote resources to collect late fees to be immaterial in relation to total fee collection activity.

Response to Recommendations

11. Collect the $2.5 million in secondary market late penalty fees by either billing lenders or offsetting against any guarantee purchase amounts.

Response: The Office of Capital Access does not view this as a material item and does not agree with the recommendation to dedicate limited staff resources and time to collect secondary market late penalty fees.