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

Final Report Transmittal
Report Number: 20-05

DATE: December 10, 2019

TO: Christopher M. Pilkerton
Acting Administrator and General Counsel

FROM: Hannibal "Mike" Ware
Inspector General

SUBJECT: KPMG Management Letter Communicating Matters Relative to SBA's FY 2019 Financial Statement Audit

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 as of and for the fiscal year ended September 30, 2019. This audit is an annual requirement of the Chief Financial Officers Act of 1990, as amended, and was conducted in accordance with generally accepted government auditing standards; the Office of Management and Budget Bulletin No. 19-03, 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 management letter represents matters that were identified during the audit. KPMG addressed recommendations to the Acting Chief Financial Officer and the Associate Administrator for Capital Access. We provided a draft of KPMG's finding to these officials or their designees, who fully concurred with the findings. The officials or designees agreed or have already taken action to address the underlying conditions.

Should you or your staff have any questions, please contact me or Andrea Deadwyler, Assistant Inspector General for Audits, at (202) 205-6586.

cc: Dorrice Roth, Acting Financial Officer and Associate Administrator for
Performance Management
William Manger, Associate Administrator, Capital Access
Martin Conrey, Attorney Advisor, Legislation and Appropriations
Michael Simmons, Attorney Advisor

Attachment

KPMG LLP
Suite 12000
1801 K Street, NW
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December 10, 2019

Hannibal “Mike” Ware
Inspector General
U.S. Small Business Administration
Washington, DC

Chris Pilkerton
Acting Administrator
U.S. Small Business Administration
Washington, DC

In planning and performing our audit of the financial statements of the U.S. Small Business Administration (SBA) as of and for the year ended September 30, 2019, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, we considered the SBA’s internal control over financial reporting (internal control) as a basis for designing 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 the SBA’s internal control. Accordingly, we do not express an opinion on the effectiveness of the SBA’s internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses and/or significant deficiencies and therefore, material weaknesses and/or significant deficiencies may exist that were not identified. In accordance with *Government Auditing Standards*, we issued our report dated November 15, 2019, on our consideration of the SBA’s internal control over financial reporting in which we communicated certain deficiencies in internal control that we consider to be a material weakness and significant deficiencies.

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. During our audit, we noted certain matters related to internal control that are presented for your consideration. These comments and recommendations, all of which have been discussed with the appropriate members of management, are intended to improve the internal control process or result in other operating efficiencies and are summarized in Attachment I. We would be pleased to discuss these comments and recommendations with you at any time.

The purpose of this letter is solely to describe the deficiencies in internal control identified during our audit. Accordingly, this letter is not suitable for any other purpose.

Very truly yours,

KPMG LLP

Attachment I

Management Letter Comments

Noncompliance with the Debt Collection Improvement Act of 1996

Condition

During our compliance testing, we identified 1 of 58 direct and guaranty loans that was not referred to the U.S Department of the Treasury within 120 days of the charge-off date. A guaranty loan with a balance of $305,698.47 was charged off in November 2018 and as of the date of our test work (9/26/2019), the liable borrowers had not been referred to Treasury (over 300 days).

Criteria

Debt Collection Improvement Act of 1996 (DCIA), as amended:

Section 3716(c)(6) of title 31, United States Code, as amended by the Digital Accountability and Transparency Act of 2014 (DATA Act): "(6) Any Federal agency that is owed by a person a past due, legally enforceable nontax debt that is over 120 days delinquent, including nontax debt administered by a third party acting as an agent for the Federal Government, shall notify the Secretary of the Treasury of all such nontax debts for purposes of administrative offset under this subsection."

SBA Standard Operating Procedure (SOP) 50 57 2, 7(a) Loan Servicing and Liquidation, states in part, "... initial offset referral for guaranty loans automatically occurs at 120 days past the charge-off date and cross servicing occurs 60 days thereafter."

Cause

The condition occurred due to untimely updates to the Next Due Date field in SBA's loan repository system and insufficient communication between the loan officers, attorneys approving the charge-off and the financial analysts.

Effects

Delays in referring delinquent liable obligors/parties to Treasury causes SBA to be noncompliant with DCIA. In addition, delays in referrals will limit Treasury's ability to collect on delinquent debt and may leave additional government and private funds susceptible to risk of loss.

Recommendations

We recommend the Acting Administrator require the Associate Administrator for Capital Access to:

1. Update appropriate Center Desk Manuals to specify relevant staff involved in the charge-off and referral processes to ensure the Next Due Date field in the loan repository system is timely updated when a loan's liable parties change. Any change to policy should be communicated to relevant staff.
2. Perform a regular review of liable parties with outstanding receivable balances to ensure they are referred timely.

Management's Response

SBA management concurred with the finding and recommendations.

Attachment I

Management Letter Comments

Analysis and Implementation of Accounting Standards

Conditions

To ensure compliance with generally accepted accounting principles, SBA's process to analyze and document the applicability of recently issued and existing standards need improvement. Specifically, we noted that SBA management did not perform a comprehensive, documented analysis of recently issued standards and do not maintain a comprehensive list of the policies.

In addition, our review of the analyses subsequently provided by SBA management showed that the analyses performed were insufficient as they did not reference the applicability of key portions of recently issued and existing standards as noted below.

Standard	Omission of Key Portion of Standard
Statement of Federal Financial Accounting Standards (SFFAS) No. 2, Accounting for Direct Loans and Loan Guarantees (September 30, 1994)	Management did not measure and disclose the portion of the subsidy re-estimate related to the interest rate re-estimate until requested.
SFFAS No. 47, Reporting Entity (September 30, 2017)	Management did not address the criteria related to the applicability of identifying and reporting any Disclosure Entities or Related Parties.
SFFAS No. 55, Amending Inter-Entity Cost Provisions (September 30, 2018)	Management did not assess whether any SBA programs met the criteria of business-type activities, did not address inter-entity costs related to personnel benefits and the Treasury Judgment Fund settlements, and did not address how inter-entity costs for non-business-type activities are recognized.
SFFAS No. 56, Classified Activities (October 4, 2018)	Management did not address the updated disclosure requirement included in the summary of significant accounting policies.

Criteria

Office of Management and Budget Circular No. A-123, Management's Responsibility for Enterprise Risk Management and Internal Control states, "Federal leaders and managers are responsible for establishing and achieving goals and objectives, seizing opportunities to improve effectiveness and efficiency of operations, providing reliable reporting, and maintaining compliance with relevant laws and regulations."

U.S. Government Accountability Office's Standards for Internal Control in the Federal Government (Green Book) states, "Management clearly documents internal control and all transactions and other significant events in a manner that allows the documentation to be readily available for examination. The documentation may appear in management directives, administrative policies, or operating manuals, in either paper or electronic form. Documentation and records are properly managed and maintained."

SFFAS No. 2, Accounting for Direct Loans and Loan Guarantees, paragraph 32 states "Credit programs should re-estimate the subsidy cost allowance for outstanding direct loans and the liability for outstanding loan guarantees as required in this standard. There are two kinds of reestimates: (a) interest rate re-estimates, and (b) technical/default reestimates. Entities should measure and disclose each program's reestimates in these two components separately."

SFFAS No. 47, Reporting Entity, paragraph 3 states, "This Statement also guides preparers of GPFFRs in identifying related parties and in determining what information to provide about related party relationships of such significance that it would be misleading to exclude information. There are disclosures required regarding the nature of the relationship and financial-related exposures to risk of loss or potential gain resulting from relationships with such related parties." Paragraph 16 states "This Statement also establishes that component reporting entities' GPFFRs must include all consolidation entities and disclosure entities for which they are accountable so that both the component reporting entity and government-wide GPFFRs are complete."

SFFAS No. 55, Amending Inter-Entity Cost Provisions, paragraph 4 states "Recognition of inter-entity costs supporting business-type activities and recognition of inter-entity costs for non-business type activities that elect to do so should be made in accordance with implementation guidance provided by FASAB through one or more Technical Releases. Activities that are not business-type activities are not required to recognize inter-entity costs other than inter-entity costs for personnel benefits and the Treasury Judgment Fund settlements unless otherwise directed by OMB. Notwithstanding the absence of a requirement, non-business-type activities may elect to recognize imputed cost and corresponding imputed financing for other types of inter-entity costs. Business-type activity is defined as a significantly self-sustaining activity which finances its continuing cycle of operations through collection of exchange revenue as defined in SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*."

SFFAS No. 56, Classified Activities, paragraph 12 states "All federal component reporting entities must include the following in the summary of significant accounting policies: Accounting standards require all reporting entities to disclose that accounting standards allow certain presentations and disclosures to be modified, if needed, to prevent the disclosure of classified information."

Cause

SBA management does not have a formal process in place to perform and document a comprehensive analysis of new and existing accounting standards which takes into account the applicability, implementation, materiality and reporting of such standards.

Effects

Without performing and documenting a comprehensive analysis of the applicability and implementation of accounting standards, SBA increases the risk of material misstatements or omissions to the consolidated financial statements that would not be in accordance with generally accepted accounting principles. In addition, there is not appropriate legacy documents or position papers that could aid the knowledge transfer of key decisions regarding applicability, implementation and materiality of existing and upcoming accounting standards.

Recommendations

We recommend the Acting Administrator direct the Acting Chief Financial Officer to:

3. Implement a process to perform and formally document a comprehensive analyses of the applicability and implementation of new and existing accounting standards.
4. Memorialize the results of the analyses in the form of a complete set of approved policies/procedure documents that are readily available.

Management's Response

SBA management concurred with the finding and recommendations.