



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

**DATE:** December 18, 2020

**TO:** Jovita Carranza  
Administrator

**FROM:** Hannibal "Mike" Ware   
Inspector General

**SUBJECT:** Independent Auditors' Report on SBA's FY 2020 Financial Statements

I am pleased to present the attached independent auditors' report on the U.S. Small Business Administration's (SBA's) consolidated financial statements for fiscal years 2020 and 2019, as required annually by the Chief Financial Officers Act of 1990, as amended.

We contracted with the independent certified public accounting firm KPMG LLP to conduct an audit of the SBA's consolidated financial statements for the fiscal years ended September 30, 2020, and September 30, 2019. KPMG was engaged to conduct the audit in accordance with U.S. generally accepted auditing standards. The audit also complied with the applicable standards for financial audits in Government Auditing Standards issued by the Comptroller General of the United States and Office of Management and Budget Bulletin No. 19-03, Audit Requirements for Federal Financial Statements.

In the report, KPMG auditors found significant matters for which they were unable to obtain sufficient, appropriate audit evidence to provide a basis for an audit opinion on SBA's consolidated financial statements for the year ended September 30, 2020. Accordingly, KPMG issued a disclaimer of opinion on the consolidated financial statements as of and for the year ended September 30, 2020. The following paragraph describes the basis for the disclaimer of opinion related to the implementation of new programs under the Coronavirus Aid, Relief, and Economic Security Act of 2020 and related legislation, most notably the Paycheck Protection Program and the expanded Economic Injury Disaster Loan program.

SBA was unable to provide adequate evidential matter in support of a significant number of transactions and account balances related to these programs because of inadequate processes and controls. As a result, KPMG was unable to determine whether any adjustments might have been necessary with respect to Credit Program Receivables and Related Foreclosed Property, Downward Reestimate Payable to Treasury, Liability for Loan Guarantees, and the related elements in the consolidated statements of net cost and changes in net position, the combined statement of budgetary resources, and related notes to the consolidated financial statements.

SBA's 2019 consolidated financial statements present fairly, in all material respects, the financial position of the SBA as of September 30, 2019.

However, for the year ended September 30, 2020, KPMG identified seven material weaknesses, two significant deficiencies in internal controls over financial reporting, and two instances of reportable noncompliance with provisions of applicable laws, regulations, contracts, and grant agreements. Details of KPMG's conclusions about the material weaknesses and significant deficiencies are described in attachments I and II of this report. Instances of noncompliance or other matters required to be reported under Government Auditing Standards or OMB Bulletin No. 19-03 are described in attachment III.

We reviewed KPMG’s report and related documentation and inquired of its representatives. Our review, as differentiated from an audit of the financial statements in accordance with U.S. generally accepted government auditing standards, was not intended to enable us to express—and we do not express—opinions on SBA’s financial statements or internal control over financial reporting or conclusions on SBA’s compliance with applicable laws and other matters.

KPMG is responsible for the attached auditors’ report dated December 18, 2020, and the conclusions expressed. However, the OIG provides negative assurance of this audit. Our oversight protocols include evaluation of major work products, attendance at critical meetings, review of significant findings and examination of related evidential matter. Our review disclosed no instances where KPMG did not comply in all material respects with U.S. generally accepted government auditing standards.

We provided a draft of KPMG’s audit report to SBA’s Chief Financial Officer, who did not agree with five material weaknesses included in the report under “Accounting and Reporting for Programs Implemented Under the CARES Act and Related Legislation” and “Entity Level Controls.” The Chief Financial Officer partially agreed with the remaining two material weaknesses, grouped in the report under “Evaluation and Monitoring of Service Organization Controls.”

SBA’s responses, as communicated to KPMG during the audit, detail the agency’s concerns with the analysis and conclusions drawn by KPMG. The Chief Financial Officer’s response is included in attachment IV, and KPMG’s response to the Chief Financial Officer’s response is included in attachment V of this report.

We appreciate the cooperation and assistance of SBA and KPMG during the audit. Should you or your staff have any questions, please contact me or Andrea Deadwyler, Assistant Inspector General for Audits, at (202) 205-6586.

cc: William Manger, Chief of Staff and Associate Administrator, Office of Capital Access  
Christopher Gray, Deputy Chief of Staff  
Stephen Kong, Acting Chief Operating Officer  
Patricia Gibson, Senior Advisor  
Tami Perriello, Chief Financial Officer  
Brittany Biles, General Counsel  
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Tonia Butler, Director, Office of Internal Controls  
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Attachment



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## Independent Auditors' Report

Inspector General  
U.S. Small Business Administration

Administrator  
U.S. Small Business Administration

### Report on the Financial Statements

We have audited the accompanying consolidated financial statements of the United States (U.S.) Small Business Administration (SBA), which comprise the consolidated balance sheet as of September 30, 2019, and the related consolidated statements of net cost and changes in net position, and combined statement of budgetary resources for the year then ended, and the related notes to the consolidated financial statements. Further, we were engaged to audit the accompanying consolidated financial statements of the SBA, which comprise the consolidated balance sheet as of September 30, 2020, and the related consolidated statements of net cost and changes in net position, and combined statement of budgetary resources for the year 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 U.S. generally accepted accounting principles; 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.

#### *Auditors' Responsibility*

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. Except as explained in the Basis for Disclaimer of Opinion paragraph, 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 Office of Management and Budget (OMB) Bulletin No. 19-03, *Audit Requirements for Federal Financial Statements*. Those standards 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 auditors' 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 on the 2019 consolidated financial statements.



### *Basis for Disclaimer of Opinion*

During fiscal year 2020, the *Coronavirus Aid, Relief, and Economic Security Act of 2020* and related legislation authorized funding for SBA to implement the Paycheck Protection Program and the expanded Economic Injury Disaster Loan program. SBA was unable to provide adequate evidential matter in support of a significant number of transactions and account balances related to these programs due to inadequate processes and controls. As a result of these matters, we were unable to determine whether any adjustments might have been necessary with respect to Credit Program Receivables and Related Foreclosed Property, Downward Reestimate Payable to Treasury, Liability for Loan Guarantees, and the related elements in the consolidated statements of net cost and changes in net position, the combined statement of budgetary resources, and related notes to the consolidated financial statements.

### *Disclaimer of Opinion on the Fiscal Year 2020 Financial Statements*

Because of the significance of the matters described in the Basis for Disclaimer of Opinion paragraph, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the consolidated financial statements as of and for the year ended September 30, 2020. Accordingly, we do not express an opinion on these consolidated financial statements.

### *Opinion on the Fiscal Year 2019 Financial Statements*

In our opinion, the 2019 consolidated financial statements referred to above present fairly, in all material respects, the financial position of the United States Small Business Administration as of September 30, 2019, and its net costs, changes in net position, and budgetary resources for the year then ended in accordance with U.S. generally accepted accounting principles.

### *Other Matters*

#### Interactive Data

Management has elected to reference to information on websites or other forms of interactive data outside the *U.S. Small Business Administration's Agency Financial Report for FY 2020* 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

U.S. generally accepted accounting principles require that the information in the Management's Discussion and Analysis and Required Supplementary 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 were unable to apply certain limited procedures to such information in accordance with auditing standards generally accepted in the United States of America because of the significance of the matters described in the Basis for Disclaimer of Opinion paragraph. We do not express an opinion or provide any assurance on the information.

#### Other Information

We were engaged to audit the basic consolidated financial statements as a whole. The Table of Contents, How this Report is Organized, Message from the Administrator, Message from the Chief Financial Officer, Other Information, and the Appendices in the *U.S. Small Business Administration's Agency Financial Report for FY 2020* are presented for purposes of additional analysis and are not a required part of the basic consolidated financial statements. Such information has not been subjected to the procedures applied in our engagement to audit 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 connection with our engagement to audit the consolidated financial statements as of and for the year ended September 30, 2020, we considered SBA's internal control over financial reporting (internal control) as a basis for designing 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*.

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 or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that have not been identified. However, as described in the accompanying Attachments I and II, we did identify certain deficiencies in internal control that we consider to be material weaknesses 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. 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. We consider the deficiencies described in Attachment I to be material weaknesses.

SBA management did not report these material weaknesses in its *Management Assurances: FMFIA and FFMIA Assurance Statement for FY 2020*, included in the Management's Discussion and Analysis section of the FY 2020 Agency Financial Report.

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. We consider the deficiencies described in Attachment II, to be significant deficiencies.

### *Compliance and Other Matters*

In connection with our engagement to audit SBA's consolidated financial statements as of and for the year ended September 30, 2020, 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 financial statements. 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 an instance of noncompliance or other matters that are required to be reported under *Government Auditing Standards* or OMB Bulletin No. 19-03 and which are described in Attachment III. Additionally, if the scope of our work had been sufficient to enable us to express an opinion on the basic fiscal year 2020 consolidated financial statements, other instances of noncompliance or other matters may have been identified and reported herein.

We also performed tests of SBA's 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 instances, described in Attachment III, in which SBA's financial management systems did not substantially comply with (1) Federal financial management systems requirements and (2) applicable Federal accounting standards. The results of our tests disclosed no instances in which SBA's financial management systems did not substantially comply with the United States Standard General Ledger at the transaction level. Additionally, if the scope of our work had been sufficient to enable us to express an opinion on the basic fiscal year 2020 consolidated financial statements, other instances of substantial noncompliance with FFMIA may have been identified and reported herein.



*SBA's Response to Findings*

SBA's response to the findings identified in our engagement is described in Attachment IV. SBA's response was not subjected to the procedures applied in the engagement to audit the consolidated financial statements and, accordingly, we express no opinion on the response.

Our response to SBA's response is included in Attachment V.

*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 results 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  
December 18, 2020

## U.S. Small Business Administration

### Material Weaknesses

The following deficiencies are considered to be material weaknesses in internal controls over financial reporting.

- 1. Approval of PPP Loan Guarantees**
- 2. Reporting of PPP Loan Guarantees**
- 3. Subsidy Reestimate of PPP Loan Guarantees**
- 4. Approval of COVID-19 EIDLs and Grants**
- 5. Service Organization Used for COVID-19 EIDLs and Grants**
- 6. Service Organizations Used for Loan Guarantee Programs**
- 7. Entity Level Controls**

For purposes of presentation and as described below, material weaknesses (1) through (4) are grouped into (A) *Accounting and Reporting for Programs Implemented under the Coronavirus Aid, Relief, and Economic Security Act of 2020 (CARES Act) and Related Legislation*; material weakness (5) and (6) are grouped into (B) *Evaluation and Monitoring of Service Organization Controls*; and material weakness (7) is under (C) *Entity Level Controls*.

#### *A. Accounting and Reporting for Programs Implemented under the CARES Act and Related Legislation*

On March 27, 2020, Congress passed the CARES Act to provide emergency assistance in response to the extensive effects of the public health and economic crisis arising from the Coronavirus Disease 2019 (COVID-19) pandemic. This law was followed by the Paycheck Protection Program and Health Care Enhancement Act passed by Congress on April 24, 2020. The largest component of these laws was the Paycheck Protection Program (PPP), which provided funding of \$670 billion. The PPP is a loan guarantee program whereby third-party lenders issue loans that are fully guaranteed by SBA. In addition, the two rounds of legislation provided a total funding of \$20 billion for COVID-19 Economic Injury Disaster Loan (EIDL) grants and an additional \$50 billion of funding for SBA to issue up to approximately \$367 billion in COVID-19 EIDLs. COVID-19 EIDLs are direct loans that SBA issues to eligible borrowers. These laws from this point forward are collectively referred to as the CARES Act and related legislation.

#### **1. Approval of PPP Loan Guarantees**

Due to the volume of loans being processed as a result of the PPP, the Office of Capital Access developed a one-time process to accept bulk loan files from lenders. The lenders sent batch files to the Office of Capital Access and direct uploads of PPP loans were made in SBA's loan repository system. As of August 8, 2020 (expiration of the program), SBA had approved over 5.2 million loan guarantees for an approximate total of \$525 billion.

Management did not adequately design and implement controls to ensure PPP loan guarantees were accurate to enable the fair presentation of the Liability for Loan Guarantees and related elements in the fiscal year 2020 consolidated financial statements. Specifically, management identified approved loans disbursed by its third-party lenders that, in numerous cases, were not accurate and potentially not in conformance with the CARES Act and related legislation. In addition, there were over 2 million approved PPP loan guarantees (with an approximate total value of \$189 billion) flagged by management within the loan repository system that are potentially not in conformance with the CARES Act and related legislation.

The loans were flagged for one or more of 35 reasons (e.g., Business in Operation After February 15, 2020; Mismatch of Taxpayer Identification Number/Employer Identification Number/Social Security Number; Criminal Record; Mismatch of Individual or Company Entity Name; Aggregate Data Mismatch; Potential Multiple Data Universal Numbering System Issue; or Inactive Business).

The deficiencies were caused by an inadequate entity wide control environment to implement processes and procedures to account for new and expanded programs under the CARES Act and related legislation with sufficiently designed, implemented, and effectively operating controls.

The following criteria were considered with respect to the matters described in the preceding paragraphs:

- The Government Accountability Office's (GAO's) *Standards for Internal Control in the Federal Government* ("Green Book"), Principle 3, *Establish Structure, Responsibility, and Authority*; and Principle 10, *Design Control Activities*
- Office of Management and Budget (OMB) Circular No. A-123, *Management's Responsibility for Enterprise Risk Management and Internal Control*

The deficiencies noted above may result in material misstatements to the Liability for Loan Guarantees, Downward Reestimate Payable to Treasury line items, and related elements in the consolidated financial statements.

#### Recommendations – Approval of PPP Loan Guarantees

We recommend the Administrator coordinate with the Associate Administrator of Office of Capital Access to:

1. Finalize the review plan and execute the loan review process for all loans in the PPP portfolio to determine whether loans were or not in conformance with the CARES Act and related legislation.
2. Determine the impact on the outstanding guarantee and eligibility for forgiveness of loans determined to be not in conformance with the CARES Act and related legislation.
3. Implement adequate controls to prevent loans from being approved that are potentially not in conformance with the legislation and program terms.
4. Develop and enforce a policy that requires the adequate training and monitoring of PPP lenders to execute their responsibilities in the loan origination process.

We also recommend the Administrator coordinate with the Chief Financial Officer to:

5. Assess the accounting considerations, including the impact on the consolidated financial statements, from the results of the loan review process for PPP loans and record any necessary adjustments for loans determined to not be in conformance with the CARES Act and related legislation.

## **2. Reporting of PPP Loan Guarantees**

As part of the PPP, lenders must report any PPP loans that have been fully disbursed or cancelled to SBA through the SBA Form 1502 (1502 report) or the loan repository system. SBA records the Liability for Loan Guarantee and related accounting entries once the lender reports the loan disbursement. Lenders were required to electronically submit the 1502 report to SBA by the latter of (1) May 29, 2020 or (2) 10 calendar days after disbursement or cancellation of a PPP loan. After reporting the initial disbursement, lenders are responsible for reporting on the status of each loan by submitting a monthly 1502 report until the lender notifies SBA that the loan has been paid in full. Through the 1502 reporting process, the outstanding loan principal balance and ultimately the liability for loan guarantees balances are updated.

The portfolio of PPP loans with an outstanding loan principal balance is also used as an input into the subsidy estimation cash flow models.

Management did not adequately design and implement controls to determine that the status of PPP loan guarantees was complete and accurate to enable the fair presentation of the Liability for Loan Guarantees and related elements in the consolidated financial statements. Specifically, management did not have processes and controls in place to review the status of PPP loans where:

- 1502 reports have not been submitted.
- 1502 reports may have been submitted incorrectly.
- 1502 reports were not processed.

As of September 30, 2020, SBA reported approximately \$6 billion of PPP loans approved but not disbursed due to unreported or unprocessed 1502 reports from lenders. In addition, there were over 896,000 errors from 1502 reports that were not reviewed or processed to update the outstanding loan principal balance. The affected PPP loans comprised of 63 distinct 1502 report error codes (e.g., PPP loans must be fully disbursed; Loan is in inactive status; Invalid Guarantee Service Status Code; Outstanding balance plus Total Amount Undisbursed cannot exceed Loan Approval Amount; Outstanding Balance must be less than or equal to Current Loan Approval Amount).

The deficiencies were caused by an inadequate entity wide control environment to implement processes, and procedures to account for new and expanded programs under the CARES Act and related legislation with sufficiently designed, implemented, and effectively operating controls.

The following criteria were considered with respect to the matters described in the preceding paragraphs:

- GAO's Green Book, Principle 3, *Establish Structure, Responsibility, and Authority*; and Principle 10, *Design Control Activities*
- OMB Circular No. A-123, *Management's Responsibility for Enterprise Risk Management and Internal Control*

The deficiencies noted above may result in material misstatements to the Liability for Loan Guarantees, Downward Reestimate Payable to Treasury line items, and related elements in the consolidated financial statements.

#### Recommendations – Reporting of PPP Loan Guarantees

We recommend the Administrator coordinate with the Associate Administrator of Office of Capital Access to:

6. Identify and review PPP loans with incomplete or inaccurate 1502 reports.
7. Determine and update the loan repository system with correct PPP loan related balances.
8. Develop and enforce a policy that requires the adequate training and monitoring of lenders to execute their responsibilities in the PPP loan servicing process.
9. Develop and enforce a policy to monitor incomplete or inaccurate PPP 1502 reports on an ongoing basis.

We also recommend the Administrator coordinate with the Chief Financial Officer to:

10. Assess the accounting considerations, including the impact on the consolidated financial

statements, from the results of the loan review process for PPP loans and record any necessary adjustments for loans determined to not be in conformance with the CARES Act and related legislation.

### 3. Subsidy Reestimate of PPP Loan Guarantees

PPP loans can be forgiven up to the full principal amount of the loan plus any accrued interest if certain criteria are met by the borrower. In general, if the borrower uses 60 percent of the loan amount on payroll costs, the full principal amount of the loan plus any accrued interest can be forgiven. As of September 30, 2020, SBA had received over 128,000 (or approximately 2.5% of total loan guarantees approved) forgiveness applications from lenders. SBA began remitting forgiveness payments to lenders on October 2, 2020.

Statement of Federal Financial Accounting Standards (SFFAS) No. 2, *Accounting for Direct Loans and Loan Guarantees*, requires that loan guarantees committed after September 30, 1991, be recorded on a present value basis consistent with the intent of the Federal Credit Reform Act of 1990. As such, SBA developed an estimation methodology to reestimate the future net cash inflows and outflows for the PPP loan portfolio as of September 30, 2020.

Management did not adequately design and implement controls over the review of the data inputs and assumptions used in the subsidy reestimate to determine that the portfolio of PPP loans was complete and accurate. Specifically, management did not consider and document the effects on the reestimate methodology for more than:

- 2 million approved PPP loan guarantees with a total approximate value of \$189 billion that are flagged as potentially not in conformance with the CARES Act and related legislation, which may affect the accuracy of such loan guarantees, within the loan repository system. Management did not evaluate and document the impact of these loan guarantees on the key assumptions such as the Forgiveness Rate and Forgiveness Curve, and on the methodology of the overall PPP loan portfolio.
- 896,000 errors in 1502 reports that were not reviewed or processed to update the outstanding loan principal balance. This includes 1502 reports that were not submitted, submitted incorrectly, or did not process due to an error.

In addition, management did not adequately design and implement controls to verify the completeness and accuracy of relevant loan characteristics that are used in the development of key assumptions. Specifically, the North American Industry Classification System code is the data attribute used for each loan to develop key assumptions related to loan forgiveness. However, the code was not a field included on the borrower's application form and the reestimate methodology relies on this data attribute being accurately reported by lenders.

Additionally, management did not adequately design and implement controls over the development and support of the Forgiveness Rate assumption. The methodology did not include documentation regarding how the Forgiveness Rates for the 'High' and 'Very High' Risk Group categories were determined. Further, management did not consider and document the availability of actual loan forgiveness applications received from the lenders to address the potential existence of disconfirming evidence related to the assumption.

The deficiencies were caused by an inadequate entity wide control environment to implement processes, and procedures to account for new and expanded programs under the CARES Act and related legislation with sufficiently designed, implemented, and effectively operating controls.

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

- GAO’s Green Book, Principle 3, *Establish Structure, Responsibility, and Authority*; Principle 10, *Design Control Activities*; and Principle 13, *Use Quality Information*
- OMB Circular No. A-123, *Management’s Responsibility for Enterprise Risk Management and Internal Control*
- Federal Accounting Standards Advisory Board (FASAB) Technical Release 6, *Preparing Estimates for Direct Loan and Loan Guarantee Subsidies under the Federal Credit Reform Act – Amendments to Technical Release No. 3 Preparing and Auditing Direct Loan and Loan Guarantee Subsidies under the Federal Credit Reform Act*

The deficiencies noted above may result in a material misstatement to the Liability for Loan Guarantees and Downward Reestimate Payable to Treasury line items, and the related elements in the consolidated financial statements.

#### Recommendations – Subsidy Reestimate of PPP Loan Guarantees

We recommend the Administrator coordinate with the Chief Financial Officer to:

11. Document the development of significant assumptions used in the PPP reestimate, including the consideration of the most recent, best available data to address the potential existence of disconfirming evidence.
12. Accumulate relevant, complete, and accurate data to develop and support the PPP reestimate.
13. Design and implement review and approval controls of the PPP reestimate by appropriate levels of management, including review of sources of relevant data inputs, development of assumptions, and reasonableness of assumptions and resulting estimates.

#### **4. Approval of COVID-19 EIDLs and Grants**

The authority to lend up to \$367 billion in COVID-19 EIDLs and \$20 billion in COVID-19 EIDL emergency advance grants represents more disaster loan funding than all of the previous years combined in SBA’s history. To receive, review, and process applications for COVID-19 EIDLs and grants, SBA contracted with a service organization to create a portal for borrowers and grant recipients to submit applications. The portal intakes and processes applications, and it supports the disaster assistance loan officer’s decisions of whether to approve or reject an application.

Applicants are subjected to certain identity, fraud, and credit checks within the portal. For COVID-19 EIDLs and grants, the portal may perform an automatic approval function for borrowers and grant recipients based on the data elements entered. If no further research is required by a loan officer, the application is sent directly to a supervisory loan officer for approval and obligation. If an automatic approval is not performed, the portal provides alerts for the loan officer to address before a loan or grant can be routed to the senior loan officer for review, approval, and obligation of funds.

Management did not adequately design and implement controls to ensure approved COVID-19 EIDLs and grants were provided to eligible borrowers and accurately recorded. Specifically, SBA approved and disbursed EIDLs and grants in the following instances:

- More than one COVID-19 EIDL or grant was approved and disbursed to the same borrower;
- Loans and grants were issued to borrowers with inaccurate or invalid Tax Identification Numbers, Employee Identification Numbers, or Social Security Numbers;
- Loans were issued that management flagged to be potentially fraudulent; and

- Loans were issued to borrowers that management flagged because the borrowers were excluded from doing business with the government.

For loans approved as of September 30, 2020, there were a total of over 6,000 approved and disbursed COVID-19 EIDLs (with a total value of over \$212 million) flagged within the loan repository system that were issued to potentially ineligible borrowers.

In addition, management noted as part of an improper payment review that adequate controls were not designed and implemented to determine that fraud alerts raised by the portal related to applications submitted by borrowers were sufficiently addressed before loans were approved. The fraud alerts noted include: Large number of applications with other lenders; Suspicious online behavior; Fraud alert detected on credit report; Owner/client information failed validation; Owner/client information failed online identity verification; or Fraud found on related deals. Management also noted instances where the applicant indicated the business was a franchise or indicated a potential issue with their character that management had not adequately addressed in accordance with its procedures.

Management did not have adequate procedures and controls implemented to address certain alerts within the portal. Specifically, the portal Reference Guide does not have adequate procedures to address the following alerts: Public records search did not find business; Bank account or routing number could not be verified; and Bank account could not be confirmed to be associated with the business.

The deficiencies were caused by an inadequate entity wide control environment to implement processes and procedures to account for new and expanded programs under the CARES Act and related legislation with sufficiently designed, implemented, and effectively operating controls.

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

- GAO's Green Book, Principle 3, *Establish Structure, Responsibility, and Authority*; and Principle 10, *Design Control Activities*
- OMB Circular No. A-123, *Management's Responsibility for Enterprise Risk Management and Internal Control*

The deficiencies noted above may result in a material misstatement of the Credit Program Receivables and Related Foreclosed Property, Net and Downward Reestimate Payable to Treasury line items, and related elements in the consolidated financial statements.

#### Recommendations – Approval of COVID-19 EIDLs and Grants

We recommend the Administrator coordinate with the Associate Administrator of Office of Disaster Assistance to:

14. Perform a thorough review of the COVID-19 EIDLs and grants portfolio and determine which transactions were made to ineligible recipients and not in conformance with the CARES Act and related legislation.
15. Implement controls that prevent or detect loans from being approved that are not in conformance with the related legislation and program's eligibility terms.
16. Update the Reference Guide to require a more thorough review to clear certain alerts and enforce the actions recommended by the Reference Guide to adequately address and mitigate the alerts prior to loan approval.
17. Provide training of loan officers and supervisory loan officers to execute their responsibilities in accordance with established guidance and standard operating procedures.

We also recommend the Administrator coordinate with the Chief Financial Officer to:

18. Assess the accounting considerations, including the impact on the consolidated financial statements, from the results of the loan review process for PPP and record any necessary adjustments for loans determined not to be in conformance with the CARES Act and related legislation.

*B. Evaluation and Monitoring of Service Organization Controls*

Management did not adequately design and implement internal controls with respect to the evaluation and monitoring of service organization controls. Adequate controls were not implemented related to the evaluation and monitoring of the service organization controls used to process COVID-19 EIDLs and emergency advance grants and for the service organization controls used for SBA loan guarantee programs.

**5. Service Organization Used for COVID-19 EIDLs and Grants**

SBA contracted with a service organization to develop and use a portal for COVID-19 EIDL and grant processing. The portal intakes and processes applications, and it supports the disaster assistance loan officer's decisions of whether to approve or reject an application. Approved loan applications are ultimately disbursed as COVID-19 EIDLs or grants, which are a part of the consolidated financial statements. As part of processing, the portal transmits application data to various external databases and sources to perform numerous fraud and validation checks, among which include the duplicate application check, business owner identity check, and bank account verification.

Management did not obtain reasonable assurance on the operating effectiveness of internal controls in the service organization's control environment relevant to the processing of SBA's COVID-19 EIDL transactions, which do not enable the fair presentation of the Credit Program Receivables and Related Foreclosed Property line item and related elements in the consolidated financial statements. The relevant control environment at the service organization includes the operation of the portal and the application controls within the portal. In addition, the relevant control environment includes the data transmissions over the Internet between the portal and various third-party organizations.

In addition, management did not provide evidence of adequate monitoring activities performed over the relevant internal control environment at the service organization, such as obtaining and reviewing an attestation report on the design, implementation, and operating effectiveness of controls at the service organization. Management also did not provide evidence whether adequate user entity controls that are designed, implemented, and operating effectively to complement the service organization's controls. Management's assessment of internal controls over financial reporting is not complete without the sufficient consideration of existing and non-existing controls at relevant service organizations and the effectiveness of those controls.

The deficiencies were caused by an inadequate entity wide control environment to implement the provisions of the CARES Act and related legislation with sufficiently designed and implemented controls resulting from the urgent need to provide financial assistance to the public. In addition, management did not hold the service organization accountable for the assigned internal control responsibilities by obtaining reasonable assurance on the operating effectiveness of internal controls in the service organization's control environment (e.g., requiring a service organization control (SOC) 1 Type 2 report for the control environment relevant to the processing of SBA's COVID-19 EIDL transactions).

The following criteria were considered with respect to the matters described in the preceding paragraphs:

- GAO's Green Book, Section 4, *Additional Considerations: Service Organizations*; Principle 5, *Enforce Accountability*; Principle 10, *Design Control Activities*; and Principle 16, *Perform Monitoring Activities*
- OMB Circular No. A-123, *Management's Responsibility for Enterprise Risk Management and Internal Control*

The deficiencies noted above prevented SBA from obtaining an understanding of relevant service organization controls and any weaknesses that increase risks of misstatements in the Credit Program Receivables and Related Foreclosed Property line item and related elements in the consolidated financial statements and potential noncompliance with provisions of laws or regulations.

#### Recommendations – Service Organization Used for COVID-19 EIDLs and Grants

We recommend the Administrator coordinate with the Associate Administrator of Office of Disaster Assistance to:

19. Develop and implement a policy requiring new service organizations to provide a SOC 1 report over the control environment that is relevant and significant to the processing and recording of SBA's transactions. If a SOC 1 report cannot be obtained, identify and evaluate relevant controls at the service organizations that have an impact on SBA's internal controls over financial reporting.
20. Assess the risk posed by the service organization's control environment and obtain sufficient assurance over the operating effectiveness of relevant and significant controls to determine the integrity of transactions processed on behalf of and recorded by SBA. If a SOC 1 report is obtained for the relevant control environment at the service organization, determine and document the following:
  - SOC 1 report is sufficiently scoped to cover transaction processing and related control activities performed by the service organization on behalf of SBA (e.g., that services, business applications and other information technology, service organization departments and locations, control objectives and activities, and other aspects of scope that are relevant to SBA's internal controls over financial reporting are included in the scope of SOC 1 reports).
  - All exceptions noted in the SOC 1 report – not just those described in the independent service auditor's report – are evaluated to determine applicability to SBA's internal controls over financial reporting, the potential impact to SBA's financial statements, and mitigating controls other considerations made during their risk assessment.
  - All complementary user entity controls described in the SOC 1 reports are evaluated using current information and with consideration to their applicability to SBA's internal controls over financial reporting.
  - Evaluation procedures include an assessment of whether complementary user entity controls and other SBA-performed controls were tested and found effective and, if they are not, the impact of such deficiencies on SBA's internal controls over financial reporting.
  - All complementary subservice organization controls described in SOC 1 reports are evaluated to determine whether they provided services and performed controls considered relevant to SBA's internal controls over financial reporting and, if relevant subservice organizations were identified, an evaluation is performed to obtain an understanding of the subservice organization(s) and their controls.
  - SOC 1 reports cover the appropriate period or corresponding gap letters provide sufficient coverage to assess impacts on SBA's internal controls over financial reporting.

#### **6. Service Organizations Used for Loan Guarantee Programs**

The use of service organizations is integral to the servicing and reporting of SBA's loan guarantee programs. To facilitate the collection of the 1502 reports from lenders, SBA uses a contracted fiscal transfer agent to collect the 7(a) and PPP loan data from lenders. The loan data collected from 7(a) Program and PPP lenders affect the Liability for Loan Guarantees line item and related elements in the consolidated

financial statements. The fiscal transfer agent also sells loans into the secondary market. SBA guarantees the timely payment, as well as a default guarantee, to 7(a) secondary market investors. The payments are made from the Master Reserve Fund that is administered by the fiscal transfer agent. SBA discloses the balances in the Master Reserve Fund in the notes to the financial statements. For the 504 program, SBA uses a financial service provider to support the central servicing agent. The financial service provider manages the day-to-day operations of the program including funding and servicing loans and managing associated payouts to third-party investors.

Management's evaluations of SOC 1 reports over the fiscal transfer agent and the financial service provider were not sufficient or properly documented to aid in management's assessment of internal controls over financial reporting and do not enable the fair presentation of the Liability for Loan Guarantees line item and related elements in the consolidated financial statements. Specifically, management did not:

1. Determine the potential impact of control deficiencies on internal controls over financial reporting and implement compensating mitigating controls for such deficiencies.
2. Evaluate and address the complementary user entity controls identified within the SOC 1 reports.
3. Evaluate relevant subservice organizations such as the fiscal transfer agent's information technology infrastructure support provider.
4. Obtain bridge letters that cover the appropriate gap period to provide sufficient coverage to assess impacts on SBA's internal controls over financial reporting.

The deficiencies were caused by inadequate policies and procedures in place to evaluate SOC 1 reports. Specifically, management did not sufficiently review the fiscal transfer agent and financial service provider SOC 1 reports because management did not consider and document all relevant aspects of the SOC 1 reports and its impact on the consolidated financial statements.

The following criteria were considered with respect to the matters described in the preceding paragraphs:

- GAO's Green Book, Section 4, *Additional Considerations: Service Organizations*
- OMB Circular No. A-123, *Management's Responsibility for Enterprise Risk Management and Internal Control*

The deficiencies noted above increased the risk that management does not make key observations regarding the sufficiency of coverage provided by SOC 1 reports and the results that are relevant to SBA's internal controls over financial reporting. This in turn could result in a failure to identify and obtain an understanding of relevant service organization controls and weaknesses that increase risks of misstatements in the Liability for Loan Guarantees and related elements in the consolidated financial statements.

#### Recommendations – Service Organizations Used for SBA Loan Guarantee Programs

We recommend the Administrator coordinate with the Associate Administrator of Office of Capital Access to enhance management's review and evaluation of SOC 1 reports for the fiscal transfer agent and financial service provider to include their performance and documentation of the following:

21. Consideration of all exceptions noted in the SOC 1 reports and determination of the applicability to SBA's internal controls over financial reporting. Management should determine the potential impact on internal controls over financial reporting and if mitigating controls exist.
22. Evaluation of each complementary user entity control identified within the SOC 1 reports. Management should determine that complementary user entity controls have been appropriately designed and implemented and are operating effectively.

23. Evaluation of the SOC 1 reports for all relevant subservice organizations to include an understanding of its role, their controls, and its effect on SBA's processes.
24. Assessment of SOC 1 reports to determine whether coverage was provided for the entire fiscal year. Management should determine the time period covered by the report, assess the significance of the gap, and obtain bridge letters for reports that do not extend through September 30 to provide sufficient coverage to assess impacts on SBA's internal controls over financial reporting.

### C. Entity Level Controls

The urgent need to implement the CARES Act and related legislation presented a number of challenges for management which resulted in a deficiency in entity level controls.

## 7. Entity Level Controls

Management did not properly design and implement entity level controls to establish an internal control system that produces reliable and accurate financial reporting. The significance of the internal control matters indicated several entity level control categories. We noted the following conditions.

Control Environment: Management did not fully design and implement an effective control environment. For example, the following matters were noted:

1. There was not sufficient prioritization for individuals to fulfill their internal control responsibilities. The rapid response and execution of the CARES Act and related legislation was the primary objective, and not the implementation or maintenance of an effective internal control system.
2. Management did not assess control considerations over significant service organizations and their impact on financial reporting.
3. There was not adequate training of disaster assistance staff involved in the review of COVID-19 EIDL transactions resulting in inadequate documentation of how fraud alerts raised by the new custom-built portal were addressed prior to loan approval.
4. There was not sufficient training of the lenders that have delegated authority to originate, approve, disburse, and service PPP loans.
5. There was not adequate documentation of the internal control system and processes related to the implementation of the CARES Act and related legislation.

Risk Assessment: Management did not design and implement an effective risk assessment process. For example, the following matters were noted:

6. The initial risk assessment prepared was not properly amended after the enactment of the CARES Act and related legislation.
7. Management did not identify risks from the implementation of new and expanded programs under the CARES Act and related legislation that could significantly impact SBA's internal control system and the ability to achieve financial reporting objectives.

Control Activities: Management did not have effective control activities. For example, the following matters were noted:

8. Established processes and control protocols were not followed due to the volume of new users or required urgency leading to general information technology control deficiencies.
9. Existing systems did not have the capability to implement the PPP and COVID-19 EIDLs and grants in accordance with the CARES Act and related legislation.

10. To allow PPP loans to process in the loan repository system, certain edit checks were changed without evidence of testing or review and approval of such changes.

Information and Communication: Management did not have effective information and communication processes. For example, the following matters were noted:

11. There was not timely communication of necessary, quality information to achieve reporting objectives internally within the agency.
12. External information received was not evaluated against the characteristics of quality information.

Monitoring: Management did not design and implement effective monitoring processes. Specifically, the following matters were noted:

13. There was not an adequate monitoring plan developed and implemented for lenders participating in the PPP program.
14. There was not effective monitoring of the effectiveness of internal control over processes performed by service organizations.

The deficiencies were primarily caused by the prioritization and the urgent need to implement the provisions of the CARES Act and related legislation as quickly and efficiently as possible over internal control processes. Further, these deficiencies were primarily caused by the inherent challenges with the implementation of a new program that does not have any historical precedence. In the case of PPP, the challenges included implementing a program with evolving and complex guidance, inadequate systems to implement such large-scale programs, and an insufficient number of personnel to assist in the implementation of the CARES Act and related legislation. Finally, these deficiencies were primarily caused by the lack of prioritization to achieve internal control responsibilities, such as in the areas of information technology and monitoring of service organizations.

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

- GAO's Green Book, Principle 3, *Establish Structure, Responsibility, and Authority*; Principle 4, *Demonstrate Commitment to Competence*; Principle 5, *Enforce Accountability*; Principle 6, *Define Objectives and Risk Tolerances*; Principle 7, *Identify, Analyze, and Respond to Risks*; Principle 9, *Identify, Analyze, and Respond to Change*; Principle 10, *Design Control Activities*; Principle 11, *Design Activities for the Information System*; Principle 12, *Implement Control Activities*; Principle 13, *Use of Quality Information*; Principle 14, *Communicate Internally*; Principle 15, *Communicate Externally*; and Principle 16, *Perform Monitoring Activities*
- OMB Circular No. A-123, *Management's Responsibility for Enterprise Risk Management and Internal Control*

As a result of the deficiencies noted above, PPP loans were approved that were not in conformance with the CARES Act and related legislation, risks that impacted the materially significant financial statement line items were not considered, the Office of Chief Financial Officer did not adequately consider the impact of the flagged PPP loans and the 1502 report errors on the relevant financial reporting processes, and PPP and COVID-19 EIDL transactions were approved and in certain cases disbursed to potentially ineligible entities. Without the proper level of entity level controls in place and operating effectively, there is an increased risk that a material misstatement in the consolidated financial statements and noncompliance with the relevant laws and regulations would not be prevented or detected and timely corrected.

#### Recommendations – Entity Level Controls

We recommend the Administrator to coordinate with the Chief Financial Officer to:

25. Assign and hold accountable individuals responsible for overseeing management's design,

implementation, and operation of SBA's internal control system.

26. Document the internal control system and processes related to the implementation of the CARES Act and related legislation.
27. Perform and document a thorough risk assessment at the financial statement assertion level to identify process level risks and assess the effectiveness of key process level controls to respond to the risks.
28. Develop and implement monitoring controls to ensure implementation of an effective internal control environment.
29. Recruit additional qualified personnel, implement a formal training program, and train appropriate SBA personnel and contractors on internal control matters that affect financial reporting and compliance with relevant laws and regulations.

## U.S. Small Business Administration

### Significant Deficiencies

The following deficiencies are considered to be significant deficiencies in internal controls over financial reporting.

#### 1. Payments for Covered Loans under Section 1112 of the CARES Act

#### 2. General Information Technology Controls

#### 1. Payments for Covered Loans under Section 1112 of the CARES Act

Section 1112 of the CARES Act appropriated \$17 billion for SBA to make 6 months of payments on loans in good standing on behalf of borrowers in existing 7(a), 504, or Microloan programs. These loans in good standing are referred to as covered loans. For the 7(a) and 504 programs, the minimum payments of these loans were made directly to lenders and applied to the borrower's outstanding balance. Covered loans that were already under deferment would receive 6 months of payment beginning with the first payment due after the deferral period. Loans initiated within 6 months after the enactment of the legislation (by September 27, 2020) will also receive a full 6 months of loan payments by SBA.

Management did not adequately design and implement controls to determine that payments made to lenders for covered loans under Section 1112 of the CARES Act were accurate, reviewed, and approved prior to payment to enable the fair presentation of the Liability for Loan Guarantees. Specifically, management did not have a documented process and sufficient controls in place to substantiate the accuracy of the payments made to lenders.

The deficiency was caused by an inadequate entity wide control environment to implement processes, and procedures to account for new and expanded programs under the CARES Act and related legislation with sufficiently designed, implemented, and effectively operating controls.

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

- GAO's Green Book, Principle 3, *Establish Structure, Responsibility, and Authority*; and Principle 10, *Design Control Activities*
- Section 1112 of the CARES Act

The deficiency noted above may result in misstatements of the Liability for Loan Guarantees line item and related elements in the consolidated financial statements. In addition, the deficiency noted above may result in a potential noncompliance with the CARES Act.

#### Recommendations – Payments for Covered Loans under Section 1112 of the CARES Act

We recommend the Administrator coordinate with the Associate Administrator of Office of Capital Access to:

30. Update and enforce the existing Procedural Notice 5000-20049 to require the adequate review and approval of Section 1112 payments made to lenders and to determine that the necessary documentation is maintained to substantiate the payment amount.

## 2. General Information Technology Controls

Management had several control deficiencies that limited SBA's ability to effectively manage its information system risks. Collectively, these conditions increase the risk of unauthorized use, modification, or destruction of financial data, which may impact the integrity of information used to prepare the financial statements.

In the sections below, we have omitted some technical details from the conditions and recommendations due to the sensitivity of the information. These details were communicated to management in notices of findings and recommendations.

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

- GAO's Green Book, Principle 5, *Enforce Accountability*; Principle 11, *Design Activities for the Information System*; Principle 12, *Implement Control Activities*; and Principle 16, *Perform Monitoring Activities*
- National Institute of Standards and Technology (NIST) Special Publication (SP) 800-53, Revision 4, *Security and Privacy Controls for Federal Information Systems and Organizations*
- Federal Information Processing Standards Publication (FIPS) 200, *Minimum Security Requirements for Federal Information and Information Systems*
- SBA Standard Operating Procedure (SOP) 90 47 5, *Cybersecurity and Privacy Policy*
- SBA System Configuration Management Plan
- SBA System Access Management Plan

We have summarized the information technology control deficiencies by the following general information technology 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 determine that logical access controls provide reasonable assurance that information technology resources, such as data files, application programs, and information technology-related facilities and equipment, are protected against unauthorized modification, disclosure, loss, or impairment. Management did not always follow established policy and procedures for the account management, authorization, and recertification processes.

#### Recommendations – Logical Access Controls

We recommend the Administrator coordinate with the Chief Information Officer to:

31. Review the automated portion of their account management process to determine what caused the process to create multiple accounts for individual users.
32. Update and test the account management process to ensure that multiple accounts will not be created when changes are applied to the production environment.

We also recommend the Administrator coordinate with the Associate Administrator of Office of Capital Access to:

33. Validate that new users identified in the notification of findings and recommendations are assigned appropriate access to SBA's information system and the supporting environment.
34. Periodically train personnel who are responsible for the approval and provisioning of accounts to emphasize the importance of documenting and approving user access requests prior to and

provisioning access to SBA's information systems and their supporting environments.

In addition, we recommend the Administrator coordinate with the Associate Administrator of Office of Disaster Assistance to:

35. Analyze and validate the users identified in the notification of findings and recommendations were granted appropriate access.
36. Periodically train personnel who are responsible for the approval and provisioning of accounts to emphasize the importance of documenting and approving user access requests prior to and provisioning access to SBA's information systems and their supporting environments.
37. Validate the accounts that are to be reviewed and recertified are performed by the appropriate or designated personnel before performing the existing recertification process.

### **System Configuration Management**

An integral part of the effectiveness of an organization's security program management efforts should be to determine that application change management controls provide reasonable assurance that program changes implemented to the applications are appropriate and authorized. Management did not maintain supporting evidence to show patches to a database and an operating system were tested before being pushed to the production environment. In addition, management migrated application changes into the production environment without appropriate approval.

#### Recommendations – System Configuration Management

We recommend the Administrator coordinate with the Associate Administrator of Office of Capital Access to:

38. Validate that the patches applied to the database and operating system are appropriately implemented and do not negatively affect the performance of the application.
39. Periodically train personnel involved with the implementation of database and operating system patches to follow the requirements of the patch management process in accordance with existing policies.
40. Design and implement a quality check process to ensure that approvals for application changes are timely and accurate prior to migrating changes into the production environment.
41. Periodically train personnel involved with the review and approval of application changes to follow the requirements of the application change management process in accordance with existing policy.

**U.S. Small Business Administration****Compliance and Other Matters****A. Federal Managers' Financial Integrity Act of 1982 (FMFIA)**

Management performed an internal control assessment as required under the FMFIA; however, management's assessment did not substantially comply with FMFIA and the related OMB Circular No. A-123 requirements. Specifically, management did not:

1. Sufficiently identify or define risks related to new programs established by the CARES Act and related legislation.
2. Perform, document, or demonstrate that they completed an internal control over financial reporting evaluation regarding these new programs.
3. Fully evaluate and consider the risks and controls of significant service organizations.
4. Report the material weaknesses identified in Attachment I – Material Weaknesses.

Management did not substantially meet FMFIA requirements due to the urgent need to implement the provisions of the CARES Act and related legislation as quickly and efficiently as possible, the lack of historical precedence, and other inherent challenges faced in implementing and expanding programs. In addition, management did not consider all FMFIA and OMB Circular No. A-123 requirements when performing their evaluation over internal controls.

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

- Section 2 of FMFIA
- OMB Circular No. A-123, *Management's Responsibility for Enterprise Risk Management and Internal Control*

Management did not substantially comply with FMFIA and the related OMB Circular No. A-123 requirements, which may lead to not identifying the appropriate risks and key controls, and not detecting internal control or compliance deficiencies. The risk of not detecting and correcting control deficiencies could result in misstatements to the consolidated financial statements.

**Recommendations – FMFIA**

We recommend the Administrator coordinate with the Chief Financial Officer to:

42. Update the enterprise risk management approach over the evaluation of internal controls to ensure it includes all significant programs, key processes, and other material line items on the consolidated financial statements.
43. Perform and document the internal control evaluation performed over all programs. This should include entity level controls, manual controls, general information technology controls, and system application controls covering key financial statement line items and risks.
44. Work with service providers to assess service organization risks and controls and monitor the service providers to determine that they properly design, implement and effectively operate controls impacting SBA's control environment.

## B. Federal Financial Management Improvement Act of 1996 (FFMIA)

Management did not establish and maintain financial management systems that substantially comply with the following FFMIA requirements:

1. **Federal Financial Management Systems Requirements.** As discussed in Attachment I – Material Weaknesses, control deficiencies over transactions arising from the implementation of the CARES Act and related legislation do not enable reliable and accurate financial reporting and do not ensure budgetary resources are safeguarded against waste, loss, and misuse. In addition, the deficiencies may not support compliance objectives related to ensuring financial transactions are in conformance with the CARES Act and related legislation are achieved.

In addition, as discussed in Attachment II – Significant Deficiencies, management did not implement sufficient general information technology controls for SBA systems critical to financial reporting. Sufficient and effective general information technology controls were not implemented to protect the financial accounting and reporting data.

2. **Federal Accounting Standards.** The deficiencies identified and reported in Attachment I – Material Weaknesses, provide an indication that SBA's financial management systems were substantially non-compliant with Federal accounting standards.

Management did not substantially meet FFMIA requirements because of the reasons discussed in Attachment I – Material Weaknesses and Attachment II – Significant Deficiencies and due to an inadequate entity wide control environment to implement the provisions of the CARES Act and related legislation with sufficiently designed and implemented controls.

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

- Section 803(a) of FFMIA
- GAO's Green Book, Section 2, *Establishing an Effective Internal Control System*
- Appendix D to OMB Circular No. A-123, *Compliance with the Federal Financial Management Improvement Act of 1996*

Management did not substantially comply with FFMIA increasing the risk that transactions are incorrectly recorded to the general ledger, impacting the completeness, existence, and accuracy of the balances in the consolidated financial statements.

### Recommendations – FFMIA

We recommend the Administrator coordinate with the Chief Financial Officer to:

45. Address the control deficiencies over transactions arising from the implementation of the CARES Act and related legislation by working with the Office of Capital Access and the Office of Disaster Assistance to implement the recommendations in Attachment I – Material Weaknesses.

We also recommend the Administrator coordinate with the Chief Information Officer to:

46. Address the deficiencies in general information technology controls for SBA systems critical to financial reporting by working with the relevant system owners to implement the recommendations in Attachment II – Significant Deficiencies.



## CFO Response to Audit Report on FY 2020 Financial Statements

**DATE:** December 18, 2020

**TO:** Hannibal M. Ware, Inspector General

**FROM:** Tami Perriello, Associate Administrator for Performance and Planning  
and Chief Financial Officer 

**SUBJECT:** FY 2020 Financial Statement Audit

The Small Business Administration has reviewed the Independent Auditors' Report from KPMG that includes the auditors' disclaimer of 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, and we are disappointed by this outcome.

The FY 2020 Agency Financial Report includes the programs funded under the CARES Act and subsequent legislation, which provided funding for new and expanded loan programs. The scope and scale of these programs and the speed with which the SBA responded were unprecedented in its history. The largest CARES Act loan programs executed by the SBA are governed by the Federal Credit Reform Act (FCRA), which requires estimation of lifetime expected subsidy costs at program implementation and does provide for annual adjustment to original subsidy cost estimates in future periods. The SBA believes the FY 2020 presentation of financial information is materially correct.

We recognize that documentation of the processes and controls over two CARES Act programs, the Paycheck Protection Program (PPP) and EIDL-COVID Program, was not sufficiently detailed to support the financial statement audit. The SBA fully supports the requirements for auditability of its financial statements and understands its obligations for providing accountability and transparency. The SBA is working diligently to complete its reviews and to correct these shortcomings for future audits.

The auditors identified material weaknesses related to the internal controls over seven areas related to the execution and reporting for the PPP and EIDL-COVID programs. The SBA has reviewed the identified material weaknesses and does not agree with five weaknesses included in the report under *Accounting and Reporting for Programs Implemented under the CARES Act and Related Legislation* and *Entity Level Controls*. The SBA partially agrees with two others, grouped in the audit report under *Evaluation and Monitoring of Service Organization Controls*. Our responses, as communicated to KPMG during the audit, detail our concerns with the analysis and conclusions drawn by the auditors.

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 the SBA's financial management practices. We remain committed to excellence in financial management and look forward to making more progress in the coming year.

**Auditors' Response to Management's Response**

We acknowledge SBA management's response to our Independent Auditors' Report, presented in Attachment IV, and commend their commitment to financial management and the accountability for and transparency of their programs. SBA management did not agree with the five material weaknesses included in our report under *Accounting and Reporting for Programs Implemented under the CARES Act and Related Legislation* and *Entity Level Controls*. We evaluated the validity of management's responses communicated to us during the engagement and have determined that the material weaknesses in internal control over financial reporting are appropriate.