

Evaluation Report



Evaluation of SBA's Progress in Reducing Improper Payments in FY 2012



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

REPORT TRANSMITTAL
REPORT NO. 13-13

DATE: March 14, 2013

To: Jonathan I. Carver, Chief Financial Officer

Jeanne A. Hult, Associate Administrator for Capital Access

James Rivera, Associate Administrator for Disaster Assistance

SUBJECT: Evaluation of SBA's Progress in Reducing Improper Payments in FY 2012

This report presents the results of our *Evaluation of SBA's Compliance with the Improper Payments Elimination and Recovery Act (IPERA)*. Our objectives were to (1) evaluate the effectiveness of controls and process improvements the SBA has implemented since Fiscal Year (FY) 2011, and (2) determine whether the SBA complied with IPERA using guidelines outlined in OMB's implementing guidance, Memorandum M-11-16, *Issuance of Revised Parts I and II to Appendix C of OMB Circular A-123*.

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

/s/

John K. Needham
Assistant Inspector General for Auditing

Cc: Sara Lipscomb, General Counsel



EXECUTIVE SUMMARY

SBA's Compliance with the Improper Payments Elimination and Recovery Act Has Improved, Further Improvement Is Needed

Report No. 13-13

What the OIG Evaluated

This report represents the results of the Office of Inspector General's (OIG) evaluation of the Small Business Administration's (SBA) compliance with the Improper Payments Elimination and Recovery Act (IPERA) requirements. The IPERA was enacted on July 22, 2010, and the Office of Management and Budget (OMB) issued implementing guidance on April 14, 2011, through OMB Memorandum M-11-16, *Issuance of Revised Parts I and II to Appendix C of OMB Circular A-123 (M-11-16)*. Part II (A) of M-11-16 requires the OIG to annually review their agency's improper payments reporting in the Performance and Accountability Report (PAR) or Agency Financial Report (AFR).

Our objectives were to evaluate the effectiveness of controls and process improvements the SBA has implemented since Fiscal Year (FY) 2011 and determine whether the SBA complied with IPERA reporting requirements, as specified in OMB's implementing guidance, M-11-16. To achieve our objectives we assessed controls the SBA has implemented to address prior year OIG recommendations, and evaluated whether SBA addressed required provisions. We also assessed the SBA's efforts to prevent and reduce improper payments, and reviewed the accuracy and completeness of improper payment disclosures in the AFR, as specified in M-11-16. This report does not include any recommendations. See Appendix B for the full text of the Agency's Comments.

Table 1. The IPERA Evaluation by Program or Activity

| SBA Program or Activity | OIG Overall Assessment for FY 2012 |
|-------------------------------|------------------------------------|
| Disbursements and Contracting | ▣ ↑ |
| 7(a) Loan Guaranty Approvals | ▣ ↑ |
| 7(a) Loan Guaranty Purchases | ▣ ↑ |
| 504 Loan Guaranty Approvals | ▣ ↑ |
| Disaster Loan Disbursements | ▣ ↑ |

Legend: Outstanding Progress Substantial Progress
 Limited Progress No Progress

What the OIG Found

The SBA's efforts to prevent and reduce improper payments have resulted in significant progress since our FY 2011 assessment. Further, the SBA was generally compliant in meeting the minimum requirements in accordance with OMB guidance.

Specifically, the Disaster Assistance Loan program made progress through the deployment of improved controls and process improvements which reduced their improper payments rate from 28.4 percent in FY 2011 to 17.9 percent in FY 2012. In addition, the 7(a) and 504 programs improved their testing procedures for loan guaranty approvals. The revised procedures were more robust and led to the identification of more improper payments during the testing process. As a result, the improper payments estimate increased from \$0 in FY 2011 to \$233 million and \$105 million, respectively, in FY 2012.

Notwithstanding these accomplishments, further improvement is still needed in the effectiveness and development of SBA improper payment controls and processes for all of the programs or activities we reviewed. Specific areas include:

- accuracy and completeness of reporting,
- quality of corrective action plans, and
- sufficiency of improper payment recapturing activities.

The OIG also assessed whether the SBA complied with IPERA reporting requirements, as specified in M-11-16. This guidance requires a limited review of controls over Agency reporting.

Our evaluation found that the SBA generally met all the IPERA reporting requirements. However, the Disaster Assistance Loan program was not compliant because their improper payment rate exceeded the 10 percent threshold. In addition, three of the five programs or activities did not achieve their annual reduction targets. We were unable to evaluate the accuracy and completeness of the improper payments rate reported for the Acquisition Program.

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Introduction

This report represents the results of our evaluation of SBA's compliance with the requirements of the Improper Payments Elimination and Recovery Act (IPERA or the Act). This Act was enacted on July 22, 2010, and the Office of Management and Budget (OMB) issued implementing guidance in Memorandum M-11-16, *Issuance of Revised Parts I and II to Appendix C of OMB Circular A-123* (M-11-16). Part II (A) of M-11-16 requires each Office of Inspector General (OIG) to review annually its agency's improper payments reporting in the Performance and Accountability Report (PAR) or Agency Financial Report (AFR).

Objectives

Our objectives were to (1) evaluate the effectiveness of controls and process improvements the SBA has implemented since Fiscal Year (FY) 2011, and (2) determine whether the SBA complied with IPERA reporting requirements using guidelines outlined in OMB's implementing guidance, M-11-16.

Scope and Methodology

To perform the evaluation, our scope included an assessment of improper payments the SBA reported for Section 7(a) loan guaranty approvals, Section 7(a) loan guaranty purchases, Section 504 loan guaranty approvals, Disaster Assistance loan disbursements, and Disbursements and Contracting. For FY 2012, the OMB granted a waiver for the Small Business Investment Company program. This waiver was granted due to the low occurrence of improper payments as determined by several years of review and the low probability for improper payments as determined by a risk assessment conducted in FY 2011.

To achieve our objectives we assessed controls the SBA has implemented to address prior year OIG recommendations, and evaluated whether the SBA addressed required provisions. More specifically, we interviewed SBA officials, and reviewed SBA documentation and plans to assess compliance with identified controls and IPERA provisions. We also assessed records and other documents obtained from SBA officials. We further assessed the Agency's efforts to prevent and reduce improper payments, and reviewed the completeness of improper payment disclosures in the AFR, as specified in OMB guidance. Moreover, we assessed progress the Agency had made against the baseline we established in 2012.

We conducted this evaluation between October 9, 2012, and February 26, 2013, in accordance with the Council of Inspectors General on Integrity and Efficiency (CIGIE) *Standards for Inspection and Evaluations*. Those standards require that we plan and perform the evaluation to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our objectives. We believe that the evidence obtained provides a reasonable basis for our conclusions based on our objectives.

Background

The SBA offers and guarantees a variety of loans for very specific purposes. During FY 2012, the SBA supported more than \$30.25 billion in lending to more than 47,000 companies which includes, but is not limited to, \$22 billion in loans to small businesses through the 7(a), Microloan, and 504 programs; and \$690 million for Disaster Assistance loans. The Agency also disbursed approximately \$130 million to contractors and vendors for services rendered.

The Improper Payments Information Act of 2002 (IPIA) requires agencies to review and identify those programs susceptible to significant improper payments; report on the amount and causes of improper payments; and develop plans for reducing improper payments. Provisions of the IPERA amended the IPIA by providing alternative improper payments measures and expanding the requirements for corrective action plans. It also increased the scope of recapture audits for all payments and program activities in excess of \$1 million.

An “improper payment¹” is any payment that should not have been made or that was made in an incorrect amount under statutory, contractual, administrative, or other legally applicable requirements. Further, the OMB states, “when an agency’s review is unable to discern whether a payment was proper as a result of insufficient or lack of documentation, this payment must also be considered an improper payment.” Incorrect amounts are overpayments or underpayments made to eligible recipients. An improper payment also includes any payment made to an ineligible recipient or for an ineligible good or service or payments for goods or services not received. In addition, according to OMB Circular A-123, Appendix C, Part I, a payment lacking sufficient documentation is an improper payment.

The IPERA guidance further requires that each OIG annually review its Agency’s improper payments reporting within 120 days of issuing its AFR. In accordance with Part II of M-11-16, the OMB requested the Inspector General to evaluate the accuracy and completeness of the Agency’s reporting in the AFR. The OMB also requested that the OIG evaluate the Agency’s performance in reducing and recapturing improper payments and report on recommendations for actions to further improve the Agency’s or program’s performance in reducing improper payments. In doing so, we performed a qualitative assessment of the Agency’s progress in meeting the following criteria:

- Overall assessment of Agency efforts – OIG evaluation of agency efforts to prevent and reduce improper payments;
- Accuracy & completeness of Agency reporting – OIG assessment of internal controls related to reported information;
- Quality of corrective action plans – OIG evaluation whether corrective action plans are robust and focused on the appropriate root causes of improper payments; and
- Performance in reducing/recapturing improper payments – Agency’s performance of recapture audits.

The OMB further requested the Inspector General to determine whether the Agency was in compliance with the IPERA. In doing so, the Agency must have, at a minimum, met the following criteria to be in compliance with IPERA:

- Posted materials —Published a PAR or AFR for the most recent fiscal year and posted that report and any accompanying materials required by the OMB on the agency website;
- Published estimates for susceptible programs—Published improper payments estimates for all programs and activities identified as susceptible to significant improper payments under its risk assessment(if required);
- Annual reduction target met —Published, and has met, annual reduction targets for each program assessed to be at risk and measured for improper payments;

¹ In accordance with Section 2(d)(2) of the IPIA, as amended by the IPERA.

- Reported rate of less than 10 percent—Reported a gross improper payments rate of less than 10 percent for each program and activity for which an improper payments estimate was obtained and published in the PAR or AFR; and
- Reported recapture information—Reported information on its efforts to recapture improper payments.

Prior OIG audits have identified high percentages of disaster and business loans that were made to borrowers who were ineligible, lacked repayment ability, or did not provide sufficient documentation to justify the approval or disbursement.² Those audits further determined that the improper payment rates reported for these programs were significantly understated. The magnitude of those findings has resulted in the OIG identifying the improper payments area as an SBA Management Challenge in its annual *Report on the Most Serious Management and Performance Challenges Facing the Small Business Administration*.

In 2012, the OIG issued [Audit Report 12-10](#), *Review of SBA's 2011 Improper Payments*, stating that the SBA was generally compliant in meeting the minimum reporting requirements for IPERA in its [FY 2011 AFR](#). However, our qualitative review of the Agency's efforts to prevent and reduce improper payments demonstrated that immediate management attention was needed in four of the six programs or activities tested in FY 2011. Specifically, attention was needed to improve the accuracy and completeness of reporting, sufficiency of improper payments recapturing activities, and quality of corrective action plans.

Results

The following five sections summarize the OIG's (1) assessment of the Agency's accuracy and completeness of reporting, and performance in reducing and recapturing improper payments and (2) OIG's review of the Agency's disclosure in the AFR per requirements of M-11-16, by reporting segment. In addition, we assessed the status of OIG's unresolved prior year recommendations, which focused on the accuracy and completeness of the Agency's reporting, and performance in reducing and recapturing improper payments. See Appendix A.

Section I – Disbursements and Contracting

Background

In October 2010, the SBA realigned its acquisition program to address several significant deficiencies that included: high staff turnover; compliance with laws and regulations; application of funding principles; training and certification of key contracting personnel; contractor oversight, and measuring performance through validated metrics. Since realignment, the SBA has provided training to, and

² SBA OIG Audit Report 12-18, *A Detailed Repayment Ability Analysis is Needed on High-Dollar Early-Defaulted Loans to Prevent Future Improper Payments*, August 16, 2012.

SBA OIG Audit Report 12-11R, *High-Dollar Early-Defaulted Loans Require an Increased Degree of Scrutiny and Improved Quality Control at the National Guaranty Purchase Center*, March 23, 2012.

SBA OIG Audit Report ROM 11-07, *Origination and Closing Deficiencies Identified In 7(a) Recovery Act Loan Approvals*, September 30, 2011.

increased the number of, acquisition staff. Our recent audit work with SBA's current acquisition activities indicate that while improvements are in process, continuing challenges exist, including (1) poorly defined requirements, (2) internal control deficiencies, (3) improper funding of contracts, (4) inadequate oversight, and (5) outdated and incomplete standard operating procedures related to acquisition.

Assessment of Agency Efforts

The OIG evaluated the Agency's accuracy and completeness of reporting, as well as its performance in reducing and recapturing improper payments. We determined that the SBA made limited progress in meeting IPERA and IPIA requirements.

We found that the SBA developed a corrective action plan that identified root causes for improper payments, and target dates for completed and implemented corrective actions. In addition, the SBA developed a cost benefit analysis, which showed that a payment recapture audit was not cost effective. However, further improvement is needed to fully comply with IPERA and IPIA requirements. Specifically, the SBA did not fully implement three of the five recommendations in Report 12-07, *The SBA's Improper Payment Review and Reporting for its Contracting Activities did not Comply with IPERA and IPIA Requirements During FY 2011*, issued on March 8, 2012.

The OIG could not evaluate the accuracy and completeness of the SBA's improper payments reported for acquisitions within the scope of this review. Further, OMB guidance provides that payments made without adequate documentation can be improper payments. Our review of the SBA's reported improper payments for acquisitions identified discrepancies in that certain payments with documentation errors were excluded from those calculations. Agency representatives have not adequately explained these exclusions. If the SBA included those documentation errors in its reported numbers, the SBA's gross improper payment rate for acquisitions would increase. The OIG is performing a separate in-depth assessment of a sample of SBA's improper payments for acquisitions, and will report the results of that audit when it is completed.

Table 2. The OIG's Evaluation of Agency Efforts

| OMB Criteria | Status at End of FY 2012 |
|---|--------------------------|
| Overall assessment of Agency efforts ³ | ■ ↑ |
| Accuracy & completeness of agency reporting | □ |
| Performance in reducing/recapturing improper payments | ■ ↑ |
| Quality of corrective action plans | □ ↑ |

Legend: Outstanding Progress Substantial Progress Limited Progress Unable to Evaluate

AFR Review

The OIG will discuss the accuracy of SBA's improper payments rate for the Acquisition Program when the in-depth assessment of a sample of SBA's improper payments is completed. The results of the OIG's review of the AFR are summarized below.

³ This is a summary of our evaluation results.

Table 3. The OIG’s Review of the AFR

| OMB Reporting Requirement | Status at End of 2012 |
|--|---------------------------------------|
| Posted materials | <input checked="" type="checkbox"/> ↑ |
| Published estimates for susceptible programs | <input checked="" type="checkbox"/> ↑ |
| Annual reduction target met | N/A ⁴ |
| Reported rate of less than 10 percent | <input type="checkbox"/> |
| Reported recapture information | <input checked="" type="checkbox"/> ↑ |

Legend: Compliant with IPERA reporting requirements Unable to Evaluate

Agency Comments

Management stated that they believe compliance is not determined by an “effort” assessment or that compliance is subject to interpretation. As such, management emphasized that they complied with IPERA requirements by reporting an improper payments rate below 10 percent. Management also stated that they implemented all five recommendations from [OIG Report Number 12-07](#). In addition, management stated that it is inappropriate to conflate the Agency’s compliance with IPERA with its compliance with contracting laws and regulations, which were separate and distinct from IPERA. Lastly, management did not agree with our assertion that the SBA was not compliant with IPERA improper payments reporting requirements and believes that the SBA satisfied all recommendations from Report Number 12-07.

OIG Response

According to M-11-16, the OIG is to evaluate the accuracy and completeness of agency reporting, and evaluate agency performance in reducing and recapturing improper payments. The OIG was unable to evaluate the accuracy and completeness of the SBA’s improper payments reporting for disbursements and contracting. We could not make this determination due to conflicting information provided by staff in the Office of the Chief Financial Officer. In addition, the SBA had not implemented three outstanding recommendations from Report Number 12-07. Further, the OIG evaluated the SBA improper payments rate in conformance with IPERA guidance. Where appropriate, we will work with the SBA during the audit resolution cycle to further detail necessary corrective actions.

Section II – 7(a) Loan Guaranty Approvals

Background

The SBA has a financial assistance portfolio of guaranteed and direct loans of nearly \$103 billion. The Agency’s largest lending program, the 7(a) Loan Guaranty program, is the SBA’s principal vehicle for providing small businesses with access to credit that cannot be obtained elsewhere. This program relies on numerous outside parties (e.g., borrowers, loan agents, and lenders) to complete loan transactions, with approximately 80 percent of loans being made by lenders to whom the SBA has delegated loan-making authority. Additionally, the SBA has centralized many loan functions and reduced the number of staff performing these functions, placing more responsibility on, and giving greater independence to, its lenders. Under the 7(a) Loan Guaranty program, the SBA guarantees up to 90 percent of the principal

⁴ SBA did not establish an improper payments target rate for FY 2012 in the FY 2011 AFR.

amount of loans made by banks and other lending institutions to small businesses not able to obtain credit elsewhere. The OIG continues to identify weaknesses in the SBA’s lender oversight processes. In FY 2012, the SBA guaranteed approximately \$12.9 billion in 7(a) loan approvals.

Assessment of Agency Efforts

The OIG evaluated the Agency’s accuracy and completeness of reporting, as well as its performance in reducing and recapturing improper payments. We determined that the SBA made substantial progress in meeting IPERA and IPIA requirements.

Specifically, we determined that the SBA developed appropriate test procedures to assess 7(a) guaranty loan approvals for improper payments. The improved testing procedures resulted in previously unidentified error conditions and related improper payments being included in the current year test results. However, further improvement is still needed to fully comply with IPERA and IPIA requirements. Specifically, the OIG found that: 1) loans identified by the SBA as having collateral deficiencies were not included as improper payments or partial improper payments, and 2) the corrective action plan for reducing improper payments did not include any actions to correct identified areas of improper payments, such as lender approval of ineligible loans under delegated authority.

Due to our limited procedures, we are not providing an assessment as to whether the SBA’s reported improper payments rate of 1.8 percent or \$233 million is accurate. The results of the OIG’s evaluation of Agency efforts are summarized below.

Table 4. The OIG’s Evaluation of Agency Efforts

| OMB Criteria | Status of End of 2012 |
|---|-----------------------|
| Overall assessment of Agency efforts | ▣ ↑ |
| Accuracy & completeness of agency reporting | ▣ ↑ |
| Performance in reducing/recapturing improper payments | N/A ⁵ |
| Quality of corrective action plans | ■ |

Legend: Outstanding Progress Substantial Progress Limited Progress No Progress

AFR Review

Our review of the AFR found that the SBA was fully compliant with most IPERA reporting requirements. However, due to improved testing procedures, previously unidentified error conditions and related improper payments were included in the current year test results, increasing the improper payments estimate from \$0 in FY 2011 to \$233 million in FY 2012. As a result, the SBA did not meet its planned target. The results of the OIG review are summarized below.

⁵ The SBA has determined that payment recapture audits for this program would not be cost effective.

Table 5. The OIG’s Review of the AFR

| OMB Reporting Requirement | Status at End of 2012 |
|--|------------------------------|
| Posted materials | ☑ |
| Published estimates for susceptible programs | ☑ |
| Annual reduction target met | ■ |
| Reported rate of less than 10 percent | ☑ |
| Reported recapture information | ☑ |

Legend: ☑ Compliant with IPERA reporting requirements ■ IPERA reporting requirements not met

Agency Comments

Management stated that the OIG’s evaluation found the Agency to be fully compliant with most IPERA reporting requirements. Management also stated a corrective action plan was in place for 7(a) approvals, but staff in the Office of Capital Access (OCA) did not address this in the FY 2012 AFR, and will do so in 2013. Also, the SBA’s improved testing procedures resulted in the identification of error conditions and related improper payments which resulted in an increase of the FY 2011 improper payments estimate for 7(a) guaranty loan approvals. The OCA will evaluate the future annual reduction target and will publish it in the FY 2013 AFR.

OIG Response

We commend the OCA for making progress in complying with IPERA requirements. We acknowledge that the Agency may have corrective actions planned outside of the AFR to reduce improper payments in the 7(a) loan guaranty approvals program. However, M-11-16 states that compliance with IPIA means that the agency has published programmatic corrective action plans in the AFR and therefore, we continue to support our finding.

Section III – 7(a) Loan Guaranty Purchases

Background

When a loan goes into default, the SBA will conduct a review of the lender's actions on the loan to determine whether it is appropriate to pay the lender the guaranty, which the SBA refers to as a “guaranty purchase.” Under SBA regulations, the SBA is released from liability on the guaranty, in whole or in part, if the lender fails to comply materially with any SBA loan program requirement or does not make, close, service or liquidate the loan in a prudent manner. The guaranty purchase review is SBA's primary control for ensuring lender compliance and preventing improper payments. The OIG’s audits continue to identify weaknesses in the SBA’s 7(a) Loan Guaranty purchase program. In FY 2012, the SBA purchased approximately \$1.4 billion in 7(a) loan guaranties.

Assessment of Agency Efforts

The OIG evaluated the Agency’s accuracy and completeness of reporting, as well as its performance in reducing and recapturing improper payments. We determined that the SBA made limited progress in meeting IPERA and IPIA requirements.

Specifically, the OIG found that test procedures for assessing the purchases of 7(a) loan guaranties continued to be incomplete and did not require a detailed analysis of creditworthiness (including

repayment ability) on early defaulted loans. Also, the test procedures for SBA Express programs were incomplete and did not require reviews for all areas of improper payments previously noted by the OIG.⁶ For example, the test procedures did not require reviewers to determine whether Express loans complied with SBA requirements related to repayment ability, IRS tax-verification, and business plans. In addition, the corrective action plan for reducing improper payments for purchased loans in the 7(a) Loan Guaranty program was incomplete. Specifically, the corrective action plan did not address all areas of improper payments including loans that did not comply with SBA repayment ability and equity injection requirements. Finally, the SBA has not yet performed a cost-benefit analysis to determine whether it was cost-beneficial to perform payment recapture audits within the program. The OIG made this recommendation in our previous IPERA evaluation⁷ but has not yet been implemented. The Agency has established an April 30, 2013 deadline to complete its cost-benefit analysis.

Due to our limited procedures, we are not providing an assessment as to whether the SBA's reported improper payments rate of 3.15 percent or \$44 million is accurate. The results of the OIG's evaluation of Agency efforts are summarized below.

Table 6. The OIG's Evaluation of Agency Efforts

| OMB Criteria | Status of End of 2012 |
|---|-----------------------|
| Overall assessment of Agency efforts | ▣ ↑ |
| Accuracy & completeness of agency reporting | ▣ ↑ |
| Performance in reducing/recapturing improper payments | ■ |
| Quality of corrective action plans | ▣ ↑ |

Legend: Outstanding Progress Substantial Progress Limited Progress No Progress

AFR Review

Our review of the AFR found that the Agency was fully compliant with most IPERA reporting requirements. However, reported improper payments increased from 1.73 percent in FY 2011 to 3.15 percent or \$44 million in FY 2012. The SBA had estimated an FY 2012 improper payments rate of 1.4 percent. As a result, the SBA did not meet its annual reduction target for the program. The results of the OIG's review of the AFR are summarized below.

Table 7. The OIG's Review of the AFR

| OMB Reporting Requirement | Status at End of 2012 |
|--|-------------------------------------|
| Posted materials | <input checked="" type="checkbox"/> |
| Published estimates for susceptible programs | <input checked="" type="checkbox"/> |
| Annual reduction target met | ■ |
| Reported rate of less than 10 percent | <input checked="" type="checkbox"/> |
| Reported recapture information | <input checked="" type="checkbox"/> |

Legend: Compliant with IPERA reporting requirements IPERA reporting requirements not met

⁶ SBA OIG Audit Report 13-07, *The SBA's Improper Payment Rate for 7(a) Guaranty Purchases Remains Significantly Underestimated*, November 15, 2012.

⁷ SBA OIG Audit Report 12-10, *Review of SBA's 2011 Improper Payments*, March 15, 2012. Recommendation #6.

Agency Comments

Management stated that the OIG's evaluation found the Agency to be fully compliant with most IPERA reporting requirements. Management also stated a corrective action plan was in place for 7(a) purchases, but the OCA did not address this in the FY 2012 AFR, and will do so in 2013. Additionally, for its 7(a) Loan Guaranty Purchases program, management stated that it reported an increase in improper payments and as a result did not meet the published target of 1.4 percent. Management also stated it will evaluate the future annual reduction, and will publish it in the FY 2013 AFR. Management further stated that it did not believe it was appropriate for the OIG to restate audit findings in a report addressing the Agency's compliance with IPERA. Management requested that the OIG either remove this finding from the report or revise the report to reflect that the agreed upon deadline for the cost benefit analysis is April 30, 2013.

OIG Response

We commend the OCA for making progress in complying with IPERA requirements. We acknowledge that the Agency may have corrective actions planned outside of the AFR to reduce improper payments in each of its loan programs. However, M-11-16 states that compliance with IPIA means that the agency has published programmatic corrective action plans in the AFR and therefore, we continue to support our finding. Additionally, we disagree that it is inappropriate to restate audit findings in a report addressing the Agency's compliance with IPERA. The finding regarding payment recapture audits for 7(a) loan guaranty purchases was identified in the OIG's FY 2011 IPERA review and remains open. We have updated our report to reflect the April 30, 2013, deadline for completing a cost-benefit analysis.

Section IV – 504 Loan Guaranty Approvals

Background

The SBA's 504 Loan Program provides small businesses with long-term, fixed-rate financing for the purchase of land, buildings, machinery, and other fixed assets. Local economic development organizations, approved by the SBA, are known as Certified Development Companies (CDCs). The CDCs package, close, and service these loans, which are funded through a mix of funds from private sector lenders, proceeds from the sale of SBA guaranteed debentures, and borrower equity investment. For the 504 program, the SBA guarantees 100 percent of the principal and interest payments on these debentures. In FY 2012 the SBA guaranteed approximately \$5.1 billion in 504 loan approvals.

Assessment of Agency Efforts

The OIG evaluated the Agency's accuracy and completeness of reporting, as well as its performance in reducing and recapturing improper payments. We determined that the SBA made substantial progress in meeting IPERA and IPIA requirements.

Specifically, the OIG determined that the SBA developed appropriate test procedures to assess 504 loan approvals for improper payments. The improved testing procedures resulted in previously unidentified error conditions and related improper payments being included in the current year test results. However, further improvement is still needed to fully comply with IPERA and IPIA requirements.

For example, we found that the corrective action plan for reducing improper payments did not include any actions to correct identified areas of improper payments such as loans that did not comply with the SBA's equity injection requirements.

Due to our limited procedures, we are not providing an assessment as to whether the SBA's reported improper payments rate of 2.04 percent or \$105 million is accurate. The results of the OIG's evaluation of Agency efforts are summarized below.

Table 8. The OIG's Evaluation of Agency Efforts

| OMB Criteria | Status at End of 2012 |
|---|-----------------------|
| Overall assessment of Agency efforts | ☐↑ |
| Accuracy & completeness of agency reporting | ☐↑ |
| Performance in reducing/recapturing improper payments | N/A ⁸ |
| Quality of corrective action plans | ■ |

Legend: ☑ Outstanding Progress ☐ Substantial Progress ■ Limited Progress ■ No Progress

AFR Review

Our review of the AFR found that the SBA was fully compliant with most IPERA reporting requirements. However, due to improved testing procedures, previously unidentified error conditions and related improper payments were included in the current year test results, increasing the improper payments estimate from \$0 in FY 2011 to \$105 million. As a result, the SBA did not meet its planned target. The results of the OIG review are summarized below.

Table 9. The OIG's Review of the AFR

| OMB Reporting Requirement | Status at End of 2012 |
|--|-----------------------|
| Posted materials | ☑ |
| Published estimates for susceptible programs | ☑ |
| Annual reduction target met | ■ |
| Reported rate of less than 10 percent | ☑ |
| Reported recapture information | ☑ |

Legend: ☑ Compliant with IPERA reporting requirements ■ IPERA reporting requirements not met

Agency Comments

Management stated that the OIG's evaluation found the Agency to be fully compliant with most IPERA reporting requirements. Management also stated a corrective action plan was in place for 504 loan guaranty approvals, but the OCA did not address this in the FY 2012 AFR, and will do so in 2013.

The SBA's improved testing procedures resulted in the identification of error conditions and related improper payments, resulting in an increase of the FY 2011 improper payments estimate for 504 loan guaranty approvals. The OCA will evaluate the future annual reduction target, and will publish it in the FY 2013 AFR.

⁸ The SBA has determined that payment recapture audits for this program would not be cost effective.

OIG Response

We commend the OCA for making progress in complying with IPERA requirements for 504 loan guaranty approvals. We acknowledge that the Agency may have corrective actions planned outside of the AFR to reduce improper payments in the 504 loan guaranty approvals program. However, M-11-16 states that compliance with IPIA means that the agency has published programmatic corrective action plans in the AFR and therefore, we continue to support our finding.

Section V – Disaster Assistance Loan Disbursements

Background

The Disaster Assistance Loan program plays a vital role in the aftermath of disasters by providing long-term, low-interest loans to affected homeowners, renters, businesses of all sizes, and non-profit organizations. The SBA offers home and personal property loans, business physical disaster loans, and economic injury disaster loans. The Disaster Assistance Loan program is particularly vulnerable to fraud and unnecessary losses because loan transactions are expedited in order to provide quick relief to disaster victims. In FY 2012, the SBA approved \$690 million in Disaster Assistance loans.

Assessment of Agency Efforts

The OIG evaluated the Agency's accuracy and completeness of reporting, as well as its performance in reducing and recapturing improper payments. We determined that the SBA made substantial progress in meeting IPERA and IPIA requirements.

Specifically, the FY 2012 reduction target of 20 percent was met with a rate of 17.9 percent, corrective action plan deficiencies were addressed and substantially improved, and a justification was provided with detailed rationale for not performing a recapture audit. However, the OIG found that despite extensive efforts to reduce the improper payments rate, the SBA continued to report improper payments in excess of 10 percent. The SBA has designed a robust corrective action plan in which specific recurring improper payment issues are identified then addressed in several ways:

- One-on-one training is provided to those individuals who were identified as having made improper payments;
- Department-wide training is provided via several outlets focused on recurring issues;
- Performance appraisals are affected by improper payment performance;
- Weekly improper payment meetings are held to monitor progress in this area;
- Loan officers are rotated to perform improper payment Quality Assurance Reviews in order to better understand the process; and
- All staff is provided the improper payment checklist.

These efforts have resulted in a significantly reduced improper payments rate from 28.4 percent to 17.9 percent. However, the process is not considered fully implemented until the rate is reduced below the 10 percent threshold to comply with IPERA requirements.

Due to our limited procedures, we are not providing an assessment as to whether the SBA's reported improper payments rate of 17.9 percent or \$91 million is accurate. The results of the OIG's evaluation of Agency efforts are summarized below.

Table 10. The OIG’s Evaluation of Agency Efforts

| OMB Criteria | Status at End of 2012 |
|---|-----------------------|
| Overall assessment of Agency efforts | ▣↑ |
| Accuracy & completeness of agency reporting | ☑ |
| Performance in reducing/recapturing improper payments | ▣↑ |
| Quality of corrective action plans | ☑↑ |

Legend: ☑ Outstanding Progress ▣ Substantial Progress ■ Limited Progress ■ No Progress

AFR Review

Our review of the AFR found that the SBA was fully compliant with most IPERA reporting requirements. However, our review showed that the SBA reported a 17.9 percent improper payments rate, which exceeded 10 percent, the level necessary to comply with IPERA requirements. The results of the OIG’s review of the AFR are shown below.

Table 11. The OIG’s Review of the AFR

| OMB Reporting Requirement | Status at End of 2012 |
|--|-----------------------|
| Posted materials | ☑ |
| Published estimates for susceptible programs | ☑ |
| Annual reduction target met | ☑↑ |
| Reported rate of less than 10 percent | ■ |
| Reported recapture information | ☑ |

Legend: ☑ Compliant with IPERA reporting requirements ■ IPERA reporting requirements not met

Agency Comments

The Agency offered no comments.

AGENCY COMMENTS AND OIG RESPONSE

On February 27, 2013, we provided a draft of this report to the Chief Financial Officer, General Counsel and Associate Administrators for Capital Access and Disaster Assistance. On March 7, 2013, the Office of Inspector General received a coordinated response where SBA management emphasized its commitment to the successful implementation of IPERA. We incorporated management's comments and OIG's evaluation in the detailed findings. The full text of the SBA's response is provided in Appendix B.

Appendix A. Status of FY 2011 IPERA Audit Recommendations

Report No 12-07, *The SBA's Improper Payment Review and Reporting for its Contracting Activities did not Comply with IPERA and IPIA Requirements During FY 2011* dated 3/8/12.

| Rec # | Recommendation | Date of Management Decision | Status as of 1/31/13 |
|-------|---|-----------------------------|----------------------|
| 2 | Chief Financial Officer (CFO) determine the underlying causes of the contracting activities improper payments for the FY 2011 IPERA review and develop and implement a robust Corrective Action Plan and a Payment Recapture Audit Plan for the improper payments for contracting activities. | N/A | 299 days overdue |
| 4 | CFO develop procedures to annually review the SBA's Corrective Action Plan to determine if actions are sufficient. | N/A | 299 days overdue |
| 5 | CFO submit to the Senate Homeland Security and Government Affairs Committee and the House Committee on Oversight and Governmental Reform within 90 days of this memorandum a plan that includes three items (see report for full description). | N/A | 299 days overdue |

These recommendations relate to Section I, Disbursements and Contracting.

Report No. 12-10, *SBA Generally Meets IPERA Reporting Guidance but Immediate Attention Is Needed to Prevent and Reduce Improper Payments* dated 3/15/12

| Rec # | Recommendation | Date of Management Decision | Target Date for Final Action | Status As of 10/10/12 |
|-------|---|-----------------------------|------------------------------|------------------------|
| 2 | Associate Administrator (AA) for Capital Access adjust the testing for 7(a) loan approvals to ensure all necessary documentation is obtained and to determine if loans approved in compliance with the relevant program regulations and requirements. | 5/15/12 | 4/16/13 | 188 days until overdue |
| 3 | AA for Capital Access upon revising the improper payment test procedures and estimating an accurate IP rate develop a correction action plan for 7(a) loan approvals that correctly addresses root causes and will reduce improper payments | 5/15/12 | 4/16/13 | 188 days until overdue |
| 4 | AA for Capital Access require loan officers to thoroughly evaluate creditworthiness (including repayment ability) on early default loans during both guaranty purchase and improper payment reviews. | 5/15/12 | 4/16/13 | 188 days until overdue |
| 5 | AA for Capital Access determine and report an accurate statistically valid estimate of improper 7(a) default purchases for FY2012 in the next Agency Financial Report. | 9/18/12 | 1/31/13 | 113 days until overdue |
| 6 | AA for Capital Access, upon completing the revised improper payment rate projection for 7(a) purchases, conduct a detailed and objective cost/benefit analysis for payment recapture audits of 7(a) purchases. | 9/26/12 | 4/30/13 | 202 days until overdue |
| 7 | AA for Capital Access, upon completing the revised improper payment rate projection for 7(a) purchases, revise the corrective action plan to identify all root causes of improper payments and appropriate actions for reduction. | 5/15/12 | 4/16/13 | 188 days until overdue |
| 9 | AA for Capital Access adjust the testing process for 504 loan approvals to ensure all necessary documentation is obtained and reviewed and to determine if the loans were approved in compliance with program regulations and requirements. | 5/15/12 | 4/16/13 | 188 days until overdue |
| 10 | AA for Capital Access, upon revising the improper payment test procedures and estimating an accurate rate of improper payments, develop a correction action plan for 504 loan approvals that correctly addresses root causes and will reduce improper payments. | 5/15/12 | 4/16/13 | 188 days until overdue |

Recommendations 2 and 3 relate to Section II, 7(a) Loan Guaranty Approvals

Recommendations 4-7 relate to Section III, 7(a) Loan Guaranty Purchases

Recommendations 9 and 10 relate to Section IV, 504 Loan Guaranty Approvals

Appendix B. Agency Comments



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

To: John K. Needham
Assistant Inspector General for Auditing

Through: Sara D. Lipscomb
General Counsel

From: Jonathan I. Carver
Chief Financial Officer

James E. Rivera
Associate Administrator
Office of Disaster

Jeanne Hult
Associate Administrator
Office of Capital Access

Date: March 7, 2013

Re: Agency Response to OIG Draft Evaluation of SBA's 2012 Compliance with the
Improper Payments Elimination and Recovery Act (IPERA), Project 13001

I. OCFO Response

The Office of the Chief Financial Officer (OCFO) appreciates the opportunity to respond to the draft report "Evaluation of SBA's 2012 Improper Payments, Project Number 13001." We also appreciate the OIG's acknowledgement of the agency's improvement efforts to reduce improper payments and increase compliance. We believe your report reemphasizes the opportunities for us to continue to strengthen our business processes and controls surrounding our disbursements and contracting. We look forward to continuing our collaboration with you as the SBA implements IPERA.

The OCFO contends the agency's compliance in FY 2012 IPERA reporting for disbursements and contracting by:

- Meeting the evaluation criteria in OMB Circular A-123⁹ and as presented in the OIG draft report

⁹ As defined in Part II of OMB Circular A-123, *Appendix C: Compliance with the Improper Payments Requirements*

- Publishing the Annual Financial Report (AFR) in compliance with OMB Circular A-136, *Financial Reporting Requirements*

The OCFO provides further details in the comments that follow.

Determining Compliance. The draft report states that the OIG conducted a “qualitative assessment of the Agency’s progress” in meeting four elements that comport to the OMB guidance. As stated in the Agency’s consolidated response to the FY 2011 IPERA compliance review (OIG Report 12-10), the OCFO continues to believe that compliance is not determined by an “effort” assessment or that it is subject to interpretation. In other words, compliance is determined by whether or not the requirements were met.

For disbursements and contracting, the OIG bases non-compliance on its 4th element, “Reported a rate less than 10 percent.” The draft report suggests in Table 3 (page 5) that the SBA did not report a figure below 10 percent (or alternatively, the agency reported a rate greater than 10 percent). This is factually inaccurate, and we would like to highlight the 9.6 percent rate published on page 118 of the FY 2012 AFR.¹⁰ If we are misinterpreting these results, we respectfully request clarification upon: (a) the determination that the published rate is not less than 10 percent; and (b) the indicator for compliance as presented in Table 3, which provides only two options: “Compliant” and “Unable to Evaluate.”

Requested Corrections to Effort Assessment. The OCFO appreciates the opportunity to highlight inaccuracies in the draft report with the hopes these are remedied in final report. Specifically, we raise the following:

Request 1: We have implemented all five recommendations in Report 12-07, *Improper Payment Review for Contracting Activities*, issued on March 8, 2012. The draft report indicates the SBA did not fully implement three of the five recommendations in Report 12-07, Recommendations 2, 4, and 5.

- Recommendation 2 requires development and implementation of a Corrective Action Plan and Payment Recapture Audit Plan. The Corrective Action Plan was developed in February 2012 and submitted on September 14, 2012, along with the plan to analyze the cost effectiveness of a Payment Recapture Audit, as allowed by OMB A-123, Appendix C. A revision was submitted on October 12 and rejected on October 26. Both plans were provided again on February 27, 2013.
- Recommendation 4 requires the Corrective Action Plan to be reviewed annually. The Corrective Action Plan was reviewed and updated as a result of the FY2012 review. The FY2012 Corrective Action Plan was submitted on December 7, 2012 and again on February 27, 2013 as evidence of the annual review.
- Recommendation 5 requires letters be sent to the Senate Homeland Security and Government Affairs Committee and the House Committee on Oversight and Governmental Reform. The letters were sent June 14, 2012; copies were provided in December 2012 and again on February 27, 2013.

¹⁰ FY 2012 AFR and Supplemental Materials: <http://www.sba.gov/about-sba-services/19301>

We would like to resubmit these responses in order to eliminate this inaccurate statement (page 4) and the list in Appendix A, *Status of FY 2011 IPERA Audit Recommendations* (page 14).

Request 2: In regards to our first request, we would like to engage in a dialogue with the OIG as it prepares its final report. We fully support all efforts for transparency and share the OIG's interest in making its final report as accurate as possible.

Request 3: We oppose the draft report making any reference to the OIG's "recent audit work with SBA's current acquisition activities" (page 4). We question the appropriateness for including such comments in a report on agency compliance with the IPERA guidance. This is misleading and confusing for readers. It is inappropriate to conflate the agency's compliance with IPERA with its compliance with contracting laws and regulations, which are separate and distinct from IPERA. In fact, the agency's findings revealed that there are no apparent significant overpayments or opportunities for recapture and all payments corresponded to valid goods and services received. The OCFO requests the removal of these comments from the "Background" and respectfully proposes a replacement containing narrative citing past IPERA reporting.

II. OCA Response

The OIG evaluated the Office of Capital Access' (OCA) accuracy and completeness of reporting, as well as its performance in reducing and recapturing improper payments for 7(a) and 504 Loan Guaranty Approvals and 7(a) Loan Guaranty Purchases in Fiscal Year (FY) 2012. OIG's evaluation noted "substantial progress" in both 7(a) and 504 Loan Guaranty Approvals, and "limited progress" in 7(a) Loan Guaranty Purchases. The OIG's review of the Annual Financial Report (AFR) found the Agency to be, "...fully compliant with most IPERA reporting requirements," in the aforementioned areas.

The OIG determined that SBA developed appropriate test procedures to assess both 7(a) and 504 loan guaranty approvals for improper payment. The implementation of the improved procedures resulted in the inclusion of error conditions and related improper payments in both program's FY 2012 test results.

The OIG also stated that at the end of 2012, 7(a) and 504 guaranty loan approvals showed "no progress" with 7(a) loan guaranty purchases showing "limited progress" in the quality of their corrective action plans. Additionally, the OIG cited "no progress" regarding the Agency's performance in reducing/recapturing 7(a) loan guaranty purchase improper payments at the end of 2012. OCA does not dispute that the due diligence performed by the Agency was not reflected properly in the Annual Financial Report (AFR); however, a corrective action plan was and remains in place for 7(a) and 504 guaranty loan approvals, as well as 7(a) loan guaranty purchases, to both reduce and recapture improper payments. OCA did not address this in the AFR for 2012, but will do so in 2013.

The OIG's review of the AFR found 7(a) and 504 guaranty loan approvals, as well as 7(a) loan guaranty purchases to be fully compliant with most IPERA reporting requirements. As discussed above, the SBA's improved testing procedures resulted in the identification of error conditions and related improper payments, resulting in an increase of the FY 2011 improper payment

estimate for 7(a) guaranty loan approvals and 504 guaranty loan approvals from 0 percent to 1.8 percent and 0 percent to 2.0 percent, respectively. As a result, the SBA did not meet the published AFR target of 0 percent. Regarding 7(a) loan guaranty purchases, the SBA reported an increase in improper payments from 1.7 percent in FY 2011 to 3.2 percent in FY 2012; as such, the Agency did not meet the published target of 1.4 percent. OCA will evaluate the future annual reduction target for all three areas, and will publish it in the FY 2013 AFR.

The OIG stated that SBA has not yet performed a cost benefit analysis to determine whether it was cost beneficial to perform recapture audits for 7(a) loan guaranty purchases. This recommendation was made by the OIG in a previous audit. As the agency indicated above, we do not believe it is appropriate to restate audit findings in a report addressing the agency's compliance with IPERA. We respectfully ask that this be removed from the report. In the event it is not, we would appreciate the OIG making clear that the agreed upon deadline for the cost benefit analysis is **April 30, 2013**, using data compiled from October 1, 2012 through March 31, 2013.

III. ODA Response

ODA offers no comment on OIG's report.