U.S. SMALL BUSINESS ADMINISTRATION

OFFICE OF INSPECTOR GENERAL

FY 2003

AGENCY MANAGEMENT CHALLENGES

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U.S. Small Business Administration
Washington, D.C. 20416

OFFICE OF INSPECTOR GENERAL

January 17, 2003

MEMORANDUM

TO: Hector V. Barreto
Administrator

FROM: Peter L. McClintock
Acting Inspector General

SUBJECT: FY 2003 Update of the Most Serious Management Challenges

I am pleased to submit the Office of Inspector General's (OIG) report on the most serious management challenges facing the Small Business Administration (SBA) in FY 2003. In accordance with the Reports Consolidation Act of 2000, we are providing it to SBA for inclusion in the Agency's FY 2002 Performance and Accountability Report. As with previous Congressional requests for Agency challenges, we have given our current assessment of Agency programs or activities that pose significant risks, including those that are particularly vulnerable to fraud, waste, error, or mismanagement. Our report is based on specific OIG, General Accounting Office (GAO), or other official reports, which are referenced in the individual sections, and our general knowledge of SBA programs.

This year's challenges are, for the most part, an update of last year's identified challenges. We added one new challenge relating to financial management and reporting (Challenge 2), and consolidated two of last years challenges relating to Section 8(a) Business Development (BD) Program into one (Challenge 7). We dropped last year's challenge on systems development because one major system (JAAMs) has been implemented and SBA is back to the drawing board on the other (LMS). We categorized the nine challenges into four areas: Agency-wide Issues, Loan Programs, Section 8(a) Business Development, and Fraud Deterrence.

The scoring system is similar to last year's – a three-point system that we have also color-coded in line with the President's Management Agenda. It evaluated the status of SBA management actions as of the end of December 2002. The system is as follows:

Green or 1 – Action has been implemented
Yellow or 2 – Progress is being made
Red or 3 – The action has not been implemented/no substantial progress is being made

SBA made substantial progress on the two of the FY 2002 challenges. In the improving information systems security challenge, the Agency has taken significant steps to address the recommendations, and continued to proactively address new issues and requirements as they arise. SBA has also made impressive progress in the challenge to have better controls over the business loan purchase process. Of the 16 actions needed, OIG raised the score on six.

The Agency is making some progress on three other challenges. These include improving its managing for results, implementing human capital management strategies, improving lender oversight.

There has been no measurable progress in addressing the challenge on preventing loan agent and borrower fraud, or on the two Section 8(a) BD Program challenges – access to business development and contracts, and pass-through procurement activity. Except for some updating and clarification, the Section 8(a) BD challenges remain essentially the same as in previous years.

The newest challenge addresses the significant challenges SBA is facing in financial management and reporting; affecting its ability to provide reliable, timely and accurate financial information. OIG is working closely with the Office of the Chief Financial Officer (OCFO), GAO, and program managers to fully evaluate the problem, identify the various implications across Agency programs, and develop appropriate remedial actions and controls to prevent similar problems in the future.

As we move forward, OIG will issue new challenges as they arise, allowing the Agency to quickly identify the appropriate resources and attention needed to address the issue. We will continue to work with SBA program managers and the OCFO to focus attention on these critical issues.

If you have any questions, please do not hesitate to call me at .

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Challenge 1. SBA needs to improve its managing for results processes and performance data.

Summary - *SBA needs to continue developing effective outcome measures and ensure that its performance data are accurate and reliable. The Agency has made progress in developing a mechanism to report on the status of measuring its performance through the implementation of an Intranet application, "SBA Execution Scorecard." While the application is not yet fully developed, it provides a performance scorecard for SBA offices and loan programs and has fields for tracking various initiatives introduced throughout the Agency.*

Actions Needed	Progress
Top management provides positive and supportive attitude toward performance based management focused on managing for results.	
• Top management provides leadership to coordinate the Agency's managing for results program and has designated sufficient resources to support the leadership effort.	2
• Strategic plan is ratified and reflects top management's vision and direction.	3
-- Appropriate Agency program goals and objectives are established.	3
-- Appropriate performance measures and indicators are established.	2
-- Program managers support SBA's strategic plan, performance goals, and objectives.	3
-- Training programs are provided to managers and others responsible for implementing the performance results requirement.	3
• Management provides adequate resources to support processes necessary to have an effective performance-based and results-driven operation.	2
SBA analyzes risks associated with achieving objectives.	
• SBA periodically assesses the risk that it may not achieve its goals, and results are used to redirect performance to enhance the successful attainment of goals.	2
• Performance outcomes are regularly measured and reflect results attributable to Agency programs and services delivered.	2(3)
Policy and procedures provide guidance to ensure consistency among organizational components.	
• Policies and guidelines for developing performance goals, objectives, and measures, and for verifying and validating data are published.	1
Information is recorded and communicated to management and others who need it to fulfill their oversight and stewardship responsibilities.	
• Managers have and use operational and financial data to assess their progress in meeting Agency goals, and ensure accountability for effective and efficient use of resources.	2

• Performance data are verified and validated.	3
Monitoring of performance occurs and findings of relevant audits and other reviews are promptly resolved.	
• Top level review and tracking of major Agency achievements occurs, and comparisons are made to plans, goals, and objectives.	2
• Feedback process is used to improve performance goals, measures, and accuracy of data.	2

Legend:
1–Green-Implemented
2–Yellow-Progress being made
3–Red-Not implemented/no substantial progress
Scores in parentheses indicate the January 2002 score in those cases where the score has been changed.

Background

SBA has three major goals: (1) Champion small business interests, (2) empower entrepreneurs, and (3) help businesses and families recover from disasters. To comply more fully with the Government Performance and Results Act (GPRA), SBA needs to develop appropriate outcome measures, improve the accuracy and completeness of its data, and institute managing for results processes throughout the organization. SBA reports that it is moving away from output measures, has identified outcome goals and targets of performance, and improved its reporting of results.

The Senate Governmental Affairs Committee identified three "key outcomes" in SBA's FY 2000 Performance Report and asked GAO to evaluate how well SBA performed during FY 2000. GAO found that in SBA's FY 2000 Performance Report its reported progress in achieving its outcomes is mixed. GAO had difficulty assessing SBA's progress due to weaknesses in its performance measures and data. GAO was unable to assess SBA's strategies for achieving its outcomes because SBA's plan and report lack either an explanation of how the strategies relate to the outcomes or a discussion regarding strategies for the outcome. Specifically, GAO determined the following:

- Planned outcome - Assist small businesses to become self-reliant and successful in the competitive marketplace. SBA's success in achieving this outcome is mixed. SBA's performance indicators provide little performance information on the self-reliance and success of small businesses or on SBA's contributions to this outcome. Because of the lack of explanation in the plan and report regarding how SBA's strategies for this outcome relate to helping small businesses succeed, GAO was unable to assess whether the strategies are clear and reasonable.

- Planned outcome - Ensure that more eligible small businesses participate in SBA programs and become more successful. SBA's reported success varied in achieving the portion of this outcome regarding having more eligible small disadvantaged businesses participate in its programs.

It was not possible for GAO to determine SBA's progress in helping more eligible small disadvantaged businesses become more successful because SBA has not developed performance

measures that assess the success of its key programs in this area. GAO indicated that SBA has discussed its strategies for this outcome as a part of its outcome of helping businesses succeed.

A team of analysts from the Mercatus Center at George Mason University also ranked the FY 2001 Performance Reports of the 24 Chief Financial Officers Act agencies. Rankings were based on whether (1) Agency accomplishments were reported in a transparent fashion, (2) the report focused on documenting the Agency's tangible public benefits, and (3) there was evidence of forward-looking leadership that uses performance information to devise strategies for improvement. SBA received 26 out of a possible 60 points, ranking it 16th of the 24 Agencies.

OIG audits and inspections have focused on SBA's implementation of performance measurement requirements and the reliability of the performance data for major Agency programs. Five audits have found that SBA's performance measures and data accuracy could be improved. For example, the Surety Bond Guaranty (SBG) audit found that the program's performance data were reliable but recommended improvements in data collection and presentation. A Section 7(a) GPRA audit, however, found that some of the program's performance data are not reliable, due primarily to an absence of effective validation and verification strategies and methods. Moreover, loan quantity indicators used are not a valid measure of output because they measure loans approved rather than actual loans made or disbursed.

The Section 8(a) GPRA audit found that data concerning the fiscal year the program participant left the program were accurate; however, some performance data were unreliable or incorrectly described.

An FY 2000 OIG inspection of SBA loan processing centers found some uncertainty in the Office of Financial Assistance concerning what constitutes adequate data verification. An inspection of SBA's Office of Entrepreneurial Development (OED) found inconsistencies in counting clients in its small business counseling and technical assistance programs that appeared to overstate the efforts of some service providers. A common unit of measurement was needed. In addition, although it is difficult to attribute outcome measures such as a small business' increased sales or hiring to OED efforts, SBA needed to develop outcome measures to determine the intermediate or long term results of OED services.

Significant Open Recommendations

Management has agreed with OIG audit recommendations and issued guidance, but the guidance needs to be fully implemented.

Current Agency Status

A retreat for SBA senior management was held in September 2002 to address issues related to performance measurement and managing for results. The Deputy Administrator and Chief Operating Officer have together set the tone for providing a positive and supportive attitude toward performance-based management.

Instead of the execution plan mentioned in last year's management challenge assessment, an Intranet application, "SBA Execution Scorecard," was designed and is now up and running. The application, which is password-protected, provides a performance scorecard for each SBA district office, headquarters program office, and loan program. The application also has fields for tracking various initiatives introduced throughout the Agency.

The initial submission of "SBA Budget Request and Performance Plan for FY 2004" was sent to the Office of Management and Budget (OMB) on November 25, 2002. Training programs for managers and others responsible for implementing the performance results requirements have not been provided because there is no money available in SBA's budget for such training programs.

Analysis of risks associated with achieving objectives in now being done through the Intranet application, "SBA Execution Scorecard," rather than the execution plan mentioned in last year's management challenge assessment.

SBA's Chief Operating Officer (COO) completed FY 2002 performance reviews with all program offices, the results of which were used in budget deliberations. The COO is continuing a review of performance data. Progress is being made, but the data still needs to be validated.

OIG Assessment of Status

Management has demonstrated that it is committed to managing for results and has provided the resources to develop the Intranet application, "SBA Execution Scorecard," which will be the primary mechanism through which management measures performance outputs and assesses risks, among other functions. While SBA has made progress in addressing this challenge by developing the Intranet application, the Scorecard focuses on measuring performance outputs rather than outcomes. More action is needed to verify and validate data, and provide resources for training programs for managers and others responsible for implementing the performance results requirement.

Reports

George Mason University, Mercatus Center, *3rd Annual Performance Report Scorecard: Which Federal Agencies Inform the Public,* May 16, 2002.

GAO, *Status of Achieving Key Outcomes and Addressing Major Management Challenges*, Report # GAO-01-792, June 2001.

SBA OIG, *Results Act Performance Measurement for the Section 8 (a) Minority Small Business and Capital Ownership Development Program,* Audit Report # 1-11, March 27, 2001.

SBA OIG, *Results Act Performance Measurement for the Disaster Assistance Program,* Audit Report # 1-06, February 15, 2001.

SBA OIG, *Results Act Performance Measurement for the Section 7(a) Business Loan Program*, Audit Report # 1-01, December 4, 2000.

SBA OIG, *Advisory Memorandum: Data Issues Regarding the Processing Centers*, Inspection Report #00-09-01, September 28, 2000.

SBA OIG, *Coordination and Performance Measurement in SBA's Entrepreneurial Development Programs*, Inspection Report #00-09-02, September 28, 2000.

SBA OIG, *Results Act Performance Measurement for the Surety Bond Guarantee Program*, Audit Report #0-26, September 25, 2000.

SBA OIG, *Results Act Performance Measurement for the Small Business Investment Company*, Audit Report #0-25, September 6, 2000.

U.S. Senate, Governmental Affairs Committee, *Summary of FY 1999 Performance Report Information: Small Business Administration*, June 2000.

Challenge 2. SBA faces significant challenges in financial management and reporting which affects its ability to provide reliable, timely and accurate financial information.

Summary – *SBA needs to make significant improvements in financial management and reporting to ensure that the Agency produces reliable, timely and accurate financial information including its annual financial statements and the results of loan asset sales. The Agency has taken steps to improve its financial management; however, these efforts have been primarily focused on improving controls over financial statement preparation. The Agency still needs to develop and implement improvements to other aspects of its financial management, including accounting and budgeting for loan asset sales, the disaster subsidy estimate process and accounting for the Master Reserve Fund (MRF).*

Actions Needed	Progress
SBA financial reporting process provides complete, accurate, timely financial management information	
• OCFO produces complete, reliable, and timely financial statements prepared in accordance with OMB Bulletin No. 01-09, Form and Content of Agency Financial Statements	3
○ SBA's core financial system is able to provide complete, reliable, timely and consistent financial management information.	3
○ SBA meets all deadlines for financial reporting	2
○ SBA's documents all aspects of its financial reporting process	2
○ SBA's maintains strong internal control over the financial reporting process	2
○ SBA maintains a compilation manual detailing the source of all financial statement line items.	2
SBA maintains proper accounting for and accountability of the MRF	
• SBA fully accounts for the MRF in accordance with all federal accounting regulations	3
• SBA ensures the fiscal transfer agent meets all its obligations related to the MRF	2
• SBA utilizes statistically valid tools to measure the financial position of the MRF	3
• SBA timely reports the financial position of the MRF to Agency decision makers and Congress	3
SBA maintains control over all aspects the loan accounting and budgeting processes	
• SBA properly accounts for loan asset sales in accordance with all federal accounting and budget regulations	3
○ SBA investigates and corrects all known errors made in the accounting and budget records from previous loan sales	3

○ SBA performs the necessary analysis to assess the effects of loan sales on the subsidy re-estimates to determine whether cash flow assumptions in SBA's subsidy rate model predict future loan performance	3
○ SBA's performs the necessary analysis to determine and correct any unexplained decline in the subsidy allowance account.	3
• SBA considers loan asset sales in its cash flow models at the outset of each cohort	3
• SBA utilizes a well-documented and tested automated methodology for accumulating cash flows necessary for subsidy calculations	2
• SBA fully implements quality assurance procedures over the subsidy re-estimation process	3

Legend:
1–Green-Implemented
2–Yellow-Progress being made
3−Red-Not implemented/no substantial progress

Background

Various laws and regulations have been enacted to improve Federal agencies' accountability to the President, Congress and taxpayers, including the Government Management and Reform Act of 1994 (GMRA), the Chief Financial Officers Act of 1990 (CFO Act), OMB Bulletin 97-01, *Form and Content of Agency Financial Statements*, as amended, Federal Accounting Standards Advisory Board (FASAB) Statements on Federal Financial Accounting Standards, the Federal Managers' Financial Integrity Act of 1982 (FMFIA), and the Federal Financial Management Improvement Act of 1996 (FFMIA). These requirements place significant responsibilities upon Federal financial managers to assess whether they are effectively and efficiently managing public resources. During FY 2002, OIG, GAO and SBA's external auditor all noted an increased number of significant issues in the area of financial management and reporting.

Weaknesses in the financial reporting process

The OIG hired an independent external auditor to perform annual audits of SBA's financial statements as required by the CFO Act. In FY 2000, SBA's financial reporting process was deemed to be a reportable condition with respect to the audit of SBA's financial statements. More specifically, the external auditor found that SBA's financial reporting processes and procedures were not adequately documented and a fully effective quality assurance process was not in place. As a result, errors occurred in SBA's financial statements. For FY 2001 SBA's auditor noted a *material* weakness over SBA's financial reporting process in its report on internal control. The report noted that although SBA made certain improvements since FY 2000, the overall financial reporting process worsened in FY 2001. Specifically, the external auditor noted that SBA did not deliver its financial statements timely and the statements contained numerous errors and misclassifications. Some examples of the errors and adjustments identified were 1) nearly $350 million in gross costs were reported in the wrong line item on the Statement of Net Cost and 2) $1.1 billion of Offsetting Receipts were excluded from the Statement of

Financing. Further, the auditor noted that SBA's automated financial reporting tool utilized a mapping process that did not have a clear and precise audit trail to support the process' results.

The external auditor also noted in its report on compliance with laws and regulations two instances in FY 2001 in which SBA did not substantially comply with Federal financial management system requirements and Federal accounting standards as required under FFMIA. SBA's core financial system was not able to provide complete, reliable, timely and consistent financial management information on operations and the significant errors and misstatements in its initial financial statements indicated that SBA was not in substantial compliance with federal accounting standards.

Reporting of the Master Reserve Fund

The Master Reserve Fund (MRF) was created to facilitate operation of SBA's Section 7(a) secondary market program where SBA lenders can sell the SBA guaranteed portion of loans to investors. The MRF is maintained by SBA's fiscal transfer agent (FTA). The MRF includes both the principal paid from borrowers and due to investors, as well as accumulated interest earnings. The accumulated earnings are intended to ensure timely payments to investors if there is shortfall in monthly loan collections of borrower payments. As of September 30, 2002, the MRF totaled approximately $1.2 billion which included the initial principal payments to secondary market investors of approximately $665 million and $535 million in accumulated interest earnings. The accumulated interest earnings have been determined to be Federal funds and these earnings are designated to cover obligations of the MRF.

OIG and SBA's external auditors have noted significant weaknesses related to SBA's financial reporting and management of the MRF. In FY 2001, SBA estimated the accumulated excess of earnings in the MRF available to meet timely payments to investors to be $68 million. Although the external auditors noted they did not believe that this amount was materially misstated, they noted in the FY 2001 report on internal control that they believed the estimation process required improvement to ensure accurate, complete, and timely data for financial statements. In addition, the auditors noted in their FY 2001 Management Letter that additional improvements should be made to how the MRF is reported in SBA's financial statements, specifically, that SBA should determine whether the MRF should be accounted for in a manner similar to a trust fund under Statement of Federal Financial Accounting Standards (SFFAS) No. 7.

OIG issued a draft report on November 19, 2002, regarding SBA's oversight of the MRF and communicated several findings related to SBA's financial management of the MRF. The audit determined:

- The MRF was not properly accounted for in accordance with Federal accounting regulations.
- SBA neither knew the fiscal health of the MRF nor timely reported this information to Congress and Agency decision-makers.
- SBA neither had financial reporting procedures which would identify the results of loan pooling operations (surpluses and shortfalls) within the MRF, nor analyzed the MRF for future potential revenues and projected shortfalls from loan pooling operations.

- The MRF was not registered with symbols and titles by the Department of Treasury (Treasury) in consultation with the OMB.

Accounting and Budgeting for Loan Asset Sales

In FY 1999, SBA began selling portions of its loan portfolio at the direction of OMB. SBA's loan sale program is part of a government-wide effort to consider loan asset sales as a tool for improving the management of Federal loan programs. GAO performed a review of the loan asset sale program at SBA. GAO found that SBA's accounting for loan sales and the remaining portfolio was flawed and could significantly affect previously reported and future results in the budget and financial statements. Specifically, GAO noted that SBA:

- Incorrectly calculated loan sale losses reported in the footnotes to its financial statements,
- Did not appropriately consider the effect of loan sales on its estimates of the cost of the remaining portfolio (subsidy estimates), which could significantly impact its budget and financial statement reporting, and
- Had significant unexplained declines in its subsidy allowance for the disaster loan program.

GAO was unable to determine the effect of the errors identified through information requested from SBA and the financial statement auditors. As a result, GAO expressed concern that the problems they noted related to accounting and budgeting for loan sales may have materially misstated SBA's financial statements for FY 2000 and 2001 and that the result of these issues might be the underestimation of the cost of SBA's credit programs.

In addition to subsidy estimate error related to loan asset sales noted by GAO, SBA's external auditor noted weaknesses related to SBA's subsidy re-estimate process in both FY 2000 and FY 2001. In FY 2000, the external auditor reported that SBA's quality control process over cash flow models used for budget estimates and financial statement re-estimates was not completely effective. In FY 2001, auditors found similar errors, including data input and cell reference mistakes which resulted in significant inaccuracies in the cash flow estimates and necessitated corrections to the Disaster, Section 7(a), and Small Business Investment Companies subsidy re-estimates.

As a result of these findings, the Chief Financial Officer (CFO) notified users to no longer rely on the Financial Statements nor the external auditor's reports for FY 2000 and 2001.

Significant Open Recommendations

Management has agreed with their external auditor's recommendations and made some progress in their implementation, however there has not yet been additional assessments of their effectiveness. Management has taken OIG and GAO recommendations under advisement and is in the process of determining what actions are necessary.

Reports

GAO, *Accounting Anomalies and Limited Operational Data Make Results of Loan Sales Uncertain, GAO-03-87*, January 2003

SBA OIG, *Audit of SBA's Oversight of the Fiscal Transfer Agent for the Section 7(a) Loan Program, (Issued in Draft – October 2002)*

SBA OIG, *Audit of SBA's FY 2001 Financial Statements Management Letter*, Audit Report #2-17, April 12, 2002

SBA OIG, *Audit of SBA's FY 2001 Financial Statements*, Audit Report #2-04, February 27, 2002.

SBA OIG, *Audit of SBA's FY 2000 Financial Statements,* Audit Report #1-08, February 28, 2001

SBA OIG, *Audit of SBA's FY 2000 Financial Statements Management Letter,* Audit Report #1-15, August 15, 2001

Challenge 3. Information systems security needs improvement.

Summary - *SBA operations depend heavily on the Agency's information systems, and the security of those systems is critical. The Agency has made a substantial commitment of resources for enhancing computer security, providing technical staff support, and developing security training. SBA needs to fully implement its Agencywide systems security program to include assessing risks, establishing and updating policies and controls, promoting awareness, standardizing security procedures and evaluating security effectiveness.*

Actions Needed	Progress
SBA needs to fully implement and maintain an ongoing information security program aimed at understanding and reducing its information security risks. This program should include assessing risks, implementing appropriate policies and controls, promoting awareness, standardizing security procedures, and monitoring and evaluating policy and control effectiveness.	
• The Chief Information Officer (CIO), in conjunction with appropriate program offices, develops and implements procedures for monitoring, assessing, and measuring security program effectiveness.	1(2)
• The CIO develops procedures to require review and approval of all proposed changes to server configurations.	2
• The CIO, in conjunction with appropriate program offices, identifies and eliminates incompatible duties, responsibilities, and functions.	2
• The CIO, in conjunction with appropriate program offices, develops a viable and complete disaster recovery and contingency test plan for all computing platforms. Additionally, establish a temporary dedicated line to the "hot-site" from the mainframe provider and test the disaster recovery plan on an annual basis.	2
• The CIO develops an agency-wide information security plan which incorporates full integration of the security approach, coordination among program offices and methods to monitor the effectiveness of the IT security assigned to each part of the program office.	2
• The CIO and Assistant Administrator for Human Resources: (1) develop personnel policies and procedures in support of defined "rules of behavior" for general support systems and major applications, and (2) develop both a non-disclosure statement and security awareness agreement that all employees and contractors will be required to sign.	2
• The Chief Operating Officer provides adequate funding and resources to develop and implement technical training for security staff and network and application security administrators.	2

• The CIO develops and implements standard operating procedures for network system administrators and security administrators for maintaining the computerized network.	2
• The Assistant Administrator for Human Resources and the Assistant Administrator for Administration provide timely separation reports to OCIO to ensure the removal of computer access accounts for former employees and contractors.	2
• The CIO modifies the Loan Accounting System (LAS) to prevent security administrators from viewing user passwords in plain text. Additionally, the CIO, creates LAS security administrator and user training courses.	2
• The CIO enhances system development procedures to ensure that security personnel actively participate in all phases of development projects for new and existing systems. Participation by security personnel should be documented at the end of each phase of development.	3
• The CIO institutes policies and procedures to ensure that network personnel apply system patches in a timely manner.	2
• The CIO enhances procedures for monitoring the network and internet traffic for suspicious activity.	2
• The CIO continues to pursue a requirement with GSA for the mainframe to be audited on an annual basis and make the results available to SBA.	3
SBA needs to complete planning and assessment activities to protect its critical infrastructure as required by Presidential Decision Directive (PDD) 63.	
• The Deputy Chief Information Assurance Officer coordinates physical infrastructure protection efforts with the General Services Administration.	3(2)*
SBA needs to comply with the Government Information Security Reform Act (GISRA).	
• The CIO completes risk assessments and security plans for SBA's high-priority and cyber-based systems. Once the vulnerabilities are identified in the risk assessments, the system owner should accept, correct, or mitigate the risk to SBA systems.	2
• The CIO completes a formalized management control process to formally act on risks identified from risk assessments. The management control process includes a schedule to correct identified deficiencies, dates for completion, and funding requirements.	2(3)
• The CIO develops a program to perform Security Test & Evaluation (ST&E) reviews on all of SBA's high-priority computer systems.	3
• The CIO identifies Agency personnel who should be required to undertake security training as end-users, Designated Security Officers (DSO), Information Resource Managers (IRM), and back-up personnel; and requires those individuals to take the course on DSO/IRM security training.	2

• The CIO reports system security incidents to FedCIRC and other law enforcement entities in a timely manner.	2
SBA's UNIX computer servers need to be more secure and meet Federal and Agency security standards.	
• SBA remedies a number of security vulnerabilities identified in the audit of SBA's UNIX servers. These include password vulnerabilities, non-review of system audit logs and configuration files, and a lack of adequate system patching.	1(2)

Legend:
1–Green-Implemented
2–Yellow-Progress being made
3–Red-Not implemented/no substantial progress
Scores in parentheses indicate the January 2002 score in those cases where the score has been changed.
An asterisk indicates that the score was lowered.

Background

SBA's programs and activities depend heavily on computerized systems. The Agency is engaged in several initiatives, such as paperless loan applications, use of digital signatures, expanded internet access, and electronic data interchange, that will increase its reliance on such systems. While information technology can result in a number of benefits, such as information being processed quickly and communicated almost instantaneously, it also increases the risk of fraud, inappropriate disclosure of sensitive data, and disruption of critical operations and services.

In 1997, the General Accounting Office (GAO) designated information security as a Government-wide high risk area because of growing evidence indicating that controls over computerized operations were not effective and risks were increasing. The FY 2000 and FY 2001 audits of SBA's financial statements and the FY 2001 audit of SBA's implementation of PDD 63 disclosed that significant progress had been made in SBA's computer security program. Additionally, the FY 2001 audit of SBA's Computer Security Program for GISRA found that SBA generally maintained an adequate information security program for its high priority financial management and general support systems. However, improvements are still needed in many areas of entity-wide security program planning, segregation of duties, computer security testing, computer access controls, and disaster recovery and contingency planning. Also, improvements in physical security (such as better coordination with the General Services Administration) are needed to ensure the protection of SBA's physical infrastructure.

Significant Open Recommendations

The audit reports listed above include a number of specific recommendations aimed at implementing an agency-wide information systems security program. The Agency has taken a number of steps to improve its information systems security program. Because of the long-term nature of implementing a security program, completion of final action on some of the recommendations is not scheduled until the FY 2002 to FY 2004 time frame or beyond. The OIG will be performing further audit work to evaluate the Agency's ongoing efforts at establishing an information security program.

Current Agency Status:

Action: *SBA needs to fully implement and maintain an ongoing information security program aimed at understanding and reducing its information security risks. This program should include assessing risks, implementing appropriate policies and controls, promoting awareness, and monitoring and evaluating policy and control effectiveness.*

OCIO continues to improve the security program. OCIO is developing an enhanced intrusion detection system for the Agency which will give us the ability to monitor and control access to Agency resources in real time. OCIO is moving the Agency's INTERNET service to a managed communications facility to provide additional security and redundancy. OCIO continues to perform system certification and accreditation reviews and are completing plans for disaster recovery testing. The Agency PC operating system upgrade is proceeding according to plan. The users are already realizing the benefits of the new system. The real-time data backup system is online and functioning.

Action: *SBA needs to complete planning and assessment activities to protect its critical infrastructure as required by Presidential Decision Directive (PDD) 63.*

OCIO is continuing to complete the Agency infrastructure protection plan in accordance with the project plan/timeline.

Action: *SBA needs to comply with the Government Information Security Reform Act (GISRA).*

SBA is complying with GISRA. OCIO delivered the quarterly Plan of Actions and Milestones (POA&M) in July 2002. OCIO successfully submitted its FY 2002 Executive Summary to OMB in September 2002.

OIG Assessment

SBA has made significant progress in improving the security of its information management systems. Further improvements are planned to be completed in FY 2003.

SBA has improved its Intrusion Detection System from the internet. SBA has continued to improve its certification and accreditation program by performing more risk assessments and security testing of systems. However, SBA has not developed a strategic security plan covering all SBA systems.

While SBA continued efforts on its critical infrastructure protection plan by naming a Deputy Chief Information Assurance Officer (CIAO) for physical security in the Office of Administration, the revised Critical Infrastructure Protection Plan lacks milestones and responsibilities for identification of physical mission essential infrastructure. It does not provide for: (i) Performance of vulnerability assessments, (ii) development of remedial plans, (iii) determination of resource requirements, and (iv) updating of policies and procedures as necessary to protect SBA's physical plant, equipment and personnel. Because no actions were

undertaken this year to correct this deficiency, the score for this area has regressed.

Reports

SBA OIG, *SBA's Information Security Program*, Memorandum Report #2-28, September 12, 2002.

SBA OIG, *Audit of SBA's Information System Controls*, Audit Report #2-18, May 6, 2002.

SBA OIG, *Audit of SBA's UNIX Operating Systems*, Audit Report #1-21, September 28, 2001.

SBA OIG, *Audit of SBA's Computer Security Program,* Advisory Memorandum Report #A1-06, September 28, 2001.

SBA OIG, *Audit of SBA's FY 2000 Information Systems Controls,* Audit Report #1-12, March 27, 2001.

SBA OIG, *Audit of SBA's Planning and Assessment for Implementing Presidential Decision Directive 63, Phase III*, Audit Report #1-09, March 26, 2001.

Challenge 4. Maximizing program performance requires that SBA fully develop and implement its human capital management strategy.

Summary - *The nature and scope of SBA's work has changed significantly, requiring a different set of skills in the Agency's workforce. SBA has begun to take the steps necessary to better manage its human capital activities, but needs to do more. The Agency has drafted a Workforce Restructuring Plan to guide organizational changes. The Office of Human Resources, in partnership with the program and district offices, is developing and must implement a comprehensive human capital strategy that will identify SBA's current and future human capital needs, including the size of the workforce and skill gaps; its deployment across the organization; the knowledge, skills, and abilities needed for the Agency to pursue its missions; and an effective succession planning process.*

Actions Needed	**Progress**				
	CA	ED	GC	MA	DA
Develop and implement a comprehensive human capital strategy that encompasses human capital policies, programs, and practices to guide the Agency and that:	3				
is linked to SBA's strategic goals,	3				
includes major human capital objectives,	3				
identifies the milestones and resources needed to implement the strategy, and	3	3	3	3	3
establishes results-oriented performance measures for human capital objectives.	3				
The human capital strategy should include the following:					
• Identification of the knowledge, skills, abilities, and other characteristics SBA employees will need to perform successfully in the new business environment**.**	3				
-- Management has analyzed the tasks that need to be performed by SBA today.	2	2	2	2	2
-- Management has analyzed the tasks that need to be performed for SBA's core competencies in the new business environment, completed a gap analysis, and linked the needed tasks to SBA's strategic plan.	3	3	3	3	3
-- Competency models or other means of identifying and defining specific tasks required for job positions have been established and implemented.	2	2	2	3	2
-- An evaluation process for regular assessments of Agency skills has been developed and implemented.	3				
• An estimate of the number of employees with the identified skills who will be needed in the new business environment.	3	3	3	3	^

• Adequate training for all employees to perform their jobs well	2
-- There are appropriate orientation and training programs to meet the needs, and minimize skills gaps/imbalances, of all employees–especially those in the core competencies.	2 2 3 3 2
-- An evaluation/control mechanism is established and implemented to ensure that all employees have received appropriate training and have the necessary skills.	3
• A comprehensive succession planning process for the Agency, including forecasting SBA's future executive resource needs at both headquarters and in the field.	2
-- The human capital plan includes an analysis of attrition rates, retirement eligibility, and retirement rates for senior managers.	2
-- The Agency has defined the types of leaders it wants through written descriptions of roles, responsibilities, attributes, and leadership competencies, has established broad performance expectations for them, and has implemented them.	2
-- The District Director development program is reestablished and continued with periodic evaluations of its impact and effectiveness.	2
-- The Senior Executive Service Candidate Development Program is reinstated and periodic evaluations of its impact and effectiveness conducted.	2(3)
-- A recruitment, retention, and development plan for lower and middle levels which has explicit links to skill needs the Agency has identified is developed and implemented.	3

Legend:
(An arrow is used to indicate SBA wide responsibility)
1–Green-Implemented
2–Yellow-Progress being made
3–Red-Not implemented/no substantial progress
CA–Capital Access
ED–Entrepreneurial Development
GC–Government Contracting/8(a) Business Development
MA–Management & Administration
DA–Disaster Assistance
^ Because each disaster is unique, it is not possible to estimate the number of employees needed until the disaster occurs.
Scores in parentheses indicate the January 2002 score in those cases where the score has been changed.

Background

Managing and investing in human capital has emerged as a critical issue throughout the Federal Government. Human capital management is especially important for SBA. Over the last

decade, small business practices, products, and needs have been transformed and SBA has made major changes in its delivery of goods and services. SBA has moved from a "direct sales" model to a partnership business model. The Agency now uses public-private partnerships to perform the loan origination, servicing, and liquidation functions that SBA personnel formerly handled. At the same time, SBA has decreased its workforce by more than 20 percent and increased the number of Section 7(a) and Section 504 loan approvals from 20,609 in FY 1991 to 57,146 in FY 2002. Organizational changes are needed to adjust to these new circumstances.

SBA's human capital strategy should be closely linked to the goals and objectives of the Agency's new Strategic Plan which is currently in draft. Under SBA's former FY 2001-2006 Strategic Plan goal of "Modernizing the SBA," a series of strategies supported the key objective of "investing in our personnel to create a motivated, creative, competent and productive workforce."

In FY 2002, OIG issued an Inspection report on modernizing human capital management. It supported the need for SBA to modernize SBA's Office of Human Resources (OHR) in order to manage human capital effectively and efficiently in the changing environment and take a leading role in workforce restructuring.

Significant Open Recommendations

No OIG formal audit or inspection recommendations have been made on the specific elements of this challenge. However, made recommendations on modernizing human capital management that are critical to the overall success of SBA's human capital strategy. The four recommendations focus on Government-wide initiatives, cross-agency servicing alternatives, and integrating human resource elements into agency budget and performance management.

Current Agency Status

SBA reports that its Transformation and Human Capital Plans address all six Standards for Success in the Human Capital Framework jointly published by GAO, OMB and OPM. The Agency's human capital strategy is aligned with its mission and is integrated into strategic plans, performances plans, and budgets. SBA's workforce planning strategy is to finish identifying future human capital needs, including the size, deployment and competencies needed to serve our citizen customers and ensure mission accomplishment. To prepare SBA for filling mission-critical skills, SBA will implement a knowledge management and continuous learning system. SBA implemented a new performance management system for managers that will hold them accountable for implementing the President's Agenda Management in their areas of responsibility, and is negotiating similar changes for bargaining unit employees.

The Office of Human Resources (OHR) has contracted with the OPM's San Francisco Service Center to conduct an agency-wide workforce/gap analysis. Many of the specific actions needed to develop and/or implement the necessary elements of a comprehensive human capital strategy are dependent on the completion of this workforce/gap analysis that was fully funded in FY 2002. The analysis will assist the Agency in (1) identifying the knowledge, skills, abilities, and other characteristics SBA employees will need to perform successfully in the new business

environment; (2) estimating the number of employees with the identified skills who will be needed in the new business environment; and (3) providing adequate training for all employees to perform their jobs well. The estimated date for the completion of Phase 1 of the workforce/gap analysis is January 2003 and for Phase 2, September 2003.

With regard to one of the key actions in the fourth human capital challenge area of developing and implementing a comprehensive succession planning process for the Agency, the Senior Executive Service Candidate Development Program was reinstated in FY 2002. Estimated completion dates for all of the various actions SBA intends to take to fully develop and implement its human capital management strategies range from January 2003 through September 2003.

OIG Assessment of Status

SBA has drafted a five-year workforce transformation/restructuring plan and a human capital plan. These have identified steps to better manage human capital activities and foster a performance culture. With these "works in progress," the Agency has made considerable progress in establishing the process and milestones needed to fully develop and implement its human capital strategy. Actual implementation of the process is only just beginning, however. Key to the successful completion of the process will be (1) ensuring that the human capital strategy is coordinated with, and specifically linked to, clearly defined and final strategic and workforce restructuring plans; and (2) finishing a high quality workforce/gap analysis; (3) maintaining the implementation schedule set; (3) regularly evaluating progress and results; and (4) making the necessary changes or adjustments at appropriate intervals.

Reports/Testimony

GAO, *Small Business Administration: Workforce Transformation Plan is Evolving*, GAO-02-931T, July 16, 2002.

SBA OIG, *Modernizing Human Capital Management*, Inspection Report #2-20, May 31, 2002.
GAO, *Small Business Administration: Current Structure Presents Challenges for Service Delivery*, GAO-02-17, October 2001.

U.S. Senate, Committee on Governmental Affairs, *Government at the Brink*, Volumes I and II, June 2001.

GAO, *Small Business Administration: Status of Achieving Key Outcomes and Addressing Major Management Challenges*, GAO-01-792, June 2001.

GAO, *Major Management Challenges and Program Risks: Small Business Administration*, GAO-01-260, January 2001.

GAO, *Small Business Administration: Steps Taken to Better Manage its Human Capital, but More Needs to be Done*, GAO/T-GGD/AIMD-00-256, July 20, 2000.

Challenge 5. SBA needs better controls over the business loan purchase process.

Summary - *OIG audits have shown that SBA field offices do not consistently follow Agency requirements when purchasing guarantees from lenders after loan defaults, resulting in purchases that may not be justified and unnecessary expenditures for the Agency. In response to this concern, SBA instituted a guaranty purchase review (GPR) process, implemented a guaranty repair tracking system, established an early warning system, issued a policy notice revising guidance on the guaranty purchase policy and procedures, which includes a uniform purchase documentation checklist, and is in the process of developing a training module. The Agency plans to continue to ensure that the guaranty is denied or reduced when a lender fails to comply with SBA requirements by continuing to update and implement changes to improve the guaranty purchase process based on the results of the guaranty purchase reviews and other sources. Responsibility for taking actions to improve the purchase process is shared by the Office of Financial Assistance (OFA) and the Office of Field Operations (OFO), with the assistance of the Office of General Counsel.*

Actions Needed	Progress
Top management provides a positive and supportive attitude toward the guarantee purchase process.	
• Management establishes an organizational culture where deny and repair actions are used when appropriate.	2
• Adequate training is provided.	2(3)
SBA analyzes risks associated with loan guarantee purchases.	
• SBA periodically determines actual or potential risks of erroneous payments.	2
• SBA determines level of erroneous payments for the entire loan portfolio.	2(3)
Policies and procedures provide guidance to ensure consistency and accuracy in the purchase process.	
• SBA has clear guaranty purchase procedures, which provide for consistent interpretation.	2
• Current guidance describes adequate documentation needed to make purchase decisions.	2(3)
• Lenders are informed of required documentation to submit with the guaranty purchase request.	2
• Goals are established for reducing erroneous payments.	2(3)
Information is recorded and communicated to those who need it to ensure proper guarantee purchase decisions.	
• SBA has a system for sharing information among field offices regarding the basis and justification for repairs, denials, and withdrawals of loan guarantees.	1(3)
• Field offices track the number of guaranty repairs/denials/withdrawals and the information is readily available centrally.	1

• Information is captured on erroneous payments and is accurate.	2
The guarantee purchase process is properly monitored.	
• A quality assurance system provides appropriate feedback to improve the purchase process.	2
• Progress in achieving established goals for reducing erroneous payments is monitored.	2(3)
• Results of the GPRs, audits, and other reviews are provided to field offices timely and accurately.	1(2)
• Problems identified by the audits and reviews are resolved timely.	2
• Information on all loans with identified guaranty purchase issues are flagged in the Delinquent Loan Collection System (DLCS).	2

Legend:
1–Green-Implemented
2–Yellow-Progress being made
3–Red-Not implemented/no substantial progress
Scores in parentheses indicate the January 2002 score in those cases where the score has been changed.

Background

A 1997 audit and a current audit of business loan guaranty purchases found that SBA did not consistently apply its procedures when purchasing guarantees. Inappropriate purchase activities may result from unclear guidelines or inconsistent application of these guidelines. In addition, OIG believes that inappropriate purchases may occur because of a possible conflict between the competing goals of maintaining good relationships with lenders to increase loan volume, and fully or partially denying a guaranty when the lender has not complied with SBA requirements. The 1997 audit found 17 of 58 (29 percent) of the decisions either were not supported by sufficient documentation to make an informed decision or resulted in paid guaranties when information in the file suggested that the guaranty should have been partially or fully denied. A statistical projection of the audit results indicated that an estimated $102.9 million in purchases were not supported by sufficient documentation at the time the decision was made, and guaranties totaling up to $16.2 million should not have been honored. The current guaranty purchase audit showed that of 153 loan guaranties purchased, 30 loans with a purchase amount of $26.6 million should have been denied in full or part by SBA.

Several audits of early defaulted loans have also shown that the lenders did not originate loans in accordance with material SBA requirements or prudent lending practices. The most prevalent lender errors involved repayment ability, equity injection, use of proceeds, and collateral (insufficient or missing).

The GPR was instituted in FY 2000 as a means to improve the guaranty purchase process. In FYs 2000, 2001, and 2002, GPR teams reviewed 603 guaranty loan purchase decisions. Of the 603 loans reviewed, 102 purchase decisions were questioned and forwarded to OFA for final determination on whether the purchase decisions were correct. As of December 2002, OFA had concurred with the GPR teams questioning of the purchase decision for 25 loans and had recovered $291,527. OFA's review of some of the FY 2002 loans is still in progress. While the

GPR efforts should help improve the guaranty purchase process, the recently completed OIG review of the guaranty purchase process has identified several potential weaknesses.

- *Training for Individuals Reviewing Guaranty Purchases*. Training for individuals reviewing guaranty purchase requests consists of personal experience and on-the-job training by individuals already reviewing purchase requests. The Agency had not developed a training course for individuals responsible for reviewing and recommending actions on guarantee purchase requests. According to the results of a survey conducted during the Guaranteed Purchase audit, 81 percent of the individuals that review purchase requests or are responsible for approving purchase recommendations did not have any formal training. Many respondents indicated that formal training would assist in the purchase review process. A training module is under development and scheduled for completion until March 31, 2003.

- *Sample Selection*. The GPR program was designed to review a random sample of 10 percent of all guaranty loan purchases (up to 300 per year) processed by field offices, including potentially problematic loans identified by OIG. The selection method used for each GPR is to select one loan from each field office. This method is not statistically valid because the samples do no comprise a valid representation of the population of purchased loans. The loan selection method also excludes certain types of purchased loans. Originally, the sample selections were restricted to loans purchased and charged off within the same 6-month period. In FY 2002, the criterion was changed to loans purchased and charged off within the same 12 month period. Past audits have shown that loans are often charged off well beyond the 12-month period and may take several years before charge off occurs, due to such factors as the amount of collateral attached to the loan and the time it takes to liquidate the collateral. Using the 12-month criterion, a total of 3,899 loans with a purchase amount of $674 million would be excluded from potential selection for review by a GPR team as of September 2002. Finally, because the GPR loan section method is not statistically sound, the results can not be used to accurately monitor and report on progress in reducing the level of erroneous payments within the Section 7(a) loan program as required by OMB.

- *Loans Identified with Potential Purchase Problems*. Loans identified with a guaranty purchase issue are required to be flagged in the Guaranty Repair Tracking System (GRTS). While not all potentially problematic loans have been entered into the system, SBA has taken action to ensure all loans are entered into the GRTS.

- *Review Limitations*. The GPR team limits its review to the loan files assembled during the purchase review performed by the field offices and uses the existing purchase procedures to conduct its reviews. The Policy Notice (5000-831) issued in October 2002 requires field offices to obtain a copy of the credit memorandum with all supporting documentation, and a complete copy of the borrower's application for the loan, along with SBA Form 912 (Statement of Personal History) for each principal for all Preferred Lender Program (PLP) loans that defaulted early or experienced early loan problems. The policy notice does not require field offices to request the lender's loan file. Past audits have found information in lender files, such as internal correspondence, that indicated lenders did not comply with origination, servicing, and/or liquidation policies and procedures.

- *Delinquent Loan Collection System (DLCS).* This system was modified to flag problem loans identified by OIG audits and other oversight reviews such as the PLP and Small Business Lending Companies (SBLC) safety and soundness examinations. All loans identified with potential purchase issues either have been flagged or are in the process of being flagged.

- *Guaranty Repair Tracking System*. This automated system was implemented in December 2000 with coding enhancements implemented in August 2001. The GRTS was developed to permit Agency wide tracking of lender performance relating to guarantee purchases. Electronic reports are available to field offices to assist them in making guarantee purchase decisions.

- *Standard Operating Procedures*. SBA has issued several notices on the GPR and the guaranty repair tracking system. The notices were provided to advise SBA personnel of the GPR and provide instructions on the use of GRTS. The guaranty purchases procedures in Standard Operating Procedure (SOP) 50 50, "Loan Servicing." In October 2002, SBA issued a Policy Notice on guaranty purchases which strengthened many of the areas in the purchase process that allowed material lender errors to go undetected. One of the improvements is requiring lenders to provide the credit memorandum with all supporting documentation, and a complete copy of the borrower's loan application for purchase requests on early defaulted PLP loans. Additional controls are needed, however, to ensure that all material lender errors are identified during the purchase review. For example, the new policy for verifying cash equity injection, the lender is required to obtain copies of the check and the borrower's bank statement to evidence the source and destination of the funds. These documents alone are not sufficient to determine if the cash came from borrower equity or a loan, which would require a stand-by agreement to qualify as equity. Lender files should be obtained to determine if it contains any information indicating that the lender did not comply with SBA policies.

- *Tracking GPR Results*. OFO established a tracking system to follow up on purchases when the review teams disagreed with the actions of the field offices. The system was developed to enable the Agency to track the actions and provide trend data for policy changes and staff training. The tracking system was used in revision of the guaranty purchase policy published in Policy Notice 5000-831.

Significant Open Recommendations

Management has agreed to take action on all but one OIG audit recommendations.

Current Agency Status and OIG Assessment

Action: *Top management provides a positive and supportive attitude toward the guarantee purchase process.*

Status: The OFO strategic plan for field office performance in FY 2002 emphasizes prompt and accurate guarantee purchase completions. SBA issued Policy Notice 5000-831, "Section 7(a) Loan Guaranty Purchase Policy" on October 2, 2002, that established an organizational

culture ensuring denial and repair action are used, when appropriate. Currently OFO staff is assisting field offices with purchase backlogs. SBA is also conducting a pilot to evaluate centralizing the loan purchase process that is scheduled for completion in September 2003. Finally, a training module on guaranty purchase processing is being developed with completion expected by March 2003. All field counsel received training on the new purchase policy notice in the first quarter of FY 2003.

Assessment: The agency's response shows that top management has taken actions to improve the guarantee purchase process. The issuance of Policy Notice 5000-831 strengthens many of the areas in the purchase process that allowed material lender errors to go unchecked in the past. The establishment of a pilot project to determine the appropriateness of centralizing the purchase process should further improve the process. However, additional time is needed to determine if the revised policy impacts the culture and results in fewer purchases of guaranties where lenders did not comply with SBA policy and requirements.

Training for individuals reviewing guaranty purchase requests consists of personal experience and on-the-job training by individuals already reviewing purchase requests. The Agency is in the process of developing a training module for all field personnel conducting purchase reviews, which is scheduled for completion in March 2003.

Action: *SBA analyzes risks associated with loan guaranty purchases.*

Status: The ongoing GPR periodically examines field office purchase decisions. The level of erroneous payments will be determined based on the sample of purchased loans reviewed by the GPR teams.

Assessment: The agency has made improvements in identifying risks associated with erroneous guaranty purchase payments. A recently completed OIG audit of the guaranty purchase process, however, showed that the GPR teams do not use valid statistical techniques to select loans for review. Before each GPR, a purchase loan is selected from each field office and reviewed. Consequently, because this method does not result a statistical representation of the purchased loan population, the results of the GPR are invalid for extrapolating the level of erroneous payments.

The selection methodology also restricts certain loans from review. The selection criteria included loans that were (i) purchased in the prior calendar, (ii) charged-off in the prior calendar year, and (iii) the time from purchase to charge-off was 12 months or less. As a result, loans that are charged off more than 12 months after the purchase date are excluded from the GPR process. As of September 30, 2002, there were 3,899 loans with a total purchase amount of $674 million that were not purchased and charged off within 12 months.

Action: *Policies and procedures provide guidance to ensure consistency and accuracy in the purchase process.*

Status: Policy Notice 5000-831, issued on October 2, 2002, provides extensive guidance on purchase policy and procedures. The Notice provides guidance on documentation needed to

make accurate purchase decisions. A new guaranty purchase document checklist accompanies the Notice setting forth required documentation. Goals for reducing improper guaranty purchases have been developed and included in the OMB erroneous payment submission.

Assessment: Policy Notice 5000-831 is a significant improvement over prior procedures. The Policy Notice has incorporated the issues identified during the GPR as well as issues identified by the OIG. The procedures in the Policy Notice should help ensure consistency and accuracy of the purchase process; however, training of purchase reviewers is a critical component to ensuring consistency and accuracy of purchase decisions.

While the new Policy Notice provides guidance on documentation needed to make purchase decisions, the OIG audit showed that the purchase process could be strengthen by requiring lenders to submit all documentation associated with the loan to verify total compliance with SBA loan guidance. This could be accomplished by establishing risk based criteria for obtaining the entire lender loan file, e.g., for all early default loans.

Action: *Information is recorded and communicated to those who need it to ensure proper purchase decisions.*

Status: The GRTS is now in place with reports available on-line to field offices showing repairs, denials, and lender withdrawals of guarantees.

Information on erroneous payments will be determined by September 2003 using the results of the GPR process.

Assessment: SBA has made improvements in recording and communicating information regarding purchase decisions to individuals who need to know. The GRTS permits Agency-wide tracking of lender performance relating to guaranty purchases. The system provides information on loans identified with guaranty issues, and information on repairs, denials, and withdrawals. This has resulted in better sharing of information; therefore, the score for this element has been increased from “2” to “1”.

SBA’s plan to extrapolate the GPR examined purchase decisions to determine erroneous payments would be appropriate only if statistically valid sampling techniques were used.

Action: *The guarantee purchase process is properly monitored*.

Status: By September 30, 2003, the OFA and OFO will complete their ongoing monitoring assessment of erroneous payments through the guaranty purchase review project. Feedback will then be provided to field offices on their purchase decisions.

Policy Notice 5000-831 advises field offices on new policy and procedures developed as a result of the GPR process.

By September 2003, the OFA and OFO will contact field offices on individual purchase decisions examined in guaranty purchase reviews.

The guaranty repair tracking system is in place and indicates problem loans and the nature of the problems.

Assessment: SBA improved guaranteed purchase monitoring by implementing the GPR process and developing reports to track purchase information. The results of the GPR process are provided to the field offices and used to determine the amount of erroneous payments. Also, the filed offices strategic plans are monitored by OFO to determine if they meet their goal to reduce erroneous payments

A recent OIG audit found that while SBA made some improvements to the guaranty purchase process, the GPR process does not identify all inappropriate purchase decisions. This is because the GPR process is limited to assessing compliance with the existing purchase procedures and documentation assembled during the initial purchase review process. The audit showed that certain lender errors could not be found without reviewing the lenders' loan files, which is not required under the new purchase policy and procedures established in Policy Notice 500-831.

The audit also found that the GPR results were not reliable for projecting to the population of purchased loans or estimating the amount of erroneous payments because the loans reviewed were not chosen in a valid statistical basis. Consequently, the results of the GPR reviews apply only to the loans reviewed. The samples selected for review were also restricted. The selection criteria included loans that were (i) purchased in the prior calendar, (ii) charged-off in the prior calendar year, and (iii) the time from purchase to charge-off was 12 months or less. As of September 30, 2002, there were 3,899 loans with a total purchase amount of $675 million that were not purchased and charged off within 12 months. These loans, therefore, would be excluded from selection for review by GPR teams because charge off is more than the 12 months from date of purchase.

The DLCS was modified to flag problem loans identified by OIG audits and other oversight reviews such as the PLP and SBLC safety and soundness examinations. SBA has taken steps to ensure all loans identified as having potential purchase issues are flagged in the DCLS. Until all loans have been flagged, loans may be inappropriately excluded from a GPR.

Reports

SBA OIG, *Audit of the Guaranty Purchase Process, (Issued in Draft – January, 2003)*

SBA OIG, *R.L.B. Vending, Inc.*, Audit Report #2-32, September 30, 2002

SBA OIG, *Earth Treasures, Inc.*, Audit Report #2-30, September 24, 2002

SBA OIG, *RSC Enterprises, Inc.*, Audit Report #2-23, August 7, 2002

SBA OIG, *Colorado Taco Corporation*, Audit Report #2-15, March 29, 2002

SBA OIG, *CFM Bracket Company, Inc.*, Audit Report #2-12, March 21, 2002

SBA OIG, *Darshan's Paradise Inn*, Audit Report #2-03, February 27, 2002

SBA OIG, *Danbart Corp.*, Audit Report #2-05, February 27, 2002

SBA OIG, *MVP Sports Cafe,* Audit Report #1-10, March 9, 2001.

GAO, *Major Management Challenges and Program Risks,* GAO-01-260, January 2001.

SBA OIG, *Roshni Foods,* Audit Report #0-10, April 23, 2000.

SBA OIG, *Vincent R. Forshan Medical Corporation,* Audit Report #0-12, March 28, 2000.

SBA OIG, *Dixieland Events/TA Mingo Farms,* Audit Report #0-05, February 14, 2000.

SBA OIG, *Business Loan Guarantee Purchases,* Audit Report #7-5-H-011-026, September 30, 1997.

Challenge 6. SBA needs to continue improving lender oversight.

Summary - *An effective lender oversight program is critical for ensuring lender activities serve Agency objectives and comply with all rules and procedures. The Agency established an Office of Lender Oversight (OLO); completed the third-cycle Preferred Lender Program (PLP) reviews; started the fourth-cycle of PLP reviews, initiated reviews of selected non-PLP lenders; completed the third cycle of safety and soundness examinations of the non-depository Small Business Lending Companies (SBLC); and implemented a review process that ensures all lenders are reviewed periodically and consistently. Congress stopped additional funding and froze existing funds available for the development of a loan monitoring system because of significant changes in scope and dramatic cost increases in the systems modernization initiative. To have an effective oversight program, the Agency needs to develop and implement the loan monitoring system.*

Actions Needed	Progress		
	7(a)	**SBIC**	**504**
Top management provides a positive and supportive attitude toward lender oversight.			
• The Agency establishes OLO to implement and manage the oversight of lending partners.	1	1	1
• SBA has a plan for Lender Oversight.	1	2	2(3)
• Training programs exist for implementing the participant oversight process.	2	3	2(3)
• Senior management provides adequate resources for the lender oversight program.	2	2	3
SBA analyzes risks associated with achieving objectives.			
• A systematic process exists to estimate the level of financial risk on a per loan/investment and participant basis.	2	2(1)*	2
• A systematic process exists to estimate the level of compliance risk on a per loan/investment and participant basis.	1	2	2
• Overall program risk is independently reassessed on a recurring basis.	3	3	3
Policies and procedures provide guidance to ensure consistency among organizational components.			
• Policy and program guidance for lender reviews exists.	1	2	2
• SBA provides guidance and training for new participants and those who demonstrate an unacceptable level of compliance.	2	2	2(3)
• Uniform policies and procedures have been established for periodic evaluations of participant performance and retention.	2	2	2
Information is recorded and communicated to management and others who need it to fulfill their oversight and stewardship.			
• SBA has an automated loan monitoring system to capture useful information and effectively monitor risk.	2	2	2
• There is effective communication among SBA's internal units.	3	2(1)*	3

Monitoring of performance occurs and findings of audits and other reviews are promptly resolved.			
• Standardized and periodic reviews of lending activities that address risk are performed.	1	1	2
• Systems tracking review results and recommendations are implemented.	2	1	2(3)
• The status of each lending partner is periodically reevaluated based on the results of the estimates of financial and compliance risk.	2	2	2

Legend:
1–Green-Implemented
2–Yellow-Progress being made
3–Red-Not implemented/no progress being made
Scores in parentheses indicate the January 2002 score which has been changed. An asterisk indicates that the score was lowered.

Background

SBA is the preeminent gap lender for entrepreneurs in the United States. As a gap lender, SBA necessarily takes more risk than the conventional lender. Since its inception in 1953, SBA has loaned or guaranteed billions of dollars in loans and investments to small business concerns. To control risk, SBA established a lender oversight function that encourages greater discipline in loan underwriting and servicing. OLO will, where a need is indicated, assist lenders in improving the discipline associated with lending to higher risk small business and optimize the relationship between taxpayer cost and mission-based risk through the use of portfolio management mechanisms. Also, OLO is responsible for coordinating all headquarters and field office lender reviews and non-depository lenders' and SBLCs' safety and soundness examinations; evaluating new programs and changes to existing programs to assess potential risk to SBA; and working with other financial regulatory bodies to leverage SBA resources. The Associate Administrator for Lender Oversight is a member of the Agency's Risk Management Committee, which is supposed to meet on a regular basis, and a key member of the working group responsible for the design and implementation of a loan monitoring system.

Current Agency Status and Agency Assessment

The following status report reflects on the CFO status report, additional information from Section 7(a) program officials, and recent audit work on the SBIC and Section 504 programs.

Actions: *Control Environment*

Status: The Agency established OLO and developed a strategic plan to address oversight of lending for each credit program. OLO implemented all elements of its strategic plan for the Section 7(a) program and continues its progress toward fully implementing all elements of the plan for the Small Business Investment Companies (SBIC) and Section 504 programs. OLO will coordinate with the Investment Division to set up policies and training for participants. Both the implementation of the plan and the training are scheduled to be achieved by March 2003. The Agency has increased staffing for both the OLO and the Investment Division.

Assessment: The OLO appears to be fully addressing the elements of its strategic plan for the Section 7(a) program and has started to address elements of the plan for the SBIC and Section 504 programs. All aspects of this element are expected to be completed by March 2003.

Actions: *Risk Identification*

Status: Systematic processes exist for estimating financial risk by loan or investment and participant, and some improvements have been made since our last review. The Investment Division developed and implemented an SBIC Risk Assessment Profile (RAP) system to measure five categories of financial risk for each SBIC. Improvements in this area are expected to be completed by June 2003.

Systematic processes also exist for measuring the level of compliance risk. The OLO engaged a contractor to analyze the feasibility of redesigning the lender oversight process to ensure that all elements of the strategic plan are implemented and has received the lender's report. Improvements in this area are expected to be completed by September 2004.

Assessment: An ongoing audit of SBIC Oversight indicates that policies and procedures in the Investment Division do not limit financial risk. OIG has tentatively concluded that existing guidance was not adequate because it was outdated, did not require a potential for recovery analysis, did not address restrictive operations, did not require consistent use of forbearance, and did not provide a systematic approach for transferring capitally impaired SBICs with participating securities to liquidation status. The auditors found that the Division's ability to limit risk was restricted by the forbearance regulations.

The proposed plans for measuring financial and compliance risk for the Section 7(a) and Section 504 programs appear acceptable. However, no specific actions were stated by management for addressing the measurement of compliance risk for the SBIC program.

The estimated completion date of September 2004 for developing a system to measure overall program risk is almost 2 years away. An interim process needs to be developed until the desired system is finalized

Actions: *Policies and Procedures*

Status: Standard Operating Procedures (SOP) for the redesigned oversight process for Section 7(a) loans were completed. Policies for the Section 504 program and the SBIC program are estimated to be in place by June 2003.

Assessment: The scheduled completion dates appear reasonable.

Actions: *Communications*

Status: Development of the Loan Monitoring System is in process and, as previously stated, should be completed by September 2004. The OLO has taken steps to improve the

communication between the Office of Financial Assistance (OFA) and itself and will take steps to have better communication with the Investment Division. The expected date of completion for these actions is December 2002.

Assessment: A recent GAO report stated that "SBA's current structure does not adequately support lender oversight." In the report, GAO expressed concerns about the fact that the OLO shares oversight responsibility with the OFA and stated that the current organizational structure created a potential conflict of interest or the appearance of a conflict. The reports states that SBA is considering having the OLO report directly to SBA's chief operating officer. We agree with the GAO analysis and agree that the contemplated relocation of the OLO would better serve the lender oversight mission and remove the appearance of a conflict of interest.

Actions: *Monitoring*

Status: Action has been implemented for the Section 7(a) and SBIC programs, and is in progress for the Section 504 Program. The actions should be completed by June 2003.

Assessment: Our audit of SBIC Oversight showed that, while there is a periodic review of each lender that attempts to assess financial and compliance risk, the elements of the review are not sufficient to ascertain properly SBA's level of risk. The review does not specifically evaluate SBA's ability to recover outstanding leverage, nor have compliance standards been set to measure how much and SBIC is in or out of compliance.

Reports

GAO, *Continued Improvements Needed in Lender Oversight*, Report 03-90, December 2002

SBA OIG, Impact *of Loan Splitting on Borrowers and SBA*, Advisory Memorandum Report #2-31, September 30, 2002.

SBA OIG, *Improvements needed in SBLC Oversight*, Advisory Memorandum Report, #2-12, March 20, 2002

SBA OIG, *Preferred Lender Oversight Program,* Audit Report # 1-19, September 27, 2001.

SBA OIG, *SBA Follow-up on SBLC Examinations*, Audit Report # 1-16, August 17, 2001.

Challenge 7. The Section 8(a) Business Development program needs to be modified so that: (i) more participating companies receive access to business development, and (ii) standards for determining economic disadvantage are clear and objective, so that more eligible companies receive 8(a) contracts.

Summary - *The Agency needs to give greater emphasis to business development assistance, develop new standards for determining economic disadvantage to effectively measure diminished capital and credit opportunities–the definition of success included in the law, and ensure a more equitable distribution of contracting opportunities to program participants. The bulk of the dollar value of Section 8(a) Business Development (BD) contracts goes to a relatively small number of companies in the program. The Agency should (1) redefine "economic disadvantage" using objective, quantitative, qualitative, and other criteria that effectively measure capital and credit opportunities; and (2) provide sufficient training to SBA staff responsible for evaluating companies.*

Actions Needed	Progress
Refocus the Section 8(a) BD program to emphasize business development.	3
Develop criteria defining "business success."	3
Graduate participants once they reach those levels defined as "business success."	3
Develop a mechanism that ensures contracting opportunities are more equitably distributed to Section 8(a) BD program participants.	3
Redefine "economic disadvantage" using objective, quantitative, qualitative, and other criteria that effectively measure capital and credit opportunities.	3
Provide sufficient financial and analytical training to business opportunity specialists to enable them to evaluate a company's business profile and competitive potential.	3

Legend:
1–Green-Implemented
2–Yellow-Progress being made
3–Red-Not implemented/no substantial progress

Background

The purpose of the Section 8(a) BD program is to assist eligible small disadvantaged business concerns to compete in the American economy through business development. A small number of Section 8(a) BD program participants obtain significant contract awards, while others receive little or no contract benefit. We believe that this occurs, in part, because SBA has not placed sufficient emphasis on business development activities to enhance the ability of Section 8(a) BD participants to compete for contracts and does not adequately ensure that only companies owned by economically disadvantaged owners remain in the 8(a) BD program. In addition, an ever-

changing Federal contracting arena, coupled with other socio-economic factors, has created an environment where reengineering of the Section 8(a) BD program is needed.

The Federal Acquisition Streamlining Act of 1994 streamlined the Federal Government's $200 billion a year acquisition system and dramatically changed the way the Government buys its goods and services. The Federal Government is seeing an increase in larger contracts that often are not suitable for small businesses to perform as prime contractors. Agencies are also using streamlined procurement practices such as multiple award contracts, Government-wide acquisition contracts, Federal supply schedules, and credit card purchases. At the same time, the Section 8(a) BD program contract mechanisms have not been modernized to work with the new acquisition methods authorized by procurement reform.

The Small Business Act requires that participants be socially and economically disadvantaged, and defines "economic disadvantage" as "diminished capital and credit opportunities compared to owners of similar businesses that are not disadvantaged." SBA, however, has not adequately determined what constitutes diminished capital and credit opportunities. Section 8(a)(6)(A) of the Small Business Act states that "[i]n determining the degree of diminished credit and capital opportunities, the Administration shall consider, but not be limited to, the assets and net worth of such socially disadvantaged individual[s]." According to SBA regulations, when considering diminished capital and credit opportunities, SBA is to review such factors as personal income, personal net worth, and the fair market value of all assets. SBA is also to compare the financial condition of the company with other small businesses in the same primary industry classification. While SBA obtains information on a number of factors when determining economic disadvantage, such as comparisons with Robert Morris Associates figures for businesses, it relies primarily on the net worth of the individual. Net worth by itself, however, does not show whether an individual has diminished capital and credit opportunities.

SBA regulations allow individuals with a net worth of up to $750,000 (after excluding the equity in their home and Section 8(a) Business Development (BD) business) to remain in the program and be classified as economically disadvantaged. The $750,000 limit appears to have been set without the use of empirical data. Further, an SBA review found that many Agency employees did not possess the range of skills required to conduct financial analyses. Participants may therefore receive benefits for which they do not qualify.

According to SBA officials, defining and implementing standards for determining economic disadvantage of the individual has been time consuming and ineffective in accomplishing its intended goal of ensuring that adequate Government resources were afforded to developing firms. SBA officials believe that in the post-Federal Acquisition Streamlining Act/Federal Acquisition Reform Act era, economic disadvantage is dated, ineffective, and largely inapplicable to the essential goal of the Section 8(a) BD program, which is the development of firms.

During FY 2001, almost 7,000 companies participated in the Section 8(a) BD program. However, 50 percent ($3 billion) of the dollar value of the contracts and modifications went to just 189 companies. Each of the top 10 companies (in terms of dollar value of Section 8(a) BD contracts and modifications) received an average of almost $63 million in Section 8(a) BD

contracts and modifications in FY 2001, with one company receiving almost $131 million (2.2 percent of the total). At least 4,000 Section 8(a) BD companies were not awarded any contracts or modifications during the same period. Program officials note, however, that the Section 8(a) BD Program does not guarantee every participating firm will receive a contract during each year of its participation. These officials reported that approximately 70 percent of Section 8(a) firms have received at least one contract during their tenure in the program, which can extend up to 9 years.

Significant Open Recommendations

A recommendation from the September 1994 audit report to modify the criteria used for determining one aspect of economic disadvantage has still not been implemented. While various recommendations have been made and implemented which address segments of economic disadvantage, SBA has not clarified the definition of economic disadvantage using objective, quantitative, qualitative, and other criteria that effectively measure capital and credit opportunities.

Current Agency Status

In January 2002, the Working Group of a task force began work to restructure the 8(a) Business Development program, enhance delivery of business development assistance, make the contracting assistance more comparable with today's Federal procurement environment, and ensure a more equitable distribution of program business. A key component of the proposed restructured program is the development of a two-stage approach to business development and training of 8(a) program participants with a focus on business development in stage 1 and contracting assistance with continued business development in stage 2. The primary objective of the program is to develop 8(a) firms so that they can be competitive in the Federal marketplace. A report on the major recommendations to restructure the program should be completed by the end of December 2002. This report is being reviewed by senior management.

A second task force was assembled concerning the issue of economic disadvantage. This task force met on several occasions. Final guidance is being drafted in the form of a procedural notice, which should be completed by December 31, 2002.

OIG Assessment of Status

At this time, no product from either task force has been approved. If we agree with the task forces' recommendations, these recommendations are accepted and implementation begins, our assessment of progress on all but the last action needed for this challenge will change to "progress being made."

Reports

SBA OIG, *Section 8(a) Program Continuing Eligibility Reviews*, Audit Report #4-3-H-006-021, September 30, 1994.

Challenge 8. SBA needs to clarify its rules intended to deter Section 8(a) Business Development participants from passing through procurement activity to non-Section 8(a) Business Development firms.

Summary - *SBA's rules, while restricting the amount of a contract that a Section 8(a) Business Development (BD) firm may pass through to a non-Section 8(a) firm, allow many non-participating companies to receive substantial financial benefit. SBA intends to include value-added resellers as a legitimate industry under the North American Industry Classification System. SBA needs to tighten the definition of "manufacturing" to preclude the pass-through practice of making only minor modifications to the products of large and other manufacturers.*

Action Needed	Progress
Tighten the definition of "manufacturing" to preclude the practice of making only minor modifications to the products of large and other manufacturers.	2

Legend:
1–Green-Implemented
2–Yellow-Progress being made
3–Red-Not implemented/no substantial progress

Background

The Section 8(a) BD program is intended to be used exclusively for business development purposes to help small businesses owned by "socially" and "economically" disadvantaged persons compete on an equal basis in the mainstream of the American economy. To ensure that the business development aspects of the program accrue to its intended participants, SBA has rules to restrict the amount of a Federal contract that may be performed by a non-participant. Nevertheless, OIG audits have found that many non-Section 8(a) BD companies benefit from the program.

An SBA rule requires that supply contracts be filled either by the manufacturer of the end product or by a company that meets SBA's criteria for a "non-manufacturer." SBA's definition of a manufacturer, however, has been interpreted to allow a small business to make only a minor modification to a finished product manufactured by another company. The product that is manufactured by the non-Section 8(a) BD company is considered to be a "basic material" for the new product. Therefore, the Section 8(a) BD company is credited with creating a new product. This occurs frequently with computer equipment, and OIG audits have found instances where 80 percent or more of the contract costs are realized by large computer manufacturers. Agency officials stated that a company providing such work should be classified as a "Value Added Reseller" instead of a "Manufacturer." Typically, according to these officials, these procurements require the contractor to "modify" or "add value" to a finished product by enhancing its functionality and features.

A June 1998 OIG audit report recommended that SBA "provide definitive guidance and definitions to evaluate the manufacturing criteria at 13 CFR 121.406." The Agency agreed with

the recommendation and stated that it planned to solicit comments from the business community and have specific discussions with businesses in computer-related industries. As of January 2003, SBA still had not clarified the manufacturing criteria.

Significant Open Recommendations

The recommendation from the June 1998 audit report to provide definitive guidance and definitions to evaluate the manufacturing criteria at 13 CFR 121.206 has not been implemented.

Current Agency Status

The Office of Government Contracting and Business Development (GCBD) developed a proposed regulation that includes a new size standard for value added resellers. On July 24, 2002, the proposed rule was published for public comment and over 300 comments were received. The Office of Size Standards analysts are reviewing the comments. A final regulation should be promulgated by February 2003.

OIG Assessment of Status

In addition to the above proposed regulations, GCBD developed proposed changes to 13 CFR to tighten the definition of "manufacturing" to preclude the pass-through practice of making only minor modifications to the products of manufacturers. These changes will be included in the Size Regulation that is in SBA clearance. These proposed changes, if properly administered, could resolve this management challenge. After the proposed changes are implemented, we will determine whether this issue has been resolved.

Reports

SBA OIG, *NOAA Computer Workstation Contracts*, Audit Report #87H002017, June 18, 1998.

Challenge 9. Preventing loan fraud requires additional measures, including new regulations and funding.

Summary – *OIG studies have demonstrated that fraud in the business loan program could be reduced by obtaining criminal background information on prospective borrowers and on loan packagers and other for-fee agents. Specific statutory authority exists to perform background checks on prospective borrowers. OIG believes that the statutory framework already exists for SBA to require background information of loan agents.*

Actions Needed	Progress
Within Privacy Act constraints, SBA requires all loan agents to provide the Agency with the information and releases necessary to conduct criminal background checks.	3
SBA informs loan agents that SBA may conduct criminal background checks on them and that they are subject to future OIG reviews.	3
SBA systematically identifies all loan agents and tracks their association with individual loans. This process would include maintaining identifying data and background information on loan agents.	3
SBA obtains sufficient funding to identify and track loan agents systematically.	3
SBA changes its policy to advise all prospective borrowers that they may be subject to criminal background checks.	3
SBA obtains sufficient funding to enable the Agency and OIG to perform criminal background checks on prospective borrowers and loan agents in a timely manner.	3

Legend:
1–Green-Implemented
2–Yellow-Progress being made
3–Red-Not implemented/no substantial progress

Background

OIG studies have demonstrated that obtaining additional background information from loan agents and prospective loan borrowers could reduce the incidence of fraudulent loans. While the fraud identified thus far is a small percentage of SBA's total portfolio, the dollar amounts are significant.

A. <u>Loan Agents</u> - Loan agents provide referral and loan application services to prospective borrowers or lenders for a fee. Some agents, particularly loan packagers, have been involved in a variety of fraudulent schemes, such as submitting false tax returns or other financial data, charging the borrower excessive fees, using fictitious names on SBA forms, exaggerating their ability to obtain loan approval, acting in illegal collusion with officials of lending institutions, conspiring with borrowers to submit false loan packages, and performing other illegal acts.

These schemes, which have been used by various agents, have resulted in borrower defaults causing loan purchases by SBA and, ultimately, losses to the taxpayers.

B. <u>Borrowers in Business Loan Programs</u>: OIG work has shown that borrowers who do not disclose their criminal histories have higher rates of default on SBA loans than those who either disclose their records or have no criminal histories. SBA currently performs criminal history checks, but only if prospective borrowers voluntarily disclose past criminal violations. As a result, the Agency does not always identify individuals with criminal histories and this results in higher losses to SBA.

Current Agency Status

The agency has responded that the Office of Financial Assistance will work with the Office of General Counsel to determine the agency's legal authority to collect the information requested by the OIG.

OIG Assessment of Status

To implement the action to inform loan agents that SBA will conduct criminal background checks on them and that they are subject to future reviews, it is necessary to change existing forms and to clarify through formal legal opinions the agency's authorities. In addition, SBA needs to identify the extent of loan agent involvement in its programs by maintaining a database of agents and the loans with which the agents are associated. Further, SBA needs to change its policy on possible criminal background checks on borrowers. The agency must identify actions necessary to resolve current vulnerabilities to fraud in the loan programs.

Reports

SBA OIG, *Applicant Character Verification in SBA's Business Loan Program*, April 5, 2001.

SBA OIG, *Summary Audit of Section 7(a) Loan Processing*, Audit Report #0-03, January 11, 2000.

SBA OIG, *Loan Agents and the Section 7(a) Program,* Inspection Report #98-03-01, March 31, 1998.

SBA OIG, *Fraud Detection in SBA Programs*, Inspection Report #97-11-01, November 24, 1997.

SBA OIG, *Operation Cleansweep Memorandum,* August 21, 1996.