

EVALUATION REPORT

SBA's FY 2014 Compliance with the Improper Payments Elimination and Recovery Act





EXECUTIVE SUMMARY

SBA's FY 2014 Compliance with the Improper Payments Elimination and Recovery Act

What OIG Reviewed

This report represents the results of the Office of Inspector General's (OIG) evaluation of the Small Business Administration's (SBA or Agency) compliance with the Improper Payments Elimination and Recovery Act (IPERA).

Our objectives were to (1) assess progress SBA made in remediating improper payment-related recommendations and (2) determine whether SBA complied with IPERA reporting requirements using guidelines outlined in the Office of Management and Budget (OMB) Memorandum M-15-02, Appendix C to Circular No. A-123, *Requirements for Effective Estimation and Remediation of Improper Payments*.

To achieve our objectives, we assessed controls SBA has implemented to address prior-year OIG recommendations and evaluated whether SBA mitigated those risks. We also assessed SBA's efforts to prevent and reduce improper payments and reviewed the accuracy and completeness of improper payment disclosures in the 2014 *Agency Financial Report* (AFR).

What OIG Found

Our overall qualitative review of Agency efforts to prevent and reduce improper payments showed that SBA continued to make progress in its efforts to prevent and reduce improper payments.

Specifically, our review of SBA's improper payment disclosures in the AFR and supporting documents showed that SBA still needs to make some improvements to effectively develop SBA improper payment controls and processes for Hurricane Sandy disaster relief grants and 7(a) loan guaranty purchases. Specific areas include ensuring reported improper payment rates are accurate, and test plans are complete.

Our review found that SBA was not compliant with IPERA reporting requirements in accordance with OMB Memorandum M-15-02 because the improper payment rate for the Disaster Assistance loan disbursements exceeded the 10 percent threshold, and 7(a) guaranty loan approvals did not meet their annual reduction target.

However, in accordance with OMB's memorandum, SBA published, and posted an AFR on its website, conducted program-specific risk assessments, published improper payment estimates for all programs and activities identified as susceptible to significant improper payments, published extracts from the applicable programmatic corrective action plans in the AFR, reported a gross improper payment rate of less than 10 percent for 5 of 6 areas tested for FY 2014 reporting, and published and met the annual reduction target for 5 of the 6 areas tested.

OIG Recommendations

We made six recommendations to improve the effectiveness of improper payment controls over Hurricane Sandy technical assistance grants and Section 7(a) loan guaranty purchases.

Agency Comments

SBA agreed with our findings and will implement actions to address the recommendations.

Actions Taken

To improve the effectiveness of improper payment controls over Hurricane Sandy technical assistance grants, SBA plans to develop a more robust test plan and provide training for staff that performs the improper payment review. SBA is also in the process of refining its guidelines and protocols for disasters to incorporate lessons learned from Hurricane Sandy to mitigate the underlying causes of improper payments. Additionally, for 7(a) loan guaranty purchases, SBA plans to revise NGPC's checklist to include the necessary detail to ensure a thorough review of creditworthiness and repayment ability.



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

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SUBJECT: *SBA's 2014 Compliance with the Improper Payments Elimination and Recovery Act*

This report presents the results of our evaluation report on the *Small Business Administration's 2014 Progress in Reducing Improper Payments in accordance with the Improper Payments Elimination and Recovery Act (IPERA)*. Our objectives were to (1) assess progress SBA made in remediating improper payment-related recommendations and (2) determine whether SBA complied with IPERA reporting requirements using guidelines outlined in OMB Memorandum M-15-02, Appendix C to Circular No. A-123, *Requirements for Effective Estimation and Remediation of Improper Payments*.

The report contains six recommendations that SBA agreed to implement. Please provide us within 90 days your progress in implementing the recommendations.

We appreciate the courtesies and cooperation extended to us during this audit.

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Table of Contents

Introduction.....	1
Prior Work.....	2
Objectives.....	3
Results.....	4
Section 1: Hurricane Sandy Disaster Relief Grants.....	4
Background.....	4
Assessment of Agency Efforts.....	4
AFR Review.....	5
Recommendations.....	6
Analysis of Agency Response.....	6
Section 2: Section 7(a) Loan Guaranty Approvals.....	8
Background.....	8
Assessment of Agency Efforts.....	8
AFR Review.....	9
Analysis of Agency Response.....	9
Section 3: Section 7(a) Loan Guaranty Purchases.....	10
Background.....	10
Assessment of Agency Efforts.....	10
AFR Review.....	11
Recommendations.....	12
Analysis of Agency Response.....	12
Section 4: Section 504 Loan Guaranty Approvals.....	13
Background.....	13
Assessment of Agency Efforts.....	13
AFR Review.....	13
Analysis of Agency Response.....	14
Section 5: Disbursements for Goods and Services.....	15
Background.....	15
Assessment of Agency Efforts.....	15
AFR Review.....	16
Analysis of Agency Response.....	16
Section 6: Disaster Assistance Loan Disbursements.....	17
Background.....	17
Assessment of Agency Efforts.....	17
AFR Review.....	18
Analysis of Agency Response.....	18

Appendix I: Scope and Methodology	19
Use of Computer-Processed Data.....	19
Nature of Limited or Omitted Information	19
Prior Coverage	20
Appendix II: Agency Comments	21

Introduction

This report represents the results of our evaluation of the Small Business Administration's (SBA or Agency) compliance with requirements of the Improper Payments Elimination and Recovery Act (IPERA or the Act). This law was enacted on July 22, 2010, and the Office of Management and Budget (OMB) issued implementing guidance in Memorandum M-15-02, Appendix C to Circular No. A-123, *Requirements for Effective Estimation and Remediation of Improper Payments* (M-15-02). Part II (A) of OMB Memorandum M-15-02 requires each Office of Inspector General (OIG) to annually review its agency's improper payments reporting in the Performance and Accountability Report (PAR) or Agency Financial Report (AFR).

SBA has five programs or activities that are subject to improper payment reporting: grant programs that received Hurricane Sandy disaster relief funds (new in 2014,), Section 7(a) and Section 504 Certified Development Company (CDC) Loan Guaranty Programs, disbursements related to goods and services, and the Disaster Loan Program. The Small Business Investment Company Program, a major credit program, obtained relief from reporting due to the low occurrence of improper payments as determined by several years of review and the continued low probability for improper payments as determined by the 2014 risk assessment.

The Agency offers and guarantees a variety of loans for very specific purposes. During FY 2014, SBA supported nearly \$29 billion in lending through the Section 7(a) and Section 504 Loan Guaranty Programs that supported more than 51,000 companies, and loan approvals totaling \$332 million for all disaster activity. For FY 2014 improper payment reporting, the Agency also disbursed \$93 million to contractors and vendors for services rendered and \$1.1 million in Hurricane Sandy disaster relief grants.

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

An improper payment is any payment that should not have been made or that was made in an incorrect amount under statutory, contractual, administrative, or other legally applicable requirements. Incorrect amounts are overpayments or underpayments that are made to eligible recipients (including inappropriate denials of payment or service, any payment that does not account for credit for applicable discounts, payments that are for an incorrect amount, and duplicate payments). An improper payment also includes any payment that was made to an ineligible recipient or for an ineligible good or service, or payments for goods or services not received (except for such payments authorized by law). In addition, when an agency's review is unable to discern whether a payment was proper as a result of insufficient or lack of documentation, this payment must also be considered an improper payment.

OMB guidance provides that each OIG should annually review the agency's improper payments reporting within 180 days of the agency issuing the AFR. In accordance with the guidance, the Inspector General evaluates the accuracy and completeness of the agency's reporting in the AFR. OMB also requested that OIG evaluate the agency's performance in reducing and recapturing improper payments and report on recommendations for actions to further improve the agency's or program's performance in reducing improper payments. In doing so, we performed a qualitative assessment of SBA's progress in meeting the following criteria:

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

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

- Posted materials—Published a PAR or AFR for the most recent fiscal year and posted that report and any accompanying materials required by OMB on the agency website;
- Assessed risks—Conducted a program-specific risk assessment for each applicable program or activity that conforms with Section 3321 note of Title 31 U.S.C. (if required);
- Published estimates for susceptible programs—Published improper payment estimates for all programs and activities identified as susceptible to significant improper payments under its risk assessment(if required);
- Published programmatic corrective action plans in the AFR or PAR (if required);
- Met annual reduction target—Published and met annual reduction targets for each program assessed to be at risk and measured for improper payments (if required and applicable);¹ and
- Reported rate of less than 10 percent—Reported a gross improper payments rate of less than 10 percent for each program and activity for which an improper payment estimate was obtained and published in the AFR or PAR.

If an agency does not meet one or more of these requirements, then it is not compliant under IPERA.

In addition, the agency should report information on its efforts to recapture improper payments.

Prior Work

Prior OIG audits have identified high percentages of disaster and business loans that were made to borrowers who were ineligible, lacked repayment ability, or did not provide sufficient documentation to justify the approval or disbursement. Those audits further determined that the improper payment rates reported for these programs were significantly understated.

In 2014, OIG issued [Report 14-11, SBA’s Progress in Complying with the Improper Payments Elimination and Recovery Act](#), stating that SBA was generally compliant in meeting the minimum IPERA reporting requirements in its [AFR for FY 2014](#). However, our qualitative review of the Agency’s efforts to prevent and reduce improper payments showed that SBA needs to improve the effectiveness and development of improper payment controls and processes for most of the programs or activities reviewed. Specific areas included completeness of test plans, quality of corrective action plans, and sufficiency of improper payment recapturing activities.

¹ A program will have met a reduction target if the improper payment rate for that program in the current year falls within plus or minus 0.1 percentage points of the reduction target set in the previous year’s AFR or PAR.

Objectives

Our objectives were to (1) assess progress SBA made in remediating improper payment-related recommendations; and (2) determine whether SBA complied with IPERA reporting requirements using guidelines outlined in OMB Memorandum M-15-02.²

² See Appendix I for a discussion on our scope and methodology.

Results

The following six sections summarize OIG's (1) assessment of SBA's accuracy and completeness of reporting, and performance in reducing and recapturing improper payments; and (2) OIG's review of SBA's disclosure in the AFR under OMB Memorandum M-15-02 by reporting segment. In addition, we assessed the status of OIG's unresolved prior year audit recommendations, which focused on the accuracy and completeness of SBA's reporting, and performance in reducing and recapturing improper payments. Due to our limited procedures, we did not assess whether specific program reported rates were accurate.

Section 1: Hurricane Sandy Disaster Relief Grants

Background

On October 29, 2012, Hurricane Sandy devastated portions of the Mid-Atlantic and Northeast United States. In response to the storm, on January 29, 2013 Congress enacted the Disaster Relief Appropriations Act of 2013 (DRAA). SBA was appropriated \$20 million under DRAA to provide technical assistance to small businesses recovering from Hurricane Sandy.³ Within SBA, the Office of Entrepreneurial Development (OED) managed these grants. OED oversees a nationwide network of programs and services that support the training and counseling needs of small businesses. OED's resource partners include Small Business Development Centers (SBDC), Women's Business Centers (WBC), and the SCORE Association located nationwide. In April 2013, OED began awarding Hurricane Sandy technical assistance grants to its resource partners through two rounds of funding that totaled \$5,811,000 for the first round (Phase 1), and \$13,189,000 for the second round (Phase 2).

Assessment of Agency Efforts

OIG evaluated the Agency's reporting accuracy and completeness, as well as its performance in reducing and recapturing improper payments. We determined that SBA needs to take immediate management action to meet IPIA and IPERA requirements.

Specifically, the improper payments test plan for Hurricane Sandy technical assistance grants was inadequate and did not provide reasonable assurance of detecting improper payments within the program. The steps within the improper payments test plan were not sufficiently detailed to guide personnel performing the review in the identification of improper payments, and additional steps were also required. For example, SBA's payment process requires a program manager to review the payment package before payment. However, the test plan did not include a step to review whether program managers reviewed and approved the payment package before a payment was disbursed.⁴ Further, personnel who performed the Agency's improper payment review did not execute and consistently apply all steps within the test plan. Specifically, in one instance, a reviewer modified the test plan by deleting certain steps and adding others. To mitigate the risk of not detecting improper payments, the Agency should develop a more robust test plan and provide training to personnel assigned to perform the improper payments reviews.

³ Sequestration resulted in the Agency's apportionment to be \$19 million.

⁴ OIG confirmed SBA's payment process for Hurricane Sandy disaster relief grants with officials within OED.

As part of our review, we selected a sample of 4 of the 19 payments reviewed by SBA personnel for any improper payments pertaining to Hurricane Sandy technical assistance grants. Within our sample, SBA did not identify any errors within the four grant payments we reviewed. However, we found multiple errors within these payments, including:

- \$840,000 payment to SCORE that included \$168,000 of unallowable indirect costs; and
- \$96,133 payment to an SBDC that was not reviewed by a program manager.

SBA reported an improper payment rate of 3 percent or \$165,642. However, while the Agency found and reported a 3 percent improper payment rate for this program, it may have understated its rate because reviewing personnel did not identify payment errors and related opportunities for correcting those errors. With an improved test plan and training, reviewing personnel may have been better equipped to identify the additional errors that we noted above. Although SBA was not required to prepare a corrective action plan—because it reported improper payments less than \$10 million in its AFR—doing so would prevent and reduce the risk of improper payments in the future. The results of OIG’s evaluation of Agency efforts are summarized in the table below.

Table 1. OIG's Evaluation of Agency Efforts

OMB Criteria	Status at End of 2014
Overall assessment of Agency efforts	■
Accuracy & completeness of Agency reporting	■
Performance in reducing/recapturing improper payments	N/A ⁵
Quality of corrective action plans	N/A ⁶

Legend: Implemented Substantial Progress Progress Needs Immediate Management Attention

AFR Review

Our review of the AFR found that SBA was fully compliant with IPERA reporting requirements. However, due to the additional improper payments identified during our review, the improper rate could be above 10 percent.

Table 2. OIG's Review of the AFR

OMB Reporting Requirement	Status at End of 2014
Posted materials	<input checked="" type="checkbox"/>
Assessed risk	<input checked="" type="checkbox"/>
Published estimates for susceptible programs	<input checked="" type="checkbox"/>
Published programmatic corrective action plans	N/A ⁶
Met annual reduction target	N/A ⁵
Reported rate of less than 10 percent	<input checked="" type="checkbox"/>
Reported recapture information	N/A ⁵

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

⁵ This step was not applicable because Hurricane Sandy grants were a new area for this year’s IPERA review. Additionally, SBA determined that this program would not benefit from a recapture audit.

⁶ Corrective action plans were not produced because SBA reported improper payments of less than \$10 million. However, SBA included corrective actions in the AFR.

Recommendations

We recommend that the Associate Administrator for Entrepreneurial Development:

1. Recover \$168,000 of unallowable indirect costs from SCORE.
2. Develop and implement a more robust test plan that provides reasonable assurance of detecting improper payments for Hurricane Sandy technical assistance grants for FY 2015 improper payment reporting.
3. Provide training to SBA personnel responsible for developing the test plan and performing the Agency's improper payment review for Hurricane Sandy technical assistance grants to ensure the detection of improper payments.
4. Develop and implement a corrective action plan that includes the underlying causes of the improper payments identified by OIG in its review of FY 2014 Hurricane Sandy technical assistance grants.

Analysis of Agency Response

SBA management provided formal comments, which are included in their entirety in Appendix II. The following provides a summary of management's comments and the actions necessary to close the report.

The Office of Entrepreneurial Development (OED) appreciated the opportunity to respond to the draft report and agreed with all four of our recommendations. OED noted that the technical assistance grants for Hurricane Sandy was unprecedented for them and required their personnel to act quickly to disburse payments to individual resource partners and a coalition of resource partners in the impacted communities, using existing program documents.

Summary of OED Actions Necessary to Close the Report

1. Recover \$168,000 of unallowable indirect costs from SCORE.

OED management stated it is working with the Office of General Counsel to address the recommendation, and it proposed implementing this recommendation by December 31, 2015. This recommendation can be closed upon OED providing evidence showing that it remedied the \$168,000 of unallowable indirect costs.

2. Develop and implement a more robust test plan that provides reasonable assurance of detecting improper payments for Hurricane Sandy technical assistance grants for FY 2015 improper payment reporting.

OED management stated it will work with OCFO to develop and implement a more robust test plan for detecting improper payments, and it proposed implementing this recommendation by December 31, 2015. This recommendation can be closed upon OED providing evidence supporting that it developed and implemented a more robust test plan.

3. Provide training to SBA personnel responsible for developing the test plan and performing the Agency's improper payment review for Hurricane Sandy technical assistance grants to ensure the detection of improper payments.

OED management stated it will work with OCFO to provide additional training to personnel responsible for developing the test plan and performing the improper payment review. OED

proposed implementing this recommendation by December 31, 2015. This recommendation can be closed upon OED providing evidence showing that it trained personnel responsible for developing the test plan and performing the improper payment review.

4. Develop and implement a corrective action plan that includes the underlying causes of the improper payments identified by the OIG in its review of the FY 2014 Hurricane Sandy technical assistance grants.

OED management stated it is in the process of refining its guidelines and protocols for disasters to incorporate lessons learned from Hurricane Sandy to mitigate the underlying causes of improper payments. OED proposed implementing this recommendation by December 31, 2015. This recommendation can be closed upon OED providing evidence supporting that its revised guidelines and protocols also addressed the root causes of the improper payments identified by OIG in its review of the FY 2014 Hurricane Sandy technical assistance grants.

Section 2: Section 7(a) Loan Guaranty Approvals

Background

The Agency's largest lending program, the 7(a) Loan Guaranty Program, is SBA's principal vehicle for providing small businesses with access to credit that cannot be obtained elsewhere. This program relies on numerous outside parties (e.g., loan agents, and lenders) to complete loan transactions, with at least 75 percent of loans being made by lenders to whom SBA has delegated loan-making authority. Additionally, SBA has centralized many loan functions and reduced the number of staff performing these functions, placing more responsibility on, and giving greater independence to, its lenders. OIG continues to identify weaknesses in SBA's lender oversight processes. Under the 7(a) Loan Guaranty Program, SBA guarantees up to 90 percent of the principal amount of loans made by banks and other lending institutions to small businesses not able to obtain credit elsewhere. In FY 2014, SBA guaranteed approximately \$19 billion in 7(a) loan approvals.

Assessment of Agency Efforts

OIG evaluated the Agency's reporting accuracy and completeness, as well as its performance in reducing and recapturing improper payments. We determined that SBA had implemented controls to meet IPIA and IPERA requirements.

Specifically, we determined that SBA implemented appropriate testing procedures to assess 7(a) guaranty loan approvals for improper payments in FY 2014. SBA's improper payment rate increased from 4.6 percent or \$511 million in FY 2013 to 5.15 percent or \$605 million in FY 2014. According to Agency officials, this increase is a result of the greater emphasis placed on IPERA training prior to the FY 2014 review, which has enhanced their ability to detect improper payments. Finally, SBA implemented corrective actions to address the root causes of identified improper payments and promote recovery.

SBA reported an improper payment rate of 5.15 percent or \$605 million. The results of OIG's evaluation of Agency efforts are summarized below.

Table 3. OIG's Evaluation of Agency Efforts

OMB Criteria	Status at End of 2014
Overall assessment of Agency efforts	<input checked="" type="checkbox"/>
Accuracy & completeness of Agency reporting	<input checked="" type="checkbox"/>
Performance in reducing/recapturing improper payments	N/A ⁷
Quality of corrective action plans	<input checked="" type="checkbox"/>

Legend: Implemented Substantial Progress Progress Needs Immediate Management Attention

⁷ SBA has determined that payment recapture audits for this program would not be cost effective.

AFR Review

Our review of the AFR found that SBA was fully compliant with most IPERA reporting requirements. However, the improper payment estimate increased from 4.6 percent, or \$511 million, in FY 2013 to 5.15 percent, or \$605 million, in FY 2014. As a result, SBA did not meet its planned reduction target of 4.0 percent for the program. The results of OIG's review are summarized below.

Table 4. OIG's Review of the AFR

OMB Reporting Requirement	Status at End of 2014
Posted materials	☑
Assessed risk	☑
Published estimates for susceptible programs	☑
Published programmatic corrective action plans	☑
Met annual reduction target	■
Reported rate of less than 10 percent	☑
Reported recapture information	☑

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

Analysis of Agency Response

The Office of Capital Access (OCA) appreciated the opportunity to respond to the draft report. OCA values OIG's acknowledgement of OCA's efforts in improving and implementing testing procedures, enhancing corrective action plans to identify root causes of identified improper payments, and its additional progress towards meeting the IPERA and IPIA requirements.

Management concurred with OIG's evaluation of the Agency efforts related to its reporting accuracy and completeness, as well as its performance in reducing and recapturing improper payments for 7(a) loan guaranty approvals in FY 2014. OCA emphasized that though the internal annual reduction target for 7(a) loan guaranty approvals was not attained in FY 2014, the improper payment rate remained significantly below OMB's prescribed improper payment threshold of 10 percent. Further, OCA will evaluate the future annual reduction targets and continue to make progress in reducing and recapturing improper payments. OIG concurs with OCA's comments.

Section 3: Section 7(a) Loan Guaranty Purchases

Background

When a loan goes into default, SBA will conduct a review of the lender's actions on the loan to determine whether it is appropriate to pay the lender the guaranty, which SBA refers to as a "guaranty purchase." Under its regulations, SBA is released from liability on the guaranty, in whole or in part, within SBA's exclusive discretion, if the lender fails to comply materially with any SBA loan program requirement or does not make, close, service, or liquidate the loan in a prudent manner. The guaranty purchase review is SBA's primary control for ensuring lender compliance and preventing improper payments. OIG continues to identify weaknesses with SBA's 7(a) loan guaranty purchases. In FY 2014, SBA purchased approximately \$832 million in 7(a) loan guarantees.

Assessment of Agency Efforts

OIG evaluated the Agency's reporting accuracy and completeness, as well as its performance in reducing and recapturing improper payments. We determined that SBA made further progress during FY 2014 in meeting IPIA and IPERA requirements.

SBA addressed previous OIG recommendations related to the adequacy of its testing procedures during FY 2014. Specifically, SBA updated its testing procedures to require a detailed analysis of creditworthiness (including repayment ability) on early defaulted regular 7(a) loans in accordance with SBA Standard Operating Procedures (SOP).⁸ Additionally, the test procedures for SBA's Express programs were revised to assess all areas of improper payments previously noted by OIG.⁹ For example, the test procedures now require reviewers to determine whether Express loans complied with SBA requirements related to repayment ability, IRS tax-verification, and business plans.

However, we noted that the FY 2014 testing procedures for regular 7(a) loans at the National Guaranty Purchase Center (NGPC) applied a different checklist than what SBA presented to close out the previous OIG recommendation.¹⁰ Specifically, for early-defaulted loans, the assessment of creditworthiness in the checklist was limited to verifying that the lender's credit memorandum included certain elements.¹¹ Additionally, during FY 2014, we identified an improper payment that SBA did not detect during its IPERA reviews. We identified this improper payment during our assessment of early-defaulted loans under our High Risk 7(a) Loan Review Program. We determined that the lender did not satisfy SBA's change of ownership and repayment ability requirements. As a result, we are concerned that the checklist used during the FY 2014 IPERA review is not sufficient to identify deficiencies in lenders' assessments of repayment ability. To address this concern, we recommend that any checklist used by NGPC to assess improper payments include the necessary detail to ensure a thorough review of creditworthiness (including repayment ability).

⁸ *7(a) Loan Servicing and Liquidation* (SBA SOP 50 57, March 1, 2013).

⁹ *The Small Business Administration's Improper Payment Rate for 7(a) Guaranty Purchases Remains Significantly Underestimated* (OIG [Audit Report 13-07](#), November 15, 2012).

¹⁰ *SBA Generally Meets IPERA Reporting Guidance but Immediate Attention Is Needed to Prevent and Reduce Improper Payments* (OIG [Audit Report 12-10](#), March 15, 2012).

¹¹ These elements include collateral, credit history, credit elsewhere, management, capitalization, and repayment ability.

During FY 2014, SBA implemented corrective actions to address the root causes of identified improper payments and promote recovery. In addition, SBA addressed a previous OIG recommendation related to payment recapture audits. Specifically, SBA determined in FY 2014 that implementing a payment recapture audit process would be cost-effective and that its quality control review process will be expanded to include payment recapture audits in FY 2015.

SBA reported an improper payment rate of 1.33 percent, or \$11.4 million. However, as noted above, we identified a \$413,704 improper payment on a loan included in the FY 2014 IPERA sample reviewed by SBA. Had SBA included the improper payment for this loan in its results, the improper payment rate would have been 1.75 percent, or \$15 million for the program. Further, OIG has conducted two previous audits that assessed the accuracy of SBA's FY 2008 and FY 2011 improper payment rates for 7(a) loan guaranty purchases.¹² OIG determined that the estimated improper payment rates reported by SBA for both years were understated.

As noted above, SBA made further progress in identifying and reducing improper payments. The results of OIG's evaluation of Agency efforts are summarized below.

Table 5. OIG's Evaluation of Agency Efforts

OMB Criteria	Status at End of 2014
Overall assessment of Agency efforts	■
Accuracy & completeness of Agency reporting	■
Performance in reducing/recapturing improper payments	■
Quality of corrective action plans	□

Legend: Implemented Substantial Progress Progress Needs Immediate Management Attention

AFR Review

Our review of the AFR found that SBA was fully compliant with IPERA reporting requirements. However, as noted above, the published estimate for 7(a) loan guaranty purchases was understated.

Table 6. OIG's Review of the AFR

OMB Reporting Requirement	Status at End of 2014
Posted materials	<input checked="" type="checkbox"/>
Assessed risk	<input checked="" type="checkbox"/>
Published estimates for susceptible programs	<input checked="" type="checkbox"/>
Published programmatic corrective action plans	<input checked="" type="checkbox"/>
Met annual reduction target	<input checked="" type="checkbox"/>
Reported rate of less than 10 percent	<input checked="" type="checkbox"/>
Reported recapture information	<input checked="" type="checkbox"/>

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

¹² *The Small Business Administration's Fiscal Year 2008 Improper Payment Rate for the 7(A) Guaranty Loan Program* (OIG [Audit Report 9-16](#), July 10, 2009) and *The Small Business Administration's Improper Payment Rate for 7(a) Guaranty Purchases Remains Significantly Underestimated* (OIG [Audit Report 13-07](#), November 15, 2012).

Recommendations

We recommend that the Director of the Office of Financial Program Operations:

5. Require that any checklist used by NGPC to assess improper payments include the necessary detail to ensure a thorough review of creditworthiness (including repayment ability).
6. Report the revised FY 2014 improper payment estimate for 7(a) loan guaranty purchases in the FY 2015 AFR.

Analysis of Agency Response

The following provides a summary of management's comments and the actions necessary to close the report.

OCA management concurred with OIG's evaluation of Agency efforts related to its reporting accuracy and completeness, as well as its performance in reducing and recapturing improper payments for 7(a) loan guaranty purchases in FY 2014. OCA will evaluate the future annual reduction targets and continue to make progress in reducing and recapturing improper payments.

Summary of OCA Actions Necessary to Close the Report

- 5. Require that any checklist used by NGPC to assess improper payments include the necessary detail to ensure a thorough review of creditworthiness (including repayment ability).**

OCA management stated that they would revise NGPC's checklist to include the necessary detail to ensure a thorough review of creditworthiness and repayment ability. OCA proposed implementing this recommendation by July 4, 2015. This recommendation can be closed upon management providing OIG the revised NGPC checklist.

- 6. Report the revised FY 2014 improper payment estimate for 7(a) loan guaranty purchases in the FY 2015 AFR.**

OCA management stated they will report the revised 2014 improper payment rate for 7(a) guaranty purchases in the 2015 AFR and they will provide a copy of the AFR with the revised language to OIG upon submission to OMB. OCA proposed implementing this recommendation by December 1, 2015. This recommendation can be closed upon management providing the FY 2015 AFR to OIG.

Section 4: Section 504 Loan Guaranty Approvals

Background

SBA's 504 Loan Program provides small businesses with long-term, fixed-rate financing to purchase land, buildings, machinery, and other fixed assets. Economic development organizations, approved by SBA, are known as certified development companies (CDC). CDCs package, close, and service these loans, which are funded through a mix of funds from private sector lenders, proceeds from selling SBA-guaranteed debentures, and borrower equity investment. For the 504 Loan Program, SBA guarantees 100 percent of the principal and interest payments on these debentures. In FY 2014, SBA guaranteed approximately \$4.2 billion in 504 loan approvals.

Assessment of Agency Efforts

OIG evaluated the Agency's reporting accuracy and completeness, as well as its performance in reducing and recapturing improper payments. We determined that SBA had implemented controls to meet IPIA and IPERA requirements. Specifically, we determined that SBA implemented appropriate testing procedures to assess 504 loan approvals for improper payments in FY 2014. Further, SBA implemented corrective actions to address the root causes of identified improper payments and promote recovery.

SBA reported an improper payment rate of 1.09 percent, or \$49.9 million.. The results of OIG's evaluation of Agency efforts are summarized below.

Table 7. OIG's Evaluation of Agency Efforts

OMB Criteria	Status at End of 2014
Overall assessment of Agency efforts	☑
Accuracy & completeness of Agency reporting	☑
Performance in reducing/recapturing improper payments	N/A ¹³
Quality of corrective action plans	☑

Legend: ☑ Implemented ☐ Substantial Progress ■ Progress ■ Needs Immediate Management Attention

AFR Review

Our review of the AFR found that SBA was fully compliant with IPERA reporting requirements.

Table 8. OIG's Review of the AFR

OMB Reporting Requirement	Status at End of 2014
Posted materials	☑
Assessed risk	☑
Published estimates for susceptible programs	☑
Published programmatic corrective action plans	☑
Met annual reduction target	☑
Reported rate of less than 10 percent	☑
Reported recapture information	☑

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

¹³ SBA has determined that payment recapture audits for this program would not be cost effective.

Analysis of Agency Response

OCA management concurred with OIG's evaluation of the Agency efforts related to its reporting accuracy and completeness, as well as its performance in reducing and recapturing improper payments for 504 loan guaranty approvals in FY 2014. OCA will evaluate the future annual reduction targets and continue to make progress in reducing and recapturing improper payments. OIG concurs with OCA's comments.

Section 5: Disbursements for Goods and Services

Background

SBA awards contracts for goods and services to assist in carrying out its mission. SBA made 3,470 disbursements for goods and services—totaling approximately \$93 million—between April 1, 2013 and March 31, 2014. Previous audit work identified instances where SBA inadequately: (1) planned and defined its requirements for the procurement of IT products and services, and (2) monitored contract performance to ensure that products and services are delivered according to contract requirements.

Assessment of Agency Efforts

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

We found that the Office of Internal Controls personnel within the Office of the Chief Financial Officer continued using the same overall methodology and improper payment review process, but they further refined their testing procedures to improve their improper payment review process in FY 2014. Since last year's assessment, Agency contracting officers, contracting officer technical representatives, and accounts payable staff received training on how to review an invoice. Continued efforts by SBA to train staff may have led to the decrease in the improper payment rate from 11.6 percent to 8.46 percent. SBA also fully implemented four unresolved, prior year recommendations.

SBA reported an improper payment rate of 8.46 percent or \$7.8 million. The results of OIG's evaluation of Agency efforts are summarized below.

Table 9. OIG's Evaluation of Agency Efforts

OMB Criteria	Status at End of 2014
Overall assessment of Agency efforts	<input type="checkbox"/>
Accuracy & completeness of Agency reporting	<input type="checkbox"/>
Performance in reducing/recapturing improper payments	N/A ¹⁴
Quality of corrective action plans	N/A ¹⁵

Legend: Implemented Substantial Progress Progress Needs Immediate Management Attention

¹⁴ SBA has determined that payment recapture audits for this program would not be cost effective.

¹⁵ Since SBA reported improper payments of less than \$10 million, a corrective action plan was not required.

AFR Review

Our review of the AFR found that SBA was fully compliant with IPERA reporting requirements.

Table 10. OIG's Review of the AFR

OMB Reporting Requirement	Status at End of 2014
Posted materials	☑
Assessed risk	☑
Published estimates for susceptible programs	☑
Published programmatic corrective action plans	☑
Met annual reduction target	☑
Reported rate of less than 10 percent	☑
Reported recapture information	☑

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

Analysis of Agency Response

OCFO management appreciated OIG's acknowledgement of the substantial progress the Agency made in meeting IPIA and IPERA requirements for the disbursements for goods and services as well as their efforts to close four unresolved prior year recommendations. OCFO plans to continue to work on improving their processes and procedures to reduce improper payments. OIG concurs with OCFO's comments.

Section 6: Disaster Assistance Loan Disbursements

Background

The Disaster Loan Program plays a vital role in the aftermath of disasters by providing long-term, low-interest loans to affected homeowners, renters, businesses of all sizes, and non-profit organizations. SBA's current disaster financial assistance portfolio is almost \$6.8 billion. SBA has disaster loan programs that assist with rebuilding uninsured, disaster-damaged property and mitigating the economic effects of a disaster. In FY 2014, SBA approved \$332 million in disaster assistance loans.

Assessment of Agency Efforts

OIG evaluated the Agency's reporting accuracy and completeness, as well as its performance in reducing and recapturing improper payments. We determined that SBA made substantial progress in meeting IPIA and IPERA requirements but has not yet reduced the improper payment rate below 10 percent.

For FY 2014, SBA reported an improper payment rate of 12 percent. This was a significant reduction from the 18.4 percent rate reported the previous year. We noted that the reported 12 percent rate was better than the planned 15 percent target reduction rate for FY 2014.

OIG found that three factors helped improve SBA's improper payment rate. The first factor is that SBA's volume of approved disaster loans was dramatically reduced for FY 2014. In FY 2013, SBA approved \$2.8 billion in disaster loans, primarily due to Hurricane Sandy. This compares to the \$332 million in disaster loan approvals in FY 2014.

The second factor is the multi-layered reviews conducted at the Processing and Disbursement Center (PDC) to identify and prevent improper payments. The first layer of reviews is conducted prior to disbursement on all disbursements of \$100,000 and over. The second layer of reviews is conducted on approved loans regardless of amount, with some reviews occurring prior to the disbursement. A third layer of reviews is targeted for specific issues, like proper documentation of insurance coverage.

The third factor is the implementation of SBA's planned corrective action. SBA has now included reducing improper payments as a rating factor into the annual performance evaluations of all loan processing staff ranging from the loan officers and attorneys to PDC management officials. SBA has also revised and expanded staff training. SBA further added a feature to the Disaster Credit Management System (electronic loan file system) to prevent the disbursement of loan funds when an insurance policy has expired.

SBA reported an improper payment rate of 12 percent or \$70.2 million. The results of OIG's evaluation of Agency efforts are summarized below.

Table 11. OIG's Evaluation of Agency Efforts

OMB Criteria	Status at End of 2014
Overall assessment of Agency efforts	☐
Accuracy & completeness of Agency reporting	☑
Performance in reducing/recapturing improper payments	N/A ¹⁶
Quality of corrective action plans	☑

Legend: ☑ Implemented ☐ Substantial Progress ■ Progress ■ Needs Immediate Management Attention

AFR Review

Our review of the AFR found that SBA was fully compliant with most IPERA reporting requirements. However, SBA reported a 12 percent improper payment rate, which exceeded the 10 percent level necessary to comply with IPERA requirements. The results of OIG's review of the AFR are shown below.

Table 12. OIG's Review of the AFR

OMB Reporting Requirement	Status at End of 2014
Posted materials	☑
Assessed risk	☑
Published estimates for susceptible programs	☑
Published programmatic corrective action plans	☑
Met annual reduction target	☑
Reported rate of less than 10 percent	■
Reported recapture information	☑

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

Analysis of Agency Response

The Office of Disaster Assistance appreciated receiving the draft report and did not have any suggestions or comments on it. However, management stated that it looks forward to generating an improper payment rate of less than 10 percent in FY 2015. OIG concurs with the Office of Disaster Assistance's comments.

¹⁶ SBA has determined that payment recapture audits for this program would not be cost effective.

Appendix I: Scope and Methodology

This report presents the results of our evaluation of SBA's FY 2014 compliance with IPERA. Our objectives were to (1) assess progress SBA made in remediating improper payment-related recommendations and (2) determine whether SBA complied with IPERA reporting requirements using guidelines outlined in OMB Memorandum M-15-02. To perform the evaluation, our scope included an assessment of improper payments that SBA reported for Hurricane Sandy disaster relief technical assistance grants, 7(a) loan guaranty approvals, 7(a) loan guaranty purchases, 504 CDC loan guaranty approvals, disbursements for goods and services, and Disaster Assistance loan disbursements.

To answer our objectives, we assessed the controls SBA has implemented to address prior-year OIG recommendations and evaluated whether SBA addressed required provisions. More specifically, we interviewed SBA officials and reviewed SBA documentation and plans to assess whether SBA complied with identified controls and IPERA provisions. We also assessed records and other documents obtained from SBA officials. We further assessed the Agency's efforts to prevent and reduce improper payments, and reviewed the completeness of improper payment disclosures in the AFR, as specified in OMB guidance. Moreover, we assessed progress the Agency had made against the baseline we established in 2011. Because this was SBA's first year reporting on Hurricane Sandy disaster relief technical assistance grants, we performed limited testing of compliance with identified controls to determine whether the reported improper payment rate was accurate.

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

Use of Computer-Processed Data

We relied on information provided by SBA officials that was extracted from SBA's Electronic Loan Information Processing System (ELIPS), Disaster Credit Management System (DCMS), Oracle Federal Financial System (JAAMS), Guaranty Purchase Tracking System, PRISM Contract Management System, and E-Tran. Previous OIG and independent public accountant audits have verified that the information maintained in those systems is reliable. While we did not conduct reliability tests on the data contained in the universe data, we believe the information is reliable for the purposes of this evaluation.

Nature of Limited or Omitted Information

No information was omitted due to confidentiality or sensitivity, nor were there limitations to information during this evaluation.

Prior Coverage

Small Business Administration-Office of Inspector General Reports

SBA's Progress in Complying with the Improper Payments Elimination and Recovery Act (Report 14-11, April 10, 2014).

Purchase Reviews Allowed \$3.1 Million in Improper Payments on 7(a) Recovery Act Loans (Report 14-09, January 29, 2014).

Purchase Reviews Allowed \$4.6 Million in Improper Payments on 7(a) Recovery Act Loans (Report 13-16R, June 14, 2013).

Evaluation of SBA's Progress in Reducing Improper Payments in FY 2012 (Report 13-13, March 14, 2013).

The Small Business Administration's Improper Payment Rate for 7(a) Guaranty Purchases Remains Significantly Understated (Report 13-07, November 15, 2012).

A Detailed Repayment Ability Analysis is Needed on High-Dollar Early-Defaulted Loans to Prevent Future Improper Payments (Report 12-18, August 16, 2012).

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

SBA Generally Meets IPERA Reporting Guidance but Immediate Attention Is Needed to Prevent and Reduce Improper Payments (Report 12-10, March 15, 2012).

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

Material Deficiencies Identified in Five 7(a) Recovery Act Loans Resulted in \$2.7 Million of Questioned Costs (ROM 11-06, August 25, 2011).

Banco Popular Did Not Adequately Assess Borrower Repayment Ability When Originating Huntington Learning Center Franchise Loans (Report 11-16, July 13, 2011).

America's Recovery Capital Loans Were Not Originated and Closed In Accordance With SBA's Policies and Procedures (ROM 11-03, March 2, 2011).

Material Deficiencies Identified in Early-Defaulted and Early-Problem Recovery Act Loans (ROM 10-19, September 24, 2010).

SBA's Management of the Backlog of Post-Purchase Reviews at the National Guaranty Purchase Center (Report 9-18, August 25, 2009).

The Small Business Administration's Fiscal Year 2008 Improper Payment Rate for the 7(a) Guaranty Loan Program (Report 9-16, July 10, 2009).

Appendix II: Agency Comments



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

Date: May 4, 2015

To: Robert Westbrooks
Deputy Inspector General

Through: Melvin Williams
General Counsel

From: Tami Perriello
Chief Financial Officer
Office of the Chief Financial Officer

Ann Marie Mehlum
Associate Administrator
Office of Capital Access

James E. Rivera
Associate Administrator
Office of Disaster Assistance

Tameka Montgomery
Associate Administrator
Office of Entrepreneurial Development

Subject: Agency Response to SBA's FY 2014 Compliance with the Improper Payments
Elimination and Recovery Act

I. OCFO Response

The Office of the Chief Financial Officer (OCFO) welcomes the opportunity to respond to the draft report "SBA's FY 2014 Compliance with the Improper Payments Elimination and Recovery Act." We appreciate the OIG's acknowledgement of the substantial progress the agency made in meeting IPIA and IPERA requirements for the disbursements for goods and services. We also want to acknowledge the OIG's assistance with our efforts to close four unresolved, prior year recommendations. We will continue to work on improving our processes and procedures to reduce improper payments.

II. OCA Response

The Office of Capital Access (OCA) appreciates the opportunity to respond to the draft report and values the OIG's acknowledgement of OCA's efforts in improving and implementing testing procedures, enhancing corrective action plans to identify root causes of identified improper payments, and its additional progress towards meeting the IPERA and IPIA requirements. OCA concurs with the OIG's evaluation of the agency efforts related to the accuracy and completeness of reporting, as well as its performance in reducing and recapturing improper payments for 7(a) and 504 Loan Guaranty Approvals and 7(a) Loan Guaranty Purchases in Fiscal Year (FY) 2014. OCA would like to emphasize that though the internal annual reduction target for 7(a) Loan Guaranty Approvals was not attained in FY 2014, the improper payment rate remained significantly below OMB's prescribed improper payment threshold of 10 percent. OCA will evaluate the future annual reduction targets and continue to make progress in reducing and recapturing improper payments.

III. ODA Response

The Office of Disaster Assistance (ODA) would like to extend our appreciation for the draft OIG IPERA Evaluation Report. ODA does not have any suggestions or comments on the draft document related to ODA.

As the evaluation report has noted, ODA's extensive internal controls are rapidly reducing the Improper Payment Rate. ODA looks forward to generating an Improper Payment Rate of less than 10% in FY'15. ODA has in place internal controls that will continue to produce an enhanced quality disaster lending program. Again, thank you for the professionalism the OIG staff demonstrated throughout the evaluation.

IV. OED Response

The Office of Entrepreneurial Development (OED) appreciates the opportunity to respond to the draft report. We concur with OIG's recommendations that OED develop and implement a more robust test plan for detecting improper payments and provide additional training to our personnel responsible for developing and performing our improper payment review. We will work with the OCFO to implement those recommendations. The technical assistance grant for Hurricane Sandy was unprecedented for our office and required our personnel to act quickly to disburse payments to individual resource partners and a coalition of resource partners in the impacted communities, using existing program documents. OED is in the process of refining our guidelines and protocols for disasters to incorporate lessons learned from our experience with Hurricane Sandy to mitigate the underlying causes of improper payments. We are working with the Office of the General Counsel to address the recommendation regarding the SCORE payment.