

U.S. SMALL BUSINESS ADMINISTRATION

OFFICE OF INSPECTOR GENERAL

**Report No. 11-01**

*Fiscal Year 2011 Report  
on the Most Serious Management and  
Performance Challenges Facing the  
Small Business Administration*

October 15, 2010



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

October 15, 2010

MEMORANDUM

TO: Karen G. Mills  
Administrator

FROM: *<Original signed by:>*  
Peggy E. Gustafson  
Inspector General

SUBJECT: Fiscal Year 2011 Report on the Most Serious Management and  
Performance Challenges Facing the Small Business Administration

In accordance with the Reports Consolidation Act of 2000, we are providing you with the Office of Inspector General's (OIG) Fiscal Year (FY) 2011 Report on the Most Serious Management and Performance Challenges Facing the Small Business Administration (SBA). This report represents our current assessment of Agency programs and/or activities that pose significant risks, including those that are particularly vulnerable to fraud, waste, error, mismanagement or inefficiencies. The Challenges are not presented in order of priority, as we believe that all are critical management or performance issues.

Our report is based on specific OIG, Government Accountability Office (GAO), and other official reports, as well as our general knowledge of SBA's programs and operations. Our analysis generally considers those accomplishments that SBA reported as of September 30, 2010.

Within each Management Challenge there are a series of "recommended actions" to resolve the Challenge. Each recommended action is assigned a color "status" score. The scores are as follows: Green for Implemented; Yellow for Substantial Progress; Orange for Limited Progress; and Red for No Progress. An upwards arrow in the color box indicates that the color score improved over last year's report, and a down arrow indicates that it regressed.

As part of the OIG's continuing evaluation of the Management Challenges, certain Challenges have been updated or revised. In addition, actions that were scored Green last year, and which remained Green this year, have been moved up to the "history bar" above the recommended actions. The history bar highlights any progress that the Agency has made on a Challenge over

the past four FYs (or as long as the Challenge has existed, if shorter) by showing the number of actions that have moved to Green each year.

We are pleased to report that one Management Challenge in last year’s report, *Insufficient and Outdated SBA Controls Contribute to Excessive Risk of the SBIC Program*, has been completed by virtue of both remaining recommended actions receiving Green color scores this year. The OIG determined that SBA (1) was actively monitoring and timely transferring impaired Small Business Investment Companies (SBICs) to liquidations when warranted and (2) had developed performance goals and indicators to evaluate effectiveness of the liquidation process of SBICs and was reporting annually on whether these goals had been met. This Challenge has been shown as “completed” in the attached report and the remaining Challenges have been renumbered accordingly.

The following table provides a summary of the FY 2011 report on the Agency’s Most Serious Management and Performance Challenges.

	Topic	Status Score				Improved <sup>1</sup>	Worsened <sup>2</sup>
		Green	Yellow	Orange	Red		
1	Small Business Contracts		2	1			
2	IT Security		3	1			1
3	Human Capital		2	1			1
4	Loan Guaranty Purchase	1		1		1	
5	Lender Oversight		4	2		2	
6	8(a) BD Program		3	1			1
7	Loan Agent Fraud		2			2	
8	Loan Management and Accounting System			4		— <sup>3</sup>	—
9	Improper Payments	1	3	3		— <sup>4</sup>	—
<b>Completed Challenge</b>							
	SBIC Program	2				2	
	<b>TOTAL</b>	<b>4</b>	<b>18</b>	<b>14</b>		<b>7</b>	<b>3</b>

We would like to thank SBA’s management and staff for their cooperation in providing us with information needed to prepare this report. We look forward to continuing to work with SBA’s leadership team in addressing the Agency’s Management Challenges.

#### Attachment

<sup>1</sup> “Improved” refers to a recommended action that showed progress this year over last year’s score (as denoted by an “up” arrow).

<sup>2</sup> “Worsened” refers to a recommended action that regressed from last year’s score (as denoted by a “down” arrow).

<sup>3</sup> Management Challenge 8, Loan Management and Accounting System, was new in FY 2010. Consequently, no color scores were shown in last year’s report against which to measure progress.

<sup>4</sup> Management Challenge 9, Improper Payments, was new in FY 2010. Consequently, no color scores were shown in last year’s report against which to measure progress.

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**Challenge 1. Procurement flaws allow large firms to obtain small business awards and agencies to count contracts performed by large firms towards their small business goals.**

The Small Business Act establishes a Government wide goal that 23 percent of the total value of all prime contract awards for each fiscal year (FY) be awarded to small businesses. As the advocate for small business, the Small Business Administration (SBA) should strive to ensure that only small firms obtain small business awards and that procuring agencies accurately report contracts awarded to small businesses when representing its progress in meeting small business contracting goals.

Office of Inspector General (OIG) audits and other governmental studies have shown widespread misreporting by procuring agencies; many contract awards recorded as going to small firms have actually been performed by larger companies. While some contractors may misrepresent or erroneously calculate their size, most of the incorrect reporting results from errors made by Government contracting personnel. Noted errors include acceptance of questionable size self-certifications and misapplication of small business contracting rules. Also, it is unclear whether contracting officers always review the on-line certifications that contractors enter into the governmental Online Representations and Certifications Application (ORCA) prior to awarding contracts. SBA needs to ensure that contracting personnel are adequately trained on small business procurement procedures and are reviewing ORCA data prior to awarding contracts.

The Agency also needs to address a loophole within General Services Administration Multiple Awards Schedule (MAS) contracts that contain multiple industrial codes. Currently, a company awarded such a contract can identify itself as small on individual task orders awarded under that contract even though it does not meet the size criteria for the applicable task. Thus, agencies may obtain small business credit for using a firm classified as small, when the firm is not small for specific orders under the MAS contract.

While more remains to be done, SBA made some progress on this challenge. For example, SBA co-chaired the President’s Interagency Task Force on Federal Contracting Opportunities for Small Businesses and recommended mandatory training on small business contracting, procurement policies and regulations for contracting personnel and program managers. It is also working on an interagency agreement with the Defense Acquisition University, expected to be executed in FY 2011, whereby SBA personnel would serve as adjunct faculty to teach small business related contracting courses; and has worked with the Department of Defense’s Office of Small Business Programs to develop two small business courses intended for program managers, contracting officers, and contract specialists. SBA estimated that the courses will be available in FY 2011. Finally, SBA conducted surveillance reviews to assess whether procurement officials confirmed the small business size status prior to contract award.

Challenge History Fiscal Year (FY) Issued: 2005	Actions Accomplished (Green Status) during Past 4 FYs			
	06-0	07-0	08-1	09-0
Remaining Recommended Actions for FY 2011				Status at end of FY 2010
1. Develop and take steps to provide reasonable assurance that agencies are providing adequate basic and continuing education training to contracting personnel on small business contracting procedures.				Yellow
2. Develop and implement a program that promotes accurate contractor certifications and ensures that contracting personnel review contractor certifications.				Yellow
3. Issue regulations that require firms to meet the size standard for each specific order they receive under a GSA schedule and Government-wide Acquisition Contract (GWAC) and show that the regulations are being followed.				Orange

Green-Implemented Yellow-Substantial progress Orange-Limited Progress Red-No progress

**Challenge 2. Weaknesses in information systems security controls pose significant risks to the Agency.**

The confidentiality, integrity, and availability of SBA’s information systems are vital to the continued successful operation of the Agency. While information technology (IT) can result in a number of benefits, such as information being processed more quickly and communicated almost instantaneously, it can also increase the risk of fraud, inappropriate disclosure of sensitive data, and disruption of critical operations and services. SBA’s computer security program operates in a dynamic and highly decentralized environment and requires management attention and resources as weaknesses are identified.

SBA continued to improve information system security in several critical areas during FY 2010. SBA issued procedures requiring vulnerability scanning in contract service level agreements and control reviews; implemented physical and administrative access controls over Agency systems; and made progress implementing standard baseline configurations for its Windows operating system servers and improving controls over major applications. SBA now reviews contractor clearances as part of its Security Authorization process and tracks compliance in its Plan of Actions and Milestones (POA&M). To show further progress, SBA needs to address both known and newly-reported information security issues. For example, SBA needs to demonstrate a process that accomplishes timely mitigation of system risks that are identified as “medium” and “high;” further implement enterprise-wide and application-level change control controls for both emergency and normal system changes; and timely implement OIG recommendations related to IT security issues. While SBA has continued to improve its information system security, the FY 2010 Financial Statement Audit has identified new weaknesses in segregation of duty controls within SBA financial systems.

Challenge History Fiscal Year (FY) Issued: 1999	Actions Accomplished (Green Status) during Past 4 FYs			
	06-2	07-2	08-2	09-0
<b>Remaining Recommended Actions for FY 2011</b>				<b>Status at end of FY 2010</b>
1. Access controls are in place and operating effectively, and contractors are not granted system access until they have obtained the required background investigations and/or security clearances.				Yellow
2. System software controls are in place and operating effectively.				Yellow
3. Segregation of duty controls are in place and operating effectively.				Orange ↓
4. The POA&M accurately reports all computer security weaknesses and corrective actions.				Yellow

**Green**-Implemented **Yellow**-Substantial progress **Orange**-Limited Progress **Red**-No progress

**Challenge 3. Effective human capital strategies are needed to enable SBA to successfully carry out its mission and become a high-performing organization.**

During the past decade, facing budget constraints at the same time that virtually of all its programs were growing significantly, SBA restructured key Agency operations, reengineered its largest loan programs, and downsized personnel through attrition and directed transfers. While these actions transformed the way SBA does business, the Agency has not adequately analyzed priorities and allocated resources consistent with those priorities and its new business processes. As a result, there is no assurance that sufficient resources—in terms of both number of staff and the knowledge and skills possessed by staff—are available and appropriately deployed to perform critical functions. For example, OIG and GAO reviews have identified training and inadequate staffing of key functions, including oversight of lenders and monitoring of 8(a) program requirements, as critical issues affecting the Agency.

The results of the Office of Personnel Management’s (OPM’s) Federal Human Capital Surveys—now the Federal Employee Viewpoint Survey (FEVS)—have highlighted SBA’s serious human capital challenges. For example, in 2006 SBA ranked near the bottom on all four human capital indices—Leadership and Knowledge Management, Results-Oriented Performance Culture, Talent Management, and Job Satisfaction. SBA was proactive in addressing these results and showed significant improvement in the 2008 survey. In addition, the Partnership for Public Service, in its 2009 rankings of “The Best Places to Work in the Federal Government,” recognized SBA as the most improved agency, although SBA still ranked 26 out of 30 large agencies. However, the 2010 FEVS did not show continued progress—SBA still trailed the government-wide average on the four human capital indices, with the most significant gap (10 percent) being in Talent Management. In addition, SBA was 29 out of 31 large agencies in the 2010 “Best Places to Work” rankings and its scores were lower than in the 2009 rankings for a number of areas, including Employee Skills/Mission Match, Strategic Management, and Training and Development.

While SBA has taken positive steps in some areas, such as performance management and leadership development, it needs to develop a comprehensive workforce planning process that provides a systematic and strategic approach for ensuring that qualified staff are available and appropriately allocated toward mission-critical functions and Agency priorities.

Challenge History Fiscal Year (FY) Issued: 2001 (Revised 2007)	Actions Accomplished (Green Status) during Past 4 FYs			
	06-0	07-0	08-0	09-0
<b>Remaining Recommended Actions for FY 2011</b>				<b>Status at end of FY 2010</b>
1. Allocate appropriate staffing toward Agency priorities – perform an analysis of Agency priorities and develop, communicate, and implement a comprehensive plan (including responsibilities, metrics, and timeframes) for allocating appropriate staffing (in terms of staffing levels and requisite knowledge, skills, and abilities) toward those priorities.				Yellow
2. Take steps to correct problems identified by the Federal Employee Viewpoint Survey (FEVS) – develop, communicate, and implement a corrective action plan (including priorities, responsibilities, metrics, and timeframes) to address the underlying causes of SBA’s poor results on the FEVS.				Yellow
3. Plan for the future of SBA – develop and implement an effective workforce planning program to ensure that there are qualified staff available to perform SBA’s mission-critical functions and meet identified priorities for the foreseeable future.				Orange ↓

Green-Implemented Yellow-Substantial progress Orange-Limited Progress Red-No progress

**Challenge 4. SBA needs better controls over loan purchase and liquidation processes.**

The majority of loans under the 7(a) loan-guaranty program are made with little or no review by SBA prior to loan approval because SBA has delegated most of the credit decisions to lenders originating these loans. SBA’s review of lender requests for guaranty purchases on defaulted loans is, therefore, the Agency’s primary tool for assessing lender compliance on individual loans and protecting SBA from making erroneous purchase payments. Furthermore, as lenders are delegated the responsibility for servicing and liquidating SBA loans, SBA’s liquidation process, including the comprehensive charge-off review, is the last opportunity to identify lender noncompliance. However, OIG audits of defaulted loans and SBA’s guaranty purchase and liquidation processes have shown that reviews performed by the loan centers have not consistently detected failures by lenders to administer loans in full compliance with SBA requirements and prudent lending practices, resulting in improper payments.

SBA has taken actions to correct many of the deficiencies identified by the OIG. SBA reengineered the 7(a) loan guaranty purchase processes at the National Guaranty Purchase Center (NGPC) and the Little Rock and Fresno Service Centers to improve the efficiency and consistency of the process; increased staffing levels at the centers; developed a comprehensive operations manual for the NGPC; trained individuals responsible for making purchase decisions; and implemented policies and procedures governing the guaranty purchase and liquidation processes to ensure lender compliance before honoring loan guaranties. While improvements have been made, SBA will need to fully implement its Quality Assurance Review Program at the centers and incorporate these procedures into a formal policy.

Challenge History Fiscal Year (FY) Issued: 2001	Actions Accomplished (Green Status) during Past 4 FYs			
	06-0	07-0	08-2	09-0
Remaining Recommended Actions for FY 2011				Status at end of FY 2010
1. Implement a Quality Assurance Program for all SBA loan centers.				Orange
2. Implement policies and procedures governing the guaranty purchase and liquidation processes to ensure lender compliance before honoring SBA loan guaranties.				Green ↑

Green-Implemented Yellow-Substantial progress Orange-Limited Progress Red-No progress

**Challenge 5. SBA needs to further strengthen its oversight of lending participants.**

Since its inception in 1953, SBA has loaned or guaranteed billions of dollars to finance and spur investment in small businesses. More than 68 percent of loan dollars guaranteed by SBA are made by lenders using delegated authorities with limited oversight. Prior reviews of SBA’s Office of Credit Risk Management (OCRM) disclosed that onsite lender examinations did not adequately assess lender risk; reviews were not made of high-risk, medium-sized lenders; and SBA had not effectively implemented enforcement actions. High risk lenders now account for more than 80 percent of SBA’s 7(a) outstanding portfolio. The risks inherent in delegated lending require an effective oversight program to: (1) monitor lender compliance with SBA policies and procedures; and (2) take corrective actions when a material noncompliance is detected.

The Agency has made substantial progress in its oversight of lenders in the 7(a) and 504 loan programs, reducing action items within this Management Challenge from 8 in FY 2006 to 3 in FY 2010. With authority to charge fees to cover the cost of on-site lender reviews, SBA expanded the scope of its oversight by more than doubling the number of on-site reviews of large high-risk lenders. It also issued a *Lender Review* Standard Operating Procedure (SOP) to guide the on-site review process and modified the Lender Risk Rating System to further strengthen lender risk assessments. In October 2010, SBA issued its new *Lender Supervision and Enforcement* SOP that establishes oversight and enforcement actions against nonperforming lenders. The SOP is comprehensive and addresses a number of the concerns that the OIG has had with lender oversight issues. In particular, the SOP provides for agreed-upon procedure reviews and corrective action plans that include milestones and timeframes for achieving results. The guidelines established for lender performance will assist the OCRM in establishing goals and target dates for inclusion in lender corrective action plans.

While the SOP took effect on October 1, 2010, SBA will need to demonstrate consistent and reliable adherence to the procedures and corrective action plans to improve the performance of high-risk lenders.

Challenge History Fiscal Year (FY) Issued: 2001	Actions Accomplished (Green Status) during Past 4 FYs			
	06-7(a)-2 06-504-1	07-7(a)-0 07-504-1	08-7(a)-2 08-504-2	09-7(a)-0 09-504-0
<b>Remaining Recommended Actions for FY 2011</b>			Status at end of FY 2010	
			7(a)	504
1. Expand the scope of lender oversight and improve the process for reviewing lenders and Certified Development Companies (CDCs) for compliance risks.			Yellow	Yellow
2. Implement guidance providing for effective oversight of lending programs.			Yellow ↑	Yellow ↑
3. Ensure that effective corrective actions are implemented, monitored, and result in improvement in the performance of participants with unacceptable performance.			Orange	Orange

**Green**-Implemented **Yellow**-Substantial progress **Orange**-Limited Progress **Red**-No progress

**Challenge 6. The Section 8(a) Business Development program needs to be modified so more firms receive business development assistance, standards for determining economic disadvantage are clear and objective, and SBA ensures that firms follow 8(a) regulations when completing contracts.**

The SBA 8(a) Business Development (BD) program was created to assist eligible small disadvantaged business concerns to compete in the American economy through business development.

Previously, the Agency did not place adequate emphasis on business development to enhance the ability of 8(a) firms to compete, and did not adequately ensure that only 8(a) firms with economically disadvantaged owners in need of business development remained in the program. Companies that were “business successes” were allowed to remain in the program and continue to receive 8(a) contracts, causing fewer companies to receive most of the 8(a) contract dollars and many to receive none.

The Agency has made considerable progress in addressing issues that challenge its ability to deliver an effective 8(a) program. The Office of Business Development has developed a Business Development Assessment Tool, as well as a plan to provide 8(a) firms with individualized business development assistance. In addition, the Office of Business Development has strengthened its policies and procedures and revised its regulations to ensure that companies that are “business successes” are graduated from the program. Also, the Agency issued proposed regulations in 2009 to establish clear and objective standards to address the definition of “economic disadvantage,” but has not taken further action. SBA has further addressed the need to identify the skills necessary for Business Development Specialists to adequately evaluate a company’s business plan and assess a participant’s competitive potential. Although the Agency has taken steps to ensure that procuring agencies enforce contractor compliance with 8(a) BD program regulations, significant improvements are still needed. The Agency also needs to finalize regulations necessary to complete applicable recommended actions.

Challenge History Fiscal Year (FY) Issued: 2003	Actions Accomplished (Green Status) during Past 4 FYs			
	06-1	07-1	08-1	09-1
<b>Remaining Recommended Actions for FY 2011</b>				<b>Status at end of FY 2010</b>
1. Develop and implement a plan, including SOP provisions, which ensures that the 8(a) BD program identifies and addresses the business development needs of program participants on an individualized basis.				Yellow
2. Develop and implement Regulations and SOP provisions to ensure that participants are graduated once they reach the levels defined as business success.				Yellow
3. Establish objective and reasonable criteria that effectively measures “economic disadvantage” and implement the new criteria.				Orange ↓
4. On a regular basis, conduct surveillance reviews of procuring agencies to ensure they are effectively monitoring and enforcing compliance with specified 8(a) BD regulations on the contracts they administer. (Previously action #5)				Yellow

**Green**-Implemented **Yellow**-Substantial progress **Orange**-Limited Progress **Red**-No progress

**Challenge 7. Effective tracking and enforcement would reduce financial losses from loan agent fraud.**

For more than a decade, OIG investigations have revealed a pattern of fraud in the 7(a) business loan guaranty program by loan packagers and other for-fee agents. Fraudulent schemes have involved hundreds of millions of dollars, yet SBA oversight of loan agents has been limited, putting taxpayer dollars at risk. The Agency could reduce this risk by establishing effective loan agent disclosure requirements, a database or equivalent means to track loan agent involvement with its loans, and a more effective agent enforcement program.

Tracking Loan Agent Data -- Over the years, in response to this Management Challenge, SBA has proposed various methods of tracking loan agent activity. At one point, SBA proposed to revise its E-Tran system (which collects loan data electronically from participating lenders) to collect information on loan agent involvement. The Agency ultimately concluded, however, that this approach was not feasible. At the end of FY 2007, SBA proposed a new approach to integrate information from the Form 159 (which asks for information about loan agents) into the Form 1502 electronic data collection process by SBA's Fiscal and Transfer Agent (FTA). The OIG revised recommended action #1 below, but SBA made no progress on this action during FY 2008, in part due to a protest of the award of the FTA contract. At the end of FY 2009, SBA presented a succinct plan for implementing the 1502 approach. However, during FY 2010, SBA again changed its position, and advised that it would capture the data by having the Form 159 faxed in to the FTA. At the end of FY 2010, SBA issued a notice with directions on how this data was to be submitted.

Loan Agent Enforcement Procedures -- In FY 2007, the Agency made progress by issuing its Lender Oversight SOP and by previously revising the guaranty purchase checklist (which lists the records that lenders need to provide when requesting SBA to pay a guaranty) to include the submission of the Form 159. However, the Agency also needs to establish a more effective enforcement program to deter fraudulent loan agent activity. Effective October 1, 2010, SBA issued a Lender Supervision and Enforcement SOP with provisions for loan agent enforcement actions and a delegation of authority to the Director of the Office of Credit Risk Management.

Challenge History Fiscal Year (FY) Issued: 2000	Actions Accomplished (Green Status) during Past 4 FYs			
	06-0	07-1	08-1	09-0
<b>Remaining Recommended Actions for FY 2011</b>				<b>Status at end of FY 2010</b>
1. Develop an effective method of disclosing and tracking loan agent involvement in the SBA business loan programs.				Yellow ↑
2. Implement procedures for enforcement actions against loan agents for improper and fraudulent conduct.				Yellow ↑

**Green**-Implemented **Yellow**-Substantial progress **Orange**-Limited Progress **Red**-No progress

**Challenge 8. SBA needs to modernize its Loan Accounting System and migrate it off the mainframe.**

In November 2005, SBA initiated the Loan Management and Accounting System (LMAS) project to update the Agency’s Loan Accounting System and migrate it off of the mainframe. Previous OIG reports noted that the system is close to the end of its expected useful life, relies on obsolete technology, contains major security vulnerabilities that cannot be addressed until the system is moved to a new operating platform, and is costly to operate. Additionally, the OIG reported concerns about SBA’s management of the project; the project’s noncompliance with the Agency’s System Development Methodology (SDM) in key areas, which impacts SBA’s ability to control project costs and quality; and the lack of an enterprise-wide or project-level Quality Assurance (QA) function to ensure that LMAS deliverables meet SBA’s requirements and quality standards. Finally, the OIG reported that the LMAS QA contractor had not performed all of the activities stipulated in its contract and that none of the issued LMAS task orders have undergone Independent Validation and Verification (IV&V) testing.

In 2009 SBA contracted with McKinsey & Company to conduct a review of the LMAS project. This review identified multiple weaknesses in SBA’s LMAS project management activities and recommended: (1) focusing on core mainframe legacy platform replacement; (2) strengthening project governance; (3) increasing project team resources; 4) focusing on COTS capabilities while minimizing customization; and 5) improving vendor management.

In 2010 OMB issued Memorandum 10-26, recommending that Federal agencies split large-scale modernization efforts into smaller, simpler segments with clear deliverables. In response, SBA changed its strategy for LMAS going forward to accelerate the migration of user interfaces from the mainframe legacy platform to the Agency’s current architecture, and convert batch COBOL systems from the mainframe to a more current and platform-independent environment. To show further progress, SBA needs to develop detailed project plans for implementing its new LMAS strategy; implement a QA/IV&V process that encompasses all of the requirements of its enterprise SDM; and provide sufficient evidence that all LMAS work products undergo IV&V activities in accordance with the Agency’s *Enterprise Quality Assurance Plan*.

Challenge History Fiscal Year (FY) Issued: 2010	Actions Accomplished (Green Status) during Past 4 FYs			
	N/A	N/A	N/A	N/A
<b>Recommended Actions for FY 2011</b>				<b>Status at end of FY 2010</b>
1. Migrate LAS to a new operating platform before the current mainframe contract expires in 2012.				Orange
2. Modify the LMAS QA/IV&V contract and establish an effective Quality Assurance (QA) process which provides senior management independent assurance that LMAS development activities and related project deliverables meet SBA Quality standards.				Orange
3. Establish a process for reviewing and accepting LMAS deliverables that complies with Systems Development Methodology requirements.				Orange
4. Implement a Quality Assurance process in LMAS in accordance with SBA’s Enterprise Quality Assurance Plan.				Orange

**Green**-Implemented **Yellow**-Substantial progress **Orange**-Limited Progress **Red**-No progress

**Challenge 9. SBA needs to accurately report, significantly reduce, and strengthen efforts to recover improper payments in the Disaster and 7(a) loan programs.**

OIG audits of SBA’s Disaster and 7(a) Loan Programs determined that the improper payment rates reported for these programs were significantly understated. SBA estimated that improper payments in the Disaster Loan Program were about \$4.5 million, or 0.55 percent of loans approved in FY 2007, while the OIG reported that it was at least 46 percent, or approximately \$1.5 billion. SBA also reported that the improper payment rate for the 7(a) program was 0.53 percent of FY 2008 program outlays, although the OIG estimated the rate to be 27 percent, or approximately \$234 million. SBA’s improper payment rates were understated because the Agency did not adequately review sampled loans, used flawed sampling methodologies, and did not accurately project review findings for both programs. Additionally, the OFA inappropriately overturned improper payments identified by reviewers.

OIG audits in prior years have also identified high percentages of disaster and business loans that were made to borrowers who were ineligible, lacked repayment ability, or did not provide the required support for loan disbursement. In 2009, we reported that over 30 percent of reviewed disaster loans were disbursed for properties that were not the applicant’s primary residence and identified an estimated \$30 million in improper loan guaranty purchases in the 7(a) program. SBA also has not aggressively pursued recovery of improper payments. SBA has not yet collected more than \$2 million of FY 2008 improper payments identified by the OIG.

SBA has taken actions to correct many of the deficiencies identified by the OIG. For example, the Agency has determined that a secondary market purchase will be considered improper to the extent that SBA failed to identify and/or collect the improper payment during its post purchase review process. The Agency also established clear policies for offsetting outstanding ongoing guaranty fees from amounts paid to the lenders. Also, the Agency has implemented a corrective action plan for the disaster loan program that addresses OMB requirements. A QAR team of experienced loan officers and legal personnel was established to perform the improper payment reviews. However, additional actions are needed to accurately report, significantly reduce, and recover improper payments. SBA needs to incorporate the improper payment review processes; a denial, repair and improper payment dispute resolution process; and an improper payment recovery process into formal policy.

Challenge History Fiscal Year (FY) Issued: 2010	Actions Accomplished (Green Status) during Past 4 FYs			
	N/A	N/A	N/A	N/A
Recommended Actions for FY 2011	Status at end of FY 2010			
	Disaster	7(a)		
1. Ensure that processes used to calculate the improper payment rate for disaster and 7(a) loans are designed to effectively identify improper payments as defined by Office of Management and Budget (OMB) Circular A-123.	Yellow	Orange		
2. Reassign responsibility for final approval of disputed denial, repair, and improper payment decisions from the Office of Financial Assistance to the Office of Risk Management to ensure an adequate and timely resolution of disputes.	N/A	Orange		
3. Develop a process to ensure that reviewers are properly trained to perform improper payment reviews.	Green	N/A		
4. Develop and implement corrective action plans to reduce improper payments in the 7(a) and Disaster Loan programs.	Yellow	Yellow		
5. Establish a process and time standards to expeditiously recover improper payments identified during Agency reviews and OIG audits.	N/A	Orange		

Green-Implemented Yellow-Substantial progress Orange-Limited Progress Red-No progress

## Completed Challenge

<b>Insufficient and outdated SBA controls contribute to excessive risk of the SBIC program.</b>
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The Small Business Investment Company (SBIC) program is designed to stimulate and supplement the flow of private equity capital and long-term debt to small business concerns. SBA uses both guaranteed debt (debentures) and equity interest (participating securities) to provide government-backed financing to SBICs. Effective October 2004, SBA discontinued the licensing of SBIC participating securities due to the over \$2 billion in unprecedented losses experienced by the program. While existing participating securities SBICs continue to operate in the program, the last funds will expire by 2014 upon the maturity of their 10-year life cycle.

As of August 2010, SBA had about \$6.4 billion of outstanding leverage in both debenture and participating securities financings at risk. As of August 2010, 138 SBICs were in liquidation with outstanding leverage of nearly \$2 billion, most of which were in Participating Securities. Prior OIG reports determined that: (1) existing guidance did not provide a systematic approach for transferring capially-impaired SBICs into liquidation status and (2) better performance goals and indicators were needed to show how well and how timely recoveries were maximized for liquidated SBICs.

Our review of the Investment Division’s management reports and discussions with division officials disclosed that management was actively monitoring and timely transferring impaired SBICs to liquidations when warranted. Also, management transferred one longstanding problematic SBIC into liquidation in September 2010, after the principals conceded that they could not raise the additional capital to cure the fund’s impairment. Management has also developed performance goals and indicators to evaluate effectiveness of the liquidation process of SBICs and reports annually on whether these goals have been met.

Challenge History Fiscal Year (FY) Issued: 2004	Actions Accomplished (Green Status) during Past 4 FYs			
	06-1	07-1	08-1	09-2
<b>Remaining Recommended Actions for FY 2011</b>				<b>Status at end of FY 2010</b>
1. Develop systematic criteria and implement a timely approach for transferring SBICs to liquidation status.				Green ↑
2. Develop and implement performance goals and indicators that address the efficiency, cost-effectiveness, and timeliness of the SBIC liquidation process. <i>(Previously action #3)</i>				Green ↑

Green-Implemented 
 Yellow-Substantial progress 
 Orange-Limited Progress 
 Red-No progress

## Appendix: Relevant Reports

*Most of the SBA OIG Reports listed can be found at [www.sba.gov/ig](http://www.sba.gov/ig).*

### Challenge 1:

- SBA Advocacy, Analysis of Type of Business Coding for the Top 1,000 Contractors Receiving Small Business Awards in FY 2002, December 2004.
- The Center for Public Integrity, The Big Business of Small Business: Top defense contracting companies reap the benefits meant for small businesses, September 29, 2004.
- The Center for Public Integrity, The Pentagon's \$200 Million Shingle: Defense data shows billions in mistakes and mislabeled contracts, September 29, 2004.
- SBA OIG, Audit of SBA's Administration of the Procurement Activities of Asset Sale Due Diligence Contracts and Task Orders, Report #4-16, March 17, 2004, pp. 8-9.
- GAO, Contract Management: Reporting of Small Business Contract Awards Does Not Reflect Current Business Size, GAO-03-704T, May 7, 2003.
- The Small Business Committee, U.S. House of Representatives Hearing, Are Big Businesses Being Awarded Contracts Intended for Small Businesses? Testimony of Mr. Fred C. Armendariz, Associate Deputy Administrator, SBA, May 7, 2003.
- The Small Business Committee, U.S. House of Representatives Hearing, Are Big Businesses Being Awarded Contracts Intended for Small Businesses? Testimony of Mr. Felipe Mendoza, Associate Administrator, Office of Small Business Utilization, U.S. General Services Administration, May 7, 2003.
- SBA OIG, SBA Small Business Procurement Awards Are Not Always Going to Small Businesses, Report #5-14, February 24, 2005.
- SBA OIG, Review of Selected Small Business Procurements, Report #5-16, March 8, 2005.
- SBA OIG, SBA's Planning and Award of the Customer Relationship Management Contracts, ROM 10-16, June 29, 2010.
- Interagency Task Force on Federal Contracting Opportunities for Small Businesses Report, September 2010.

### Challenge 2:

- SBA OIG, Audit of SBA's FY 2009 Financial Statements, Report #10-04, November 13, 2009
- SBA OIG, SBA's FY2008 Financial Statements, Report #9-03, November 14, 2008
- SBA OIG, Audit of SBA's Financial Statements for FY 2006, Report #7-03, November 15, 2006.
- SBA OIG, Audit of SBA's Information System Controls for FY 2004, Report #5-12, February 24, 2005.

### Challenge 3:

- Partnership for Public Service, Best Places to Work in the Federal Government 2010, <http://bestplacestowork.org/BPTW/rankings/>
- OPM, 2010 Federal Employee Viewpoint Survey (FEVS), <http://www.fedview.opm.gov/2010/>
- SBA OIG, The Colorado District Office's Servicing of 8(A) Business Development Program Participants, Report #10-15, September 30, 2010
- SBA OIG, Adequacy of Procurement Staffing and Oversight of Contractors Supporting the Procurement Function, ROM 10-13, April 9, 2010
- SBA OIG, SBA's Administration of the Microloan Program under the Recovery Act, ROM 10-10, December 28, 2009
- Partnership for Public Service, Best Places to Work in the Federal Government 2009
- OPM, 2008 Federal Human Capital Survey (FHCS)
- GAO, Agency Should Assess Resources Devoted to Contracting and Improve Several Processes in the 8(a) Program, GAO-09-16, November 2008

- GAO, Opportunities Exist to Build on Leadership's Efforts to Improve Agency Performance and Employee Morale, GAO-08-995, September 2008
- SBA OIG, Non-Native Managers Secured Millions of Dollars from 8(a) Firms Owned by Alaska Native Corporations through Unapproved Agreements that Jeopardize the Firms' Program Eligibility, Report #8-14, August 7, 2008
- GAO, Opportunities Exist to Improve Oversight of Women's Business Centers and Coordination Among SBA's Business Assistance Programs, GAO-08-49, November 2007
- SBA OIG, Audit of Two 8(a) Sole-Source Contracts Awarded to Contractors in SBA's Mentor Protégé Program, Report #7-19, March 30, 2007
- SBA OIG, Management Advisory Report on the Transfer of Operations to the National Guaranty Purchase Center, Report #4-39, August 31, 2004
- GAO, Small Business Administration: Progress Made, but Transformation Could Benefit from Practices Emphasizing Transparency and Communication, GAO-04-76, October 2003
- GAO, Results Oriented Cultures: Implementation Steps to Assist Mergers and Organizational Transformations, GAO-03-699, July 2003
- GAO, Small Business Administration: Workforce Transformation Plan is Evolving, GAO-02-931T, July 16, 2002
- SBA OIG, Modernizing Human Capital Management, Report #2-20, May 31, 2002
- GAO, Small Business Administration: Current Structure Presents Challenges for Service Delivery, GAO-02-17, October 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
- SBA OIG, A Framework for Considering the Centralization of SBA Functions, November 1996

#### **Challenge 4:**

- SBA OIG, Material Deficiencies Identified in Early-Defaulted and Early-Problem Recovery Act Loans, #10-19, September 24, 2010
- SBA OIG, SBA's Management of the Backlog of Post-purchase Reviews at the National Guaranty Purchase Center, #9-18, August 25, 2009
- SBA OIG, , The Small Business Administration's Fiscal Year 2008 Improper Payment Rate for the 7(a) Guaranty Loan Program #9-16, July 10, 2009
- SBA OIG, Review of Key Unresolved OIG Audit Recommendations in Program Areas Funded by the American Recovery and Reinvestment Act and Related Activities Need to Safeguard Funds, #ROM 09-1, April 30, 2009
- SBA OIG, Audit of the Liquidation Process at the National Guaranty Purchase Center, #9-08, January 30, 2009
- SBA OIG, Audit of Six SBA Guaranteed Loans, #8-18, September 8, 2008
- SBA OIG, Audit of Loan Classifications and Overpayments on Secondary Market Loans, #8-09, March 26, 2008
- SBA OIG, Audit of UPS Capital Business Credit's Compliance with Selected 7(a) Lending Requirements, #8-08, March 21, 2008
- SBA OIG, Audit of the Guarantee Purchase Process for Section 7(a) Loans at the National Guaranty Purchase Center, Report #7-23, May 8, 2007
- SBA OIG, Audit of an SBA Guaranteed Loan, Report #7-17, March 12, 2007
- SBA OIG, Audit of an SBA Guaranteed Loan, Report #7-15, February 12, 2007
- SBA OIG, Audit of an SBA Guaranteed Loan, Report #7-10, January 16, 2007
- SBA OIG, Audit of an SBA Guaranteed Loan, Report #7-09, January 9, 2007
- SBA OIG, Audit of an SBA Guaranteed Loan, Report #7-07, December 29, 2006
- SBA OIG, Audit of an SBA Guaranteed Loan, Report #7-06, December 28, 2006
- SBA OIG, Audit of an SBA Guaranteed Loan, Report #7-05, December 20, 2006
- SBA OIG, Audit of an SBA Guaranteed Loan, Report #7-02, October 23, 2006
- SBA OIG, Audit of Deficiencies in OFA's Purchase Review Process for Backlogged Loans, Report #6-35, September 29, 2006

- SBA OIG, Survey of the Quality Assurance Review Process, Report #6-26, July 12, 2006
- SBA OIG, Audit of SBA's Implementation of the Improper Payments Information Act, Report #6-25, June 21, 2006
- SBA OIG, Audit of an SBA Guaranteed Loan, Report #6-22, May 17, 2006
- SBA OIG, Audit of an SBA Guaranteed Loan, Report #6-17, March 20, 2006
- SBA OIG, Audit of an SBA Guaranteed Loan, Report #6-16, March 20, 2006
- SBA OIG, Audit of an SBA Guaranteed Loan, Report #6-14, March 2, 2006
- SBA OIG, Audit of an SBA Guaranteed Loan, Report #5-26, September 28, 2005
- SBA OIG, Audit of an SBA Guaranteed Loan, Report #5-21, July 15, 2005
- SBA OIG, Management Advisory Report on the Transfer of Operations to the National Guaranty Purchase Center, Report #4-39, August 31, 2004
- SBA OIG, Audit of an Early Defaulted Loan, Report #4-38, August 24, 2004
- SBA OIG, Audit of an Early Defaulted Loan, Report #4-33, July 30, 2004
- SBA OIG, Audit of an Early Defaulted Loan, Report #4-28, July, 9, 2004
- SBA OIG, Audit of an Early Defaulted Loan, Report #4-25, June 22, 2004
- SBA OIG, Audit of an Early Defaulted Loan, Report #4-06, January 8, 2004
- SBA OIG, Audit of an Early Defaulted Loan, Report #3-38, September 22, 2003
- SBA OIG, Audit of an Early Defaulted Loan, Report #3-30, June 19, 2003
- SBA OIG, Audit of an Early Defaulted Loan, Report #3-27, May 22, 2003
- SBA OIG, Audit of the Guaranty Purchase Process, Report #3-15, March 17, 2003
- SBA OIG, Audit of an Early Defaulted Loan, Report #3-07, January 23, 2003
- SBA OIG, Audit of an Early Defaulted Loan, Report #2-32, September 30, 2002
- SBA OIG, Audit of an Early Defaulted Loan, Report #2-30, September 24, 2002
- SBA OIG, Audit of an Early Defaulted Loan, Report #2-23, August 7, 2002
- SBA OIG, Audit of an Early Defaulted Loan, Report #2-15, March 29, 2002
- SBA OIG, Improvements are Needed in Small Business Lending Company Oversight Process, Report #2-12, March 21, 2002
- SBA OIG, Audit of an Early Defaulted Loan, Report #2-03, February 27, 2002
- SBA OIG, Audit of an Early Defaulted Loan, Report #2-05, February 27, 2002
- SBA OIG, Audit of an Early Defaulted Loan, Report #1-10, March 9, 2001
- GAO, Major Management Challenges and Program Risks, GAO-01-260, January 2001
- SBA OIG, Audit of an Early Defaulted Loan, Report #0-10, April 23, 2000
- SBA OIG, Audit of an Early Defaulted Loan, Report #0-12, March 28, 2000
- SBA OIG, Audit of an Early Defaulted Loan, Report #0-05, February 14, 2000

### **Challenge 5:**

- SBA OIG, SBA's Oversight of SBA Supervised Lenders, Report #8-12, May 9, 2008
- SBA OIG, UPS Capital Compliance with Selected 7(a) Lending Requirements, Report #8-08, March 21, 2008
- GAO, Small Business Administration: Additional Measures Needed to Assess 7(a) Loan Program's Performance, GAO-07-769, July 13, 2007
- SBA OIG, SBA's Oversight of Business Loan Center, LLC, Report #7-28, July 11, 2007.
- SBA OIG, SBA's Use of the Loan and Lender Monitoring System, Report #7-21, May 2, 2007.
- SBA OIG, Audit of the Office of Lender Oversight Corrective Action Process, Report #7-18, March 14, 2007.
- GAO, Small Business Administration: Improvements Made, But Loan Programs Face Ongoing Management Challenges, GAO-06-605T, April 6, 2006
- SBA OIG, SBA's Administration of the Supplemental Terrorist Activity Relief (STAR) Loan Program, Report #6-09, December 23, 2005
- GAO, Small Business Administration: New Service for Lender Oversight Reflects Some Best Practices, But Strategy for Use Lags Behind, GAO-04-610, June 8, 2004
- 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, Report #1-19, September 27, 2001
- SBA OIG, SBA Follow-up on SBLC Examinations, Report #1-16, August 17, 2001

### **Challenge 6:**

- SBA OIG, Audit of Two 8(a) Sole –Source Contracts Awarded to Contractors in SBA’s Mentor Protégé Program, Report #7-19, March 30, 2007
- SBA OIG, Audit of Monitoring Compliance with 8(a) Business Development Regulations During 8(a) Business Development Contract Performance, Report #6-15, March 16, 2006
- SBA OIG, Business Development Provided by SBA’s 8(a) Business Development Program, Report #4-22, June 2, 2004.
- SBA OIG, SACS/MEDCOR: Ineffective and Inefficient, Report #4-15, March 9, 2004
- SBA OIG, Section 8(a) Program Continuing Eligibility Reviews, Report #4-3-H-006-021, September 30, 1994

### **Challenge 7:**

- SBA OIG, Applicant Character Verification in SBA’s Business Loan Program, Report #3-43, April 5, 2001
- SBA OIG, Summary Audit of Section 7(a) Loan Processing, Report #0-03, January 11, 2000
- SBA OIG, Loan Agents and the Section 7(a) Program, Report #98-03-01, March 31, 1998
- SBA OIG, Fraud Detection in SBA Programs, Report #97-11-01, November 24, 1997
- SBA OIG, Operation Cleansweep Memorandum, August 21, 1996

### **Challenge 8:**

- SBA OIG, Adequacy of Quality Assurance Oversight of the Loan Management and Accounting System Project, Report 10-14, September 13, 2010
- SBA OIG, Review of Allegations Concerning How the Loan Management and Accounting System Modernization Project is Being Managed, Report #9-17 July 30, 2009
- SBA OIG, Planning for the Loan Management and Accounting System Modernization and Development Effort, Report #8-13, May 14, 2008
- SBA OIG, SBA Needs to Implement a Viable Solution to its Loan Accounting System Migration Problem, Report #5-29, September 20, 2005 – all recommendations closed
- GAO, Information Technology: Agencies Need to Improve the Accuracy and Reliability of Investment Information, GAO-06-250, January 12, 2006.
- GAO, Major Management Challenges and Program Risks: Small Business Administration, GAO-03-116, January 1, 2003
- GAO, SBA Loan Monitoring System: Substantial Progress Yet Key Risks and Challenges Remain, Testimony of Joel C. Willemsen, Director, Civil Agencies Information Systems Accounting and Information Management Division, Before the Subcommittee on Government Programs Statement Committee on Small Business, House of Representatives, GAO/T-AIMD-00-113, February 29, 2000
- GAO, SBA Needs to Establish Policies and Procedures for Key IT Processes, Accounting and Information Management Division, GAO/AIMD-00-170, May 31, 2000

### **Challenge 9:**

- SBA OIG, Material Deficiencies Identified in Early-Defaulted and Early-Problem Recovery Act Loans, Report #10-19, September 24, 2010
- SBA OIG, SBA’s Management of the Backlog of Post-Purchase Reviews at the National Guaranty Purchase Center, Report #9-18, August 25, 2009

- SBA OIG, The Small Business Administration's Fiscal Year 2008 Improper Payment Rate for the 7(a) Guaranty Loan Program, Report #9-16, July 10, 2009
- SBA OIG, Audit of Borrower Eligibility for Gulf Coast Disaster Loans, Report #9-09, March 31, 2009
- SBA OIG, The Small Business Administration's Fiscal Year 2007 Improper Payment Rate for the Disaster Loan Program, Report #9-10, March 26, 2009
- SBA OIG, Audit of the Liquidation Process at the National Guaranty Purchase Center, Report #9-08, January 30, 2009
- SBA OIG, The Use of Proceeds From Gulf Coast Disaster Loans, Report #9-06, January 15, 2009
- SBA OIG, Disaster Loss Verification Process, Report #8-15, June 17, 2008
- SBA OIG, Review of the Adequacy of Supporting Documentation for Disbursements, Report #8-07, January 29, 2008
- SBA OIG, The Quality of Loans Processed Under the Expedited Disaster Loan Program, Report #7-34, September 28, 2007
- SBA OIG, SBA's Quality Assurance Reviews of Loss Verifications, Report #7-29, July 23, 2007
- SBA OIG, Securing Collateral for Disaster Loan Disbursements, Report #7-22, May 9, 2007