

**THE SMALL BUSINESS ADMINISTRATION'S  
FISCAL YEAR 2008 IMPROPER PAYMENT  
RATE FOR THE 7(A) GUARANTY LOAN  
PROGRAM**

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**Prepared by the  
Office of Inspector General  
U. S. Small Business Administration**



**U.S. Small Business Administration  
Office Inspector General**

# Memorandum

To: Ana M. Ma  
Chief of Staff

Date: July 10, 2009

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Subject: Final Report on the Small Business Administration's Fiscal Year 2008 Improper Payment Rate for the 7(a) Guaranty Loan Program  
Report No. 9-16

This report summarizes the results of our audit of the Small Business Administration's (SBA) Fiscal Year (FY) 2008 improper payment rate for the 7(a) Guaranty Loan Program (7(a) program). The Improper Payments Information Act (IPIA) of 2002 requires Federal agencies to review their programs and activities annually, identify programs that may be susceptible to significant improper payments, estimate amounts improperly paid, and report on the amounts of improper payments and actions to reduce them.

Since implementation of the Act, SBA has reported a low improper payment rate for the 7(a) program. However, because several recent OIG audits uncovered a significant number of improper 7(a) guaranty loan purchases, we initiated the audit to determine (1) whether SBA's FY 2008 estimate of the improper payment rate for the 7(a) program was accurate, (2) if the estimate was not accurate, the reasons why, and (3) if recovery goals for FY 2007 and FY 2008 were met.

To assess the accuracy of SBA's FY 2008 improper payment review process, we compared the Agency's review methodology with Office of Management and Budget (OMB) guidelines contained in Appendix C of OMB Circular A-123. These guidelines, which were published in 2006, provide agencies with specific instructions for estimating and reporting the rate of improper payments.

Additionally, we consulted with OMB officials to determine how the improper payment definition specifically applies to the 7(a) program to determine whether SBA had applied the definition correctly. We also interviewed Office of Capital Access (OCA) officials, including those from the Office of Financial Program Operations (OFPO) and the Office of Financial Assistance (OFA), regarding their assessment and review approaches. In addition, we interviewed officials from the Office of the Chief Financial Officer (OCFO). Our scope and methodology is provided in Appendix I.

We independently validated SBA's estimate of improper payments by reviewing a statistical sample of 30 of the 186 loan guaranties purchased between April 1, 2007 and March 31, 2008 that SBA had reviewed, to determine whether these loans met SBA's origination, servicing, and/or liquidation requirements. Our sample included 10 regular 7(a),<sup>1</sup> 17 SBAExpress, and 3 Community Express loans. Based on our review results, consult from OMB, and assistance from a statistician, we developed an estimate of improper payments for the 7(a) program. Our sampling methodology is explained in Appendix II.

We also reviewed seven additional loans for which OFA had overturned the improper payment decisions to determine whether these decisions were appropriate. Finally, we assessed SBA's improper payment recovery efforts for FY 2007 and FY 2008. We conducted the audit between August 2008 and March 2009 in accordance with *Government Auditing Standards* prescribed by the Comptroller General of the United States.

## **BACKGROUND**

The IPIA was enacted to enhance the integrity of the Federal government's payments and the efficiency of its programs. This legislation, in conjunction with implementing guidance from OMB Circular A-123, requires executive branch agency heads to review their programs and activities annually, identify those that may be susceptible to significant improper payments, estimate amounts improperly paid, and report on the amounts of improper payments and actions to reduce them.

An improper payment is defined by the IPIA as any payment that should not have been made (including paying a guaranty for a loan made to an ineligible recipient), or that was made in an incorrect amount (including overpayments and underpayments) under statutory, contractual, administrative, or other legally applicable requirements. Under SBA's guaranty loan programs, improper payments may include SBA's payment of guaranties (known as guaranty

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<sup>1</sup> These included Preferred Lender Program (PLP) and General Program (GP) loans.

purchases) that are based on incomplete, inaccurate, or fraudulent information. They may also include duplicate payments and payments in the incorrect amount. Erroneous payments exceeding both 2.5 percent of program payments and \$10 million are considered “significant.”

In 2002, OMB identified SBA’s 7(a) Guaranty Loan Program, which provides guaranteed loans to small businesses, as susceptible to significant improper payments. This program includes SBA guaranteed loans provided under regular 7(a), *SBAExpress*, and Community Express procedures. In FY 2003, SBA first reported an improper payment rate for the 7(a) program, which it determined was insignificant. Since FY 2003, SBA has reported an improper payment rate for the program ranging from 0.43 to 1.56 percent. Most recently, in the Agency’s *FY 2008 Performance and Accountability Report*, SBA estimated the improper payment rate for the 7(a) program to be 0.53 percent, or \$6.5 million,<sup>2</sup> of the FY 2008 program outlays of \$1.2 billion. Although the reported rate was insignificant, the Agency developed a corrective action plan.

Several recent OIG audit reports of the 7(a) program have identified a significant number of improper guaranty purchases, causing us to question whether the rate of improper payments reported for the program was accurate. These improper purchases occurred because SBA loan officers did not review all relevant documentation related to borrower repayment ability, creditworthiness, eligibility, use of proceeds, equity injection, collateral liquidation, and other SBA requirements to ensure lender compliance. For example:

- In December 2006, we reported that SBA purchased approximately \$128 million to \$130.6 million in *SBAExpress* and Community Express loan guaranties without the required documentation.<sup>3</sup>
- In May 2007, we reported that SBA purchased approximately \$36 million in 7(a) loan guaranties without obtaining or analyzing documentation to assess whether lenders originated, serviced, and/or liquidated loans in accordance with SBA requirements.<sup>4</sup>
- In a January 2009 report on the liquidation process at the National Guaranty Purchase Center, we reported that SBA made at least \$23 million in improper payments on loans charged off between October 1, 2005, and

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<sup>2</sup> This amount is overstated since the estimate came from a different universe it was applied against.

<sup>3</sup> OIG Report 7-08, *Audit of the SBAExpress and Community Express Loan Purchase and Liquidation Process*, December 29, 2006.

<sup>4</sup> OIG Report 7-23, *Audit of the Guarantee Purchase Process for Section 7(a) Loans at the National Guaranty Purchase Center*, May 8, 2007.

July 31, 2007, because it did not identify lender noncompliance with SBA loan origination, servicing, and/or liquidation requirements.<sup>5</sup>

OFA, with assistance from the OCFO, prepares the Agency's estimate of improper payments for the 7(a) program. This estimate is based on an annual review of a sample of guaranty loan purchases. The FY 2008 review for improper payments was performed by review teams operating in three separate loan servicing centers, including the National Guaranty Purchase Center and the Fresno and Little Rock Commercial Loan Servicing Centers. These teams reviewed a sample of 186 loans, totaling \$15.2 million, of the 13,022 7(a) loan guaranties purchased between April 1, 2007 and March 31, 2008, totaling \$869 million. Before calculating the FY 2008 improper payment rate reported to OMB, OFA reviewed those loans identified by the centers as having improper payments to determine which improper payments should be reported.

## **RESULTS IN BRIEF**

SBA's estimate for FY 2008 significantly understated the level of improper payments in the 7(a) program. SBA reported that improper payments were 0.53 percent of FY 2008 program outlays. In contrast, we estimated the improper payment rate to be 27 percent, or approximately \$234 million, of the \$869 million in loan guaranties purchased between April 1, 2007, and March 31, 2008.<sup>6</sup>

We determined that all 30 purchased loans we reviewed had improper payments totaling \$680,548. For all 30 loans, outstanding ongoing guaranty fees due to SBA (approximately \$300 on average), were not offset against purchase amounts paid to lenders. Additionally, 12 of the 30 loans lacked evidence to support that lenders complied with SBA origination, servicing, and/or liquidation requirements. In contrast, OFA reported improper payments of \$4,468 on only 2 of the sampled loans. Loan reviews performed in the loan processing Centers missed many of the deficiencies identified by our audit. A listing of the 30 loans is provided in Appendix III.

In addition to the 30 sampled loans we reviewed, we found that improper payments on three other loans reported by SBA's National Guaranty Purchase Center, totaling \$1.6 million, were inappropriately overturned by OFA. Had these improper payments not been overturned, the improper payment rate reported to OMB would have been 10.75 percent rather than the 0.53 percent reported. OFA's justification for overturning the improper payment findings was inadequate

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<sup>5</sup> OIG Report 9-08, *Audit of the Liquidation Process at the National Guaranty Purchase Center*, January 30, 2009.

<sup>6</sup> This estimate was based on the same statistical projection methodology used by SBA to report its rate of improper payments and reflects the point estimate of improper payments in the payment universe of \$869 million. See Appendix II for additional projection information.

as it was based on insufficient information to correct the deficiencies and inaccurate interpretations of SBA's procedures.

OFA's sampling design was also flawed because it employed attribute sampling when it should have used variable sampling since the payment universe contained divergent guaranty purchase amounts. Additionally, OFA, in coordination with OCFO, did not properly apply the error rate in projecting the total value of improper payments made in FY 2008. As a result, OFA's projection was statistically invalid. These errors occurred because OFA did not consult with a statistician, as required, or obtain approval to deviate from OMB's sampling requirements.

Because our estimate of SBA's FY 2008 improper payment rate for the 7(a) program was so significant, it requires corrective action by the Agency. Although SBA developed a plan to reduce improper payments, the plan had not been fully implemented.

Finally, we found that OFA did not timely recover improper payments identified during its FY 2007 and FY 2008 improper payment reviews, and had only recovered about 1 percent of the improper payments identified in these 2 years.

We made several recommendations to the Associate Administrator for Capital Access, including that he (1) recover \$2.3 million of improper payments (i.e., \$680,548 from the sample and \$1.6 million from 3 other loans); (2) ensure that complete and consistent reviews are performed; (3) consult with a statistician to ensure variable sampling procedures are employed, precision requirements are met, and projections are statistically valid; (4) fully implement the Agency's corrective action plan to reduce improper payments, and (5) establish recovery time frames for improper payments identified by the centers during their improper payment reviews.

We also recommended that the Acting Chief Financial Officer report the OIG's FY 2008 estimate of improper payments to OMB. Finally, we recommended that the Chief of Staff delegate final approval of improper payment decisions to the Office of Risk Management.

Management agreed or partially agreed with all of the recommendations made to improve the improper payment review process. In addition, the Agency agreed that recovery should be sought for some of the identified improper payments, but did not specify agreement or disagreement for each loan, and suggested that disputes be presented to the Office of Risk Management for final resolution.

The Office of Capital Access also agreed to implement its corrective action plan, report the OIG's FY 2008 improper payment estimate to OMB, and establish recovery time frames. However, it did not agree to delegate final approval of improper payment decisions to the Office of the Chief Financial Officer, as originally recommended, but suggested that the Office of Risk Management be responsible for resolving improper payment disputes. This alternative course of action included an inappropriate threshold for Center and OFA disputes, and therefore, did not fully address our recommendation.

## RESULTS

### OFA Significantly Underestimated the FY 2008 Improper Payment Rate

A review of 30 of the 186 loans sampled by SBA disclosed that it did not identify all improper payments associated with these loans. SBA identified only 2 improper payments, totaling \$4,468, for the 30 loans we sampled. In contrast, we identified improper payments related to ongoing lender guaranty fees on all 30 loans, of which 12 evidenced lender compliance issues or SBA processing errors.<sup>7</sup>

- **Outstanding Guaranty Fees.** For all 30 sampled loans, we found that outstanding guaranty fees due to SBA (approximately \$300 on average<sup>8</sup>) were not offset against the guaranty purchase amounts disbursed to lenders. On a monthly basis, SBA collects an ongoing guaranty fee from lenders based on the outstanding balance of the guaranteed portion of each loan. Upon loan default, however, the fees are not collected and continue to accrue. Therefore, at guaranty purchase, the unpaid guaranty fees must be offset against the purchase amounts disbursed to lenders. We found that these adjustments were not made for the 30 sampled loans, resulting in improper payments.
- **Creditworthiness.** Four of the early-defaulted loans in our sample were purchased without the required evidence for repayment ability and creditworthiness. 13 CFR 120.150 requires applicants to be creditworthy and loans to be so sound as to reasonably assure repayment, considering the character, reputation, and credit history of the borrower. Further, when credit decisions are delegated to lenders, they must use appropriate and generally accepted credit analysis procedures consistent with their non-SBA guaranteed commercial loans. If a lender's credit analysis

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<sup>7</sup> The 12 we identified included the two identified by OFA.

<sup>8</sup> While individual improper payments related to fees were relatively small, the cumulative effect is estimated to be over \$3 million for the universe of 13,022 loans.

demonstrates that the applicant lacks reasonable repayment ability, the loan request should be declined.

- **Eligibility.** In one case, SBA purchased a loan to a business demonstrating religious influence, which was not eligible for financing. SOP 50 10 (4), *Loan Processing*, dated December 1, 2000, specifically prohibits SBA financing to such businesses.
- **Use of Proceeds.** In two instances, loan proceeds were used to reimburse borrowers for expenses incurred up to 10 months prior to loan approval. SBA Form 1050, *Settlement Sheet*, states that proceeds may be used to reimburse borrowers for evidenced expenditures made after loan approval.
- **Collateral Liquidation.** Lenders on two loans did not conduct timely site visits, provide collateral lists, or secure collateral, as required. SOP 50 51, *Loan Liquidation and Acquired Property*, dated April 20, 2005, requires SBA to repair or deny loans if collateral is missing or devalued as a result of a lender's failure to conduct a timely site visit or obtain a meaningful collateral inspection.

We also found that SBA made improper payments on 4 of the 30 sampled loans because it did not identify that lenders (1) sold a loan after receiving SBA's guaranty purchase, or (2) charged a disallowed fee to the borrower. SBA also lost one of its loan files, and did not reconcile loan transcripts for another loan, as required.<sup>9</sup>

Lastly, the three Community Express loans in our sample did not demonstrate evidence that borrowers received the required technical assistance. Under the Community Express program, borrowers must receive pre- and post-loan closing management and technical assistance. If the lender cannot provide documentation showing technical assistance was provided or strongly encouraged, SBA may deny liability on the guaranty in full or in part. However, SBA procedures in place during the FY 2008 improper payment review period were unclear regarding the documentation required from lenders to demonstrate that they met the technical assistance requirements. As a result, SBA's purchases of these loans were not considered improper for this audit. In the future, however, SBA should ensure that all Community Express loans meet the current SBA technical assistance requirements and that the guaranty percentage is reduced to 50 percent<sup>10</sup> in instances of noncompliance.

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<sup>9</sup> SBA reported the related improper payments for these two loans to OMB.

<sup>10</sup> This is the SBA guaranty share for regular SBAExpress loans, which do not have a technical assistance component.

## **SBA Did Not Adequately Review Sampled Loans, Report All Identified Improper Payments, or Comply with OMB Guidance for Its Sample Design and Measurement Methodology**

### *SBA Relied on Loan Review Processes that Did Not Adequately Detect Errors*

We found deficiencies in the reviews conducted by all three SBA loan centers and noted inconsistencies in the reviews of SBAExpress and Community Express loans conducted by the Fresno and Little Rock Servicing Centers. For example, the Fresno center did not identify any improper payments in the 6 loans in our sample, while we found that 2 of the 6 loans, valued at \$73,884, had material improper payments totaling \$34,747. We found that all of the sampled loans had unpaid ongoing guaranty fees that were not offset against purchase amounts paid to lenders even though the Quality Assurance Review (QAR) checklist required a review of lender fees. Further, reviews for eligibility and collateral liquidation were inadequate to identify improper payments because the QAR checklist did not require a detailed review of all material areas of lender compliance.

In contrast, the Little Rock checklist generally covered the material areas of lender compliance. Nevertheless, we found that credit analysis reviews were inadequate to identify improper payments. Specifically, borrower creditworthiness was not supported for three purchased early-defaulted loans. Additionally, the QAR checklist did not require a review of lender ongoing guaranty fees.

Finally, SBA's National Guaranty Purchase Center generally performed adequate reviews using a detailed checklist covering all material areas of lender compliance. The Center, however, did not identify unpaid ongoing guaranty fees for all loans reviewed and missed material improper payments on one CAPLines loan and one secondary market loan. The improper payment on the CAPLines loan involved lender noncompliance with complex SBA disbursement requirements. The improper payment on the secondary market loan was not identified because Headquarters officials inappropriately directed the Center to limit its review to a reconciliation of loan transcripts rather than performing a complete purchase review. According to OMB officials, a full purchase review should have been completed prior to the improper payment review.

### *OFA Did Not Report All Identified Improper Payments to OMB*

We determined that 7 improper payments reported by the National Guaranty Purchase Center were overturned by OFA. Four of the seven were overturned primarily because SBA secured additional information from lenders after the Center's review, which showed lender compliance. However, the remaining three were inappropriately overturned because OFA did not properly apply SBA's

policies and procedures or OMB's definition of an improper payment. These loans were not included in the statistical sample for the audit, and therefore, did not affect the OIG's estimated improper payment rate. Nevertheless, had OFA upheld the Center's decisions on these three loans, the improper payment rate reported to OMB for the 7(a) program would have been 10.75 percent rather than the 0.53 percent reported.

Instead of holding lenders accountable for noncompliance with Agency requirements and disclosing improper payments, OFA upheld the guaranty purchase decisions on the three loans without adequate justification. OFA's rationale was based on information received from lenders that was not sufficient to correct the deficiencies and inaccurate interpretations of SBA's procedures. Specifically:

- The National Guaranty Purchase Center recommended recovery of an improper payment because a lender did not provide evidence that credit card debt refinanced with SBA loan proceeds was used for legitimate business purposes, as required. OFA ignored this requirement and claimed the lender's cash flow analysis demonstrated that the owner did not need to use business credit card debt for personal living expenses. Regardless of the cash flow sufficiency, the lender was required to provide evidence that the credit card debt was used for business purposes. Since the lender did not do so, SBA procedures and OMB guidance required that this guaranty purchase be treated as an improper payment for reporting and recovery purposes.
- The Center determined that another loan was ineligible for SBA financing because it was subject to an excessively restrictive license agreement. SBA's Office of General Counsel (OGC) concurred, opining that lenders are required to verify the eligibility of each loan. OFA dismissed this decision, claiming that the lender relied on SBA's approval of a previous loan made to the borrower that was also subject to the license agreement. However, we found that SBA was unaware of the license agreement when the first loan was approved. Therefore, based on the Center findings and OGC opinion, both loans were ineligible for SBA financing. The lender's reliance on the previous loan approval and OFA's overturning of the improper payment decision were inappropriate.
- The Center identified an improper payment of approximately \$1.5 million because a lender failed to underwrite an early defaulted loan in a commercially prudent manner. The Center found that the lender did not (1) verify that a significant cash injection was made, (2) ensure the borrowers were properly licensed to operate the business, and (3) appropriately value

the business. After obtaining additional information from the lender, OFA overturned this improper payment decision stating that all of the Center's findings could be satisfactorily addressed except for the verification of \$40,000 of equity injection, which it deemed immaterial. We determined that OFA inappropriately overturned the decision because the lender did not appropriately support repayment ability or ensure that the borrowers had adequate working capital to support the early business operations, as was deemed necessary in its credit analysis. Additionally, we found that (1) the lender's business valuation was inappropriate for the type of assets being purchased and appeared to be overstated, (2) \$240,000 of the \$300,000 equity injection was not verified as required, and (3) the primary owner of the business was not licensed in the state where the business was operating. OFA refuted each of the Center's findings individually and did not consider the cumulative effect of the lender's deficiencies on this early-defaulted loan, as required by SOP 50 51. As a result, OFA's decision conflicted with SBA procedures.

OFA's decision to overturn the three loans, demonstrates its unwillingness to hold lenders accountable for noncompliance, which was brought to the attention of SBA management in a previous OIG audit.<sup>11</sup> The lender advocacy role of OFA and OCA conflicts with that of the National Guaranty Purchase Center, which is responsible for timely processing guaranty purchase requests and ensuring lender compliance with SBA's rules and regulations. Therefore, allowing OFA to make the final decision on which improper payments get reported compromises the improper payment reporting process as OFA lacks the organizational independence needed to maintain the integrity of the process. Removing this function from OFA is essential to provide assurance that all correctly-identified improper payments are reported.

#### *OFA Did Not Comply with OMB Guidance for Its Sample Design and Measurement Methodology*

OMB Circular A-123 requires agencies to obtain a statistically valid estimate of the annual amount of improper payments for programs that are most susceptible to erroneous payments. Agencies must also consult with a statistician to ensure the validity of their sample design, sample size, and measurement methodology. In some cases, agencies may need to use more complex sample designs because their universe contains divergent dollar amounts. Despite this requirement, OFA did not use the appropriate sample design or measurement methodology for estimating improper payments. It also did not consult with a statistician or obtain OMB approval to deviate from requirements at any point during the review process.

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<sup>11</sup> OIG Report 9-08, *Audit of the Liquidation Process at the National Guaranty Purchase Center*, January 30, 2009.

In testing for improper payments, OFA employed attribute sampling, which is a technique used to determine whether a characteristic exists in the population. This methodology can be used to test whether a payment was improper, but it is inappropriate for estimating the rate or value of improper payments. OFA should have used variable sampling to derive its estimate of improper payments. Variable sampling is generally used to predict a value for a given population. This technique involves sampling a number of payments, computing the value of those payments, and finally deriving the statistical projection of the value of those payments in the population. Because OFA used attribute sampling to derive its estimate of improper payments, its estimate did not meet the precision requirements established in Appendix C of OMB Circular A-123.

Further, in making its projections, SBA combined data from different time periods, using one time period for its sample error rate and another for the population that the rate was applied against. Specifically, the error rate was obtained from a sample of loans purchased between April 1, 2007, and March 31, 2008, but was projected to the universe of loans purchased between October 1, 2007 and September 30, 2008. Consequently, SBA's projection methodology was statistically invalid. The sampling and measurement methodology flaws could have been avoided had OFA consulted with a statistician. Instead, OFA's sampling plan was developed by SBA officials who had no statistical sampling expertise.

### **OFA Did Not Timely Recover Improper Payments**

OMB Circular A-123 also requires SBA to report in its annual Performance and Accountability Report to OMB its efforts to (1) recover the identified improper payments, (2) implement corrective actions to reduce improper payments, and (3) prevent recurrence.

SBA's corrective action plan for reducing improper payments in the 7(a) program states it will (1) identify, analyze, and communicate error patterns to the reviewers; (2) revise policies and procedures and issue specific guidance where necessary; (3) provide training and supplement center resources where possible; and (4) implement a quality assurance review program to identify and mitigate emerging patterns or potential problem areas that might result in future improper payments.

For FY 2007, SBA established a target recovery rate of 85 percent of the total reported improper payments, or \$50,717. As of September 17, 2008; however, SBA had recovered only \$1,674, or 2.8 percent. When interviewed, OFA officials could not explain the reasons for the delay in recovering the improper payments.

In addition, SBA had not achieved the improper payment target recovery rate of 85 percent, or \$76,441, for FY 2008. As of February 2, 2009, OFA had not recovered any of these improper payments, which, according to an OFA official, was due to a miscommunication regarding who was responsible for collection.

While the Agency's corrective action plan for reducing improper payments in the 7(a) program is sufficient to track the causes of improper payments and to mitigate similar improper payments, due to the low error rate identified by SBA, it has not been fully implemented. Since we found that the improper payment rate is significantly higher than reported, the corrective action plan must be fully implemented in conjunction with our other recommendations to improve the review processes and ensure that all improper payments are identified and considered for corrective action.

## **RECOMMENDATIONS**

We recommend that the Associate Administrator for Capital Access:

1. Seek recovery of \$2.3 million from lenders on the loans listed in Appendices III and IV.
2. Revise checklists used by the Fresno and Little Rock Loan Servicing Centers and the National Guaranty Purchase Center to conduct improper payment reviews to include a review of all loan program requirements and lender ongoing guaranty fees to ensure that complete and consistent reviews are performed.
3. Instruct the centers to offset ongoing guaranty fees due SBA at the time of guaranty purchase against purchase amounts or servicing fees paid to lenders.
4. Ensure post purchase reviews are completed prior to the improper payment review of loans purchased from the secondary market.
5. Ensure that all Community Express loans meet the current SBA technical assistance requirements and that the guaranty percentage is reduced to 50 percent in instances of noncompliance.
6. Require that a statistician be consulted when developing the sampling design and projection methodology to ensure that variable sampling procedures are employed, precision requirements are met, and projections are statistically valid as required by OMB guidance.

7. Fully implement the corrective action plan reported in SBA's FY 2008 *Performance and Accountability Report* to reduce improper payments in the 7(a) Guaranty Loan Programs.
8. Establish time frames for the recovery of improper payments identified by the centers during their improper payment reviews.

We recommend that the Acting Chief Financial Officer:

9. Report the revised improper payment rate calculated by the OIG for FY 2008 to OMB.

We recommend that the Chief of Staff:

10. Delegate final approval of all disputed denial, repair, and improper payment decisions to the Office of Risk Management, rather than OFA, to enhance independence of the purchase review process and accuracy of the improper payment estimate.

## **AGENCY COMMENTS AND OFFICE OF INSPECTOR GENERAL RESPONSE**

On April 29, 2009, we provided a draft of this report to SBA for comment. On June 17, 2009, SBA submitted its formal comments, which are contained in their entirety in Appendix V. Management agreed with recommendations 2, 5, 6, 7, and 9; partially agreed with recommendations 1, 3, and 4; and disagreed with recommendation 10, but proposed an alternative course of action, which did not fully address the recommendation. It appears that management misunderstood the intent of recommendation 8 and as a result, its comments were non-responsive. Specific management comments on the report findings and recommendations, and our evaluation of them, are summarized below.

### **Management Comments**

#### *Comment 1*

Management stated that the audit contained recommendations that would improve the improper payment review process, but expressed concern about the classification of all 7(a) guaranty purchases as improper due to the unpaid lender servicing fees on purchased loans. While management agreed that SBA should have a process to collect unpaid annual guaranty fees, it disagreed that a purchase that was otherwise proper should be deemed improper because of an outstanding fee due SBA.

Management stated that the OIG conclusion assumes that SBA must exercise a right of offset with respect to the unpaid fees and that by not doing so, an improper payment was made. Management claimed that SBA is not required to exercise its right to offset to collect debts, and cannot for loans that have been sold in the secondary market. As a result, management believes that the collection of outstanding fees and the evaluation of purchase disbursements under the Improper Payments Information Act of 2002 are two separate issues.

### *OIG Response*

We disagree that a purchase can be deemed proper if unpaid guaranty fees have not been offset against the amount paid to the lender. Appendix C of OMB Circular A-123, *Requirements for Effective Measurement and Remediation of Improper Payments*, states that an improper payment includes any payment that was made in the incorrect amount. Any payment made to an SBA lender in excess of what is owed is an overpayment, and therefore, improper under OMB guidance.

13 CFR § 120.220(f) requires lenders to pay SBA an annual service fee equal to a designated percentage of the outstanding balance of the guaranteed portion of each loan. SBA has implemented the collection of this fee from lenders via its Fiscal and Transfer Agent (FTA) on a monthly basis in order to correspond with its 1502 reporting process. SOP 50 10 (5) states that by the third calendar day of each month, lenders must remit to the FTA either the payment owed (including the ongoing guaranty fee) if the guaranteed portion has been sold in the secondary market, or the ongoing guaranty fee if the guaranteed portion has not been sold. Upon loan default, however, ongoing guaranty fees are not paid by lenders and continue to accrue until guaranty purchase.

While there has been some confusion within the Agency as to who is responsible for calculating and collecting the outstanding fees, it has always been management's intent to exercise a right of offset against purchase amounts for both regular and secondary market loans. In fact, when this issue was brought to the attention of Agency officials during a previous audit,<sup>12</sup> they were surprised to learn that these offsets were not taking place. Additionally, while not being used, SBA's Guaranty Purchase Tracking System contains a field to deduct unpaid lender fees from the purchase amounts.

Further, when a loan is purchased from the secondary market, SBA pays the secondary market investor its guaranty amount, and separately pays the lender its servicing fees. It is these lender servicing fees that can be offset by those owed to

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<sup>12</sup> OIG Report 8-09, *Audit of Loan Classifications and Overpayments on Secondary Market Loans*, January 11, 2008.

SBA at the time of purchase. As a result, we disagree with management's statement that it cannot offset unpaid fees against the purchase of loans that have been sold on the secondary market. In fact, in response to a recommendation made in our previous audit, SBA agreed that unpaid ongoing guaranty fees could be offset against the servicing fees paid directly to the lender at the time of purchase. Therefore, we maintain our position that all 30 purchased loans we reviewed had improper payments.

## **Recommendation 1**

### *Management Comments*

Management agreed to seek recovery on the purchases it agreed were classified as improper, and stated it would provide a full discussion of those it disagrees with after a review of the files is completed. Management suggested that disagreements between OFA and OIG be presented to the Office of Risk Management for review and final resolution.

### *OIG Response*

Management's comments were not fully responsive to this recommendation. During March and April 2009, we provided SBA management detailed deficiency summaries for the 30 loans we reviewed. We also conducted meetings with Center and OFA officials to discuss our findings, and provided a 3-week extension for the Agency's response. As a result, we believe management was provided sufficient time to fully respond to this recommendation, and it is unclear why management could not provide a full discussion of its agreement or disagreement to the individual identified improper payments in its response to our draft report. Additionally, management needs to provide a target date for final action to address this recommendation.

## **Recommendation 2**

### *Management Comments*

Management agreed with the recommendation and stated it would revise the review checklists by September 30, 2009.

### *OIG Response*

Management's comments were responsive to the recommendation.

### **Recommendation 3**

#### *Management Comments*

Management agreed with this recommendation for loans that were not sold on the secondary market and suggested that modifications be made to Agency systems so that unpaid fees can be calculated and deducted automatically from purchase disbursements. Management stated that it would implement these changes by June 30, 2010. In the meantime, for purchases having an SBA-guaranteed principal amount over \$250,000, management stated it will determine its authority under existing regulations to calculate manually and deduct the unpaid fee from the purchase. With regard to loans sold on the secondary market, management stated it cannot implement these changes since lenders do not receive any payment for the purchase.

#### *OIG Response*

We commend the Agency for recognizing the importance of this function and offering the necessary adjustments needed to collect outstanding fees. However, we disagree that this recommendation cannot be implemented for loans sold on the secondary market. When a loan is purchased from the secondary market, SBA pays the secondary market investor its guaranty amount, and separately pays the lender its servicing fees. It is these lender servicing fees that can be offset by any fees owed to SBA at the time of purchase. In response to a previous audit recommendation, SBA agreed to this practice. Furthermore, the June 30, 2010 target date for implementation is unacceptable as management previously agreed to implement a similar process by September 30, 2009.

We acknowledge and appreciate the Agency's effort to implement an interim process for the calculation and deduction of unpaid fees from purchase amounts for those loans with guaranteed principal amounts over \$250,000. However, we believe this threshold is too high as 90 percent of SBA's 7(a) purchases fall below this amount. Consequently, we consider management's comments to be partially responsive to the recommendation.

### **Recommendation 4**

#### *Management Comments*

Management stated that it agreed with the recommendation to the extent that the improper payment review for secondary market purchases is limited to a review of the disbursement to the secondary market holder. Management stated that its obligation to the secondary market holder is an independent contractual obligation

and cannot be considered an improper payment even if SBA later determines it has grounds for recovery from the lender.

*OIG Response*

Management's comments were not fully responsive to the recommendation. SBA did not consult with OMB before directing the centers to limit their improper payment reviews on secondary market loans to a reconciliation of loan transcripts, rather than performing complete post-purchase reviews. SBA claimed that because of its contractual obligation to the secondary market investor, SBA's payment could not be considered improper even if it was later determined that SBA had grounds for recovery from the lender. This interpretation of the improper payment guidance is flawed as it allows the Agency to ignore a significant amount of potential improper purchases.

During our audit, we provided OMB with an explanation of SBA's review process for secondary market loans and its contractual obligation to secondary market investors. OMB's position is that a full post-purchase review should be completed prior to the improper payment review because it can reasonably be expected to identify a significant amount of payment errors. Therefore, if SBA took timely action to perform a post-purchase review and identified and recovered the payment error, the purchase would not be considered improper. In contrast, if SBA did not perform a timely post-purchase review or its review was deficient in identifying lender noncompliance, the purchase from the secondary market would be deemed improper.

Management needs to provide a revised response and a target date for final action to sufficiently address this recommendation.

**Recommendation 5**

*Management Comments*

Management stated that it agreed with this recommendation as long as the technical assistance requirements required at the time of loan approval are applied. Management stated that these requirements were made increasingly clear over time, and that retroactive application of technical assistance instructions on lenders is inappropriate.

*OIG Response*

Management's comments were responsive to the recommendation, but a target date for final action is needed to sufficiently address this recommendation. It is

important to note, however, that pre and post-closing technical assistance has been a requirement of the SBA Community Express program since August 1, 2000. None of the loans we reviewed exhibited support that lenders provided, arranged, and, when necessary, paid for post-closing technical assistance to borrowers. Further, SBA had not issued clear guidance on its technical assistance requirements to lenders until September 16, 2008.

## **Recommendation 6**

### *Management Comments*

Management agreed with this recommendation and is making arrangements to retain a statistician.

### *OIG Response*

Management's comments are responsive to the recommendation, and needs to provide a target date for final action to sufficiently address this recommendation.

## **Recommendation 7**

### *Management Comments*

Management agreed with this recommendation, and stated it has been implementing its corrective action plan on an ongoing basis. Management provided an overview of the corrective action plan and a status of current efforts.

### *OIG Response*

Management's comments were responsive to the recommendation. However, the Quality Assurance Review (QAR) program must be fully implemented before this recommendation can be closed. Management also needs to provide a target date for final action to sufficiently address this recommendation.

## **Recommendation 8**

### *Management Comments*

Management agreed with this recommendation, and stated that purchases identified as improper by the OIG and agreed to by the Office of Capital Access will be recovered by September 30, 2009 or referred to the Office of General Counsel.

*OIG Response*

Management misinterpreted our recommendation and believed it referred only to those improper payments identified in this audit. The intent of our recommendation was for SBA to establish timeframes for the recovery of *all* improper payments identified by the centers during their improper payment reviews. Our recommendation has been revised to reflect this intent. Resolution of this recommendation will occur during the audit resolution process. Management also needs to provide a target date for final action to sufficiently address this recommendation.

**Recommendation 9***Management Comments*

Management agreed to work with OMB to clarify its guidance on the Improper Payments Information Act. After clarification is received, SBA will issue the appropriate disclosure for the FY 2008 estimate. This will occur in November 2009.

*OIG Response*

Management's comments were responsive to the recommendation.

**Recommendation 10***Management Comments*

Management disagreed and offered an alternative action for this recommendation. Management believes that delegating final approval of improper payment decisions to the Office of the Chief Financial Officer (OCFO) would be inconsistent with its primary organizational responsibilities and resources. Management suggested an alternative resolution process when OFA disagrees with an OIG recommendation or OFA disagrees with a purchase center's recommendation involving an amount in excess of \$250,000. In such instances, the Office of Risk Management (ORM) will review the opinions of each party, and within 30 to 60 days, cast a tie-breaking vote.

*OIG Response*

The alternative action proposed by management is an important step in improving the independence of the improper payment review process. However, this resolution process should apply to all repair and denial disputes arising during the

7(a) guaranty purchase process and OIG audits, in addition to those arising in the improper payment review process. Furthermore, the materiality threshold of \$250,000 proposed by management for Center and OFA disputes would exclude the majority of repair and denial amounts recommended by the centers. We believe a more appropriate threshold would be \$50,000. Our recommendation has been revised to reflect the alternative resolution process and to incorporate all disputed denial and repair decisions. However, management needs to establish a more appropriate threshold and provide a target date to sufficiently address this recommendation.

## **ACTIONS REQUIRED**

Because your comments did not fully address recommendations 1, 3, 4, and 8, we request that you provide a written response providing additional details for implementing the recommendations within 2 weeks from issuance of this report. Furthermore, forms 1824 must be provided for all recommendations in our report, and target dates for final action must be provided for recommendations 1, 4, 6, 7, 8, and 10. If a timely response is not received, these recommendations will be pursued through the audit resolution process.

We appreciate the courtesies and cooperation of the Office of Capital Access and Office of the Chief Financial Officer during this audit. If you have any questions concerning this report, please call me at (202) 205-[FOIA ex. 2] or Pamela Steele-Nelson, Acting Director, Credit Programs Group, at (202) 205-[FOIA ex. 2].

## APPENDIX I. SCOPE AND METHODOLOGY

The audit objectives were to determine (1) whether the Small Business Administration's (SBA) FY 2008 estimate of the improper payment rate for the 7(a) program was accurate, (2) if the estimate was not accurate, the reasons why, and (3) if recovery goals for FY 2007 and FY 2008 were met.

To satisfy the audit objectives, we analyzed the Agency's sampling procedure, error rate calculation, and statistical projection methodology. We also consulted Office of Management and Budget (OMB) officials to determine how the improper payment definition specifically applies to the 7(a) program. SBA conducted improper payment reviews on a sample of 186 7(a) guaranty loans purchased between March 31, 2007 and April 1, 2008 to determine its FY 2008 improper payment rate.

We tested the accuracy of the Agency's estimate by reviewing a random sample of 30 of the 186 loans reviewed by the Agency. Our analysis involved testing all 30 loans for lender noncompliance with SBA origination, servicing, and/or liquidation requirements and comparing our results to those reported by SBA. In instances where deficiencies were noted, we interviewed Office of Financial Program Operations (OFPO) and Office of Financial Assistance (OFA) officials regarding their assessment and review approach. Additionally, we reviewed each loan to determine whether ongoing lender guaranty fees due SBA were offset against guaranty purchase amounts.

We also reviewed 7 loans where OFA had overturned the National Guaranty Purchase Center's improper payment decisions to determine whether OFA's reversal of these decisions was appropriate. These 7 loans were not part of our statistical sample, but were part of the 186 purchased loan guaranties reviewed by OFA. Finally, we assessed SBA's improper payment recovery efforts for FY 2007 and FY 2008 by reviewing SBA's accounting records and interviewing OFA officials.

We tested the reliability of the FY 2008 7(a) purchase data in the Loan Accounting System (LAS) that was used by SBA to define the loan universe by verifying that all disbursement dates fell within the FY 2008 time frame. We also compared disbursement amounts reported in LAS to amounts reported in SBA's Guaranty Purchase Tracking System to ensure that they were identical.

The audit was conducted between August 2008 and March 2009 in accordance with *Government Auditing Standards* prescribed by the Comptroller General of the United States, and included such tests considered necessary to provide reasonable assurance of detecting abuse or illegal acts.

## APPENDIX II. STATISTICAL SAMPLING METHODOLOGY

OFA randomly selected a statistical sample of 186 purchased 7(a) loans from a population universe of 13,022 purchases totaling approximately \$869 million to estimate its FY 2008 improper payment rate. From OFA's sample of 186 loans, which totaled approximately \$15 million, we randomly selected a statistical sample of 30 loans (totaling \$2.5 million), to estimate our population values. In statistical sampling, the estimate of attributes in the population universe has a measurable precision or sampling error. The precision is a measure of the expected difference between the value found in the sample and the value of the same characteristics that would have been found if a 100-percent review had been completed using the same techniques.

We calculated the population point estimates and the related lower limits for the selected attributes, using the Defense Contract Audit Agency's "EZ Quant" software program, at a 90-percent confidence level. Projecting our sample results to the universe of approximately \$869 million in loan disbursements, we estimated SBA's FY 2008 improper payment rate to be approximately 27 percent, or approximately \$234 million. The table below shows our calculation for the value and rate of FY 2008 improper payments.

<b><i>OIG CALCULATIONS OF SBA'S FY 2008 IMPROPER PAYMENTS</i></b>			
	<b><i>Occurrence in Sample of 30 Loans</i></b>	<b><i>Population Point Estimate</i></b>	<b><i>Lower Limit at 90-Percent Confidence</i></b>
<i>Number</i>	30	13,022	12,058
<i>Dollar value</i>	\$680,548	\$233,638,035	\$31,213,702 <sup>13</sup>
<i>\$ Error Rate</i>	26.89%	26.89%	3.59%

<sup>13</sup> The lower limit dollar value projection was computed using the Difference method rather than the Ratio method.

### APPENDIX III. IMPROPER PAYMENTS ON 30 SAMPLED LOANS

Loan Number	Payment Amount	Improper Payment Amount	Questioned Costs	Deficiency Summary
[FOIA ex. 2]	\$456,426	\$456,426	\$456,426	A,C,F
[FOIA ex. 2]	\$9,678	\$9,678	\$9,678	A,E,F
[FOIA ex. 2]	\$19,885	\$19,885	\$19,885	D,E,F
[FOIA ex. 2]	\$37,007	\$165	\$165	F
[FOIA ex. 2]	\$125,425	\$118,883	\$118,883	C,F
[FOIA ex. 2]	\$38,763	\$199	\$199	F
[FOIA ex. 2]	\$9,921	\$35	\$35	F
[FOIA ex. 2]	\$288,230	\$523	\$5,523	F
[FOIA ex. 2]	\$25,636	\$227	\$227	F
[FOIA ex. 2]	\$2,919	\$8	\$8	F
[FOIA ex. 2]	\$476,712	\$1,803	\$1,803	E,F
[FOIA ex. 2]	\$3,672	\$25	\$25	F
[FOIA ex. 2]	\$216,996	\$100	\$100	F
[FOIA ex. 2]	\$9,619	\$35	\$35	F
[FOIA ex. 2]	\$7,195	\$63	\$63	F
[FOIA ex. 2]	\$2,236	\$3	\$3	F
[FOIA ex. 2]	\$12,619	\$40	\$40	F
[FOIA ex. 2]	\$15,271	\$85	\$85	F
[FOIA ex. 2]	\$144,883	\$214	\$214	F
[FOIA ex. 2]	\$14,540	\$14,540	\$14,540	E,F
[FOIA ex. 2]	\$2,321	\$2,321	\$6	E,F
[FOIA ex. 2]	\$25,623	\$116	\$116	F
[FOIA ex. 2]	\$68,704	\$29,567	\$29,567	D,F
[FOIA ex. 2]	\$5,180	\$5,180	\$5,180	B,F
[FOIA ex. 2]	\$5,180	\$5,180	\$5,180	A,E,F
[FOIA ex. 2]	\$38,856	\$155	\$155	F
[FOIA ex. 2]	\$8,753	\$8	\$8	F
[FOIA ex. 2]	\$393,901	\$998	-\$998	E,F
[FOIA ex. 2]	\$12,563	\$12,563	\$12,563	A,F
[FOIA ex. 2]	\$52,296	\$1,330	\$1,330	F
<b>Totals</b>	<b>\$2,531,010</b>	<b>\$680,548</b>	<b>\$681,237</b>	

#### Deficiency Type Legend:

- A. Creditworthiness
- B. Eligibility
- C. Use of Proceeds
- D. Collateral Liquidation
- E. Miscellaneous (Underpayment to Secondary Market, Loan Sold After Receiving Guaranty, Disallowed Lender Fees, or Incomplete Documentation)
- F. Ongoing Lender Fees

## APPENDIX IV. IMPROPER PAYMENTS ON OVERTURNED LOANS

Loan Number	Payment Amount	Improper Payment Amount	Questioned Costs	Deficiency Summary
[FOIA ex. 2]	\$25,502	\$25,502	\$25,502	B
[FOIA ex. 2]	\$189,229	\$90,252	\$90,252	C
[FOIA ex. 2]	\$1,464,279	\$1,464,279	\$1,464,279	A,B,D,E
<b>Totals</b>	<b>\$1,679,010</b>	<b>\$1,580,033</b>	<b>\$1,580,033</b>	

Deficiency Type Legend:

- A. Creditworthiness
- B. Eligibility
- C. Use of Proceeds
- D. Collateral Liquidation
- E. Equity Injection

## APPENDIX V. MANAGEMENT COMMENTS



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

DATE: June 17, 2009  
 TO: Debra S. Ritt  
 Assistant Inspector General for Auditing  
 FROM: Eric R. Zarnikow  
 Associate Administrator, Office of Capital Access [FOIA ex. 6]  
 Jonathan Carver [FOIA ex. 6]  
 Acting Chief Financial Officer  
 Ann Ma  
 Chief of Staff [FOIA ex. 6]  
 SUBJECT: Draft Report on SBA's Fiscal Year Improper Payment Rate for the 7(a) Guaranty  
 Loan Program, Project No. 8018

Thank you for the opportunity to comment on the referenced draft audit and for the courtesies extended to Office of Capital Access and center staff during the course of the project. We believe the audit contains recommendations that will improve the improper payment review process.

We have an important threshold concern about the draft audit's classification of all 7(a) guaranty purchases as improper if there is an unpaid amount that a lender owes in connection with the annual service fee (referred to in your draft audit as the ongoing guaranty fee) on a purchased loan. While we believe the SBA should have a cost effective process to collect unpaid annual guaranty fees on its loan, we do not agree that a purchase that is otherwise proper should be deemed to be improper for the sole reason that there is an outstanding fee payable from the lender.

According to OMB, an improper payment occurs when funds go to the wrong recipient, the recipient receives the wrong amount of funds, or the recipient uses the funds in an improper manner (from OMB Office of Federal Financial Management improper payments website). We assume that OIG has concluded that there is an improper payment with respect to the fee based on the second category above where the recipient receives the wrong amount of funds. OIG's conclusion assumes that SBA must exercise a right of offset with respect to the fee and that, to not do so, means that an improper payment has been made. However, SBA is not required to exercise a right of offset to collect this debt and, in fact, cannot offset the fee against loans that have been sold in the secondary market. Accordingly, while an offset may in some instances be an appropriate means to collect a debt, we disagree with the conclusion that the purchase of the guaranty is rendered an improper payment by not offsetting the fee. The collection of the debt owed for the outstanding fees and the evaluation of purchase disbursements under the Improper Payments Information Act of 2002 are two separate issues.

Set forth below are our responses to each of the recommendations in your draft audit.

1. Seek recovery of \$7.3 million from lenders on the loans listed in Appendices III and IV.

**Response:** We agree that recovery should be sought on those purchase disbursements that OIG and OFA consider to be improper. However, we disagree with OIG's conclusions regarding some of the purchases classified as improper in the draft audit report and will provide a full discussion of the reasons for our disagreement on each purchase after all file reviews are completed. As indicated in the responses to Recommendations 9 and 10, we suggest that the individual cases on which OFA and OIG disagree be presented to the Office of Risk Management for review and final resolution.

2. **Revise checklists used by the Fresno and Little Rock Loan Servicing Centers and the National Guaranty Purchase Center to conduct improper payment reviews to include a review of all loan program requirements and lender ongoing guaranty fees to ensure that complete and consistent reviews are performed.**

**Response:** We agree with this recommendation. This will be done by 9/30/09.

3. **Instruct the centers to offset ongoing guaranty fees due SBA at the time of guaranty purchase against purchase amounts paid to lenders.**

**Response:** We agree with this recommendation for loans that were not sold in the secondary market, although as stated above, we do not agree that the purchase of any loan that is otherwise proper should be deemed improper if there is an unpaid annual service fee associated with the loan. To collect the service fee for loans that were not sold in the secondary market, we recommend that a modification to GPTS and other systems, including any amendments to the agency's regulations (if necessary), be made so that the amount of the unpaid fee can be calculated and deducted automatically from the purchase disbursement. We anticipate that this modification will be completed by June 30, 2010. In the meantime, for purchases having an SBA guaranteed principal amount over \$250,000 (in which we estimate quarterly fees on these loans to be approximately \$300 on average), we will determine our authority under existing regulations to calculate manually and to deduct the unpaid fee from the purchase similar to the process for a "repair" (although the fee amount offset will not be classified as a repair). As lenders do not receive any payment for the purchase of loans sold in the secondary market, the above changes cannot be implemented for secondary market loans.

4. **Ensure post purchase reviews are completed prior to the improper payment review of loans purchased from the secondary market.**

**Response:** We agree with this recommendation to the extent that the improper payment review for secondary market purchases is limited to the review of the disbursement to the secondary market holder. The issue of whether SBA may seek reimbursement from the lender as a consequence of the post purchase review is a separate issue and is not relevant to whether the disbursement to the secondary market holder was the proper amount. SBA's obligation to the secondary market holder is an independent contractual obligation, and SBA's payment to the secondary market holder cannot be considered to be an improper payment even if it is later determined that SBA has grounds for recovery from the lender.

5. **Ensure that all Community Express loans meet the current SBA technical assistance requirements and that the guaranty percentage is reduced to 50 percent in instances of noncompliance.**

**Response:** We agree with this recommendation to the extent that technical assistance requirements are applied that were required at the time of loan approval. As you know, T/A requirements were made increasingly clear to lenders over time, and a lender cannot be held responsible for the retroactive application of technical assistance instructions promulgated after a loan was approved.

**6. Require that a statistician be consulted when developing the sampling design and projection methodology to ensure that variable sampling procedures are employed, precision requirements are met, and projections are statistically valid as required by OMB guidance.**

**Response:** We agree with this recommendation and are making arrangements to retain a statistician that has worked with OCFO on other 7(a) projects and is therefore familiar with SBA's loan programs.

**7. Implement the corrective action plan reported in SBA's FY 2008 Performance and Accountability Report to reduce improper payments in the 7(a) Guaranty Loan Programs.**

**Response:** We agree with this recommendation and have been implementing the corrective action plan on an ongoing basis. The corrective action plan in the FY 2008 PAR includes the following:

Corrective action procedures followed for the 7(a) guaranty purchase process involve advising the purchase processing team of improper payment determinations and also providing clarification as to the nature of the issues to avoid possible improper payments in the future. In this regard, a fully documented guaranty purchase procedure handbook has been completed, including transcript analysis instructions, and will be updated as needed. This assures consistency in the purchase process and will serve to minimize errors. Other remedial action will be accomplished by:

- identifying and analyzing error patterns;
- communicating error patterns to the centers processing purchases;
- reviewing current policies and procedures to ensure that any error patterns are appropriately addressed in current guidance;
- revising policies and procedures where necessary;
- issuing guidance to the purchase centers on specific issues;
- providing training and
- supplementing center resources where possible to ensure ongoing quality assurance review programs that will identify any emerging patterns or potential problem areas that might result in future improper payments, as well as take action to mitigate these potential problem areas.

With regard to the foregoing corrective action plan, the following has been accomplished and is underway:

Recommended actions	Status and current efforts
1. Identify and analyze error patterns	<ul style="list-style-type: none"> <li>○ as part of the purchase review process, approving officials are attentive to any errors, including repetitive ones, on the part of purchase recommenders</li> <li>○ approving officials address these errors as they arise</li> </ul>

	with the purchase recommenders
2. Communicate error patterns to the centers processing purchases	<ul style="list-style-type: none"> <li>○ SBA HQ staff advise the appropriate center of any errors encountered on loans forwarded for review and present comprehensive analyses of purchases submitted to HQ for consideration</li> <li>○ error patterns are noted for discussion during bi-weekly policy application conference calls and on an individual purchase basis</li> <li>○ written case analyses are circulated among purchase staff at NGPC</li> </ul>
3. Review current policies and procedures to ensure that any error patterns are appropriately addressed in current guidance	<ul style="list-style-type: none"> <li>○ SOP 50 51, chapter 13, on guaranty purchases is being revised, and we are current evaluating comments from the initial clearance process</li> <li>○ in addition, SOP 50 51 as a whole is currently under review for a comprehensive revision; it is anticipated that this revision will be placed in the clearance process by October 31, 2009</li> </ul>
4. Revise policies and procedures where necessary	<ul style="list-style-type: none"> <li>○ as indicated above, the policy revision process is underway on the guaranty purchase chapter of SOP 50 51, and on the entire SOP</li> <li>○ future revisions will take place as needed</li> <li>○ NGPC 10-tab purchase submission system and purchase processing manual are updated when necessary to address error avoidance</li> <li>○ SBAExpress purchase demand kit has been revised</li> <li>○ a matrix for lender servicing and liquidation actions has been posted on the websites of the purchase centers</li> </ul>
5. Issue guidance to the purchase centers on specific issues	<ul style="list-style-type: none"> <li>○ Headquarters and the NGPC purchase approvers and managers began a series of bi-weekly policy application conference calls in March of this year to address topics that have caused errors in the purchase process</li> <li>○ the calls have resulted in written guidance on equity injection verification, lien positions/collateral, verification of borrower financial statements with IRS transcripts and use of proceeds</li> <li>○ these conference calls are continuing on a bi-weekly basis and will address other topics prone to errors</li> </ul>
6. Provide training	<ul style="list-style-type: none"> <li>○ training of purchase staff members is ongoing in connection with the written guidance prepared for the policy application conference calls</li> <li>○ this written guidance is also provided to the commercial loan servicing centers where applicable to SBAExpress purchases</li> </ul>
7. Supplement center	<ul style="list-style-type: none"> <li>○ a QAR function was started at NGPC in November 2008</li> </ul>

resources where possible to ensure ongoing quality assurance review programs	<ul style="list-style-type: none"> <li>o QAR staff at NGPC has increased to four as of May 2009</li> <li>o a designated HQ QAR manager is developing QAR functions at all purchase centers</li> </ul>
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**8. Establish time frames for the recovery of identified improper payments.**

**Response:** We agree with this recommendation. Purchases identified as improper by OIG and agreed to by OCA will be recovered by 9/30/09 if the lender cooperates. If a lender disagrees with an improper payment determination and therefore does not repay the amount in issue, we will refer the matter to OGC for a litigation analysis.

**9. Report the revised improper payment rate calculated by the OIG for FY 2008 to OMB.**

**Response:** The FY 2008 reporting period is closed at this time. SBA will work with OMB to clarify OMB's guidance on the Improper Payments Information Act. After this clarification, SBA will issue an appropriate disclosure on the previously reported improper payments rates. SBA will report SBA's FY 2009 improper payments rate to OMB in November 2009 using the MAX reporting system. At that time, SBA will include an appropriate disclosure related to the previously reported FY 2008 improper payments rate.

**10. Delegate final approval of improper payment decisions to the OCFO, rather than OFA, to enhance independence of the review process and accuracy of the improper payment estimate.**

**Response:** We do not agree with the recommendation that OCFO be an independent reviewer of these improper payment cases, given that it would be inconsistent with OCFO's primary organizational responsibilities and resources. However, in order to appropriately weigh and resolve conflicting opinions during the review of improper payments, OCA will adopt the following resolution process:

- **Scope:**  
Resolution process to be applied to situations in which:
  - o OFA disagrees with an OIG recommendation regarding an individual purchase in the context of an improper payments audit and the disagreement cannot be resolved by the two offices
  - o OFA disagrees with a purchase center's recommendation during an improper payment review and the disputed amount is sufficiently 'material' to warrant consideration through the resolution process. Materiality is defined as involving an amount in excess of \$250,000.
- **Proposed resolution process:**
  - o The Office of Risk Management (ORM) will be charged with conducting a review of both parties' opinions, and then cast a 'rule of two' tie-breaking vote (ie, ORM would concur with one of the two recommendations)

- ORM review and resolution should be completed within 30-60 days on each individual case
- ORM will consult with OGC and other offices as needed