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BY THE U.S. GENERAL ACCOUNTING OFFICE

Report To The Administrator, Small Business Administration

The Small Business Administration's Second-Year Implementation Of The Federal Managers' Financial Integrity Act

GAO reviewed the implementation of the Federal Managers' Financial Integrity Act of 1982 by 23 federal departments and agencies. The act was intended to help reduce fraud, waste, and abuse across the spectrum of federal government operations by requiring agencies to assess and report annually to the President and the Congress on the adequacy of their internal controls and accounting systems.

This report highlights the progress made and problems encountered by the Small Business Administration during its second year under the act. GAO evaluates SBA's efforts to correct internal control weaknesses and improve its accounting systems and discusses ways in which SBA can strengthen its internal control and accounting system evaluations.

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GAO/RCED-86-24
OCTOBER 18, 1985

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UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

RESOURCES, COMMUNITY, AND ECONOMIC DEVELOPMENT DIVISION

B-216946

The Honorable James C. Sanders
Administrator, Small Business Administration

Dear Mr. Sanders:

This report presents our evaluation of the Small Business Administration's second-year implementation of the Federal Managers' Financial Integrity Act of 1982 (U.S.C. 3512 (b) and (c)), which is aimed at strengthening internal control and accounting systems in federal agencies.

This report contains recommendations to you on pages 26, 38, and 39. As you know, 31 U.S.C. 720 requires the head of a federal agency to submit a written statement on actions taken on our recommendations to the Senate Committee on Governmental Affairs and the House Committee on Government Operations not later than 60 days after the date of the report and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report.

We are sending copies of this report to the Director, Office of Management and Budget; appropriate congressional committees; and other interested parties.

Sincerely yours,

J. Dexter Peach
Director

EXECUTIVE SUMMARY

Responding to continuing reports of fraud, waste, and mismanagement in government programs, the Congress enacted the Federal Managers' Financial Integrity Act in 1982. The act establishes government-wide procedures to identify, remedy, and report on internal control and accounting problems that hamper effectiveness, potentially cost taxpayers billions of dollars, and erode the public's confidence in government. The Small Business Administration (SBA), which has a loan portfolio of about $19 billion, is implementing agency-wide efforts to evaluate and improve internal controls, as required by the act.

In evaluating SBA's second-year implementation, GAO examined

--the progress made to identify and correct internal control weaknesses and to evaluate systems of internal controls,

--the status of SBA's accounting systems and evaluations to determine if they conform to GAO requirements, and

--the accuracy and completeness of the SBA administrator's annual report to the President and the Congress on internal controls and accounting systems.

BACKGROUND

The act requires all federal agencies to establish controls that are consistent with standards prescribed by the Comptroller General of the United States and reasonably ensure that (1) obligations and costs comply with applicable law; (2) assets are safeguarded against fraud, waste, and mismanagement; and (3) revenues and expenditures are properly recorded and accounted for. (See p. 1.)

The act also requires agency heads to evaluate their controls and annually report whether their internal control systems comply with the act's objectives. To the extent systems do not comply, the report must identify material weaknesses in their systems together with plans for corrective actions. Agency heads must also report on whether their agencies' accounting systems conform to the Comptroller General's accounting principles, standards, and related requirements. (See pp. 1 and 2.)

To provide a framework for implementation as prescribed by the act, GAO issued standards for agencies to meet in establishing their internal control systems. The Office of Management and Budget (OMB) also has published guidelines that require managers to analyze programs and functions to determine their vulnerability to waste, fraud, and mismanagement. Activities found vulnerable must be further evaluated to determine how internal controls can be strengthened or, if the cause of vulnerability is known, what corrective actions can be taken immediately.

RESULTS IN BRIEF

SBA made progress in correcting internal control weaknesses and implemented a follow-up system that logs and keeps track of related recommendations. While SBA also made reasonable progress in reviewing internal controls in many areas, automated data processing (ADP) controls were not adequately reviewed.

SBA made progress in strengthening its accounting systems, but needs to improve its methods of testing related controls.

The SBA Administrator reported that the system of internal accounting and administrative control, taken as a whole, generally provides reasonable assurance that the act's objectives were achieved. Because the ADP controls were not adequately reviewed, GAO believes SBA does not have a basis to assert such broad assurance. In addition, the administrator's report on accounting systems could be misunderstood because it did not disclose the relatively small size of the systems reviewed.

PRINCIPAL FINDINGS

Correcting Control Weaknesses

In 1984 SBA identified 17 material internal control weaknesses, of which 6 were reported as corrected. SBA's report included plans and schedules for correcting the other 11 material weaknesses. The weaknesses are similar to the ones reported in 1983. (See p. 9.)

SBA made progress in implementing corrective actions pertaining to 16 material weaknesses identified in 1983--the first year of the act. The weaknesses included inadequate examination of loan applications, inadequate computer security, and inadequate controls over payments made to small businesses. (See p. 8 and 9.)

During 1983 and 1984, SBA also identified 225 weaknesses (some offices identified the same weaknesses) that were not categorized as material. GAO examined the corrective actions pertaining to 40 of these and found that virtually all were implemented or are in the process of being implemented. (See p. 11.)

During 1984, SBA implemented a follow-up system to keep track of actions taken to correct material weaknesses. The system tracks recommendations, corrective actions, and related completion dates, and is in accordance with OMB guidelines. (See pp. 11 and 12.)

Evaluating Internal Controls

The internal control reviews completed in 1984 were generally in accordance with OMB guidelines. In addition, SBA's computerized internal control review system provides a good basis for reviewing internal controls at field offices where the preponderance of SBA programs are delivered. Improvements are being made that will make the system more responsive to OMB guidelines. (See pp. 14 and 20 to 25.)

SBA has not, however, adequately reviewed its ADP controls because testing was not performed and staff told GAO that they did not fully understand how to review ADP controls. Furthermore, SBA has not issued guidelines on how to evaluate ADP controls. The evaluation of internal controls is significant because SBA is highly dependent on automated systems to support its mandated mission. (See pp. 16 to 20.)

Accounting Systems Status

The SBA Administrator's report stated that two of SBA's six accounting systems are generally in conformance with the Comptroller General's principles, standards, and related requirements. GAO believes that the report is somewhat misleading because it does not disclose that the two systems accounted for less than 5 percent of the funds accounted for by SBA. (See pp. 36 and 37.)

The administrator's report did not clearly identify and summarize accounting system weaknesses. Instead, the weaknesses were presented in three separate sections of the report and were categorized three different ways--"material weaknesses," "areas of nonconformance," and "deficiencies." GAO believes that the separate reporting and the unexplained disparity in terminology obscures the report's message. (See pp. 36 and 37.)

RECOMMENDATIONS

GAO recommends that

--the SBA Administrator require that ADP controls be reviewed. To accomplish this, appropriate guidelines should be issued and SBA managers should be trained. (See p. 26.)

--in future annual reports, the SBA Administrator accurately describe the scope of assurance given and clearly identify all known accounting system weaknesses. (See p. 39.)

GAO makes other recommendations to the SBA Administrator directed toward improving internal control and accounting systems evaluations. (See pp. 26, 38, and 39.)

AGENCY COMMENTS

The SBA Administrator said that the agency basically agrees with the report's content and will take appropriate action to implement the recommendations. SBA also made several comments to clarify points made in GAO's draft report. These comments have been incorporated into the report where appropriate. (See app. III.)

Contents

ILLUSTRATIONS

ABBREVIATIONS

ADP	automated data processing
CICR	Computerized Internal Control Review
FMFIA	Federal Managers' Financial Integrity Act
GAO	General Accounting Office
OCS	Office of Computer Sciences
OMB	Office of Management and Budget
OPAR	Office of Program Analysis and Review
SBA	Small Business Administration

CHAPTER 1

INTRODUCTION

In 1982 the Congress enacted the Federal Managers' Financial Integrity Act (FMFIA) (31 U.S.C 3512(b) and (c)). The act strengthened the Accounting and Auditing Act of 1950, which required executive agencies to establish and maintain systems of accounting and internal control designed to provide effective control over and accountability for all funds, property, and other assets for which the agencies are responsible (31 U.S.C. 3512 (a)(3)). This report discusses the Small Business Administration's (SBA's) efforts to evaluate and report on the status of its internal controls and accounting systems during fiscal year 1984.

THE ACT'S REQUIREMENTS

FMFIA requires each agency to establish and maintain internal controls in accordance with standards prescribed by the Comptroller General of the United States,[1] and reasonably ensure that (1) obligations and costs comply with applicable law, (2) assets are safeguarded against fraud, waste, and mismanagement, and (3) revenues and expenditures are properly recorded and accounted for. The act also requires agency heads to evaluate the internal controls and report annually to the President and the Congress on whether the internal controls comply with the act's requirements. It also requires a separate statement as part of its annual report on whether the agency's accounting systems conform to the Comptroller General's principles, standards, and related requirements.[2] To the extent that internal controls do not comply with the act's

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[1]The Comptroller General issued Standards for Internal Controls in the Federal Government in June 1983.

[2]The GAO Policy and Procedures Manual for Guidance of Federal Agencies contains the principles, standards, and related requirements to be observed by federal agencies. Specifically, title 2 prescribes the overall accounting principles and standards, while titles 4, 5, 6, and 7 specify requirements governing claims, transportation, pay leave and allowances, and fiscal procedures, respectively. Also, agency accounting systems must include internal controls that comply with the Comptroller General's internal control standards and related requirements, such as the Treasury Financial Manual and OMB circulars.

requirements, the act also requires each agency to identify any material weaknesses[3] in its internal controls and to describe its plan for corrective action.

THE SMALL BUSINESS ADMINISTRATION

SBA was created in 1953 to assist small businesses through various financial, procurement, and management assistance programs. SBA guarantees loans to small businesses that would otherwise be unable to obtain private financing and purchases the guaranteed portion of the loan from the private lender if the borrower defaults. Additionally, SBA has (1) procurement assistance activities that are aimed at assuring that small businesses receive a fair share of government procurements and (2) management assistance programs designed to help small business owners improve the management and efficiency of their businesses. Further, under its disaster assistance program, SBA makes loans to homeowners, renters, and businesses.

As of July 1985, SBA had 3,766 permanent full-time employees. It delivers most of its programs through a network of 66 district and 21 branch offices, which report to its 10 regional offices.

GUIDANCE FOR IMPLEMENTING THE ACT'S REQUIREMENTS

To assist the agencies in implementing FMFIA, GAO has issued standards for agencies to meet in establishing their internal control systems. Likewise, OMB and SBA have issued guidelines on how to conduct internal control evaluations.

GAO standards

The Comptroller General's internal control standards apply to program management as well as to traditional financial management areas and encompass all operations and administrative functions. In publishing the standards, the Comptroller General emphasized that

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[3]Material weaknesses are defined by the House Committee on Government Operations as those matters that could (1) impair fulfillment of an agency's mission, (2) deprive the public of needed government services, (3) violate statutory or regulatory requirements, or (4) result in a conflict of interest.

"The ultimate responsibility for good internal control rests with management. Internal controls should not be looked upon as separate, specialized systems within an agency. Rather, they should be recognized as an integral part of each system that management uses to regulate and guide its operations. In this sense, internal controls are management controls. Good internal controls are essential to achieving the proper conduct of government business with full accountability for the resources made available."

OMB guidance

In October 1981, OMB issued Circular A-123 (which was revised in Aug. 1983). It required agencies to set up an internal control system that meets GAO standards, determines whether internal controls are operating as intended, and assures that necessary corrections are made. OMB, in consultation with GAO, also published guidelines in December 1982 for agencies to use in evaluating, improving, and reporting on their internal control systems. The guidelines describe how agencies should organize the process and segment their programs and functions into assessable units. Agencies then assess the vulnerability of the units to determine their susceptibility to waste, loss, unauthorized use, or misappropriation.

On the basis of the vulnerability assessment's results, the agency makes a further determination about the adequacy of the units' internal controls. The OMB guidelines suggest that highly vulnerable units be subject to a detailed review of internal controls. This involves an examination to determine whether adequate control objectives have been established and control techniques exist and are functioning as intended. A report is then prepared that identifies system weaknesses and contains recommendations as to how weaknesses can be corrected.

SBA guidance

SBA issued a revised operating procedure manual in 1983 to provide policies and standards for internal control systems and to make SBA managers responsible and accountable for establishing, evaluating, improving, and reporting on internal controls. The manual includes copies of the act, OMB guidelines, and GAO standards. In July 1984 SBA issued an appendix to the manual that provided additional guidance on how to conduct internal control evaluations.

ORGANIZATION AND MANAGEMENT OF THE INTERNAL CONTROL REVIEW EFFORT

In March 1982, SBA established an Internal Control Steering Committee to oversee the FMFIA process. This committee meets periodically to assess SBA progress, evaluate ongoing activities, and plan future actions. The day-to-day responsibility for coordinating the internal control review effort has been assigned to the Director, Office of Program Analysis and Review (OPAR), who reports to the senior internal control official--the Associate Deputy Administrator for Management and Administration. In 1982 SBA segmented the agency into 65 assessable units and completed vulnerability assessments to determine whether the units were susceptible to waste, fraud, or abuse.

In December 1983, the steering committee reassessed 12 programs or activities as highly vulnerable to waste, fraud, or abuse. Since that time the internal controls of seven of these areas have been reviewed. Of the remaining five units, one has been reclassified as moderately vulnerable and no review is planned, two were examined by the Inspector General, and two were scheduled for internal control reviews during fiscal year 1985.

At the end of fiscal year 1983--SBA's first year under the act--the SBA Administrator reported to the President and the Congress[4] that its system of internal accounting and administrative control, taken as a whole, generally provided reasonable assurance that the FMFIA objectives were achieved. After reviewing this effort, we reported[5] that the internal controls relating to the automated data processing (ADP) systems had not been adequately evaluated and that no agency-wide system to follow up on internal control weaknesses existed. We also pointed out other problems, including the need to document the internal control review process.

At the end of fiscal year 1984--SBA's second year under the act--the administrator again reported to the President and the Congress[6] that its system of internal accounting and administrative control, taken as a whole, generally provides reasonable assurance that the FMFIA objectives were achieved. In this second-year report, SBA emphasized its heavy reliance on

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[4]U.S. Small Business Administration, Report to the President and the Congress as Required by the Federal Managers' Financial Integrity Act of 1982 (Public Law 97-255), for fiscal year 1983, dated Dec. 23, 1983.

[5]U.S. General Accounting Office, Report to the Administrator, Small Business Administration, Small Business Administration's First-Year Implementation of the Federal Managers' Financial Integrity Act (GAO/RCED-84-125, June 12, 1984).

[6]U.S. Small Business Administration, Report to the President and the Congress as Required by the Federal Managers' Financial Integrity Act of 1982 (Public Law 97-255), for fiscal year 1984, dated Dec. 31, 1984.

a Computerized Internal Control Review (CICR) system to examine the controls at its field offices. The second-year effort was to have included six internal control reviews, but SBA did not complete all six on schedule. Two of the reviews were completed and had reports issued by the end of fiscal year 1984. Two other reviews were completed and were issued as a single report by the end of November 1984. The fifth review was completed in December 1984; however, during the course of our review, SBA management did not accept it as a valid internal control review. After we completed our work, the report was modified and accepted by SBA management; however, we did not review it. (See p. 18.) The sixth internal control review was not finished until February 1985 because of a lack of administrative support. In addition, SBA made preparations to reorganize the entire agency for FMFIA purposes during fiscal year 1985--the third year of the act. This reorganization process will include a reassessment of the agency's vulnerability.

COMPUTERIZED INTERNAL CONTROL REVIEW SYSTEM

In October 1980 SBA began to develop the CICR system for conducting and reporting on reviews of its operations at field offices. This was in recognition of the fact that the preponderance of SBA's programs are delivered through these offices. SBA has described the system as a means for complying with the internal control precepts of the act and OMB requirements pertaining to safeguarding assets against waste, loss, unauthorized use, or misappropriation.

Under this system, SBA managers consult with field office representatives and determine the items to be checked--called checklist items--by identifying those procedures that in their opinion are significant enough to warrant examination and then including them on the checklists. A percentage of compliance with the controls in the operating procedures is arrived at based on an evaluation of the data examined for each checklist item.

Following the reviews, the regional team makes recommendations to the field office to strengthen compliance with internal controls and to improve management and operations within the field office. The team's findings and corrective action plans are transmitted to SBA headquarters, where summary reports are available for management use. The reports can be used to highlight deficient areas, analyze program trends, evaluate corrective actions, and improve internal controls throughout the agency.

REVIEW OF ACCOUNTING SYSTEM EVALUATIONS

SBA's primary effort to determine if the accounting systems conform to requirements prescribed by the Comptroller General consisted of reviews related to two of the agency's six accounting systems. Most of the work was performed by private-sector management consultants under the direction of SBA's Office of the Comptroller. Additionally, SBA scheduled future accounting system reviews on a cyclical basis and developed written guidance for their performance.

The administrator's report to the President and the Congress about SBA's second-year FMFIA effort summarized the results of the evaluation of the two accounting systems. It stated that the accounting systems reviewed, taken as a whole, conform in all material respects to the Comptroller General's principles, standards, and related requirements. The report identified weaknesses in five of the six accounting systems that SBA has either corrected or has plans for correcting.

OBJECTIVES, SCOPE, AND METHODOLOGY

This review's overall objective was to assess SBA's progress in assuring that its internal control and accounting systems were complying with FMFIA. Specific objectives included the following:

--Updating and evaluating SBA's progress in implementing the act, including the role of the CICR system.

--Evaluating corrective actions taken to address internal control and accounting system weaknesses.

--Assessing the reasonableness of SBA's second-year report to the President and the Congress.

Our review was conducted between August 1984 and February 1985. While our major audit effort was performed at SBA's headquarters office in Washington, D.C., we also visited SBA regional offices in Atlanta, Georgia; Boston, Massachusetts; Denver, Colorado; Kansas City, Missouri; Philadelphia, Pennsylvania; and San Francisco, California. In addition, we visited SBA district offices located in these cities as well as in Baltimore, Maryland; Providence, Rhode Island; Salt Lake City, Utah; and Phoenix, Arizona. The purpose of these visits was to validate and test selected SBA policies and procedures.

Our assessment of SBA's progress in evaluating its internal controls included discussions with cognizant SBA headquarters officials, the Inspector General, and selected SBA staff members involved in implementing the act. We also reviewed documentation; made observations; and interviewed officials regarding the CICR system, follow-up systems to address prior internal control weaknesses, and efforts to prepare vulnerability assessments and internal control reviews. Our methodology included (1) independent testing of loan files judgmentally selected at the Providence, Rhode Island, district office that were previously examined by SBA, (2) determining the reasonableness of actions taken to correct all 16 and 17 material weaknesses that SBA identified in 1983 and 1984, respectively, and (3) examining four internal control reviews to determine whether they were reasonable and supported by documentary evidence.

Our review of SBA's accounting systems concentrated principally on evaluating efforts to correct known weaknesses. In addition, we evaluated the process for reviewing the accounting systems and for reporting under the act. This included an examination of the effectiveness of action taken to correct known system weaknesses and the reasonableness of planned corrective actions.

The methodology we used included the validation of SBA's inventory of accounting systems, a review of agency guidelines to see if they provided adequate instructions, and an examination of workpapers supporting system evaluations. We did not independently determine the extent to which SBA's accounting systems comply with the Comptroller General's principles and standards. The review included discussions with the SBA comptroller's office staff and its contractors and a review of Inspector General reports, GAO reports, and internal memoranda to identify known system weaknesses.

In reviewing SBA's annual reports to the President and the Congress, we compared all weaknesses noted in SBA's 1983 report with the corrective actions taken or planned to be taken during fiscal year 1984. Similarly, we assessed instances of noncompliance with SBA's standard operating procedures that were reported by the CICR system in 1984. We also assessed the impact that the CICR system, the SBA efforts on vulnerability assessments, and internal control reviews had on the annual reasonable assurance statement contained in SBA's annual report.

Our work was conducted in accordance with generally accepted government auditing standards.

CHAPTER 2

PROGRESS HAS BEEN MADE IN CORRECTING INTERNAL CONTROL WEAKNESSES

In his 1983 and 1984 FMFIA reports to the President and the Congress, the administrator identified 16 and 17 material weaknesses, respectively. In both of these reports, the administrator outlined a variety of material weaknesses pertaining to SBA's major program and administrative functions. These included personnel management, accounting, ADP, compliance with existing internal controls in the minority small business and capital ownership development programs, and deficiencies in loan processing, servicing, and liquidation. As a result of FMFIA, SBA also identified other internal control weaknesses that were not classified as material. Our review showed that SBA has made progress toward correcting the material and nonmaterial weaknesses. We did not identify any additional weaknesses beyond those that SBA identified during our review.

In our review of SBA's first-year FMFIA activities, we noted that SBA did not have an agency-wide follow-up and tracking system (a method of determining whether the agency has taken action to correct weaknesses), as required by OMB guidelines. SBA has also made progress in this area. It has established a follow-up system to track material weaknesses that the administrator identifies in his annual FMFIA reports. Additionally, SBA's program organizations have begun to develop similar systems to track internal control weaknesses that they identify.

PROGRESS IN CORRECTING MATERIAL WEAKNESSES

In the fiscal year 1983 FMFIA report, the administrator listed seven material weaknesses that SBA had corrected and nine material weaknesses requiring corrective actions. SBA reported that while one of the fiscal year 1983 material weaknesses--inadequate operating procedures--was an agency-wide weakness, the remainder pertained to specific programs and administrative functions such as

--inadequate financial analysis of loan applications prior to approval,

--inadequate computer security,

--inadequate controls over advance payments made to eligible minority small businesses, and

--insufficient SBA action after a loan is in liquidation (procedures to recover collateral after SBA has no reasonable assurance that the loan will be repaid).

In his fiscal year 1984 FMFIA report, the administrator reported on the progress SBA had made in correcting the previous year's material weaknesses and identified 17 additional material weaknesses. The 1984 report stated that six of the 17 additional material weaknesses had been corrected during fiscal year 1984 and 11 required corrective actions. (App. I lists material weaknesses the administrator identified in his 1984 report.) The fiscal year 1984 material weaknesses were similar to the ones that the administrator identified in the previous year--in eight instances, weaknesses pertained to the same programs. In 9 of the 17 instances, the material weaknesses pertained to SBA's failure to comply with existing procedures such as

--failure to annually evaluate banks that have SBA-guaranteed loans,

--inadequate compliance with various loan liquidation procedures, and

--failure to maintain adequate files on minority small businesses that participate in SBA programs.

The 1984 FMFIA report also included plans and schedules for the material weaknesses requiring corrective actions. For example, in six instances, SBA proposed to revise and strengthen its operating procedures and rules to give its staff additional guidance and direction.

Our review showed that SBA made progress in correcting all the material weaknesses identified in the 1983 FMFIA report. The following sections identify some of the problems and related corrective actions that SBA has taken in the (1) finance and investment and (2) minority small business and capital ownership development programs. These two areas accounted for 11 of the 16 material weaknesses reported in 1983 and 10 of the 17 material weaknesses reported in 1984.

Finance and investment

Programs in this area are designed to assist small business growth and to develop and expand the total number of small businesses. SBA's loan portfolio was valued at $19 billion in fiscal year 1984. In his 1983 and 1984 FMFIA reports, the administrator reported seven and five material weaknesses, respectively, in the finance and investment areas. The majority of material weaknesses pertained to loan processing, servicing, and liquidation.

SBA has implemented corrective actions in response to material weaknesses in the finance and investment area. For example, SBA staff were not adequately analyzing financial statements that supported loan applications. To aid staff in processing and analyzing loan applications, SBA has issued revised operating procedures and has developed an evaluation system. In his 1984 report, the administrator stated that SBA was adequately analyzing financial statements.

Instances where SBA did not take timely action for loans that were in liquidation status were also identified as a material weakness in the fiscal year 1983 FMFIA report. By not acting quickly, SBA jeopardizes the value of the loan collateral and other assets due to SBA if the borrower defaults. This is a long-standing problem that we identified in a previous report.[1] As a partial solution to this problem, SBA revised its operating procedures requiring loan offices to prepare liquidation plans with milestone dates. In the 1984 report, the administrator reported that loan officers were not completing liquidation plans and that the district offices developed additional corrective action plans to solve this weakness.

Minority small business and capital ownership development

The objective of programs in this area is to assist minority firms in becoming independently competitive. In the 1983 and 1984 FMFIA reports, the administrator identified four and five material weaknesses, respectively, in this area. Most of the material weaknesses pertained to inadequate compliance with existing internal controls and fell within the major programs described below. Under the 8(a) program, SBA contracts with other federal agencies to supply goods and services that those agencies need. SBA then subcontracts the actual performance of work to small businesses owned and controlled by socially and economically disadvantaged individuals (8(a) firms). In addition, SBA supports 8(a) firms by providing management and technical assistance and issuing advance payments and business development expenses enabling them to perform specific contracts.

SBA has made progress in implementing corrective actions in this area. For example, to further strengthen controls, SBA is in the process of revising its operating procedures on minority small business and capital ownership development programs. For one program--Business Development Expense--SBA appropriated $17 million to assist small businesses during fiscal year 1985. In a significant number of instances, SBA was not making checks payable to both the minority firm and the vendor, a control technique to prevent the misuse of funds. SBA plans to include instructions on implementing this control technique in the

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[1] Better Management of Collateral Can Reduce Losses in SBA's Major Loan Programs (GAO/CED-81-123, July 17, 1981).

revised operating procedures. To identify additional weaknesses and corrective actions, SBA conducted an internal control review of this program in fiscal year 1984.

SBA HAS CORRECTED NONMATERIAL INTERNAL CONTROL WEAKNESSES

During fiscal year 1983 and 1984, SBA identified 225 internal control weaknesses (some offices identified the same weaknesses) that the administrator did not categorize as material. We examined the status of 40 internal control weaknesses and 48 related corrective actions. As of March 1985, SBA had either implemented or was in the process of implementing 44 of the 48 corrective actions. Two examples follow:

--In 1984 SBA completed an internal control review of its Pollution Control Financing Guarantee Program that identified eight weaknesses. This program provides qualified small businesses with a means of financing the costs of pollution-abatement equipment. As of August 1984, SBA had paid $17 million out of a $46 million fund established for defaults. The internal control review showed that SBA did not have credit analysis criteria to determine whether participating firms could repay the cost of the pollution-control equipment, and this problem could be contributing to the defaults. SBA remedied this problem by publishing operating procedures for its loan officers to assist them in credit analysis and repayment ability determinations.

--In February 1984 SBA completed a review of internal controls relating to a program that certifies development companies that in turn make loans to small businesses. SBA is required to monitor the activities of the development companies. The internal control review identified four internal control weaknesses, which SBA is correcting. For example, the review disclosed that SBA was not conducting adequate evaluations of the development companies. SBA is correcting this weakness by (1) developing operating procedures that will now specify guidelines, responsibility, and authority for conducting evaluations, (2) designing a system to evaluate certified development companies, and (3) including this program in the CICR system.

SBA HAS ESTABLISHED A FOLLOW-UP SYSTEM

In our report on SBA's first-year FMFIA activities, we pointed out that SBA did not have an agency-wide tracking and follow-up system, as required by OMB guidelines. The guidelines require agencies to establish a formal follow-up system that logs and keeps track of actions recommended to correct internal control weaknesses (material or nonmaterial) that have been identified. The follow-up system is also intended to include target dates to correct internal control weaknesses, assist in developing plans for implementing corrections, and monitor whether the changes are made as scheduled. The guidelines state that the system would help agencies manage the overall FMFIA process and facilitate preparing the annual report to the President and the Congress.

During fiscal year 1984, SBA implemented an agency-wide follow-up system to track material weaknesses that the administrator identified in the annual FMFIA report. The system tracks recommendations, corrective actions and target completion dates, and is in accordance with OMB guidelines. SBA staff monitor whether the weaknesses are corrected by contacting the SBA managers and reviewing and documenting the corrective actions.

SBA program organizations have also begun to develop their own follow-up systems to track internal control weaknesses identified in internal control reviews and reports. They are planning to design follow-up systems that will be in accordance with OMB guidelines. If implemented as planned, the follow-up systems will track recommendations and target dates and monitor whether changes are made as scheduled.

SBA also has another system to track internal control weaknesses that the field offices identify as a result of the CICR system. This system and corresponding SBA follow-up activities are further discussed on pages 24 and 25.

CONCLUSIONS

SBA has made progress in correcting material and other internal control weaknesses. It has also implemented an agency-wide follow-up system to track material weaknesses, in accordance with OMB guidelines.

CHAPTER 3

EVALUATING INTERNAL CONTROLS:

PROGRESS IS BEING MADE BUT

ADP CONTROLS NEED TO BE REVIEWED

The administrator stated in his fiscal year 1984 report that the system of internal accounting and administrative control, taken as a whole, generally provides reasonable assurance that the FMFIA objectives were achieved.

In addition to performing internal control reviews of highly vulnerable areas, SBA used its CICR system to evaluate internal controls at its field offices. The CICR reviews performed during fiscal year 1984 showed that the internal controls outlined in the agency's standard operating procedures are generally being followed. In our opinion, the system provides a good basis for performing these evaluations. We are encouraged by the agency's efforts to streamline the system and make it more responsive to FMFIA.

Overall, our review of SBA's second-year FMFIA efforts to review its internal controls showed that reasonable progress is being made. The completed reviews appeared to be generally in accordance with OMB guidelines. However, SBA needs to better document its internal control reviews. In addition, SBA needs to review its ADP general and application controls as required by OMB guidelines. This examination is particularly important and desirable because the agency is highly dependent upon computer systems to fulfill its mission and monitor its loan portfolio, which totaled $19 billion in fiscal year 1984. Moreover, in our report about SBA's first-year FMFIA activities, we pointed out that SBA had not given adequate consideration to its ADP activities.

Because the ADP controls were not adequately reviewed, and because we previously reported this matter to SBA, we believe the administrator does not have an adequate basis for concluding that internal controls, taken as a whole, provide reasonable assurance that the act's objectives have been achieved.

COMPLETED INTERNAL CONTROL REVIEWS

In fiscal year 1984 SBA planned to complete internal control reviews of six highly vulnerable areas (see p. 5) identified in December 1983. These detailed examinations were highlighted in the administrator's report in support of his statement of reasonable assurance. In addition, SBA relied on its CICR system to examine controls at its field office. (For discussion of CICR see p. 20.)

We examined the four internal control reviews that SBA completed in 1984 and determined that they generally complied with OMB guidelines, except for documentation of the work done. OMB guidelines recommend that internal control reviews include an identification of the event cycles, which are the processes used to perform the activity of the program being examined. The guidelines also recommend that the internal control objectives and techniques be identified. These are the desired goals or condition for a specific event cycle and the process that enables them to be achieved. Additionally, an examination of the general control environment, testing of internal controls, and a written report on the results of the review are required.

SBA generally followed OMB guidelines in approaching its internal control review work. For each review, a team of personnel was formed, including individuals who were familiar or involved with the area under review. Team leaders and some team members attended orientation sessions that included presentations on FMFIA, the OMB guidelines, and SBA's procedures for conducting internal control reviews. In addition, a copy of a report on an internal control review performed during the first year was provided as an example to follow.

Each of the teams identified event cycles for its respective program or functions. For example, one team began its internal control review effort with a review of relevant legislation, regulations, and standard operating procedures. From this effort, they were able to construct a program narrative and flow chart that documented the purpose and organization of the program. Our examination of each team's work showed that all potential event cycles appeared to be identified.

With respect to identifying and evaluating internal controls, we found that each team followed OMB and SBA procedures and recorded its work on standard forms provided by SBA for this purpose. Similarly, each team generally followed the procedures for reporting on the results of the internal control reviews. While the reporting formats of the teams varied somewhat, the reports included the data required by SBA's internal control systems procedures manual.

Our concern with the internal control reviews is the general lack of written support. OMB guidelines specifically require that adequate written documentation be produced. They state that documentation is useful for reviewing the validity of conclusions reached, evaluating the performance of individuals involved in the reviews, and performing subsequent assessments and reviews. OMB states the amount of documentation should be sufficient to enable independent examiners to understand how conclusions were reached. The documentation should also contain sufficient detail to permit effective supervisory review, quality review by management, and oversight by the inspector general and the General Accounting Office.

Our examination showed that three of the four internal control reviews were not adequately documented. Two of the reviews related to SBA's Minority Small Business Programs and one review related to a Pollution Control Equipment Financing Guarantee Program. In the case of the two Minority Small Business Programs, there was no support for the work done except for tests made to validate that necessary controls were in place. The documentation supporting the two reviews--except for the test data--consisted solely of a few handwritten notes. We could not determine the evaluation methods used or the rationale that led to the conclusions reached. For example, while the internal control review report for the two reviews states that many interviews of SBA personnel were conducted, there were no records or transcripts of these interviews. Transcripts or summaries would have been beneficial in establishing credibility and in evaluating the team's conclusions about the two programs. In the case of the Pollution Control Equipment Financing Guarantee Program, the reviewers determined that on the basis of tests of loan files, proper controls existed. When we requested evidence to support that these tests were made, we were told that no such support existed. The fourth internal control review was adequately documented to show how the review was accomplished and how the conclusions were reached.

It is not clear why the three internal control reviews were not properly documented. The team leader who reviewed the Minority Small Business Programs told us that the review team was not aware of the need to support its work or of the importance of maintaining written documentation. The person who reportedly performed the tests for the Pollution Control Financing Guarantee Program has resigned from SBA, so we could not interview him to determine why the tests were not documented.

When we discussed the lack of documented testing with the program chief, he could not offer any explanation other than that the reviewer saw no need to document the testing process. While the reasons for inadequate documentation are not clear, the lack of documentation points to a need for SBA to require that future internal control reviews are properly supported.

In addition to discussing our concerns with team members and leaders, we also brought this matter to the attention of SBA managers responsible for implementing FMFIA, including the

Associate Deputy Administrator for Management and Administration. SBA's internal control coordinator informed us that the agency recognizes the need for proper documentation and that future internal control review work will be documented. This will be accomplished by emphasizing the importance of documentation during training sessions and by OPAR representatives monitoring the internal control review process.

SBA HAS NOT ADEQUATELY EVALUATED ITS ADP CONTROLS

SBA has not adequately evaluated its ADP general controls, nor has it examined its ADP application controls in accordance with OMB guidelines. Because of this, we believe the administrator does not have an adequate basis for concluding that internal controls, taken as a whole, provide reasonable assurance that the act's objectives have been achieved.

OMB guidelines provide that agencies include a review of ADP systems when evaluating internal controls. ADP systems are critical to SBA's daily operations, and the agency has designated ADP to be one of its highly vulnerable areas. Moreover, several instances of known ADP internal control weaknesses have been identified and brought to the agency's attention. Despite the significance of ADP, its high vulnerability, and the known internal control weaknesses, SBA did not adequately review ADP controls in either its first- or second-year implementation of the FMFIA.

The evaluation of ADP controls is significant because SBA is highly dependent on ADP systems to support its mandated mission. Besides placing heavy reliance on ADP systems for sensitive administrative, personnel, and payroll functions, SBA depends on these systems to perform critical loan accounting and collection functions. For example, in fiscal year 1984, automated systems maintained accounting records for $18.5 billion of SBA's $19 billion loan portfolio and processed collection activities, which averaged 12,000 items and over $6 million daily. SBA also uses ADP systems to provide the Congress with operating and financial information on its programs.

Our review of SBA's first-year implementation of FMFIA concluded that the agency did not have assurance that ADP controls were adequate because managers generally had not evaluated them. We also found that SBA had not assigned responsibility for assessing ADP internal controls or established guidelines for making such assessments. At the end of our first-year review in January 1984, we discussed the need for addressing ADP activities with the agency's internal control coordinator, who agreed that such activities should be included in SBA's internal control evaluation process. Furthermore, in

December 1983, SBA's Internal Control Steering Committee reassessed the vulnerability of each of its assessable units and designated the entire ADP function as highly vulnerable. In the first-year report to the President and the Congress, SBA stated that because of this high vulnerability rating, selected segments of the ADP operations would be evaluated in its second-year FMFIA activities.

Problems relating to ADP internal controls and management over SBA's ADP systems were brought to the agency's attention by the Congress, SBA employees, and GAO during calendar year 1984.

The problems are as follows:

--On May 1, 1984, the SBA Comptroller became aware that the Office of Portfolio Management, in conjunction with the Office of Computer Science (OCS), authorized a pilot program for writing off loans via terminals located in three of SBA's district offices. This action resulted in financial transactions being recorded in SBA's accounting systems by unauthorized persons. Furthermore, this action violated two GAO general internal control standards (supportive attitude and competent personnel) and four specific GAO internal control standards (documentation, execution of transactions and events, separation of duties, and access to and accountability for resources). Although the SBA Comptroller discontinued the pilot program, this was not the first instance of OCS personnel making unauthorized entries in the accounting system. (Other unauthorized accounting entries were reported in memoranda to OCS on Sept. 19, 1980, and Feb. 17, 1983.)

--On June 27, 1984, the Subcommittee on General Oversight and the Economy, House Committee on Small Business, held hearings on SBA's computer systems. Among other things, the hearings disclosed that in late 1983, SBA erroneously disbursed 621 checks worth over $180,000 to SBA borrowers instead of to the banks that were entitled to the funds. As of March 19, 1985, $127,428 of the improperly issued funds had been returned to SBA. This error occurred because OCS did not test a modification to an automated payment system. ADP general controls require new and modified systems to be properly tested and implemented.

--During 1984 GAO conducted a review of SBA's computer-based information and loan-accounting systems. Agency officials were made aware of problems found during the course of this review. This study found several problems in the area of ADP internal controls. Examples are as follows:

--Users, for the most part, do not actively participate in system development.

--Output is not routinely returned to users for evaluation and correction.

--Output is not always complete, timely, or accurate, causing the creation of duplicate manual systems.

ADP general and application controls

Internal ADP controls include general controls and application controls. SBA assigned responsibility for assessing general controls to OCS and application controls to major program users. General controls govern overall functions such as organization and management, application systems development, and computer operations. The scope of general controls is quite broad, affecting most ADP hardware and application software systems. Application controls are part of the individual systems and control the quality of data input, processing, and output. Because they are designed to meet the specific controls objectives of each system, application controls are narrower in scope than general controls. Whenever internal control reviews are performed for programs that are supported by ADP systems, the reviews are supposed to include an evaluation of application controls.

ADP general controls were not adequately reviewed

OCS, which is responsible for reviewing SBA's general controls, performed an internal control review in fiscal year 1984. As of mid-February 1985, a report on this review, although completed, had not been released, even though SBA's second annual report to the President and the Congress, dated December 31, 1984, reported that it would be completed and issued in December 1984.[1] Nevertheless, the administrator based his provision of reasonable assurance on the results of a draft copy of this internal control review along with the results of five other internal control reviews, CICR system reviews, and other related activities.

Our examination of the draft review found that ADP general controls were not adequately reviewed because testing was not performed and supporting documentation was not prepared. OMB internal control guidelines require testing to determine if internal controls are functioning as intended. The OCS team leader said he had insufficient time to test internal controls

[1]This report was issued in May 1985.

and, instead, relied on OCS managers' statements that these controls were in place and working. OMB guidelines also require the documentation of an internal control review. When we requested supporting documentation for this draft, the OCS team leader said the review was done on a verbal basis and that no formal written supporting documentation existed. Because of these limitations, we believe that the draft results are unreliable and that this review does not constitute a valid examination of ADP general controls.

In addition to the time constraints mentioned above, we found several other factors affecting the general controls review. According to OMB guidelines, each program or function, i.e., assessable unit, contains one or more event cycles that provide the focal point for conducting internal control reviews. The review's scope was large, encompassing all five of OCS' assessable units. The OCS team leader said that if the scope had been smaller, he would have had sufficient time to test internal controls. Furthermore, OCS officials responsible for this review told us that they did not fully understand the FMFIA process. Part of the process includes the segmentation of the agency into assessable units and then rating them. The team leader was unaware of the vulnerability rating process and was also unaware that OCS was composed of several distinct assessable units.

ADP application controls were not reviewed

Application controls were not reviewed by SBA program managers who performed internal control reviews during SBA's second-year implementation of the act. Internal control reviews were scheduled in three program areas supported by automated systems; however, as of February 16, 1985, when we completed our audit work, only two of these reviews had been completed and two reports had been issued. A report on the third review was issued on February 22, 1985, and we did not evaluate it. Our analysis of the two completed reviews found that SBA officials did not identify, evaluate, or test application control objectives or techniques.

We found that the program officials responsible for both reviews did not know who was responsible for evaluating application controls or how to evaluate them. Although major program users are responsible for assessing application controls, they have not been provided with information on what these controls are or guidance on how to evaluate them. Officials in both program areas said that the responsibility for assessing application controls should rest with the OCS. For example, one internal control review team leader said personnel from OCS are more technically qualified and, therefore, should perform such evaluations. We discussed our findings with the

Associate Deputy Administrator for Management and Administration, who agreed that ADP application controls have not been examined and that more information and guidance is required.

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In a report to the SBA Administrator in October 1984, the Assistant Administrator for Administration, who has overall responsibility for ADP operations, assured the administrator that ADP controls were adequate in fiscal year 1984. This assurance was considered by the SBA Administrator when he reported on the agency's systems of internal control to the President and the Congress.

In December 1984 we discussed our findings regarding SBA's inadequate examination of ADP internal controls and the problems noted above with SBA's internal control coordinator. In early January 1985, we had further discussion with the Assistant Administrator for Administration, who provided assurance to the SBA Administrator in October. He recognized problems in the ADP area and attributed them to incomplete knowledge, brought about by poor communication between the OCS Director and himself, and because, he said, he did not become sufficiently involved in ADP operations. The Assistant Administrator for Administration stated that he should not have assured the SBA Administrator in October 1984 that ADP controls were adequate.

THE CICR SYSTEM PROVIDES A GOOD BASIS FOR REVIEWING FIELD OFFICE INTERNAL CONTROLS

The CICR system is designed to assure that internal controls prescribed in SBA's operating procedures are in place and are being followed at district and branch offices. While the system is not represented by SBA to be in full compliance with OMB guidelines for complying with FMFIA, it provides evaluations of district and branch offices' internal controls. The CICR system results are highlighted in the agency's annual report to the President and the Congress. For fiscal year 1984, SBA reported that the evaluations showed that more than 90 percent of the internal controls tested were satisfactory and plans for corrective actions for those that were not satisfactory were prepared for field offices.

Our examination of the CICR system disclosed the following:

--CICR is assuring that internal controls are in place and are being followed;

--improvements are being made so that the CICR system will be more responsive to FMFIA; and

--generally, corrective actions are being taken to address deficiencies.

Overall, we believe the CICR system provides a good basis for reviewing internal controls outlined in SBA's operating procedures.

The CICR system is assuring that internal controls are being followed

On the basis of our review of a sample of CICR system checklist items, our observations of a review at a district office, and examinations of several loan transactions, we believe that the system provides a good basis for determining whether internal control procedures are being followed at SBA field offices.

The CICR system is segmented into 76 areas that cover programs, operations, and functions of the field offices. The 76 areas are further refined into 491 specific checklist items. The total number of checklist items and compliance areas included in the CICR reviews performed in fiscal year 1984 is shown in the following table.

Table 3.1: Segmentation of CICR System During Fiscal Year 1984

Areas	Number of checklist items	Number of program/ operational/ functional areas
Financial Assistance Programs		
Processing function	35	9
Servicing function	37	10
Liquidation	38	8
Certified Development Company Program	31	7
Minority Small Business and Capital Ownership Development Programs	94	7
Management Assistance Programs	98	10
Legal support function	44	9
Administrative operations	114	16
Total	491	76

We judgmentally selected 6 of the 76 areas for review, 3 from the Financial Assistance Programs with a total of 17 checklist items and 3 from the Minority Small Business and Capital Ownership Development Programs with a total of 59 checklist items. These program areas were selected because they appeared to be representative of programs controlled at the district office level. SBA's Director, Office of Program Analysis and Review--who is responsible for overall implementation of the CICR system--agreed with our judgment.

For the six areas examined, we identified the internal control techniques that are required by the agency operating procedures and then compared these techniques with the checklist items shown in the CICR system. The purpose of this comparison was to determine if the more significant techniques are included in the checklists.

We found that for the three Financial Assistance Program areas, the checklists included the required internal control techniques. For the three Minority Small Business and Capital Ownership Development Program areas, the checklists excluded six internal control techniques required by the operating procedures. For example, the procedures require that SBA record a lien on equipment purchased for a minority small business, but the CICR system did not include a checklist item to verify that this was being done.

SBA agreed that the missing internal control techniques required by the operating procedures should be included in the checklists. We were advised that the need for these checklist items had simply been missed.

SBA's CICR examination at the Providence district office

To further validate the usefulness of the CICR system, we observed a CICR examination at SBA's district office located in Providence, Rhode Island, which was performed by five regional staff persons having expertise in various areas such as management, financial, and legal assistance. The CICR examination included a review of the processing, servicing, and liquidation functions of SBA's loan program, interviews with district program and management officials, and consideration of prior-year findings and recommendations.

The CICR examination took 5 days and included testing of the district office's major programs. For example, the regional legal counsel reviewed district case files to make sure that loan closings were appropriate and in accordance with agency operating procedures. Additionally, regional financial assistance personnel tested loan files to determine if the loans were supported by adequate financial analysis and credit reports. Moreover, the regional staff tested employee time and attendance records, travel vouchers, and cash on hand, and verified that selected government properties were accounted for.

To independently validate the work performed by the regional review staff, we randomly selected 4 of 62 loan files that SBA had examined. We then reviewed the same transactions that SBA examined in the four cases. Essentially, SBA's tests and our tests were designed to determine if the loan decisions were properly documented in accordance with agency operating procedures. Our conclusions about the four cases were the same as those of the SBA regional staff.

On the basis of our limited examination, we believe that the CICR review at the Providence district office provided a good basis for examining the internal controls. In our view, the regional review team covered all significant aspects of the district office operations.

SBA is improving the CICR to better comply with OMB guidelines

SBA is improving the CICR system to strengthen its conformance to OMB guidelines. Our examination showed that SBA has established inherent risk ratings and set minimum compliance objectives for each checklist item. In addition, the agency is revising its sampling procedures to produce better, more representative results.

According to OMB guidelines, when assessing a unit's vulnerability, a level of inherent risk is to be assigned. In its efforts to comply with OMB guidelines, SBA has assigned an inherent risk for each checklist item. The inherent risk is the relative degree of adverse impact possible by not complying with an internal control technique. Each item is assigned a risk factor ranging between low-risk nonfinancial items and high-risk financial items. For example, a checklist item pertaining to the submission of periodic reports would be assigned a low-risk factor while an item related to the use of loan proceeds would be a high-risk factor.

To further assess the vulnerability of its operations to waste, loss, or unauthorized use, SBA has devised a process to measure the minimum acceptable level of compliance for each checklist item. Prior to November 1984, SBA had a uniform compliance standard of 80 percent for all checklist items. Since that time, conformance objectives range from 70 to 100 percent. For example, the checklist that measures whether loans were approved by the proper management level requires

100-percent compliance, while a lower compliance rate of 70 percent is required concerning the proper documentation of inquiries made by loan applicants.

CICR tests the adequacy of field office internal controls by examining samples of transactions that have occurred since the prior review. For each transaction, review teams examine checklist items to verify that SBA's operating procedures are being followed. For example, when the review team tests internal controls relating to a loan applicant's financial position, it takes a sample of at least 10 different loan files and examines 7 different checklist items. These checklist items include whether the analysis of collateral was made, whether the use of resources was considered, and whether approval was made at the correct level.

To further comply with OMB guidelines, SBA is strengthening CICR sampling techniques to produce better and more representative test results. In fiscal year 1985, SBA plans to use a comprehensive sampling guide developed by an outside consultant and designed specifically for the CICR team's use. More precise sampling methods will improve the reliability and assurance of the CICR system results. Currently, each CICR review section has specific sampling instructions that contain sample selection criteria and minimum sample size requirements. We often found the sample selection criteria to be so specific that it prevented review teams from taking a random sample. For example, instructions for the loan-processing section required for certain loans, examples of the latest three cases, and instructions for the Management Assistance Program require samples to be selected from the second month prior to the review. Furthermore, because of time constraints, samples are often limited to the minimum sample size requirement.

While the sampling techniques used to test internal controls have not yet been developed to the extent of projecting to the universe or drawing any hard and fast conclusions, we believe they provide SBA some assurance regarding the adequacy of its internal controls and that positive steps are being taken to comply with FMFIA.

Status of internal control weaknesses identified by CICR system

The CICR system includes a separate process that tracks internal control weaknesses identified as a result of reviews at the field offices. At the end of each review, the regional team documents the problems found and makes an appropriate recommendation. The district offices then develop a corrective action plan that the region must approve.

We visited four SBA district offices to determine the status of internal control weaknesses identified through the CICR system during fiscal years 1983 and 1984. We selected all 143 corrective actions relating to the agencies' Financial Assistance Programs and determined that 111 had been implemented. The 143 represented all of the corrective actions relating to these programs for the 2 years. When the district office could not implement a recommendation, it cited a variety of explanations, such as resource limitations or a disagreement in operating procedure interpretation.

We also reviewed the follow-up action taken by the regional office staff who perform the CICR system reviews for Financial Assistance Programs. Of the four regional offices we visited, one automatically made follow-up visits after the review was performed. This region also made subsequent visits, and checked files to determine whether the district office implemented actions to correct internal control weaknesses. In contrast, the other three regional offices were conducting follow-up visits only at district offices they believed had severe problems. According to regional officials at these three offices, limited staff resources prevented follow-up visits unless they believed district internal control weaknesses to be severe.

CONCLUSIONS

The SBA Administrator based his statement of reasonable assurance on a variety of reviews and reports. While we believe that progress has been made, we also believe that because SBA has not adequately evaluated ADP controls, the administrator does not have an adequate basis for concluding that internal controls, taken as a whole, provide reasonable assurance that the act's objectives have been achieved. However, if the administrator takes the necessary corrective actions, we believe he will have a better basis for providing reasonable assurance in his annual report.

The four internal control reviews that we examined were generally accomplished in accordance with OMB guidelines. However, SBA did not adequately document three of the four internal control reviews as required by OMB. We believe that proper documentation would facilitate future reviews and management evaluations of the quality of the reviews. Although it is not clear why the documentation was lacking, SBA plans to ensure that future internal control reviews are documented in accordance with OMB guidelines. According to SBA, this will be accomplished by training the reviewers and monitoring their activities.

SBA has neither evaluated its ADP general controls adequately nor examined its ADP application controls in accordance with OMB guidelines. This same matter was reported in our report about SBA's first-year FMFIA activities. Furthermore, during fiscal year 1984, several instances of known ADP internal control weaknesses were brought to the attention of SBA officials. In our opinion, this situation was caused by several factors. First, SBA personnel responsible for examining ADP controls told GAO that they did not fully understand the FMFIA process and how to review internal controls. Second, SBA has not issued guidelines to program managers on how to evaluate ADP controls. Finally, the senior agency official responsible for providing reasonable assurance in the ADP area said that he did not become sufficiently involved in ADP operations.

SBA has highlighted the CICR system as a means for reviewing internal controls at district and branch offices where the preponderance of SBA's programs are delivered. SBA's evaluations for fiscal year 1984 showed that more than 90 percent of the internal controls were satisfactory. In our opinion, the CICR system provides a good basis for reviewing field office internal controls even though it is not represented by SBA to be in compliance with OMB guidelines. To a large extent our conclusion is based on SBA's efforts to make the system more responsive to FMFIA and our belief that, generally, deficiencies disclosed through CICR are being corrected.

RECOMMENDATIONS

We recommend that the SBA Administrator ensure that internal control reviews are performed in accordance with OMB and SBA guidelines. Specifically, we recommend that internal control reviewers be required to develop documentation to support the basis for the conclusions reached and the amount of testing done. Because of the importance of reviewing ADP application and general internal controls, we recommend that the SBA Administrator require the Director, OCS, to ensure that these controls are evaluated in accordance with OMB and SBA guidelines. We also recommend that the SBA Administrator

--issue guidelines describing what ADP controls are, who should evaluate them, and how to evaluate them, and

--provide SBA managers with training on how to evaluate ADP controls and, where necessary, ADP technical assistance, to assist them in their assessments.

AGENCY COMMENTS

In commenting on an advance copy of this report, SBA said that it will take the appropriate action to implement the recommendations.

CHAPTER 4

STRENGTHENING ACCOUNTING SYSTEMS: PROGRESS MADE BUT BETTER DISCLOSURE OF RESULTS IS NEEDED

In its 1984 report to the President and Congress, SBA identified weaknesses in five of its six accounting systems and described related corrective actions, most of which are scheduled for completion in 1985 and 1986. In addition, SBA reported that in 1984 it evaluated two of its systems and found that the "systems reviewed, taken as a whole, conform in all material respects" with the Comptroller General's principles, standards, and related requirements. We believe that SBA has accurately reported its accounting system weaknesses and, in most cases, is correcting these weaknesses in a timely manner. However, SBA's 1984 report does not adequately disclose the current status of most of its accounting systems because it does not indicate that the systems reviewed accounted for less than 5 percent of the administration's loans, guarantees, and annual appropriations and because it does not summarize system weaknesses.

SBA's 1984 accounting system reviews, although narrow in scope, represent the first in a series of scheduled evaluations designed to assess the conformance of all SBA systems by the end of 1986. SBA has also developed basic guidelines for performing future reviews. While the review process could be improved by better identification and testing of key internal control objectives and techniques, better documentation, and more staff involvement, we believe SBA has taken the first steps toward an effective review process.

SBA HAS IDENTIFIED WEAKNESSES IN FIVE OF ITS SYSTEMS

SBA's fiscal year 1984 report identified weaknesses in five of its six accounting systems. We believe that SBA has included all known significant system weaknesses in the report and, in most cases, is implementing corrective actions in a timely manner.

Actions to correct weaknesses in four systems are scheduled for completion in fiscal years 1985 and 1986. SBA is in the preliminary stages of planning a redesign to correct weaknesses in a fifth system, but has not yet estimated a completion date. SBA has taken appropriate interim measures to alleviate problems until these redesigns are complete. Details follow.

The Business Loan and Investment Revolving Fund system and the Disaster Loan Revolving Fund system share automated operations and jointly accounted for about $8 billion in direct loans and over $10 billion in loan guarantees in fiscal year

1984. SBA reported that these systems (1) have a cumbersome loan disbursement process resulting in delayed issuance of loan checks to borrowers and (2) lack adequate fund control to ensure that funds loaned will not exceed lending allotments. To correct both of these weaknesses, SBA is expanding its computer communications network[1] to process loan disbursement transactions and to include lending allotment criteria. These system enhancements are to allow SBA to process and record loan disbursements more efficiently and, by automatically comparing loan amounts entered with lending allotment criteria, prevent the processing of excessive amounts. SBA implemented the new loan process on April 1, 1985. System design changes to improve fund control, estimated for completion in fiscal year 1986, are in progress.

The Salaries and Expenses system accounts for annual appropriations, which were $226 million for fiscal year 1984 and $234 million for fiscal year 1985. As of September 30, 1984, this automated system also accounted for $11.3 million in administrative capitalized property. In 1984 SBA identified fund control weaknesses in the Salaries and Expenses system owing to a lack of timely processing and reporting of obligations. To correct this problem, SBA plans to redesign the system to enable transaction processing via the computer communications network. Such a redesign will provide more timely information to managers and eliminate other inefficiencies in this 17-year-old system. As of April 1985, the SBA Comptroller's office had begun preliminary planning for this system redesign, but had not established milestones for the project's completion. As an interim measure, SBA's Administrator issued a memorandum on the importance of recording obligations in a timely and accurate manner in order to avoid exceeding allotments.

The Pollution Control Equipment Contract Guarantees Revolving Fund system accounts for $325 million in guarantees. Problems in this system, which were reported in 1984, include lack of adequate fund control, no established reserve for losses, and incorrect recognition of defaulted commitments. To correct these problems, SBA plans to adjust the account structure and improve the operating procedures for this manually operated system during 1985.

The Surety Bond Guarantees Revolving Fund system accounted for about $660 million in short-term guarantees during fiscal year 1984. SBA identified a variety of weaknesses in this

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[1]SBA's computer communications network links computer terminals at field offices throughout the United States with computerized records at SBA's central office in Washington, D.C. The network allows authorized personnel to read, enter, and update records related to certain SBA activities directly through computer terminals, thereby reducing paperwork and providing users with access to the most current records.

system that have resulted in a lack of timely and accurate information needed to operate the program efficiently. For example, records used to prepare monthly bills were not current, resulting in complaints from sureties that they could not reconcile their fee payments with bills from SBA and hindering SBA efforts to collect over $800,000 in delinquent surety fees. SBA initiated a redesign of this system in 1982. However, implementation, which was targeted for June 1984, has been delayed and is now tentatively scheduled for October 1985.

As an interim measure, in mid-1984 the SBA Comptroller's office changed from monthly to quarterly billing of surety fees in an effort to provide more accurate bills, thus reducing complaints from sureties and speeding up the collection of delinquent fees due SBA. According to the Director of the Surety Bond Guarantees Program, SBA has received fewer complaints from sureties since the billing change was made. However, our examination of outstanding surety fees showed that the amount of delinquent fees (outstanding for more than 90 days) had increased from $851,396 in November 1983 to $962,878 in October 1984.

SBA REVIEWED A SMALL SEGMENT OF ITS ACCOUNTING OPERATIONS

During fiscal year 1984, SBA completed three reviews related to two accounting systems. One review covered the entire Pollution Control Equipment Contract Guarantees system. The other two reviews covered the fund control and the administrative property segments of the Salaries and Expenses system. These systems account for about $560 million in loan guarantees, annual appropriations, and capitalized property, or less than 5 percent of approximately $19 billion accounted for by SBA. The 1984 reviews are the first in a 3-year series of accounting system reviews scheduled to cover all of SBA's accounting systems by the end of 1986.

The evaluations for fiscal year 1984 included examinations of the accounting systems' designs and of some aspects of their manually processed operations. However, they did not include a comprehensive, orderly examination and testing of internal controls or consideration of ADP operations. In addition, more complete documentation would have better supported review findings and served as a base for future reviews.

Several factors limited scope of fiscal year 1984 review work

Because of scheduling changes and a late start, SBA did not complete all reviews planned for fiscal year 1984. The SBA Comptroller's office had scheduled reviews of selected accounting activities related to each of SBA's six systems, and on September 28, 1984, SBA reported to the Chairman, House Committee on Government Operations, that it planned to review all six financial systems by the "end of the year."

We identified four factors that contributed to SBA's inability to review a larger segment of its accounting operations during fiscal year 1984. The SBA's Comptroller's office

--revised its schedule for performing reviews several times as it developed a practical approach to address sections 2 and 4 of the FMFIA, which both require assessment of internal controls;

--did not begin review work until mid-year;

--decided to review two smaller accounting systems first in order to better define known problems; and

--had limited resources for performing reviews.

Reviewers did not thoroughly evaluate internal controls

Although SBA examined many aspects of the systems reviewed, internal control objectives and techniques were not thoroughly identified and tested. To determine whether a financial system conforms to the principles, standards, and related requirements prescribed by the Comptroller General, it is necessary to review and test the system in operation. Although agency personnel may have extensive system knowledge, systems may operate differently than they believe. Therefore, testing should be done on critical aspects of the system and may include:

--interviewing persons who operate the system,

--observing operating procedures,

--examining system documentation,

--applying procedures to live transactions and comparing results,

--direct testing of computer-based systems via simulated transactions, and

--reviewing error reports and evaluating error follow-up procedures.

Tests should be designed to disclose whether valid transactions are processed properly and whether the system rejects invalid transactions. The tests should cover the entire transaction, from initial authorization through processing, posting to the accounts, and reporting. Accordingly, manual as well as automated operations should be included. In developing test plans, consideration should be given to the results of any prior system testing.

This testing criteria has been adopted by OMB and included in appendix H of its publication Guidelines for Evaluating Financial Management/Accounting Systems (May 20, 1985). In determining the tests that would be appropriate for any system, it is important to keep in mind that, in most cases, more than one of the above techniques are needed to test all key aspects of an accounting system.

SBA's reviewers performed some of the testing techniques described above. They interviewed accounting personnel and reviewed accounting records, financial reports, and system documentation. In addition, they observed manual processes, evaluated some account balances, and traced a series of hypothetical transactions through the systems. Reviewers said that they performed these tests mainly to determine how each system operated, if accounts were being properly used, and how proposed system changes would affect accounting operations.

Although SBA's reviewers considered the adequacy of internal controls in all three reviews, for two reviews they did not attempt to identify control objectives and related control techniques. Reviewers stated they were alert for internal control weaknesses during the course of these two evaluations and that they reported three such weaknesses to the SBA Comptroller. However, they said that a separate and more detailed review would be needed to identify and test the overall adequacy of accounting system internal control techniques.

For the administrative property sub-system, the reviewer did identify control objectives and techniques. However, except for verification of a few property records at SBA's central office, the reviewer of this system relied on discussion with system users to verify whether or not control techniques were operating as designed.

In order to more thoroughly assess the adequacy of accounting system internal controls in the future, the SBA Comptroller's office has scheduled a series of internal control reviews that will begin in fiscal year 1985 in addition to a series of planned accounting system reviews. SBA's plans for future reviews are discussed on page 33.

ADP considerations were omitted from accounting system reviews

SBA purposely omitted ADP considerations from the Salaries and Expenses System reviews because, according to SBA, ADP staff were busy with another review of ADP operations. For ADP systems, it is important to examine both application controls (controls pertaining to data origination, entry, processing, and output) and general controls (computer security, access, and system design). If such controls are not in place, there is a risk of processing erroneous data, inaccurate reports, and unauthorized system access.

Although SBA's decision appears reasonable, this omission resulted in SBA's having incomplete information on which to report the conformance of the automated salaries and expenses system. The omission of ADP did not affect SBA's review of its Pollution Control Equipment Contract Guarantee system, which is an entirely manual system.

Documentation did not support the work performed

For all three SBA reviews, documentation did not fully support or indicate the work performed. OMB guidelines regarding internal controls require reviewers to document their work in sufficient detail to assist in future efforts to evaluate the controls and to facilitate management review for quality assurance and oversight. We believe that this requirement for adequate documentation also applies to accounting system reviews. We found it necessary to discuss the work with the reviewers at length to determine specifically what had been examined and why. For example, the reviewers of two systems, who were experienced accounting managers, told us that they relied extensively on their experience and judgment when selecting segments for close scrutiny. However, documentation does not include the reasoning that supports their subjective judgments, such as which aspects of the systems merit detailed examination.

The Director, Policy and Procedures, told us that documentation of such details was time-consuming and decreased the time available for actual review work. However, he agreed that documentation should be improved and said he will emphasize this in future reviews. We realize that agency officials, faced with limited resources, must prioritize their work and that review findings, especially those that confirm system conformance, can be communicated faster when detailed documentation is not required. However, documentation that supports review objectives and findings can serve as a base for future reviews, thereby saving time and promoting continuity from one year to the next. In addition, such documentation provides managers with a means to assess the scope and quality of the work performed.

SBA HAS DEVELOPED PLANS FOR FUTURE ACCOUNTING SYSTEM REVIEWS

During fiscal year 1984, SBA developed a cyclic schedule for future reviews and written guidance for conducting accounting system conformance evaluations. These plans should help ensure that SBA reviews all of its systems in a comparable and timely manner.

However, management consultants developed the guidelines and performed the majority of conformance evaluations. In addition, the SBA Comptroller's office plans to have contractors perform all fiscal year 1985 conformance evaluations. Consequently, SBA staff may develop neither an understanding of FMFIA requirements nor the expertise necessary to conduct subsequent reviews.

SBA has scheduled future reviews

SBA's Comptroller's office has developed separate schedules for accounting system reviews and internal control reviews. Generally, SBA (1) will review accounting systems on a fund-by-fund basis to enable the administrator to comment on the conformance of systems as a whole and (2) will conduct internal control reviews on an organizational basis to promote management accountability and allow detailed examination of control techniques. A 3-year cycle of accounting system reviews began in fiscal year 1984, and a 4-year cycle of internal control reviews is scheduled to begin in fiscal year 1985. It is important that SBA coordinate these parallel reviews to ensure that accounting systems contain adequate internal controls as prescribed by the Comptroller General's principles and standards and to avoid duplication of review work.

SBA has scheduled four reviews for fiscal year 1985, one for 1986, and three for 1987. These eight reviews will cover all six of SBA's accounting systems. We believe this schedule is reasonable and will enable SBA to meet its FMFIA responsibilities if reviewers cover all aspects of each system, including ADP and testing the accounting systems in operation.

SBA has developed written guidelines

SBA's management consultants wrote guidelines to facilitate its accounting system reviews and assess system conformance with the Comptroller General's principles and standards. The guidelines describe the organizational structure for conducting reviews and provide general instructions. In addition, they contain checklist questions tied to specific sections of Titles 2 and 6 of GAO's Policy and Procedures Manual for Guidance of Federal Agencies. These titles contain our principles and standards that apply to accounting systems and payroll systems. The checklist provides a systematic approach to summarizing conformance with segments of the Comptroller General's principles and standards and to referencing supporting documentation.

Review guidelines, such as those developed at SBA, are an important step toward developing a consistent review process. However, we believe that in some parts of SBA's guidelines, additional detail would help ensure that future reviews are conducted in a comparable manner and promote continuity of SBA's multi-year cyclic effort. We found that SBA's guidelines do not provide adequate instructions in the following areas:

--They do not specifically mention that reviews should include determinations of conformance with Titles 4, 5, and 7 of the Comptroller General's principles and standards, which cover claims, transportation, and fiscal procedures, respectively, and with related requirements such as those found in the Treasury Financial Manual and in OMB circulars. FMFIA requires agencies to report on conformance with all of the Comptroller General's principles and standards, as well as applicable related requirements.

--Adequate details on conducting compliance tests are not provided. Specifically, sampling, documenting test procedures, and recording results are not addressed.

--The review guide needs to be expanded to include detailed worksteps for identifying, documenting, and evaluating ADP controls. Although the guide contains general instructions on examining automated processes, we believe the technical nature and importance of such examinations call for further explanation regarding coordinating such a review with SBA's Office of Computer Science and testing of automated controls.

--We noted other miscellaneous areas that the guidelines do not specifically address. These are criteria for ranking systems to review, preparing flowcharts, and identifying the role of the Inspector General in accounting system reviews. For example, although the guidelines instruct reviewers to prepare flowcharts to supplement system documentation, instructions on how to prepare them or on what types of information they should contain are not included.

SBA officials told us that the guidelines may be expanded to address these deficiencies as the review process continues. They also said that they would consider developing a testing plan. Because the SBA Comptroller's office did not decide to conduct separate internal control reviews until late in 1984, specific instructions for performing these reviews were not developed. However, the Director, Policy and Procedures, said that his office will try to develop such guidelines during 1985, drawing on SBA's operating procedures for conducting internal control reviews and OMB guidance.

SBA staff may not be gaining review experience

Since SBA staff generally are not performing accounting system reviews, expertise and understanding of the FMFIA process may not develop within the agency. Consultants developed the accounting system review guidelines and performed all fiscal year 1984 reviews except that of administrative capitalized property. In addition, SBA has planned to have these consultants perform all fiscal year 1985 accounting system reviews and help develop the internal control review guidelines.

OMB guidelines for performing internal control reviews state that although contractors may assist in the review process, ". . . management personnel should participate in the contractor conducted reviews to gain the experience and understanding necessary to permit them to perform the reviews in subsequent years." We believe this same rationale could apply to contractor assistance on accounting system evaluations.

SBA officials believe that there is not enough time for SBA staff to review the accounting systems and still do the work of the agency. However, we are not suggesting that SBA staff perform the reviews, but rather observe or participate so they would understand how the reviews were conducted and conclusions reached. Although we recognize the constraints involved, because of the recurring nature of these cyclic reviews, SBA should consider that when the consultants leave, SBA will lose a great deal of experience and knowledge of its accounting systems and of the review work performed in 1984 and 1985. Additionally, the lack of good documentation and sufficient detail in the guidelines, as previously discussed, heightens the need for SBA to develop its "institutional memory" by involving some staff in the reviews. In the long run, staff involvement could save time and improve review continuity and quality by building on the previous year's experience and findings and by providing a means of coordinating system reviews and internal control reviews.

SBA's REPORT IS INCOMPLETE AND UNCLEAR

In the 1984 report to the President and the Congress, SBA reported that its "accounting systems reviewed, taken as a whole, conform in all material respects" to the Comptroller General's principles, standards, and related requirements. This statement does not describe the extent to which the systems were reviewed. In addition, the report and its attachments do not clearly disclose material weaknesses.

By referring only to "the accounting systems reviewed," SBA's report does not adequately disclose the extent of assurance given. An attachment to the report describes the scope of the reviews performed, but does not disclose the size of these systems, relative to SBA's other systems. The systems reviewed in fiscal year 1984 account for less than 5 percent of the funds accounted for by SBA. In our opinion, by neglecting to describe the relatively small size of the systems for which assurance is given, SBA's letter is somewhat misleading.

In addition, SBA did not restrict its statement of assurance regarding the Salaries and Expenses system to the system segments that were reviewed in fiscal year 1984. SBA purposely omitted the payroll sub-system from the Salaries and Expenses system review because a new payroll system was to begin operation in 1985. In addition, as previously discussed, ADP processes were not reviewed. These are significant omissions. Payroll involved about half of the funds accounted for by this system in fiscal year 1984, and most system recordkeeping and reporting is automated. We believe agencies should consider other factors, such as redesign efforts and ongoing audits, when scheduling system reviews and that SBA's decision to omit these segments was reasonable. However, we also believe the fiscal year 1984 Salaries and Expenses system review does not provide a basis for stating that this system, "taken as a whole," conforms to the Comptroller General's principles, standards, and related requirements.

Lastly, SBA has not clearly identified and summarized accounting system weaknesses. According to OMB guidelines, internal control weaknesses in an agency's accounting system reported under section 2 of the act should also be mentioned in the accounting system report required by section 4. We believe such summarization of weaknesses improves the clarity of the report. However, instead of summarizing accounting system weaknesses, SBA has identified different weaknesses in three separate locations of the report. SBA reported two "material weaknesses" related to two accounting systems in the report cover letter, two "areas of nonconformance" related to a third and fourth system in an attachment to the report, and "deficiencies" related to a fifth system in a footnote to a schedule contained in the attachment. (SBA's Comptroller had reported all of these problems to the administrator in November 1984 as being "significant.") These weaknesses and related corrective actions are discussed on pages 27 to 29. In our opinion, this inconsistent reporting of accounting system weaknesses and unexplained disparity in terminology in the administrator's report obscures the message of the report.

CONCLUSIONS

In his 1984 report to the President and the Congress, SBA's Administrator reported that SBA evaluated two of its six accounting systems and found them generally in conformance with the Comptroller General's principles, standards, and related requirements. In addition, he reported weaknesses in five systems and described related corrective actions, most of which are scheduled for completion in 1985 and 1986. We believe that although SBA is in the process of correcting accounting system weakness, the Administrator's report did not adequately disclose the current status of these systems. We believe that the statements in the 1984 report could have been made more informative by better describing the scope of assurance given as supported by completed evaluations and by summarizing known system weaknesses. In addition to better disclosure, this would facilitate determining SBA's system improvement progress in 1985.

Despite our opinion of SBA's annual report, we believe that in most cases, the agency is correcting accounting system weaknesses in a timely manner. Some of the corrective actions are in the form of system redesigns, and it is essential that SBA ensure that the new systems meet the necessary requirements before they are placed in operation.

In 1984 SBA began a series of accounting system conformance evaluations that, when complete, will encompass a significant segment of SBA's accounting operations. However, because of several factors that limited their scope, reviews actually completed in fiscal year 1984 and available as support for the administrator's year-end report covered only a small segment of these operations. In addition, the completed reviews were deficient in two areas significant in determining system conformance with the Comptroller General's principles, standards, and related requirements: reviewers omitted examination of automated processes and did not comprehensively examine or test internal controls.

In addition to the performance of actual reviews, SBA took steps toward institutionalizing the review process by developing schedules and guidelines that can serve as a framework for performing future reviews. The guidelines need additional detail, especially related to system testing and evaluating ADP processes. In addition, coordination of accounting system compliance evaluations and internal control reviews has yet to be addressed. Nevertheless, we believe that SBA now has a base on which to build a practical and useful evaluation process.

SBA relied on contractors to perform almost all of the review work, and this detracted from its attempts to institutionalize the review process. We realize that staffing limitations and OMB guidance encourage agencies to rely on contractors for many activities. Nevertheless, we believe that staff involvement can help ensure continuity in multi-year review efforts such as those planned at SBA. In addition, participating in the performance of accounting system reviews would help reinforce SBA staff's understanding of systems operations and the importance of internal controls.

RECOMMENDATIONS

SBA has made progress in determining and reporting accounting systems conformance with the Comptroller General's principles, standards, and related requirements. However, additional action is needed to advance SBA's review effort to a thorough and ongoing process and to ensure proper disclosure of the accounting systems' status. Accordingly, we recommend that the SBA Administrator

--Expand SBA guidelines to include detailed steps for testing its accounting systems in operation and evaluating the ADP aspects involved. In addition, SBA should expand its guidelines to provide for examining conformance with Titles 4, 5, and 7 of the GAO Policy and Procedures Manual for Guidance of Federal Agencies and with related requirements, such as those found in the Treasury Financial Manual and OMB circulars.

--Coordinate planned internal control and accounting system reviews to ensure that all key accounting system internal controls are evaluated. Such evaluation is needed to support a statement regarding the degree of a system's conformance with the Comptroller General's principles, standards, and related requirements.

--Provide for increased staff involvement in accounting system reviews to the extent resources permit.

--Describe accurately the scope of assurance given and known system weaknesses in future FMFIA reports. For example, the report should include an indication of accounting system size, such as the number of dollars involved, use consistent terminology throughout, and summarize accounting system weaknesses. In addition, systems that have not been adequately evaluated should not be reported in conformance with the Comptroller General's requirements.

AGENCY COMMENTS

In commenting on an advance copy of this report, SBA said that it will take the appropriate action to implement the recommendations.

SBA also made several comments to clarify points in this chapter. SBA said that although our report relates that only about 5 percent of the dollar value of the accounting systems were reviewed by SBA, we did not evaluate why these systems were selected for review.

We do not take issue with SBA's selection of accounting systems for review and acknowledge this in this chapter. Our point is that SBA did not clearly reveal that its fiscal year 1984 reviews covered only a small segment of its accounting activity. Additionally, SBA reviewed only half of its salaries and expense activities and, therefore, had insufficient basis for reporting that the system "taken as a whole" was in conformance with the Comptroller General's principles, standards, and related requirements. SBA also said that although it agreed with the need to document system evaluations, there is a point where such documentation becomes costly and burdensome compared with benefits. We recognize, on page 32, the need to consider benefits in relation to costs.

MATERIAL WEAKNESSES IDENTIFIED IN SBA's 1984 FMFIA REPORT

FINANCE AND INVESTMENT

1. Failure to annually evaluate portfolios of banks that participate in SBA's guaranteed loan program.

2. Failure to ensure that lenders licensed by SBA to approve loan applications (Certified Lenders) adequately analyze those applications.

3. Failure to complete liquidation plans for defaulted loans on time.

4. Inadequate compliance with requirements pertaining to bidding procedures and auctioneer agreements for liquidation of loans.

5. Failure by the Office of Investment to update its operating procedures.

MINORITY SMALL BUSINESS AND CAPITAL OWNERSHIP DEVELOPMENT

6. Deficient monitoring of minority small business firms, pertaining to eligibility for continued participation in the section 8(a) program.

7. Failure to maintain adequate files on section 8(a) firms, especially with respect to negotiating information, selection of the firm, and quarterly financial statements.

8. Failure to adequately control advance payments (assistance given to section 8(a) firms).

9. Failure to discuss adequacy of management consulting services given to minority small businesses.

10. Failure to obtain OMB clearance on proposed rules for minority small business and capital ownership development.

MANAGEMENT ASSISTANCE

11. Inadequate management assistance to small businesses, including such things as failure to assure that timely follow-up counseling is scheduled and accomplished for all clients.

PROCUREMENT AND TECHNICAL ASSISTANCE

12. Continued problems with design of SBA's ADP data bank of qualified small businesses.

PERSONNEL

13. Deficient personnel management and classification programs.

COMPTROLLER

14. Delays in loan disbursements owing to processing difficulties.

15. Inadequate control to ensure that funds loaned will not exceed lending allotment.

AGENCY-WIDE

16. Inefficient ordering of and payment for costly credit reports.

17. Widespread deficiencies in setting employee performance objectives and standards and in timely completion of performance evaluations for nonsupervisors.

DESCRIPTION OF SBA's SIX ACCOUNTING SYSTEMS

SBA has six general ledger systems, one to account for each of its five revolving funds and one to account for an annually appropriated fund. A brief description of accounting system activity as of September 30, 1984, follows:

--The Business Loan and Investment Revolving Fund system accounts for $3.3 billion in direct loans and $9.8 billion in loan guarantees. Since 1980 SBA has been redesigning this ADP system to process an increasing variety of transactions through SBA's computer communications network.

--The Disaster Loan Revolving Fund system accounts for $5 billion in direct loans and $4 million in loan guarantees. Because it shares automated operations with the Business Loan and Investment system, the Disaster Loan system is also gradually increasing use of SBA's computer communications network.

--The Surety Bond Guarantees Revolving Fund system accounted for about $660 million in short-term guarantees during fiscal year 1984. SBA plans to replace the currently operating ADP system with a redesigned system in mid-1985.

--The Pollution Control Equipment Contract Guarantees Revolving Fund system accounts for $325 million in guarantees. During fiscal year 1985, SBA plans to adjust the account structure of this manually operated system to correct instances of nonconformance with GAO's principles and standards identified during fiscal year 1984.

--The Lease Guarantees Revolving Fund system accounts for $97 million in guarantees. SBA discontinued this program in 1976 but is liable for a decreasing number of outstanding guarantees until 1996. The system is manually operated.

--The Salaries and Expenses system accounts for annual appropriations, which were $226 million for fiscal year 1984 and $234 million for fiscal year 1985. As of September 30, 1984, this ADP system also accounted for $11.3 million in administrative capitalized property.

ADVANCE COMMENTS FROM THE SMALL BUSINESS ADMINISTRATION

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

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

OFFICE OF THE ADMINISTRATOR

SEP 3 1985

J. Dexter Peach, Director
Resources Community and Economic
Development Division
U. S. General Accounting Office
414 G Street, N. W.
Washington, D. C. 20548

Dear Mr. Peach:

This letter is in response to your letter of August 6, 1985, requesting this Agency's response to the GAO draft report entitled "Small Business Administration's Second Year Implementation of the Federal Managers' Financial Integrity Act."

We have read the report and basically agree with its content and we will take the appropriate action to implement the recommendations.

Now on p. 27. See comment 1.

However, we would like to clarify several points made in the report. First, on page 38, your report relates that only approximately five percent of the dollar value of the accounting system was reviewed. However, you did not elaborate as to why these two systems were selected for review. We informed your staff that we considered these systems the most in need of a thorough evaluation. We further stated the larger dollar part of the Salaries and Expenses Appropriations dealing with payroll was not reviewed because the payroll system was being redesigned. At no time were we ever apprised of the fact that our selection for system reviews were to be based upon dollar magnitude of the system. Since the premise of our reviews are based on a three year review cycle, how important does the dollar value system become? Secondly, on page 46, first paragraph, there is no disagreement that documentation is needed, but there is a point where such documentation becomes costly and burdensome as compared to the benefits.

See comment 2.

Now on p. 32.

We appreciate the opportunity to comment on the report and if you need any further information, please advise.

Sincerely,

James C. Sanders
Administrator

ADVANCE COMMENTS FROM THE SMALL BUSINESS ADMINISTRATION

The following are GAO's comments on the Small Business Administration's letter dated September 3, 1985.

GAO COMMENTS

1. Discussed in Agency Comments section, ch. 4.

2. Discussed in Agency Comments section, ch. 4.

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