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United States General Accounting Office
Washington, DC 20548

Resources, Community, and
Economic Development Division

B-285237

May 26, 2000

The Honorable Christopher S. Bond
Chairman, Committee on Small Business
United States Senate

Subject: Small Business Administration: 7(a) Program's General Characteristics and Summary of Issues

Dear Mr. Chairman:

The 7(a) General Business Loan Program is the largest of the Small Business Administration's (SBA) lending programs.[1] The program provides loans for small businesses unable to secure financing on reasonable terms through normal lending channels. The 7(a) program operates through private-sector lenders that provide loans guaranteed by SBA. Under the program, SBA guarantees up to 80 percent of the loan made by a participating lender. When a borrower defaults, SBA reimburses the lender for the guaranteed portion of the loan.

In December 1999, you requested that we assist in your oversight and monitoring efforts by reviewing the 7(a) program. Specifically, you asked us to (1) describe the general characteristics of the 7(a) program, including how the program operates, and (2) summarize issues, such as the lack of coordinated lender oversight, that have been identified in recent studies and reports on the program and indicate how SBA has responded to these issues. This report summarizes the information presented to your office at our briefing on March 30, 2000, and provides copies of our briefing charts.

In summary, the 7(a) program makes up almost 60 percent of the dollar amount of SBA's guaranteed loan portfolio. As of January 2000, the 7(a) loan portfolio consisted of 182,745 loans totaling about $23 billion. Within the 7(a) program, there are three classifications of lenders—regular, certified, and preferred. SBA reviews all loan documentation for regular lenders' loans and makes final loan approval decisions. Certified lenders determine borrowers' eligibility and creditworthiness, but require SBA's review and approval before making loans. Preferred lenders are given full authority to determine eligibility and creditworthiness and to approve loans without SBA's prior approval. SBA estimated that preferred lenders represented 16 percent of

[1] Section 7(a) of the Small Business Act (15 U.S.C.§636(a)) authorizes this loan guaranty program.

the active 7(a) lenders and made 55 percent, by dollar volume, of all 7(a) loans, for fiscal year 1999.

Most of the recent studies and reports on the program that we reviewed focus on lender oversight procedures and loan guaranty procedures. Lender oversight is the process that SBA uses to monitor program lenders. Guaranty procedures are the steps used to process, service, liquidate, and purchase 7(a) guaranteed loans. In terms of lender oversight, the studies and reports indicate that SBA lacks a coordinated lender oversight program. For example, SBA's operating procedures for the 7(a) program require on-site reviews of lenders, but SBA had not consistently reviewed lenders to ensure that they are complying with its 7(a) loan policies and procedures. When SBA did not review lenders, it increased the potential for program abuse. The studies and reports also show that lenders are not always following SBA's procedures for processing and disbursing 7(a) loans. For example, the SBA Inspector General reported in January 2000 that 12 7(a) loans totaling $2.7 million were inappropriately approved or disbursed from March 1996 through June 1997. SBA officials told us that they have addressed or are addressing most of these issues through new policies and procedures or the agency's systems modernization efforts.[2]

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To describe the general characteristics of the 7(a) program, we reviewed and analyzed data on the loan portfolio and lenders, as well as program policies and procedures. To identify program issues, we synthesized GAO reports and testimonies, together with reports by the SBA Inspector General and private contractors issued from 1995 through March 2000. To determine how SBA responded to issues raised in these reports, we asked SBA to describe its efforts to address these issues. We also interviewed SBA Inspector General officials about the reports and responses that SBA provided. We performed our work from December 1999 through May 2000 in accordance with generally accepted government auditing standards.

The slides from our March 30, 2000, briefing are presented in enclosure I. A more detailed description of the studies and reviews, and SBA's responses to issues identified in them, is presented in enclosure II.

We provided a draft of this report to the Small Business Administration for its review and comment. SBA agreed with the report's findings, but commented that the report should more fully reflect the progress that the agency has made in completing the planning for its loan-monitoring system. Accordingly, we added as a reference our April 25, 2000, report,[3] which notes that SBA has made substantial progress in completing the planning actions for its loan-monitoring system. SBA also provided certain technical clarifications that we incorporated as appropriate.

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[2] SBA has embarked on a $40 million multiyear systems modernization program to permit better data collection, analysis and evaluation of loans, and lender and program performance.

[3] *SBA Loan-Monitoring System: Substantial Progress, Yet Key Risks and Challenges Remain* (GAO/AIMD-00-124, Apr. 25, 2000).

We are sending copies of this report to the Honorable Aida Alvarez, Administrator, Small Business Administration. Please contact me at (202) 512-7631 if you or your staff have any questions. Major contributors to this report were Carol Anderson-Guthrie, Michael Mgebroff, LaSonya Roberts, and Cheri Truett.

Sincerely yours,

Stanley J. Czerwinski

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Associate Director, Housing and
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Enclosures - 2

Briefing to the Committee on Small Business, U.S. Senate

SBA's 7(a) Program: General Characteristics and Summary of Issues

Briefing Outline

- Objectives
- Methodology
- Program Design
- Program Statistics
- Program Issues and SBA's Responses

Objectives

- What are the general characteristics of the 7(a) program, including how the program operates?

- What issues have been identified in studies and reports on SBA's 7(a) program, and how has the agency responded to these issues?

Methodology

- Reviewed studies and reports by GAO, SBA's Inspector General (IG), and private contractors, issued from 1995 through 2000, that evaluated the 7(a) program.
- Interviewed SBA's IG and 7(a) program officials.
- Synthesized program studies and reports.
- Obtained SBA's responses to 7(a) program issues identified in studies and reports.

Program Design

- 7(a) is SBA's loan guaranty program, serving small business borrowers who otherwise could not obtain credit on reasonable terms in the commercial marketplace.

- SBA transitioned from processing direct loans to overseeing lending institutions participating in the 7(a) program.

Program Design

- SBA oversees three types of lenders in the 7(a) program:

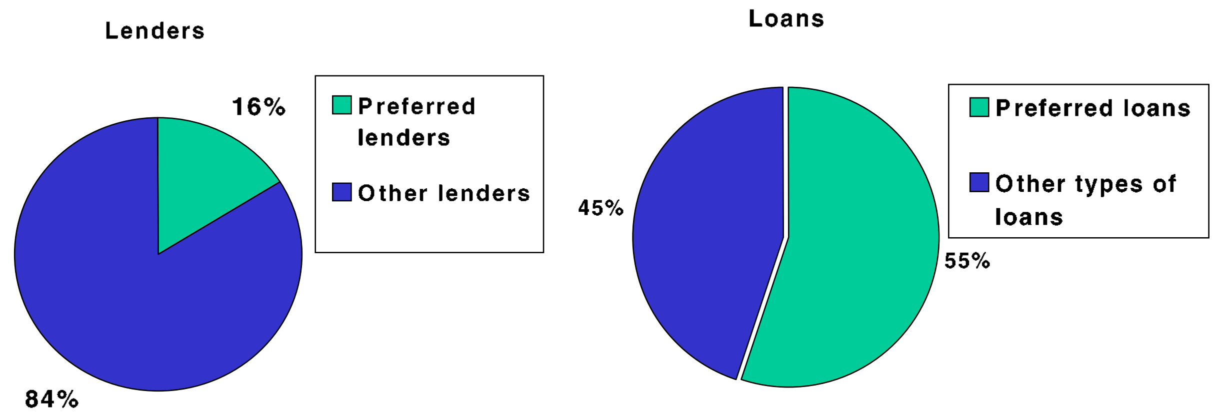
    - *Regular lenders:* SBA reviews all loan documentation and makes final loan approval decisions.

    - *Certified lenders:* SBA reviews and approves borrowers' creditworthiness and eligibility within 3 days of application submission. In addition, the lender services, and may liquidate loans.

    - *Preferred lenders:* SBA allows lenders to process, service, and liquidate loans without requiring its prior review or approval.

Program Design

- For FY 1999, preferred lenders represented:[a]
  - 16% of 7(a) lenders (number of active lenders)
  - 55% of all 7(a) loans (by dollar amount)



[a]SBA does not maintain a separate database for certified lenders.

[b]Includes LowDoc (19%), Standard (13%), Certified (9%), and SBA Express (4%) loans.
Source: SBA's data as of March 2000.

Program Design

- SBA and a contractor identified five 7(a) loan program management processes:[a]
- *Lender oversight:* the processes used to monitor program lenders.
- *Guaranty procedures:* the processes used to process, service, liquidate, and purchase all guaranty loans.
- *Risk management:* the processes used to monitor and manage the loan portfolio and lenders' performance.
- *Subsidy rate calculation:* the processes used to estimate the program's cost and the amount of lending activity that the budget can support.
- *Asset sales:* the processes used to sell loans to investors.

[a]Booz, Allen & Hamilton, under a contract with SBA, used these processes to define SBA's 7(a) practices and procedures. *(Business Process Re-engineering of the Office of Capital Access/Financial Assistance Loan Monitoring Programs,* Order No. SBA HQ-98-F-0293 [July 1999]).

Program Statistics

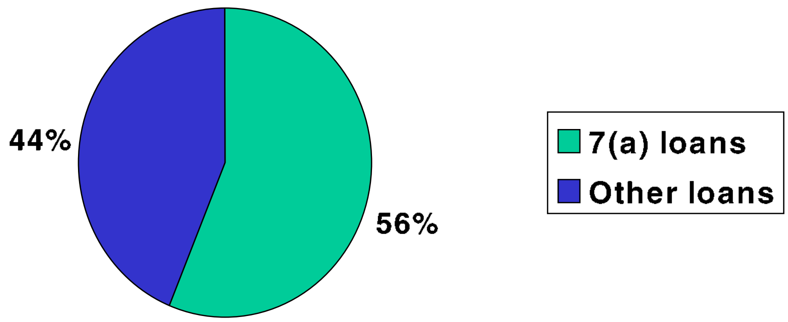
- 182,745 outstanding loans in the 7(a) portfolio.[a]
- $23.0 billion in outstanding 7(a) loans.[a]
- $230,000 was the average loan size in FY 1999.
- SBA's FY 2000 budget for 7(a):
  - $ 113.1 million ($107.5 million appropriated and $5.6 million in carryover).
  - $ 9.75 billion in new loans.[b]

[a]As of January 2000, includes amounts for certain specialized loan programs but not for the Small Business Investment Company, Section 504, and Microloan programs.

[b]Assumes a subsidy rate of 1.16 %. For FY 2000, the 7(a) program costs taxpayers $1.16 for every $100 guaranteed.

Program Statistics

- 7(a) loans comprise almost 60% of SBA's total loan portfolio (by dollar amount).[a]



[a]Other SBA loan programs include those such as the Section 504, Small Business Investment Company, Microloans, and Disaster Assistance programs.

Source: SBA's data as of January 2000.

Program Issues and SBA's Responses

Summary:

- Studies and evaluations conducted from 1995 through 2000 identified issues related to SBA's 7(a) program. Most evaluations focused on the two primary loan management functions--lender oversight and guaranty procedures. While not focusing on 7(a), other studies and reviews have included aspects of the other three loan management functions: risk management, subsidy rates, and asset sales. SBA is addressing most of the identified issues through new policies and procedures.

Program Issues and SBA's Responses

Lender Oversight:

- *Issue:* SBA lacks a coordinated lender oversight system.

- *SBA's Response:* SBA established the Office of Lender Oversight. When fully staffed, this office will take over responsibility for and centralize the agency's coordinated oversight program. In addition, as part of systems modernization, SBA developed a new process to collect information electronically in order to evaluate individual loans, individual lenders, and overall performance.

Program Issues and SBA's Responses

Lender Oversight:

- *Issue:* SBA conducted few on-site reviews of lenders.

- *SBA's Response:* SBA revised time frames and methods for reviewing 7(a) lenders:
  – On May 1, 1998, SBA began its program to review preferred lenders on an annual basis.
  – Certified and regular lenders are reviewed at least once every 3 years; the order of reviews is determined by a series of performance indicators.

Program Issues and SBA's Responses

Lender Oversight:

- *Issue:* SBA had not performed and completed planning actions for its loan-monitoring system.

- *SBA's Response*: SBA has completed all eight planning actions.[a]

[a] According to GAO's report *SBA Loan-Monitoring System: Substantial Progress Yet Key Risks and Challenges Remain* (GAO/AIMD-00-124, Apr. 25, 2000), SBA has not completed the eight planning steps for the loan-monitoring system. Although SBA has made progress, it must still complete work for some actions and implement key functions to effectively manage the development of the loan-monitoring system.

Program Issues and SBA's Responses

Guaranty Procedures:

- *Issue:* Lenders did not always process loans, disburse funds, and ensure that the funds were used in accordance with program guidelines.

- *SBA's Response:* SBA, as part of its revised lender review system, effective October 1, 1999, rates lenders on their degree of compliance with program requirements and enforcement of program guidelines.

Program Issues and SBA's Responses

Guaranty Procedures:

- *Issue:* SBA has no policy to review borrowers' records after default.

- *SBA's Response:* In 1998, SBA implemented a data collection system to capture various ratios at the time a lender requests purchase of a guaranty. The agency also reviews every defaulted loan as part of purchasing loan guaranties. Beginning in FY 2000, headquarters will review 10 percent of the quarantee purchases approved by district offices.

Program Issues and SBA’s Responses

Guaranty Procedures:

- *Issue:* District office officials did not encourage lenders to obtain maximum recoveries on a consistent and effective basis and did not always allow lenders to assume full responsibility for liquidating loans.

- *SBA’s Response:* SBA has given lenders more authority to liquidate loans in order to aid in maximizing recoveries. SBA liquidations personnel have also been instructed to allow lenders to do their own loan liquidations, with minimal SBA involvement.

Program Issues and SBA's Responses

Risk Management:

- *Issue:* The agency had not established and implemented controls needed to ensure that its risk management database contained timely and accurate data.

- *SBA's Response:* SBA's existing databases are adequate for evaluation, but the new lender review system will collect better risk management data. SBA plans to use these data for many functions, including assessing lender risk and portfolio performance trends, and determining priority for on-site reviews of poor performers.

Program Issues and SBA's Responses

Risk Management:

- *Issue:* No strategies exist to measure and monitor risk.

- *SBA's Response:* In 1998, SBA formed the Risk Management Committee, which has started to evaluate lenders' performance trends so that adverse trends can be corrected. The committee is also identifying performance data to use in projecting and managing risk.

Program Issues and SBA's Responses

Subsidy Rate:

- *Issue:* In reestimating its subsidy rate in FY 1998, SBA used some incorrect data.

- *SBA's Response:* SBA significantly enhanced its quality assurance process for subsidy estimates and reestimates by instituting review steps. The review now includes peer review, independent verification and validation, and selected review by the SBA IG and an independent audit firm.

Program Issues and SBA's Responses

Asset Sales:

- *Issue:* SBA lacks well-defined criteria for selecting assets to sell, including timely and accurate loan performance information.

- *SBA's Response:* SBA has developed clearly defined asset selection criteria. Asset sale selection criteria include capital market considerations, credit reform implications, public policy concerns, and legal issues.

SBA's 7(a) Program: Identified Program Issues, Fiscal Years 1995–2000

Identified program issues	Corrective action, recommendations, suggestions, or comments	**SBA's reported corrective action** GAO's responses and the responses from other sources are shown in italics. Unless otherwise indicated, all responses are from SBA.
Lender oversight: The process by which SBA monitors the activities of program lenders.		
In 5 of the 69 district offices, we found the following: • SBA had no method of tracking the review process or the number of reviews completed and had no evidence that some lenders were actually reviewed. • SBA conducted few on-site reviews of lenders. Therefore, SBA had no systematic means to help ensure that lenders' actions did not render loans ineligible, uncreditworthy, or uncollectable, thus increasing the risk of loss to the agency. *Small Business Administration: Few Reviews of Guaranteed Lenders Have Been Conducted* (GAO/GGD-98-85, June 11, 1998).	We recommended that SBA • ensure that the required 7(a) lender oversight reviews are conducted. • implement a supervision and examination function for Small Business Lending Companies (SBLC). • establish organizational responsibilities and ensure that information on the review process is collected, reported, and analyzed.	• In FY 1998, SBA embarked on a $40 million multiyear systems modernization program to permit better data collection, analysis and evaluation of loans, and lender and program performance. • The new system will allow SBA to efficiently collect enough information electronically to allow the agency to identify lending patterns in general and specific lender behavior patterns that will flag potential problems for priority handling. • The Farm Credit Administration is assisting SBA with SBLC examinations. The first round of examinations was completed in 1999, and a second round of examinations is under way. • As of March 1999, SBA had completed its first annual preferred lender program (PLP) reviews. The second round of PLP reviews began April 1999 and concluded in March 2000. • In October 1999, SBA initiated a compliance review program for non-PLP 7(a) lenders and 504 program Certified Development Companies (CDC). In January 2000, SBA's field offices began implementing this program. Under the review program, all 7(a) and 504 participants will be reviewed at least every 3 years; the priority of reviews will be established on the basis of identified risk elements.

SBA does not have a coordinated lender oversight system. Although a number of processes are in place, not all are consistently administered throughout the organization. *Business Process Reengineering of the Office of Capital Access/Financial Assistance Loan Monitoring Programs*, Booz, Allen & Hamilton (July 31, 1999).		The ongoing development of the multiyear $40 million systems modernization program will permit better data collection and analysis. It is intended to provide a better tool for SBA to evaluate individual loan, individual lender, and overall performance. SBA is also staffing its Office of Lender Oversight (OLO). This office will be responsible for coordinating the agency's finance programs oversight. The agency expects to select a head for this office in May 2000. The Office of Financial Assistance (OFA) played a significant role in the business process reengineering related to the agency's overall system modernization efforts. The purpose was to redesign SBA's loan guarantee, lender oversight, and risk management functions to make use of new technology in order to be able to work effectively with lender partners as they evolve their technologies and to enhance the ability to assess risk to the agency. Part of the process involved reviewing "best practice" organizations (as identified by GAO and outside consultants) to consider their systems and adapt those that are applicable to SBA. SBA plans to begin implementation of the new loan-monitoring system in fiscal year 2000. The new system will allow SBA to efficiently collect enough information electronically to allow the agency to identify lending patterns in general and specific lender behavior patterns that will flag potential problems for priority handling.

SBA had not performed essential planning needed to serve as a basis for funding the development of the proposed loan-monitoring system. *Small Business Administration: Better Planning and Controls Needed for Information Systems* (GAO/AIMD-97-94, June 27, 1997).	SBA should not proceed with funding the monitoring system until adequate plans are prepared in accordance with the Clinger-Cohen Act and the Office of Management and Budget's (OMB) criteria. We recommended that SBA • benchmark loan-monitoring business processes and systems, • analyze the benefits and costs of the alternatives, and • ensure that the proposed information system is consistent with the agency's information architecture. The Congress subsequently enacted provisions in the Small Business Reauthorization Act of 1997 that required the Administrator of SBA to "…perform and complete the planning needed to serve as the basis for funding the development and implementation of the computerized loan-monitoring system." *Small Business Administration: Mandated Planning for Loan-Monitoring System Is Not Complete* (GAO/AIMD-98-214R, June 30, 1998) and *Small Business Administration: Enhancements Needed for Loan-Monitoring System Benchmark Study* (GAO/AIMD-99-165, May 14, 1999).	Booz, Allen & Hamilton, under contract with SBA, has issued a study that benchmarks SBA's loan-monitoring and business processes and systems against various public and private institutions. SBA believes that it has fulfilled the eight essential planning steps. SBA recognizes that many people will review these and may disagree on what is "complete." However, SBA is confident that it will have sufficient planning completed prior to implementation. *On February 29, 2000, GAO testified before the Subcommittee on Government Programs and Oversight, House Committee on Small Business, that SBA had not completed the eight essential planning steps for the loan-monitoring system. GAO reported that, although SBA has made substantial progress in completing the steps, the agency must still complete work for some actions and implement key functions to effectively manage the development of the loan-monitoring system. SBA needs to establish and implement several key functions, including quality assurance and system security. GAO testified that SBA should consider completing an analysis of benefits and costs for alternative business processes, among other actions.* *GAO discussed its recommendations to assist SBA in completing the work for the eight planning actions and in strengthening its information technology practices in a report issued on April 25, 2000, on SBA's loan-monitoring system. The report is entitled SBA Loan-Monitoring System: Substantial Progress Yet Key Risks and Challenges Remain (GAO/AIMD-00-124, Apr. 25, 2000)*

SBA had not yet completed the eight planning actions for its loan-monitoring system, as required by the Small Business Reauthorization Act of 1997, in accordance with federal guidance and generally accepted systems development practices. *Small Business Administration: Mandated Planning for Loan-Monitoring System Is Not Complete* (GAO/AIMD-98-214R, June 30, 1998).	The act requires SBA not only to come up with a plan for the loan-monitoring system, but also to perform and complete the eight planning actions. We believed that SBA's actions in this regard were inconsistent with the wording of the act.	SBA believes that it has fulfilled the eight essential planning steps. SBA recognizes that many people will review them and may disagree on what is "complete." *See GAO comment above.*
A contractor's benchmark study identified wide gaps between SBA's practices and those of its benchmark partners. We identified areas where enhancements would make the benchmark study report more useful, as SBA decides which processes it will reengineer and proceeds with its reengineering. *Small Business Administration: Enhancements Needed for Loan Monitoring System Benchmark Study* (GAO/AIMD-99-165, May 14, 1999).	We suggested that SBA • define processes associated with best practices and relate those to SBA's current processes; • address activities delegated to lenders and develop monitoring processes concerning lenders to prevent delinquencies, mitigate losses on delinquencies, and liquidate defaulted loans; • collect measurement data to allow comparisons between SBA's current processes and the processes of benchmark partners; • set "stretch" goals for reengineering; and • identify from benchmark partners potential outsourcing and candidate systems for purchase.	SBA considered our suggestions and decided to address the issues as part of the business process reengineering (BPR) process (which is the second part of the benchmark/BPR step). Additionally, because the agency chose the iterative approach to systems development, we will continue to benchmark each part so that when a specific part is being developed, the benchmarking will be current for that piece of the system.

The IG found that loan liquidators recovered $652,608 less in total than they should have for 12 of 71 liquidations, which projects statistically to underrecoveries of $28 million in FY 1994. *Audit Reports on Loan Liquidations,* SBA, Office of Inspector General (SBA/OIG) (Feb. 1998).	The IG recommended that the SBA Associate Administrator for Financial Assistance (1) ensure that loan liquidators understand their responsibility for identifying and correcting improper lender actions and (2) initiate recovery action, if the statute of limitations has not expired, on the basis of the lender deficiencies identified in the report.	The recommendations have been completed. Regarding recommendation No. 1, the liquidation standard operating procedures (SOP) were revised to address and highlight the liquidator's responsibility for identifying and correcting improper lender actions. An opinion from SBA's Office of General Counsel was obtained and, where appropriate, recovery action was pursued.

The IG reported barriers to making loan agents more accountable. These include confusion over the role of agents; a lack of fraud measures, such as background checks; a lack of data on the number of loan agents; few resources for monitoring agent activities; and difficulty in assessing the impact of loan agent activity. *Loan Agents and the Section (7a) Program,* SBA/OIG (Mar. 1998).	The IG recommended that SBA (1) propose expanding current legislation to include loan agents among those subject to criminal history checks, (2) require agents to register with SBA to provide basic information, and (3) establish a loan-agent-monitoring system that holds lenders accountable for data originated by loan agents and centralizes the evaluation of loan agents in one office.	The IG's legislative proposals are included in the agency's FY 2001 legislative package. The establishment of loan agent registration and monitoring systems is tied to the development of a partner information management system (PIMS), a joint effort of the Office of the Chief Information Officer OFA. PIMS will be incorporated into the monitoring portion of the systems modernization effort. SBA Form 159, which contains information on loan agents, has been modified to capture registration data and will be sent to OMB for approval as part of the implementation of SBA's systems modernization efforts. The first phase of PIMS is expected to be operational in the third quarter of 2000. The loan agent portion is subject to the passage of proposed legislation that may affect the system's implementation and will be completed with appropriate lead time.
SBA requires that lenders be reviewed by the field offices, but there is no method of tracking the review process or the number of reviews completed. Without this critical information, reviews are incomplete and are based on speculation regarding the status of loans and lenders' portfolios. *Business Process Reengineering of the Office of Capital Access/Financial Assistance Loan-Monitoring Programs,* Booz, Allen & Hamilton (July 31, 1999).		OFA has designed a laptop-compatible lender review system that is in place, is being used at all field offices, and should remedy this problem. Each field office certifies the completion of the required reviews, which are directly tied to fiscal year field office goals. SBA expects this procedure to remove speculation regarding the status of loans and lenders' portfolios. In addition, SBA plans to link these review data to other data it gathers regarding the lender, such as default and currency rates for the lender's 7(a) loans.
A majority of lenders are not required to renew their lending authority within a given time frame because their right to participate does not expire. The lack of review increases the potential for program abuse and raises SBA's program risk. *Business Process Reengineering of the Office of Capital Access/Financial Assistance Loan Monitoring Programs.* Booz, Allen & Hamilton (July 31, 1999).		Currently, the implementation of the lender review system requires a review of each lender at least once every 3 years, subject to loan volume minimums. SBA expects this procedure to reduce the potential for program abuse and diminish the potential level of program risk. PLP status is approved for a maximum of 2 years, and renewal is subject to consideration of various factors related to a lender's performance and participation with SBA.

Guaranty procedures: The processes used to approve loan guaranties and collect origination and service data. This function includes servicing and liquidating loans and guaranties.		
The IG audits conducted at eight SBA district offices from September 1997 through March 1999 found that 7(a) loans are not always processed, nor are funds always disbursed and used in accordance with requirements. *Summary Audit of 7(a) Loan Processing,* SBA/OIG (Jan. 2000).	The IG recommended that SBA establish goals and measures to evaluate lenders' performance and establish a procedure to track guaranty repairs and report the results to the Administrator for Financial Assistance.	As stated in the IG's report, the OFA has implemented a lender review system. The review system will rate lenders relative to their degree of compliance (i.e., substantially in compliance, generally in compliance, etc.). The Administrator has approved the creation of OLO within the Office of Capital Access. The risk management system was developed as a primary method to be utilized by OLO to set agency benchmarks that compare baseline loan portfolio performance goals with the performance of lenders, both individually and collectively. OLO, not OFA, will be responsible for managing the agency's risk management function. The agency and the IG have negotiated a compromise related to the recommendation that the processing of loan purchase requests be centralized. Under this compromise, a staff position will be established in the Office of Field Operations (OFO) to review 10 percent of all loan purchase requests. Loan purchase processing will be tracked by OFO to identify offices that require additional action because of noted shortcomings in their processing of guaranty purchase requests. Full implementation should be achieved in fiscal year 2000. The SBA Deputy Administrator approved this compromise action.

The IG reviewed 17 guaranteed loans that defaulted within 2 years of approval and for 9 of the 17, found indicators of potential fraud or abuse that may have contributed to the defaults. Nine of these had been reported for investigation. The IG also found that neither SBA nor lenders had policies to review borrowers' records after defaults were declared. Finally, lenders did not always ensure that loan proceeds for working capital were used appropriately. *Summary Report on the Early Default of Guaranteed Loans,* SBA, Office of Inspector General (Feb. 1997).	The IG recommended that SBA (1) incorporate a policy notice concerning site visits and record reviews into its operating procedures, (2) refer borrowers to the IG for possible audit if they refuse to provide books and records, (3) refer discrepancies in lenders' and borrowers' records to the IG for investigation, (4) determine the feasibility of using joint payee checks or making partial disbursements for loans designated as working capital, and (5) ensure that lenders include all expenses paid by an operating concern to its eligible passive company in repayment ability calculations.	All recommendations have been completed and implemented. Regarding recommendations No. 1, No. 2, and No. 3, policy notices and SOP revisions were made and implemented. Regarding recommendation No. 4, the standard loan authorization was revised to address the issue of loan proceeds for working capital, and the requirement to ensure that lenders include all expenses in their repayment ability calculations was included in the rewrite of SOP 50-10-(4)(B), effective January 29, 1999.
Existing controls in the liquidation process should adequately protect the interests of the government if consistently and effectively applied. The IG determined that SBA does not take full advantage of lenders' liquidation capabilities. *Increasing Lender Liquidation Responsibility in the Section 7(a) Business Loan Program,* SBA/OIG (Apr. 1997).	The IG recommended that SBA (1) develop policies to refocus efforts away from direct involvement in liquidations and toward improving monitoring of the preferred and certified lender programs, (2) use a "hands-off" liquidation policy, and (3) create a reliable method for collecting data to measure individual lenders' performance in liquidating loans.	In December 1997, SBA released a new liquidation SOP. The stated goal of the SOP is to decrease SBA's direct involvement in liquidations and delegate more responsibility to lenders for liquidations. OFA has implemented the requirements of the Small Business Improvement Act of 1996, which (1) gives preferred lenders complete authority to liquidate loans and certified lenders expedited approval procedures; (2) developes courses for SBA liquidation personnel, which highlighted the need to enable lenders to complete their own loan liquidations with minimal SBA involvement and issued a policy notice that promotes greater uniformity in the way district offices handle their relationships with preferred lenders on liquidation matters; and (3) provides a better automated system to oversee lenders' performance in loan liquidations; systems modifications for producing performance data were made to the risk management database.

The IG found inappropriate guaranty purchases because of insufficient documentation to support the purchase or lenders' noncompliance with loan-making and loan-servicing requirements. The IG found that 17 of the 58 sampled purchase decisions, valued at $2.1 million, were inappropriate. *Audit Report on Business Loan Guarantee Purchases,* SBA/OIG (Sept. 1997).	The IG recommended that SBA (1) centralize the decision to purchase guaranties to ensure consistency and quality, (2) provide additional guidance on the types of information that should be reviewed to support purchase decisions, and (3) establish time frames for purchase reviews.	In response to this audit, SBA partially centralized the guaranty purchase review process. If SBA determines that a loan has been improperly serviced, it automatically delegates the purchase decision to its centralized processing center in California. District offices still perform all other guaranty purchase reviews. Regarding recommendation No. 1, the agency and the IG have negotiated a compromise related to the IG's recommendation that the processing of loan purchase requests be centralized. Under this compromise, a staff position will be established in OFO to review 10 percent of all loan purchase requests. Loan purchase processing will be tracked by field office to identify offices that require additional action because of noted shortcomings in their processing of guaranty purchase requests. The SBA Deputy Administrator approved this compromise action. Regarding recommendation No. 2, OFA requested that the Office of General Counsel (OGC) determine whether the recoveries were appropriate. Final action is expected by June 30, 2000. SBA will also take the following actions: obtain missing documents on the remaining four loans noted in appendix C and determine if purchase decisions were proper. Regarding recommendation No. 3, OFA has requested advice from OGC as to whether recoveries are appropriate. Final action is expected by June 30, 2000. SBA will also seek recovery of $333,730 where a full purchase decision should not have been made.

The IG reviewed Low Documentation (LowDoc) program loans to determine whether they were processed and the loan funds were disbursed and used according to requirements. The IG concluded that at least 351 of 3,066 loans should not have been approved but that lenders' performance improved as program guidance became more detailed. *Summary Audit Report on the LowDoc Loan Program,* SBA/OIG (Nov. 1997).	The IG recommended that SBA initiate a LowDoc training program for new lenders.	A LowDoc training program is in place. SBA district office personnel provide training for new LowDoc lenders and continued training for existing LowDoc lenders regarding changes in the program.

Risk Management: The process by which SBA monitors the loan portfolio, tracks lenders and borrowers, and oversees the management of the portfolio in order to identify an acceptable risk to the taxpayer.		
SBA had not established and implemented controls needed to ensure that the risk management database contained timely and accurate data, as required by the Small Business Improvement Act of 1996. The database had missing or incorrect data for about half of the guaranteed loans because SBA had not effectively implemented controls over lender reporting. SBA also had no controls to identify missing or incorrect underwriting data on defaulted loans. *Small Business Administration: Better Planning and Controls Needed for Information Systems* (GAO/AIMD-97-94, June 27, 1997).	We recommended that SBA establish data quality standards for the risk management database and implement a system of controls to ensure compliance with the standards.	In 1998, SBA implemented a comprehensive lender review system on the basis of risk management data that ensure priority on-site lender reviews for poor performers. The reviews identify missing or incorrect eligibility and underwriting and loan-monitoring data, and provide useful information for conducting focused lender training. SBA also plans to explore the integration of the loan credit data accumulated on defaulted loans for use in an expanded lender oversight function. The agency's loan-servicing procedural manual has been updated with lender review instructions, and field office training in the new procedures has taken place throughout the agency. Monthly reporting by lenders on the status of their SBA guaranteed loans is approaching 90 percent compliance. These reports can be submitted in a variety of formats to accommodate the needs of lenders.
No definition of risk management has been agreed upon, only responsible parties understand risk, and no strategies exist to measure and monitor risks. *Benchmarking Capital Access/Financial Assistance Program. Final Benchmark Report,* Booz, Allen & Hamilton (Dec. 1998).	The report states that SBA needs to have an automated system that accepts the loan origination and servicing data as well as probabilistic and historical information as input for a risk analysis mechanism.	SBA formed the Risk Management Committee in 1998 and is creating a risk management function. It will evaluate lenders' performance trends so that adverse trends can be corrected and will enable the agency to evaluate and adjust the 7(a) program's requirements when appropriate. The committee is working on identifying performance data to be used in managing risk. The committee also plans to examine recovery rates and time in liquidation as additional measures.

Subsidy rate calculation: The process to ultimately determine the capital requirements of the program.		
In reestimating its subsidy rate in FY 1998, SBA used some incorrect data and spreadsheet cell references. SBA did not detect the failure of the OMB-provided spreadsheet to calculate interest on the Cohort 1998 reestimate. *Independent Auditors' Report on Internal Control*. Cotton and Co., *FY 1998 Small Business Administration Annual Report*. Office of the Chief Financial Officer.	SBA needs to continue to refine its quality assurance process to ensure that reviewers have the experience, training, and time to perform reviews. *FY 1998 Small Business Administration Annual Report,* Office of the Chief Financial Officer.	Starting this year, SBA significantly enhanced its quality assurance process for subsidy estimates and reestimates. SBA instituted the following review steps: 1. Preparation and review of models by analysts. 2. Review of models by peer. 3. Review of models by supervisor. 4. Independent verification and validation review by accounting firm of Bradson Corp. 5. Review of models by OMB with final validation of results. 6. Selected review by IG and Independent Financial Advisor, Cotton and Co. Individuals used in this process have experience with Federal Credit Reform and SBA data. Assuming the timing of the budget and financial reporting process allows for the complete review cycle, SBA is confident that this process will result in highly accurate estimates and reestimates.

Asset sales: The processes used to value and sell loan assets to investors in order to increase cash flow and decrease exposure to risk.		
SBA lacks well-defined criteria for selecting assets to sell and timely and accurate loan performance information. *Benchmarking Capital Access/Financial Assistance Program. Final Benchmark Report.* Booze, Allen & Hamilton (Dec. 1998).		SBA has clearly defined asset selection criteria, which have been developed in the following manner: • SBA interviewed all the GSA-approved program financial advisors and through a competitive procurement, engaged the firm best suited to manage its Asset Sales Program. The program financial advisor's (PFA) principal task is to advise SBA on the structure of the program. • A key PFA deliverable is the asset sale action plan, which includes a detailed analysis of the SBA assets available for sale, a detailed description of the relevant capital markets into which the assets will be sold, an analysis and recommendation of the types of loan pool structures preferable for different asset types and characteristics, a sale program time line, and a detailed discussion of public policy issues. • Sale selection criteria include capital market considerations, credit reform implications, public policy concerns, operational and logistical considerations, and legal issues. The relative emphasis that each of these criteria plays in the selection varies from sale to sale, depending upon the structure of the sale, current market conditions, and public policy considerations. • SBA maintains detailed, extensive (all transaction information going back over 10 years) cash flow histories in electronic format for all loans in the owned portfolio. For each individual sale, SBA hires several contractors (transaction financial advisor, due diligence contractor, and outside legal counsel) to prepare loans for sale. The primary objective of these outside contractors is to maximize sales proceeds. One way that the objective is accomplished is by providing bidders with complete and full disclosure on all aspects of all loans offered for sale, i.e., the information is plentiful, accurate, and timely.

Note: Although we reviewed reports related to the 7(a) program for 1995, we did not find any specific issues identified in this time frame.

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