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

Transmittal Memorandum
Report No. 15-04

DATE: December 15, 2014

TO: Tami Perriello
Acting Chief Financial Officer

FROM: Troy M. Meyer /S/
Assistant Inspector General for Auditing

SUBJECT: KPMG Management Letter Communicating Matters Relative to the SBA's FY 2014 Financial Statement Audit

The attached management letter identifies matters that were identified during the audit of the SBA's FY 2014 financial statements. The audit was performed by an independent public accountant, KMPG LLP, under a contract with the Office of Inspector General and in accordance with *Generally Accepted Government Auditing Standards;* Office of Management and Budget's (OMB) Bulletin No. 14-02, *Audit Requirements for Federal Financial Statements*; the U.S. Government Accountability Office (GAO)/President's Council on Integrity and Efficiency *Financial Audit Manual;* and GAO's *Federal Information System Controls Audit Manual.*

The management letter addressed recommendations to the Associate Administrator for Capital Access; Chief Human Capital Officer; and Directors for the Offices of Credit Risk Management, Performance and Systems Management, Financial Assistance, and Financial Program Operations. We provided a draft of KPMG's findings to each of these officials or their designees, who fully or substantially concurred with the findings relative to their respective areas. The officials or designees agreed to implement the recommendations or have already taken action to address the underlying conditions.

Should you have any questions, please contact Jeffrey Brindle, Director, Information Technology and Financial Management at (202) 205-7490.

Attachment

KPMG LLP
Suite 12000
1801 K Street, NW
Washington, DC 20006

MANAGEMENT LETTER

November 17, 2014

CONFIDENTIAL

Inspector General
United States Small Business Administration
Washington, DC

Ladies and Gentlemen:

In planning and performing our audit of the consolidated financial statements of the U.S. Small Business Administration (SBA), as of and for the year ended September 30, 2014 and 2013, in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States, and Office of Management and Budget Bulletin No. 14-02, *Audit Requirements for Federal Financial Statement*, we considered the SBA's internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the SBA's internal control. Accordingly, we do not express an opinion on the effectiveness of the SBA's internal control.

During our audit we noted certain matters involving internal control and other operational matters that are presented for your consideration. These comments and recommendations, all of which have been discussed with the appropriate members of management, are intended to improve internal control or result in other operating efficiencies and are summarized in Exhibit I.

In addition, we identified a combination of certain deficiencies in internal control that we consider to be a significant deficiency, and communicated them in writing to management and those charged with governance on November 17, 2014.

Our audit procedures are designed primarily to enable us to form an opinion on the financial statements, and therefore may not bring to light all weaknesses in policies or procedures that may exist. We aim, however, to use our knowledge of the SBA's organization gained during our work to make comments and suggestions that we hope will be useful to you.

We would be pleased to discuss these comments and recommendations with you at any time.

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This communication is intended solely for the information and use of management, the Office of Inspector General, others within the organization, the Government Accountability Office, and the U.S. Congress, and is not intended to be and should not be used by anyone other than these specified parties.

Very truly yours,

KPMG LLP

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Improvement Needed in Timely Issuance of Safety and Soundness Examination Reports

The SBA, by statute, assumes responsibility as the primary Federal regulator for Small Business Lending Companies (SBLCs) and conducts safety and soundness examinations of the SBLCs.

Per discussion with SBA management and verified through our control testwork over the safety and soundness examinations, we noted the following deficiencies in the Office of Credit Risk Management (OCRM):

- Within the past 24 months, the OCRM did not complete safety and soundness examinations for SBLC in accordance with its Standard Operating Procedures (SOP).
- The OCRM had not issued reports for the 5 SBLC safety and soundness examinations performed in FY 2014.

We recommend the Associate Administrator for the Office of Capital Access and the OCRM Director work together to:

1. Clearly document and communicate any instances in which the OCRM determines it necessary to depart from SOP guidance, and/or align the related SOP guidance with permanent changes to its examination selection methodology (e.g., implementing an interim risk-based approach for conducting examinations).

2. Prioritize the completion and issuance of reports for the five safety and soundness examinations that were performed during the fiscal year.

3. Develop specific criteria for the timing of issuing reports for safety and soundness examinations completed during the fiscal year.

Management's Response:

The SBA's management concurred with the finding and recommendation.

Inadequate Controls over 1502 Reporting for the 7(a) Guaranty Loan Program

In FY 2011, KPMG reported that a deficiency existed in Colson's 1502 reporting process for the SBA's 7(a) guaranty loan program. We reported there was no reconciliation between Colson and the SBA's error populations - which caused a backlog of errors that were not timely remediated. We determined those errors were not material, but could have an effect on the financial statements. Since FY 2011, the SBA has made progress in its 1502 reporting process, however, improvement is needed.

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Since October 2013, the SBA has identified differences in record count between the Colson End of Month (EOM) file and the SBA's E-Tran Monthly Report. The number of differences has varied each month, ranging between 20 and 400 records. However, the SBA has not evaluated or corrected the issue to-date.

We recommend the Director of the Offices of Performance and Systems Management and Financial Assistance work together to:

4. Evaluate and correct the reporting issue between the Colson EOM file and E-Tran Monthly Report.

5. Design and implement a formal process to timely address discrepancies identified during the reconciliation between the Colson EOM file and the SBA's E-Tran Monthly Report.

Management's Response:

The SBA's management concurred with the finding and recommendation.

Untimely 7(a) Loan Charge-off Reviews and Processing

The SBA determines that a charge-off action is appropriate when: all reasonable efforts by SBA have been exhausted to achieve recovery; the estimated cost of further collection efforts exceeds the anticipated recovery; the loan balance is determined to be uncollectible, or the only remaining avenue of recovery is from obligors who cannot be located or are unable to pay the loan balance.

During our testwork over 7(a) guaranty loan charge-offs, we noted the following deficiencies at the National Guaranty Purchase Center (NGPC) in Herndon, VA:

Loan Number	Deficiency
5725924000	There was no documented activity or correspondence between the SBA and lender for approximately four years (11/17/09 - 11/26/13). This resulted in the loan being charged off in FY 2014 rather than an earlier fiscal year.
2419376002	There was no documented activity or correspondence between the SBA and lender for approximately 1.5 years (9/26/12 - 4/17/14). This resulted in the loan being charged off in FY 2014 rather than FY 2013.

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Loan Number	Deficiency
3001186001	There was a four month delay between the Senior Loan Officer approval and final legal approval for charge-off (5/14/13 - 9/11/13). Additionally, there was a three month delay between final legal approval and processing of the charge-off (9/11/13 - 12/14/13). These delays resulted in the loan being charged off in FY 2014 rather than FY 2013.
9630404003	There was a 1.5 year delay between the final approval for Care and Preservation of Collateral expenses and time of charge-off (1/15/13 - 9/29/14). These delays resulted in the loan being charged off in FY 2014 rather than FY 2013.
2175035001	There was no documented activity or correspondence between the SBA and lender for approximately 3.5 years (10/22/10 - 8/7/14). This resulted in the loan being charged off in FY 2014 rather than an earlier fiscal year.
4571304004	There was no documented activity or correspondence between the SBA and the lender for approximately 3.5 years (11/26/10 - 8/12/14). This resulted in the loan being charged off in FY 2014 rather than an earlier fiscal year.

We recommend the Office of Financial Program Operations Director:

6. Continue to leverage the existing quarterly reviews of the inventory of purchased loans to ensure that loan charge-offs occur timely.

7. Reinforce the importance of immediate processing of approved charge-offs at the Herndon NGPC to ensure loan charge-offs occur timely and in the appropriate fiscal year

Management's Response:

The SBA's management concurred with the finding and recommendation.

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Inadequate Review of STAR Time and Attendance Reports

The SBA has controls in place to ensure timely review and approval of STAR Time and Attendance (T&A) Reports as well as requests for request for leave or approved absence.

During our testwork over approvals of T&A Reports and related supporting documentation for amounts certified, we noted the following 7 control deficiencies in a sample of 45 reports:

- Three STAR T&A Reports were signed by either the timekeeper (certifier) and/or the supervisor (approver) after the payroll disbursement occurred.
- Two STAR T&A Reports were not signed by the supervisor.
- One STAR T&A Report was not dated by the employee's supervisor.
- One Office of Personnel Management Form 71, *Request for Leave or Approved Absence*, was not obtained or maintained to support the credit hours taken during the selected pay period.

We recommend the Chief Human Capital Officer:

8. Continue to reinforce policies and procedures regarding the certification of STAR T&A Reports with supervisors and timekeepers (i.e., issuance of a memorandum, training).

9. Continue to perform periodic quality assurance reviews to ensure supervisors and timekeepers are properly certifying and dating all STAR T&A Reports.

10. Develop and implement appropriate enforcement actions against individuals and offices with multiple instances of non-compliance.

Management's Response:

The SBA's management concurred with the finding and recommendations.