Office of Inspector General
U.S. Small Business Administration

DATE: November 15, 2023

TO: Isabella Casillas Guzman
Administrator

FROM: Hannibal "Mike" Ware
Inspector General

SUBJECT: Independent Auditors' Report on SBA's Fiscal Year 2023 Financial Statements (Report 24-03)

I am pleased to present the attached independent auditors' report on the U.S. Small Business Administration's (SBA) financial statements for fiscal year 2023, as required annually by the Chief Financial Officers Act of 1990, as amended.

We contracted with the independent certified public accounting firm KPMG LLP to conduct an audit of SBA's consolidated balance sheets as of September 30, 2023 and 2022 and the related notes to these statements. Our contract with KPMG required that the audit be performed in accordance with auditing standards generally accepted in the United States of America, *Government Auditing Standards* issued by the Comptroller General of the United States, and Office of Management and Budget (OMB) Bulletin No. 24-01, Audit Requirements for Federal Financial Statements.

KPMG's responsibility was to express an opinion on the consolidated balance sheets based on their audit. KPMG was not engaged to audit the consolidated statements of net cost and changes in net position and combined statements of budgetary resources for the years ended September 30, 2023 and 2022 and the related notes to these statements.

In the audit, KPMG reported significant matters for which they were unable to obtain sufficient and appropriate audit evidence to provide a basis for an audit opinion on SBA's balance sheet as of September 30, 2023. Accordingly, KPMG issued a disclaimer of opinion on the consolidated balance sheets as of September 30, 2023 and 2022.

The basis for the disclaimer was that due to inadequate processes and controls, SBA was unable to provide adequate evidential matter in support of a significant number of transactions and account balances related to the Paycheck Protection Program, Economic Injury Disaster Loan program, the Restaurant Revitalization Fund, and the Shuttered Venue Operators Grant program.

As a result, KPMG was unable to determine whether any adjustments might have been necessary with respect to the following line items and related notes:

- Credit Program Receivables and Related Foreclosed Property, Net
- Other than Intragovernmental Accounts Receivable, Net
- Downward Reestimate Payable to Treasury
- Loan Guarantee Liabilities

For the period ended September 30, 2023, KPMG identified material weaknesses over six areas and significant deficiencies over three areas in internal control over financial reporting. Appendices I and II of this report describe details of KPMG's conclusions about the material weaknesses and significant deficiencies. Appendix III describes instances of noncompliance with applicable laws or other matters required to be reported under *Government Auditing Standards* or OMB Bulletin No. 24-01.

In connection with the contract, we reviewed KPMG's report and related documentation and inquired of its representatives. Our oversight protocols included evaluation of major work products, attendance at critical meetings, review of significant findings, and examination of related evidential matter. Our review, as differentiated from an audit of the financial statements in accordance with government auditing standards, was not intended to enable us to express, and we do not express, opinions on SBA's financial statements or internal control over financial reporting or conclusions on SBA's compliance with applicable laws and other matters. Our review disclosed no instances where KPMG did not comply in all material respects with auditing standards. KPMG is responsible for the attached auditors' report dated November 15, 2023 and the conclusions expressed. However, OIG provides negative assurance of this audit.

We provided a draft of KPMG's report to SBA's Chief Financial Officer, who generally concurred with its findings and recommendations and agreed to implement the recommendations. The Chief Financial Officer stated that SBA remains committed to excellence in financial management and looks forward to furthering progress in the coming year. The Chief Financial Officer's response is included in Appendix IV.

We appreciate the cooperation and assistance of SBA and KPMG during the audit. Should you or your staff have any questions, please contact me or Andrea Deadwyler, Assistant Inspector General for Audits, at (202) 205-6586.

cc: Dilawar Syed, Deputy Administrator, Office of the Administrator
Arthur Plews, Chief of Staff, Office of the Administrator
Isabelle James, Deputy Chief of Staff, Office of the Administrator
Peggy Delinois Hamilton, Special Counsel for Enterprise Risk, Office of the Administrator
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Kathryn Frost, Acting Associate Administrator, Office of Capital Access
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Therese Meers, General Counsel, Office of General Counsel
Michael Simmons, Attorney Advisor, Office of General Counsel
Anna M. Calcagno, Director, Office of Program Performance, Analysis, and Evaluation
Tonia Butler, Director, Office of Internal Controls

Attachment

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Independent Auditors' Report

Inspector General
U.S. Small Business Administration

Administrator
U.S. Small Business Administration

Report on the Audit of the Consolidated Financial Statements

Disclaimer of Opinion

We were engaged to audit the consolidated balance sheets of the United States (U.S.) Small Business Administration (SBA) as of September 30, 2023 and 2022, and the related notes to the consolidated balance sheets (the consolidated financial statements).

We do not express an opinion on the accompanying consolidated financial statements of the SBA. Because of the significance of the matter described in the Basis for Disclaimer of Opinion section of our report, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these consolidated financial statements.

Basis for Disclaimer of Opinion

The SBA's pandemic relief programs include the Paycheck Protection Program, Economic Injury Disaster Loan program, Restaurant Revitalization Fund program, and Shuttered Venues Operators Grant program, which were authorized by the Coronavirus Aid, Relief, and Economic Security Act of 2020 and related legislations. These programs affect a substantial proportion of SBA's consolidated financial statements. The SBA was unable to provide adequate evidential matter in support of a significant number of transactions and account balances related to these programs due to inadequate processes and controls. As a result of this matter, we were unable to determine whether any adjustments might have been necessary related to the Credit Program Receivables and Related Foreclosed Property, Net; Other than Intragovernmental Accounts Receivable, Net; Downward Reestimate Payable to Treasury; Loan Guarantee Liabilities; and the related notes.

Other Matter – Report on Certain Fiscal Year 2023 and 2022 Information

We were not engaged to audit the consolidated statements of net cost and changes in net position, and combined statements of budgetary resources for the years ended September 30, 2023 and 2022, and the related notes to these statements. Accordingly, we express no opinion on them.

Other Matter - Interactive Data

Management has elected to reference to information on websites or other forms of interactive data outside the Agency Financial Report to provide additional information for the users of its consolidated financial statements. Such information is not a required part of the consolidated financial statements or supplementary information required by the Federal Accounting Standards Advisory Board. The information on these websites or the other interactive data has not been subjected to any of our auditing procedures, and accordingly we do not express an opinion or provide any assurance on it.

Responsibilities of Management for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with U.S. generally accepted accounting principles, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibilities for the Audit of the Consolidated Financial Statements

Our responsibility is to conduct an audit of the SBA's consolidated financial statements in accordance with auditing standards generally accepted in the United States of America (GAAS), *Government Auditing Standards*, issued by the Comptroller General of the United States, and Office of Management and Budget (OMB) Bulletin No. 24-01, *Audit Requirements for Federal Financial Statements*, and to issue an auditors' report. However, because of the matter described in the Basis for Disclaimer of Opinion section of our report, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these consolidated financial statements.

We are required to be independent of the SBA and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit.

Required Supplementary Information

U.S. generally accepted accounting principles require that the information in the Management's Discussion and Analysis and Required Supplementary Information sections be presented to supplement the basic consolidated financial statements. Such information is the responsibility of management and, although not a part of the basic consolidated financial statements, is required by the Federal Accounting Standards Advisory Board who considers it to be an essential part of financial reporting for placing the basic consolidated financial statements in an appropriate operational, economic, or historical context. We were unable to apply certain limited procedures to the required supplementary information in accordance with GAAS because of the significance of the matter described in the Basis for Disclaimer of Opinion paragraph. We do not express an opinion or provide any assurance on the information.

Report on Internal Control Over Financial Reporting

In connection with our engagement to audit the SBA's consolidated financial statement as of September 30, 2023, 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 an opinion on the consolidated financial statement, 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. We did not test all internal controls relevant to operating objectives as broadly defined by the *Federal Managers' Financial Integrity Act of 1982*.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying Appendices I and II, we identified certain deficiencies in internal control that we consider to be material weaknesses and significant deficiencies.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. We consider the deficiencies described in Appendix I to be material weaknesses.

A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies described in Appendix II to be significant deficiencies.

Report on Compliance and Other Matters

In connection with our engagement to audit the SBA's consolidated financial statement as of September 30, 2023, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the consolidated financial statement. However, providing an opinion on compliance with those provisions was not an objective of our engagement, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* or OMB Bulletin No. 24-01, and which are described in Appendix III.

We also performed tests of the SBA's compliance with certain provisions referred to in Section 803(a) of *the Federal Financial Management Improvement Act of 1996* (FFMIA). Providing an opinion on compliance with FFMIA was not an objective of our engagement, and accordingly, we do not express such an opinion. The results of our tests disclosed instances, described in Appendix III, in which the SBA's financial management systems did not substantially comply with the (1) Federal financial management systems requirements, and (2) applicable Federal accounting standards. The results of our tests disclosed no instances in which the SBA's financial management systems did not substantially comply with the United States Government Standard General Ledger at the transaction level.

Additionally, if the scope of our work had been sufficient to enable us to express an opinion on the consolidated financial statements, other instances of noncompliance or other matters may have been identified and reported herein.

SBA's Response to Findings

Government Auditing Standards requires the auditor to perform limited procedures on the SBA's response to the findings identified in our engagement and described in Appendix IV. The SBA's response was not subjected to the other auditing procedures applied in the engagement to audit the consolidated financial statements and, accordingly, we express no opinion on the response.

Purpose of the Reporting Required by *Government Auditing Standards*

The purpose of the communication described in the Report on Internal Control Over Financial Reporting and the Report on Compliance and Other Matters sections is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the SBA's internal control or compliance. Accordingly, this communication is not suitable for any other purpose.

KPMG LLP

Washington, DC
November 15, 2023

Appendix I

U.S. Small Business Administration

Material Weaknesses

The following deficiencies are considered to be material weaknesses in internal controls over financial reporting.

1. **Controls over Paycheck Protection Program (PPP) Loan Guarantees Need Improvement**
2. **Controls over Coronavirus Disease 2019 (COVID-19) Economic Injury Disaster Loans (EIDLs) Need Improvement**
3. **Controls over Monitoring of Restaurant Revitalization Fund (RRF) and Shuttered Venues Operators Grant (SVOG) Programs Need Improvement**
4. **Controls over Financial Reporting for Programs Funded by CARES Act and Related Legislation Need Improvement**
5. **Controls over the Evaluation of Service Organizations Need Improvement**
6. **Entity Level Controls Need Improvement**

Background

The PPP, COVID-19 EIDLs, RRF, and SVOG programs were authorized and funded by the Coronavirus Aid, Relief, and Economic Security Act of 2020, the Paycheck Protection Program and Health Care Enhancement Act, the Economic Aid to Hard-Hit Small Businesses, Nonprofits, and Venues Act, and the American Rescue Plan Act. The referenced laws are collectively referred to as the CARES Act and related legislation. The CARES Act and related legislation were passed by Congress to provide emergency assistance in response to the extensive effects of the public health and economic crisis arising from the COVID-19 pandemic. The PPP, COVID-19 EIDLs, RRF, and SVOG programs affect a substantial proportion of the consolidated financial statements.

1. Controls over PPP Loan Guarantees Need Improvement

A. Reporting of PPP Loan Guarantees

As part of the PPP, lenders must report on the status of PPP loans using the lender loan status reports on a monthly basis. The SBA updates the outstanding principal balances and ultimately the Loan Guarantee Liabilities and related accounting entries based on the submitted lender reports.

Management did not have adequate processes and controls in place to determine the status of PPP loan guarantees based on the lender loan status reports that were not submitted, submitted incorrectly, or submitted but not processed and evaluated by SBA for the majority of the fiscal year 2023. Also, management did not design and implement effective controls to ensure that the population of active PPP loan guarantees reviewed by management for status determination was complete and accurate.

Management did not implement controls to identify and resolve variances between SBA's and the lenders' records for 6 of 28 PPP loan guarantees samples tested. In addition, management flagged PPP loan guarantees that had eligibility concerns as part of their review process and did not have controls to support the existence and accuracy for 11 of 28 samples tested due to unresolved eligibility concerns as of September 30, 2023.

These deficiencies were caused by insufficient risk assessment and monitoring controls over the follow-up process for lender loan status reports. Also, management did not design and implement an effective process of accountability over the lenders that were not submitting loan status reports timely or accurately. Further, the automated system control used to reduce the outstanding principal balance for loan guarantees that received partial forgiveness payments is not designed and implemented effectively to prevent errors.

The following criteria were considered with respect to the matters described in the preceding paragraphs:

- Government Accountability Office's (GAO's) Standards for Internal Control in the Federal Government (Green Book), Principle 7, Identify, Analyze, and Respond to Risks; Principle 10, Design Control Activities;

- Office of Management and Budget (OMB) Circular No. A-123, Management's Responsibility for Enterprise Risk Management and Internal Control

The deficiencies described above may result in material misstatements to the Loan Guarantee Liabilities, Downward Reestimate Payable to Treasury line items and related elements in the consolidated financial statements.

Recommendations – Reporting of PPP Loan Guarantees

We recommend the Administrator coordinate with the Acting Associate Administrator for the Office of Capital Access to:

1. Design and implement controls to ensure the population used in the review and follow-up of nonreporting loan status reports or loan status reports with errors is complete and accurate.

2. Determine enforceable actions and controls to hold lenders accountable for submitting loan status reports timely and correctly.

3. Assess the sufficiency of implemented controls to monitor incomplete or inaccurate PPP lender loan status reports on an ongoing basis, including the identification and resolution of the root causes of reporting noncompliance.

4. Design and implement an automated system control to accurately reduce the outstanding principal balance after the processing of all forgiveness payments.

B. Forgiveness Review of PPP Loan Guarantees

The PPP program terms, authorized by the CARES Act and related legislation, permitted for the forgiveness of PPP loan guarantees if the borrower met the forgiveness criteria. To request forgiveness, borrowers submit the forgiveness application to the lenders for approval. The lenders will subsequently notify SBA of their forgiveness decision and submit the request to SBA.

Management did not design and implement adequate monitoring controls over the work performed by a contractor and the use of its case management system to ensure that the population of PPP loan guarantees identified with eligibility flags was complete and accurate and ultimately determine their eligibility for forgiveness. Moreover, management did not provide sufficient evidence to demonstrate that an effective control environment existed when the case management system was used to perform the automated screening of the PPP loan guarantees. Management did not effectively perform independent review controls to determine whether the results of the contractor's screening process of certain loan guarantees were effective and accurate. These loan guarantees included those with no flags identified for eligibility concerns, or those that had flags identified for eligibility concerns but were not reviewed further based on management's policy decision.

Management did not design and implement an effective review and monitoring process for the 2021 cohort of PPP loan guarantees, which comprises the majority of the outstanding principal balance of PPP loan guarantees as of September 30, 2023. While the case management system contains a comprehensive series of validation checks to identify potential noncompliance with PPP loan guarantee program eligibility requirements, management communicated that the case management system performed only a limited number of validation checks against program eligibility requirements for the 2021 cohort of PPP loan guarantees. Further, management did not implement a sufficient monitoring process to ensure that lenders followed established procedures and adequately resolved the eligibility concerns identified by the case management system's limited automated screening.

Management did not design and implement effective controls to determine the accuracy and completeness for their sample of PPP loan guarantee forgiveness transactions. Management's review of the sample from the largest subset of PPP loan forgiveness transactions did not address the eligibility for forgiveness and the accuracy of the approved loan guarantee and forgiveness amounts. In addition, management's review process did not consider a follow-up requirement when a difference exists for each sample's loan approval amount and the loan forgiveness amount within an acceptable variance threshold. Instead, management's review process allowed for a variance threshold between the calculated loan guarantee approval amount as compared to the actual approved loan guarantee amount. Similarly, management's review process allowed for a variance threshold between the calculated loan forgiveness amount and requested loan forgiveness amount. As a result, management's sample review process was not properly designed to sufficiently evaluate and quantify the magnitude of the actual error amounts for the loan guarantee approval and loan guarantee forgiveness variances.

Management did not adequately design and implement the post payment review control to determine the appropriate status and financial reporting impacts of PPP loan guarantees forgiven as of the end of the fiscal year. Also, management's process and related control activities for funds recovery of PPP loan guarantees that were erroneously forgiven was not documented.

These deficiencies were caused by management's reliance on the contractor's automated and manual loan review processes without adequate monitoring controls to evaluate and assess the work product. Further, there was reliance placed on the lenders' self-certifications prior to the approval of the 2021 cohort of PPP loan guarantees without adequate monitoring controls. In addition, management did not perform an adequate risk assessment process to identify and mitigate relevant risks and design appropriate controls to ensure a complete and accurate portfolio of PPP loan guarantees that were disbursed to eligible recipients.

The following criteria were considered with respect to the matter described in the preceding paragraphs:

- GAO's Green Book, Principle 3, Establish Structure, Responsibility, and Authority; Principle 6, Define Objectives and Risk Tolerances; Principle 7, Identify, Analyze, and Respond to Risks; Principle 10, Design Control Activities; and Principle 16, Perform Monitoring Activities

- OMB Circular No. A-123, Management's Responsibility for Enterprise Risk Management and Internal Control

The deficiencies described above may result in a material misstatement to the Loan Guarantee Liabilities and Downward Reestimate Payable to Treasury line items, and the related elements in the consolidated financial statements.

Recommendations – Forgiveness Review of PPP Loan Guarantees

We recommend the Administrator coordinate with the Acting Associate Administrator for the Office of Capital Access to:

5. Perform a thorough review of the outstanding PPP loan guarantees and determine the impact on the outstanding guarantee and eligibility for forgiveness of loans determined to not be in conformance with the related legislation and program's terms.

6. Design, implement, and document an effective PPP forgiveness review process for loan guarantees that were forgiven that addresses both the eligibility and the accuracy of the loan approval and forgiveness amounts.

7. Design and implement an effective funds recovery plan to ensure PPP funds disbursed on behalf of ineligible recipients are recovered and reported accurately in a timely manner. The plan should include an effective process to provide the information necessary to the Office of Performance, Planning, and the Chief Financial Officer to record any required accounting adjustments.

C. Purchases of PPP Loan Guarantees

The PPP program terms, authorized by the CARES Act and related legislation, fully guaranteed the PPP loans disbursed by lenders on behalf of the SBA. Lenders are required to service the PPP loans and continue to report on their status on a monthly basis until the loan is fully forgiven, repaid, or the borrower defaults. In the event of default, the lender may request that SBA honor its full guarantee and purchase the loan.

Management did not adequately design and implement controls to ensure that purchase requests of PPP loan guarantees were appropriately reviewed to verify that requesting lenders met the program requirements prior to approving and disbursing the original loan.

The PPP loan guarantee purchases review process relied on the identification of flags by the case management system indicating that the lender may not have fulfilled the program requirements. Management did not design and implement adequate controls to ensure the completeness and accuracy of flags identified and resolved. In addition, management added additional flags that would require a manual purchase review at various stages of the program. However, management did not retroactively review PPP loan guarantee purchase requests that were previously automatically approved that subsequently required a manual review.

The PPP loan guarantee purchases review process documentation did not consider all guidance issued to lenders as part of the origination process when determining the subset of flags that would require a manual purchase review. Specifically, SBA did not include adequate evaluation of flags communicated to lenders in the procedural notices related to the cohort 2021 loan approval requirements.

These deficiencies were caused by an inadequate risk assessment performed to ensure sufficient controls were designed and implemented for the review of PPP loan guarantee purchase transactions.

The following criteria were considered with respect to the matter described in the preceding paragraphs:

- GAO's Green Book, Principle 3, Establish Structure, Responsibility, and Authority; Principle 6, Define Objectives and Risk Tolerances; Principle 7, Identify, Analyze, and Respond to Risks; Principle 10, Design Control Activities; and Principle 16, Perform Monitoring Activities

- OMB Circular No. A-123, Management's Responsibility for Enterprise Risk Management and Internal Control

The deficiencies described above may result in a material misstatement to the Loan Guarantee Liabilities and Downward Reestimate Payable to Treasury line items, and the related elements in the consolidated financial statements.

Recommendations – Purchases of PPP Loan Guarantees

We recommend the Administrator coordinate with the Acting Associate Administrator for the Office of Capital Access to:

8. Perform a thorough and complete analysis of all requirements communicated to lenders for the PPP program and determine how to evaluate whether lenders met the requirements prior to disbursing a PPP loan. The analysis should include evidence to support the adequacy of SBA's review process when determining which purchase requests will require additional review.

9. Develop and implement an effective process to review purchase requests for outstanding PPP loan guarantees and for loans that have already been purchased that addresses whether the lender met their requirements in accordance with the program requirements.

10. Develop and implement an effective funds recovery plan to ensure funds related to PPP purchases disbursed to ineligible recipients are recovered and reported accurately in a timely manner. The plan should include an effective process to provide the information necessary to the Office of Performance, Planning, and the Chief Financial Officer to record any required accounting adjustments.

2. Controls over COVID-19 EIDLs Need Improvement

COVID-19 EIDLs were approved in fiscal years 2020 through 2022 and have a 30-year term. Payments on COVID-19 EIDLs were deferred by the SBA for up to 30 months after loan disbursement. The payment deferral period ended for a significant number of COVID-19 EIDLs during fiscal year 2023.

Management did not design and implement adequate monitoring controls over the COVID-19 EIDLs portfolio to ensure reliable financial reporting as of the end of the fiscal year. Management's review was not appropriately designed to identify a complete and accurate COVID-19 EIDLs population of outstanding loans disbursed to eligible recipients. The review process relied on hold codes in the SBA's loan repository system to identify the COVID-19 EIDLs with eligibility concerns. However, management was not able to provide evidence of the completeness and accuracy of the population of loans with hold codes as of the end of the fiscal year.

Management's review controls over loans with existing hold codes were not properly designed. The review did not contain sufficient evidence about the identification, research, and resolution of hold codes to support management's reliance for financial reporting purposes as of the end of the fiscal year. Management did not identify and research COVID-19 EIDLs with unresolved hold codes for loans charged-off, in deferment, repayment, and delinquent stages as of the end of the fiscal year.

Management did not fully design and implement effective controls over their charge-off process for non-performing COVID-19 EIDLs. The non-performing loans are those that are 90 days or more past due. Management implemented a process to automatically charge-off non-performing COVID-19 EIDLs that have an original loan balance of $200,000 or less without any unresolved hold codes. These loans subject to automated charge-off are significant to the COVID-19 EIDLs portfolio, were not reviewed, did not have justification to support the charge-off decision, and were not assessed for recoverability. In addition, management's charge-off process was primarily based on the number of days past due without sufficient regard to the recoverability of the loan. Thus, management's controls were not appropriately designed to identify the root cause of the delinquency of the charged-off COVID-19 EIDLs.

These deficiencies were caused by an inadequate risk assessment process to identify and mitigate relevant risks and design appropriate controls to ensure a complete and accurate population of COVID-19 EIDLs that were disbursed to eligible recipients. In addition, management implemented a policy that was not adequately supported because the review of the COVID-19 EIDLs portfolio was incomplete. Therefore, the information used by management to make an informed charge-off policy decision was not relevant and reliable. In addition, management's risk assessment process did not adequately consider the accounting and financial reporting implications of charging off a loan without assessing the impact of the likelihood of recovery.

The following criteria were considered with respect to the matters described in the preceding paragraphs:

- GAO's Green Book, Principle 3, Establish Structure, Responsibility, and Authority; Principle 6, Define Objectives and Risk Tolerances; Principle 7, Identify, Analyze, and Respond to Risks; Principle 9, Identify, Analyze, and Respond to Change; and Principle 10, Design Control Activities

- OMB Circular No. A-123, Management's Responsibility for Enterprise Risk Management and Internal Control

The deficiencies described above may result in a material misstatement of the Credit Program Receivables and Related Foreclosed Property, Net and Downward Reestimate Payable to Treasury line items, and related elements in the consolidated financial statements.

Recommendations – Controls over COVID-19 EIDLs Need Improvement

We recommend the Administrator coordinate with the Acting Associate Administrator for the Office of Capital Access to:

11. Perform and update the program's internal control risk assessment to identify changes to risks that may require the design and implementation of effective monitoring controls over the review of the COVID-19 EIDLs portfolio.

12. Design and implement an effective funds recovery plan to ensure COVID-19 EIDLs funds disbursed to ineligible recipients are recovered and reported accurately and in a timely manner. The plan should include an effective process to provide the information necessary to the Office of Planning, Performance, and the Chief Financial Officer to record any required accounting adjustments.

13. Reevaluate the appropriateness and update SBA's existing policies and procedures to ensure they are supported by quality information stemming from effective control activities. This includes assessing the recoverability of COVID-19 EIDLs prior to charge-off. Perform a regular review of implemented policies to ensure they are responding to relevant risks.

3. Controls over Monitoring of RRF and SVOG Programs Need Improvement

A. Monitoring of RRF Awards

The period to use RRF awards for eligible purposes expired on March 11, 2023. Management's process relies on award recipients to submit Post Award Reports by April 30, 2023, to disclose the amount of the award used on eligible purposes prior to expiration. If any amount of the award was not used for eligible purposes before expiration, the unused funds must be returned to SBA.

Management did not design and implement the appropriate monitoring controls over RRF awards to ensure that the funds were used in accordance with the CARES Act and related legislation and accurate financial reporting as of the end of the fiscal year. Specifically, a Post Award Report was not submitted for a significant number of awards as of September 30, 2023. While management performed follow-up procedures to ensure the outstanding Post Award Reports were submitted by the remaining recipients, the procedures were not substantial enough to support the completeness and accuracy of financial reporting as of the end of the fiscal year. Management selected a sample of RRF awards for review to determine the accuracy of submitted Post

Award Reports. However, management did not initiate or fully complete reviews for a significant number of samples to ensure accurate financial reporting as of the end of the fiscal year. Further, management's process for funds recovery was not fully implemented for RRF awards that had eligibility concerns.

These deficiencies were caused by an inadequate risk assessment process to identify and mitigate relevant risks and design appropriate controls to ensure funds were spent on eligible expenses to be relied upon for financial reporting.

The following criteria were considered with respect to the matters described in the preceding paragraphs:

- GAO's Green Book, Principle 10, Design Control Activities; Principle 12, Implement Control Activities; and Principle 13, Use Quality Information

- OMB Circular No. A-123, Management's Responsibility for Enterprise Risk Management and Internal Control

The deficiencies described above may result in a material misstatement to the Other than Intragovernmental Accounts Receivable, Net, line item and the related elements in the consolidated financial statements.

Recommendations – Monitoring of RRF Awards

We recommend the Administrator coordinate with the Acting Associate Administrator for the Office of Capital Access to:

14. Perform and update the program's internal control assessment to identify changes to risks that may require the design and implementation of effective monitoring controls and review processes of RRF awards to identify recipients that may not have been eligible to receive awards or that may have spent awards on ineligible expenses in accordance with the program's terms.

15. Design and implement effective follow-up procedures for RRF award recipients that are not complying with the program's terms and to ensure complete, accurate, and timely reporting for the use of the award.

16. Design and implement an effective funds recovery plan and controls to ensure RRF awards disbursed to ineligible recipients or spent on ineligible expenses are recovered and reported accurately and in a timely manner. In conjunction with the Office of Planning, Performance, and the Chief Financial Officer, design and implement an effective process to provide the information necessary to record any required accounting adjustments.

B. Monitoring of SVOG Awards

The period to use SVOG funds for eligible purposes expired for a majority of SVOG awards as of September 30, 2023. Management's process relies on award recipients to submit an Expense Report and Standard Form (SF) 425, Federal Financial Report, to disclose the amount of the award used for eligible purposes prior to expiration. If any amount of the award was not used for eligible purposes before expiration, the unused funds must be returned to SBA.

Management did not design and implement appropriate monitoring controls over SVOG awards to ensure that the funds were used in accordance with the CARES Act and related legislation and accurate financial reporting as of the end of the fiscal year. Specifically, as of September 30, 2023, an Expense Report or SF-425 was not submitted for a significant number of awards. In addition, management selected samples of SVOG awards to review the accuracy of report submissions and eligibility of award recipients. However, management did not initiate or fully complete the sample reviews for a significant number of samples. Thus, management's sample review process is not adequately designed and implemented to ensure accurate financial reporting as of the end of the fiscal year.

Management's process for funds recovery was not fully implemented for SVOG awards that had identified eligibility concerns. Additionally, management's process to review the recipients' single audit reports was not fully implemented by the end of the fiscal year. Therefore, management could not determine the impact of potential control and compliance deficiencies noted in the single audit reports over the use of SVOG awards.

These deficiencies were caused by an inadequate risk assessment process to identify and mitigate relevant risks and design appropriate controls to ensure funds were spent on eligible expenses to be relied upon for financial reporting.

The following criteria were considered with respect to the matters described in the preceding paragraphs:

- GAO's Green Book, Principle 10, Design Control Activities; Principle 12, Implement Control Activities; and Principle 13, Use Quality Information

- OMB Circular No. A-123, Management's Responsibility for Enterprise Risk Management and Internal Control

The deficiencies described above may result in a material misstatement to the Other than Intragovernmental Accounts Receivable, Net, line item and the related elements in the consolidated financial statements.

<u>Recommendations – Monitoring of SVOG Awards</u>

We recommend the Administrator coordinate with the Associate Administrator for the Office of Disaster Recovery and Resilience to:

17. Perform and update the program's internal control assessment to identify changes to risks that may require the design and implementation of effective monitoring controls and review processes of SVOG awards to identify recipients that may not have been eligible to receive awards or that may have spent awards on ineligible expenses in accordance with the program's terms.

18. Design and implement effective follow-up procedures for SVOG award recipients that are not complying with the program's terms and to ensure complete, accurate, and timely reporting for the use of the award.

19. Design and implement an effective funds recovery plan and controls to ensure SVOG awards disbursed to ineligible recipients or spent on ineligible expenses are recovered and reported accurately and in a timely manner. In conjunction with the Office of Planning, Performance, and the Chief Financial Officer, design and implement an effective process to provide the information necessary to record any required accounting adjustments.

4. Controls over Financial Reporting for Programs Funded by CARES Act and Related Legislation Need Improvement

A. Accounting for Funds Recovery

The PPP, COVID-19 EIDLs, RRF, and SVOG programs affect a significant portion of SBA's consolidated financial statements. As these programs are either in the servicing or post payment review phases, SBA began the process to recover funds or identify funds that need to be recovered.

Management did not adequately design and implement controls to account for the recovery of funds related to these programs. Management did not provide evidence of documented policies and procedures for the recovery of funds related to the RRF and SVOG programs and the recording of activities associated with the related accounts receivable, and the allowance for estimated uncollectible amounts. For example, management was not able to demonstrate the application of the accounts receivable recognition criteria for the determination of a claim to cash or other assets due to recovery of funds for each program. Also, management did not have adequate documentation about the estimation methodology used to determine the accounts receivables and the related allowance for estimated uncollectible amounts. Finally, management did not have adequate documentation about the financial reporting considerations related to the recovery of funds for the RRF and SVOG programs including the respective accounting entries.

Management did not provide sufficient evidence of documented accounting policies for the recovery of funds related to the COVID-19 EIDLs and PPP loan programs. Further, management did not have adequate documentation about the appropriate accounting treatment and the respective accounting entries throughout each step of the recovery life cycle in accordance with generally accepted accounting principles.

These deficiencies were caused by an inadequate risk assessment to identify and mitigate relevant financial reporting risks. Also, management did not develop the appropriate policies and procedures for considerations related to the recovery of funds through the applicable programs' lifecycle including the servicing and post payment review phases.

The following criteria were considered with respect to the matters described in the preceding paragraphs:

- GAO's Green Book, Principle 3, Establish Structure, Responsibility, and Authority; and Principle 10, Design Control Activities

- OMB Circular No. A-123, Management's Responsibility for Enterprise Risk Management and Internal Control

The deficiencies identified above may result in a material misstatement to the Other than Intragovernmental Accounts Receivable, Net, Credit Program Receivables and Related Foreclosed Property, Net, and Downward Reestimate Payable to Treasury line items, and related elements in the consolidated financial statements.

<u>Recommendations – Accounting for Funds Recovery</u>

We recommend the Administrator coordinate with the Chief Financial Officer to:

20. Develop and document the policies and procedures for the recovery of funds, the accounts receivable, and the allowance for estimated uncollectible amounts related to the programs created or expanded by the CARES Act and related legislation.

21. Document the current state of accounting policies and procedures for the recovery of funds, including the respective accounting entries for all applicable scenarios (e.g., fraud related, ineligibility) for COVID-19 EIDLs and PPP loans that have been charged-off or forgiven.

22. Inquire with standard setting bodies to confirm the appropriate accounting treatment throughout each step of the recovery lifecycle for COVID-19 EIDLs and the PPP loans that have been charged-off or forgiven. Memorialize the response by updating management's documented policies and procedures including the respective accounting entries under generally accepted accounting principles for all applicable scenarios.

23. Design and implement effective controls and communication processes to timely obtain the information necessary from program offices to record any required accounting adjustments for programs created or expanded by the CARES Act and related legislation.

B. Subsidy Reestimate

Statement of Federal Financial Accounting Standards Number 2, Accounting for Direct Loans and Loan Guarantees, requires that direct loans and loan guarantees committed after September 30, 1991, be recorded on a present value basis consistent with the intent of the Federal Credit Reform Act of 1990. As such, SBA developed an estimation methodology to reestimate the future net cash inflows and outflows for the COVID-19 EIDLs and PPP loan portfolios as of the end of the fiscal year.

Management did not design and implement adequate controls over the review of the data inputs used in the PPP subsidy reestimate. Specifically, management did not adequately design and implement controls to ensure the data inputs used in the PPP subsidy reestimate methodology that are derived from the lender loan status reporting, and the forgiveness and purchases processes, are complete and accurate. Therefore, management did not have sufficient controls in place to ensure the development of significant assumptions in the methodology were appropriate.

Management did not adequately design and implement controls to ensure the assumptions used in the subsidy reestimate for the COVID-19 EIDLs were appropriate with their risks. Management's review was not appropriately designed to identify a complete and accurate COVID-19 EIDLs population of outstanding loans disbursed to eligible recipients. Management's review was still in process as of the end of the fiscal year and management did not sufficiently document an assessment to demonstrate that the assumptions applied are appropriate for the COVID-19 EIDLs in the portfolio based on their specific risk characteristics.

Further, the loan-level projection datasets included projected cash flows for COVID-19 EIDLs that were charged-off without an outstanding loan receivable balance as of September 30, 2023. The projected cash flows for these charged-off loans inappropriately affected the allowance for subsidy balances without the related recognition of the gross loans receivable.

These deficiencies were caused by an inadequate entity wide control environment related to the design, implementation, and operating effectiveness of controls related to the review of the loan portfolio at a precision level necessary to ensure the data inputs used for the reestimate models are complete and accurate. In addition, the deficiencies were caused by the implementation and development of subsidy reestimate models for new programs that do not have a significant volume of historical data or precedence and inadequately designed and implemented controls to ensure the reestimate output complied with the applicable accounting standards related to charged-off loans.

The following criteria were considered with respect to the matter described in the preceding paragraphs:

- GAO's Green Book, Principle 10, Design Control Activities; and Principle 13, Use Quality Information
- OMB Circular No. A-123, Management's Responsibility for Enterprise Risk Management and Internal Control

The deficiencies described above may result in a material misstatement to the Credit Program Receivables and Related Foreclosed Property (Net), Downward Reestimate Payable to Treasury, and Loan Guarantee Liabilities line items, and the related elements in the consolidated financial statements.

<u>Recommendations – Subsidy Reestimate</u>

We recommend the Administrator coordinate with the Chief Financial Officer to:

24. Continue implementing controls in collaboration with relevant program offices for the PPP and COVID-19 EIDLs portfolios to accumulate relevant, complete, and accurate data on which to base the subsidy reestimate.

25. Design and implement adequate review and approval controls over the reestimate for the PPP and COVID-19 EIDLs portfolios by appropriate levels of management, and to coordinate with relevant

program offices to assess the integrity of relevant data inputs used in the development of assumptions, and reasonableness for the selected assumptions used and the resulting estimates.

26. Refine existing review and approval controls to ensure the reestimate output is in accordance with accounting standards for charged-off loans.

5. Controls over the Evaluation of Service Organizations Need Improvement

A. Service Organizations Used for Loan Guarantee Programs

Management did not obtain reasonable assurance on the operating effectiveness of internal controls in multiple service organizations' control environments relevant to the 7(a) loan guarantee program fiscal transfer agent, the financial service providers for the 7(a) and 504 loan guarantee programs, and the PPP forgiveness and purchases platform. With regards to the financial service providers for the 7(a) and 504 loan guarantee programs, the relevant control environments include the facilitation, maintenance, and reporting of the account balances for the respective secondary market programs. With regards to the PPP forgiveness and purchases platform, the relevant control environment includes the operation of the PPP loan forgiveness and PPP loan purchase modules, the data transmissions over the internet between the relevant modules and SBA systems used in the configured checks, the cloud-based infrastructure hosting provider, and the application controls within the application intake platform.

In addition, management did not provide evidence of adequate monitoring activities performed over the relevant internal control environments at the respective service organizations and subservice organizations, such as obtaining and reviewing an attestation report on the design, implementation, and operating effectiveness of controls at the service organization.

Management did not have adequate evidence that complementary user entity controls identified in the service organization control (SOC) 1 Type 2 reports obtained for the 504 loan guarantee program central servicing agent and the financial service provider were designed, implemented, and operating effectively. Specifically, management's review of complementary user entity controls indicated that controls were in process of being identified as of the end of the fiscal year. Management's assessment of internal controls over financial reporting is not complete without the sufficient consideration of existing and non-existing controls at relevant service organizations and the effectiveness of those controls.

These deficiencies identified above were caused by inadequate monitoring controls over the relevant service organizations for their assigned internal control responsibilities to obtain reasonable assurance on the operating effectiveness of internal controls in the service organizations' control environments.

The following criteria were considered with respect to the matters described in the preceding paragraphs:

- GAO's Green Book, Section 4, Additional Considerations: Service Organizations; Principle 5, Enforce Accountability; Principle 10, Design Control Activities; and Principle 16, Perform Monitoring Activities

- OMB Circular No. A-123, Management's Responsibility for Enterprise Risk Management and Internal Control

The deficiencies described above prevent SBA from obtaining an understanding of relevant service organization controls and their operating effectiveness to identify all relevant control gaps and deficiencies that require a complementary user control to mitigate the risk of error to the Loan Guarantee Liabilities line item and related elements in the consolidated financial statements.

Recommendations – Service Organizations Used for Loan Guarantee Programs

We recommend the Administrator coordinate with the Acting Associate Administrator for the Office of Capital Access to:

27. Continually evaluate the established policy for SOC 1 reports that requires service organizations to provide a SOC 1 report over the control environment that is relevant and significant to the processing and recording of SBA's transactions as it relates to loan guarantee programs. If a SOC 1 report cannot be obtained, management should design, implement, and operate controls within SBA's control environment.

28. Assess the risk posed by the service organizations' control environments and obtain sufficient assurance over the operating effectiveness of relevant and significant controls to determine the integrity of loan guarantee programs transactions processed on behalf of and recorded by SBA. To achieve this, consider obtaining a SOC 1 report for the relevant control environments at the service organizations, and perform and document the following:

    - SOC 1 report is sufficiently scoped to cover transaction processing and related control activities performed by the service organizations on behalf of SBA.

    - All exceptions noted in the SOC 1 report – not just those described in the independent service auditor's report – are evaluated to determine applicability to SBA's internal controls over financial reporting, the potential impact to SBA's financial statements, and mitigating controls considerations made during their risk assessment.

    - All complementary user entity controls described in the SOC 1 reports are evaluated using current information and with consideration to their applicability to SBA's internal controls over financial reporting.

    - Evaluation procedures performed to assess whether complementary user entity controls and other SBA-performed controls were tested on a frequency determined by SBA and found operating effectively and, if they are not, assess the impact of such deficiencies on SBA's internal controls over financial reporting.

    - All complementary subservice organization controls described in SOC 1 reports are evaluated to determine whether they provided services and performed controls considered relevant to SBA's internal controls over financial reporting and, if relevant subservice organizations were identified, an evaluation is performed to obtain an understanding of the subservice organization(s) and their controls.

    - SOC 1 reports cover the appropriate period or corresponding gap letters provide sufficient coverage to assess impacts on SBA's internal controls over financial reporting.

B. Service Organization Used for the SVOG Program

Management did not obtain reasonable assurance on the operating effectiveness of internal controls in the service organization's control environments relevant to the external cloud service provider used for the SVOG platform in monitoring the status of awards.

Management did not obtain and review the SOC 1 report for the service provider in a timely manner as of fiscal year-end. Additionally, management did not provide evidence of adequate monitoring activities performed over the relevant internal control environment at the respective subservice organizations identified in the SOC 1 report for an earlier period in the fiscal year. Further, management did not provide evidence of adequate evaluation of the control exceptions identified in the SOC 1 report and the impact to SBA's internal controls over financial reporting. Management's assessment of internal controls over financial reporting is not complete because it did not fully consider the existing and non-existing controls at relevant service and subservice organizations and the effectiveness of those controls.

These deficiencies were caused by management not implementing effective monitoring of the effectiveness of internal control over the assigned processes performed by the relevant service organization.

The following criteria were considered with respect to the matters described in the preceding paragraphs:

- GAO's Green Book, Section 4, Additional Considerations: Service Organizations; Principle 5, Enforce Accountability; Principle 10, Design Control Activities; and Principle 16, Perform Monitoring Activities
- OMB Circular No. A-123, Management's Responsibility for Enterprise Risk Management and Internal Control

The deficiencies described above prevented SBA from obtaining an understanding of relevant service organization controls and their operating effectiveness to identify all relevant control gaps and deficiencies that require a complementary user control to mitigate the risk of error to the Other than Intragovernmental Accounts Receivable, Net line item and related elements in the consolidated financial statements.

<u>Recommendations – Service Organizations Used for the SVOG Program</u>

We recommend the Administrator coordinate with the Associate Administrator for the Office of Disaster Recovery and Resilience to:

29. Continually evaluate the established policy for SOC 1 reports that requires service organizations to provide a SOC 1 report over the control environment that is relevant and significant to the processing and recording of SBA's transactions as it relates to the SVOG program. If a SOC 1 report cannot be obtained, management should design, implement, and operate controls within SBA's control environment.

30. Assess the risk posed by the service organizations' control environments and obtain sufficient assurance over the operating effectiveness of relevant and significant controls to determine the integrity of SVOG program transactions processed on behalf of and recorded by SBA. To achieve this, consider obtaining a SOC 1 report for the relevant control environments at the service organizations, and perform and document the following:

    - SOC 1 report is sufficiently scoped to cover transaction processing and related control activities performed by the service organizations on behalf of SBA.
    - All exceptions noted in the SOC 1 report – not just those described in the independent service auditor's report – are evaluated to determine applicability to SBA's internal controls over financial reporting, the potential impact to SBA's financial statements, and mitigating controls considerations made during their risk assessment.
    - All complementary user entity controls described in the SOC 1 reports are evaluated using current information and with consideration to their applicability to SBA's internal controls over financial reporting.
    - Evaluation procedures performed to assess whether complementary user entity controls and other SBA-performed controls were tested on a frequency determined by SBA and found operating effectively and, if they are not, assess the impact of such deficiencies on SBA's internal controls over financial reporting.
    - All complementary subservice organization controls described in SOC 1 reports are evaluated to determine whether they provided services and performed controls considered relevant to SBA's internal controls over financial reporting and, if relevant subservice organizations were identified,

an evaluation is performed to obtain an understanding of the subservice organization(s) and their controls.

- SOC 1 reports cover the appropriate period or corresponding gap letters provide sufficient coverage to assess impacts on SBA's internal controls over financial reporting.

6. Entity Level Controls Need Improvement

Management faced challenges in maintaining an adequate entity level controls system that produces reliable and accurate financial reporting. The significance of the internal control matters indicated weaknesses across several entity level control categories. The following conditions were identified.

A. Control Environment and Risk Assessment

Management did not establish an effective control environment and did not perform effective risk assessment processes. The following deficiencies were identified across the SBA:

- The materiality threshold developed and documented was not adequately considered and applied by program offices when key decisions regarding controls and review processes were implemented. The controls within the relevant offices were not designed, implemented, and operating effectively to a sufficient precision level to ensure the reporting objective of preparing the financial statements free of material misstatement could be achieved. For example, the COVID-19 EIDLs and PPP loan review processes were not designed to ensure the reviews performed were to a sufficient level of precision to ensure the related balances were free of material misstatement. Management implemented a policy in fiscal year 2022 to automatically charge-off non-performing COVID-19 EIDLs with an original loan balance of $200,000 or less that do not have eligibility concerns without further review. However, management did not reassess this policy in fiscal year 2023 given relevant risks and materiality thresholds to ensure the review controls over COVID-19 EIDL charge-offs were operating effectively to a sufficient precision level.

- Management did not complete the planned risk assessments for material programs, including COVID-19 EIDLs, PPP, COVID-19 EIDL grants, and Debt Relief Program payments in fiscal year 2023.

- Management did not implement adequate risk assessment processes to identify, analyze, and respond to relevant risks. For example, management did not adequately respond to the increased risk of noncompliance due to the significant volume of COVID-19 EIDLs going into servicing phase beginning in fiscal year 2023.

B. Monitoring

Management did not design and implement effective monitoring processes. SBA did not have adequate or effective monitoring controls related to:

- PPP lenders.

- Internal control over processes performed by service organizations.

- RRF and SVOG program award recipients.

- The COVID-19 EIDLs portfolio to identify a complete and accurate population of loans disbursed to eligible recipients for financial reporting purposes as of fiscal year-end.

These deficiencies were caused by the prioritization of the continued execution and servicing of the CARES Act and related legislation programs over internal control processes and related remediation of prior year control deficiencies. In addition, these deficiencies were caused by the lack of dedicated staff to perform an adequate risk assessment, appropriately remediate prior year control deficiencies, implement, and monitor the operating effectiveness of controls, and operationally service large-scale programs effectively.

The following criteria were considered with respect to the matters described in the preceding paragraphs:

- GAO's Green Book, Principle 6, Define Objectives and Risk Tolerances; Principle 7, Identify, Analyze, and Respond to Risks; Principle 9, Identify, Analyze, and Respond to Change; Principle 10, Design Control Activities; Principle 12, Implement Control Activities; Principle 16, Perform Monitoring Activities; Principle 17, Evaluate Issues and Remediate Deficiencies
- OMB Circular No. A-123, Management's Responsibility for Enterprise Risk Management and Internal Control

As a result of the deficiencies described above, we noted that without the proper level of entity level controls in place and operating effectively, there is an increased risk that a material misstatement in the consolidated financial statements, and noncompliance with the relevant laws and regulations would neither be prevented or detected and corrected in a timely manner.

Recommendations – Entity Level Controls Need Improvement

We recommend that the Administrator coordinate with the Acting Associate Administrator of the Office of Capital Access and the Associate Administrator of the Office of Disaster Recovery and Resilience to:

31. In conjunction with the Office of the Chief Financial Officer, complete the internal control risk assessments for programs that have a material impact on the financial statements at a process level in a timely manner including the consideration of whether controls are designed, implemented, and are operating at a sufficient precision level in accordance with management's materiality threshold and will be sufficient for financial reporting purposes.
32. Design, implement, and monitor the operating effectiveness of key controls that respond to significant risks of material misstatements and compliance with relevant laws and regulations.

We recommend that the Administrator coordinate with the Chief Financial Officer to:

33. Perform and document a thorough risk assessment at the financial statement assertion level to identify process level risks and communicate the results to relevant program offices. Also, assess the effectiveness of the key process level controls to respond to the identified risks in conjunction with relevant program offices.

Appendix II

U.S. Small Business Administration

Significant Deficiencies

The following deficiencies are considered to be significant deficiencies in internal controls over financial reporting.

1. **Controls over Payments for Covered Loans under the Debt Relief Program Need Improvement**

2. **Controls over General Information Technology Need Improvement**

3. **Controls over Subsequent Events Need Improvement**

1. Controls over Payments for Covered Loans under the Debt Relief Program Need Improvement

The CARES Act and related legislation authorized the Debt Relief Program that allowed SBA to make payments on behalf of certain loans in the 7(a) and 504 loan guarantee programs and the Microloan program.

Management did not design and implement effective controls over the Debt Relief Program post payment review process. Management used a contractor to develop and perform a risk-based methodology to identify the payments for covered loans that may have a higher risk for overpayments and would require further review. However, management did not provide documentation evidencing adequate monitoring controls over the methodology produced by the contractor. Specifically, management did not provide evidence of an effective review over the accuracy of the inputs, appropriateness of significant assumptions, and the application of the methodology.

Further, management did not provide evidence of an effective review of the other alternative methodologies considered and a documented approved basis for the selected risk-based methodology. In addition, management did not provide documentation evidencing a risk assessment for the impact of the payments that were not considered, determined to be of lower risk, and the application of variance thresholds. Despite the high rate of false positive loan payments that were identified for review by the methodology, management did not provide documentation considering whether the applied methodology was still appropriate.

These deficiencies were caused by management's reliance on the contractor's work product without adequate monitoring controls. Also, management's lack of an adequate risk assessment process to identify and mitigate relevant risks and design appropriate controls to ensure an effective post payment review of payments for covered loans under the Debt Relief Program caused the deficiency identified above.

The following criteria were considered with respect to the matter described in the preceding paragraphs:

- GAO's Green Book, Principle 3, Establish Structure, Responsibility, and Authority; Principle 6, Define Objectives and Risk Tolerances; Principle 10, Design Control Activities; and Principle 16, Perform Monitoring Activities

- OMB Circular No. A-123, Management's Responsibility for Enterprise Risk Management and Internal Control

The deficiencies described above may result in misstatements of the Loan Guarantee Liabilities line item and related elements in the consolidated financial statements.

Recommendations – Payments for Covered Loans under the Debt Relief Program

We recommend the Administrator coordinate with the Acting Associate Administrator for the Office of Capital Access to:

34. Design and implement controls that demonstrate oversight over the contractor, including documentation that provides evidence over the adequate review and validation of the contractor's work product.

35. Perform and document a thorough risk assessment of the payments for covered loans under the Debt Relief Program, including the impact of payments not considered, determined to be of lower risk, for which a variance threshold was applied, and the appropriateness and sufficiency of the applied methodology given the results of the review.

36. Based on the results of the risk assessment performed, design and implement appropriate controls to ensure an effective post payment review of payments for covered loans under the Debt Relief Program.

2. Controls over General Information Technology Need Improvement

Management had control deficiencies that limited SBA's ability to effectively manage its information system risks. Collectively, these conditions increase the risk of unauthorized use, modification, or destruction of financial data, which may impact the integrity of information used to prepare the financial statements. In the sections below, we have omitted some technical details from the conditions and recommendations due to the sensitivity of the information. These details were communicated to management in notices of findings and recommendations.

The following criteria were considered with respect to the matters described in the following paragraphs:

- GAO's Green Book, Principle 7, Identify, Analyze, and Respond to Risks; Principle 10, Design Control Activities; Principle 11, Design Activities for the Information System; and Principle 12, Implement Control Activities

- National Institute of Standards and Technology Special Publication 800-53, Revision 5, Security and Privacy Controls for Federal Information Systems and Organizations

We have summarized the information technology control deficiencies by the following general information technology control objectives: logical access controls and system configuration management.

Logical Access Controls

Management did not have adequate controls designed, implemented, and operating effectively for the timely removal of access to SBA systems for separated employees and contractors. In addition, management did not consistently implement recertification and authentication controls to the network and applications.

These deficiencies were caused by the lack of a policy defining an overall timeframe for the removal of access following separation, an improper reliance of separated personnel reports, lack of effective monitoring of job processing failures, lack of enforcement of authentication controls, and an inadequate risk assessment process to identify and mitigate the risk of inappropriate access.

The deficiencies described above increases the risk that unauthorized users may retain access to the system resulting in unauthorized modification, destruction, or exposure to SBA systems and data.

Recommendations – Logical Access Controls

We recommend the Administrator coordinate with the Acting Chief Information Officer to:

37. Review and update current processes and procedures for defining a time period by which system access must be disabled or removed for separated individuals.

38. Develop procedures to validate that access for separated employees is removed in accordance with required timeframes.

39. Develop procedures to validate that access for separated contractors is removed in accordance with required timeframes.

40. Design, implement, and document controls for monitoring job failures to ensure complete and accurate reports are generated.

41. Design and implement multi-factor authentication controls for non-privileged users.

42. Implement monitoring controls to track compliance with the multi-factor authentication controls.

We recommend the Administrator coordinate with the Chief Financial Officer to:

43. Design and implement controls to validate that access for separated employees is removed in accordance with required timeframes.

44. Develop, design, and implement controls for access recertification for accounts with administrative or privileged roles annually.

45. Perform a risk assessment and obtain an approved waiver in accordance with established policy of not updating authentication controls due to system limitations. Design and implement relevant compensatory controls if necessary.

System Configuration Management

The general ledger system was not properly configured to retain the actual preparer of a manually uploaded journal entry. Once the manually uploaded journal entry transaction is approved and posted, the transaction history is modified, and the preparer's name is replaced with a generic system name.

The deficiency was caused by an information system not designed to obtain and process information to meet each operational process' information requirements and respond to the entity's objectives and risks.

Without capturing auditable application system events, the risk increases that unauthorized or inappropriate access and actions could occur. Such actions could negatively affect the completeness, accuracy, and availability of the system and its data.

Recommendations – System Configuration Management

46. We recommend the Administrator coordinate with the Chief Financial Officer to make the necessary adjustments to system configurations to ensure a complete record of the journal entry process is maintained, including the actual user identification of the preparer, for all journal entry transactions.

3. Controls over Subsequent Events Need Improvement

Statement of Federal Financial Accounting Standards Number 39, Subsequent Events, establishes the accounting and financial reporting requirements for subsequent events. Subsequent events are events or transactions that affect the consolidated financial statements that occur after the end of the reporting period, but before the financial report is issued. Certain subsequent events require adjustments to amounts recognized in the consolidated financial statements and others may require disclosure.

Management did not have adequate controls designed and implemented to identify and determine whether significant subsequent events required disclosure in the consolidated financial statements in accordance with generally accepted accounting principles.

The deficiency was caused by the lack of an effective communication process between the Office of Performance, Planning, and the Chief Financial Officer and the Office of General Counsel. Also, management did not adequately consider the requirements of generally accepted accounting principles for the treatment of subsequent events.

The following criteria were considered with respect to the matter described in the preceding paragraphs:

- GAO's Green Book, Principle 4, Demonstrate Commitment to Competence; Principle 10, Design Control Activities; and Principle 14, Communicate Internally

- OMB Circular No. A-123, Management's Responsibility for Enterprise Risk Management and Internal Control

The deficiency described above may result in misstatements or omissions to the subsequent events disclosure in the consolidated financial statements.

<u>Recommendations – Subsequent Events</u>

We recommend the Administrator coordinate with the Chief Financial Officer to:

47. Design and implement effective communication processes with other relevant offices, including the Office of General Counsel, to ensure subsequent events are timely identified and reported completely and accurately.

48. Improve training plans to ensure individuals responsible for financial reporting functions are adequately prepared to respond to the occurrence of events or transactions that may require financial reporting considerations, including subsequent events, under generally accepted accounting principles.

Appendix III

U.S. Small Business Administration

Compliance and Other Matters

A. Debt Collection Improvement Act of 1996, as amended (DCIA)

Certain provisions of the DCIA require agencies to notify and refer debts that are delinquent by 120 days or more, for purposes of administrative offset and centralized collection, to the U.S. Department of Treasury (Treasury).

The SBA did not refer delinquent loans to the Treasury for collection within the required timeframe. Management identified and communicated that over one million COVID-EIDLs and 16,814 PPP loans were noncompliant with DCIA requirements for the fiscal year ended September 30, 2023.

In addition, management implemented a policy to end collection efforts on certain delinquent PPP loans and COVID-19 EIDLs and cease the referral of these loans to Treasury. However, management did not provide evidence that the policy was reassessed in fiscal year 2023 given the updated status of outstanding loans and relevant risks.

The conditions identified were caused by inadequate design and implementation of risk assessment and monitoring processes that enable management to identify, analyze, and respond to the relevant risks of noncompliance and to ensure delinquent loans were referred to Treasury within the required timeframe. Also, the SBA's operational infrastructure could not accommodate the volume of delinquent loans.

The following criteria were considered with respect to the matter described in the preceding paragraphs:

- DCIA
- GAO's Green Book, Principle 10, Design Control Activities; and Principle 13, Use Quality Information

As a result of delays and absence of referrals of delinquent borrowers and guarantors to Treasury, SBA did not comply with DCIA requirements. The absence of referrals of delinquent borrowers and guarantors to Treasury, based on the policy to end collections and cease referral to Treasury, increases the risk of additional instances of noncompliance with DCIA.

<u>Recommendations – DCIA</u>

We recommend the Administrator coordinate with the Acting Associate Administrator for the Office of Capital Access to:

49. Reassess existing policies to ensure they are supported by quality information stemming from an effective control environment that reviews the root causes of borrower delinquency prior to charge-off and referral to Treasury. Perform a regular review of the implemented policies to ensure they are responding to relevant risks of noncompliance for the current fiscal year.

50. Design, implement, and document appropriate monitoring controls to address compliance with DCIA.

51. Reevaluate the operational infrastructure to address relevant risks of noncompliance and ensure that borrowers are notified timely of delinquency, and if applicable, subsequently referred to Treasury timely.

B. Federal Managers' Financial Integrity Act of 1982 (FMFIA)

Management performed an internal control assessment as required under FMFIA. However, management's assessment did not substantially comply with FMFIA and the related OMB Circular No. A-123 requirements. Specifically, management did not:

- Perform, document, and demonstrate that they completed an internal control over financial reporting evaluation regarding significant programs while giving consideration to relevant risks during the fiscal year.
- For the risks significant to financial reporting, consistently document financial statement risks and assertions covered, testing procedures performed, extent of sampling performed, testing results, corrective action plans to respond to deficiencies identified, and provide evidence of management review. Additionally, management did not complete testing over significant areas and did not plan for and test information technology controls as part of the internal control evaluation program.
- Ensure their own assurance process was sufficient to identify material weaknesses that existed during the fiscal year in addition to those identified by external auditors.

Management did not substantially meet FMFIA requirements due to the urgent need to implement the provisions of the CARES Act and related legislation as quickly and efficiently as possible, the lack of historical precedence, and other inherent challenges faced in implementing and expanding programs. In addition, management did not consider all FMFIA and OMB Circular No. A-123 requirements when performing their evaluation over internal controls.

The following criteria were considered with respect to the matter described in the preceding paragraphs:

- Section 2 of FMFIA
- OMB Circular No. A-123, Management's Responsibility for Enterprise Risk Management and Internal Control

Management did not substantially comply with FMFIA and the related OMB Circular No. A-123 requirements, which may lead to not identifying the appropriate risks and key controls, and not detecting internal control or compliance deficiencies. The risk of not detecting and correcting control deficiencies could result in misstatements to the consolidated financial statements.

<u>Recommendations – FMFIA</u>

We recommend the Administrator coordinate with the Chief Financial Officer to:

52. Update the risk assessment regarding the evaluation of internal controls to ensure it includes all significant programs, key processes, and other material line items on the consolidated financial statements.
53. In conjunction with relevant program offices, perform and document the internal control evaluation for significant programs or processes affecting the financial statements. This should include entity level controls, manual controls, general information technology controls, and system application controls covering key financial statement line items and risks.
54. Update the existing policy and implement adequate controls to ensure that the statement of assurances provided by the program offices are adequately documented and reviewed for completeness and accuracy to provide a sufficient basis to support the Administrator's statement of assurance.

C. Federal Financial Management Improvement Act of 1996 (FFMIA)

Management did not establish and maintain financial management systems that substantially comply with the following FFMIA requirements:

- Federal Financial Management Systems Requirements. As discussed in Appendix I – Material Weaknesses, control deficiencies over transactions arising from the implementation of the CARES Act and related legislation do not enable reliable and accurate financial reporting, do not ensure compliance objectives are met, and do not ensure budgetary resources are safeguarded against waste, loss, and misuse.

- Federal Accounting Standards. The deficiencies identified and reported in Appendix I – Material Weaknesses, provide an indication that SBA's financial management systems were substantially noncompliant with applicable federal accounting standards. Specifically, management was unable to provide evidence that the accounting treatment and financial reporting of the recovery of funds related to the RRF, SVOG, COVID-19 EIDLs, and PPP programs were in accordance with U.S. generally accepted accounting principles.

Management did not substantially meet FFMIA requirements because of the reasons discussed in Appendix I – Material Weaknesses and due to an inadequate entity wide control environment to implement the provisions of the CARES Act and related legislation with sufficiently designed and implemented controls.

The following criteria were considered with respect to the matter described in the preceding paragraphs:

- Section 803(a) of FFMIA

- GAO's Green Book, Section 2, Establishing an Effective Internal Control System

- Appendix D to OMB Circular No. A-123, Compliance with the Federal Financial Management Improvement Act of 1996

Management did not substantially comply with FFMIA increasing the risk that transactions are incorrectly recorded to the general ledger, impacting the completeness, existence, and accuracy of the balances in the consolidated financial statements.

Recommendations – FFMIA

We recommend the Administrator coordinate with the Chief Financial Officer to:

55. Address the control deficiencies over transactions arising from the implementation of the CARES Act and related legislation by working with the Office of Capital Access and the Office of Disaster Recovery and Resilience to implement the recommendations in Appendix I – Material Weaknesses.

Appendix IV

CFO Response to Audit Report on FY 2023 Financial Statements

DATE: November 15, 2023

TO: Hannibal M. Ware, Inspector General

FROM: Kate Aaby, Associate Administrator for Performance, Planning and the Chief Financial Officer

SUBJECT: FY 2023 Financial Statement Audit

The Small Business Administration has reviewed the Independent Auditors' Report from KPMG that includes the auditors' disclaimer of opinion on the Agency's FY 2023 and FY 2022 Consolidated Balance Sheets. The independent audit of the Agency's financial statements and related processes is a core component of SBA's financial management program, and we are concerned by this result.

The FY 2023 Agency Financial Report includes pandemic relief programs: the Paycheck Protection Program, COVID-19 Economic Injury Disaster Loan program, Restaurant Revitalization Fund program, and Shuttered Venues Operators Grant program, which were authorized by the Coronavirus Aid, Relief, and Economic Security Act of 2020, the Economic Aid Act, the American Rescue Plan Act and related legislations. As in FY 2022, the management of these programs during prolonged unprecedented times continued to emphasize the importance of serving small businesses as they navigate extraordinary circumstances.

The SBA has continued making tremendous progress strengthening internal controls for pandemic-focused programs and is dedicated to accountability and transparency to the American public. SBA's Fraud Risk Management Board (FRMB) mitigates, manages, and monitors fraud risks aligned with GAO's Fraud Risk Management Framework. The FRMB is chaired by the CFO and members include Deputy Associate Administrators of key Program Offices, who are supported by an Advisory Team of SBA leaders with subject matter expertise across cyber security, data, systems, learning and development, and more. In addition, to the governance bodies SBA has in place, the CFO and key SBA Program Offices have partnered in the development and implementation of corrective actions that will strengthen internal controls as well as address audit identified deficiencies.

The SBA Senior Management Council (SMC) which is chaired by the Deputy Chief Financial Officer and comprised SBA managers from program and support offices, actively plans and executes the Agency's internal control activities that include assessing and improving compliance, monitoring and remediation of identified deficiencies and communicating results of reviews to senior management.

As in FY 2022, the auditors identified material weaknesses related to the internal controls over six areas; PPP Loan Guarantees, COVID-19 EIDL Loans, Restaurant Revitalization Fund and Shuttered Venues Operators Grant Program, Financial Reporting for Programs Funded by CARES Act and Related Legislation, Entity Level Controls, and Evaluation of Service Organizations. The SBA has undergone tremendous efforts to strengthen internal controls, policies and procedures and will continue remediation efforts in the coming audit year.

We appreciate your efforts and those of your colleagues in the Office of the Inspector General, as well as those of KPMG. The independent audit process continues to provide us with beneficial recommendations that support our efforts to further enhance the SBA's financial management practices. We remain committed to excellence in financial management and look forward to furthering progress in the coming year.