

May 1999

SMALL BUSINESS ADMINISTRATION

Enhancements Needed for Loan Monitoring System Benchmark Study



**Accounting Information and
Management Division**

B-280910

May 14, 1999

The Honorable James M. Talent
Chairman
Committee on Small Business
House of Representatives

The Honorable Roscoe G. Bartlett
Chairman
Subcommittee on Government
Programs and Oversight
Committee on Small Business
House of Representatives

The Small Business Reauthorization Act of 1997 required the Small Business Administration (SBA) to complete eight planning actions to serve as a basis for funding the development and implementation of a proposed loan monitoring system. At your request, we evaluated the report produced for SBA's first planning action—a benchmark study by a contractor that compared SBA's loan monitoring business processes to those of selected public and private sector organizations. On April 6, 1999, we briefed your offices on the results of our work. The briefing slides are included in appendix I.

This report provides a high-level summary of the information presented in the briefing, including the background, methodology and findings of the benchmark study, and our observations on the benchmark report. This report also presents the suggestions we made to enhance the usefulness of the benchmark study as well as SBA's comments.

Results in Brief

The benchmark study was an important first step in SBA's efforts to develop a loan monitoring system. It identified wide gaps between SBA's practices and its benchmark partners. However, the study would be more useful if it included a better definition of processes associated with best practices, addressed monitoring processes for important activities delegated to lenders, collected measurement data on SBA's and the benchmark partners' processes, identified goals for reengineering, and identified potential outsourcing and candidate systems for purchase. SBA agreed with this analysis and stated that it plans to act on each of these items.

Background

The purpose of SBA's proposed loan monitoring systems is to use technology and new processes to manage portfolios of small business loans, identify and effectively mitigate risks incurred through loans guaranteed by SBA, implement oversight of internal and external operations, and calculate subsidy rates.

The Small Business Reauthorization Act of 1997 required SBA to complete eight planning actions to serve as a basis for funding the development and implementation of the loan monitoring system. One of these requirements was that SBA benchmark loan monitoring business processes and systems against comparable industry processes and, if appropriate, simplify and/or redefine its work processes based on these benchmarks.

Benchmarking is the comparison of core process performance with other components of the agency (internal benchmarking) and/or with leading organizations (external benchmarking). Through this comparison, best practices are identified for adaptation into the agency's operations. Best practices include the processes, practices, and systems that perform exceptionally well in specific areas of public and private organizations. Benchmarking provides a means of establishing a compelling business case for change. It should identify more efficient and effective processes for achieving intended results and suggest goals for program output, product and service quality, and process improvement.

Methodology and Findings of the Benchmark Study

SBA's contractor used a seven-step benchmarking process to evaluate SBA business gaps with similar organizations for five loan management functions. The functions benchmarked included risk management, lender oversight, guaranty procedures, subsidy rate calculation, and asset sales. These functions were benchmarked against the practices at 11 federal and private sector organizations.

The benchmark report, issued in December 1998, showed a significant gap between SBA's and benchmark partners' practices for each of the management functions. The report also suggested that senior management needs to buy into the reengineering process, communications plans need to be developed, system requirements should be preliminary defined, and training plans should be examined.

Observations on the Benchmark Report

In general, the benchmarking methods used were consistent with accepted practices and the benchmarking methodology was followed at a high level. The benchmark report identified standard industry or 'good' practices. It also pointed out wide gaps between SBA's practices and those of and its benchmark partners.

The benchmark study was an important first step in SBA's efforts to develop a loan monitoring system. However, there were areas where enhancements would make the benchmark study report more useful as SBA decides which processes it will reengineer and proceeds with the reengineering. The report would be more useful if it included

- the criteria used to determine and validate "best-in-class" processes,¹
- the monitoring processes, practices, and systems for activities delegated to lenders for preventing delinquencies, mitigating losses on delinquencies, and liquidating defaulted loans,
- candidates for the outsourcing of functions and the extent of outsourcing by benchmark partners, and
- quantitative measurements of SBA's and benchmark partners' processes, measurable improvement goals, and guidelines and parameters for the reengineering of processes.

Suggested Actions and Agency Comments

We suggested that SBA

- define processes associated with best practices and relate these to SBA's current processes,
- address activities delegated to lenders and develop monitoring processes concerning lenders to prevent delinquencies, mitigate losses on delinquencies, and liquidate defaulted loans,
- collect measurement data to allow comparisons between SBA's current processes and the processes of benchmark partners,
- set "stretch" goals for reengineering, and
- identify from benchmark partners potential outsourcing and candidate systems for purchase.

¹According to SBA, the contractor used criteria to select benchmark partners and determine best practices but did not present this information in the benchmark report. SBA plans to have the report modified to specify these criteria.

SBA agreed with our analysis of the benchmark study and stated that it plans to implement these suggested actions. Appendix II contains the agency comments.

Objective, Scope, and Methodology

Our objective was to determine if SBA had completed the benchmarking activities required by the Small Business Reauthorization Act of 1997 in accordance with generally accepted practices. We analyzed SBA's benchmark report to determine if it was completed in accordance with the principles specified by the Council for Continuous Improvement² and our business process reengineering (BPR) guidance. We performed our work between January 1999 and March 1999 in accordance with generally accepted government auditing standards.

We are sending copies of this report to The Honorable Nydia M. Velazquez, Ranking Minority Member of the Committee on Small Business; The Honorable Aida Alvarez, Administrator, Small Business Administration; The Honorable Jacob J. Lew, Director, Office of Management and Budget; and other interested parties. Copies will also be made available to others upon request.

If you have any questions on matters discussed in this report, please contact me at (202) 512-6253 or James Hamilton, Assistant Director, at (202) 512-6271. Major contributors to this report are listed in appendix III.



Joel C. Willemsen
Director, Civil Agencies Information Systems

²The Council is a nonprofit consortium of companies whose purpose is to develop a comprehensive system for implementing continuous product and process improvement using state-of-the-industry methods and tools.

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Abbreviations

BPR	business process reengineering
SBA	Small Business Administration

Briefing on the Benchmark Study for SBA's Loan Monitoring System

GAO Accounting and Information Management
Division

Small Business Administration's Loan Monitoring System

Briefing on the Benchmark Study

April 6, 1999



*Presented to the House Committee on Small Business and its Subcommittee on
Government Programs and Oversight.*

GAO Briefing Purpose & Outline

- Briefing purpose is to present results of our review of a benchmark report on the development of Small Business Administration's (SBA) loan monitoring system (LMS).
- Briefing outline:
 - Objective & Scope
 - Background
 - Benchmarking methodology and findings
 - Suggestions
 - SBA comments

GAO Objective & Scope

- Our objective is to determine if SBA is completing planning actions required by the Small Business Reauthorization Act of 1997 in accordance with required and generally accepted system development practices.
- This part of the review pertains to our evaluation of SBA's benchmark report.
- We analyzed the benchmark report to determine if it was completed in accordance with the principles specified by the Council for Continuous Improvement and GAO's Business Process Reengineering (BPR) guidance. We performed our work between January 1999 and March 1999 in accordance with generally accepted government audit standards.

GAO **Background**
Purpose of LMS

- Use of technology and new processes to
 - manage portfolios of small business loans
 - identify and effectively mitigate risks incurred through loans guaranteed by SBA
 - implement oversight of internal and external operations
 - calculate subsidy rates

GAO **Background**

Planning actions for LMS

The Small Business Reauthorization Act of 1997 required SBA to complete eight planning actions to serve as a basis for funding the development and implementation of the loan monitoring system

- ***Benchmark loan monitoring business processes and systems against comparable industry processes and, if appropriate, simplify and/or redefine work processes based on these benchmarks***
- Define system requirements using on-line, automated capabilities to the extent feasible
- Identify all data inputs and outputs necessary for timely report generation

GAO **Background**

Planning actions for LMS (continued)

- Determine data quality standards and control systems for ensuring information accuracy
- Identify an acquisition strategy and work increments to completion
- Analyze the benefits and costs of alternatives and use to demonstrate the advantage of the final project
- Ensure that the proposed information system is consistent with the agency's information architecture
- Estimate the cost to system completion

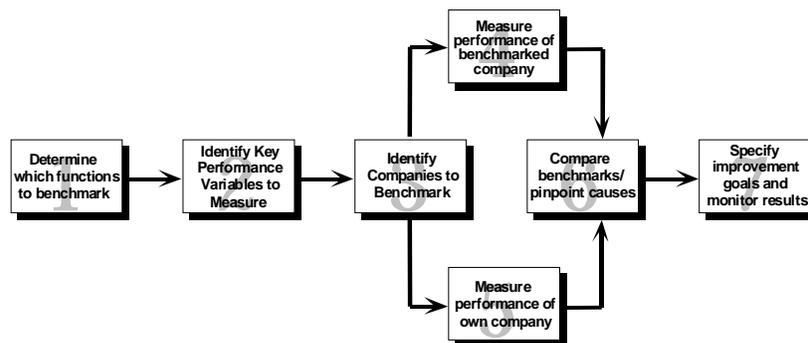
GAO **Background**

Benchmarking definition

- Benchmarking is the comparison of core process performance with other components of the agency (internal benchmarking) or with leading organizations (external benchmarking). Through this comparison, best practices are identified for adaptation into the agency's operations.
- Best practices include the processes, practices, and systems that perform exceptionally well in specific areas of public and private organizations.
- Benchmarking provides a means of establishing a compelling business case for change. It should
 - identify more efficient and effective processes for achieving intended results, and
 - suggest goals for program output, product and service quality, and process improvement.

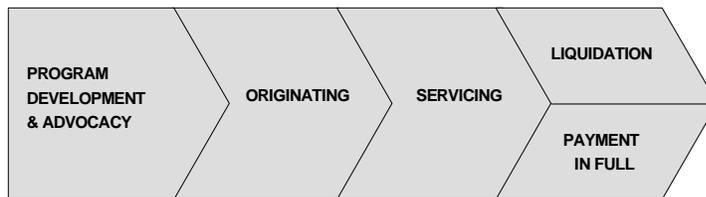
GAO Contractor's Benchmarking Methodology

- SBA's contractor used a seven-step benchmarking process to evaluate SBA business gaps with similar organizations.



Source: Benchmarking Capital Access/Financial Assistance Program, Final Benchmark Report, Booz Allen & Hamilton, December 1998

GAO Lender and SBA Activities for Guaranteed Loans



Lender and SBA
 loan activities
 that were to be
 addressed in the
 benchmark
 study

<p>Lender Activities</p> <ul style="list-style-type: none"> • Direct potentially eligible borrowers to programs 	<p>Lender Activities</p> <ul style="list-style-type: none"> • Evaluate eligibility • Evaluate credit risk • Underwrite loans • Disburse loans 	<p>Lender Activities</p> <ul style="list-style-type: none"> • Bill recipients • Receive and process payments • Update loan status info. • Send delinquency notices • Sell/purchase loans 	<p>Lender Activities</p> <ul style="list-style-type: none"> • Liquidate and collect on bad loans • Clean-up liquidation for resale • Close loans paid in-full • Perform work-out agreements and refinance loans
<p>Guarantor Activities</p> <ul style="list-style-type: none"> • Determine Credit Policy • Design lending programs • Advocate programs to lenders and recipients • Monitor program results 	<p>Guarantor Activities</p> <ul style="list-style-type: none"> • Monitor/approve eligibility • Capture credit risk information and update portfolio risk management • Capture underwriting and eligibility information • Track disbursements 	<p>Guarantor Activities</p> <ul style="list-style-type: none"> • Monitor subsidy rate(s) against repurchases • Monitor portfolio status through loan updates • Take corrective action where needed 	<p>Guarantor Activities</p> <ul style="list-style-type: none"> • Monitor liquidation • Ensure fair treatment • Re-evaluate credit policy • Monitor program results

Source: Benchmarking Capital Access/Financial Assistance Program, Final Benchmark Report, Booz Allen & Hamilton, December 1998

GAO Loan Management Functions Benchmarked

- Risk management -- use captured information to determine optimal underwriting criteria and portfolio exposure
- Lender oversight -- use captured information to ensure lenders are acting in the best interest of the SBA
- Guaranty procedures -- approve loan guaranties and collect origination and servicing data
- Subsidy rate calculation -- use captured information to predict accurately future cash flows
- Asset sales -- use captured information to determine optimal value for a portfolio of loans and guaranties

Source: Benchmarking Capital Access/Financial Assistance Program, Final Benchmark Report, Booz Allen & Hamilton, December 1998

GAO Organizations Selected as Benchmarking Partners

ORGANIZATION	LENDER OVERSIGHT	RISK MANAGEMENT	LENDING PROCEDURES	SUBSIDY RATE	ASSET SALES
Freddie Mac	XX	XX	XX		
Fannie Mae	XX	XX	XX		
NationsBank Corp		XX	XX		
First Union Corp.		XX	XX		
Citibank Corp.		XX	XX		
Hibernia Corp.		XX	XX		
The Money Store		XX			
Federal Housing Authority	XX				XX
Veterans Administration	XX	XX			XX
Comptroller of Currency	XX			XX	
Office of Management And Budget				XX	
	XX	Denotes Best Practices			

Source: Benchmarking Capital Access/Financial Assistance Program, Final Benchmark Report, Booz Allen & Hamilton, December 1998

GAO Gap Between SBA and Benchmark Partners' Practices for Risk Management

DIMENSION	○ Below Average	◐ Average	◑ Average	◒ Above Average	● Above Average	COMMENTS
Definition of Risk Management						<ul style="list-style-type: none"> No definition has been agreed upon within the organization
Understanding Different Risks						<ul style="list-style-type: none"> Risk are understood only by responsible parties
Strategies For Defined Risks						<ul style="list-style-type: none"> No Strategies exist to measure, monitor or mitigate risks
Point at which risk is Incurred						<ul style="list-style-type: none"> Risk is incurred when guaranties are purchased from lenders
Organizational Placement of Risk Management Function						<ul style="list-style-type: none"> Risk Management group has been loosely defined
Risk Management Coordinator						<ul style="list-style-type: none"> A coordinator has been assigned but risks have not been defined
Power to Induce Change						<ul style="list-style-type: none"> Management has authorized power but it has not been tested
How Much Information is Collected & When?						<ul style="list-style-type: none"> Information is gathered at time of guaranty purchase
Is Information Used to Mitigate Risk?						<ul style="list-style-type: none"> Possible risks are not understood until they materialize



Source: Benchmarking Capital Access/Financial Assistance Program, Final Benchmark Report, Booz Allen & Hamilton, December 1998

GAO Gap Between SBA and Benchmark Partners' Practices for Risk Management (continued)

DIMENSION	○ Below Average	◐	◑	◒	● Above Average	COMMENTS
Risk Information Used in Program Development						<ul style="list-style-type: none"> Risk Information is not available for use
Program Eligibility						<ul style="list-style-type: none"> Comprehensive data on eligibility is not collected
Underwriting Criteria						<ul style="list-style-type: none"> Origination data is not collected from lenders
Guaranty Fee Calculations						<ul style="list-style-type: none"> Fees are based on public policy only
Program Subsidy Rate						<ul style="list-style-type: none"> Subsidy Rate is based on historical data
Information Used in Developing Program Strategy						<ul style="list-style-type: none"> Lack of information makes it difficult to develop strategies
Additional Risks in Regions Explained						<ul style="list-style-type: none"> Regional risks are understood but not quantified
Overall Effectiveness of Program						<ul style="list-style-type: none"> Indicators are not managed but are used for performance
Seamless and Consistent Transfer of Information						<ul style="list-style-type: none"> Information is mainly paper based with some use of on-line transfers



Source: Benchmarking Capital Access/Financial Assistance Program, Final Benchmark Report, Booz Allen & Hamilton, December 1998

GAO Gap Between SBA and Benchmark Partners' Practices for Lender Oversight

DIMENSION	○ Below Average	◐ Average	◑ Average	◒ Above Average	● Above Average	COMMENTS
Communication to Lenders					●	<ul style="list-style-type: none"> The lender review process has been communicated effectively to the lenders
Program Goals					●	<ul style="list-style-type: none"> Program goals and objectives are communicated regularly
Program Procedures					●	<ul style="list-style-type: none"> Procedures can be easily found on the Internet
Effective Lender Review Process		●				<ul style="list-style-type: none"> Lender review process does not review all aspects of a lenders operations
Process Communicated					●	<ul style="list-style-type: none"> Lenders have no say in determining optimal schedule
Understanding & Compliance					●	<ul style="list-style-type: none"> Lenders comply with the process but do not provide extra assistance
Includes All Lenders					●	<ul style="list-style-type: none"> Only PLP lenders are included in the process



Source: Benchmarking Capital Access/Financial Assistance Program, Final Benchmark Report, Booz Allen & Hamilton, December 1998

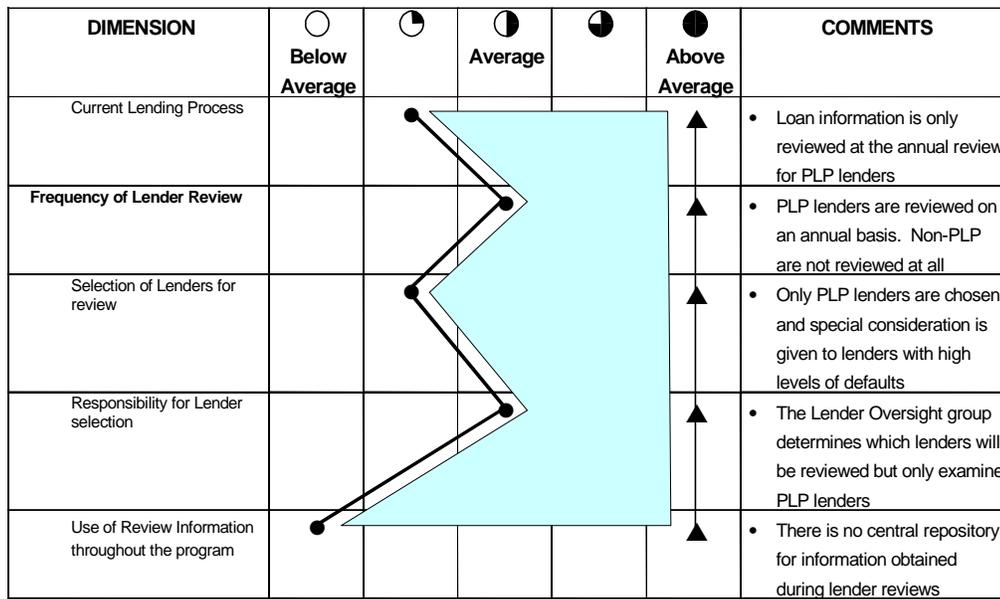
GAO Gap Between SBA and Benchmark Partners' Practices for Lender Oversight (continued)

DIMENSION	○ Below Average	◐ Average	◑ Above Average	● Above Average	COMMENTS
Ensuring SBA's Best Interests					<ul style="list-style-type: none"> Lender Oversight attempts to balance SBA needs while protecting lender operations
Timely & Efficient					<ul style="list-style-type: none"> Reviews are done efficiently by an independent team on an annual basis for PLP only
Lenders' Treatment of Loans					<ul style="list-style-type: none"> Only SBA loans are reviewed
Procedure Review					<ul style="list-style-type: none"> Underwriting, servicing and liquidating are reviewed
Credit Analysis Review					<ul style="list-style-type: none"> Reviewers rely on examination of historical data
Reason For Lender Inclusion					<ul style="list-style-type: none"> Only PLP lenders are included in review process
Portfolio Analysis					<ul style="list-style-type: none"> Past portfolio performance is used to determine if an on-site review will occur



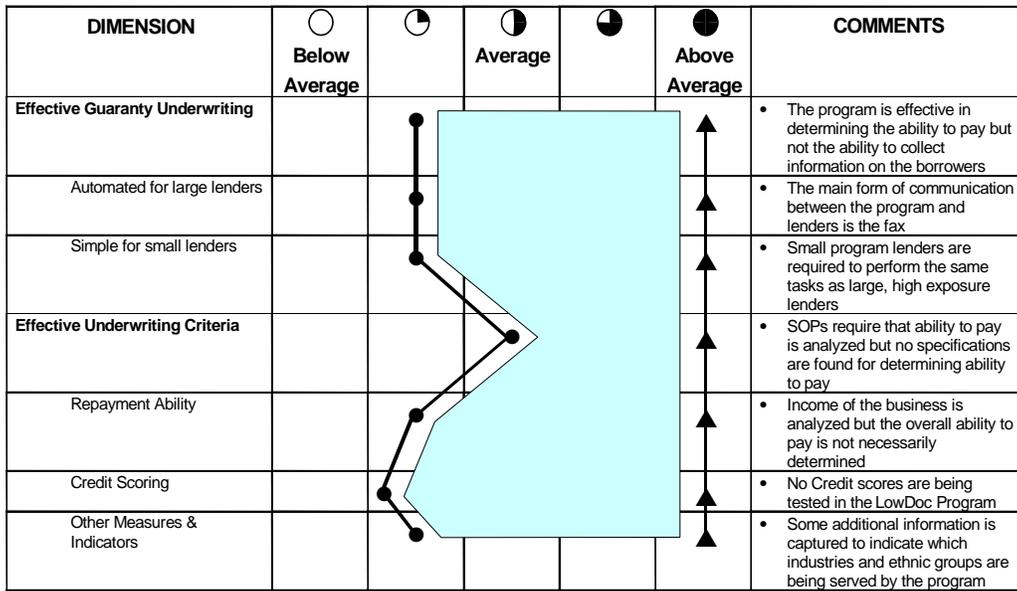
Source: Benchmarking Capital Access/Financial Assistance Program, Final Benchmark Report, Booz Allen & Hamilton, December 1998

GAO Gap Between SBA and Benchmark Partners' Practices for Lender Oversight (continued)



Source: Benchmarking Capital Access/Financial Assistance Program, Final Benchmark Report, Booz Allen & Hamilton, December 1998

GAO Gap Between SBA and Benchmark Partners' Practices for Guaranty Procedures



Source: Benchmarking Capital Access/Financial Assistance Program, Final Benchmark Report, Booz Allen & Hamilton, December 1998

GAO Gap Between SBA and Benchmark Partners' Practices for Guaranty Procedures (cont.)

DIMENSION	○ Below Average	◐ Average	◑ Above Average	● Above Average	COMMENTS
Relevant Information Captured					<ul style="list-style-type: none"> Inadequate information is captured during the origination and loan approval process
Proper Data Collected					<ul style="list-style-type: none"> Relevant risk data from the origination process is not captured for future use
Information Used for Tracking					<ul style="list-style-type: none"> Loan information is entered into the accounting system for tracking purposes
Data Used for Risk Management					<ul style="list-style-type: none"> No relevant risk management information is captured
Data Used for Lender Oversight					<ul style="list-style-type: none"> No data is captured to review the lenders' underwriting effectiveness
Centralization of Approval & Underwriting Processes					<ul style="list-style-type: none"> The PLP, FA\$TRAK and LowDoc processes centralized
Credit Criteria Sets Guaranty Level					<ul style="list-style-type: none"> Guaranty levels are set through public policy
Credit Criteria Sets Guaranty Fees					<ul style="list-style-type: none"> Guaranty fees are set through public policy
Efficient Approval System					<ul style="list-style-type: none"> The loan approval system provides timely approval with little underwriting of loans



Source: Benchmarking Capital Access/Financial Assistance Program, Final Benchmark Report, Booz Allen & Hamilton, December 1998

GAO Gap Between SBA and Benchmark Partners' Practices for Subsidy Rate

DIMENSION	○ Below Average	◐ Average	◑ Average	◒ Above Average	● Above Average	COMMENTS
Subsidy Rate Model						<ul style="list-style-type: none"> Current model uses 10-year cohort with estimated cash flows
Structural Changes Are Considered						<ul style="list-style-type: none"> Changes are only made with large scale program adjustments
Macro-Economic Changes Are Accounted For						<ul style="list-style-type: none"> Macro-economic changes can not be added into the model
Risk Management & Origination Data is Used in Calculation						<ul style="list-style-type: none"> Any risk management information is used to determine validity of the calculation
Frequent Subsidy Rate Calculation						<ul style="list-style-type: none"> Quarterly analysis of the calculation is possible
Comparison of Subsidy Rate to Actual Program Cash Flows						<ul style="list-style-type: none"> Examination of actual program expenditures is done often
Actions Are Taken if Program Exceeds Budget						<ul style="list-style-type: none"> Program changes must be approved by governing bodies
Program Changes Are Timely						<ul style="list-style-type: none"> Program changes can be made but not frequently



Source: Benchmarking Capital Access/Financial Assistance Program, Final Benchmark Report, Booz Allen & Hamilton, December 1998

GAO Gap Between SBA and Benchmark Partners' Practices for Asset Sales

DIMENSION	○ Below Average	◐ Average	◑ Average	◒ Above Average	● Above Average	COMMENTS
Primary Purpose						<ul style="list-style-type: none"> The Asset Sales mission has not been clearly defined
Revenue Enhancer						<ul style="list-style-type: none"> SBA is attempting to reduce servicing and liquidating responsibilities
Mitigate Credit Risk						<ul style="list-style-type: none"> No attempt is made to mitigate credit risk
Underlying Assets Fairly Valued						<ul style="list-style-type: none"> SBA does attempt to value the loans using an independent contractor
Types of Assets Sold						<ul style="list-style-type: none"> Only Loan Assets are currently in the sale process (Disaster Loans Only)
High or Low Risk						<ul style="list-style-type: none"> Risk is not examined prior to the sale of the assets
Performing or Non-Performing						<ul style="list-style-type: none"> Loans are not examined to determine if they are performing or non-performing prior to sale
Asset Sales Process an Efficient Use of SBA Resources						<ul style="list-style-type: none"> The overall value creation can not be determined until an actual sale takes place



Source: Benchmarking Capital Access/Financial Assistance Program, Final Benchmark Report, Booz Allen & Hamilton, December 1998

GAO **Actions Suggested by Contractor**

- Senior management needs to buy-in to the process
- Communications plans need to be developed
- System requirements should be preliminarily defined
- Training plans should be examined

Source: Benchmarking Capital Access/Financial Assistance Program, Final Benchmark Report, Booz Allen & Hamilton, December 1998

GAO Observations on Report

- In general, the benchmarking methods were consistent with accepted practices.
- The benchmarking methodology was followed at a high level.
- The benchmark report identified standard industry or 'good' practices.
- The report pointed out wide gaps between SBA's practices and its benchmark partners.

GAO Observations on Report (continued)

This benchmarking effort was an important first step. There are a number of areas where enhancements would have made the report more useful.

- Selecting benchmark partners
 - No evidence on how partners were selected
 - No validation that partners had “best-in-class” processes
- Determining “best practices”
 - No criteria specified
 - No criteria cited to compare between practices--only a determination of whether or not SBA uses the practices

GAO Observations on Report (continued)

- Addressing activities delegated to lenders - the study did not address the processes, practices, and information systems for
 - preventing delinquencies
 - mitigating losses such as follow-up actions on delinquencies
 - liquidating defaulted loans

- Outsourcing functions
 - criteria for outsourcing were not specified
 - candidates for outsourcing functions were not identified
 - the extent of outsourcing by benchmark partners was not identified

GAO Observations on Report (continued)

- Using measurements
 - quantitative measurements of SBA and benchmark partners were not presented
 - measurable improvement goals for operational services and products were not cited
 - guidelines and parameters for reengineering were not defined

GAO Suggested Actions

- SBA should define processes associated with best practices and relate to SBA's current processes.
- In its benchmarking and reengineering, SBA should address activities delegated to lenders and develop monitoring processes concerning lender actions to
 - prevent delinquencies,
 - mitigate losses such as follow-up actions on delinquencies, and
 - liquidate defaulted loans.

GAO Suggested Actions (continued)

- SBA should collect measurement data to allow comparisons between SBA's current processes and the processes of benchmark partners.
 - Measurement of current SBA operations can enable a clear demonstration of the benefits of adopting best practices and reengineering
 - Measurement of benchmark partners' processes to compare and select among alternatives
- SBA should set "stretch" goals for reengineering.
 - Goals for each loan monitoring activity
 - Goals to serve as objectives of reengineering
 - Goals based on measurement data

GAO **Suggested Actions (continued)**

- SBA should identify from benchmark partners potential outsourcing and candidate systems for purchase.
 - business activities
 - information processing services
 - commercial-off-the-shelf software

GAO Agency Comments

SBA agreed with our analysis of the benchmark study and plans to implement the suggested actions. SBA plans to

- Review the benchmark project information to identify those organizations with best practices for critical loan monitoring processes and contact them to request a continuation of the benchmark process to collect measurement data.
- Identify improvement goals for loan guaranty procedures and lender oversight processes.
- Define and document processes of benchmark partners to assist in comparing and selecting new processes that best meet SBA's business needs.

GAO Agency Comments (continued)

- Specifically address outsourcing as SBA performs quantitative analysis of the benchmark information. SBA plans to identify and evaluate information systems for purchase while completing the benchmark and business process reengineering.
- Contact other government agencies to identify their lender oversight procedures for loan servicing, loss mitigation, and liquidations actions, and address these during business process reengineering efforts.

Comments From the Small Business Administration



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

March 26, 1999

Joel Willemssen
Director, Civil Agencies Information Systems
Accounting and Information Management Division
General Accounting Office
441 G St NW
Washington DC 20548

Dear Mr. Willemssen:

The Loan Monitoring System project is crucial to SBA's viability in the 21st Century. In the past few years SBA has responded to Congressional direction to move away from direct "hands on" lending, decreased staffing, and increased lending volume. Because we can no longer look at each loan prior to guaranteeing it, it has become imperative that we make a significant shift in our approach to delivering the loan programs and protecting the taxpayer's interests.

We are committed to completing the eight mandatory planning steps as quickly as possible. We have very carefully reviewed the comments and suggested actions provided by the GAO staff who analyzed and critiqued our benchmark report. Fortunately, many of GAO's concerns stem simply from the benchmark report not documenting all of the information we gathered. We do appreciate and agree with many of their comments and suggestions and have already taken actions to address the deficiencies in the report as well as the benchmark study itself. We are revising the report and reanalyzing some additional performance data. We have attached an itemized response to both the comments and suggested actions. We believe that the benchmark, upon completion, will provide the SBA with the knowledge of best practices and performance indicators to ensure the success of our business process reengineering (BPR) and systems efforts.

It is important to understand that we started the benchmark phase of our project by identifying the entire scope of the business processes of SBA's Financial Assistance Program. In the past, SBA processes consisted of credit underwriting, servicing, and liquidation, but SBA must now develop new



Appendix II
Comments From the Small Business
Administration

processes to operate in the current environment where SBA relies on private sector financial intermediaries to originate, service and liquidate guaranteed loans. Because this method of operation at the SBA is very different from the way we delivered programs and services just a few years ago, we needed to start our modernization efforts by developing a complete big picture understanding of the functional areas and business processes we would need to develop. Many of the changes SBA has been asked to make were piecemeal and focused at a lower level. Before we embarked on the systematic development of the Loan Monitoring System, it was necessary to focus at a high level to provide context.

Our initial task before we could begin the benchmark study was to identify the business processes we would need. These include two core functional areas: guarantee procedures and lender oversight including lender performance standards; and three supporting functional areas: credit risk management, selling of loan assets, and the calculation and management of the subsidy rate. By defining the scope of the entire financial assistance function, we have defined the boundaries of our reengineering and systems implementation projects. This task not only identified functions within the project scope, it also identified other functions that are external to this project and not under the control of this business function but will ultimately be linked to the system we build.

SBA considers Loan Monitoring specifically to be guarantee procedures and lender oversight including lender performance standards. The focus of the benchmark, and the subsequent BPR activity is on SBA's loan monitoring processes. Although our focus will be on loan monitoring, we included the other relevant business processes in the benchmark. This ensures an understanding of these other best practices and that our reengineered loan monitoring processes will be integrated smoothly with these processes, particularly where collection of needed information is concerned. The report on our benchmarking efforts did not adequately reflect that our first priority for modernization is loan monitoring.

The benchmark report also did not adequately reflect SBA's commitment and implementation of outsourcing and privatization. As a result, the existing model and the standards or guidelines were not detailed in the report. We will illustrate the existing model and contrast it with the results of this effort. Included in that contrast will be the future standards or operating goals that will exist. SBA has already recognized the advantages of relying more heavily on its private sector partners to efficiently and cost-effectively meet the credit needs of small businesses. Consistent with its public policy goals and Congressional mandate, SBA is delegating more functions, such as loan servicing and liquidation, to the lenders that serve as its private sector partners. Free of these functions, SBA can focus efforts on expanding access to affordable capital to eligible creditworthy small businesses that do not have adequate access to capital in the commercial marketplace. Successful "privatization" is a critical element in SBA's

Appendix II
Comments From the Small Business
Administration

current plans to achieve its goals of expanding access to capital. SBA's partnership with its participating lenders has evolved significantly. Over the past several years the Agency has been evolving to a model where underwriting and servicing standards are set by the SBA, but the loan origination, underwriting, and servicing functions are performed by lenders. In this model, SBA's responsibility is focused on overseeing the performance of lenders through analysis of data, post-origination reviews, and in adjustments to repurchased guarantees, when necessary. SBA's Report on Privatization (attached) provides the detail of SBA's privatization and outsourcing efforts. Additional outsource and privatization alternatives at the process level were identified in the initial stages of the BPR.

Please contact LeAnn Oliver if you have any questions about this response or our proposed approach to correcting the benchmark report. She can be reached on 202-205-7526.

Sincerely,


John L. Gray
Associate Deputy Administrator
for Capital Access

SBA Response to GAO's "Preliminary Analysis"

GAO Comment:

In general, the contractor had proposed using benchmarking processes that were consistent with generally accepted practices. The report showed that the contractor followed their benchmarking processes, but at a high level. The benchmarking effort could be characterized as a search of external sources for practices that SBA should consider for its programs. In this regard, the benchmark report did identify

- what can be considered standard industry or "good" practices
- candidates for benchmarking; however, it was not clear whether SBA will do more detailed benchmarking later.

The report pointed out wide gaps between SBA's practices and the best practices of the benchmark partners.

While this benchmarking effort was an important first step, there are a number of significant omissions in the report that limit its usefulness.

- The report did not contain evidence on how the contractor picked the organizations as benchmarking partners.
- The report did not specify the study's criteria for determining best practices.

SBA Response:

The benchmark report is being revised to include the information requested in the above two (2) bullets. The contractor performed these steps but did not document the results in the report.

GAO Comment:

- The report contained qualitative results, but no quantitative results. For example, no quantitative data were presented that defined the results achieved by benchmarking partners.

SBA Response:

The benchmark report is being revised to include the information requested in the above bullet only for SBA's core loan monitoring functional areas - guarantee procedures and lender oversight. The contractor will contact benchmark partners to request quantitative data to aid us in completing this part of the study. We have asked Freddie Mac to work with us on guarantee procedures and lender oversight.

GAO Response:

- There was no method cited that documented how the specific results were obtained from the input that was received. For example, the report cited no measures or qualitative criteria that were used to compare between the practices—only a determination of whether SBA did or did not use the practices.

SBA Response:

The contractor is revising the benchmark report to include this information.

GAO Response:

- The report did not specify benchmarking criteria for outsourcing entire functions, or parts of a process, rather than developing in-house operations.

SBA Response:

In addition to our current outsourcing and privatization activities, the initial stages of our BPR addressed outsourcing and privatization. We analyzed outsourcing/privatization alternatives at the process level for each of our core loan monitoring functions and these results will be addressed in the BPR final report.

GAO Response:

- The benchmark study did not look at candidates for outsourcing functions, nor did it identify the extent that benchmark partners use outsourcing.

SBA Response:

Our benchmark report did not identify criteria for outsourcing and candidates for outsourcing functions. Although SBA has made dramatic changes in loan guarantee processing, outsourcing of servicing of the portfolio, and selling of loan assets, the report did not directly address outsourcing and privatization of lending functions. The contractor is revising the report to specifically describe what SBA has done and plans to do in this area.

GAO Comment:

- The report did not clearly map functions to processes to systems – only generic functional areas were identified.

SBA Response:

The report is being revised to provide this information for loan guarantee procedures. During the period of the benchmark, SBA did not have defined processes or

systems for lender oversight, asset sales, and risk management.

GAO Comment:

- The report contained logic diagrams for SBA's current loan processes, but it did not contain any benchmarking examples that clearly detailed how missing or deficient practices connect to related processes of the benchmarking partners. The report did not contain logic diagrams for the processes of the benchmark partners. The report did not show a logic diagram for the current risk management processes.

SBA Response:

We are revising the report to clearly state that SBA has identified its core loan monitoring functional areas to be guarantee procedures and lender oversight including lender performance standards. The report will also be revised to include logic diagrams only for the core loan monitoring functions. The contractor will contact benchmark partners to try to obtain practices of the benchmark partners for these two functional areas. The report will be revised to provide examples that include information on how SBA processes relate to benchmark processes.

GAO Comment:

- No measurable improvement goals for operational services and products were cited: cost/revenue, volume/quality, and throughput/response. The report mentions hypotheses pertaining to the improvement of SBA in terms of generic functional areas (e.g. risk management, asset sales, etc.) but the report fails to define these hypotheses and their significance to the benchmarking effort.

SBA Response:

The benchmark report will be revised to provide this information.

GAO Comment:

The report did not specify the parameters and guidelines for pursuing the reengineering of processes. Nor did it define how the results of the report could be used to define parameters and guidelines for focusing the re-engineering efforts. It did not identify candidate or alternative processes for SBA's consideration in engineering or reengineering its processes. It did not specify methods and measures for targeting, optimizing, or selection (e.g. trade-off analysis).

Some important lender activities specified in the background introduction were dropped in subsequent discussions and analyses. These included

**Appendix II
Comments From the Small Business
Administration**

- loan servicing to proactively prevent delinquencies, such as the use of early warning systems,
- loss mitigation activities such as follow-up actions on delinquent payments and negotiating workout agreements for delinquent loans, and
- liquidation actions for defaulted loans.

SBA Response:

The original report provided information and analysis at a function area level and did not provide detail on the processes of each functional area. The BPR that is now underway will address the above three (3) bullets.

GAO Suggested Actions

GAO Suggestion:

We suggest that SBA start collecting data to allow comparisons between operations with SBA's current processes and the processors of benchmark partners. Measurements of current SBA operations would enable a clear demonstration of the benefits of adopting best practices and facilitate establishing priorities for pursuing reengineering opportunities. Measurements of benchmark partners' processes are necessary to adequately compare and select among alternatives. SBA could use the initial study to select benchmark partner for collecting measurement data.

SBA Response:

We agree. We intend to focus on our guarantee procedures and lender oversight as these are the core functions of loan monitoring. Our benchmark study did identify and document our current work processes but did not present quantitative data about these processes - cycle times, delays, redundant activities, etc. We have this information for SBA and will include it in the revised report. We will recontact the benchmark partners to request their continued support in collecting measurement data to support a quantitative analysis. This will move us closer to GAO's expectations to a full benchmark.

GAO Suggestion:

We suggest that SBA set goals for improvements to each process that is to be reengineered. Such goals are based on the measurement data and serve as the foundation for the direction and objectives of the reengineering efforts.

SBA Response:

We agree. During the initial stages of our BPR we did identify improvement goals for our core loan monitoring functions - loan guaranty procedures and lender oversight. Our improvement goals will include customer satisfaction, loss reduction, reaching underserved markets, etc. We also intend to identify quantitative goals such as faster turn around times, improved fraud detection, improved loss mitigation, and proactive delinquency detection. We will use the additional measurement data from the revised benchmark to refine these goals.

GAO Suggestion:

For adequate comparisons and selection of the processes that best meet business needs, we suggest that SBA better define processes associated with the best practices identified during the initial benchmark study and relate these to SBA's current processes. Such efforts would include the mapping of processes to activities and key events.

SBA Response:

We agree. The initial benchmark report was at a functional area level and did not define and document processes of the benchmark partners. We would like to have this information to assist us in our efforts to compare and select new processes which will best meet SBA's business needs. We believe that revising the benchmark study will provide these benefits.

GAO Suggestion:

To serve as a basis for decisions on how reengineered processes can be most effectively and economically established and implemented, we suggest that SBA identify the potential for outsourcing as it collects information from benchmark partners. Similarly SBA should identify candidate information systems for purchase during benchmark and reengineering studies.

SBA Response:

We agree. We are addressing outsourcing alternative analysis during the initial stages of our BPR efforts. Our initial benchmark report did not specifically address what we learned about outsourcing activities by some of the best practices organizations; we intend to specifically address outsourcing as we perform the quantitative analysis of the benchmark. We will continue to look for and evaluate information systems for purchase as we complete the benchmark and BPR and we will document this information in the reports. Our alternatives analysis, another of the eight mandatory planning steps, will also address these areas.

GAO Suggestion:

To ensure that the reengineering efforts address all activities that have been delegated to lenders, we suggest that SBA include in its

benchmarking and reengineering efforts the processes to monitor lenders performing -

- Loan servicing actions to proactively prevent delinquencies, such as early warning systems;
- Loss mitigation actions, such as follow up actions on delinquent payments and negotiating workout agreements for delinquent loans; and
- Liquidation actions for defaulted loans.

SBA Response:

We agree that we should identify lender monitoring processes and our BPRs are already working on these. We have contacted other government agencies to identify their procedures for lender oversight and will continue to work on identifying appropriate lender monitoring processes. We are working with Freddie Mac in adapting their best practices to our situation.

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