

Congress of the United States
U.S. House of Representatives
Committee on Small Business
2361 Rayburn House Office Building
Washington, DC 20515-0515

To: Members, Committee on Small Business Committee
From: Barry Pineles, Chief Counsel, Committee on Small Business
Re: Full Committee Hearing: "Attention Needed: Mismanagement at the SBA"
Date: January 4, 2016

On Wednesday, January 6, 2016 and Thursday, January 7, 2016, at 11 a.m. in Room 2360 of the Rayburn House Office Building, the Committee on Small Business will meet for the purpose of reviewing a recent report issued by the United States Government Accountability Office (GAO)¹ that addresses the overall management of the Small Business Administration (SBA or Agency). On Wednesday, January 6, GAO will testify about the report and on January 7, the Administrator, the Hon. Maria Contreras-Sweet, will respond to the GAO findings. This memorandum provides the appropriate background on the issues raised in the GAO Management Report.² Should you or your staff have any questions, please do not hesitate to contact the Committee's Chief Counsel, Barry Pineles at x55821.

I. SBA Purposes and Functions

Before addressing the issues the GAO report and genesis, it is necessary to provide a brief overview of SBA's origin and its functions. The agency was created in 1953 by President Eisenhower as a replacement for the Small Defense Plants Administration (an entity created to help maintain a robust small business industrial base for providing goods to the military) and the Reconstruction Finance Corporation (started during the Great Depression as a federal lender to businesses).³ The mission of the SBA, as evinced in the Small Business Act, 15 U.S.C. §§ 631-57p, is to "aid, counsel, assist, and protect, insofar as is possible, the interests of small business concerns..." *Id.* at § 631(a). In 1958, Congress enacted the Small Business Investment Act of 1958, *id.* at §§ 661-97g, to "stimulate and supplement the flow of private equity capital and long-term loan funds which small-business concerns need for the sound financing of their business operations...." *Id.* at § 661.

¹ GAO, SMALL BUSINESS ADMINISTRATION: LEADERSHIP ATTENTION NEEDED TO OVERCOME MANAGEMENT CHALLENGES (GAO-15-347) (2015), available at <http://www.gao.gov/products/GAO-15-347> [hereinafter "GAO Management Report"].

² For more detailed information on SBA programs, members and their staff should refer to the following documents: 1) the memorandum for the full committee hearing entitled "The SBA Budget for FY 2016: Does it Meet the Needs of America's Small Businesses," available at http://smbiz.house.gov/uploadedfiles/2-25-2015_memo.pdf; and 2) the Views and Estimates of the Committee on Small Business on Matters to be set forth in the Concurrent Resolution on the Budget for Fiscal Year 2016, available at http://smbiz.house.gov/uploadedfiles/2-12-2015_views_and_estimates_document.pdf.

³ J. BEAN, BIG GOVERNMENT AND AFFIRMATIVE ACTION 8-9 (2001).

The SBA meets its statutory obligation in three ways: 1) provision of credit (mainly through the issuance of guaranteed loans offered by private entities); 2) assistance to small businesses that vend goods and service to the federal government; and 3) offering entrepreneurs education in the opening and operating small business concerns. Each of these components is executed through multiple Congressionally-mandated programs, often in conjunction with non-federal “partners.”⁴ The SBA delivers most its services through one of the 68 district offices established throughout the United States.⁵

Like any large organization, execution of the functions carried out by the SBA requires that the bureaucracy operate in an efficient manner with a management structure aligned to achieve the objectives of the organization.⁶ This is not only sensible practice long understood by public and private entities but is a requirement imposed by Congress in the Government Performance and Results Act of 1993 (better known as GPRA to federal agency management cognoscenti).⁷ GPRA was enacted to improve agency performance by focusing on effective and efficient management to ensure that an agency met the goals imposed upon it by Congress.⁸

II. Committee Examination of SBA Operations

To determine whether the SBA is meeting its statutory responsibilities to effectively and efficiently manage programs created by Congress, the Committee has undertaken formal investigations (including examination of specific programs through reviews by GAO) and informal investigations. The results of these examinations and investigations revealed a pattern of failure to perform tasks delegated to the SBA by Congress, undocumented ad hoc decisionmaking, lax or non-existent oversight of entities participating in programs authorized by the Small Business Act and Small Business Investment Act of 1958, and organizational deficiencies that increase the risk to the taxpayer.⁹

A. Failure to Take Actions Mandated by Congress

As a federal agency, the SBA only has powers to the extent that Congress delegates an agency powers set forth in statute. The converse of this delegated authority is that Congress, under Article II of the Constitution is required to *promptly* and faithfully execute the powers

⁴ This is the SBA’s terminology and covers for-profit, non-profit, and state governmental entities that help the SBA carry out its mission of assistance to small businesses.

⁵ Each state and territory has at least one district office. In larger states, there are multiple district offices, including smaller so-called branch offices. This distinguishes the SBA from most other federal agencies that provide services locally through one of ten federal regional headquarters. In addition to these district offices, the SBA also has regional offices located in each one of the ten federal regions.

⁶ Cf. STRATEGIC MANAGEMENT AND COMPETITIVE ADVANTAGE 4-7 (5th ed. 2015) (for-profit companies develop organizational structures and strategic plans to maximize economic competitive advantage).

⁷ Pub. L. No. 103-62, 107 Stat. 285 (1993) (codified at 3 U.S.C. § 305, 31 U.S.C. §§ 1105(a), 1115-19, 9703-04, and 39 U.S.C. §§ 2801-05).

⁸ *Id.* at § 2(a), 107 Stat. at 285.

⁹ The memorandum will not address all of the Committee and previous GAO findings; nor will the memorandum provide detailed legal analysis of each problem found by the Committee. To do so would reduce the overall utility of the memorandum. Cf. W. SHAKESPEARE, HAMLET, Act II, Scene II (Riverside ed. 1974) (“brevity is the soul of wit”).

delegated to it by Congress.¹⁰ The Committee has found a number of instances in which the Agency has failed to execute its responsibilities under Article II of the Constitution.

In 2004, Congress amended § 21 of the Small Business Act by requiring the SBA to promulgate new regulations to protect the privacy of individuals who seek the counseling services provided by grantees who operate Small Business Development Centers (SBDCs).¹¹ While the SBA continues to create new delivery systems to provide counseling for small business owners, eleven years after enactment, the SBA has failed to promulgate regulations to protect the privacy of small business owners seeking assistance from SBDCs.

This delay, by itself, would be problematic even if it was an isolated incident. However, delay is anything but an anomaly at the SBA. Congress made a number of changes to the SBA's federal procurement programs in the 2013 National Defense Authorization Act for Fiscal Year 2013 ("2013 NDAA") which was signed into law by the President on January 2, 2013.¹² Congress delegated authority to the SBA to promulgate nine rules and required the SBA to promulgate rules within 180 days of enactment or by July 3, 2013. Not only did the SBA fail to meet that deadline of by Congress but it did not even issue proposed rules in six of those instances for nearly two years after the date of enactment and, in one instance,¹³ has (as of the date of this memorandum) not even issued a proposed rule. Of numerous changes made in later defense authorization bills for fiscal years 2014 through 2016 (those for fiscal years 2014-16) to SBA programs, the SBA only has issued one proposed rule and promulgated one final rule.

Even when rulemaking is not required but Congress changes how the Agency operates, the SBA has refused to take those actions. Prior to the enactment of the 2013 NDAA, the Administrator utilized so-called "anchor size standards" which constitute common size standards for all industries in a two or four digit industrial classification¹⁴ rather than establishing unique size standards for each of the 1100 or so classification of businesses that are described in the NAICS. Congress prohibited, in 2013 NDAA, SBA use of anchor size standards absent compelling evidence that such anchor standards are appropriate for all industrial classifications in the four or two digit industrial categories.¹⁵ Despite this

¹⁰ *Loving v. United States*, 517 U.S. 748, 758 (1996). Congress is so concerned with prompt execution by federal agencies that it authorizes challenges by aggrieved parties when an agency unreasonably withholds agency action. 5 U.S.C. § 706(1). The SBA should be intimately familiar with the requirement for prompt action since the SBA was compelled by a federal district court to take actions needed to implement a women's procurement program for which SBA had taken almost no action for five years. *U.S. Women's Chamber of Commerce v. SBA*, 2005 U.S. Dist. Lexis 32,497 at * 54-*64 (D.D.C. 2005).

¹¹ Small Business Reauthorization and Manufacturing Assistance Act of 2004, Pub. L. No. 108-447, Div. K, § 142, 118 Stat. 3441, 3454 (2004).

¹² Pub. L. No. 112-239, Tit. XVI, 126 Stat. 1632, 2060 (2013).

¹³ The rule that has yet to be proposed addresses issues of contract bundling, i.e., the consolidation of contracting requirements in a manner that makes it difficult if not impossible for small businesses to compete for the bundled contract.

¹⁴ The Administrator establishes size standards for industrial classifications as those are categorized in the North American Industrial Classification System of NAICS published by the Office of Management and Budget. NAICS divides all of the American economy into two, four and six digit codes with two-digit codes describing the broadest industrial classifications with six digit codes describing the narrowest industrial classifications.

¹⁵ Pub. L. No. 112-239, Tit. XVI, § 1661, 126 Stat. at 2083.

restriction, the SBA continues to promulgate size standards using these so-called anchor standards because “they have stood the test of time through practice....”¹⁶

Nor is this disregard of Congressional directives a recent phenomenon. In 1986, Congress authorized that debentures issued by certified development companies (CDCs) and Small Business Investment Companies (SBICs) be sold in the secondary market in order to reduce the budgetary impact of SBA financing programs and counter President Reagan’s calls to eliminate the Agency. That required the SBA to contract with an outside party (a central registration agent) to keep track of those sales in an expeditious manner. Congress recognized that normal competitive procurement procedures would inhibit the implementation of secondary market sales so it exempted the SBA with respect to the central registration agent contract for a period of two years from such competition requirements. SBA continued to issue the contract without competition until Committee pointed out that the Agency only had a two year exemption for its central registration agents’ contracts.

In sum, the Agency only has one job – prompt and faithful execution of the laws. As the aforementioned discussion aptly demonstrates, the SBA has been neither prompt nor faithful in its execution of the powers granted to it by Congress.

B. Ad Hoc Decisionmaking

The Committee’s investigations also revealed Agency problems in implementing statutory directives that governs how the SBA makes decisions. In 1946 Congress enacted the Administrative Procedure Act (APA). The main purpose of the APA was to ensure that administrative policies of federal agencies will be promulgated in accord with statutory procedures in order to avoid unpublished ad hoc determinations.¹⁷ Committee investigations of the SBA revealed numerous instances in which the Agency conducted ad hoc decisionmaking in contravention of the procedures set out in the APA or the Agency’s own rules (which itself is a violation of the APA¹⁸).

1. Standard Operating Procedures

The SBA promulgates regulations but often those regulations do no more than merely parrot the language of the Small Business Act or Small Business Investment Act of 1958.¹⁹ The SBA then supplements these regulatory directives in often mandatory language in documents designated by the Agency as standard operating procedures or SOPs. These documents are

¹⁶ SBA, Small Business Size Standards; Industries with Employee Based Size Standards Not Part of Manufacturing, Wholesale Trade, or Retail Trade, Proposed Rule, 79 Fed. Reg. 53,646, 53,649 (Sept. 10, 2014). While the SBA may wish to exercise its delegated authority in this manner, the Supreme Court has made it abundantly clear that if “the intent of Congress is clear ... the agency must give effect to the unambiguously expressed intent of Congress.” *Chevron U.S.A., Inc. v. NRDC*, 467 U.S. 837, 842-43 (1984). In short, the SBA cannot act as a legislative body when Congress expressly limited the SBA’s delegated authority.

¹⁷ See *Morton v. Ruiz*, 415 U.S. 199, 232 (1974); see also Pineles, *Marketing Orders and the Administrative Process: Fitting Round Fruit into Square Baskets*, 5 SAN JOAQUIN AG. L. REV. 89, 98 (1995).

¹⁸ *FCC v. Fox Television Stations*, 556 U.S. 502, 515 (2009) (agencies must comply with their own rules or be deemed to violate the rational decisionmaking requirements of APA).

¹⁹ For example, the definition of “credit elsewhere” in § 3(h) of the Small Business Act, 15 U.S.C. § 632(h) is repeated nearly verbatim in the Agency’s regulation, 13 C.F.R. § 120.101.

not issued pursuant to the procedures set out in the APA for the issuance of legally binding regulations nor are the public made aware of their issuance in the Federal Register.²⁰ As a result, the SBA can modify the operation of its programs through modification of SOPs without alerting the public, receiving input from the public in violation of the SBA's own rules,²¹ or ignoring the SOPs altogether.²² The Committee has uncovered instances in which the SBA or its employees blatantly ignored the strictures of SOPs.

For example, the Agency issued a SOP for licensing SBICs in 1984 which was not modified until 2014 despite the fact that the SOP failed to address applications for new types of SBICs created after 1984; in fact, the SBA simply abandoned the procedures set out in the SOP at some point and suggested that licensees rely on the SBA website for procedures associated with filing SBIC license applications.²³

Such abandonment of strictures in SOPs was not limited to review of SBIC applications. The Committee investigated the procedures by which the Agency reviewed franchise agreements to determine whether a franchisor was affiliated with the franchisee thus making the franchisee ineligible for receiving assistance under the Small Business Act or Small Business Investment Act of 1958. That investigation revealed attorneys in the Office of General Counsel (OGC) were citing a SOP as the basis for making determinations on affiliation to outside third parties even though the SOP being cited explicitly prohibited the citation of the SOP as precedent to outside parties.²⁴

To exacerbate problems associated with utilization of SOPs, the SOPs frequently contradict either statute or regulations.²⁵ For example, the SOP addressing the operation of the SBA's guaranteed loan programs permitted a lender to find that credit was not available without a SBA guarantee if the *lender* was prohibited from making the loan even though the statutory restriction focuses solely on the ability of the borrower to obtain credit through normal

²⁰ Publication of agency rules in the Federal Register is required by the Freedom of Information Act or the agency cannot enforce those requirements. 5 U.S.C. § 552(a)(1). Such publication also is beneficial to an agency because such publication ensures that all individuals have legal notice of such requirements irrespective of whether they have actual notice. *Federal Crop Ins. Co. v. Merrill*, 332 U.S. 380, 384-85 (1947).

²¹ Most SBA regulations address matters such as federal government contracts, loans, or benefits. For these rules, the APA exempts agencies from obtaining public comment when issuing such rules. However, the SBA has waived such an exemption and requires that it comply with the public notice and comment provisions of the APA. 13 C.F.R. § 101.108.

²² For a complete discussion of the legal nature of SOPs and how the SBA abuses their use in violation of the APA and its own rules, see Letter from the Hon. Steve Chabot, Chairman, Committee on Small Business, to Ms. Mary Frias, Office of Capital Access, SBA at 39-44, 50-53 (Mar. 27, 2015) (on file with the Committee) (hereinafter "Franchise Letter").

²³ The SBA undertook the update after numerous discussions with Committee staff pointing out that the Agency risked significant legal liability from a disappointed SBIC applicant if the Agency could not point to the procedures that the SBA followed in processing the application.

²⁴ *Id.* at 46 & nn. 151-52.

²⁵ While there is a thread of Supreme Court decisions that require courts to provide deference to agency interpretations of their own regulations, *see, e.g., Auer v. Robins*, 519 U.S. 452, 461 (1997); *Bowles v. Seminole Rock Co.*, 325 U.S. 410, 414 (1945), such deference requires that the interpretation be consistent with the language of the regulation, *Bowles*, 325 U.S. at 414.

commercial sources.²⁶ Similarly, the new SOP that addresses SBIC application processing requires completion of additional forms not set out in the Agency's regulation.²⁷

2. Undocumented Agency Decisions

Under the Freedom of Information Act, agencies are required to publish in the Federal Register delegations of authority, i.e., which part of an agency is empowered by the agency head to make a decision.²⁸ Yet, the Committee has not found the publication of such delegations since they were removed from the Code of Federal Regulations in 1996.²⁹ Without publication, it is unclear who has authority to make decisions within the agency. The Committee can think of no more problematic undocumented decision than the failure to explicate which officials in an agency have the power to make decisions.

a. Failure to Publish Delegations of Authority

The Committee found that SBA's OGC (without a delegation of authority) and SBA's Office of Government Contracting (with a delegation of authority) both make determinations on whether a franchisor is affiliated with a franchisee. Given that the personnel are not identical and that the determinations of the Office of Government Contracting issues written determinations while the Office of General Counsel does not, inconsistencies can and do arise in what constitutes affiliation in the context of the franchisor/franchisee relationship.³⁰

b. Procedural Notices

In another example of undocumented decisions, the Agency utilizes procedural notices³¹ by which it notifies *its employees* of decisions and then expects employees to notify the affected public about such decision. First, it is unclear whether the affected public ever actually receives actual notice of what is contained in these so-called procedural notices.³² Second, use of procedural notices enables the SBA to issue and rescind policy declarations, making it difficult for the regulated community to adjust their behavior to these new policy directives.

The use of these procedural notices is evidenced by the Agency's recent difficulties in interpreting the Anti-Deficiency Act (which prohibits federal employees from entering into obligations prior to the enactment of appropriations unless permitted by some other law³³). CDCs issue debentures guaranteed by the SBA for the purchase of, among other things, real

²⁶ Compare 15 U.S.C. § 632(h) with SBA, SOP 50 10 5 (H), at 88. Congress partially closed this loophole in § 4 of the Veterans Entrepreneurship Act of 2015, Pub. L. No. 114-38, 129 Stat. 437, 438 (2015).

²⁷ Compare 13 C.F.R. § 107.300 with SBA, SOP 10 04 1, at 9 (Aug. 6, 2014).

²⁸ 5 U.S.C. § 552(a)(1)(A).

²⁹ Franchise Letter, *supra* note 22, at 63 & n.190.

³⁰ *Id.* at 34 & n.123.

³¹ For a detailed discussion of SBA procedural notices, see *id.* at 18-19.

³² *Id.* at 19 n.70, 54. Procedural notices or their availability are not published in the Federal Register or easily uncovered on the SBA website. As a test of procedural notice awareness, Committee staff conducted an informal survey in May 2015 of certified development companies to determine whether they were aware of any procedural notices. The admittedly unscientific survey revealed that only about half of the companies knew of the procedural notices.

³³ 31 U.S.C. § 1341(a)(1)(B).

property, if the loans will contribute to the economic development of a region.³⁴ For decades, the SBA found no problems in closing CDC loans policy with open-ended indemnity agreements.³⁵ Then in late 2013, an OGC attorney in a district office reviewing a loan from a CDC in Hawaii determined that an open-ended indemnity agreement violated the Anti-Deficiency Act (with no written decision or any other issuance from the Agency that suggested the previous policy would be reversed). It is unclear whether other OGC district counsel interpreted the Anti-Deficiency Act in the same way. The response of the SBA “officially” arrived in terms of a procedural notice in September of 2014 that imposed obligations on CDCs to obtain waivers of open-ended indemnity agreements.³⁶ Seven months later, the Agency rescinded that procedural notice thereby returning the SBA to its longstanding interpretation of the Small Business Investment Act of 1958 and the Anti-Deficiency Act. Nothing prohibited the SBA from changing its interpretation; the problem was that the Agency violated the Supreme Court dictates that an agency must explain its changes in policies³⁷ – something that did not happen in the case of the Anti-Deficiency Act and CDC debentures.

c. Undocumented Affiliation Decisions

As already noted, SBA OGC attorneys made decisions whether determining whether a franchisor was affiliated with a franchisee. These findings were then used as the basis for establishing a registry of franchisors who were not affiliated with their franchisees making it easier for franchisees whose franchisors were listed on the registry to obtain financing from the SBA. The bases for these decisions were never published and as a result SBA attorneys could determine eligibility for the registry in any manner they wished. In fact, the Committee has reviewed emails in which a SBA attorney simply stated that the franchisor was eligible for listing because the attorney could not remember what, if any, problems existed in the franchise agreement that might have created an affiliation problem. If the *raison d’être* of the APA is the establishment of a reasoned decisionmaking process, such arbitrary decisions undermine the basic premise for the enactment of the APA.

³⁴ In some cases, the real property that is purchased by a borrower using a CDC debenture may contain an agreement by which the borrower agrees to indemnify adjacent landowners against damages that the borrower’s activity may cause to these adjacent landowners. These indemnification agreements may have limits in terms of years or dollar value of damages; in other instances the agreements may be open-ended without limitations on when the borrower would be liable or the amounts of such liability has no dollar limit. If the borrower defaults on the CDC loan and the SBA seizes the property, the SBA then potentially becomes liable under the indemnity clause. To the extent that such indemnity clauses are open-ended they may run afoul of the Anti-Deficiency Act; however, there is no legal opinion from GAO or a court that specifically addresses such indemnity agreements in the context of guaranteed loans whose costs are accounted for in a given year under the Federal Credit Reform Act.

³⁵ The Anti-Deficiency Act, in its current form, was enacted in 1950 – three years before the SBA was created.

³⁶ It is unclear whether all CDCs received actual notice of the contents of the procedural notice. Further, it is unclear how the SBA can impose obligations related to the Anti-Deficiency Act on private parties since the strictures of that Act only are imposed on federal employees and violations of such may imposed criminal penalties only on federal employees. 31 U.S.C. § 1350.

³⁷ *E.g., Smiley v. Citibank (South Dakota), N.A.*, 517 U.S. 735, 742 (1996); *Motor Vehicle Mfrs. Ass’n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 29-50 (1983); *ConocoPhillips Co. v. EPA*, 612 F.3d 822, 833 (5th Cir. 2010).

C. Lack of Effective Metrics

In order to undertake a reasoned decisionmaking process concerning the effectiveness of agency programs under GPRA, an agency needs adequate information, included metrics to evaluate such programs. The Committee (in various hearings on a bipartisan basis) and GAO³⁸ have both noted the absence of metrics in evaluating various entrepreneurial education initiatives created by the Agency. If the Agency has no effective metrics for evaluation of these programs, it is difficult to assess their effectiveness – a key component of GPRA.

The Agency also lacks metrics when creating new programs for providing capital to small businesses. The Committee found that the SBA does not have adequate measures to evaluate the effectiveness of these efforts to direct SBICs to invest in specific areas of the country or in early-stage businesses. The Agency validated this concern by issuing an advanced notice of proposed rulemaking requesting input from the public on the value of early-stage business and whether it should be discontinued or modified.³⁹ GAO also reached a similar conclusion about the absence of evaluative metrics with respect to the now-disbanded Patriot Express Loan Program.⁴⁰

D. Lack of Effective Enforcement

The SBA primarily views itself as a promoter of small business. However, Congress has delegated to the SBA an important enforcement role to ensure that its taxpayers are not a risk and the benefits of various programs created by Congress redound to the benefit of small business. Unfortunately, the Agency's record on enforcement is not strong.

Federal agencies are permitted to suspend or debar contractors providing goods or services to those agencies if the contractor has taken actions that undermine the integrity of the procurement system.⁴¹ Unlike other federal agencies, the SBA has the authority to suspend and debar any small business (irrespective of the federal agency for which the concern is providing goods or services) should it obtain a federal contract by misrepresenting its status as a small business concern or one of the targeted categories of small business concerns set out in the Small Business Act.⁴² Despite this broader authority, the SBA, in fiscal year 2014, suspended 27 contractors and debarred 21, while the Department of the Air Force suspended 109 contractors and debarred 138. To place this effort in context, there were more than

³⁸ GAO also found that SBA lacked effective metrics to evaluate its entrepreneurial education efforts. See GAO, ENTREPRENEURIAL ASSISTANCE: OPPORTUNITIES EXIST TO IMPROVE PROGRAMS' COLLATIONATION, DATA TRACKING AND PERFORMANCE MANAGEMENT 21 (Aug. 2012) (GAO-12-819), available at <http://www.gao.gov/products/GAO-12-819>; GAO, SMALL BUSINESS ADMINISTRATION, COSPONSORED ACTIVITIES CAN BENEFIT SMALL BUSINESSES BUT LACK A CONSISTENT FEEDBACK MECHANISM 13 (May 2014) (GAO-14-260), available at <http://www.gao.gov/products/GAO-14-260>.

³⁹ SBA, Small Business Investment Companies – Early Stage, Advanced Notice of Proposed Rulemaking, 80 Fed. Reg. 14,034, 14,035-37 (Mar. 18, 2015). Had the SBA established metrics, it would be able to assess the success of the initiative without relying solely on input from the public.

⁴⁰ GAO, PATRIOT EXPRESS: SBA SHOULD EVALUATE THE PROGRAM AND ENHANCE ELIGIBILITY CONTROLS 30 (Sept. 2013) (GAO-13-727), available at <http://www.gao.gov/products/GAO-13-727>.

⁴¹ This is somewhat of an oversimplification of suspension and debarment but an appropriate legal exegesis of these matters is beyond the scope of the hearings for which this memorandum is prepared.

⁴² 15 U.S.C. § 645(d)(2)(C).

30,000 businesses that obtained federal contracts due to their status under the Small Business Act in fiscal year 2014 while the Department of the Air Force procured goods and services from about 16,000 businesses.

The SBA's enforcement activity is no stronger with respect to its guaranteed loan programs which have a total loan portfolio of more than \$100 billion. Since the current version of the CDC program was established (a period of more than 30 years), the SBA has revoked the licenses of exactly 2 CDCs (both of which were related entities which in itself constitutes a violation of the Agency's CDC regulations). Similarly, the Committee is unaware that any of SBA's 3,000 active lenders have had their status revoked for violating SBA regulations. In fact, the Committee is unaware that any such action has ever been taken.⁴³

E. Failure to Fill Critical Positions

Effective and efficient agency operation also requires that appropriate personnel are in place to execute the responsibilities mandated by Congress. The Committee has raised concerns about SBA personnel in two separate contexts. On a bipartisan basis, members have questioned SBA Administrators on the lack of skilled personnel to fill positions as procurement center representatives (SBA personnel that provide significant assistance in helping small businesses obtain federal prime contracts). The Committee also has investigated matters related to the position of the Chief Information Officer (the official charged by statute with overseeing the Agency's information technology) and notes that the SBA, while creating a new Office of Interagency Affairs (which may blur further the responsibilities of various offices within the SBA that perform disaster response), the SBA has no permanent Chief Information Officer.⁴⁴ Given the critical nature of these positions, the failure to fill them undermines the capacity of the SBA to effectively and efficiently, as required by GPRA, to implement the responsibilities delegated to the Agency by Congress.

III. GAO Management Report

Given the Committee's concerns about the management and operation of the Agency, the then Chairman, the Hon. Sam Graves and Ranking Member, the Hon. Nydia M. Velázquez, in 2014 requested that GAO undertake a general review of SBA management and operations. GAO agreed to perform the task and issued its report in September of 2015.

Before addressing GAO's findings, it is absolutely necessary to discuss the difficulties GAO faced in performing its statutory role of conducting an investigation requested by Congress. As part of its review SBA visited ten district offices to interview Agency, including non-management, staff. In conducting interviews with these employees, SBA headquarters

⁴³ The Committee is aware that a number of lenders are dropped from preferred status because they made insufficient loans to meet the minimum loan volume requires to achieve preferred status. However, the Committee does not consider that enforcement of the Agency's operating rules for 7(a) because it involves a simple ministerial task rather than the exercise of enforcement discretion.

⁴⁴ From November 2013 to July 2015, the SBA had a permanent Chief Information Officer who has since moved on to a different post at the Department of Commerce. Prior to November 2013, the SBA had left this critical position unfilled for some time.

management required that district counsels be present at all such interviews,⁴⁵ which could not have been done for any purpose other than as an intimidation tactic by SBA management to curtail input from employees to GAO. In addition, whenever GAO requested information, SBA OGC had to review the information before submitting it to GAO.⁴⁶ Despite these roadblocks, GAO was able to craft a comprehensive report that raised a number of serious issues with overall SBA management.

A. Failure to Implement Recommendations of GAO and Inspector General

As we have seen, the SBA has failed to expeditiously implement legislative directives and in some cases, outright reject such mandates. The GAO report found that the SBA is no more diligent in implementing recommendations of the SBA's Inspector General or GAO.

The Inspector General identified 11 major management challenges for the SBA. GAO found that seven of those have persisted for more than ten years.⁴⁷ These issues include: repurchase of loan guarantees; operation of the 8(a) and other small business contracting programs; security of the Agency's information technology;⁴⁸ fraud by loan agents;⁴⁹ lender oversight; human capital planning; improper payments; the Loan Management and Accounting System;⁵⁰ and the SBA's acquisition management. Only three have persisted for five years or less.

The Agency's record in addressing GAO's recommendations is no better. From fiscal years 2010 through 2013, GAO found that more than half of those recommendations had not been fully implemented by July 2015.⁵¹ Since fiscal year 2000, there are still 69 open recommendations from GAO and, in the opinion of GAO, should be implemented.

According to the GAO, the failure to implement the changes recommended by the Inspector General and GAO is the "lack of sustained priority attention over time."⁵² This has been

⁴⁵ GAO Management Report, *supra* note 1, at 3 n.5.

⁴⁶ The procedures on submission of information to GAO related to were contained in a SOP written by the Office of Congressional and Legislative Affairs in 2007, SOP 40 00 2. The irony of the SBA's scrupulous compliance with the SOP 40 00 02 while ignoring other SOPs needs no further comment.

⁴⁷ GAO Management Report, *supra* note 1, at 13.

⁴⁸ The problem of cybersecurity is no doubt exacerbated by the Agency's failure to fill the position of the Chief Information Officer.

⁴⁹ Loan agents may represent small businesses in obtaining loans from lenders offering SBA-guaranteed loans or may represent banks in finding potential businesses that need SBA-guaranteed financing. *See* 13 C.F.R. § 103.4(f).

⁵⁰ The Loan Management Accounting System is the primary computer system used by the SBA to manage its loan portfolio. A study of that system and its vulnerabilities was the subject of a GAO study commissioned by then Chairman Sam Graves. GAO, INFORMATION TECHNOLOGY: SBA NEEDS TO STRENGTHEN OVERSIGHT OF ITS LOAN MANAGEMENT AND ACCOUNTING SYSTEM MODERNIZATION (GAO-12-295) (Jan. 2012). Of the projects studied by GAO with respect to system modernization, the SBA has completed one – migration from a proprietary system to a non-proprietary system. The migration took two and a half years longer than the SBA expected and the person specifically hired by the previous Administrator to oversee the project (as recommended by the SBA's own consultants) left within six months of being hired. Nor did the SBA have a permanent Chief Information Officer to oversee the migration. In short, GAO found that no one was in charge of the project. *Id.* at 53.

⁵¹ GAO Management Report, *supra* note 1, at 15.

⁵² *Id.* at 33.

exacerbated by frequent turnover of SBA personnel (some of which is beyond the control of the Agency – such as changes resulting from Presidential elections).⁵³

B. SBA Did Not Utilize Program Evaluation in Strategic Planning

GPRM requires federal agencies to undertake strategic planning. In 2010, GPRM was updated with the enactment of the GPRM Modernization Act or GPRAMA (to agency management cognoscenti).⁵⁴ Among other things, GPRAMA strengthened the strategic planning process by requiring more input from agency leadership.

The weakness found by GAO found was not in issuance of strategic plans but rather in the Agency's failure to incorporate program evaluations into those plans.⁵⁵ The point of the strategic planning in GPRM and GPRAMA is to determine which programs are effective and which require changes. If the Agency, as GAO points out, does not routinely develop metrics and evaluate programs according to those metrics, the utility of the strategic plans are enervated.⁵⁶ Senior management officials noted that the Agency had trouble conducting such evaluations, which GAO noted may stem from the SBA's failure to devote needed management leadership and resources to such assessments.⁵⁷

C. Human Capital Planning

Congress does not delegate to agencies; it delegates to individuals. Therefore, this requires that an agency have personnel with appropriate training to operate efficiently and effectively.

The SBA admits that it faces significant challenges in staffing the Agency with an adequate workforce: employees lack necessary skills as the SBA evolves; an aging workforce with more than half eligible to retire by 2019; and lack of funds to retain individuals with needed skills.⁵⁸ In response, the SBA has begun to develop a workforce plan.⁵⁹

However, the workforce plan does not incorporate key principles developed by GAO for creating an adequate agency workforce plan.⁶⁰ For example, the workforce plan does not incorporate an agency-wide competency and skill gap assessment since the Agency has not performed such an evaluation since 2006.⁶¹ If the SBA does not understand the scope or type of gaps in skills of Agency personnel, it makes it difficult, if not well-nigh impossible, to

⁵³ *Id.* at 34. For the ten years prior to the issuance of the report, GAO found that there were eight Administrators (including acting), four Deputy Administrators, four chief financial officers of which two were acting; four chief human capital officers (two of whom were temporary); seven chief information officers, including three who are not permanent; six chief operating officers (three of whom were acting); and eight general counsels four of whom were temporary. *Id.*

⁵⁴ Pub. L. No. 111-352, 124 Stat. 3866 (2011).

⁵⁵ GAO Management Report, *supra* note 1, at 39.

⁵⁶ *Id.*

⁵⁷ *Id.* at 42.

⁵⁸ *Id.* at 44-45. The findings by GAO are bolstered by SBA communications with the Committee about its inability to find sufficient salaries for procurement center representatives. Of course, the SBA has typically requested significant sums for additional educational outreach and very little in funds for procurement center representatives from Congress.

⁵⁹ *Id.* at 46-47.

⁶⁰ *Id.* at 47.

⁶¹ *Id.* at 48.

create a strategy to eliminate those gaps.⁶² The failure to perform an assessment also undermines the ability of the Agency to create appropriate training for existing and new employees that will reduce those skills gaps.⁶³

D. Organizational Structure of the SBA

Efficient delivery of services not only requires a well-trained workforce but also requires an appropriate organizational structure. This requires that the employees understand their responsibilities and that managers have clear lines of authority.

In 2003, GAO assessed the SBA's organizational structure and found that it created "complex overlapping relationships among offices that contributed to challenges in delivering services to small businesses."⁶⁴ According to GAO, those complex overlapping relationships still exist.⁶⁵

An exhaustive analysis of the SBA's organizational structure was beyond the remit of the request by Mr. Graves and Ms. Velázquez. Nor would it be possible to provide such an analysis in this memorandum without creating a tome-like document. Nevertheless, a few examples will place the SBA's organizational structural problems in stark relief. The personnel involved in providing assistance to 8(a) contractors are located in SBA district offices and report to local managers but work most directly with SBA Office of Government Contracting staff located in headquarters in Washington, DC.⁶⁶ There are regional offices in each of the ten federal regions ostensibly to oversee the district offices but the district offices actually report to the Office of Field Operations in Washington, DC which raises the issue of regional office responsibilities.⁶⁷ In 2007, the SBA eliminated the Office of the Chief Operating Officer but six years later recreated the position to act as the Office of Management and Administration and integrated separate offices, including the Chief Information Officer into the Office of the Chief Operating Officer without explaining how the new lines of responsibility would improve Agency operations.⁶⁸ Finally, as already noted, the SBA created a new Office of Interagency Affairs, which may create additional confusion as the Agency now has a panoply of offices dedicated to disaster response.⁶⁹

The issues of organizational structure are compounded by the failure of the Agency to have a workforce plan. Without understanding the skills that employees need for a 21st Century SBA, it is difficult to align the Agency's organizational structure to meet the needs of America's entrepreneurs.⁷⁰

⁶² *Id.* at 49-50.

⁶³ *Id.* at 56.

⁶⁴ *Id.* at 59.

⁶⁵ *Id.* at 59-60.

⁶⁶ *Id.* at 59.

⁶⁷ *Id.* For the past four years, the Committee's Views and Estimates have questioned the need for SBA regional offices.

⁶⁸ *Id.* at 64.

⁶⁹ Lines of responsibility are especially important in disaster response. For example, it is open question of which office within the SBA liaises with the Federal Emergency Management Administration – the Office of Disaster Assistance or the Office of Interagency Affairs.

⁷⁰ *Id.* at 61-62, 65.

Ultimately, an appropriate organizational structure is necessary for proper internal controls to ensure that the SBA delivers its services in an effective and efficient manner while protecting the federal fisc. The Agency understood this and committed to an assessment of its organizational structure in 2012 but due to leadership changes, was not commenced until November of 2014, was finished in March of 2015 and SBA maintained that no significant structural changes were necessary. However, the SBA did not provide any documentation that supports this conclusion – another problem examined by GAO.⁷¹

E. Lack of Documentation in SBA Decisions

Efficient and effective delivery of services by a federal agency requires the establishment of well-documented process for establishing and implementing a strategic plan across the agency, including the identification of potential risk to its operations.⁷² While the SBA's process for creating managing this enterprise risk is documented, GAO noted that the Agency did not provide adequate documentation for this enterprise risk management.⁷³ Given the absence of documentation, GAO had difficulties determining the adequacy of the plan but concluded, with the limited amount of information, that the Agency will be able "to provide reasonable assurance that its enterprise risk management efforts effectively identify, assess, and manage risks before they can adversely affect SBA's ability to achieve its mission."⁷⁴

The problems with enterprise risk management and the absence of documentation are exacerbated by the Agency's reliance on SOPs. The SOPs, as already discussed, provide additional information to SBA personnel and outside parties on the operations of various Agency programs. GAO found that of the 153 SOPs, 71 (or 46 percent) had not been updated in past ten years, 36 (of the 71), had not been updated since the 1990s, and almost a quarter date from the 1980s.⁷⁵ It is difficult to assess risk to Agency programs if the detailed operations of those programs are not adequately described to SBA personnel or the regulated community.⁷⁶ Even when the SBA updates SOPs (as noted previously), the updates do not "align with current program requirements."⁷⁷ In an effort to correct this problem during the GAO review, SBA conducted its own assessment of SOPs and found that 105 of them (nearly two-thirds) need either updating or cancellation but have not undertaken significant efforts to revise or eliminate them.⁷⁸ In short, according to GAO, the SBA is reviewing SOPs in its normal course of business which means outdated guidance documents will continue to be used by Agency personnel and outside parties.

⁷¹ *Id.* at 65. Given the problems associated with the SBA's organizational structure, the failure to modify the organization is more than puzzling.

⁷² *Id.* at 66.

⁷³ *Id.* at 67.

⁷⁴ *Id.* at 72.

⁷⁵ *Id.* at 78.

⁷⁶ In fact, it can create greater risk because outside parties are unable to ascertain how they are to comply with federal law.

⁷⁷ *Id.* at 78. In one example, the updated SOP for the HUBZone program did not address subsequent changes in the program (such as the partial elimination of self-certification as a HUBZone-eligible firm). *Id.*

⁷⁸ Since the SOPs are not rules that require the public participation requirements of the APA, the SBA revise or cancel them in an expeditious manner. Nor would such modifications or cancellations require that the SBA to submit them to the Office of Information and Regulatory Affairs at the Office of Management and Budget for review under Executive Order 12,866 since that Order does not apply to the SBA's SOPs.

F. Acquisition Management Including Information Technology

Federal agencies, to conduct operations, utilize private sector enterprises to supply it with goods and services that the agencies do not produce (resulting in an approximately half trillion dollar federal procurement marketplace). Management of this process by each agency ensures that the government operates at the lowest cost while maximizing the delivery of services to the taxpayer.

1. Acquisition Management in General

The Inspector General's annual report on challenges facing the Agency includes management of the acquisition process. GAO determined that the SBA has made major progress in resolving this problem by granting the Chief Financial Officer control over Agency acquisition.⁷⁹ SBA made additional improvement efforts by retaining a contractor to examine the Agency's procurement process. The recommendations made by the contractor have not been implanted;⁸⁰ more troubling is the fact that no timetable exists for the implementation of the recommendations.

2. Information Technology Acquisition

A significant component of the SBA's acquisition budget is devoted to information technology.⁸¹ The Office of Management and Budget issued guidance to federal agencies on the best practices to manage acquisition of information technology. GAO's assessment of SBA's compliance with this guidance shows mixed results.

Some of the information technology projects undertaken by SBA went through a detailed review process known as TechStat.⁸² On the other hand, the Agency abandoned TechStat reviews for other information technology projects and determined that other oversight in the Agency would be an adequate substitute for TechStat.⁸³ Of course, those determinations were made by a Chief Information Officer no longer at the SBA so it is unclear whether the oversight for information technology acquisition remains adequate.

Once information technology is acquired, the SBA should examine the ongoing performance of the acquired computer systems. Rather than conduct such formal ongoing operational analyses, the SBA substitutes reviews by the Chief Information Officer whose reviews are not documented.⁸⁴

⁷⁹ *Id.* at 77.

⁸⁰ To be fair, the contractor report was delivered in May of 2015 and it would be difficult for the SBA to have reengineered processes to comport with the contractor's recommendations in a three or four month period.

⁸¹ SBA relies heavily on information technology in the management of its capital access programs (from back office operations utilizing its Loan Management Accounting System) to interfaces with the public and lenders through SBA One.

⁸² *Id.* at 81.

⁸³ *Id.* at 81-82.

⁸⁴ *Id.* at 82. Without a permanent Chief Information Officer, it is unclear that the reviews would be an adequate substitute for the ongoing operational analyses that constitute best practices for information technology acquisition. *See id.*

As information technology moves from an on-site hardware-based system to a cloud computing infrastructure, it requires new management priorities with respect to information technology investments. GAO found that SBA has or is in the process of rectifying weaknesses in its plan to consolidate its data centers.⁸⁵ However, the Agency's plans beyond data center consolidation to a full-based cloud computing network were not fully developed and, like many SBA management decisions, undocumented.⁸⁶ Nor did the SBA have sufficient controls over its acquisition of software licenses although, according to GAO, the Agency was beginning to address the situation in the summer of 2015.⁸⁷

IV. Conclusion

It has now been nearly 70 years since Congress mandated regularized and transparent federal agency decisionmaking. For more than 20 years, federal agencies have been under an obligation to deliver their services in an efficient and effective manner. The investigations of this Committee and the GAO have found that the SBA is not meeting those statutory mandates. To get the Agency moving forward in the correct direction will require a concerted effort on the part of senior management to ensure that the Agency meets the objectives set out by Congress. Ultimately, this will require the SBA to align its mission to promote entrepreneurship with its mission to enforce the mandates of Congress on itself and its partners that help deliver services to America's small businesses.

⁸⁵ *Id.* at 83.

⁸⁶ *Id.* at 86.

⁸⁷ *Id.* 87. GAO also noted that decisionmaking with respect to software licenses also lacked sufficient documentation – a not surprising result given that flaw in other areas of SBA management. *Id.*