STATEMENT OF

PEGGY E. GUSTAFSON
INSPECTOR GENERAL
U.S. SMALL BUSINESS ADMINISTRATION

BEFORE THE

COMMITTEE ON SMALL BUSINESS
U.S. HOUSE OF REPRESENTATIVES

FEBRUARY 24, 2016

INTRODUCTION

Chairman Chabot, Ranking Member Velázquez, and distinguished members of the Committee, thank you for the opportunity to discuss our oversight activities of the U.S. Small Business Administration (SBA or Agency).

The Office of Inspector General (OIG) was established within SBA by statute to promote economy, efficiency, and effectiveness and to deter and detect waste, fraud, and abuse in the Agency's programs and operations. During FY 2015, OIG achieved nearly $134 million in monetary recoveries and savings—a more than a six-fold return on investment relative to our FY 2015 operating budget—and made 80 recommendations for improving SBA's operations and reducing fraud and unnecessary losses in the Agency's programs.

OIG'S ROLE

OIG promotes economy, efficiency, and effectiveness in Government operations and helps detect and deter fraud, waste, abuse, and mismanagement. The stated purpose of the Inspector General Act of 1978, as amended (IG Act), is to create an independent and objective unit within specified agencies to combat fraud and abuse in the programs. To this end, my office is responsible for conducting audits and investigations of the programs and operations, and undertaking other activities, such as inspections and evaluations, to promote economy, efficiency and effectiveness in its programs. Importantly, as IG, I am charged with keeping the Administrator and Congress fully and currently informed about problems and deficiencies in the Agency. The IG Act contains a variety of statutory guarantees of OIG independence, designed to ensure the objectivity of OIG work and to safeguard against efforts to compromise that objectivity or hinder OIG operations. It is these guarantees of independence that make statutory IGs unique.

The IG Act affords my office the authority to mount a multi-disciplinary approach to Agency oversight. We have a broad statutory mandate to conduct audits and investigations relating to the programs and operations of the agency and to conduct other activities for the purpose of promoting economy and efficiency in the administration of the agency. Within this broad mandate, I am given full discretion to undertake those audits and investigations that are "necessary or desirable."

OIG audits are conducted in accordance with Federal audit standards established by the Comptroller General, and other reviews generally are conducted in accordance with standards established by the Council of the Inspectors General for Integrity and Efficiency (CIGIE). In addition, we coordinate with the Government Accountability Office (GAO) to avoid duplicating Federal audits. We also establish criteria to ensure that the non-Federal auditors (typically, CPA firms) OIG utilizes comply with Federal audit standards.

OIG investigations are conducted in accordance with the CIGIE Quality Standards for Investigations and Federal law. In conducting investigations, whenever the IG has reason to believe that Federal criminal law has been violated, the IG must promptly report that evidence directly to the Department of Justice, without prior clearance by Agency officials outside OIG.

Top Management Challenges Facing SBA

We have aligned our resources to focus on the areas of highest risk within SBA, especially those programs with identified, systemic concerns. In accordance with the Reports Consolidation Act of 2000, OIG released its *Report on the Most Serious Management and Performance Challenges Facing the Small Business Administration in FY 2016* in October 2015 and has prepared similar reports since FY 2000. This report represents our current assessment of Agency programs and/or activities that pose significant risks, including those that are particularly vulnerable to fraud, waste, error, mismanagement, or inefficiencies. Its overall goal is to focus attention on significant issues in order to work with Agency managers to enhance the effectiveness of SBA's programs and operations. The report highlights top management challenges facing SBA, which are listed below:

- Weaknesses in Small Business Contracting Programs and Inaccurate Procurement Data Undermine the Reliability of Contracting Goals Achievements
- Weaknesses in Information Systems' Security Controls Pose Significant Risks to the Agency
- SBA Needs Effective Human Capital Strategies to Carry Out its Mission Successfully and Become a High-Performing Organization
- SBA Needs to Further Strengthen its Oversight of Lending Participants
- SBA Needs to Modify the Section 8(a) Business Development Program So More Firms Receive Business Development Assistance, Standards for Determining Economic Disadvantage are Justifiable, and Firms Follow 8(a) Regulations When Completing Contracts
- Effective Tracking and Enforcement Would Reduce Financial Losses from Loan Agent Fraud
- SBA Needs to Modernize its Loan Accounting System and Migrate it Off the Mainframe
- SBA Needs to Accurately Report, Significantly Reduce, and Strengthen Efforts to Recover Improper Payments in the 7(a) Loan Program
- Disaster Assistance Must Balance Competing Priorities to Deliver Timely Assistance and Reduce Improper Payments
- SBA Needs to Effectively Manage Its Acquisition Program

The management challenges report is driven by SBA's current needs and based on not only our understanding of SBA's programs and operations but also recent OIG, GAO, and other reports. Accordingly, the challenges we present each year may change based on the Agency's risks, as well as the actions that have—or have not—taken to remedy past weaknesses.

For example, this year, OIG expanded its challenge regarding small business contracting (Challenge 1). SBA is responsible for managing and overseeing the small business procurement process throughout the Federal Government. Last year, we reported that procurement flaws allow large firms to obtain small business awards and allow agencies to count contracts performed by large firms towards their small business goals. While large firms continue to receive contracts that are counted towards small business goals, we have realigned the discussion to include our concerns regarding weaknesses in small business contracting programs, the reliability of data used to calculate contracting goal achievements, and unnecessary restrictions on SBA using fraud remedies.

In addition, we added a new challenge regarding SBA's Disaster Assistance Program (Challenge 9). SBA's disaster assistance helps people and businesses recover from disasters by providing loans to homeowners, renters, and businesses. However, there is an inherent risk of non-repayment for disaster loans because these loans repair or replace existing property, which means that loan recipients are incurring additional debt to maintain existing assets. In carrying out its mission, SBA must balance competing priorities to deliver timely assistance and reduce the risk of fraud and default.

We also removed the challenge pertaining to SBA's implementation of a quality control program in its loan centers (previously Challenge 4), since the Agency has made progress in implementing a quality control program for all of its loan centers. This program is designed to verify and document compliance with the loan process, from origination to close-out, and to identify where material deficiencies exist so that the Agency can take remedial action. However, SBA needs to demonstrate that the program is effective at identifying and correcting material deficiencies. We will continue to monitor SBA's quality control program during FY 2016 to verify that reviews are completed and effective at identifying and correcting material deficiencies.

The management challenge process is an important tool that we believe assists the Agency in prioritizing its efforts to improve program performance and enhance its operations. A summary chart of depicting the status of top management challenges is below:

		Color Scores					
		Status at End of FY 2015				Change from Prior Year	
	Challenge	Green	Yellow	Orange	Red	Up ↑	Down ↓
1	Small Business Contracting		1				
2	IT Security		2	3			1
3	Human Capital	1	2			1	
4	Lender Oversight		2				
5	8(a) Business Development Program			2	1		
6	Loan Agent Fraud	1	2	1		2	
7	Loan Management and Accounting System	4				4	
8	Improper Payments – 7(a) program	1	3			1	
9	Disaster Loan program (NEW)						
10	Acquisition Management	1		4		1	
	TOTAL	8	12	10	1	9	1

RISK ASSESSMENT

SBA was established to maintain and strengthen the Nation's economy by protecting the interests of and assisting small businesses, and by helping families and businesses recover from disasters. While SBA's programs are essential to strengthening America's economy, the Agency faces a number of challenges in carrying out its mission. These include fraudulent schemes affecting SBA programs, significant losses from defaulted loans, procurement flaws that allow large firms to obtain small business awards, improper payments, and information technology (IT) management concerns. OIG plays a critical role in addressing these and other challenges by conducting audits to identify wasteful expenditures and program mismanagement, investigating fraud and other wrongdoing, and taking other actions to deter and detect waste, fraud, abuse, and inefficiencies in SBA programs and operations. As you have heard in recent hearings before this Committee, OIG works closely with GAO to provide oversight of SBA's programs and operations and to promote integrity and efficiency.

Risks Due to Limited Oversight and Controls in SBA's Lending Programs

SBA faces a heightened risk of losses and improper payments due to expedited loan processing initiatives and its considerable reliance on outside financial institutions, over which the Agency has not always exercised adequate oversight. The Agency's business loan programs include the Section 7(a) Loan Program, in which SBA partially guarantees loans to small businesses made by its lending partners. The majority of loans made under the Section 7(a) Loan Program undergo little or no review by SBA prior to loan approval because the Agency has delegated most of the credit decisions to lenders originating these loans.

Audits of early defaulted loans and improper payments continue to note a number of lender errors in originating loans, resulting in undue risk and loss to the program. In addition, OIG reviews have detected vulnerabilities in SBA's Standard Operating Procedure (SOP) for the Section 7(a) Loan Program. These vulnerabilities include a provision that allows financing of large amounts of intangible assets, including goodwill, in change-of-ownership transactions where the entire equity injection can be provided in the form of seller take-back financing. Further, OIG has identified management challenges relating to the Agency's quality control process at the loan servicing centers and the National Guaranty Purchase Center, efforts to prevent loan agent fraud in the Section 7(a) Loan Program, and improper payments under the Section 7(a) Loan Program. Finally, a recent OIG audit (Report 15-06) highlighted that the outsourcing of traditional lender functions in SBA lending programs to third-party agents has significantly increased, further impacting SBA's ability to maintain appropriate oversight.

Numerous OIG criminal investigations have identified fraud by borrowers, loan agents, lenders, and other participants in SBA business loan programs. Since 2005, OIG has investigated at least 22 cases with confirmed loan agent fraud totaling at least $335 million. Criminals fraudulently obtain—or induce others to obtain—SBA-guaranteed loans through a variety of techniques. These include submitting fraudulent documents, making fictitious asset claims, manipulating property values, using loan proceeds contrary to the terms of the loans, and failing to disclose debts or prior criminal records. The result is a greater chance of financial loss to the Agency and its lenders. In addition, higher loan limits in recent years are likely to attract additional attention by criminals and increase the consequences of improper lending decisions.

Through the Disaster Loan Program, SBA makes direct loans to homeowners and businesses harmed by disasters to fund repair or replacement of damaged property and to businesses to provide needed working capital. This program is vulnerable to fraud and unnecessary losses because (1) loan transactions are often expedited in order to provide quick relief to disaster victims, (2) lending personnel hired in connection with a disaster declaration may lack sufficient training or experience, and (3) the volume of loan applications may overwhelm SBA's resources and its ability to exercise careful oversight of lending transactions.

OIG reviews of SBA loan processing activities have disclosed significant problems in making, servicing, and liquidating disaster loans. For example, expedited processes implemented to reduce Hurricane Sandy application backlogs were not effective in reducing loan approval cycle times. Further, insufficient training and internal controls resulted in incorrect economic injury disaster loan amount determinations (Report 15-13). In a separate audit, we found that principals' incomes are relied upon as a source to repay disaster business loans without sufficient consideration and analysis of the impact on the principals' ability to pay living expenses, placing the loans at a higher risk of default (Report 15-05). In addition, OIG investigations have led to numerous convictions of disaster loan borrowers for making fraudulent statements to obtain loans or misusing loan proceeds.

Risks Affecting SBA's Oversight of Contracts for Small and Disadvantaged Businesses

The Small Business Act directs SBA to promote the award of Federal contracts to small businesses and firms owned by disadvantaged individuals such as minorities, service-disabled veterans, women, firms from areas of low economic activity, and others. Under a statutory goal, the Government directs approximately 23 percent of Federal procurement funds to these programs. For FY 2014—the latest year for which information is available—SBA reported that small and disadvantaged firms were awarded $91.1 billion Government-wide in prime contracting assistance. However, OIG audits and investigations have identified numerous instances where firms that were neither "small" nor "disadvantaged" have improperly obtained contracts under SBA contracting programs. For example, a joint investigation with other agencies resulted in the president of a Colorado firm pleading guilty to conspiracy in connection with his concealment of millions of dollars in assets and income in order to maintain the company's 8(a) status. This led to the wrongful award of over $17 million in 8(a) contracts to the firm. In addition, GAO has issued a series of reports documenting that ineligible companies had been admitted to SBA contracting assistance programs and were seeking set-aside contracts. These improprieties have resulted from a variety of factors, including fraud by company managers, excessive control over small or disadvantaged firms by large companies or non-disadvantaged individuals, SBA's and federal procurement personnel's weak oversight, and regulatory ambiguities and loopholes. OIG has issued management challenges recommending corrective actions to promote integrity in small business contract awards and oversight of the Section 8(a) Business Development Program.

Risks Associated with SBA's Information Security Controls and Other Operations

SBA's IT systems play a vital role in managing the Agency's operations and programs, including a loan portfolio that is approaching $120 billion. However, OIG audits and other reviews have identified serious shortcomings in SBA's information systems and related security controls. SBA has not fully implemented adequate oversight of its IT systems, has not established an effective process to remediate security vulnerabilities, and has not developed an effective process to upgrade IT capabilities. Consequently, OIG has issued management challenges recommending corrective actions in SBA's IT security and acquisition processes.

Risks Associated with SBA's Oversight and Controls of Grants for Entrepreneurial Development

SBA provides training, mentoring, and counseling services to small businesses through a variety of strategic partnerships. In its FY 2016 budget submission, SBA requested $206 million in grant funding to support these training and assistance programs. SBA's Office of Entrepreneurial Development (OED) oversees a network of programs and services that support the training and counseling needs of small business. OED manages and leverages three major resources: small business development centers (SBDCs), SCORE, and women business centers (WBCs). Although each resource program's goals and target audiences may vary, they share a common mission: to provide business advice, mentoring, and training to small businesses and entrepreneurs. The SBDC program is the largest grant program in the Agency's portfolio. OIG has identified problems with co-mingling SBDC grant funds with private-enterprise contributions and accounting for required matching funds. Some SBDCs are also co-located with WBCs, which makes it difficult to determine what services are associated with each grant program. In addition, having two grant programs delivering similar services increases the risk of duplicating services and contributes to government waste. A recent OIG review determined that SBA's internal controls did not detect that an SBDC failed to meet matching requirements for grant funding and other critical grant requirements (Report 14-19). In addition, for grants awarded under the Disaster Relief Appropriations Act of 2013, OIG found that SBA did not enhance its internal controls to ensure program goals were achieved and expenditures were allowable (Report 15-15).

Risks Associated with SBA's Acquisition Program

SBA spends approximately $120 million annually to acquire goods and services to assist in carrying out its mission. OIG has identified common risks in SBA's acquisition program, primarily inadequate acquisition planning, poorly defined requirements, internal control deficiencies, an incomplete acquisition policy, and inadequate oversight that contributed to ineffective or inefficient results and increased costs. A recent OIG review determined that SBA personnel did not adequately plan for contracts and inconsistently evaluated vendor quotes while performing a best value determination. In addition, SBA did not establish effective controls to manage the Agency's use of assisted acquisitions (Report 16-05). An OIG investigation recently found an improper relationship between an SBA employee and the president of an 8(a) and Historically Underutilized Business Zone (HUBZone) business regarding the award of an SBA contract, resulting in the employee's removal from his position. Additionally, in FY 2015, SBA reported an estimated improper payment rate of 13.52 percent for disbursements for goods and services, which is a significant increase from the FY 2014 estimated improper payment rate of 8.46 percent. OIG has issued a management challenge recommending corrective actions in SBA's acquisition processes.

OIG OVERSIGHT ACTIVITIES

Through audits and other reviews, OIG provides independent oversight of critical aspects of SBA's programs and operations to improve the Agency's efficiency and effectiveness. An important aspect of this work is identifying and following up on SBA's major management and performance challenges, as required by the Reports Consolidation Act. OIG also supports SBA's mission by detecting, investigating, and deterring fraud and other wrongdoing in the Agency's programs and operations. OIG serves as a Government-wide training resource for small business fraud and enforcement issues. These activities help to ensure that SBA employees, loan applicants, and program participants possess a high level of integrity. This is critical to properly administrating SBA programs because it helps ensure that the Agency's resources are utilized by those who deserve and need them most.

FY 2015 Accomplishments

During FY 2015, OIG issued 17 reports containing 80 recommendations for improving SBA's operations and reducing fraud and unnecessary losses in the Agency's programs. In addition, OIG investigations resulted in 52 indictments/informations and 57 convictions. We made 74 debarment referrals to SBA. OIG also conducted training and outreach sessions on topics related to fraud in Government lending and contracting programs, providing 28 presentations for more than 1,067 attendees, including SBA and other Government employees, lending officials, and law enforcement representatives. Topics included types of fraud, fraud indicators and trends, how to report suspicious activity that may be fraudulent, suspension and debarment, the Program Fraud Civil Remedies Act, and other topics related to deterring and detecting fraud in Government lending and contracting programs. Overall, OIG achieved monetary recoveries and savings of nearly $134 million from recommendations that funds be put to better use agreed to by management, disallowed costs agreed to by management, court ordered and other investigative recoveries and fines, loans or contracts not made as a result of investigations, and name checks.

CONCLUSION

SBA OIG continues to focus on the most critical risks facing SBA. Our resources are directed at key SBA programs and operations, to include financial assistance, Government contracting and business development, financial management and information technology, disaster assistance, Agency management challenges, and security operations. We also will continue to partner with the Agency to ensure that taxpayer and small business interests are protected and served well by reviewing proposed regulations and initiatives, pursuing debarment and administrative enforcement actions, and providing fraud awareness briefings. We value our relationship with this Committee, and with the Congress at large, and look forward to working together to address identified risks and the most pressing issues facing SBA.