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# SBA MANAGEMENT AND PERFORMANCE CHALLENGES: THE INSPECTOR GENERAL'S PERSPECTIVE

## HEARING

BEFORE THE

## COMMITTEE ON SMALL BUSINESS
## UNITED STATES
## HOUSE OF REPRESENTATIVES

ONE HUNDRED FOURTEENTH CONGRESS

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# CONTENTS

## OPENING STATEMENTS


| | Page |
|---|---|
| Hon. Steve Chabot | 1 |
| Hon. Nydia Velázquez | 2 |


## WITNESS


| | |
|---|---|
| Hon. Peggy E. Gustafson, Inspector General, United States Small Business Administration, Washington, DC | 3 |


## APPENDIX


Prepared Statement:
Hon. Peggy E. Gustafson, Inspector General, United States Small Business Administration, Washington, DC ..... 21
Questions for the Record:
None.
Answers for the Record:
None.
Additional Material for the Record:
None.

# SBA MANAGEMENT AND PERFORMANCE CHALLENGES: THE INSPECTOR GENERAL'S PERSPECTIVE

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**WEDNESDAY, MARCH 16, 2016**

HOUSE OF REPRESENTATIVES,
COMMITTEE ON SMALL BUSINESS,
*Washington, DC.*

The Committee met, pursuant to call, at 11:00 a.m., in Room 2360, Rayburn House Office Building. Hon. Steve Chabot [chairman of the Committee] presiding.

Present: Representatives Chabot, Hanna, Huelskamp, Curbelo, Hardy, Kelly, Velázquez, Meng, Clarke, and Adams.

Chairman CHABOT. Good morning. The Committee will come to order.

I would like to welcome back before the Committee the Inspector General of the Small Business Administration, the Honorable Peggy Gustafson. Over the past few weeks, the Committee, along with its Subcommittees, has held a series of hearings in response to a report by the Government Accountability Office, the GAO, regarding management deficiencies within the Small Business Administration. The GAO noted that many of the challenges identified in its report were first identified by the SBA's Office of the Inspector General.

Today, we will hear Inspector General Gustafson's unique perspective on the management of the SBA, as well as her insight into ways in which the SBA may more effectively and more efficiently assist small businesses.

I was troubled by the findings made in the GAO's report, and I think most of the members of this Committee were as well. What was particularly disturbing was just how many of the challenges identified in the report had already been identified by the Inspector General and were known by the SBA. In fact, reports and audits compiled by the Inspector General reveal that some of the most serious management challenges affecting the SBA were first highlighted over a decade ago. As these issues have gone unresolved, SBA programs have remained vulnerable to waste, fraud, and abuse, which undermines the agency's mission to support America's small businesses.

It is clear that the Inspector General plays a critical role in ensuring effective management of the SBA. By conducting audits to identify program mismanagement, by investigating fraud or other wrongdoing, or by recommending changes to increase the efficiency

of SBA operations, she has provided independent and objective reviews of agency actions.

Now the SBA, under the watchful eye of this Committee, must act. By clarifying the specific areas in which improvement is needed and highlighting possible paths forward for the agency, the insights offered by the Inspector General are invaluable as the Committee continues to work with the SBA to develop meaningful solutions to its management and performance challenges.

I would like to thank you, Ms. Gustafson, for coming today, and we look forward to your testimony. I would now like to yield to the ranking member, Ms. Velázquez, for her opening remarks.

Ms. VELAZQUEZ. Thank you, Mr. Chairman. And welcome.

Today we are holding the last in a series of oversight hearings this committee has undertaken over the past 2 months. It is only fitting that we culminate by examining the work of the Office of Inspector General and seek their input on ways to improve the agency. The OIG is an independent office tasked with auditing, investigating, and making recommendations to SBA that help the agency fulfill its mission. The OIG plays a critical role protecting the taxpayers' investment in SBA.

In 2015, the OIG helped recover or save over $134 million. Every year, the OIG is tasked with informing this committee of SBA's top management challenges. This report not only helps with our oversight responsibilities, but also provides SBA with recommendations to address the challenges that are identified. Unfortunately, many of those issues are very longstanding problems, some going as far back as 1999.

One area of serious concern is small business contracting. The OIG again identified several shortcomings in SBA oversight and data collection, and in turn, the reliability of the reporting of small business contracting goals. Furthermore, both the IG and GAO have recently reported weaknesses in SBA internal controls that ensure only eligible firms receive contracts set aside for the women-owned small business federal contracting program.

Congress has given SBA the tools to address many of these problems, yet they remain unimplemented, and that is unacceptable. I look forward to hearing from the IG on ways SBA can improve the reporting on small business data and compliance with the small business minority and women-owned contracting goals. Another outstanding issue is the lack of oversight in the SBA-7 lending program. Though the agency has made progress, the IG continues to find fraud, waste, and abuse, particularly when loan agents are involved. The IG has recommended SBA assign unique identifiers to loan agents as a way to root out bad actors. I hope to explore this option during today's hearing and determine how we can better protect the American taxpayers.

Additionally, multiple IG audits have uncovered millions in improper payments made under the 7(a) loan program. Particularly troubling to me is the IG's finding that SBA is not adhering to its own practices and procedures when reviewing high dollar, early default loans. As the size of the agency's portfolio increases, SBA must be more diligent in overseeing the 7(a) approval and purchase processes to minimize risk or we may need to reexamine the size of loans SBA can make.

Finally, weaknesses in the administration of disaster loan programs continue to drag on at the agency. I cannot stress enough that this committee, the GAO, and the IG have all identified issues with disaster loan processing and we have implored the agency to implement the alternative loan programs enacted almost nearly 10 years ago.

I know Administrator Contreras Sweet has prioritized improving the Disaster Loan program, and I am hopeful the increased scrutiny of the administrator's changes as a result of the IG adding this program to the list of management challenges will lead to its overall improvement. I am confident that we can use the IG's expertise and insight to explore ways for SBA to improve the delivery of small business contracting lending and entrepreneurial development resources.

I look forward to hearing the IG's recommendations and working with you, Ms. Gustafson, to improve the SBA. I want to thank you for your presence here today, and I yield back. Thank you, Mr. Chairman.

Chairman CHABOT. Thank you very much. The gentlelady yields back.

I will now take a moment to go over our timing rules here, which with one panel member are pretty easy. We operate by the 5-minute rule which we stick to, and we would ask you to stay within that if at all possible. There is a lighting system. The green light will be on for 4 minutes. The yellow light will come on for a minute to let you know that you have got about a minute to go, and the red light will come on. If you need a little more time since you are our sole witness that is okay. I ask Committee members if they have opening statements prepared to submit them for the record.

We are now pleased to welcome back to the Committee Inspector General Peggy Gustafson, who has served as the SBA's Inspector General since 2009. We very much appreciate you being with us, and you are recognized for 5 minutes.

**STATEMENT OF THE HONORABLE PEGGY E. GUSTAFSON, INSPECTOR GENERAL, UNITED STATES SMALL BUSINESS ADMINISTRATION**

Ms. GUSTAFSON. Chairman Chabot, Ranking Member Velázquez, and distinguished members of the Committee, thank you very much for the opportunity to be here today and for your continued support of the work of the Office of Inspector General. I am extremely proud to represent the dedicated men and women of our office, and I am very happy to come and talk to you about their work today.

As you have noted, as an independent office, the Office of Inspector General conducts and supervises reviews and investigations relating to SBA programs and supporting operations. We seek to detect and prevent waste, fraud, and abuse and try to promote economy, efficiency, and effectiveness in the programs of the Small Business Administration.

During the last fiscal year 2015, we achieved nearly $134 million in recoveries and savings, which is more than a sixfold return on investment to the American taxpayer. We issued 17 reports containing 80 recommendations for improving the SBA's operations

and reducing fraud and the necessary losses. In addition, our criminal investigators, their investigations resulted in 52 indictments or informations and 57 convictions.

While SBA's programs are essential to strengthening America's economy, this agency does face a number of challenges in carrying out its mission, including fraudulent schemes affecting all SBA programs, losses from defaulted loans, procurement frauds that allow large firms to obtain small business awards, excessive improper payments, and some pretty significant information technology management concerns.

In October of 2015, we released our latest report on the most serious management challenge and performance challenges facing the SBA. Based on the agency's efforts, SBA did demonstrate positive progress in resolving recommendations associated with five of the identified challenges. However, they remained at status quo on four of the challenges and demonstrated no progress on one recommendation in an area related to information technology.

Now, clearly these results I would say paint a mixed picture relative to SBA's commitment to addressing these challenges in earnest and their ability to overcome these challenges. As you have heard in your series of recent hearings held by the Committee, they face many serious concerns, SBA does, even beyond, of course, those designated as top management challenges. GAO did document some of these in September 2015 report, and I was certainly pleased to note that GAO cited the work products of this office as a basis for a lot of their findings in that report. It is nice to have one oversight give props to another. We appreciated that.

So for your information, SBA currently has 144 open OIG recommendations pertaining to reviews conducted in recent years and not so recent years across SBA programs.

I want to note that I do share the overarching concern expressed by GAO before this Committee in January. It would be irresponsible for me to not be concerned about the fact that SBA has not resolved many of these longstanding management challenges and that part of this reason may be due to a lack of sustained priority attention given to these challenges over time.

Having said that, I think it also has to be acknowledged that SBA has shown that with a sustained, committed effort over time, they can achieve successful results in these challenges. For example, they moved to green and the very large challenge related to their LMAS IT system. So I think that really shows that these are challenges that with the right effort can really be conquered and met.

The agency needs to strive for excellence in carrying out their programs. The agency leaders look to—it is essential that they look to and address the root cause of these problems evidenced by these recurring findings in these reports, and also pay attention to surveys, such as the Federal Viewpoint Survey mentioned in the GAO reports that where the SBA workforce does continue to express some dissatisfaction with the management.

The challenge of long-term organizational transformation in areas of these, such as human capital and IT, they are hard challenges but they are not insurmountable with sustained attention by competent managers. I think that sustained leadership absolutely

is necessary and that the SBA needs to try to close some of the revolving door on some of these key positions. For example, the CIO, the position of CIO that I know has been a source of concern and discussion within the SBA. There really needs to be an effort to work on having sustained leadership in positions like that.

I am positive that everybody in the room agrees that America's small businesses and the taxpayer, they deserve no less than the SBA performing at its highest levels at all times. And for all those reasons, I really want to thank you for the opportunity to speak with you today, and I very much look forward to answering your questions.

Chairman CHABOT. Thank you very much. We appreciate your time here, and now we will recognize some questions. I will recognize myself for 5 minutes for that purpose. You are right, we do owe the small businesses all across the country the best that we can provide and the best that the SBA can provide. You indicated their record as mixed, and mixed is not good enough. So they do need to do better, and also questions here is part of that process.

My first question would actually be, last week your office released a report in which you identified a number of weaknesses in the SBA's management information security. Specifically, you found that the SBA is not sufficiently tracking security incidences, nor is it properly reporting them to the United States Computer Emergency Readiness Team. Your office made a similar finding last year looking at the SBA's 2014 fiscal year. Could you expand upon that and address that issue and what you found?

Ms. GUSTAFSON. Yes. Thank you, Chairman.

The report that we are talking about, of course, is the annual FISMA, Federal Information Security, okay, FISMA report. You are right; one of the most concerning things about that report is in addition to 5 new recommendations in our report, 2 of which the SBA was able to close in the course of our audit work, there were 31 recommendations that had been carried over from previous years, which is just an exceptionally large number of IT—we are talking about IT vulnerabilities, IT system issues. The ones that you are talking about, there were definite concerns about, again, instances not being reported timely, happening again. Information security is an excellent area where, again, it is clear that SBA, like every agency, has to always evidence a strong commitment to never, ever taking their eye off the ball on the state of information security and the state of their IT security. You will note that in their report, some of the issues that they talked about as far as the incidents not being centrally reported, not being reported in time, they even mentioned the idea of there has been a lot of turnover in the IT area. There are things that are happening where they almost dropped the ball. That is, of course, unacceptable. I think that FISMA, again, which was looking at how they did in fiscal year 2015, is a concerning report. I think it goes to show a perfect area where the agency needs to show leadership from the very top, saying this is not going to be acceptable. We are going to dedicate whatever resources it requires and address these issues.

I will say that, you know, I know that the Deputy Administrator, Mr. Kramer, has taken this on as something that is important to him. In the middle of FISMA, there is also that cybersprint exer-

cise where actually SBA did better. That was an exercise that all of the Federal Government went through after the OPM breach and things like that.

Chairman CHABOT. Well, if I could just maybe—I have limited time.

Ms. GUSTAFSON. Sure. I am sorry.

Chairman CHABOT. I have 2 minutes to go. That is okay. You know, and I think the point is, and the important thing is they have a lot of sensitive information——

Ms. GUSTAFSON. Right.

Chairman CHABOT.—from a lot of small businesses all across the country.

Ms. GUSTAFSON. Right.

Chairman CHABOT. Bad actors are trying to get access to this information for all kinds of nefarious purposes. You know, we know that the Russians and the North Koreans and the Iranians and others want access to this, so the government has to do a better job.

Ms. GUSTAFSON. Absolutely.

Chairman CHABOT. The government has been hacked time and time again.

Ms. GUSTAFSON. Absolutely.

Chairman CHABOT. I assume you agree with everything——

Ms. GUSTAFSON. I agree. I was hacked twice in the OPM audit. Do you know what I mean? I mean, in the OPM breach, so I think we all feel that. You are right, there is a lot of sensitive information related to businesses and individuals.

Chairman CHABOT. Thank you. Let me follow up, also. Your reports have identified weaknesses in the SBA's incident reporting. Yet, in their most recent budget justification, the SBA claims to have had 100 percent success rate in timely reporting incidences during that time. Is there a way to explain how the SBA is making this claim? If the SBA is going to claim success in the face of failure, how can we be sure that they will actually address and resolve their management challenges?

Ms. GUSTAFSON. Well, it would be hard for me to—and obviously, I cannot answer that question on behalf of the agency. I would note a couple of things. One is we are looking at a very specific time period when we are looking at FISMA where we did note that there were incidents not being reported. I would further note that the agency agreed with our findings in FISMA and actually had no quarrel with anything. So to the extent that there may be a disconnect on why one and not the other, I have to respectfully request that I think you may need to ask them because all I know is that they agreed with us.

Chairman CHABOT. We will.

Ms. GUSTAFSON. Yes.

Chairman CHABOT. Thank you. My time is about to expire, so rather than trample on somebody else's time, I am going to yield back. I will now recognize the ranking member, Ms. Velázquez, for 5 minutes.

Ms. VELÁZQUEZ. Thank you. Your office has repeatedly recommended that SBA should implement a women-owned small business certification program in tandem with the sole source authority

granted in the 2015 NDAA. However, the agency moved forward with only the sole source provision. Can you discuss the risk that this poses to the integrity of the program?

Ms. GUSTAFSON. Yes, Ranking Member Velázquez. Thank you.

I would point out two things that did cause us grave concern about that. One was quite simply, the sole source authority was provided for that program in the very same legislative vehicle that directed SBA to institute a certification program for women-owned small businesses. On a very basic level, we believed that they should be done at the same time because Congress seemed to be telling SBA "we think we should change this in the program but also do this." That was a concern to us, especially given our work early on in the WOSB program where there was self-certification being happened very early on when we took a sample, and when we looked to see what documents were behind the self-certification of some of these businesses that were supposed to be uploaded in that website to show why these businesses that are supposed to be in the program, they simply were not there. That seems to evidence a weakness in a self-certification program that was of concern to Congress, and yet, here you are doing sole source, which is a much faster way of getting contracts out. There is more money flowing out the door, and yet the safeguard that Congress has asked for has not happened yet. It is a source of great concern for us, and I appreciate Congress' continued attention to that.

Ms. VELAZQUEZ. Thank you. So my understanding is that SBA recently asked for comments on an Advanced Notice of Public Rulemaking for what a certification could look like for the women's program. Has your office made any recommendation as to what the agency should do to prevent fraud and abuse when implementing a certification program?

Ms. GUSTAFSON. I have the same understanding as you that this has been set out and sought comment. I know that we have done prior work in some of these self-certification programs and these certification programs that I think should always be a lesson for SBA when a new program, such as WOSB, comes in. I think that there are lessons to be learned from the HUBZone program, for example, that talked about those certifications. Those are out there and, of course, they are known to SBA, because those are recommended directly to SBA. Whether we have made formal comments on the WOSB, I do not believe so. I do not think that we have. But certainly, we are there to help. We are there to give opinions. If they have further questions, I would be happy to meet with them. And I certainly——

Ms. VELAZQUEZ. I am just afraid that they will use that as an excuse saying that they are waiting for you to provide the comments they requested.

Ms. GUSTAFSON. We are always happy to give them any comments that they ever want, Ranking Member Velázquez.

Ms. VELAZQUEZ. Thank you. For years, OIG investigations have revealed a pattern of fraud by loan packagers in the 7(a) Loan program. Your office has recommended implementation of a registration system, including the issuance of a unique identifying number for each agent. However, the SBA has made only limited progress in implementing this recommendation. Can you explain

how the implementation of a loan agent registration system will reduce fraud in the 7(a) program?

Ms. GUSTAFSON. Yes. Thank you very much for your question. Loan agents are outside parties that help package the documents that are used for getting a loan through. What our investigators have found and have brought forward, and it has been a management challenge for a very long time, is if there is a loan agent out there who is falsifying documents and knowingly committing fraud, they are not doing it one time. That is what they do. What has been a source of frustration for us for years is at first there was absolutely no way to know, here I have Loan Agent Jones and I know he is a fraud. Can you tell me what other loans has he worked on? We have been for years saying you have got to find a way to have a system where we can look up Loan Agent Jones and see what other loans there are, not only to detect patterns, but absolutely to detect the amounts of fraud.

Ms. VELAZQUEZ. What is the reason for SBA not to——

Ms. GUSTAFSON. There have been——

Ms. VELAZQUEZ.—implement this recommendation?

Ms. GUSTAFSON. I apologize for interrupting. There have been several reasons. At one point, and they have evolved as they have tried to make progress, to be fair on the challenge. There were technology challenges. They wanted to do some updating of the databases. They did not want to, and believe that they cannot use Social Security numbers, which is fine, which is why we are suggesting you do not need a social. Make up a number. Just have a certain one. So I think that they are getting closer. I think they have now acknowledge that they need to have a searchable database that cannot just be that if I am Peggy Gustafson for one, but Peggy Elizabeth Gustafson for another, it will not get a match and stuff like that. So I——

Chairman CHABOT. The gentle——

Ms. GUSTAFSON. I am sorry.

Chairman CHABOT. You can complete your thought.

Ms. GUSTAFSON. No, I think that I am pleased that they are working with us finally on this because for a while there was no progress, but absolutely, it is time to have a central system. And the lenders agree. I really do not think there is any question about that.

Ms. VELÁZQUEZ. Very good. Thank you.

Chairman CHABOT. Thank you very much. The gentlelady's time is expired.

The gentleman from Mississippi, Mr. Kelly, is recognized for 5 minutes.

Mr. KELLY. Thank you, Mr. Chairman, and thank you, Inspector General, for being here.

Your testimony is not the first time we have heard of the problems of large businesses receiving contracts that were supposed to be reserved for small businesses. And as you know, this Committee is taking steps to address this concern. We have increased penalties, including liquidated damages imposed on companies for perpetrating fraud. We required companies to recertify their status as small upon a merger or novation of a contract. We have met with the GSA to require the new version of the government's procure-

ment data system accurately classify small and large businesses. Just this past January, we marked up legislation requiring the SBA to report separately on companies who have outgrown their size status. The Committee has given the SBA tools to ensure that large businesses are not receiving small business contracts. Do you have any explanation on why the SBA is not using the tools provided to them by Congress?

Ms. GUSTAFSON. I do not know, Representative Kelly, that it is a question of not using the tools. I think it is more a question of that this is just a very big issue involving a lot of money and there are so many kind of different aspects to this issue that there is not one good fix.

Now, some of the things you mentioned I think should be tremendously helpful. The idea of recertification in the instance of a merge innovation should really change some of these things because when a small company is bought by a big company, now to have to be certified is a big deal. I think that those are all very positive steps. I think that we are talking about 23 percent of Federal contracting. We are talking about billions and billions and billions of dollars. Where there is money, there is going to be fraud. I think that—I do not know that SBA is not using them. I think that we are quite frankly at a moment in time when time is going to tell very soon whether this is having an impact. These are things that this Committee has advocated for and given in the relatively recent past. These are changes. It is hard to change IT systems and things like that. But I think that they are going to be crucial to kind of addressing those issues. So I think that is, to be fair, a better way of putting it. Some of them should be very impactful and should help on this.

Mr. KELLY. Going back to your earlier opening statement, one of the things that is important is for leadership to prioritize and to set goals and to have suspenses and deadlines. In our answer, I am going to ask you another question, but I also want you to comment. Do you think that the leadership in SBA is properly prioritizing and properly setting standards and focusing on the right thing? Because in my experience as both a district attorney and as a commander in the military, our followers focus on those things which we check up on or those things which we prioritize. If we are looking at them, they fix them. If we are not and they just give it lip service, they do not. Do you think that they are setting the correct priorities?

Ms. GUSTAFSON. I think that you are exactly right; that change is only going to happen when they are setting the correct priorities. I think, as I noted in my statement, when they do that, change happens, and I think that is why LMAS happened. I think that on some of these management challenges, what they have done in the recent past is they have gone to program officials and say, you own this challenge, and so if we do not make progress on this challenge, I am going to want to know why. You are absolutely right. Without that, change probably does not happen.

Now, whether in the big picture, where their priorities are is exactly right, I think it is a bigger question. I think that sometimes SBA—and I have talked about this before—suffers from the fact that as hard as it is an advocacy organization, I think it often feels

pressure to get the loans out the door, get the numbers up for 8(a). While those are lofty and important goals, they always need to be mindful that the right people and businesses have to be getting those goals. So it is an art really on applying the right type of pressure.

Mr. KELLY. Right. When you referred companies for suspension or debarment or to the Department of Justice for prosecution using the liquidated damages provision, what has been the response from the SBA and the Department of Justice?

Ms. GUSTAFSON. I think that SBA has been incredibly receptive to our suspension and debarment referrals, up to and including taking a lot of credit for it, which is fair, because in the end they do the suspensions and debarments, so I am happy to share the credit and things like that. We do find a receptive audience for them because we work very hard to give them a package that allows for a suspension or disbarment.

The same thing with the Department of Justice. In my experience in the past 6 years, I have found, I think, a stronger appetite, especially in the procurement area, for assistant U.S. attorneys to take these cases. I think there has been progress made in defining damages which makes them more attractive to a prosecutor. We certainly do our best to give them the case all pretty and wrapped up and ready to go. And I think the will is there on both parts.

Chairman CHABOT. The gentleman's time has expired. Thank you, gentleman.

The gentlelady from New York, Ms. Clarke, is recognized for 5 minutes.

Ms. CLARKE. I thank you, Mr. Chairman, and I thank our ranking member. I would also like to thank our distinguished witness, The Honorable Peggy Gustafson.

Ms. CLARKE. Ms. Gustafson, is it imperative that the Small Business Administration accurately report the contracts awarded to small businesses? I am raising this because I think it is impossible to know where to focus our efforts in meeting small business contracting goals when we are possibly dealing with inaccurate procurement data. Can you speak about how the SBA plans to mitigate this issue of inaccuracy in goaling data?

Ms. GUSTAFSON. I think that, Representative Clarke, you are alluding to an incredibly crucial point, which is it makes no sense to tout a goal and to tout having reached the goal if in the end you cannot really have confidence in the numbers behind that goal. I do think that there has been a body of work by my office and by GAO that has called into question whether there can be complete confidence in those goaling numbers. I think it is a complicated issue because when you start getting into goals and the reporting, often the reporting begins with the procurement agency doing the right coding and putting it into the system, and SBA ends up doing kind of a capping of, you know, we are adding those up. I acknowledge that that is a challenge, but I do think that it is important that SBA take a hard look and really be not skeptical but question the numbers just so that they can reach a confidence level that really is representing small businesses; that when you talk about the billions of dollars and save 25 percent, that you can look at the American public and say, I am telling you that 25 percent of that

money, that money is going to small businesses who is performing that work.

I do think that for various reasons, both in inadequacy of data systems, data errors, which seem to always be one way and not the other, which is it is coded small when it should have been coded large, you do not see the opposite happening. I think with some of the very complex rules related to what Representative Kelly referred to, which is companies that graduate out of the program, that get big, that get bought, that is a whole lot of details that get lost when it is just about the numbers. I think what is crucial is that the number really be delved into by those of us, myself included, GAO, Committees such as yours, and really what you think that number means, SBA. Explain to us why Northrop Grumman might be on there. Let's talk about that. I think it is important to shine a light. But the work after that gets very complex. Without holding feet to the fire, both the SBA and the procuring agencies, there is too big an incentive to really meet those numbers. There is a huge incentive to meet those numbers. That is often at the cost of making sure that you can tell the taxpayers that those numbers are right.

Ms. CLARKE. Very well. I hope that you will continue to encourage them to sort of drill down.

Ms. GUSTAFSON. Absolutely.

Ms. CLARKE. As we will as well.

As you are aware, collaboration between the SBA and other Federal agencies is so critical to the mission that small businesses can fairly compete for Federal contracts. How can the SBA improve its collaboration with other Federal agencies so that small businesses are treated fairly in contracting practice? Which steps are the SBA already taking to do so?

Ms. GUSTAFSON. When you look at our management challenges, especially when you look at them historically, there has always been a challenge related to small business, to the contracting goals and things like that. One of the things that I think SBA is to be commended for is that we really tried to push them to say, look—and I think this is a government-wide issue—you cannot say your responsibility ends at the door to the procuring agency because these are difficult programs that you know better than anybody else. The problem becomes to diffuse if you are going to say, well, that is a DOD contract or that is an Air Force contract or an EPA contract. And I think that they have taken some steps in that as far as training, as far as going to the colleges. I do not mean the colleges, but the acquisition courses that teach acquisition because it is a very confusing area and say, hey, let's have a small business section and let's talk about that. I think that that is progress on their part, and I think they need to continue to do that and really continue to own the responsibility for ensuring the integrity of those programs. Because of SBA does not own them, nobody is going to.

Ms. CLARKE. I thank you for your answers this morning, and I yield back, Mr. Chairman.

Chairman CHABOT. Thank you. The gentlelady yields back.

The gentleman from New York, Mr. Hanna, who is the chairman of the Subcommittee on Contracting and Workforce, is recognized for 5 minutes.

Mr. HANNA. A couple of quick things. You are doing a great job, incidentally. It is wonderful to hear you speak.

The 22 cases, $333 million, can you describe to me what that looks like in the real world? How that can even happen? Why should someone have to be prosecuted criminally to eliminate them from a loan organization that is designed to help people? You know, there is a national group. Frankly, we would like to have the cap raised from the $21 billion I think it is today, even higher. It is hard to justify or it is going to be more difficult with this kind of fraud. But should it be necessary to have somebody prosecuted criminally in order to get them debarred?

Ms. GUSTAFSON. Absolutely not. Absolutely not. I mean, the easiest way to debar somebody is to wait for a conviction, and then it is easy because you can debar them with no question. But the law has always provided for what we would call, and you are well aware, of fact-based debarment or suspension. I do not think it necessary takes a criminal prosecution, especially because in these programs it is a very sophisticated type of person who knows how to take advantage and defraud these programs because they are confusing. You need to know how to take advantage of the system. All it really takes is—I do not think it takes somebody behind bars, but I think you need to hit them in their pocketbook. I think debarment is often a very easy way to do that.

Mr. HANNA. The next question is, if it is that easy, why is it that you need to be the person to identify this? That you need to be the person, the organization, actually, to see that this is done? If I were running the SBA and I had credible suspicions——

Ms. GUSTAFSON. Right.

Mr. HANNA. Go ahead. You know where I am going.

Ms. GUSTAFSON. Oh, no, no, no, no. I think the quick answer to your question is it does not have to be me. I mean, they certainly have the enforcement authority and ability and that.

Mr. HANNA. Okay, so the question is, is there a cultural problem?

Ms. GUSTAFSON. I do think, first off, I think government-wide, just in my experience as an IG and speaking to other IGs, I think government-wide there had been a cultural problem of, especially on the suspension and disbarment front, of trying to touch that if you did not have a conviction. I think the Federal Government, and there was a task force that was created, I think they are doing better government-wide on doing that, led by some much more aggressive agencies. EPA was actually pretty aggressive about S&D, as was the Air Force. They had some pretty strong suspension and debarment officials who were out there really doing that type of work, which is always easier to follow somebody who does it first because then you know how to do it. I think SBA has that capability.

I will say that as I previously mentioned, but I absolutely think it is true, I think it is sometimes hard for SBA to put their enforcement hat on. I really do. I think it is because it really—I think they somehow feel it is at odds with their advocacy element, which I personally do not understand but I am not an agency official in

that way. Just because any time somebody is getting, be it a loan or a contract that are not supposed to, some legitimate small business is getting hurt. I firmly believe that the honest participants in these programs, be it the small businesses getting the contracts or the lenders, they would be happy to see these bad actors get out of there.

I do think that it is unfortunate that a lot of times the enforcement angle has not been given the same priority as the advocacy angle. Anecdotally, I think they are better about it, and I think one of the reasons is—I wish it was because of me, maybe it is—but I also think it is because of you. I think it is because of Congress, because nothing, nothing is more impactful, quite frankly, than hauling an agency official up here.

Mr. HANNA. Well, you seem pretty scary to me.

Ms. GUSTAFSON. Do I?

Mr. HANNA. So is there something that you might advise this Committee to do to kind of open that opportunity for them or reinforce—they should not have to go through this to get to that point.

Ms. GUSTAFSON. Right. I think that the best thing that Congress can possibly do is to never let the agency forget that you are there. I do not think they forget that you are there, but I think that as somebody noted before, unless they think you are anybody—it is a rational actor kind of thing—unless they are worried that this is what you are paying attention to, they are going to worry about the other stuff. In addition to the series of hearings, which I think really has been impactful, at least certainly right now in the short term, there are other things that you can do that would not be as onerous for you all as hearings. You do not have to call me up all the time or anything like that, but I think just kind of holding their feet to the fire. I think it pays off immense dividends, be it a letter or briefings or things like that in addition to this. They will not forget that.

Mr. HANNA. Thank you, Chairman. I yield back.

Chairman CHABOT. Thank you. The gentleman from New York's time is expired.

Another member from New York, Ms. Meng, who is the ranking member of the Agriculture, Energy, and Trade Subcommittee. I think 80 or 90 percent of the people that have asked questions other than the chairman himself are from New York are here today.

Chairman CHABOT. The gentlelady is recognized for 5 minutes.

Ms. MENG. Thank you, Mr. Chairman, and to our ranking member. Thank you to our witness for being here today and all the great work that you are doing.

In your testimony you identify weak oversight and lack of regulatory clarity as among the reasons that under the 8(a) mentor protégé program larger companies can end up benefitting more from the program than minority-owned small businesses, which is contrary to the aims of the program and the SBA Act. What resources does the SBA need to strengthen oversight of this program? Can existing loopholes in the regulation be closed? I also want to find out if anything more can be done through outreach and education to enable some of these small businesses to better protect themselves.

Ms. GUSTAFSON. I cannot address the resource issue because I think that is really more appropriate for the agency. I do not know if they feel like they have enough resources or they do not on that. Our Mentor-Protégé audit is at least a couple of years old now, but it did evidence a source of concern, especially in the joint venture area because the Mentor-Protégé Joint Venture will count for small business credit, will count towards the small business goal. So it is really crucial that the requirements of that program and the limits and things like that be met.

I think you are right. There is always an education component because, again, it is not an excuse, but those regs are no fun to read and they are complicated. I think that, similar to what I noted before, I think SBA needs to continue their education component because they really are the best ones to educate the procuring agencies and things like that on what the issues are. So I think it is a tremendous tool if used correctly. If Mentor-Protégé Joint Ventures are not used correctly, they become kind of almost a pass-through where not only are there credit being given for things being done by small businesses, or pardon me, by large businesses, but I think even just as tragically, the small businesses are not getting the development experience that the whole Mentor-Protégé program is meant to do which is to say you have this mentor and we are going to show you how to do it. When that program is not running the way it should, they are not developing the way that Congress has anticipated that they would be developed.

That is kind of the attention that I think needs to remain and I do not really have an update in all candor on Mentor-Protégé since then, but I am hopeful that the agency has followed through on some of that. I cannot remember off the top of my head.

Ms. MENG. On the same program, in 2011, the SBA revised its regulations for this program and established additional standards to address the definition of economic disadvantage. In your report you indicate concern that the additional standards are not justified or objective. Can you explain your concerns as well as your recommendation for improving the standards?

Ms. GUSTAFSON. The definition of economic disadvantage has been if you are aware of our color coding that we use for management challenges currently, which is red, orange, yellow, and green, like a stop sign but with orange in there. It has been at red because we believe there is no progress. And it is, quite frankly, a place where the agency has just completely disagreed with us. We firmly believe, and we think it is crucial, that there be an economic analysis done to try to figure out what economic disadvantage means in terms of numbers. I mean, we do not think that the agency has performed or contracted out to get that robust economic advantage.

I think it is crucial because if you are not defining economic disadvantage based on a competent and strictly done economic analysis, then how can you be sure that only the right people are getting into the program? If you are letting people in who are not economically disadvantaged, again, not only are the wrong people getting contracts, but, quite frankly, they are at an advantage because they are probably more wealthy, they may be more sophisticated,

have more assets. It really puts the truly academically disadvantaged behind the 8-ball to even benefit from the program.

I have been here now for two administrators. They do not agree with me on this, and they do not agree before me and before the first administrator, they do not agree with us on this. But I think it is something that really needs to be—it is an important enough issue that we have kept it at red. It is in the management challenges, and we think it is crucial to really be again. These programs are not worthwhile if you are not benefiting the right people. Because they are expensive programs, very often the Federal Government pays a premium on some of these contracts if you believe that full and fair and open competition would be maybe cheaper for the government, and so you need to benefit the right people. Without starting with the right definitions, I do not think you are going to do that.

Chairman CHABOT. The gentlelady's time has expired. Thank you very much.

The gentleman from Nevada, Mr. Hardy, who is the chairman of the Subcommittee on Investigations, Oversight, and Regulations, is recognized for 5 minutes.

Mr. HARDY. Thank you for being here.

Ms. GUSTAFSON. Thank you.

Mr. HARDY. As a small business guy myself, hearing some of the things that have happened with the SBA, I know they are trying to do a good job but I continue to hear these issues over and over again, and it gives me a lot of angst as a small business person myself. I truly believe overall the SBA is trying to do a good job.

I am going to ask you a question that has to do with your office. I believe you are the head of that office, are you not?

Ms. GUSTAFSON. Yes.

Mr. HARDY. When you put people into place, do they know their responsibility?

Ms. GUSTAFSON. I believe so.

Mr. HARDY. Do you assure that they are fulfilling their responsibility?

Ms. GUSTAFSON. Well, all of my employees are career government employees who have to be, who have to fit the qualifications that we have for the positions, and then are managed. I have certainly made it a priority to make sure that we are managing the employees so that they are doing the right thing. So we provide the training that they need. Our auditors have to go through continuing CPE, which is like CLE for lawyers.

Mr. HARDY. Thank you. I think you know where I am headed with this.

Ms. GUSTAFSON. Yeah.

Mr. HARDY. You have issued dozens of recommendations, and with these recommendations, do you feel like they are being implemented in the expeditious manner that they should be? Or does it seem like it is taking too long? I have only been here a year, a little over a year now, and I know this has been going on before I got here. Is this happening in a manner that you perceive should be happening if you were managing this department?

Ms. GUSTAFSON. Representative, clearly, no. In my opening statement I referred to 144 open recommendations, and some of those date back to at least 2011. There are some that—so we are talking about some 5 years old, 4 years old, 3 years old, and that is a source of frustration. It can be frustrating at times as the IG because we cannot make them do anything. So we report the recommendations and we keep them there.

I will tell you that as IG even, I have emphasized to my staff that it is also on us. Do you know what I mean? It is kind of like we have said a couple of times but I think it is crucial, it has to be a priority and it kind of has to be mentioned and I think that certainly my head of audits has made it a priority as well to let our auditors know as well, hey, where are those recommendations? Where do they stand? There is no point in making a recommendation if nobody——

Mr. HARDY. I think that is my point, is if we make recommendations and people do not follow them, something has to change. This culture has to change. You brought it up yourself. You believe it is a culture, and I believe it is a culture. I think it is what is happening in the Federal Government in a lot of cases. I do not know what caused it but we need to fix it and I do not know how to get to that point. I guess that is what we are asking.

With improper payments, do we really need to tell the SBA that they need to accurately report these? I mean, do we really need to do that?

Ms. GUSTAFSON. Well, I think you could extrapolate that to the whole government. I think the emphasis on the Improper Payments Act has been much higher in the last several years after some improvements to the act and stuff like that, and I think it would be fair to ask, does it really take an act of Congress to make the agencies care about improper payments? The answer sometimes is yes, because sometimes while they are running their programs and getting their stuff done, it is hard. The stuff in the mirror, the stuff in the rearview mirror sometimes gets left behind. I do think that the Federal Government as a whole has made progress because of the Improper Payments Act and because of the attention paid to it. And SBA to a certain extent, too. But they started with no processes on some of this. So we are at a stage now, after 4 years or so, of these improper payments reports of where on some of these programs, okay, now they have the processes and now we, as the IG, are going to wait to see what they have instituted now that what they have been told to do are working. I cannot defend the inaction for that, but I am grateful for acts like that because I do think some progress has been made.

Mr. HARDY. Well, I appreciate what your office is doing, but you really need to help us because I truly believe the SBA is one of those economic drivers for this nation, and this nation is hurting economically. The small businesses are our economic driver overall. We need to get this thing functioning in the proper manner and we need your help to make sure that we continue to push. We need to continue to do our job, but it is becoming very frustrating that this engine is not getting moving. So thank you.

Ms. GUSTAFSON. Thank you.

Chairman CHABOT. The gentleman's time is expired.

The gentleman from Kansas, Mr. Huelskamp, who is chairman of the Economic Growth, Tax, and Capital Access Committee, is recognized for 5 minutes.

Mr. HUELSKAMP. Thank you, Mr. Chairman. I appreciate the topic of this hearing, and I am looking for some accountability, and I appreciate your work on that.

I want to follow up on the issue of improper payments. I think in multiple reports your office found that SBA is currently understating its improper payment rate. Can you describe that more fully for the Committee, or at least summarize what is in your report and whether we have seen any steps at the SBA to fix this problem?

Ms. GUSTAFSON. Again, absolutely. As I noted, it has been a process over the last several years. Starting with the first time that agencies were required to report improper payments, that year we actually went and did our own analysis. You may recall, and again, it certainly is in my tenure, I think it was 2011, we vastly disagreed where those numbers were. It was inconceivable how far apart the agency was from the IG on that. We very quickly got into the weeds on some of this. Was it a sampling error? Things like that, and projection and stuff like that. The process as we have gone forward, and as the management challenges have noted, is that we have really tried to hold their feet to the fire to institute the type of quality assurance reviews and the more stringent look at high dollar, early default loans which are often an indicator that there may be something wrong with the origination of those loans. That really did require SBA to kind of start some processes that were not there and dedicate some resources that really had not been dedicated.

I think when you look at the Management Challenges report, to be fair to SBA, we have seen progress. There has been absolute upward movement in a positive way instituting some of those processes and getting those in place. As I noted before, when you look at our report of last October, which was our most recent Management Challenges report, the next step is for us to be shown that the processes are now working and they are being used the way they are supposed to be used and that they are working. The numbers that SBA has reported and the loan programs have been the largest numbers, and especially the Disaster Loan Program, which started at a very, very high number, they have gone down extraordinarily in the last several years. Now, I will tell you that——

Mr. HUELSKAMP. But at the beginning, if I might interrupt, at the beginning, though, they were denying those high rates, so I did not follow——

Ms. GUSTAFSON. They were. They were. And I am sorry. At one of them they were indicating that they did not think there was an improper payment rate. I forget if it was 7(a) or if it was disaster. It was one of them where they said we do not think there are any improper payments. That is not the case anymore. They have started reporting rates and our most recent and proper payments reviews which come out in the spring—our latest one will come out within the next couple of months—it is either April or May—have shown that they have followed the act and instituted the processes that are in there. Again, I——

Mr. HUELSKAMP. But at the beginning, when you came in, you were using SBA data or did you go back and pull more information separately?

Ms. GUSTAFSON. Oh, no. We were doing SBA data and trying to use the same sample. It got to questions of—and of course, because we are talking about projections, I know that in some of the early work it was just a matter of disagreeing over a couple of loans that caused them to have an incredibly low rate and then to cause us to have what we felt was a more reasonable, and not excessively high but a higher rate, and that was several years ago under Administrator Mills' tenure. I was pleased because the end result of that—and of course, that always takes a while and that is after the numbers have been reported and stuff, and everybody has kind of moved on because the rates are there—they ended up agreeing with us and adjusting. I remember getting into a fight with them over are you going to go back and change the report? We will put it in a little footnote. You know what I mean. But whenever they agree with us, however begrudgingly, I think that that is good.

Mr. HUELSKAMP. Do you think that is at the administrator level? What about kind of the upper midlevel management, the folks that likely a year from now will still be there even though a new administrator? Have they somehow agreed with you all's assessment and the actual data mining that it takes to generate this type of rate and understanding of it?

Ms. GUSTAFSON. We do believe that, and that is where the work is done, of course, is at the centers and at that program level. If they had not come around there would not have been movement on the challenges. We think that they are there. The latest rate in disaster is down to under 10 percent. What is interesting about that is it started at about 28 percent. What is interesting about that is that causes them to be in compliance with IPRO, which is the act, which is good, but last year it was at 12 percent. That is a big jump or decline or whatever you do when you go from 12 to 8 percent.

Mr. HUELSKAMP. What is the penalty for noncompliance?

Ms. GUSTAFSON. You have to start instituting processes and devoting resources. There are financial penalties after a certain extent in that you can only——

Mr. HUELSKAMP. No, for SBA, if they do not reach——

Ms. GUSTAFSON. No, that is what it is. The act begins to require you to, you know, it kind of takes away your ability to spend money in certain ways because you have to devote certain amounts of money to those processes and things like that. It was good that they went to 8.5 percent. It was a pretty crucial number.

Mr. HUELSKAMP. Well, thank you. Chairman, I am out of time. I yield back. Thank you.

Chairman CHABOT. Thank you. The gentleman's time has expired. Thank you.

I would now like to yield up to 5 minutes to the gentlelady who has a few more questions.

Ms. VELAZQUEZ. I just have one more question. This is an area that I have been deeply engaged in since 2005, when Hurricane Katrina struck, and we saw the poor response from SBA, particu-

larly in terms of the disaster lending program and the processing times. As a result of that, we passed legislation in this committee that provided tools for SBA to be ready for the next disaster. We saw what happened during Sandy. Processing times took over 40 days and the decline rate was extremely high, to the point where I introduced legislation that the president signed into law, reopening for the first time in its history the Disaster Loan program, and the fact that tens of millions of dollars has been already disbursed shows that the need is still there.

My question to you is, since then the SBA has improved its response during recent disasters with loan processing times of less than 13 days; however, these events have not been of the magnitude of Superstorm Sandy or Hurricane Katrina, both of which resulted in significant delays. What level of confidence do you have that SBA will be able to respond as quickly as it has to another large catastrophe?

Ms. GUSTAFSON. I think the best way to describe my confidence level is probably mixed. I think that the pressure that was put on and the attention that was paid to the inadequate response times and processing times in Sandy surely got the attention of the agency. I know that you have paid a great deal of attention. I am sure you have met with Mr. Rivera on that. You did that report that I thought was extraordinarily helpful about the processing times and things like that.

I do think that in a way, again, when the agency knows that this is something that they have to be laser focused on, they will be laser focused on it. I think that certainly that is going to be a number one priority for wherever the next big disaster, a Sandy or a Katrina or something like that. That is going to be a huge priority. But the challenge is going to be, and I know that you are keenly aware of this, is one of the things that affected the processing times in Sandy was the kind of new programs that they were trying to institute. In an ironic twist, the things that they were instituting that involved—they were supposed to expedite some of the processes both in IDOL and in some of the smaller home loans—because there is a learning curve there, because of whatever reason, that did not help. It showed, and we did a report that showed that that did not really help. That remains a concern for me.

If there is going to be this kind of learning curve in the initial response to disaster, especially in the context of the programs that I know that you have talked about and that we have talked about in our management challenges that have yet to be instituted, the third-party lender programs and things like that that Congress had told SBA to use, I believe, in 2008, I think. So my fear is, I guess, if this time they are really going to do that, that is going to be good except for is that going to again cause a learning curve or a lag in the beginning and we find ourselves exactly where it is?

I hate to quote yourself back to you, but I think this may have been in your report. If so, I apologize for parroting back to you, but SBA needs to not be so reactionary. As long as they continue to be reactionary and trying to do that, I think they are always going to be a little bit behind the curve on that. In the disaster area, that has such dire consequences because, again, that means that the people who have just been devastated, their business or their

homes, are not going to get the type of service that Congress, and certainly SBA, wants them to get.

Ms. VELAZQUEZ. Thank you. Thank you.

Chairman CHABOT. Thank you. The gentlelady yields back.

I would like to note, as chair of this Committee and having worked with the gentlelady from New York, just to acknowledge how determined and how fiercely she has fought for her constituents in the matter of the devastation that was wreaked upon them by Hurricane Sandy, and they were challenged, many of them. Some were bureaucratic challenges. The SBA and others made it very difficult for people to rebuild, and she fought time and time again consistently, never gave up, and has not given up to this day, so I want to publicly recognize that. And they say we are never bipartisan in Congress, right?

Ms. VELAZQUEZ. Thank you, Mr. Chairman. With your help, it was a bipartisan effort, and we have to make sure the agency is ready because there will be another diaster.

Ms. GUSTAFSON. Right.

Ms. VELAZQUEZ. We cannot go back to them and say, I understand your pain, but we are not ready to provide the assistance that you need in a timely basis. Many of these businesses have to shut down their doors if they do not get the assistance they need in the next four weeks after a disaster strikes, and that is unacceptable.

Chairman CHABOT. Absolutely. We want to thank the Inspector General for appearing before this Committee today, and we also want to thank her for all the work that her office does and continues to do highlighting the management and performance challenges within the SBA, the Small Business Administration. Moving forward, this Committee will remain committed to working together with the SBA to ensure that these challenges are addressed and that the agency is able to provide effective and efficient assistance to America's small businesses, and that is what this Committee is all about, working in a bipartisan manner to improve the lot of small businesses in this country.

All members will have 5 legislative days to submit questions or to supplement their remarks. If there is no further business to come before this Committee, we are adjourned. Thank you.

Whereupon, at 12:06 p.m., the Committee hearing was adjourned.

# APPENDIX

**STATEMENT OF**

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

**BEFORE THE**

**COMMITTEE ON SMALL BUSINESS**
**U.S. HOUSE OF REPRESENTATIVES**

**MARCH 16, 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 con-

ducting 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 increases 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 process.

## 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.

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