# OVERSIGHT IMPROVEMENTS NEEDED: SBA OIG'S REVIEW OF THE MICROLOAN PROGRAM

## HEARING

BEFORE THE

## SUBCOMMITTEE ON INVESTIGATIONS, OVERSIGHT, AND REGULATIONS

OF THE

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

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# OVERSIGHT IMPROVEMENTS NEEDED: SBA OIG'S REVIEW OF THE MICROLOAN PROGRAM

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**THURSDAY, OCTOBER 12, 2017**

HOUSE OF REPRESENTATIVES,
COMMITTEE ON SMALL BUSINESS,
SUBCOMMITTEE ON INVESTIGATIONS, OVERSIGHT, AND REGULATIONS,
*Washington, DC.*

The Subcommittee met, pursuant to call, at 2:00 p.m., in Room 2360, Rayburn House Office Building, Hon. Trent Kelly [chairman of the Subcommittee] presiding.

Present: Representatives Kelly, Chabot, Brat, Blum, Bacon, Adams, Evans, and Murphy.

Chairman KELLY. I call this hearing to order. Today we will be examining the Small Business Administration's Microloan Program, specifically, the SBA's Office of Inspector General's recent audit of the program. The Microloan Program was the created to help women, low-income citizens, veterans, and minority and entrepreneurs. The program's mission is to provide microloans, along with training and technical assistance to help give qualifying small businesses a boost to start up, stay open, and even to grow. This is how the program is supposed to work. SBA makes direct loans to intermediaries. These intermediaries then use the proceeds from the direct loans to make small short-term loans to eligible small businesses. Although the intermediaries can lend up to $50,000, the average microloan is $13,000. These intermediaries are nonprofit community-based organizations with lending and business management experience. SBA's Office of Capital Access is responsible for overseeing the Microloan Program, specifically, the intermediaries that are the face of the program for small businesses. It is supposed to make sure that the intermediary allows only qualifying small businesses to participate in this program; to make sure that the intermediary's loans' files are accurate and complete; to make sure that the intermediary is following SBA's lending policies and procedures.

Ultimately, SBA is supposed to make sure that the Microloan Program, a program there to help the smallest of the small guys, is actually fulfilling its purpose. According to a recent audit from the SBA's Office of Inspector General, however, the agency needs to improve its oversight of the Microloan Program. Two weeks ago, the Office of the Inspector General released a new audit of the Microloan program. Its last audit was in 2009.

According to the recent audits, OIG determined that SBA is unable to measure whether the program is performing well. In fact, OIG found that SBA did not even implement all the recommendations from the 2009 audit, even though SBA said it would. That is not acceptable. SBA must do better.

The Microloan Program is an important program to this Committee. And for that reason, strong oversight is needed. This oversight is needed to make sure the program is functioning as intended, and without fraud, waste, and abuse. We expect SBA to completely and fully implement the OIG's recommendations this time around. We appreciate the witnesses being here today and look forward to hearing their testimony. I now yield to our ranking member, Ms. Adams.

Ms. ADAMS. Thank you, Mr. Chair, and thank you all for being here today, and we appreciate the time you have taken. In recent years, the nature of small business financing has evolved. No longer do many banks want to take on a business loan under $250,000, leaving much of the Nation's small employers empty-handed. SBA's Microloan program fulfills a critical need in the capital markets by serving entrepreneurs who are not served by the private sector or SBA 7(a) loan programs. The Microloan program is a key resource for startup, newly established and growing small businesses as well. It has provided millions of dollars in financing and technical assistance to small business and entrepreneurs since its inception in 1992 by providing loan programs to non-profit intermediaries who, in turn, lend funds to the smallest of small businesses. The program helps borrowers streamline their operations, grow to profitability, and create new jobs.

This Committee has recognized growth in microlending. And by recently passing legislation increasing the intermediary loan limit, we have extended the reach of the program. Doing so enhances the ability of small firms to access much-needed capital. And so, as we enhance the program, it is invaluable to consider the program's performance at both the intermediary and agency levels. The Office of Inspector General has recently focused its attention on the SBA's management of the program. The report found a number of improvements were needed to measure performance and ensure the program's integrity. And a number of concerns were raised in regards to the reporting system and documentation of loans. So we take these issues very seriously, because it is our duty to guarantee the Microloan program performs at its best if we intend to see the success of entrepreneurs in our communities. So today's hearing will provide us with the opportunity to hear about the OIG's findings related to oversight and performance of the program.

Overall, this Committee seeks to ensure that the Microloan program works with small business borrowers, and I look forward to hearing from our witnesses today and gaining their insights on how we can improve the program. And thank you, Mr. Chair. I yield back.

Chairman KELLY. Thank you to our ranking member, Ms. Adams. And I now yield to the gentleman from Virginia, the chairman of Subcommittee on Economic Growth, Tax, and Capital Access, Mr. Brat.

Mr. BRAT. All right. Our chairman did such a good job of summarizing the issues we are going to cover today, along with our ranking member, that, in the interest of efficiency, I am going to yield back and look forward to your testimony.

Chairman KELLY. I now yield to the gentleman from Pennsylvania, the ranking member on the Subcommittee of Economic Growth, Tax, and Capital Access, Mr. Evans.

Mr. EVANS. In that spirit that the gentleman just expressed, and my ranking member did such a great job, I am, too, going to yield back in efficiency and effectiveness. Thank you.

Chairman KELLY. Thank you. And as you guys can see, we work, I think, more bipartisan on this Committee than any of the other committees I am on. And that is just a wonderful thing to have such great members. If Committee members have an opening statement prepared, I ask that they be submitted for the record. I would like to take a moment to explain the timing lights to you. And you guys are both veterans. You have 5 minutes to deliver your testimony. The light will start out green. When you have 1 minute remaining, it will turn yellow. And finally, at the end of your 5 minutes, it will turn red. I ask that you try to adhere to the time limit.

I now want to formally introduce our witnesses today. Our first witness is Mr. Hannibal "Mike" Ware. Mr. Ware serves as the Acting Inspector General for the Small Business Administration Office of the Inspector General. The OIG is responsible for the independent oversight of SBA's program and operations. The OIG conducted the audit that is the subject of today's hearing. We look forward to hearing Mr. Ware's testimony.

And our second witness will be Mr. William Manger Mr. Manger is the Associate Administrator for the Office of Capital Access at the Small Business Administration. One of the programs Mr. Manger's office administers and oversees is the Microloan Program. Thank you for joining us today. And with that being said, Mr. Ware, you are recognized for 5 minutes.

**STATEMENTS OF HANNIBAL "MIKE" WARE, ACTING INSPECTOR GENERAL, UNITED STATES SMALL BUSINESS ADMINISTRATION; AND WILLIAM MANGER, ASSOCIATE ADMINISTRATOR, OFFICE OF CAPITAL ACCESS, UNITED STATES SMALL BUSINESS ADMINISTRATION**

**STATEMENT OF HANNIBAL "MIKE" WARE**

Mr. WARE. Thank you very much, Chairman Kelly and Brat, Ranking Members Adams and Evans, and distinguished members of the Subcommittee. Thank you for the opportunity to be here today and for your continued support of the Office of Inspector General. We recently published the results of our audit of SBA's management of the Microloan program. And I am happy to discuss our findings with you today. The Microloan program assists women, low-income veteran, and minority entrepreneurs as well as other small businesses in need of financial assistance. Under the program, SBA makes direct loans to intermediaries that, in turn, use the proceeds to make small short-term loans, microloans, up to $50,000, to eligible small businesses. SBA also awards grants to intermediaries to provide training and technical assistance to microloan borrowers. From fiscal years 2014 to 2016, intermediaries closed 12,168 microloans, totaling approximately $170 million.

As background, we initiated this review in response to a request from the Senate Committees on Small Business and Entrepreneurship to audit the program. And for historical context, our office conducted prior reviews of the Microloan program in 2003, and again in 2009. The objectives of our current review were to determine whether SBA effectively implemented actions to improve oversight of the Microloan program and the extent that SBA oversight is sufficient to measure program performance and ensure program integrity. We found SBA management did not effectively implement all prior audit recommendations to improve oversight. Furthermore, SBA management did not conduct adequate program oversight to measure program performance and ensure program integrity.

These internal control weaknesses were due to SBA not having an overall site visit plan, an adequate information system, available funding for system improvements, or clear standard operating procedures. Additionally, SBA management focused on output-based performance measures instead of outcome measures. In our review of the statistical sample of 52 microloan files, we found that data contained in SBA's information system for 27 of the loans did not match the information included in the intermediaries' loan files.

In addition, we found that intermediaries did not have sufficient documentation to support that it originated and closed 85 percent of the loans in accordance with SBA's requirements. As a result, SBA's ability to validate microloan data, conduct analyses across multiple programs and systems, and capture outcome-based measures was impaired. We found there was no way to ensure program integrity or measure program success. These internal controls over the Microloan program are critical as Congress considers expanding the program.

On a positive note, we also found SBA did take some steps to improve its oversight of the Microloan program. Those steps include the following: They developed a justification to request funds for technology improvements; they conducted a time study to evaluate staff time spent on tasks in support of technology improvements; and they developed a module within the program information system for new loan requests analysis which replaced the use of spreadsheets.

To keep this progress moving forward, we offered four recommendations to SBA to improve SBA's oversight of the Microloan program. We recommend that they continue efforts to improve their information system; develop a site visit plan to further monitor Microloan portfolio performance; update their SOPs to clarify requirements regarding evidence for use of proceeds and credit elsewhere; and update the Microloan reporting system manual to reflect current technology capabilities.

SBA management agreed with the four recommendations, and our office will monitor these recommendations until we assess corrective action has been implemented. I am proud of the work performed by our auditors to provide to Congress timely insight into the Microloan program. Thank you once again for the opportunity to speak to you today, and I look forward to your questions.

Chairman KELLY. Thank you, Inspector General Ware. And, Mr. Manger, you are now recognized for 5 minutes.

**STATEMENT OF WILLIAM MANGER**

Mr. MANGER. Thank you, Chairman Kelly and Brat, and Ranking Member Adams and Evans, for the opportunity to testify before you today. I appreciate that this Committee has various champions of the Microloan program, and I know that today's hearing will focus us on how to make the program function and operate better. To do that, we need to take a hard look at the past and present IG recommendations. And in my capacity as the head of SBA's Office of Capital Access, I recognize that I need to drive those changes home. I view the IG report as a road map on how to strengthen and improve a program that many of you care so strongly about. We have a shared goal in wanting to spur economic investment and business opportunity in communities throughout this country. The IG report, through pointing out areas where SBA needs to do better, will enable us to further enhance our lending. To illustrate the reach of our Microloan program, I wanted to share some data. In fiscal year 2017, the intermediaries in SBA's Microloan program lent $64 million to over 4,700 businesses that were unable to get credit elsewhere. The average loan amount was close to $14,000. The number of jobs created or retained was close to 18,000.

Those figures tell us we are on track, but further analysis also tells us we are being successful in reaching communities. In fiscal year 2017, microloans were only 4 percent of the SBA's total loan portfolio, but a full 40 percent of those loans went to startups, and 30 percent of microloans go to businesses in rural areas. This represents greater penetration than our other SBA loan programs.

Finally, all small business owners that receive a Microloan from SBA receive technical assistance, which is critical for business survival. In fact, businesses that receive technical assistance are three times more likely to stay in business past year one than those that do not receive technical assistance.

Mr. Chairman, this data shows us that we are on the right path. It affirms the members' interest apparent on this Committee and also the geographic reach to lending communities.

So the question is—how do we do better? The IG report makes specific recommendations that we agree with. First, our data system is 25 years old, and desperately needs to be upgraded. When I came into my position in March, this was one of the first things I identified. We have now funded a review of the system which will lead to a specific recommendation for an upgrade in conjunction with Maria Roat, our Chief Information Officer at SBA. I want us to get a new system in place as soon as possible.

Second, our SOP is currently being updated to provide better direction and guidance to both SBA staff and our intermediaries. We are in the process of creating a more thorough, on-site review plan of intermediaries, and we will continue training our SBA staff in the field and in headquarters to provide them better direction on their engagement with our intermediaries. Compliance is of utmost importance to maintain the integrity of the Microloan program. This program does so much.

Let me share one entrepreneur's success story with you. John Palmer of Gardena, California, is an African-American disabled veteran who wanted to start a security business when he left the Army. He started Servexo, but after 3 years, needed capital to take a bold leap into a municipal contract. Because of extended credit, John could not secure traditional financing to grow his business. He went to a Small Business Development Center and was referred to a microlender, CDC Small Business Finance in California. They provided John with a $40,000 microloan that allowed him to staff a new contract and purchase new employee uniforms. John also received technical assistance related to financial literacy. This led him to bill weekly instead of biweekly, which greatly improved his cash flow.

This is one success story, but there many, many others. Lastly, I want to speak to a portion of the IG report that observes the necessity for better program integrity in view of legislation to bolster the Microloan program.

We were pleased to work with the Committee on the Microloan bill that passed out of Committee and brought forward to the full House in July. We appreciate the continued interest and support of the program. And you have my commitment that we will make the changes necessary to achieve continued success. Thank you, Mr. Chairman. I look forward to your questions.

Chairman KELLY. And I thank both of you witnesses for being here. I thank the ranking member for being here as part of this to have this important hearing. It matters to me that 30 percent of the people who are financed are from rural areas. That is the type of area that I represent. It matters to me that these loans go to the people who need them most, which are our veterans and minorities in areas, whether it is for startup or whether it is for continuing and growing that business, that is very, very important.

Mr. Manger, you have got a road map. I mean, the Office of Inspector General told you exactly what you need to do to do this thing right. And so, my hope is that the SBA will follow to the T those recommendations, or either dispute with this Committee, or the Office of Inspector General, what they don't agree with there. But otherwise, I think you have a road map to get this program right so that we make sure the right people are getting that. In your recent audit, Mr. Ware, your office found that the SBA did not implement all the recommendations from the 2009 audit. Specifically, which recommendations did they not implement?

Mr. WARE. It is important to note that they definitely made attempts to implement the recommendation. We are saying they didn't effectively implement three of them. And the first one was recommendation 3 that dealt with actually going out and validating and verifying the data that is being reported by the intermediaries.

So one of the ways that we asked them to do that was to bolster up their site visits, to get out there and back-check these things to see if the information is actually accurate. And when we looked, we found that more than half of the files that our auditors reviewed showed that the information had disparities. It just wasn't accurate. So we dug into the site visits and found that they didn't necessarily have a site visit plan in place that would ensure that all the intermediaries were covered, number one, or that it was in any kind of scheduled manner to ensure that there is continuity. So we asked them to shore that up.

So that was the first one. And then recommendations 5 and 6 both had to do with performance measures. So we know, and Mr. Manger and I spoke about the way that SBA does a lot of their performance measure, and it is more output-based than outcome-based. And we are asking to have a greater lens into outcome-based performance measures. So that could be done through their IT system as well.

Like Mr. Manger said, it is very old. It is missing fields. There are just certain things that could be placed in there, because some of the data, quite honestly, is readily available. It is right there. It is just not being rolled up in any way that they could have a programwide view of the program to make program-wide-type decisions.

Chairman KELLY. And thank you. And just as an old soldier and old commander, I know that, number one, we don't do well, those things that aren't measured. And so you have to have performance measures or something to measure against. And we also don't do well those things that aren't inspected. And inspected doesn't mean online. The things we follow up on and show the importance by visiting are the things that people do well. If you don't show up, they assume that you really didn't mean that they were important. Was your office surprised to learn, Mr. Ware, that they have not implemented the things that you had asked?

Mr. WARE. I got to tell you, we were a little surprised that technical capabilities were not in place, mainly because we thought they were, quite honestly. After the 2009 one, we were provided with screenshots and with everything. And they had a contract in place to make these improvements. We actually thought they were done, but the contract, we found out later, fell apart, and that project went way.

Chairman KELLY. Mr. Manger, now, how will SBA make sure that it actually implements these recommendations under your leadership?

Mr. MANGER. Well, I am here to, again, drive this home. And I will ensure that the office and the staff in my office, we will pay very, very close attention to the IG report, the road map, as you said, sir. And we are going to implement it. We have already taken steps actually to implement some of the recommendations in the report by the IG. As we mentioned, we are actually funding now an evaluation with our Office of the Chief Information Officer, Maria Roat, to identify what is the best system to capture all of the information that we need to capture. And as Mr. Ware said, we want to capture, again, not just outputs, but outcomes. And we are going to do a whole new system to replace the 25-year old system, and we are going to try and do that, as I said, as soon as possible. We also have taken steps to change the language in the SOP. My office has already started to work on that. Again, with Mr. Ware and the inspector general's recommendations, we are changing the language in the SOP to make it clear and readily identifiable by the lending intermediaries, our staff, field staff, so everyone knows what is necessary to be in compliance.

Chairman KELLY. Okay. And I am going to go just a little over, but I will tell you, it goes back to we measure—we do well what people measure. You need to have timelines, if you don't, of when these things are going to be completed. If you do not have timelines and it is just when we get to it, people will not complete it. And with that, I have overextended my time, and I yield to the ranking member, Ms. Adams.

Ms. ADAMS. Thank you, Mr. Chair, and thank you, gentlemen, for your testimony.

Mr. Ware, in fiscal year 2016, the Microloan program was responsible for the creation of nearly 18,000 jobs. 47 percent of microloans went to minority entrepreneurs, and 45 percent of borrowers were women entrepreneurs. To what extent should factors such as job creation and borrower type be included as measures of the program's success?

Mr. WARE. That is a good question, actually. Actually, our office believes that that is at the crux of what should be measured, because if we want to know for certain that the program is meeting its intended purpose, those are exactly the type of performance measures that are more outcome-based that we have been discussing with the Small Business Administration.

Ms. ADAMS. Right. I understand that intermediaries may utilize the Microloan program and the Community Advantage program simultaneously for one small business borrower. So with your recommendation on data collection in mind, can you elaborate on how SBA can ensure that its programs, particularly when being combined, can each meet their intended purposes?

Mr. WARE. That was one of the things we found in the report that might—was not being tracked in a way that could roll out programwide to determine what is the impact of having the programs combined, what is really going on, because those programs we found during the audit that sometimes they combined, and it causes more—higher fee to the borrower and things like that.

So the intermediaries were saying that we are doing this to make it easier for the lender, which might be the case if you look at it from their standpoint. But we also think that, Hey, this is also adding a different cost to the borrower. But we still believe that SBA needs to be better—have better oversight over that, especially when you are combining the programs.

Ms. ADAMS. Okay. Thank you. Mr. Manger, SBA has promoted creating a continuum of access to capital. The OIG report noted that some intermediaries were not reporting whether small businesses were still in operation. What measures are in place to track the development of small businesses in the Microloan program such that they could avail themselves, if eligible, to additional SBA loans?

Mr. MANGER. Thank you very much. We are putting in place identifiable markers so that we can track someone who receives a small business loan through a microlender. In fact, we have done some analysis already since I came aboard in March, and we are able to tell you that over 8 percent of those that received a microloan through the SBA have come back and received a larger loan through one of our other loan programs. So we do have hard evidence that shows the continuum, and we would like, again, to have people eventually not even need the SBA, we would like them to be able to get loans conventionally. That is our ultimate goal. And we are working towards that goal.

But we need to—and you are correct and the inspector general is correct—we need to have identifiable markers to be able to track businesses into the future. With the 504 program, as you may know, we do track at least 2 years of the continued job creation by that business. We need to do that and even more with the microlender program so that it is the strongest program that we can have.

Ms. ADAMS. Yeah. Thank you. So to what extent do you attribute the discrepancies that the OIG found between the data in SBA's information system and the data in the intermediary loan files?

Mr. MANGER. So a lot of that can be explained, and we did talk to the IG about this. A lot of that can be explained by the fact that much of the information that is initially recorded is done in the application. What really should be looked at is the credit memo that follows the application, the credit memo and then the information that is in the system is actually consistent. Sometimes someone puts in an application that they are going to create four jobs. And then when they talk further and they get more technical assistance, they say, actually, it is going to end up being three jobs. And then when we do the final loan disbursement or the lending intermediary does that, it shows that there were three jobs created. So it is consistent with the credit memo. It is not always consistent with the application. And we did point this out to the OIG.

Ms. ADAMS. So consistency and coordination, then?

Mr. MANGER. Correct.

Ms. ADAMS. Very good. Thank you, sir. Yield back, Mr. Chair.

Chairman KELLY. Thank you, Ms. Adams. And I now yield to Mr. Brat.

Mr. BRAT. Thank you all for being with us today. I just have a question in terms of the Office of Inspector General. I think you have done us a good service in, first of all, checking into programs, making their—serving our interests, and et cetera. But most of what I saw and the types of metrics you put in place just kind of assure at the managerial type of level that the program will be implemented in a good way.

And beyond that—I mean, what we are really concerned about is that small business loans are being administered to people and they are having some effect as well. And so, if you could both just say a word on that, right? I mean, you have given us some good examples. I am not critical. I want these loans; I want economic growth. I taught economics for 20 years, so it is all good, right? I love it. But the anecdotal stuff doesn't cut it for me. And even if you got a metric. You said, I think, you know, we got, you said, tech assistance. And the firms that take that have three times the survival. That could just be casual correlation, right? It could be that the bigger firms that survive have access to, you know, mid-level managers or as one manager, that can take advantage of assistance where the small guy can't.

I mean, we want to see kind of real evidence, right? Not just, Hey, we think, you know, three times this, and they are better over here. You know, is that a fluke? I mean, if you run a regression and you control for some things, right? Like, my daughter is in high school doing this stuff with a control group, right? I mean, do we have some assurance that these programs are bearing fruit in terms of economic growth and helping business? And I would like to see that in the report as well. Just yield to hear your response.

Mr. MANGER. So as I mentioned, the microloans that were made last year, we have on record that they created 18,000 jobs. If you look at our statistics based on different groups, we outperform every group with this program as opposed to our other SBA lending programs. For example, the percentages of loans in this program that went to African-Americans this past year was almost 33 percent. That is a third. That is a much higher number than with our other SBA lending programs. The numbers for the last 5 years, the loans to Hispanics was over 21 percent, and to women it was almost half.

We are reaching people that we do not reach with our other programs. The lending intermediaries are on the ground in communities—in rural communities, making those loans, a lot of the times with a high-touch character rationale. And they are making loans to people who would not—I mean, case after case, they have said we cannot get the money. They have gone back repeatedly to banks and cannot get loans.

This program provides them that access to capital. They do not have to max out credit cards. They are not going to an online lender that is going to charge huge interest rates to them. Our interest rates are reasonable. This program is successful. And we just want to strengthen it and make sure that it is doing the right thing for the American people.

Mr. WARE. What you are saying is part of what we are driving at. And SBA, I think in 2011, after that 2009 report, they got with the consultant. And I am drawing a blank. I was sitting here trying my best to come up with that consultant that I knew right up until I sat in this seat a second ago. And that consultant had some of the same concerns and put forth some recommendations that were very much in line with what we had done.

But one of the things they put out there is they were talking about getting to a performance metric that deals with overall impact, absent some of the things that you mentioned like, well, did those that were successful have access to the other programs. It was Aspen Institute. Thank you. I am here, like, the Archer Institute? Okay. The Aspen Institute. And one of the things they recommended, and I believe that at the time, SBA thought it was expensive, was that you actually speak to the people who are benefiting from the program to find out if it is actually working. Why were you successful? And that way you could dig in much deeper into determining, wait, is this—are you isolated in this instance because you had a little bit more charisma, or was it because of this and that? So I still think that that Aspen Institute study had a lot of merit. I am not sure if you saw it. But it has a lot of merit, and that was one of their recommendations.

Mr. BRAT. Thank you.

Chairman KELLY. I would like to thank and recognize the chairman of the full Committee, Chairman Chabot from Ohio, for—he is in now. And with that being said, I recognize Mr. Evans for 5 minutes.

Mr. EVANS. Thank you, Mr. Chairman.

Mr. Manger, I want to go back to something you said when you talked about the shared goals. And I want to go back to the part about what is application on jobs and actually what happens. I think I heard you say sometime when people apply on paper, they may have a number of 6, but when it actually comes up to 3. You sort of said that, right?

Mr. MANGER. Yes. There are many times when the application does not have the same information that is then contained in the credit memo which is used, actually, just before the loan is funded.

Mr. EVANS. Correct. And what I guess I am trying to understand, the actual number you have is 18,000 jobs that you said have been created from this particular program, is what you have said.

Mr. MANGER. That is correct, in fiscal year 2017.

Mr. EVANS. Right. So in other words, what I see, one is sort of like the projected and actual. That is what I am hearing you say?

Mr. MANGER. Yeah. That number is the number that was captured by the intermediaries that was put into our system.

Mr. EVANS. So it is the actual——

Mr. MANGER. That is the actual.

Mr. EVANS.—versus what was projected?

Mr. MANGER. Yes. I mean, what was in the application is not captured here. This is actual——

Mr. EVANS. But it could have been higher?

Mr. MANGER. It could have been, that is correct.

Mr. EVANS. It could have been higher. Right. So what I want you to do is could you walk us through the process of applying for a microloan? I want to just understand how that process works.

Mr. MANGER. Sure. Well, in the instance that I gave you, a small business entrepreneur was referred to a microlender. Microlenders are—we have 150 that are using our program today, approximately. They go into the microlender. The microlender sits down with them. And then, as you know, Congressman, a very important component of receiving one of these loans is the technical assistance. They must, as of today, get 25 percent of the technical assistance up front before they receive the loan. And it is many times when they are sitting down with the lending intermediary who is going to make the loan to them, that they understand what is necessary to have a sound business plan, and what it is going to take for them to be able to fund that loan, and then operate once they receive that loan.

So a lot of the information, again, you know, on the initial application then is different. But then the lending intermediary sits down with the potential borrower, puts together a credit memo. They then—the intermediary funds the loan with the money that is loaned to them through the SBA. The lending intermediary makes that loan. And they have, on average, 3 years to repay that loan. But the SBA allows them, in fact, to repay that loan up to 6 years.

Then once that business is funded, as current statute requires, 75 percent of the technical assistance must be applied again after they receive the loan to make sure that the business is going to get up and running and growing as it is supposed to.

Mr. EVANS. I need to do this so I can get through real quick. The question I am leading into is does the Office of Capital Access ever get funding and staffing? Because if you have done 18,000, I am just kind of curious, is there a need to be more staffing, rearrange a budget and—that could be many more job opportunities, businesses grow?

Mr. MANGER. No. Honestly, I think our office is really adequately staffed for the amount of lending that we are doing. Again, we are making a loan to the 150 microlenders that are out there. It is the microlenders, who then, in turn, make the loans to the small business entrepreneurs. So we are not directly involved at the loan level to the small business owner. We are there working with the 150 microlenders that are in our program today.

Mr. EVANS. One other thing I want to jump into. You said a shared goal that one day there wouldn't be a need for SBA, a Microloan program.

Mr. MANGER. I am saying that we would like to see small business owners grow a business so strong and become so economically viable that they do not need to come back and use the SBA; that they are able to access capital directly through the conventional marketplace. That is correct.

Mr. EVANS. What is your sense on the percentage of companies that you are dealing with that are in that position that, in a sense, kind of grow out of needing the Microloan program?

Mr. MANGER. You know, I don't think I have an exact number for that. I could certainly get back to you on that. But we are addressing a need that is clearly evident out there for these small loans that are very impactful. And the lending intermediaries play a major role, again, in making sure that these businesses get the technical assistance they need and then the capital they need to start a strong business and we are hoping that all the businesses then become strong enough, again, that they graduate from the SBA.

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

Chairman KELLY. The gentleman yields back. I now recognize Mr. Bacon for 5 minutes.

Mr. BACON. Thank you, Mr. Chairman. And thank you gentlemen for coming back. Mr. Ware, if you could talk a little about site visits. I just want to make sure I understand what they are. If I interpret it right, it is the higher headquarters go out to visit smaller units?

Mr. WARE. No.

Mr. BACON. What are they?

Mr. WARE. So the district offices actually go out to do the site visits where they are, to the intermediaries in those States.

Mr. BACON. So what is the intermediary, then?

Mr. WARE. An intermediary is who the SBA gives—well, they apply—they are their non-profits that apply to SBA to get the money necessary to make the loans to the——

Mr. BACON. So they actually do the loaning—the loans out? Got it.

Mr. WARE. Yes.

Mr. BACON. Okay. So it is farther down the food chain than what I was thinking.

So why is it important that SBA have a site visit plan and assemble the data from its visits? And is that directed from the top and tells the middle offices how to do it?

Mr. WARE. Yes. Well, let me explain: So absent the plan, what happens, you have the district offices going out there, and they are doing site visits. But there is no overarching plan that says this is how we are supposed to do it. And then the information doesn't roll up to the top to be able to have a programwide view as to what is being found in the site visits.

So let's say you find—if Wisconsin, I guess, is finding that one thing is happening that is regular, that is wrong all the time that they are doing, whether it is credit elsewhere, how to review it, or anything else, and it is being done that way also in Nevada, and it is being done in these other places. Right now the information is piecemeal from the site visits, and part of us being able to see that we have a problem in the program, that we probably need to put something in the system to address.

Mr. BACON. So it is important that the folks at the top standardize the reporting processes, how you do it, and format it in a certain way so the data can be shared better?

Mr. WARE. Right. Well, I think that, for the most part, that is being done. We are just asking them to make sure that they can have a programwide lens by having these folks roll up this information, and everybody be playing from the same playbook.

Mr. BACON. Right. So it makes sense to me, because we did the same thing in the Air Force. We inspect, but we determine at the top how those inspections should look or those visits. So it is standardized. And you can take those lessons learned. My question to Mr. Manger, if I may, part of this audit, did your office have regular communications with the intermediaries? It sounds like you did, it just wasn't standardized.

Mr. MANGER. Yes, that is correct. And, actually, this gets to another point that is very important to note. You know, actually, several years ago, I was the Associate Administrator for Field Operations. Field Operations plays a big role in carrying out the site visits, because it is actually the staff in the district offices, as the inspector general just said, that actually carries out the site visits. So we have to be completely coordinated with the district offices.

When I came back aboard the SBA in March of this year, I spoke to the Administrator and said we need to do some training with the field staff, specifically the lender relations specialist, to make sure they are doing what we need in headquarters for them to do in carrying out some of these site visits.

In fact, in September, we had an on-site meeting with all the lender relations specialists from across the country for 2 days out near Dulles Airport, and we went over this with them. They now are on board and we are mandating annual site visits of every microlender in the program; they will be doing that. The staff in the headquarters office will also be following up with that. I think once we have that in place, we do have a checklist already; we can refine it a little bit further. But I think within, you know, this fiscal year, we are going to have a very good system in place to ensure that the site visits and the reporting is done effectively.

Mr. BACON. Okay. Thank you. One last question for you, Mr. Manger. So you had the inspection results, 2017, from the inspector general. And you already said this, but I just want to verify, make sure I got it right. You found their findings on target, not overly cumbersome? Should be applied?

Mr. MANGER. We agreed with their findings. I mean, honestly, the biggest problem is the 25-year-old system that we are working off of. That needs to be updated, without question. I identified that when I first came on board before I even knew the inspector general was looking at it. As I said, we have already funded a study with our Chief Information Officer to get the right system in place. We are hoping to do that as soon as possible, and we are working to that goal. I found out there were issues with the SOP and I immediately started working with our legal team to update the SOP. In terms of the site plan we have already done some training with the field staff. We are going to work on that. So we have adopted, really, the IG's recommendations. We agree with them, and we are moving forward to make sure the integrity of the program is intact.

Mr. BACON. Thank you very much to both of you. I yield back.

Chairman KELLY. The gentleman yields back. I now yield 3 minutes to Ms. Murphy.

Mrs. MURPHY. Thank you, Mr. Chairman, for holding today's hearing. I am very pleased to have worked with this Committee to pass H.R. 2056, the Microloan Modernization Act, in the House. It is an important bill that I think will help ensure the program keeps up with the increased demand for microlending. I also want to note that the bill recognizes the need for increased oversight by requiring GAO to conduct a thorough evaluation of the program.

As we look to the potential Senate passage of the bill, this hearing comes at a particularly fortuitous time. My first question is for Mr. Manger. As you know, under current law, an intermediary can use no more than 25 percent of its Microloan technical assistance grant to provide preloan assistance, that is, assistance to perspective microloan borrower as opposed to an approved microloan borrower.

Microloan intermediaries have long regarded the 25 percent cap as an arbitrary requirement that limits their ability to design support services that address the specific needs of borrowers and get more perspective borrowers loan-ready. Given these concerns, H.R. 2056, as amended, would increase the cap to 50 percent. Could you provide your thoughts on the current 25/75 rule and the proposed change to 50/50?

Mr. MANGER. Sure. We are in completely in favor of that change. And we want to also thank Congressman Bacon for his amendment.

We think that it makes much more sense to lift some of those restrictions; the 25 percent restriction on the intermediaries for the up-front training. We also realize, and there is evidence to prove this, that loans are made and businesses are more successful when the up-front training is greater. And so we are in complete favor of increasing the up-front training prior to receipt of the loan; shifting to the 50/50 split, we think that is the right way to go. We appreciate the House for putting that forward and look forward working with the Senate to get that passed into law.

Mrs. MURPHY. Great. Thank you. And one quick question. According to the agency's fiscal year 2018 congressional budget justification, microlending has seen an increased demand, and the number of small businesses assisted by the program was up by 23 percent in fiscal year 2016. Is the SBA prepared to meet the increased demand going forward? And what additional resources may be needed?

Mr. MANGER. I think we are perfectly poised to address the need and the demand in 2018. In fact, if we get this system in place, we will be able to create greater efficiencies in our office, and I think we will be perfectly well-suited to address the increased demand.

Mrs. MURPHY. Great. Thank you. And I yield back.

Chairman KELLY. The gentlewoman yields back. I now recognize Mr. Blum for 3 minutes.

Mr. BLUM. Thank you, Chairman Kelly, and thank you to the panelists for being here today I would also like to recognize the ranking member, Ms. Adams, who is standing up there, on her hat today. Very nice. Very nice. We are not here to question the effectiveness of the need for the Microloan programs. We are here to question the management by the SBA of these programs. Mr. Manger, how long have you been in your position?

Mr. MANGER. Since March of this year.

Mr. BLUM. Okay. I am reading here that the OIG did an audit. 52 microloans. They did an audit, a statistical sample. I was on a bank audit committee, so I know enough about this to be dangerous. Twenty-seven loans are not matched the information included in the intermediary's loan files. Thirty-two loan files did not have adequate evidence that the proceeds were used for the stated purpose, 32 of them. Twenty loans did not have adequate support that the borrower could not get credit elsewhere that is required. Thirteen loan files show that the intermediary charged interest rates above SBA requirements. And seven loan files show the intermediary charged fees above SBA requirements.

Now, I know if the bank that I was on the board of got this type of audit information, we would be in serious trouble by the Federal Reserve. My question is, what happened to these intermediaries? What happens to these people when they do not follow our rules as stated by the OIG? Mr. Manger.

Mr. MANGER. You raise a very good point, Congressman. Since I have come aboard, we have taken action. In the last 2 1/2 years, even longer than I have been there, we have the Office of Economic Opportunity, which oversees the Microloan program within my office working now very closely with my Office of Credit Risk Management.

Mr. BLUM. What happens to these intermediaries? Are they terminated?

Mr. MANGER. I will tell you, Congressman, we did actually just terminate a microlender——

Mr. BLUM. One?

Mr. MANGER.—in the last 2 months.

Mr. BLUM. Clearly, there is—over 50 percent of the 52 analyzed had issues. 50 percent. One has been terminated?

Mr. MANGER. Yes. But if you also look at the number of loans that were checked, that was less than 1 percent of the loans made by the Microloan program.

Mr. BLUM. It is a statistical sample, though. You can't tell me with any reasonable accuracy that 50 percent of them are not in error, of the total loan portfolio. So this is a statistical sample. 50 percent or more were in error. These intermediaries should be terminated.

Mr. MANGER. And as I said, we just terminated one, and I am working to look at doing that with another one. So I am taking action, sir, since I arrived in March.

Mr. BLUM. And I have every confidence now in the SBA with Linda McMahon at the top of it. And you are new to your job, so I will give you the benefit of the doubt. But they need to be held accountable.

Mr. MANGER. Absolutely.

Mr. BLUM. I yield back my time.

Chairman KELLY. The gentleman yields back.

As this hearing comes to a close, I want to, again, thank both of our witnesses for their testimony today. The Microloan Program is important to this Committee and important to small businesses. For those reasons, we encourage the SBA to take heed of the OIG's audit report and improve its oversight. Doing so will ensure the program fulfills its purpose. Going forward, we are eager to learn how SBA is implementing the OIG's recommendations. The Committee expects to be updated on the progress SBA is making on the OIG's recommendations. Thank you. I ask unanimous consent that members have 5 legislative days to submit statements and supporting materials for the record.

Without objection, so ordered. We are adjourned.

[Whereupon, at 2:49 p.m., the Subcommittee was adjourned.]

# APPENDIX

**STATEMENT OF**

**HANNIBAL "MIKE" WARE**
**ACTING INSPECTOR GENERAL**
**U.S. SMALL BUSINESS ADMINISTRATION**

**BEFORE THE**

**SUBCOMMITTEE ON INVESTIGATIONS, OVERSIGHT, AND REGULATIONS**
**&**
**SUBCOMMITTEE ON ECONOMIC GROWTH, TAX, AND CAPITAL ACCESS**

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

**OCTOBER 12, 2017**

## INTRODUCTION

Chairman Kelly and Brat, Ranking Members Adams and Evans, and distinguished members of the Subcommittees, thank you for the opportunity to be here today and for your continued support of the Office of Inspector General (OIG). We recently published the results of our audit of the Small Business Administration's (SBA's) management of the Microloan Program. I am happy to discuss our findings with you today.

## OIG'S ROLE

OIG was established within SBA by statute to promote economy, efficiency, and effectiveness and to deter and detect waste, fraud, abuse, and mismanagement in the Agency's programs and operations. During fiscal year (FY) 2016, OIG achieved nearly $145 million in monetary recoveries and savings—an almost sevenfold return on investment relative to our FY 2016 operating budget—and made 81 recommendations for improving SBA's operations and reducing fraud and unnecessary losses in the Agency's programs. Already in FY 2017, through March 31, 2017, OIG achieved monetary recoveries and savings of over $22 million.

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 on Integrity and Efficiency. In addition, we coordinate with the Government Accountability Office to avoid duplicating Federal audits. We also establish criteria to ensure that the non-Federal auditors that OIG uses (typically, certified public accountant firms) comply with Federal audit standards.

## OIG'S FINDINGS PERTAINING TO THE MICROLOAN PROGRAM

OIG report 17-19, titled *Audit of SBA's Microloan Program,* presents the results of our audit of SBA's Microloan Program. The Microloan Program assists women, low-income, veteran, and minority entrepreneurs, as well as other small businesses in need of financial assistance. Under the program, SBA makes direct loans to intermediaries that, in turn, use the proceeds to make small short-term loans (microloans) up to $50,000 to eligible small businesses. SBA also awards grants to intermediaries to provide training and technical assistance to microloan borrowers. From FYs 2014 to 2016, intermediaries closed 12,168 microloans totaling approximately $170 million.

Our objectives were to determine (1) whether SBA effectively implemented actions to improve oversight of the Microloan Program and (2) the extent that SBA oversight is sufficient to measure program performance and ensure program integrity.

*What OIG Found*

OIG last conducted an audit of SBA's Microloan Program in 2009 and made several recommendations to SBA to improve its program oversight.[1] However, SBA management did not effectively implement all prior audit recommendations to improve oversight. Furthermore, SBA management did not conduct adequate program oversight to measure program performance and ensure program integrity. These internal control weaknesses were due to SBA not having an overall site visit plan, an adequate information system, available funding for system improvements, or clear Standard Operating Procedures (SOPs). Additionally, SBA management focused on output-based performance measures instead of outcome measures.

In our review of a statistical sample of 52 microloan files, we found that data contained in SBA's information system for 27 of the loans did not match the information included in the intermediaries' loan files. In addition, we found that intermediaries did not have sufficient documentation to support that it originated and closed 44 of the 52 microloans, or 85 percent, totaling approximately $910,000, in accordance with SBA's requirements. These deficiencies affect the reliability of the data reported to SBA by the intermediaries. When projecting these findings to the microloan population, we estimated that intermediaries did not have adequate documentation for at least 9,196 microloans approved from FY 2014 to FY 2016 for approximately $137 million.

As a result, SBA's ability to validate microloan data, conduct analyses across multiple programs and systems, and capture outcome-based measures was impaired, and there was no way to ensure program integrity or measure program success. These internal controls over the Microloan Program are critical as Congress considers expanding the program.

It is important to note that during the period of the current audit, SBA took steps to improve its oversight of the Microloan Program. Those steps included the following:

- Developed a justification to request funds for technology improvements.
- Conducted a time study to evaluate staff time spent on tasks in support of technology improvements.
- Developed a module within the program information system for new loan request analysis which replaced the use of spreadsheets.

*OIG Recommendations*

To improve SBA's oversight of the Microloan Program, we recommended the Associate Administrator for the Office of Capital Access (1) continue efforts to improve the information system for effective monitoring of the Microloan Program, (2) develop a site visit plan to further monitor microloan portfolio performance, (3) update SOP 52 00A to clarify requirements regarding evidence for use of

[1] ROM 10-10, *SBA's Administration of the Microloan Program under the Recovery Act*

proceeds and credit elsewhere, and (4) update the microloan reporting system manual to reflect current technology capabilities.

*Agency Response*

SBA management agreed with the four recommendations offered by OIG. Specifically, SBA plans to study and recommend solutions to replace its microloan information system. SBA also will develop a comprehensive site visit review program and will update SOP 52 00A to clarify requirements regarding evidence for use of proceeds and credit elsewhere. Additionally, SBA will update the microloan reporting system user's manual to reflect current technology capabilities.

## CONCLUSION

The Microloan Program's mission is to integrate microlevel financing with training and technical assistance for start-up, newly established, existing, and growing small businesses. Improvements are needed in SBA's oversight to validate microloan data, conduct analyses across multiple programs and systems, and capture outcome-based measures. Furthermore, because Congress introduced two bills to expand the program, adequate oversight is necessary to sufficiently measure program performance and ensure the integrity of the program. The exceptions we identified on the microloans demonstrate that SBA must continue to improve its oversight to ensure the program is meeting its intended purpose. When projecting our findings in the 44 microloans to the microloan population, we estimate that at least 9,196 of 12,157 microloans, totaling $137 million, had deficiencies.

I am proud of the work performed by our auditors to shine the light on the Microloan Program, appreciating it is timely in context of the congressional debate to expand participation in the program. As noted in the Congressional Research Service's report titled Small Business Administration 7(a) Loan Guaranty Program, dated September 15, 2017, inadequate performance metrics are a persisting concern with SBA's lending programs. OIG believes the recommendations offered in this report will strengthen the management of the Microloan Program and ultimately, facilitate a capacity and analyze date in a manner that SBA can effectively measure performance of the program.

OIG will continue to provide independent, objective oversight to improve the integrity, accountability, and performance of the SBA and its programs for the benefit of the American people. Our focus is to keep SBA leadership, our congressional stakeholders, and the public currently and fully informed about the problems and deficiencies in the programs as identified through our work. We value our relationship with these Subcommittees, the Committee on Small Business, and the Congress at large, and we look forward to working together to address identified risks and the most pressing management challenges facing SBA.

# U.S. Small Business Administration

**TESTIMONY of**

## WILLIAM MANGER

Associate Administrator, Office of Capital Access
U.S. Small Business Administration

**House Small Business Committee**
**Subcommittee on Investigations, Oversight, and Regulations and Economic Growth**

Thursday, October 12, 2017

Thank you Chairman Kelly, Ranking Member Adams, and the entire Subcommittee for the opportunity to testify before you today. It's great to be back here once again and to have the ability to speak with you further about the Office of Capital Access' Microloan Program.

I am grateful for the dialogue that we've seen between the Office of Capital Access and the members of this Committee and your staff. It is incredibly important to the SBA and the American taxpayer that all of our lending programs are running as efficiency and effectively as possible. In that pursuit, we always value the feedback and input of this Committee when it comes to helping entrepreneurs access capital across our great country. We also appreciate the role the Office of Inspector General plays in ensuring that programs are successfully managed.

Administrator McMahon and the Office of Capital Access are very focused on providing smaller dollar loans to small business borrowers. Under Administrator McMahon's leadership, there has been responsible growth in all of our lending programs this year, including our Microloan Program. Administrator McMahon understands the importance of these loans and the life changing impact they can have for so many of our nation's entrepreneurs and their communities. The SBA's Microloan Program offers small dollar loans to businesses that banks are simply unable to make. As we've seen for years, the program has been incredibly successful in filling a need. For example, in Fiscal Year 2017, the Microloan Program provided small dollar loans with a reasonable interest rate to 4,708 small businesses.

As the Associate Administrator of the SBA's Office of Capital Access, I am one hundred percent committed to upholding the integrity of all of our loan programs and making sure that they are run properly with maximum accountability to this Committee and the American people. We do believe the Microloan Program is being administered appropriately, but there is of course always room for improvement.

As many of you know, in this program the SBA makes loans to not-for-profit lending intermediaries who then make microloans to small businesses for up to $50,000. However, the program has an average loan size of just $13,800. Year-over-year, we have seen a 5% increase in these loans which have created and/or retained an estimated 17,500 American jobs. Another interesting fact is that over 8% of our microloan recipients have gone on to receive larger loans from the SBA. This is incredibly encouraging and we would definitely like to see this number continue to increase.

In the coming weeks the Office of Capital Access will also be implementing new collaborative efforts with our Office of Field Operations to increase the number of these loans in both inner cities and rural areas. We view this initiative and others such as the recent launch of our Lender Match program as valuable tools in providing access to capital for entrepreneurs looking to attain the American dream.

It is incredibly encouraging to see the impact that the Microloan Program has had for so many American small business owners.

This program is a way for aspiring and existing small business owners to access capital at a reasonable rate, especially when you compare it to maxing out multiple credit cards at much higher interest rates. I'd also like to note that historically the Microloan Program has had a less than 2% loss rate. Keeping that number as low as possible is incredibly important for us at the SBA.

In regards to the recent Inspector General's audit of the Microloan Program, the SBA has agreed to implement the recommendations and has already begun working on enhancements to its on-site reviews by district office staff. We are also working on a project to evaluate system alternatives to modernize our Microloan lending and reporting system.

Lastly, the Office of Capital Access is committed to providing enhanced training to our lending intermediaries and the Office of Economic Opportunity has already provided two webinar trainings on how to properly document the "credit elsewhere" test. The SBA is committed to implementing the suggestions put forth in the Inspector General's most recent audit. We believe we are well on our way to improving our program and making it that much better for our nation's small business owners and the American taxpayers.

Thank you again for this opportunity to discuss the Microloan Program and I look forward to answering any questions you may have.

# AUDIT REPORT

## AUDIT OF SBA'S MICROLOAN PROGRAM

September 28, 2017 REPORT NUMBER 17-19

# EXECUTIVE SUMMARY

## AUDIT OF SBA'S MICROLOAN PROGRAM

Report No. 17-19

September 28, 2017

### What OIG Reviewed

This report presents the results of our audit of the Small Business Administration's (SBA's) Microloan Program. The Microloan Program assists women, low-income, veteran, and minority entrepreneurs, as well as other small businesses in need of financial assistance. Under the program, SBA makes direct loans to intermediaries that, in turn, use the proceeds to make small short-term loans (microloans) up to $50,000 to eligible small businesses. SBA also awards grants to intermediaries to provide training and technical assistance to microloan borrowers. From fiscal year (FY) 2014 to 2016, intermediaries closed 12,168 microloans totaling approximately $170 million.

Our objectives were to determine (1) whether SBA effectively implemented actions to improve oversight of the Microloan Program and (2) the extent that SBA oversight is sufficient to measure program performance and ensure program integrity.

### What OIG Found

We last conducted an audit of SBA's Microloan Program in 2009 and made several recommendations to SBA to improve its program oversight. However, SBA management did not effectively implement all prior audit recommendations to improve oversight. Furthermore, SBA management did not conduct adequate program oversight to measure program performance and ensure program integrity. These internal control weaknesses were due to SBA not having an overall site visit plan, an adequate information system, available funding for system improvements, or clear Standard Operating Procedures (SOPs). Additionally, SBA management focused on output-based performance measures instead of outcome measures.

In our review of a statistical sample of 52 microloan files, we found that data contained in SBA's information system for 27 of the loans did not match the information included in the intermediaries' loan files.

In addition, we found that intermediaries did not have sufficient documentation to support that it originated and closed 44 of the 52 microloans, or 85 percent, totaling approximately $910,000, in accordance with SBA's requirements. These deficiencies affect the reliability of the data reported to SBA by the intermediaries. When projecting these findings to the microloan population, we estimated that intermediaries did not have adequate documentation for at least 9,196 microloans approved from FY 2014 to FY 2016 for approximately $137 million.

As a result, SBA's ability to validate microloan data, conduct analyses across multiple programs and systems, and capture outcome-based measures was impaired, and there was no way to ensure program integrity or measure program success. These internal controls over the Microloan Program are critical as Congress considers expanding the program.

### OIG Recommendations

To improve SBA's oversight of the Microloan Program, we recommended the Associate Administrator for the Office of Capital Access (1) continue efforts to improve the information system for effective monitoring of the Microloan Program, (2) develop a site visit plan to further monitor microloan portfolio performance, (3) update SOP 52 00A to clarify requirements regarding evidence for use of proceeds and credit elsewhere, and (4) update the microloan reporting system manual to reflect current technology capabilities.

### Agency Response

SBA management agreed with the four recommendations. Specifically, SBA plans to study and recommend solutions to replace its microloan information system. SBA also will develop a comprehensive site visit review program and will update SOP 52 00A to clarify requirements regarding evidence for use of proceeds and credit elsewhere. Additionally, SBA will update the microloan reporting system user's manual to reflect current technology capabilities.

**U.S. SMALL BUSINESS ADMINISTRATION**
**OFFICE OF INSPECTOR GENERAL**
**WASHINGTON, D.C. 20416**

**Final Report Transmittal**
Report Number: 17-19

**DATE:** September 28, 2017

**TO:** Linda E. McMahon
Administrator

**FROM:** Hannibal "Mike" Ware
Acting Inspector General

**SUBJECT:** *Audit of SBA's Microloan Program*

This report presents the results of our audit on the Small Business Administration's Microloan Program. We conducted this audit in accordance with Generally Accepted Government Auditing Standards.

We considered management comments on a draft of this report when preparing the final report. SBA agreed with all four recommendations.

We appreciate the courtesies and cooperation extended to us during this audit. If you have any questions, please contact me at (202) 205-6586 or Andrea Deadwyler, Director, Credit Programs Group, at (202) 205-6616.

cc: Mary Anne Bradfield, Chief of Staff
William Manger, Associate Administrator, Office of Capital Access
John Miller, Deputy Associate Administrator, Office of Capital Access
Timothy E. Gribben, Chief Financial Officer and Associate Administrator for Performance Management
Christopher Pilkerton, General Counsel
Martin Conrey, Attorney Advisor, Legislation and Appropriations
Manuel Hidalgo, Director, Office of Economic Opportunity
LaNae Twite, Director, Office of Internal Controls

## Table of Contents

## Introduction

The Small Business Administration's (SBA's) Microloan Program was established to assist women, low-income, veteran, and minority entrepreneurs, as well as other small businesses in need of financial assistance. Under the program, SBA makes direct loans to intermediaries that, in turn, use the proceeds to make small short-term loans (microloans) up to $50,000 to eligible small businesses. The microloans may fund working capital and the purchase of materials, supplies, furniture, fixtures, machinery, and equipment. The program's mission is to integrate microlevel financing with training and technical assistance for start-up, newly established, existing, and growing small businesses. SBA awards grants to intermediaries to provide this training and technical assistance.

Intermediaries are responsible for determining whether a small business is qualified to receive a microloan using SBA's eligibility and program guidelines as well as its own lending policies. SBA loans made to the intermediaries have averaged a 2 percent charge-off rate over the life of the Microloan Program. Critical information about the microloans such as borrower information and payment status are self-reported by intermediaries in the Microloan Program Electronic Reporting System (MPERS).[1]

The Office of Capital Access (OCA) Microenterprise Development Division is responsible for reviewing intermediary loan requests and reports. Seven financial analysts oversee approximately 140 intermediaries. From fiscal year (FY) 2014 to FY 2016, intermediaries closed 12,168 microloans totaling approximately $170 million (Table 1).

**Table 1. Microloans Closed From FY 2014 to FY 2016**

| Fiscal Year | Number of Microloans | Microloan Amount (in millions) | Average Microloan Size |
|---|---|---|---|
| 2014 | 3,974 | $56.5 | $14,214 |
| 2015 | 3,708 | $52.3 | $14,106 |
| 2016 | 4,486 | $60.7 | $13,533 |
| **Totals** | **12,168** | **$169.5** | |

Source: MPERS data provided by SBA.

This audit of SBA's Microloan Program (current audit) was initiated in response to the Senate Committee on Small Business and Entrepreneurship requesting that the SBA Office of Inspector General (OIG) complete the planned second phase of the 2009 audit to confirm whether program oversight by SBA was sufficient. The Committee also requested that OIG determine whether oversight was adequate to prevent intermediaries from imposing excessive requirements on microloan borrowers or making loans at terms that were not in the best interest of borrowers.

### SBA Actions Taken

It is important to note that during the period of the current audit, SBA took steps to improve its oversight of the Microloan Program. Those steps included the following:

[1] During the period of our current audit, MPERS was the reporting system for microloans.

- Developed a justification to request funds for technology improvements.
- Conducted a time study to evaluate staff time spent on tasks in support of technology improvements.
- Developed a module within the program information system for new loan request analysis which replaced the use of spreadsheets.

**Prior Work**

On December 28, 2009, SBA OIG issued a memorandum ROM 10-10, *SBA's Administration of the Microloan Program under the Recovery Act.* The audit found that SBA had not conducted adequate program oversight, validated the reliability of program data, accurately reported program performance, or established meaningful outcome-oriented performance measures. We made six recommendations, all of which are closed, to the OCA's Associate Administrator to ensure that microloans made with Recovery Act funds are properly monitored and the program has meaningful performance measures.

**Objectives**

Our objectives were to determine (1) whether SBA effectively implemented actions to improve oversight of the Microloan Program and (2) the extent that SBA oversight is sufficient to measure program performance and ensure program integrity. See Appendix I for information on our scope and methodology.

## Finding: Improvements Are Needed in SBA's Oversight of Its Microloan Program to Measure Performance and Ensure Integrity

SBA management did not effectively implement all prior audit recommendations to improve its oversight of the Microloan Program. Furthermore, SBA management did not conduct adequate program oversight to measure program performance and ensure program integrity. These internal control weaknesses were due to SBA not having an overall site visit plan, an adequate information system, available funding for system improvements, or detailed Standard Operating Procedures (SOPs). Additionally, SBA management focused on output-based performance measures instead of outcome measures. In our review of a statistical sample of 52 microloan files, we found that data in MPERS for 27 of the loans did not match the information included in the intermediaries' loan files.

We also found that intermediaries did not have sufficient documentation to support that it originated and closed 44 of the 52 microloans, or 85 percent, totaling approximately $910,000, in accordance with SBA's requirements. These deficiencies affect the reliability of the data reported to SBA by the intermediaries. When projecting these findings to the microloan population, we estimated that intermediaries did not have adequate documentation for at least 9,196 microloans approved from FY 2014 to FY 2016 for approximately $137 million. (See Appendix II for a schedule of our questioned costs.) As a result, SBA's ability to validate microloan data, conduct analyses across multiple programs and systems, and capture outcome-based measures was impaired, and there was no way to ensure program integrity or measure program success.

### Implementation of Prior Recommendations to Improve Program Oversight

SBA OIG last conducted an audit of SBA's Microloan Program in 2009. We made several recommendations to SBA management to improve its oversight of intermediaries and their compliance with program requirements, collect and validate intermediary-reported data supporting program performance, and develop additional performance metrics to measure program achievement. Although SBA officials provided documentation evidencing that corrective actions were implemented in FY 2011 (Table 2) for the previous six recommendations, we found in our current audit that management did not effectively implement corrective actions for Recommendations 3, 5, and 6.

**Table 2. Microloan Program Audit Recommendations Closed in FY 2011**

| Number | Recommendation |
|---|---|
| 1 | Require intermediaries to provide 3 months' worth of bank statements with each quarterly financial report submitted to SBA and revise the review process to include an analysis of the sources and uses of the Microloan Revolving Fund and Loan Loss Reserve Fund. |
| 2 | Develop a staffing plan and hire and train the additional staff required to provide an adequate level of program oversight. |
| 3 | Examine, verify, and test microloan data reported by the intermediaries in MPERS. |
| 4 | Provide guidance to intermediaries and correct the processes used to calculate the number of small businesses assisted and jobs created and retained under the Microloan Program. |
| 5 | Develop additional performance metrics to measure the program's achievement in assisting microloan borrowers in establishing and maintaining successful small businesses. |
| 6 | Require intermediaries to report in MPERS the technical assistance provided in relation to each microloan made and use this data to analyze the effect technical assistance may have on the success of microloan borrowers and their ability to repay microloans. |

Source: OIG Report ROM 10-10, *SBA's Administration of the Microloan Program under the Recovery Act* (December 2009).

*Data Verification (Recommendation 3)*

In response to Recommendation 3, SBA expanded its quarterly performance reviews to include verification of microloan data. During our current audit, we determined that SBA used site visits to verify data reported by intermediaries in MPERS. Site visits were performed by SBA district offices and included interviews with intermediary personnel, reviews of sampled microloans to determine whether SBA requirements were being met, and a comparison of microloan files to MPERS. However, we found that site visits were not performed regularly for all intermediaries, and no formal plan existed to ensure all intermediaries received a site visit. Further, no summary data of site visits was available for programwide analysis of noncompliance. As a result, if issues were found, SBA could not identify financial impact and determine appropriate ways to address the noncompliance across the program. This could have included requiring an action plan for remediation, additional microloan file reviews, and increased monitoring through more frequent reporting. In addition, although site visits are an important method used to verify data and compliance with program requirements, SBA's SOPs did not require them.

*Performance Metrics (Recommendations 5 and 6)*

To respond to our prior recommendations and better measure the program's success, SBA required intermediaries to capture in MPERS the status of operation for microloan borrowers and technical assistance the intermediaries provided to those borrowers. However, during our current audit we identified some intermediaries were not reporting whether small businesses were still in operation, making this data element unreliable to measure the effectiveness of the program. For example, during our review of microloans, we identified a business that was no longer in operation, but MPERS did not reflect its current operating status. In addition, improvements programmed by a contractor in FY 2011 to have MPERS capture technical assistance were never completed and therefore never implemented. Nonetheless, the MPERS manual still illustrates steps to document this information. In FY 2015, SBA management developed a list of basic information technology requirements that would improve MPERS. According to SBA management, however, funding to address these types of system issues was not available. SBA management is in the process of requesting funds to make necessary technology improvements.

According to the General Accounting Office's Standards for Internal Control in the Federal Government, control activities must be established within all Federal agencies to monitor performance.[2] This may include the validation of source information that supports the data used to measure performance. As noted above, we identified irregular site visits, inadequate SOPs, ineffective reporting by intermediaries, and an insufficient information system, indicating that SBA is not meeting this standard.

**Measuring Program Performance and Ensuring Its Integrity**

We reviewed a statistical sample of 52 microloans approved for approximately $1 million by 14 intermediaries to validate data input in MPERS. We also assessed whether intermediaries originated and closed these microloans in accordance with SBA's requirements for use of proceeds, credit elsewhere, interest rates, fees, and insurance. In our review of these microloan files, we found that data in MPERS for 27 of the loans reviewed did not match the information included in the intermediaries' loan files.

[2] GAO-14-704G, Standards for Internal Controls in the Federal Government (September 2014).

We also found that intermediaries did not have sufficient documentation to support that it originated and closed 44 of the 52 microloans, or 85 percent, totaling approximately $910,000, in accordance with SBA's requirements. Specifically, we found inadequate support for use of proceeds, unsupported credit elsewhere, interest rate charges above SBA guidelines, and fees exceeding SBA guidelines (Table 3). When projecting these findings to the microloan population, we estimated that intermediaries did not have adequate documentation for at least 9,196 microloans approved from FY 2014 to FY 2016 for approximately $137 million.

**Table 3. Type of Exceptions from Microloan File Review**

| Exception | Number of Loans* |
|---|---|
| MPERS data did not match loan file | 27 |
| Inadequate evidence for use of proceeds | 32 |
| Unsupported credit elsewhere | 20 |
| Interest rate charges above guidelines | 13 |
| Fees exceeding guidelines | 7 |

Source: Generated by OIG based on microloan file reviews.
*Some microloans had multiple exceptions.

*MPERS Data Matching*

The agency's SOPs required intermediaries to report microloan information in MPERS.[3] However, when we compared the information in the loan files to what was in MPERS, the information did not match for 27 of the microloan files. In most instances, the jobs creation and retention data in MPERS was different from the information contained in the microloan files.

*Use of Proceeds*

The agency's SOPs required intermediaries to maintain evidence that the proceeds of the microloan were used for the purpose for which the application was made. However, 32 microloan files did not contain adequate evidence. For example, receipts or copies of checks related to purchases were not retained. In some cases, intermediaries only relied on follow-up visits to the business for verification, without obtaining documentary evidence to support the use of proceeds.

*Credit Elsewhere*

The agency's SOPs stated microloan files must contain documentation supporting that borrowers applying for $20,000 or more could not obtain similar rates and terms from private sector lenders. This documentation could include a bank denial letter, a survey of local loan products available at the time of application, or marketing materials listing terms the borrower was unable to meet. We identified 20 microloan files that did not have adequate support for credit elsewhere. For example, intermediaries relied on a borrower certification or an application question and in some cases the borrower indicated on the application that they were not denied elsewhere.

[3] During our audit, the SOPs that controlled the microloans we reviewed were SOP 52 00, *Microloan Program*, dated March 1, 2013, and SOP 52 00 A, *Microloan Program*, dated April 28, 2016.

*Interest Rates*

The agency's SOPs restricted intermediaries to a maximum interest rate it can charge microloan borrowers based on its cost of funds and the microloan amount. However, in 13 loan files, we found that intermediaries charged a range of 0.15 to 1.15 percent above SBA requirements. For example, one intermediary used another loan program in conjunction with microloan funds to fulfill the borrower's request. This led to an interest rate that exceeded SBA requirements.

*Fees*

The agency's SOPs allowed intermediaries to charge reasonable loan fees up to 3 percent depending on the approval date and term of the loan. Three intermediaries, however, charged fees above those requirements. For example, one intermediary used a state program for loan loss reserves, which it then charged its microloan borrowers to enroll in. This program, called the California Capital Access Program for Small Business (CalCAP), charges a fee between 2 and 3.5 percent of the loan amount, which can be passed on to the borrower. Four microloan borrowers for this intermediary were charged an origination fee of 2 percent plus a CalCAP fee of 4 percent. We reviewed microloan policies for the 14 intermediaries, and the CalCAP fee was the only requirement deemed excessive.

These exceptions occurred because SOP guidelines did not provide detail regarding what qualified as appropriate documentary evidence for use of proceeds and credit elsewhere. In addition, intermediaries used incorrect policies to charge fees and interest rates contrary to SBA requirements.

**Additional MPERS Enhancements**

We identified additional issues with the agency's ability to monitor the Microloan Program using MPERS. The issues we found included concurrent use of the Microloan and Community Advantage Programs, ownership of and responsibility for microloans, and accuracy of use of proceeds data in MPERS.

*Combined Use of Microloan and Community Advantage Program*

We found that some small businesses received separate loans from SBA's Community Advantage Program and Microloan Program to support one project. For example, one intermediary had two small businesses that requested loan amounts within the $250,000 limit of the Community Advantage Program. Instead of using only the Community Advantage Program, the intermediary split each of the loans between the Community Advantage and Microloan Programs. This intermediary stated it used the programs simultaneously to provide the best terms to the borrowers. However, we found the intermediary used a higher interest rate microloan in combination with a Community Advantage loan for one borrower. With another borrower, it used a shorter term microloan with the Community Advantage loan. These actions resulted in higher loan payments for both borrowers.

One intermediary that used both programs stated it was difficult to find borrowers for the Microloan Program. SBA management noted intermediaries may use both programs to allow them to obtain a grant under the Microloan Program.[4] We found MPERS did not include information that

[4] An intermediary may be eligible to receive grant funding from SBA to provide microloan borrowers with marketing, management, and technical assistance.

would capture intermediaries' use of the Community Advantage Program, which could be used for analysis and monitoring. Monitoring of the two programs is important to ensure each is being used as intended and intermediaries are providing loans that are in the best interest of small businesses that need their assistance.

*SBA's Ownership of and Responsibility for Microloans*

When intermediaries exit the Microloan Program, SBA's Birmingham Loan Processing Center inherits the responsibility of billing and collecting on those active microloans. However, MPERS does not capture these microloans, and management indicated it was difficult to monitor the debts. SBA management has to use a report from another system to compare to MPERS data; however, there is no common identifier to assist in this analysis. As a result, SBA management is required to take multiple steps to get an accurate understanding of these microloans, which increases the possibility of errors.

*Accuracy of Use of Proceeds Data in MPERS*

We also identified that MPERS could not accurately capture use of proceeds. For example, debt refinance was an allowed use of proceeds under the program but could only be considered when it improved the debt position of the microloan borrower. However, debt refinance was not a selection option in the system. Debt refinance was identified as a use of proceeds in our sample, so this omission makes it difficult for SBA management to fully assess the program.

We found that the internal control weaknesses identified in this report preventing SBA from providing adequate oversight were due in large part to the limited capabilities of MPERS. In addition, we found SBA measured program performance using output indicators in lieu of outcome metrics. For example, SBA focused on the number of small businesses assisted and number of jobs supported by microloans. Outcome based measures would include the success of microloan borrowers which would consider the operation status of small businesses and the technical assistance provided. According to OMB's Policies for Federal Credit Programs and Non-Tax Receivables (OMB Circular A-129), outcome-based measures are a necessary component for measuring program performance. Absent the capturing of key outcome metrics, success of the Microloan Program cannot be fully determined. SBA management recognized that outcome-based measures are needed and that the indicated system improvements will help accomplish this.

**Conclusion**

The Microloan Program's mission is to integrate microlevel financing with training and technical assistance for start-up, newly established, existing, and growing small businesses. Improvements are needed in SBA's oversight to validate microloan data, conduct analyses across multiple programs and systems, and capture outcome-based measures. Furthermore, because Congress introduced two bills to expand the program, adequate oversight is necessary to sufficiently measure program performance and ensure the integrity of the program. The exceptions we identified on the microloans demonstrate that SBA must continue to improve its oversight to ensure the program is meeting its intended purpose. When projecting our findings in the 44 microloans to the microloan population, we estimate that at least 9,196 of 12,157 microloans, totaling $137 million, had deficiencies.

**Recommendations**

We recommended that the Associate Administrator for the Office of Capital Access:

1. Continue efforts to improve the information system to include outcome-based performance measurements and ensure the data captured can be used to effectively monitor the Microloan Program compliance, performance, and integrity.

2. Develop and implement a site visit plan to comprehensively monitor microloan portfolio performance and ensure program results can be evaluated programwide.

3. Update SOP 52 00A to clarify requirements regarding evidence for use of proceeds and credit elsewhere.

4. Update the microloan reporting system manual to reflect current technology capabilities.

**Analysis of Agency Response**

SBA management concurred with the four recommendations and stated that the agency will target September 30, 2019, for full implementation. Management also provided additional comments regarding improvements made to the Microloan Program since SBA OIG's last audit in 2009. The Agency's response is included in its entirety in Appendix III.

**Summary of Actions Necessary to Close the Report**

The following provides the status of the recommendations and the necessary actions to close them.

1. **Resolved.** SBA management concurred with our recommendation and plans to continue efforts to improve the information system to effectively monitor the Microloan Program. This recommendation can be closed upon management providing evidence that a replacement for MPERS has been implemented. The replacement should include outcome-based performance measurements and ensure the data captured can be used effectively to monitor the Microloan Program compliance, performance, and integrity.

2. **Resolved.** SBA management concurred with our recommendation and plans to develop and implement a comprehensive site visit plan. This recommendation can be closed upon management providing evidence that a comprehensive site visit plan has been developed and implemented.

3. **Resolved.** SBA management concurred with our recommendation and plans to update SOP 52 00A to clarify requirements regarding evidence for use of proceeds and credit elsewhere. This recommendation can be closed upon management providing evidence that SOP 52 00A has been updated.

4. **Resolved.** SBA management concurred with our recommendation and plans to update the microloan reporting system manual to reflect current technology capabilities. This recommendation can be closed upon management providing evidence that the MPERS user's manual has been updated.

## Appendix I: Objective, Scope, and Methodology

Our objectives were to determine (1) whether SBA effectively implemented actions to improve oversight of the Microloan Program and (2) the extent that SBA oversight is sufficient to measure program performance and ensure program integrity. The scope of this audit included recommendations from our previous report issued December 28, 2009, and microloans approved from FY 2014 to FY 2016. To accomplish our objectives we:

- Reviewed the actions taken in response to prior recommendations to determine if they were still in place and operational.
- Reviewed a statistical sample of 52 microloan files from 14 intermediaries to determine if microloans were approved and closed in accordance with SBA requirements. The sample was selected from a universe of 150 intermediaries and 12,157 microloans approved for approximately $169 million. The review also included the validation of MPERS data.
- Reviewed microloan policies from 14 intermediaries to determine if the policies contained excessive requirements. We searched for requirements including, but not limited to, interest rates above SBA limits, application and origination charges above 2 percent, closing costs unrelated to the loan closing, required insurance provided by the intermediary, credit life insurance, disability insurance, and late fees exceeding 5 percent of the payment amount.
- Reviewed applicable laws and SBA's SOP including 52 00 and 52 00A. In addition, we reviewed Office of Management and Budget (OMB) guidance on internal controls and program reviews as well as the General Accounting Office's Standards for Internal Control in the Federal Government.
- Interviewed intermediaries as well as SBA management and personnel responsible for managing and monitoring the Microloan Program.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

### Use of Computer-Processed Data

We relied on specific data elements from SBA's MPERS to select our statistical sample of intermediaries and microloan borrowers and to analyze the microloan portfolio. We conducted reliability tests on those data elements provided by SBA. For example, we verified that the microloan approval dates and amounts were within the scope of our requests and did not include material data errors. Further, data elements associated to the reviewed microloans were verified against source documents. As a result, we believe the information is reliable for the purposes of this audit.

**Review of Internal Controls**

SBA's SOP 00 02 2, *Internal Control Systems,* provides guidance on implementing and maintaining effective internal control systems, as required by OMB Circular A-123.[5] According to OMB, agencies are responsible for establishing and maintaining internal controls to operate effectively and efficiently, report reliable financial data, and comply with applicable laws and regulations. We limited our assessment of internal controls to the oversight of the Microloan Program. We identified weaknesses and deficiencies, which are addressed in the report.

[5] SOP 00 02, *Internal Control Systems* (January 1986).

## Appendix II: Questioned Costs

**Table 4. OIG Schedule of Questioned Costs[6]**

| Description | Amount | Explanation |
|---|---|---|
| Projected total approval value of microloans | $137,199,806 | Unsupported documentation for microloans closed by intermediaries projected over total microloan population |
| **Total Questioned Costs** | **$137,199,806** | |

Source: Generated by OIG based on review of microloan files.

[6] Questioned costs are expenditures that are not supported by adequate documentation at the time of the audit or otherwise do not comply with legal, regulatory, or contractual requirements.

SBA

DIRECTOR, OFFICE OF ECONOMIC OPPORTUNITY

RESPONSE TO AUDIT REPORT

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

**Date:** September 20, 2017

**To:** Hannibal "Mike" Ware
Acting Inspector General

**From:** Manuel "Manny" Hidalgo
Director, Office of Economic Opportunity

**Subject:** Audit of SBA's Microloan Program

Thank you for the opportunity to review the draft audit report on the U.S. Small Business Administration (SBA) Microloan Program. We appreciate the role the Office of Inspector General (OIG) plays in assisting management in ensuring that programs are effectively managed, and for the feedback provided in this draft report.

The OIG draft audit report mentions that SBA has taken steps to improve its oversight of the Microloan Program including:

- Developed a justification to request funds for technology improvements;
- Conducted a time study to evaluate staff time spent on tasks in support of technology improvements; and
- Developed a module within the Microloan Program Electronic Reporting System (MPERS) to automate the analysis of new loan requests, replacing the manual and labor intensive past practice of using spreadsheets to complete the analysis.

The Office of Economic Opportunity (OEO) agrees that significant progress has been made in the oversight of the Microloan Program and is committed to its continual improvement.

OEO takes oversight of the Microloan Program very seriously. Numerous improvements to the Microloan Program have been made over the past several years to protect the integrity of the Program and minimize cost to the taxpayer. These improvements are summarized in the following paragraphs.

In 2010, the program office implemented a comprehensive quarterly reporting analysis, which has been completed on a quarterly basis for each active Intermediary in the Microloan Program since that time. This analysis consolidates each Intermediary's outstanding debt balance to SBA, the value and status of the Intermediary's microloan portfolio, and the deposit balance of each Intermediary's microloan revolving fund (MRF) and loan loss reserve fund (LLRF) bank accounts. This information enables SBA to understand each Intermediary's relative health by displaying historical default rate, delinquency rate, collateral coverage rate, loan loss reserve coverage rate and other valuable risk indicators. Performing this quarterly analysis on every Intermediary has enabled SBA to minimize its losses due to Intermediary non-payment by providing warning signs well before performance issues reach a non-recoverable level. As an example, SBA will not approve new loan requests, or make new loan disbursements to an Intermediary that has failed to provide collateral equal to 115% of its outstanding debt balance to SBA, until additional funds are contributed to restore this ratio back to the required 115% level.

Also in 2010, OEO implemented an annual financial statement analysis that OEO staff has completed annually for each Intermediary. This analysis also allows SBA to see potential financial issues well in advance of becoming a problem in order to limit the risk of Intermediary non-payment to SBA.

Further, in 2012 OEO designed its first Site Visit Checklist to be used by SBA District Office personnel when conducting annual site visits to the Microloan intermediaries. The Site Visit Checklist has undergone numerous revisions as a result of input from the SBA District Offices, the Office of Credit Risk Management and the Office of General Counsel. The current checklist is used to guide the District Office personnel through the onsite review of a Microloan Intermediary. It asks simple yes/no questions related to both oversight issues, and compliance issues.

In 2013 OEO published its first Microloan Standard Operating Procedure (SOP) since the Program's inception in 1992. This SOP provides guidance to both SBA staff who are involved in managing the Program and the Intermediary lenders who participate. This SOP was updated in 2015 to incorporate changes made to the Microloan Program regulations.

In 2014 the Microloan Program Office designed and implemented a grant calculator spreadsheet that is used by both OEO staff and each Intermediary as a project management tool for the technical assistance grants and the Intermediary's quarterly expense billings and performance reports. This spreadsheet incorporates every document required for an Intermediary to complete their required requests and reports. Further, it allows for the input of all required expense and performance data into a single input sheet which then imbeds the needed data into each of the required forms. The grant calculator allows the Intermediary to manage the reimbursement and performance reporting process more efficiently (with greatly reduced errors), which in turn allows SBA to review and approve their expense reimbursements more quickly and with greater accuracy.

OEO conducts monthly webinar sessions with all participating lenders in order to provide Program-related updates, ongoing training and allow for presentation of best practices. Time is set aside each month during these webinars to allow participants to ask questions and make recommendations. OEO also conducts a national training conference every two years where it requires each active Intermediary lender to participate. The most recent national training conference was held in April, 2016 in Chicago. OEO is currently planning its national training conference that will take place in May, 2018.

The OIG performed audits of 14 Intermediary lenders and 52 microloan files and found documentation deficiencies, or differences between the information contained in the lender's loan file vs. that in the SBA Microloan Program Electronic Reporting System (MPERS) system in 44 of the 52 files. The audit revealed that inadequate documentation exists to show that the "no credit elsewhere" test had been properly administered. The audit showed in some cases that inadequate supporting documentation existed to show how the microloan funds were used by the borrower. Further, the audit showed that in some cases interest rates and fees were charged that exceeded the limits allowed under the program rules and regulations. To correct these findings, OEO will complete the following:

1. Institute a comprehensive site visit plan ensuring each Intermediary is visited by local District Office staff on an annual basis and that the information they are reporting to SBA are properly and accurately documented in their loan files;
2. Update the Microloan SOP to provide more detailed examples of the types of documentation required for evidence of the "no credit elsewhere" test, microloan use of proceeds and reporting of jobs created and retained;
3. Continue to provide monthly webinar training and a national training conference every 2 years for microloan program Intermediary lenders to ensure a thorough understanding of reporting, compliance and documentation issues; and
4. Replace the Microloan Program Electronic Reporting System (MPERS) with a modern IT platform that will better enable accurate and efficient reporting and enable SBA to report on outcomes instead of outputs.

Since the Microloan Program's inception in 1992, it has completed in excess of 68,000 microloans totaling over $840 million with a charge-off percentage to SBA of less than 2%. OEO believes that this demonstrates that the Microloan Program is performing well.

**Management's response to the recommendations in the draft report is noted as follows:**

1. **Continue efforts to improve the information system to include outcome-based performance measurements and ensure the data captured can be used to effectively monitor the Microloan Program compliance, performance and integrity.**

OEO concurs with this recommendation and has presented its recommendation to replace the Microloan Program Electronic Reporting System (MPERS) to SBA's Business Technology Investments Committee (BTIC). BTIC approved OEO's request and has committed $150,000 to study and recommend the best possible cloud-based IT solution to replace MPERS. OEO has already selected a contractor and is scheduling to begin this work in early FY2018. OEO targets having a replacement for MPERS completed by the end of FY2019.

**2. Develop and implement a site visit plan to comprehensively monitor microloan portfolio performance and ensure program results can be evaluated program-wide.**

OEO concurs with this recommendation. It will continue to update its existing site visit review checklist. Further, OEO will coordinate with the Office of Field Operations to visit each Intermediary lender and complete a site visit checklist at least annually. OEO in partnership with the Office of Credit Risk Management will provide detailed training (at least annually) to all SBA Field Office staff who will be conducting the site visits. OEO targets having a comprehensive site visit review program in place by the end of FY2018.

**3. Update SOP 52 00A to clarify requirements regarding evidence for use of proceeds and credit elsewhere.**

OEO concurs with this recommendation and has already begun drafting updates to SOP 52 00A. In addition to other updates, the SOP sections covering use of proceeds and performance of the credit elsewhere test will be updated to more closely mirror the language used in the 7(a) program SOP 50 10 5. OEO targets a completion date for updating the SOP by the end of FY2018.

**4. Update the microloan reporting system manual to reflect current technology capabilities.**

OEO concurs with this recommendation. OEO will consult with the Office of Performance and Systems Management (OPSM) to ensure that the MPERS User Manual is updated to reflect current system capabilities. OEO targets a completion date for completing revisions to the MPERS user's manual by the end of FY2018.

Again, thank you for the opportunity to review and comment on the draft report. Please let us know if you need additional information or have any questions regarding our response.

Friends of the SBA
MICROLOAN PROGRAM

Written testimony submitted by The Friends of the SBA Microloan Program

October 12, 2017

The Friends of the SBA Microloan Program (The Friends) is an informal network of Small Business Administration (SBA) Microloan intermediaries that work every day to improve job and business opportunities in their communities and who have banded together to support improvements in resources, policies and procedures for the SBA Microloan program. (List Attached).

Small businesses are the engine for job growth in America. Small businesses make up: 99.7 percent of U.S. employer firms, 64 percent of net new private-sector jobs, 49.2 percent of private-sector employment and 42.9 percent of private-sector payroll.

The SBA Microloan program is a tested financing tool for entrepreneurs or small businesses with a good idea, but limited access to capital. Since the program's inception in 1992, SBA Microloan Intermediaries have made more than $845 million in loans to small businesses that created or retained some 246,000 jobs. The program provides resources for technical and financial assistance that is often essential to creating jobs and business opportunities for woman, minority, veteran and low-income -owned businesses and entrepreneurs. Non-profit intermediary organizations combine SBA resources to make loans of up to $50,000 to small businesses and entrepreneurs, with an average loan size of just $13,500. Despite lending to individuals and small businesses that lack or have an uneven credit history and often propose to work in low-income and/or sparsely populated markets, the loss rate to the federal government on Microloans is around just 2 percent.

The small business borrowers of this program provide tangible benefits for their communities. For example, Entrepreneur Fund in Minnesota worked with Army veteran Jason Amundsen to invest in a farm and equipment, augment a flock of hens, and provide business advice for their company, Locally Laid Eggs. Thanks to the Microloan and technical assistance from Entrepreneur Fund, Jason and his wife Lucie are selling their eggs throughout their region, successfully expanded their operations, and they are now partnering with other farms in Minnesota to continue in their mission of selling local eggs around the state. The farms they partnered with only sell their eggs local to their region, and any unsold eggs are given to local food banks.

Another example is Maria Empanada, an Argentinian Bakery and Restaurant owned by Lorena Cantarovici in Denver, CO. An immigrant from Argentina, Lorena is a naturalized U.S. citizen who often refers to herself as a "New" American. She started baking her mother's empanadas in her kitchen for friends to earn extra money to support her family—a familiar beginning for many entrepreneurs in pursuit of their American Dream. As demand grew for her delicious product, she built a commercial kitchen in her garage, then expanded to a small storefront using funds from friends. When she needed a larger store, she got a Microloan from Colorado Enterprise Fund (CEF) after being turned down by five banks. The new store was so successful, she opened a second location with funding from a 7a guaranteed bank loan, then turned back to CEF for another Microloan to open a third location. Her hub-and-spoke production model supplies small storefront locations and delivery to coffee shops around

Denver. She now employs 26 people in living-wage jobs, with plans for further expansion, including franchising. In addition to the Microloan, CEF also provided Ms. Cantarovici with technical assistance in the form of advising on marketing and cash flow management to ensure the success of the company.

**In Fiscal Year (FY) 2016, there were approximately 150 Microloan intermediaries that provided $60.8 million in SBA Microloans, creating nearly 18,000 jobs. Of those loans, 47.3 percent went to minority entrepreneurs and 45.2 percent were women entrepreneurs. Moreover, despite providing financing to individuals and businesses with limited credit, the SBA's default rate on microloans is only about 2 percent.**

While the Friends value data and evidence-based evaluation of their microloan activity, the September 28, 2017 Audit Report of the SBA Microloan Program released by the Office of the Inspector General (OIG) fails to provide an equitable assessment of the performance of the SBA Microloan intermediaries. The report provides a crude analysis of the intermediaries reporting and performance. Further, it lacks sufficient transparency concerning the type or significance in the data inconsistencies that were reviewed.

The SBA Inspector General report on the Microloan program was based on reviews of 14 Microloan intermediaries out of a total of the 140 intermediaries participating in the program at that time and reviewed just 52 of the loans made by those intermediaries during Fiscal year 2014-2016. During that time period, Microloan intermediaries made 12,168 loans; the 52 loans represent 0.4 percent of the total.

Of those loans, the OIG found:

- 27 of the 52 loan files contained information that did not match SBA's information system, and
- 44 of the 52 loans did not have adequate documentation meeting SBA requirements.

Using the findings from this meager sample – 10 percent of the intermediaries and 0.4 percent of the loans, the OIG projected that some 9,000 loans made between FY 2014 and FY 2016 did not have adequate documentation. **A reliable statistical analysis would require review of 1,189 loans to extrapolate on the 12,168 loans. Thus, these claims cannot be made with a reasonable and standard level of statistical confidence.**

Additionally, the report does not provide documentation of what type of information was found to be different from MPERS data for the 27 loans cited under the section on MPERS Data Matching. While the report indicates that the difference in data between the intermediaries' files and the data reported on MPERS was on job creation and retention, the added term "in most instances" does not provide evidence for this assertion, which is especially problematic given the flawed sample size upon which all of the observations were made.

The data differences cited in the IG report were between the original application submitted by the borrower and the MPERS data. There is an easily explainable reason for this difference, which is that the borrower's application is just that – an application. It does not reflect a binding commitment on the part of the borrower and may not reflect a complete understanding of the metrics used, for example, to calculate full-time equivalent jobs. After the intermediary reviews the application and fully explains the details of the program and its metrics, the intermediary prepares a credit memo. The credit memo is a more accurate document as it is completed after technical assistance and underwriting is provided by the intermediary.

Thus, ignoring this detail, the IG report gives the reader an unduly negative conclusion on the quality of documentation. The findings do not indicate a discrepancy between the data in the credit memo and the MPERS data. Most importantly, the fact that the data in the original applications does not match the MPERS data while the data in credit memo does match MPERS is a sign that the pre-loan technical assistance provided by the intermediaries is effective.

Moreover, a key consideration concerning the report's calculations on data differences is the fact that the 27 loans cited represent just 0.2 percent of the total loans for FY 2014 and FY 2016 (12,168 loans). Because such a small percentage of the total loan volume was audited, it is not reasonable to make assumptions about the validity of the data for the program at-large.

Further, the report notes that 20 files did not have "adequate support" to document the credit elsewhere test. This finding is misleading, as **all of the files did have information regarding the lack of credit elsewhere for the borrower. As noted on page 6 of the Audit Report, the SOP for the Microloan program does not provide details on the requirements for documenting the lack of credit elsewhere.** The intermediaries are therefore being judged without guidance on what would qualify as adequate documentation.

Furthermore, as a practical matter, documenting the lack of credit elsewhere is difficult. Many banks do not write denial letters but tell the business over the phone that they are denied credit. Many banks refer the business directly to the Microlender without even underwriting it if they know it won't qualify. Also, there are many good reasons that a small business should come to an SBA Microloan intermediary *before* going to a bank; Microlenders offer businesses assistance, which a bank both cannot afford and cannot offer because of lender liability. Finally, banks support the Microloan program because it leads to stronger businesses that will ultimately become bankable customers.

With over 12,000 loans provided, at an average of just $13,500 per loan, and an exceptionally low loss rate of under 2 percent to the SBA, it should be clear that intermediaries are successfully operating the program. In addition, the **intermediaries report a significant amount of data, which is not disputed by the OIG—rather the critique is in how the data is retained and presented using SBA technology.**

While the rationale for the four recommendations made in the report is flawed, we do not object to the recommended changes, especially with regard to improvements to the electronic reporting system and additional guidance in an updated SOP. Further, the SBA has agreed to make improvements in monitoring and guidance for the Microloan program. While we support the SBA's efforts to improve and modernize the Microloan program, the data and research contained in the Audit Report simply does not support the conclusions drawn by the OIG.

**Friends of the SBA Microloan Program Membership List**

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| Access to Capital for Entrepreneurs | GA |
| ACCION The US Network, Inc. | NY |
| Bridgeway Capital | PA |
| California Coastal Rural Development Corporation | CA |
| CDC Small Business Finance | CA |
| Center for Rural Affairs (REAP) | NE |
| Chicanos Por La Causa | AZ |
| Coastal Enterprises, Inc. | ME |
| Colorado Enterprise Fund | CO |
| Common Capital | MA |
| Community Ventures Corporation | KY |
| Connecticut Community Investment Corporation | CT |
| Economic and Community Dev. Institute | OH |
| Entrepreneur Fund | MN |
| Impact Seven | WI |
| Justine Peterson Housing & Reinvestment Corp. | MO |
| Kentucky Highlands Real Estate Corporation | KY |
| LiftFund | TX |
| MACED | KY |
| Montana Community Development Corporation | MT |
| Northern Initiatives | MI |
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