

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

MEMORANDUM

TO: Members, Committee on Small Business
FROM: Chairwoman Nydia M. Velázquez
RE: Full Committee Hearing: “SBA Management Review: SBA IG Report on the Most Serious Management and Performance Challenges Facing the SBA”
DATE: October 16, 2019

On **Wednesday, October 16, 2019, at 11:30 a.m. in Room 2360 of the Rayburn House Office Building**, the Committee on Small Business will convene for a hearing titled, “SBA Management Review: SBA IG Report on the Most Serious Management and Performance Challenges Facing the SBA.” Each year, the Small Business Administration’s (SBA) Office of Inspector General (OIG) releases a report on the most significant management and performance challenges facing the SBA. The goal is to focus attention on significant issues to enhance the effectiveness of the agency and its programs. The hearing will focus on the management and performance challenges identified in the OIG’s FY 2020 report, and the OIG’s recommendations on the ways in which SBA may address these challenges. Among other things, the hearing will cover issues related to SBA’s contracting, counseling, access to capital, and disaster assistance programs, as well as information technology (IT) controls. The sole witness for the hearing is:

- Mr. Hannibal “Mike” Ware, Inspector General, United States Small Business Administration

Background

In accordance with the Reports Consolidation Act of 2000, the OIG is required to annually assess and report on SBA’s programs and activities that pose significant risks, including those that are particularly vulnerable to fraud, waste, error, mismanagement, or inefficiencies. In its report, the OIG identifies performance and management challenges and proposes “recommended actions” designed to enhance the effectiveness of the SBA. The FY 2020 report titled, “Report on the Most Serious Management and Performance Challenges Facing the Small Business Administration in Fiscal Year 2020,” identifies eight management and performance challenges. The FY 2019 report identified the same eight challenges.¹

¹ See SMALL BUS. ADMIN., OFF. OF INSPECTOR GEN. [hereinafter, OIG], REPORT ON THE MOST SERIOUS MANAGEMENT AND PERFORMANCE CHALLENGES FACING THE SMALL BUSINESS ADMINISTRATION IN FISCAL YEAR 2019 (2018).

Challenge 1: Weaknesses in Small Business Contracting Programs and Inaccurate Procurement Data Undermine the Reliability of Contracting Goals Achievements

Exclusions from the Small Business Goaling Report Impact the Overall Prime Contract Goal

The Small Business Act established a governmentwide goal that 23 percent of all prime contracts be awarded to small businesses each fiscal year. Since FY 2013, SBA has reported that the federal government met or exceeded this goal. However, SBA's goaling guidelines exclude certain procurements—such as those awarded under the Javits-Wagner-O'Day Act, UNICOR, and certain Department of Defense contracts—from the small business goaling baseline. According to the OIG, these exclusions are not mandated by the Small Business Act. The OIG found that by excluding certain types of contracts from the goaling baseline, SBA overstates the federal government small business goal achievements. This is evidenced in the General Services Administration's FY 2018 Goaling Without Exclusions Report, which reported small business contract expenditure data without goaling exclusions applied, resulting in a small business procurement goal achievement of 22.4 percent—2.6 percent lower than the 25 percent reported by SBA.² The OIG recommended that SBA should include the appropriate universe of federal procurement opportunities in its goaling baseline to ensure policymakers and the public receive the most accurate and transparent picture of small business participation in federal contracting.³

Agencies Receive Goaling Credit for Ineligible Firms, Firms No Longer in the 8(a) or HUBZone Programs, or Firms That Are No Longer Small

The OIG continued to identify federal agencies that potentially received credit towards their small business goals because contracting officers incorrectly reported firms as either certified in the 8(a) program or Historically Underutilized Business Zone (HUBZone) program. For instance, a September 2018 OIG audit found that 20 of the 25 firms reviewed by OIG should have been removed from the 8(a) program. These firms received \$126.8 million in new 8(a) set-aside contract obligations in FY 2017 at the expense of eligible disadvantaged firms.⁴ More recently, an OIG audit found that 2 of 15 firms reviewed did not meet the HUBZone principal office eligibility requirement while one firm did not meet the employee residency requirement. These firms received \$589,000 in HUBZone contract obligations.⁵

Additionally, a September 2014 OIG audit found that over \$1.5 billion in FY 2013 contract actions were included toward small business contracting goals even though the firms were no longer in the 8(a) or HUBZone programs.⁶ And of the approximately \$3.1 billion in contracts awarded to the top 100 individually owned firms in the 8(a) program in FY 2016, the OIG determined that roughly \$1.5 billion was awarded to firms no longer in the program. SBA also revised its regulations in 2004, 2006, and 2013 to allow procuring agencies to receive small disadvantaged business and HUBZone goaling credit on certain contract actions even after firms have left SBA preference contract programs or outgrown their small-business status.

² GEN. SERVS. ADMIN., FISCAL YEAR 2018 GOALING WITHOUT EXCLUSIONS REPORT (2019).

³ OIG, REPORT ON THE MOST SERIOUS MANAGEMENT AND PERFORMANCE CHALLENGES FACING THE SMALL BUSINESS ADMINISTRATION IN FISCAL YEAR 2020, at 1-2 (2019) [hereinafter, FY 2020 REPORT].

⁴ OIG, IMPROVEMENTS NEEDED IN SBA'S OVERSIGHT OF 8(A) CONTINUING ELIGIBILITY PROCESSES (Report No. 18-22, 2018).

⁵ OIG, SBA'S HUBZONE CERTIFICATION PROCESS (Report No. 19-08, 2019).

⁶ OIG, AGENCIES ARE OVERSTATING SMALL DISADVANTAGED BUSINESS AND HUBZONE GOALING CREDIT BY INCLUDING CONTRACTS PERFORMED BY INELIGIBLE FIRMS (Report No. 14-18, 2014).

The OIG found that SBA needs to strengthen its oversight to ensure only eligible firms participate in SBA preference contract programs. While procuring agencies are permitted to receive goaling credit for firms that are no longer in SBA preference programs or no longer small, including these contracts in the reported small business goals prevents SBA from accurately measuring true program impact. The OIG recommended that SBA enhance the accuracy of its Small Business Goaling Report by specifying the amount awarded under long-term small business contracts to firms that have since left the program or are no longer small.⁷

Women-Owned Small Business Federal Contracting Program Susceptible to Abuse

SBA's Women-Owned Small Business (WOSB) program provides greater access to federal contracting opportunities to WOSBs and economically-disadvantaged WOSBs that meet the program's requirements. The FY 2015 National Defense Authorization Act (NDAA) granted contracting officers the authority to award sole-source contracts to firms in the WOSB program and required firms to be certified by a third party. However, SBA implemented the sole-source authority provision without a certification program. A June 2018 OIG audit found that contracting officers made sole-source awards to self-certified WOSBs without having the proper documentation to determine eligibility, resulting in approximately \$52.2 million awarded to potentially ineligible firms.⁸

Although SBA published a proposed rule in May 2019 to establish a certification process, the WOSB program continues to operate without a certification program that Congress required under the 2015 NDAA. SBA officials estimate that a Final Rule will be implemented in June 2020, and they are exploring the use of contractors to conduct prescreening in advance of the Final Rule. OIG recommended that SBA ensure timely completion of the remaining steps involved in the creation of a Final Rule for and implementation of a certification process for the WOSB program.⁹

Challenge 2: Information Technology Controls Need Improvement to Address Cybersecurity Risks

Office of the Chief Information Officer Made Progress in Deploying FITARA Criteria

Enacted in December 2014, the Federal Information Technology Acquisition Reform Act (FITARA) sought to realize long-term cost savings across the federal government through improved IT risk management, transparency, and more effective IT investment oversight. During the past year, SBA's Office of the Chief Information Officer (OCIO) established a human resource planning process that fulfills all FITARA workforce development standards.

However, the OIG identified three areas of IT investment oversight and accountability in need of improvement: OCIO should develop a process for capturing performance goal estimates and actual cost savings/avoidance for IT initiatives; cloud migration decisions should require approved business cases through SBA's IT governance boards; and SBA should ensure cloud services contracts specify system interoperability, portability, and data ownership. OCIO asserts that it has implemented controls in these areas, and the OIG will validate progress in future reviews.¹⁰

⁷ OIG, FY 2020 REPORT, *supra* note 3, at 2-3.

⁸ OIG, SBA'S WOMEN-OWNED SMALL BUSINESS FEDERAL CONTRACTING PROGRAM (Report No. 18-18, 2018).

⁹ OIG, FY 2020 REPORT, *supra* note 3, at 3-4.

¹⁰ *Id.* at 5.

Long-Standing Weaknesses in IT Security Controls Are Being Addressed

Each year, the OIG monitors the effectiveness of SBA's IT controls against frameworks established by the Federal Information Systems Controls Audit Manual (FISCAM) and the Federal Information Security Modernization Act (FISMA), among other federal guidance. The OIG's evaluations indicate that SBA has expended significant effort to formalize and document policies, procedures, and strategies in this area. For instance, during FY 2019, OCIO took corrective actions to resolve 44 outstanding OIG recommendations. Nevertheless, cybersecurity vulnerabilities remain. In the past year, OIG's independent public accountant found SBA had a "significant deficiency" in IT security controls, and the OIG assessed SBA as "not effective" against criteria established by FY 2018 IG FISMA Reporting Metrics. OIG continues to identify critical control issues in areas such as audit logging, network vulnerability management, and access controls.¹¹

Challenge 3: SBA Needs Effective Human Capital Strategies to Carry Out Its Mission Successfully and Become a High-Performing Organization

SBA Has Made Progress to Update Human Capital Management Policies

Over the past decade, SBA made substantial progress to address this long-standing challenge by implementing strategic workforce and succession plans to identify competency gaps, strengthening its leadership capacity, and addressing the challenges of its aging workforce. Nonetheless, according to GAO, agencies need to do more to fully use workforce analytics to evaluate actions taken and demonstrate progress in closing competency gaps. In a May 2019 evaluation, the Office of Personnel Management noted that SBA should regularly assess the effectiveness of human capital strategies and workforce plans on addressing gaps and surpluses and adjust its plans accordingly. Additionally, SBA previously identified 50 percent of its employees in mission critical occupations and senior positions as eligible to retire by 2020. The OIG plans to evaluate SBA's actions to mitigate this risk, as well as its use of workforce analytics to track its progress in closing competency gaps.¹²

Challenge 4: SBA Needs to Improve Risk Management and Oversight Practices to Ensure Its Loan Programs Operate Effectively and Will Continue to Benefit Small Businesses

SBA's Oversight of Lending Participants

SBA's Office of Credit Risk Management (OCRM) manages credit risk for a \$120 billion loan portfolio originated by lenders and certified development companies that have various degrees of expertise regarding SBA loan program requirements. The majority of SBA loans are originated by lenders with delegated approval authority, resulting in limited SBA oversight until a default occurs. Many lenders rely on the services of "for-fee" and other third-party agents to assist in the origination, closing, servicing, and liquidation of SBA loans. A September 2012 OIG audit found that SBA did not always recognize significant lender weaknesses. In particular, OIG found that SBA failed to consistently determine the risks that lender weaknesses posed to SBA during its onsite reviews, link the risks associated with the weaknesses to the lender's corresponding risk

¹¹ *Id.*

¹² *Id.* at 7.

ratings and assessments of operation, or require lenders to correct performance problems that could have exposed SBA to unacceptable levels of financial risk.¹³

From FY 2013 to FY 2018, SBA took steps to improve its oversight of lending participants. For example, SBA developed risk profiles and lender performance thresholds, developed a select analytical review process to allow for virtual risk-based reviews, updated its lender risk rating model to better stratify and predict risk, and conducted test reviews under the new risk-based review protocol. Moreover, OCRM revised its review methodologies for 7(a) Loan Guaranty and 504 Loan Guaranty program lenders and engaged contractor support to expand on its corrective action follow-up process. However, an ongoing OIG audit has found additional significant matters regarding SBA's oversight of lenders. The OIG anticipates issuing recommendations to address these internal control weaknesses and improve lender oversight at the end of October 2019.¹⁴

SBA Improved Portfolio Risk Management Program

A July 2013 OIG audit found that SBA had not developed an effective portfolio risk management program that monitored portfolio segments to identify risk based on default statistics. SBA continued to guarantee loans to high-risk franchises and industries without monitoring risks, and where necessary, implementing controls to mitigate those risks.¹⁵ From FY 2016 to FY 2018, SBA made substantial progress in demonstrating that information from the portfolio risk management program is used to support risk-based decisions and implementing additional controls to mitigate risks in SBA loan programs. For example, OCRM conducted portfolio analyses of problem lenders with heavy concentrations in SBA 7(a) lending and sales on the secondary market and proposed actions to mitigate SBA's exposure. In FY 2019, SBA conducted analyses on 7(a) and 504 loan program performance, which indicated that loans greater than \$2 million are beginning to show signs of declining performance. Moving forward, SBA needs to continue demonstrating that information from this program is used to support risk-based decisions and implement additional controls to mitigate risk.¹⁶

Increased Risk Introduced by Loan Agents

Prior OIG audits and investigations found that SBA did not effectively identify and track loan agent involvement in its 7(a) and 504 loan portfolios and had outdated enforcement regulations. OIG investigations also revealed a pattern of fraud by loan packagers and other fee-for agents in the 7(a) program. Since FY 2005, OIG has investigated at least 22 cases with confirmed loan fraud, totaling at least \$335 million. Loan agents were involved in approximately 15 percent of all 7(a) loans and resulted in an increased risk of default.

SBA has made substantial progress in developing effective methods to disclose and track loan agent activities on 7(a) program loans. Specifically, SBA requires lenders to provide a loan agent disclosure form (Form 159) to SBA's fiscal and transfer agent (FTA), who must enter the data into an SBA-accessible database. SBA also links Form 159 information with its loan data, although a

¹³ OIG, ADDRESSING PERFORMANCE PROBLEMS OF HIGH-RISK LENDERS REMAINS A CHALLENGE FOR THE SMALL BUSINESS ADMINISTRATION (Report No. 12-20R, 2012).

¹⁴ OIG, FY 2020 REPORT, *supra* note 3, at 8.

¹⁵ OIG, THE SBA'S PORTFOLIO RISK MANAGEMENT PROGRAM CAN BE STRENGTHENED (Report No. 13-17, 2013).

¹⁶ OIG, FY 2020 REPORT, *supra* note 3, 9.

September 2015 OIG audit identified significant issues in the data quality on Form 159.¹⁷ In the past year, the Office of Management and Budget (OMB) approved an enhanced Form 159, which was rolled out with official notification and lender training SBA's upcoming FTA contract also will require the FTA to develop controls to ensure critical fields on each form are completed. In FY 2019, OIG found that SBA implemented an effective method of disclosing and tracking loan agent involvement in SBA's 504 program by requiring lenders to electronically submit Form 159 directly into SBA's electronic lending platform and providing lender training on the enhanced Form 159.

Additionally, a March 2015 OIG audit found that outsourcing of traditional lender functions to Lender Service Providers (LSPs), a type of loan agent, has increased significantly in recent years.¹⁸ Since then, SBA began assigning an identifying number for all LSPs that access SBA's systems and records all SBA-approved LSP agreements, which has allowed OCRM to develop initial metrics on LSP participation in the 7(a) program. However, SBA's loan agent performance analysis does not aggregate LSP loan-level information in order to identify high risk LSPs.¹⁹

Challenge 5: SBA Needs to Ensure That the Section 8(a) Business Development Program Identifies and Addresses the Needs of Program Participants, Only Eligible Firms Are Admitted into the Program, and Standards for Determining Economic Disadvantage Are Justifiable

The 8(a) program was created to provide business development assistance to eligible small disadvantaged businesses seeking to compete in the American economy. 8(a) firms can receive sole source and set-aside competitive federal contracts, allowing eligible firms to avoid competing with large businesses that may have an industry advantage.

SBA Continues to Address Its Ability to Deliver an Effective 8(a) Program

After unsuccessful attempts to revamp its IT systems for monitoring 8(a) firms, SBA pursued a more comprehensive approach to service delivery through Certify.sba.gov, which is broader in scope than just the 8(a) program and includes the WOSB, HUBZone, and mentor-protégé programs. To date, SBA has implemented only limited functionalities for the 8(a) program, and it did not make progress in enhancing these functionalities since the last fiscal year. According to program officials, although the system is not fully operational, SBA has gained efficiencies by collapsing the functionality of two previous systems—E-8(a) and the Business Development Management Information System—that were used to manage the program. As of August 2019, SBA has spent over \$27 million on this system. In FY 2019, SBA decided to use certify.SBA.gov only as a certification management system. SBA now plans to develop a separate system to monitor 8(a) program participants' business development. Currently, SBA has no system to assist program officials in monitoring 8(a) participants' business development. SBA formed a team to develop a solution to this issue in FY 2020.²⁰

¹⁷ OIG, SBA NEEDS TO IMPROVE ITS OVERSIGHT OF LOAN AGENTS (Report No. 15-16, 2015).

¹⁸ OIG, IMPROVEMENT IS NEEDED IN SBA'S OVERSIGHT OF LENDER SERVICE PROVIDERS (Report No. 15-06, 2015).

¹⁹ OIG, FY 2020 REPORT, *supra* note 3, at 9-10.

²⁰ *Id.* at 11.

Streamlined Application Process May Expose the 8(a) Program to a Higher Fraud Risk

Since 2010, there has been a steady decline in the number of firms participating in the 8(a) program—from about 7,000 firms in 2010 to about 4,900 as of August 2016. In FY 2016, SBA developed a plan to increase the number of 8(a) participants by 5 percent over the previous year through a streamlined application process aimed at reducing burdens on applicants. Under this streamlined process, documents previously used to determine an applicant’s eligibility are no longer requested or are required in a modified version. As of August 2019, SBA reported that the 8(a) program included 4,450 firms, a decline of about 10 percent from April 2018.

Lessening the 8(a) review process by eliminating documents may erode core safeguards that prevented questionable firms from entering the 8(a) program. An OIG audit released in FY 2016 found that SBA did not fully document whether 30 of 48 firms reviewed were eligible for the 8(a) program.²¹ After a follow-up audit in July 2017, OIG continued to question the eligibility of 10 of these firms.²² Based on the audit, SBA added some controls to the streamlined 8(a) application process. However, SBA does not have a fully functional information system to assist the agency in monitoring whether these procedures are operating effectively. The OIG urged SBA to ensure only eligible firms are admitted into and remain in the 8(a) program, and to ensure that documentation supporting 8(a) program application approvals is maintained in a manner demonstrating clear eligibility of the applicant. This will help avoid evidentiary challenges when pursuing fraud against SBA and program participants.²³

Deficiencies in Continuing Eligibility Processes Expose the 8(a) Program to a Higher Risk of Fraud

In FY 2018, an OIG audit found SBA’s oversight insufficient to ensure that 8(a) program participants met continuing eligibility requirements. In particular, the OIG found that SBA did not consistently identify ineligible firms, always act to remove firms it determined were no longer eligible, perform required continuing eligibility reviews when it received specific and credible complaints regarding firms’ eligibility, or log all complaints. Of the 25 firms reviewed, the OIG determined that 20 firms—which received \$126.8 million in new 8(a) set-aside contract obligations in FY 2017—should have been removed from the 8(a) program.²⁴ In response, SBA drafted updates to its 8(a) program Standard Operating Procedures (SOP). SBA expects a final SOP to be implemented in early FY 2020. Until then, the OIG cautioned that ineligible firms continue to compete with and receive federal awards intended to develop disadvantaged small businesses under the 8(a) program.²⁵

Challenge 6: SBA Can Improve Its Loan Programs by Ensuring Quality Deliverables and Reducing Improper Payments at SBA Loan Operation Centers

In FY 2018, SBA’s 7(a) loan approvals reached \$25.4 billion. Most of these loans are made by lenders with delegated approval authority. When a loan goes into default, SBA conducts a review of the lender’s actions to determine whether it is appropriate to pay the lender the guaranty. For

²¹ OIG, SBA’S 8(A) BUSINESS DEVELOPMENT PROGRAM ELIGIBILITY (Report No. 16-13, 2016).

²² OIG, REASSESSMENT OF ELIGIBILITY REQUIREMENTS FOR 30 FIRMS IN SBA’S 8(A) BUSINESS DEVELOPMENT PROGRAM (Report No. 17-15, 2017).

²³ OIG, FY 2020 REPORT, *supra* note 3, at 11-12.

²⁴ OIG, IMPROVEMENTS NEEDED IN SBA’S OVERSIGHT OF 8(A) CONTINUING ELIGIBILITY PROCESSES, *supra* note 4.

²⁵ OIG, FY 2020 REPORT, *supra* note 3, at 12-13.

loans sold on the secondary market, SBA is obligated to purchase the guarantee from the investor, and it performs a review of the lender's actions after payment is made. Pursuing recovery from a lender on sold loans generally is a more difficult task for SBA.

SBA Improved Its Quality Control Program to Reduce Improper Payments

The Office of Capital Access (OCA) has made significant progress in developing and implementing a quality control program for all its loan centers to verify and document compliance with SBA's loan process. OCA has also taken actions to accurately report and reduce improper payments in SBA's 7(a) program. SBA's preliminary FY 2019 estimates indicate that the agency met its published improper payment reduction target for 7(a) loan guaranty approvals. However, the OIG did not validate this estimate, and its own preliminary results indicate that SBA did not meet its published target, although the dollar value of estimated improper payments decreased.²⁶

Improvements Needed to Ensure Quality Deliverables and Mitigate Loss

While OCA has taken actions to accurately report and reduce improper payments in SBA's 7(a) program, OIG audits have identified 7(a) loans that were ineligible, lacked repayment ability, or were not properly closed, resulting in improper payments that occurred, in part, because SBA did not adequately review the related loans. As of September 2018, under the High Risk 7(a) Loan Review Program, the OIG reviewed 27 loans with purchase amounts totaling almost \$23.2 million. The OIG recommended recoveries on 11 loans (totaling more than \$8.5 million) and identified suspicious activity on five loans (totaling nearly \$4 million), resulting in formal referrals to the Investigations Division. In response, OCA modified the production standards to allow loan specialists more time to review such loans. OCA made further improvements to its review of loans by providing training to loan specialists and updating the loan review checklist.

During FY 2019, the OIG identified material lender noncompliance in five of eight loans reviewed under the High Risk program, totaling approximately \$8.7 million in questioned costs. OCA staff completed purchase and quality control reviews on these eight loans, but they did not identify or fully address these deficiencies.²⁷

Challenge 7: SBA's Disaster Assistance Program Must Balance Competing Priorities to Deliver Timely Assistance and Reduce Improper Payments

Private Lender Programs Intended to Quickly Disburse Disaster Funds Not Implemented

The disaster loan program plays a vital role in the aftermath of disasters by providing long-term, low-interest loans to homeowners, renters, businesses, and non-profits. The Small Business Disaster Response and Loan Improvements Act of 2008 required SBA to establish three new guaranteed disaster programs using private sector lenders: the Expedited Disaster Assistance Program (EDAP), Private Disaster Assistance Program (PDAP), and Immediate Disaster Assistance Program (IDAP). Although SBA established regulations and procedures to deliver IDAP, it did not do so for EDAP or PDAP. SBA received limited responses to its solicitation for advance public comment on proposed rulemaking, most of which were opposed to the programs' implementation. Additionally, SBA's partner lenders chose not to participate.

²⁶ *Id.* at 14.

²⁷ *Id.* at 15.

Per SBA’s request, the Appropriations Act of 2018 permanently canceled the funds appropriated for IDAP and EDAP, and the Appropriations Act of 2019 repealed the statutory authority for EDAP. SBA requested rescission of IDAP and PDAP in its FY 2020 Congressional Budget Justification, and SBA officials anticipate that Congress will permanently cancel these programs in the Appropriations Act of 2020. SBA indicated that it has improved its disaster assistance delivery channel and is now better equipped to provide more timely disaster assistance. SBA also indicated that its larger unsecured disaster loan limit (\$25,000 until the end of 2019) allows more funds to be disbursed quickly following a disaster.²⁸

Express Recovery Opportunity Loan Program Not Implemented

The RISE After Disaster Act, enacted on November 25, 2015, introduced the Express Recovery Opportunity Loan (Express Recovery) program that intended to leverage private sector resources to quickly provide up to \$150,000 loans to disaster survivors. The Act required SBA to promulgate regulations for the program within 270 days, which was not done. In FY 2017, SBA concluded that the proposed program duplicates the existing Express Loan Program and could not be delivered at zero subsidy with the fee structure enacted. SBA also believes the proposed five-year disaster eligibility period would cause lenders to shift ordinary Express loans to Express Recovery loans due to the higher guarantee rate, exposing SBA to greater risk and endangering the existing program. SBA requested rescission of the Express Recovery program in its FY 2019 and FY 2020 Congressional Budget Justifications and deferred creation of program regulations. SBA plans to seek congressional support for cessation of this program.

On October 16, 2017, SBA announced the implementation of the Express Bridge Loan Pilot Program, which adopts some objectives included in the Express Recovery program without duplicating or endangering the existing SBA program. The pilot program provides a streamlined approach to get emergency financial relief of up to \$25,000 to small businesses in Presidentially declared disaster areas. SBA is running the pilot program for three years, from October 16, 2017 through September 20, 2020. As of August 13, 2019, SBA has approved or disbursed only two loans under this program.²⁹

Increased Maximum Acceptable Fixed Debt Threshold May Limit Borrower’s Ability to Repay Disaster Loans

SBA uses the fixed-debt method to determine disaster home-loan affordability, which assumes there is a debt threshold—the “maximum acceptable fixed debt” (MAFD)—beyond which loans become unaffordable and likely to default. A November 2012 policy memorandum, later incorporated into SOP 50 30 8 issued in July 2015, raised MAFD to 50 percent for incomes of \$60,000 and above, and diminished the level of authorization required to approve loans not conforming to the established MAFD percentages. On May 31, 2018, the Office of Disaster Assistance (ODA) issued SOP 50 30 9, increasing MAFD to 75 percent for all income levels without the need to provide justification. ODA now considers credit score and income as the primary factors to determine repayment ability. When ODA is unable to decide based on these factors, ODA will use a debt-to-income calculation, allowing up to 75 percent.

²⁸ *Id.* at 16-17.

²⁹ *Id.* at 17.

Data for FY 2019 indicates a 27 percent increase in SBA’s charge-off rate—up from 3.01 percent in FY 2018 to 3.84 percent in FY 2019. The OIG also found that this policy change contributed to a significant increase in the percentage of approved borrowers with a MAFD over 50 percent. The OIG intends to perform a review of this policy change on the default rate once the loans have sufficient time to perform.³⁰

Reserve Staff Require Training to Sustain Productivity During Mobilization

During large-scale disasters, such as Hurricanes Sandy and Harvey, SBA must bring on new loan officers and loss verifiers to match the volume of loan applications and prevent processing backlogs. For instance, in response to Hurricanes Harvey, Irma, and Maria, ODA increased trained staff from 800 to its peak of 5,094 on December 13, 2017. On May 31, 2018, ODA completed an After Action Report on Hurricanes Harvey, Irma, and Maria. As a result, ODA launched a cross-functional Training Plan Development Team that is developing core training modules, as well as online and automated tutorials.³¹

Improper Payment Rate Was Reduced to Compliant Level

SBA’s improper payment rate for the Disaster Direct Loan program disbursements decreased from 13.65 percent (\$123.38 million) in FY 2017 to 8.91 percent (\$274.4 million) in FY 2018. However, the OIG noted that ODA eased controls for one of the root causes attributed to the reported improper payment rate being above the acceptable threshold for FY 2017. The OIG is currently conducting an audit of the improper payment quality control process.³²

Inadequate Verification of Cause and Extent of Damages

A critical part of the disaster-loan-making process is evaluating the cause and extent of property damages so SBA may make appropriate decisions regarding disaster-loan eligibility. Previously, loss verifiers conducted only on-site inspections to assess damages. On January 31, 2017, ODA issued Memo 17-06, Desktop Verifications. The desktop loss verification process allows loss verifiers to estimate the cost of repairs through phone interviews with the applicant in conjunction with third-party information, such as Google Earth, Zillow, and tax assessors’ websites. After this initial desktop loss verification, SBA requires a post-desktop review to validate total damage estimates. The desktop loss verification process contributed to SBA meeting its timeliness goals for processing disaster loan applications after Hurricanes Harvey, Irma, and Maria.

However, controls need strengthening to mitigate the risk of fraud and ensure program integrity. In a September 2019 audit, the OIG found that SBA disbursed 36,869 of the 73,313 loans reviewed—totaling over \$594 million—without validating the cause, extent, or cost of damages, and without ensuring that the loans were provided only to individuals impacted by Hurricanes Harvey, Irma, or Maria.³³ SBA management plans to explore substitutes to the post-desktop review and implement additional controls that require loss verifiers to provide sufficient documentation to support the post-desktop review conclusions.³⁴

³⁰ *Id.* at 18.

³¹ *Id.* at 19.

³² *Id.*

³³ OIG, AUDIT OF SBA’S DESKTOP LOSS VERIFICATION PROCESS (Report No. 19-23, 2019).

³⁴ OIG, FY 2020 REPORT, *supra* note 3, at 19-20.

Challenge 8: SBA Needs Robust Oversight of Its Grant Management

In FY 2020, SBA budgeted \$180 million in grants and cooperative agreements to its resource partners and other nonfederal entities to provide technical assistance and training programs to develop small businesses. The OIG previously identified systemic issues with SBA's accuracy of grant data for both financial and performance reporting, ineffective oversight, and inadequate SOPs. The OIG continues to identify grant-management deficiencies in its recent reviews of SBA grant programs.

SBA Has Made Progress to Address Its Grant Management Issues

In FY 2019, SBA conducted an analysis of its organizational structure and determined that it needed to centralize its oversight of SBA grant management. On September 24, 2019, SBA issued its revised SOP for grants management, which standardized policies related to grants awarded by SBA and established the Office of Grants Management as the authority for oversight and compliance of SBA grant policy.³⁵

Grants Management System

SBA continues to rely on its current grant management system to report on its grant programs. A March 2018 OIG advisory memorandum noted that an independent consulting firm found that 64 of the 72 randomly selected grant transactions had inaccuracies reported in USASpending.gov.³⁶ An internal SBA review on the grant management process found that 100 percent of the sampled transactions contained inaccuracies. During FY 2019, SBA approved \$2.5 million in funding (over five years) to modernize its grants management system. SBA recently entered into an interagency agreement with the Office of Health and Human Services to provide transition analysis, infrastructure setup, and training services as SBA transitions to this system, which SBA plans to fully implement by October 2020.³⁷

Conclusion

The OIG's top management challenges process is an important tool that assists the SBA in prioritizing its efforts to improve program performance and enhance its operations. Of the 25 challenge areas identified in both the FY 2019 and FY 2020 reports, the OIG found that SBA either "fully implemented" or made "substantial progress" in 23 of these areas. At the same time, the OIG concluded that SBA faces significant risks in loan program oversight and controls, oversight of its statutory programs to promote small business development and government contracting, and deploying IT and related cybersecurity controls. Members will have an opportunity to explore these and other significant challenges facing the agency and discuss the OIG's recommendations.

³⁵ OIG, FY 2020 REPORT, *supra* note 3, at 21.

³⁶ OIG, FINAL ADVISORY MEMORANDUM, IMPROVEMENT NEEDED IN THE ACCURACY OF SBA DATA REPORTED ON USASPENDING.GOV (Report No. 18-15, 2018).

³⁷ OIG, FY 2020 REPORT, *supra* note 3, at 21-22.