S. HRG. 112–892

AN EXAMINATION OF SBA PROGRAMS: ELIMINATING INEFFICIENCIES, DUPLICATIONS, FRAUD, AND ABUSE

HEARING

BEFORE THE

COMMITTEE ON SMALL BUSINESS AND ENTREPRENEURSHIP UNITED STATES SENATE

ONE HUNDRED TWELFTH CONGRESS

FIRST SESSION

JUNE 16, 2011

Printed for the Committee on Small Business and Entrepreneurship

Available via the World Wide Web: http://www.fdsys.gov

U.S. GOVERNMENT PRINTING OFFICE

88–373 PDF WASHINGTON : 2014

For sale by the Superintendent of Documents, U.S. Government Printing Office
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AN EXAMINATION OF SBA PROGRAMS: ELIMINATING INEFFICIENCIES, DUPLICATIONS, FRAUD, AND ABUSE

THURSDAY, JUNE 16, 2011

UNITED STATES SENATE,
COMMITTEE ON SMALL BUSINESS
AND ENTREPRENEURSHIP,
Washington, DC.

The committee met, pursuant to notice, at 10:05 a.m., in Room SR–428A, Russell Senate Office Building, Hon. Mary L. Landrieu (Chair of the committee) presiding.

Present: Senators Landrieu, Pryor, Snowe, Risch, Paul, and Brown.

OPENING STATEMENT OF HON. MARY L. LANDRIEU, CHAIR, AND A U.S. SENATOR FROM LOUISIANA

Chair LANDRIEU. Good morning. I would like to call the Small Business meeting to order. The purpose of our meeting this morning is to review duplication, inefficiencies, fraud, abuse, and exploitation in programs run by the Small Business Administration. I want to thank Administrator Mills and Peggy Gustafson for being with us this morning, and we are looking forward to a second panel as well.

I thank you for joining us today. I, along with members of this Committee, have made it a priority to ensure that all SBA programs are running efficiently, effectively, and free of exploitation. In a December 2010 letter to SBA Administrator Karen Mills, Ranking Member Snowe and I expressed our deep concern with the allegations of some fraud and abuse in small business contracting programs, as highlighted by recent Washington Post articles—there were two that I am going to submit for the record—and GAO reports that I will also submit for the record.

I would like my staff to present the document that we are working off of. This is a review of the last 5 years of all of the reports done by GAO and the Inspector General. We have reviewed these reports, we have summarized these reports, and we are going to submit them. Of course, they are already part of the record, but we will refer to them today, if necessary.

The Washington Post

Small-business contracts under scrutiny from several federal agencies

By Robert O'Harrow Jr.
Washington Post Staff Writer
Thursday, December 9, 2010; 8:40 PM

A half-dozen federal agencies are looking into alleged abuses of small-business contracts, some involving Alaska native corporations that have received hundreds of millions of dollars in recent years under special set-aside rules.

Contracting specialists and government officials said the flurry of enforcement efforts signals a shift toward more oversight of contracts by the Obama administration in the wake of reports about questionable contracting practices. "This is a warning to everybody," said Stan Soloway, president and chief executive of the Professional Services Council, a national trade group of government contractors. "Clearly, there is a signal here."

Daniel Gordon, administrator of the White House Office of Federal Procurement Policy, said the administration supports set-aside contracts for small business and Alaska native corporations, or ANCs, but only with sufficient oversight. "We can only do that if the public . . . are confident that we are protecting those programs from fraud," Gordon said. "The days of 'No one is checking' are over. For too long, there was inadequate oversight."

The government requires agencies to devote about a quarter of procurement spending to small businesses - almost $100 billion last year. In some cases, though, small firms and ANCs allegedly have operated as fronts to pass on work and revenues to traditional companies, in violation of small-business rules.

In September, President Obama signed legislation that provides billions in new loan guarantees and other support for small businesses, with the aim of helping spur job growth and stimulating the flagging economy.

The surge in enforcement follows an unprecedented action by the Small Business Administration in October to suspend a large contractor, GTSI, from all government business. The SBA said it had evidence that GTSI had used two small firms to illegally get work from a $3 billion contracting program at the Department of Homeland Security.

Those measures came after The Washington Post detailed the relationships between the companies in a series of articles that began in September. The series has focused on abuses in the government's small-business programs for Alaska native corporations, subsidiaries of which have received more than $29 billion in contracts over the past decade.

Among the recent enforcement and oversight efforts:

l Justice Department civil enforcement authorities are considering how to recover money from firms involved in questioned small-business contracts. The companies under scrutiny include GTSI and the two firms it worked with - EG Solutions and MultimaxArray Firstsource, according to people with knowledge of the inquiry.

In a statement, the U.S. Attorney's Office in the District said the department is working with the SBA on civil fraud cases, but it declined to identify the companies it is reviewing.

"The U.S. attorney's office is committed to working with SBA and inspectors general to examine whether the United States may be entitled to monetary damages and penalties from companies that abuse the small business contracting rules," the statement said.

l Senior procurement officials at the Department of Homeland Security have launched a "comprehensive review" of the agency's small-business contracting program, known as First Source. Officials plan to examine whether the businesses are doing the proper amount of work themselves and not handing it off to subcontractors, according to a DHS e-mail obtained by The Post.

"In light of the recent SBA's suspensions and The Washington Post article regarding abuses in the First Source program, DHS intends to undertake a comprehensive review of all 11 First Source contracts to ensure that the program can continue forward without further risk or abuse," the e-mail said.

In a statement, a DHS spokesman said the agency "takes very seriously the issues that resulted in the recent SBA suspensions of two of the First Source contractors."

l The Army Criminal Investigation Command and the Defense Criminal Investigative Service have joined with the Interior Department Inspector General's Office to examine a $250 million Army contract given to an inexperienced Alaska native corporation subsidiary, United Solutions and Services (US2).

That investigation came after The Post reported that the subsidiary received the large contract without competition, even though it could not do the work itself. Army officials said they used the company to avoid a contracting competition. They also said they knew that the firm was not doing at least half the work during much of the contract period, something that is required under SBA rules.

A spokesman for US2 said the firm "is confident that any review of this kind will show that the company and government agencies acted properly and responsibly. US2 will fully cooperate with any such inquiry in this matter."

l The SBA Inspector General's Office also is investigating First Source contractors that SBA officials said "entered in a relationship with a subcontractor in order to defraud the government."

The SBA is continuing to examine GTSI, even though the suspension of the company was lifted, officials said. As part of an agreement with the SBA to resume contracting, two senior GTSI executives resigned, and three others were suspended until the probe is complete.

SBA officials later also suspended the two small businesses that worked with GTSI, EG Solutions and MultimaxArray. In suspension letters to the companies, the SBA said it has evidence that the firms worked with a large company to "defraud the Government."

Eyak Corp., the parent of EG Solutions, said in a statement that the firm is working with the SBA "to demonstrate its compliance with all relevant SBA regulations in an effort to lift the suspension and restore the company's good standing. We are not aware of the status of any U.S. Attorney's Office investigation but will certainly fully cooperate with any such inquiry.

"We will also work with DHS to ensure that the First Source program will continue to operate in the highly ethical manner EG Solutions adheres to."

A spokesman for GTSI declined to comment on recent developments. An executive at MultimaxArray did not respond to inquiries.

Lars Anderson, a contracting attorney who represents a First Source contractor who raised questions about GTSI to Homeland Security officials, said there "appears to be a bellwether shift in enforcement" by the SBA and other agencies.

"I believe that this recent SBA action represents the start of a crackdown on the widespread abuses of programs meant to assist small businesses, and it is long overdue," Anderson said.

Soloway, the trade group president, said he does not believe the problems are endemic. He said some of them stem from confusion about the government's complex small-business rules - by contractors and government regulators alike. He said the enforcement efforts present an opportunity to clarify the regulations. "We need to be looking at the laws," he said. "It becomes a learning moment as well as a legal moment."

The Washington Post

SBA suspends major contractor GTSI from government work

By Robert O'Harrow Jr.
Washington Post Staff Writer
Friday, October 1, 2010; 11:17 PM

Federal officials on Friday suspended one of the nation's largest government contractors from receiving new work, alleging that the Northern Virginia company inappropriately went through other firms to gain access to contracts set aside for small companies.

The U.S. Small Business Administration's action imperils hundreds of millions of dollars in revenue for GTSI Corp., a top-50 contractor that has relied on the Pentagon and the rest of the federal government for more than 90 percent of its sales in recent years.

At issue is work GTSI did as a subcontractor for small businesses serving as the prime contractors on government contracts.

"There is evidence that GTSI's prime contractors had little to no involvement in the performance of contracts, in direct contravention of all applicable laws and regulations regarding the award of small business contracts," an SBA official wrote in a letter to GTSI's chief executive, Scott W. Friedlander. "The evidence shows that GTSI was an active participant in a scheme that resulted in contracts set-aside for small businesses being awarded to ineligible contractors."

In an "open letter" to employees, customers, partners and investors Friday night, Friedlander said, "Until tonight, no government agency had made an allegation that GTSI had violated any law or regulations regarding this matter." He said that the company looks forward "to providing you with a report on our activities as the situation warrants" and that "we appreciate your support during this time." He added: "Please be assured that we will fight to restore our good name."

The temporary suspension is one of the strongest contracting enforcement steps taken by the government in recent memory. GTSI can challenge the action, which could lead to a longer-lasting ban from government work, contracting specialists said.

"It's the first time in decades that the government has completely suspended a significant player, a legitimate top-tier contractor," said Steven Schooner, a contracting law professor at George Washington University. "It puts everybody on notice."

The move follows an internal SBA examination of GTSI activity over the past few years. It comes after a Washington Post investigation that detailed the relationship between GTSI and three small businesses, two of them entities known as Alaska native corporations.

The Post story cited an internal GTSI e-mail in which a company vice president said one of its small-business partners was "very open to the concept of GTSI doing ALL the work" on a contract. Another document cited in the story called for GTSI to receive 99.5 percent of the revenue, even though it was a subcontractor to a small business.

The SBA suspension is based in part on those documents and The Post's findings, officials said.

"The Small Business Administration has no tolerance for fraud, waste and abuse in any of our programs," said SBA Administrator Karen G. Mills in a statement. "This action is based on information the agency has compiled regarding GTSI's business practices."

Among other allegations, the SBA said that GTSI used e-mail addresses of small businesses "so that employees of GTSI could appear to be employees" of those companies while doing government work.

Behind the SBA's inquiry are long-simmering suspicions that large businesses have been able to gain access to billions in deals that were meant to provide a boost to the nation's small companies. Officials have worried that increasingly large contracts awarded in recent years through small-business programs - oftentimes without competition - are paradoxically crowding out actual small businesses from federal work.

The Pentagon and a wide array of federal agencies have used such deals because they save time and enable the agencies to meet government policy targets for small-business contracts.

GTSI was founded in 1983. Operating in Herndon, it has experienced substantial growth largely as a result of federal contracts. It reported revenue of $762 million last year from the sale of a variety of information technology products and a variety of services. The company said it had 615 employees, according to its most recent annual report.

GTSI was ranked 49th on trade magazine Washington Technology's list of Top 100 government contractors last year.

Despite its growth, GTSI has for years maintained a small-business status on some older contracts under federal rules. But the company anticipated losing direct access to set-aside deals as a consequence of its growth. Several years ago, the company disclosed a plan to "mitigate any potential adverse affect on our sales from the loss of our small business status" by developing "strategic relationships with small businesses that benefit from the small business benefits," according to a filing with the SEC.

One relationship was with EyakTek, an Alaska native corporation. EyakTek's parent, Eyak Corp., and GTSI founded the company in 2002. Eyak received 51 percent ownership, while GTSI received 37 percent. As an Alaska native corporation, EyakTek has special contracting privileges, including the right to receive contracts of any size without competition.

In 2006, EyakTek and GTSI formed another subsidiary called EG Solutions, which was among 11 companies chosen to provide equipment and services to the Department of Homeland

Security through a $3 billion contracting program called First Source. GTSI also worked as a subcontractor for MultimaxArray FirstSource, another small business in the program. The department First Source's contracts are cited in the SBA notice of suspension letter.

federaltimes.com

SBA suspends two firms alleging contracting abuse

By SEAN REILLY
November 19, 2010

Two more Washington-area firms have been suspended from new federal business in connection with alleged abuse of small business set-aside rules on a Department of Homeland Security information technology contracting program.

In similar letters Thursday to EG Solutions and MultimaxArray FirstSource, the Small Business Administration wrote that there is "adequate evidence" establishing that both firms "committed fraud or a criminal offense in obtaining and attempting to obtain contracts."

The SBA's inspector general is investigating, according to the letters, signed by Michael Chodos, the SBA's suspension and debarment official. The two firms have 30 days to respond.

EG Solutions, based in Dulles, Va., is a subsidiary of Eyak Corp., an Alaska native corporation eligible for special treatment under government procurement rules. MultimaxArray FirstSource, headquartered in Greenbelt, Md., is a joint venture between Harris Corp. and Array Information Technology. Both were mentioned in a Washington Post series into small-business contracting earlier this year. The suspensions affect only their ability to compete for future federal business, not work on existing government contracts, a SBA spokeswoman confirmed.

In a statement posted on its website, Eyak Corp. said the company and its subsidiaries "take seriously the obligation to provide the federal government with quality contracting services in an ethical and responsible manner."

At MultimaxArray FirstSource, program manager Brian Leung said in an e-mail that the company's actions were appropriate, and it intends to fully cooperate with the SBA investigation.

SBA's latest move appears to be part of the same investigation that last month led the agency to suspend Herndon, Va.-based GTSI Corp., which has served as a subcontractor to both companies on the $3 billion DHS FirstSource program. While the SBA letters do not mention GTSI by name, Chodos wrote that evidence shows that both EG Solutions and MultimaxArray FirstSource "entered in a relationship with a subcontractor in order to defraud the government."

The government had essentially accused GTSI of using other firms as fronts to get the DHS set-aside business, while attempting to hide the extent of its involvement as a subcontractor. The Oct.1 suspension was lifted after 2½ weeks as part of a settlement that saw two top GTSI executives step down and three others placed on indefinite paid suspensions. Soon after, the company was named one of the winners on an eight-year FBI information technology contract, according to a corporate news release.

Chair LANDRIEU. We requested that Administrator Mills provide this Committee with a detailed plan for addressing and rectifying some of the problems that have been brought to her for her review. We are looking forward to that report this morning.

In addition, in subsequent letters Administrator Mills and SBA Inspector General Peg Gustafson were asked to make recommendations for eliminating or substantially reducing programs within the SBA that were duplicative, ineffective, or redundant. I will report this morning that, as a result of at least the initial review, two programs—Community Express and the Coverdell Drug-Free Workplace Program—have been or are in the process of being eliminated.

We are here today to further examine actions that can be taken to reduce or eliminate inefficiency or fraud or abusive operations. Even as we take on this task, we must be careful to act in a manner that does not undermine the SBA's ability to serve the needs of the 26 million small businesses in our country that are the backbone of our economy and counting on the SBA to do its job and do its job well.

On Panel 2 we will hear testimony from representatives from the GAO, the American Small Business League, the National Association of Government Guaranteed Lenders, the Cato Institute, and the Women's Business Development Council in Stamford, Connecticut, that will add their voice to this debate.

I welcome an opening statement by Ranking Member Snowe and look forward to hearing the testimony today.

OPENING STATEMENT OF HON. OLYMPIA J. SNOWE, A U.S. SENATOR FROM MAINE

Senator SNOWE. Thank you, Chair Landrieu, for holding this critical hearing to assess and to analyze inefficiencies, duplication, waste, fraud, and abuse in the programs of the Small Business Administration. Clearly more can and must be done to eliminate these obstacles that prevent the agency from reaching its full potential. We are fortunate today to have with us the SBA Administrator, Karen Mills, who is truly on the front lines of this issue. Administrator Mills has shown strong and outstanding leadership by putting a framework in place to help prevent illegitimate firms from siphoning away contracts from rightful small businesses trying to compete for Government contracts.

Additionally, on the first panel we have Inspector General Peggy Gustafson, whose testimony in March provided this Committee valuable insight and recommendations for the SBA in the area of procurement fraud, and we appreciate our second panel of witnesses representing the Government Accountability Office and the small business community. We are anxious to hear everyone's suggestions for streamlining programs and efforts while reducing fraud and improving the agency's effectiveness.

There cannot be any clearer impetus for us to find ways to eliminate inefficiencies, duplication, and waste across the Government than the current economic crisis. Our national debt will reach 100 percent of GDP by the end of 2011.

The bottom line is that our Nation's revenues and spending are vastly misaligned. We cannot and must not finance operating expenses with perpetual deficits. It is through this lens that we must examine every taxpayer dollar our Government spends and utilize our Nation's small businesses to spur private sector job growth.

Today's hearing is truly a piece of a much larger puzzle. Congress has been reviewing a 345-page report issued in March from the GAO that outlines Federal programs, agency offices, and initiatives with duplicative goals and activities. As revealed by this report, there is no shortage of waste to identify.

What is so remarkable about these efforts is that the Federal government could cut spending without eliminating programs it services by simply implementing solutions such as sharing resources or collaborating among departments. For instance, the GAO report exposed massive duplication throughout our Government, such as 80 economic development programs across four Federal agencies, including the SBA, which administers 19 of the programs. Of those programs, the GAO identified that 52 either exclusively or in part address entrepreneurial efforts. The total 2010 funding for these 80 programs alone amounted to $6.5 billion.

While I am eager to hear the SBA's response to the GAO report, I also would want to know what changes the SBA is actively considering as it reviews all of its programs for replication, such as working with other agencies to consolidate programs and resources to help eliminate duplication.

To date, the SBA has taken some modest first steps with regard to streamlining or eliminating programs. Last January the Chair and I sent a letter to Administrator Mills and Inspector General Gustafson soliciting their insight as to how the agency recommends eliminating wasteful spending, and I want to thank the Inspector General for her in-depth response.

I know the SBA has responded by deferring to the President's fiscal year 2012 budget request which proposed eliminating the Prime Technical Assistance Program, the Drug-Free Workplace Program, and several special purposes counseling grants for the Small Business Development Center Program. I hope that we can be able to do more in that category.

In addition, today's discussion of making the agency more efficient will also explore efforts to eliminate fraud and abuse in any of the SBA's programs. Our Committee held a March hearing to discuss steps to remedy the findings of the recent GAO reports that revealed 14 ineligible firms receiving $325 million sole-source contracts and set-aside contracts, even though these firms were not eligible for the 8(a) program to begin with. At my request the SBA sent two letters outlining actions taken against these 14 firms, as well as creating a special task force focused on strengthening enforcement actions. I appreciate the timely and comprehensive response Administrator Mills provided my office and believe these administrative changes present additional deterrence to those who perpetuate fraud against the Government.

It is our duty in Congress to provide the statutory tools necessary to create additional deterrence against fraud. That is why I recently introduced, together with Chair Landrieu and a number of my colleagues on this Committee, the Small Business Contracting Fraud Prevention Act to bolster fraud prevention at the SBA. This bill includes provisions specifying damages sustained by the Government in cases of fraud, aims to standardize the certification processes, and increases transparency when the Government takes enforcement actions against such firms.

Simply put, we must remain vigilant in assuring that all of the SBA's contracting programs are running efficiently, effectively, and free of exploitation.

Additionally, collaboration must extend to other agencies such as the Department of Justice for enforcement of punishment of any bad actors found to be fraudulent. This week I sent a letter along with Senator Grassley, the Ranking Member of the Judiciary Committee, to the Attorney General inquiring why the Department of Justice is declining to prosecute cases that were referred from the SBA's Inspector General, including 20 cases since October of 2010 to March. In any event, we know that strong punitive actions and strong enforcement will result in, I think, a very strong deterrent, and that is what we have to accomplish as well.

So I am hopeful that we will hear from our witnesses here today about how best we can do that in identifying all the waste and inefficiencies that may continue to exist and also to implement many of the ideas that the GAO has recommended.

Thank you, Madam Chair.

Chair LANDRIEU. Thank you.

Senator Paul.

OPENING STATEMENT OF HON. RAND PAUL, A U.S. SENATOR FROM KENTUCKY

Senator PAUL. Thank you. Thank you, Chair Landrieu and Senator Snowe for allowing me to participate and to bring a witness from the free market think tank of Cato today. I am happy to be here.

I was pleased last night to meet Ms. Mills, and we had a great conversation, and I hope we get to continue that today in public.

As I told Ms. Mills last evening when we met, I am a great believer in the free market, and the thing about the free marketplace and capitalism in general is it is a place where you have voluntary interaction and people get to vote every day. So in the marketplace, people vote with their dollars, with their loans. Everybody gets to vote and everybody gets to choose, so it is really about choice.

And to me, whether the Government makes the loans or the private marketplace makes the loans, it is really about choice, and it is whether or not we are going to say that our choice is somehow superior to the market's choice.

As Ms. Mills told me, she thinks that there is market failure, and I will let her describe that when we get to that.

The problem I think I have with that, with saying that the market fails in giving loans is that you basically are bringing your opinion to bear to say that the market is failing. It could be that the market is just choosing other people that you would rather choose, you know, certain people to get a loan and the market is choosing other people to get a loan.

Frederic Bastiat was a philosopher back in the 19th century and a French parliamentarian, and he wrote several books, and he was a critic of mercantilism and protectionism. But one of the things he talked about, that he is famous for talking about, is the seen and the unseen. The seen is very easy. We can show a small business loan, and we can say Mr. Smith got this loan and look at this bright, shiny new building that he has built and how good this is and how he created these jobs. But the unseen is the money came from somewhere. You know, he had to either tax somebody or he had to borrow it. There are costs to Government loans. But basically really what you have done is you have changed who gets to choose—private individuals choosing where the money goes or Government, select Government.

And then there is the possibility that the loans end up going to your friends or your contributors, and I am not saying anything about this Administration or anyone, but there is the potential for Government abuse where the loans go to friends and go to maybe windmills because we like windmills better than coal companies or certain people might make those decisions. There is possibility for politicization of the loans.

But the unseen is where the person who did not get the loan because the loan was distributed by the Government, that money is taken out of the marketplace, and that money would have gone to someone else. So I do not think it is enough to argue that we have these great multipliers. Everybody argues this. You know, every business organization says, "Oh, we created this one job with this small business loan, and it created ten other jobs." Well, so do all jobs that are created. I mean, that just means that you have created it, but the private marketplace may have delegated or designated the money to go somewhere else, and it would have the same multipliers of employing other people. The main difference is that a private loan would have gone to—basically the decision is democratic capitalism. We all vote every day on where those loans go.

And so I would just make a pitch and like to have the viewpoint known that there are people who believe that the marketplace and individuals should freely interact and make the decision where loans go and that really Government should not be in this business at all.

Thank you.

Chair LANDRIEU. Thank you so much.

Ms. Mills.

STATEMENT OF HON. KAREN GORDON MILLS, ADMINISTRATOR, U.S. SMALL BUSINESS ADMINISTRATION

Ms. MILLS. Well, thank you very much, Chair Landrieu and Ranking Member Snowe and members of the Committee, Senator Paul. Thank you for inviting me to testify today. Half of the people who work in America own or work for a small business. That is 26 million small businesses. And as you all know, two out of every three jobs are created by small business.

Over the past 2 critical years, the SBA has helped put $53 billion in lending support and $195 billion in Federal contracts in the hands of these small businesses. And at the same time, we have counseled and trained and mentored over 2 million Americans who have turned to us to start or grow their business. We have also delivered on our promises, such as this Committee's request to reinvent SBA's website, and we launched it in January. So far it has attracted over 3 million unique users in just 6 months.

Our focus remains twofold: number one, to deliver proven tools directly into the hands of small businesses; and, number two, to give taxpayers strong oversight of their dollars and the best possible bang for their buck.

We do this across our 3 Cs—capital, counseling, and contracts—and I am going to touch briefly on the latter two.

Often, the first interaction a small business has with the Federal government is with our field offices and counseling partners. We are the front door.

Let us say you walk into the Tacoma Business Center in Washington State. If you have a simple business idea, you will be referred to the Tacoma SCORE chapter to help you flesh it out and test its feasibility. Nationwide, 12,000 SCORE volunteers helped 400,000 people last year, three-fourths of whom were just starting out, and the cost of all of that program is $7 million.

If you had a home-based small enterprise already running, but you needed more guidance, the Tacoma Women's Business Center would be your best bet. Nationwide, 110 Women's Business Centers served over 160,000 clients last year, with a budget of just $14 million because of public-private partnerships. They are strategically located in easy-to-access, underserved areas.

And maybe you had an established business that needed help with commercialization or exports. You would be referred to our Small Business Development Center. Nationwide, we have about 900 SBDCs, often located at universities and community colleges. They helped nearly 600,000 clients last year, about half of which were established businesses. The cost was about $110 million.

As Administrator, I have been all around the country. I have been to 34 states over the past 2 years, and I visited with these resource partners and small businesses in every area.

This is our bone structure. Our doors are open to small businesses in the places where they live and work. That is important because our data shows that long-term counseling leads to better sales and more longevity. We leverage this bone structure to collaborate, as Senator Snowe described, across the Federal government with the Veterans Administration to serve veteran small business owners, by cross-training our people with the Department of Agriculture in serving rural business, with the Department of Commerce to serve small exporters, and with many other Federal partners.

Finally, we remain, as you described, strongly committed to oversight of taxpayers' dollars. I committed to this Committee to get aggressive on fraud, waste, and abuse, and I committed to remove fraud, waste, and abuse in our contracting with a three-pronged approach.

First, up-front certification. We now have much stronger requirements for 8(a) and HUBZone applicants.

Second, with continued surveillance and monitoring. For instance, we made a dramatic increase in the site visits in our HUBZone. Six months before I came, we had done seven site visits. In the last year, we have done 1,200.

And, finally, with aggressive pursuit of misconduct. We have removed many firms, suspended, or proposed for debarment dozens of bad actors.

As the front door for small business seeking help in any industry at any stage of growth, we will continue to ensure that the benefits of all SBA programs flow directly to small businesses so that they can do what they do best: create jobs.

Thank you. I look forward to your questions.

[The prepared statement of Ms. Mills follows:]

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

TESTIMONY OF KAREN G. MILLS
ADMINISTRATOR
U.S. SMALL BUSINESS ADMINISTRATION
BEFORE THE
U.S. SENATE SMALL BUSINESS COMMITTEE
JUNE 16, 2011

Chair Landrieu, Ranking Member Snowe and members of the Committee. Thank you for inviting me to testify on this important topic. Half of America's workforce is in our 26 million small businesses. They create two of every three jobs.

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If you have just a business idea, you'll immediately be referred to the Tacoma SCORE chapter to help you flesh it out and test its feasibility. Nationwide, these 12,000 volunteers helped 400,000 people last year, about three-fourths of whom were just starting out, at a cost of just $7 million in federal funding.

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Or maybe you had an established business that needed help with exporting or commercialization. You would be referred to a nearby Small Business Development Center. Nationwide, we have about 900 SBDCs, often co-located at universities and community colleges. They helped nearly 600,000 clients last year, nearly half of which were established businesses, on a federal budget of about $110 million.

As Administrator, I've been to 33 states over the past 2 years. In each place, I meet with small businesses, lenders, and our resource partners.

We have a strong bone structure, with a counselor within an hour of most small businesses. That's important for several reasons:

- Our "front door" needs to be open for them in the places where they live and work.
- Data shows that long-term counseling relationships result in better sales, more longevity, and more hires.
- We leverage this bone structure to collaborate across government: with the VA to serve our veterans who own small businesses... with USDA to serve rural small businesses... and with the Department of Commerce to serve small exporters... and many others. We also recently announced an unprecedented collaboration among 16 agencies to accelerate job growth through a Jobs and Innovation Accelerator Challenge.

Also, these counseling partnerships leverage $130 million each year from state and nonprofit organizations, giving us a good bang for the federal buck. The result is a strong, integrated, collaborative approach to meeting the needs of small business in each community.

Additionally, we remain strongly committed to oversight of taxpayer dollars. As I committed to this Committee, we are removing waste, fraud and abuse in contracting programs through a 3-pronged approach.

First, we are ensuring that there are effective certification processes on the front-end to make sure only qualified, eligible firms participate in our programs. For example, if a firm would like to participate in the 8(a) or HUBZone Programs, it must be certified by SBA through an application process. For both programs, we have recently improved the certification processes to better ensure only eligible firms gain entry.

Second, we're conducting continued surveillance and monitoring on firms once they are in our programs. This confirms that only eligible firms have been certified, and identifies firms whose eligibility may have lapsed since certification. We have ramped up our efforts in this stage. For example, in the HUBZone program, we increased the number of site visits conducted from less than 10 in the six months before I arrived to over 1,200 in fiscal year 2010.

Third, we are taking robust and timely enforcement actions on any non-compliant or fraudulent firms. Over the past two years, we have removed many firms from our HUBZone, 8(a) and service-disabled veteran-owned contracting programs. We have also suspended or proposed for debarment dozens of firms and individuals involved in procurement misconduct. Every firm that the GAO or Inspector General has referred to us has been investigated or is in the process of being investigated.

Two additional efforts are key to combating fraud, waste and abuse:

The first is the implementation of the Small Business Jobs Act and Interagency Task Force on Federal Contracting Opportunities for Small Businesses. Some key highlights include requiring annual certification of a firm's size and status and strengthening the skills of the acquisition workforce by requiring training on small business contracting.

The second effort is the SBA's Suspension & Debarment Task Force. We recently assembled this Task Force, which is chaired by our General Counsel, to work closely with each SBA program office and with the Agency's Inspector General to identify bad actors, vigorously pursue them, and expel them from further government business.

As the portal for small businesses seeking help in any industry and at any stage of growth, we will continue to ensure that the benefits of all SBA programs flow directly to small businesses so that they can do what they do best: create jobs.

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Karen G. Mills

Karen Gordon Mills was sworn in April 6, 2009, as the 23rd Administrator of the U.S. Small Business Administration after being appointed by President Barack Obama and unanimously confirmed by the U.S. Senate.

She leads a team of 3,000 employees whose mission is to help entrepreneurs and small business owners grow and create jobs by providing greater access to capital, counseling, federal contracting opportunities, disaster assistance and more. Among its priorities, the SBA has a portfolio of more than $90 billion in loan guarantees. Each year, the agency helps leverage nearly $100 billion in federal contracts to small businesses and supports free counseling and technical assistance to more than 1 million entrepreneurs. In addition, SBA provides disaster assistance to homeowners, renters, and businesses with the help of 2,000 additional on-call employees.

Throughout her career, Mills has owned, managed, mentored, and invested in small and growing businesses across the country.

As an investor and owner, she helped several small manufacturers improve their competitiveness and ultimately survive the downturn of the early 1990s. This included producers of hardwood flooring, refrigerator motor manufacturers, plastic injection molding companies, and more. More recently, she was President of the MMP Group, which invested and grew businesses in sectors such as consumer products, food, textiles, and industrial components.

In 2007, Maine Gov. John Baldacci appointed Mills to chair the state's Council on Competitiveness and the Economy, where she focused on attracting investment in rural and regional development initiatives, including a regional economic cluster with Maine's boatbuilding industry. She also served on the Governor's Council for the Redevelopment of the Brunswick Naval Air Station.

In her current position, Mills has helped expand access to capital through SBA lending, increase small business' share of federal contracts, strengthen SBA's network of more than 14,000 affiliated counselors, and oversee critical disaster assistance operations across the country.

Mills earned an A.B. in economics from Harvard University and an M.B.A. from Harvard Business School where she was a Baker Scholar. Additionally, she served as a member of the Council on Foreign Relations and was vice chairman of the Harvard Overseers.

She and her husband, Barry Mills, president of Bowdoin College, live in Brunswick, Maine. They have three sons.

Chair LANDRIEU. Thank you very much, and will you submit to the record the list of the companies that you have just debarred and disqualified?

Ms. MILLS. Yes.

Chair LANDRIEU. Thank you.

Ms. Gustafson.

STATEMENT OF HON. PEGGY E. GUSTAFSON, INSPECTOR GENERAL, OFFICE OF INSPECTOR GENERAL, U.S. SMALL BUSINESS ADMINISTRATION

Ms. GUSTAFSON. Chair Landrieu, Ranking Member Snowe, Senator Paul, good morning. I want to thank you for inviting me again to testify in front of your Committee.

As you know, I head the SBA Office of Inspector General, which is a statutorily created independent office established to deter and detect waste, fraud, abuse, and inefficiencies in SBA programs and operations.

My verbal testimony today is going to focus on three areas: an update of my testimony from the March 3rd hearing of this year regarding fraud in SBA's preferential contracting programs; our concerns about fraud and abuse in SBA's business loan programs; and some areas of potential cost savings in SBA's programs, as mentioned in the letter that we had sent to you in March.

As noted in my March 3rd testimony, my office remains very concerned about fraud in SBA's preferential contracting programs. The bottom line is that when ineligible companies are fraudulently obtaining Federal contracts that are meant for small and disadvantaged companies, the congressional intent behind these programs is thwarted and legitimate companies are deprived of the contracting and the business development opportunity that these programs are supposed to provide.

Therefore, I want to commend the Chair, the Ranking Member, and other members of this Committee for their support and sponsorship of S. 633, the Small Business Contracting Fraud Prevention Act of 2011. I believe this is very important legislation that will greatly assist my office's efforts in deterring, detecting, and prosecuting false statements made to obtain these contracts.

I also want to recognize SBA's recently introduced plan to promote suspensions and debarments. This plan provides for greater training of SBA personnel to recognize suspicious activity and envisions better processes for ensuring that this suspicious activity is referred to my office and to agency suspension and debarment officials for necessary action.

Since my testimony in March, my office has referred an additional 14 contracting cases for suspension or debarment to SBA. As of this morning, the agency has acted to debar or suspend the wrongdoer in seven of these cases, and we have been advised that the agency will proceed shortly with final decisions on the remaining referrals.

I want to mention an audit my office recently conducted of the SBA surveillance review process, which are the on-site reviews that the agency conducts of procuring agency contract files to determine whether procuring agencies are properly awarding and monitoring these preferential contracts that are supposed to be going to small, disadvantaged, and the other preferential contracting programs. This review found that SBA had only evaluated a limited number of procuring offices over the past several years, and it was not using a systematic, thorough, or consistent approach in conducting these reviews.

We also found that these review teams were not generally evaluating whether small businesses and 8(a) firms were performing the required percentage of work on set-aside contracts.

I was very happy to note that the agency has agreed with most or all of our recommendations, but I would note that there is one final step in the audit process, which is the management decision, which is where SBA tells us what they are going to do to implement these recommendations. And I would gently note that these management decisions are overdue as of today, and it is pretty crucial that we get these management decisions, and I look forward to them because they will really be a framework for what happens next.

Another priority for my office is investigating SBA's 7(a) and 504 business loan programs. Our investigations run the gamut from false statements made by borrowers to get these loans to fraud by lenders or fraud by third parties who are involved in the loan process.

From October 1, 2008, to the present, in criminal cases related to business loan programs, we have opened 84 investigations of alleged fraud and obtained 114 indictments, 82 guilty pleas and convictions, and restitution, civil fraud, and asset forfeiture recoveries in excess of $91.5 million.

We remain concerned about fraud by third parties in 7(a) loans, notably loan brokers, loan packagers, consultants, and other loan agents. Although loan agents often serve a very valuable purpose in the loan process because they work with the borrower to connect the borrower to a lender who will help them with the SBA loan and help them get an SBA loan, there have been unscrupulous agents who have exploited the program through sometimes very far-reaching fraudulent schemes. In the last decade alone, my office has obtained convictions and guilty pleas in cases involving loan agent fraud, where the amount of loans involved were hundreds of millions of dollars.

We have had for several years a management challenge that the SBA track the loan agent activity and institute some enforcement processes to kick bad agents out of the program. They are getting there. They are beginning to track the activity. They do have the enforcement process in place, but this has to be a big priority for SBA, and we look forward to this getting finished.

As noted, I did submit a letter in March with some suggestions for savings. I believe that letter was submitted with my written testimony, and I welcome any questions, and again, thank you.

[The prepared statement of Ms. Gustafson follows:]

STATEMENT OF PEGGY E. GUSTAFSON, INSPECTOR GENERAL
U.S. SMALL BUSINESS ADMINISTRATION

BEFORE THE SENATE SMALL BUSINESS AND ENTREPRENEURSHIP COMMITTEE
JUNE 16, 2011

Introduction:

Chair Landrieu, Ranking Member Snowe, and distinguished members of the Committee, thank you for giving the Small Business Administration (SBA) Office of Inspector General (OIG) an opportunity to discuss some of our current activities.

As you know, I head an independent office established within SBA by statute to deter and detect waste, fraud, abuse and inefficiencies in SBA programs and operations. Every year, our staff of approximately 110 employees, which includes criminal investigators, auditors, attorneys, and program analysts, conducts numerous criminal investigations to identify fraud and other wrongdoing throughout the country and issues dozens of audit reports identifying weaknesses and deficiencies in SBA programs and operations.

Based upon my office's discussions with Committee staff, my testimony today will focus on three areas: (1) an update to my testimony on March 3, 2011 regarding fraud and abuse in SBA preferential contracting programs; (2) fraud and abuse in SBA's business loan programs; and (3) my correspondence to the Committee earlier this year in which I identified areas of potential cost savings in SBA programs. I am also happy to answer questions about the SBA OIG's work in other areas.

Fraud and Abuse in SBA Preferential Contracting Programs

As I noted in my testimony before this Committee on March 3, 2011, my office remains very concerned about continued fraud and improper activity in SBA's preferential contracting programs, including the 8(a), Service-Disabled Veteran-Owned (SDVO), and HUBZone programs. My March testimony highlighted examples of our recent cases involving these programs. The bottom line is that there is a real societal cost when ineligible companies improperly profit from preferential contracting through fraud and illegal conduct – this fraud thwarts congressional intent behind these programs and deprives legitimate small businesses of contracting opportunities. My office will continue to investigate these cases aggressively and to pursue criminal prosecution, civil fraud recovery, and suspension and debarment remedies whenever warranted.

However, our current efforts to bring wrongdoers to justice is hampered by various laws and Federal guidelines. Therefore, I want to commend the Chair, the Ranking Member and other members of this Committee for their support of S. 633, the Small Business Contracting Fraud Prevention Act of 2011. We believe this important legislation will greatly assist our efforts -- and the efforts of law enforcement organizations throughout the Government -- to prosecute those who make false statements regarding their eligibility for contracts set aside for small or disadvantaged business and those who fraudulently use front companies to divert profits from set-aside contracts awarded to eligible businesses towards large and non-disadvantaged companies. In particular, the legislation's definition of the term "loss" as being equal to the amount that the Government pays the wrongdoer under the contract will help prosecution efforts.

I also want to recognize SBA's efforts to introduce a plan to promote suspension and debarment in the Agency's government contracting programs. We believe that implementing a robust suspension and debarment process is critical to improving the level of integrity in the various preferential contracting programs. This plan, which the SBA Office of General Counsel presented to the Agency in late March, provides for greater training of agency personnel to recognize suspicious activity, and better processes for ensuring that suspicious activity is referred to my office and to the appropriate agency suspension and debarment officials. The Agency is working with my office to improve the communication and coordination between our offices, and we appreciate the Agency's efforts in this regard.

Since my testimony in March, my office has referred an additional 14 contracting cases for suspension or debarment to SBA. The Agency has acted to debar or suspend the wrongdoer in seven of these cases, and has advised my office that it intends to issue debarment or suspension notices on the remaining referrals shortly.

I mentioned in my March testimony that the OIG was close to completing an audit of SBA surveillance reviews, which are on-site reviews that the Agency conducts of the contract files of procuring agencies to determine, among other things, whether contracting offices are properly awarding and monitoring preferential contracts consistent with applicable regulations. Since then, my office has issued this report and posted it on our website at www.sba.gov/ig.

To summarize our findings: our review found that SBA had only evaluated a limited number of procuring offices over the past seven years, and did not use a systematic, thorough, or consistent approach in identifying which offices were reviewed or which information was evaluated. In addition, although SBA had previously indicated that it would use these surveillance reviews to determine whether procuring agencies were ensuring that 8(a) contractors were performing the legally required amount of work on set-aside contracts, we found that SBA's review teams generally did not evaluate whether small businesses and 8(a) firms were performing the required percentage of work. Although we recognize that SBA has limited resources, SBA's inconsistent approach in conducting surveillance reviews has limited its ability to assess whether procuring agencies are adequately overseeing performance of work on 8(a) contracts. This type of oversight by procuring agencies, if conducted, can limit opportunities for fraudulent pass-through contracts. I am pleased to report that SBA has agreed to implement all of the OIG's recommendations in the audit report.

We understand that the Committee is also concerned about large businesses obtaining contracts that are set aside for small business concerns. My office has identified this issue as a management challenge for SBA since 2005, and my predecessor, Eric Thorson, testified about our concerns before this Committee on July 12, 2006 (this testimony is available on the SBA OIG website at www.sba.gov/ig). SBA has made some progress in this area, such as making corrections to procuring agency data when agencies erroneously claim credit towards meeting their small business contracting goals for a contract awarded to a large company. SBA has also issued regulations to limit the time that a company which grows from a small business to a large business can remain on long-term GSA schedules and other government-wide acquisition contracts. However, we believe SBA can do more, including working to see that contracting officers are getting more training on small business procurement to prevent government errors that allow ineligible large businesses to perform on small business set-asides. Congress could also act to require contracting officers to conduct more oversight of subcontracting on small business set-aside contracts to ensure that large businesses are not performing an excessive amount of the work. We also believe that passage of S. 633, which I mentioned above, would strengthen the Government's ability to prosecute and seek civil fraud recovery for fraudulent and excessive subcontracting.

Fraud and Abuse in SBA Business Loan Programs

Another priority for my office is investigating fraud in SBA's business loan programs (the 7(a) Loan Guaranty Program and the 504 Certified Development Company (CDC) Program). This includes fraud by small businesses that apply for guaranteed loans, fraud by lenders in making false statements to SBA, and fraud by loan agents in assisting borrowers with the 7(a) loan applications. Since October 1, 2008, in cases relating to the business loan programs, we opened 84 investigations of alleged fraud and obtained 114 indictments, 82 guilty pleas and convictions, and recoveries in excess of $91.5 million in restitution, civil fraud recoveries, asset forfeitures.

Here are a few examples of recent cases we have worked on:

An investigation we are conducting jointly with the FBI in Missouri initially charged 11 individuals with various Federal crimes in a 185-count indictment that resulted from a scheme to defraud a Missouri bank and the SBA. The charges involved at least 31 fraudulent business loans, totaling more than $10 million, issued by the bank. The defendants included a former executive vice president and chief lending officer of the bank, a former SBA branch manager, and two Missouri business consultants. Recently, our continuing investigation resulted in additional indictments and convictions including:

- The indictment of a former vice president/loan compliance officer of the bank for conspiracy and making false statements to the SBA in connection with a $1.6 million SBA loan from the bank. As part of the conspiracy, the indictment alleges that the former vice president/compliance officer assisted others in preparing false affidavits representing that the business was not overdue in paying its debts and hiding a previous loan taken out by the business, and forging the signature of another bank official on an affidavit.
- A businessman pled guilty to making false statements by using a sham company to obtain an SBAExpress loan, which was not used to purchase equipment for the man's purported business, but rather was used for personal expenses and to pay a third party's outstanding debts.

In another recent case, a business owner pled guilty to making false statements on three loan applications submitted to a bank for SBA-guaranteed loans totaling over one million dollars. On all three loan applications, the individual falsely reported that neither he, nor his business, were involved in any pending lawsuits or had any business indebtedness when, in fact, he was a defendant in two civil lawsuits that resulted in judgments against him totaling approximately $1.9 million.

Another example of fraud we encounter arises under the 504 CDC Program, in which lenders make initial loans that generally fund real estate improvements, and then SBA authorizes the issuance of debentures that are sold to investors with an SBA guarantee. Proceeds from the debenture sale pay off part of the lender's loan, reducing the lender's risk on the transaction. In one recent case, in order to induce SBA to authorize the debenture sale, the lender falsely certified to SBA that there had been no adverse changes in the borrower's financial condition when, in fact, the lender was aware that the borrower was experiencing financial difficulties. An investigation led to the lender paying $2.2 million dollars to the Government to settle False Claims Act allegations.

In addition to fraud by lenders and borrowers, an area of significant concern for my office is an ongoing pattern of fraud by third parties in 7(a) program transactions, notably, loan brokers, loan packagers, consultants, and other loan agents. Although loan agents often serve a useful purpose by helping to connect borrowers with guaranteed lenders, unscrupulous agents have exploited the program by pursuing fraudulent schemes. In the last decade alone, my office has obtained convictions and guilty pleas on numerous cases involving loan agent fraud, totaling hundreds of millions of dollars in SBA guaranteed loans.

For example, a loan broker recently pled guilty to one count of conspiracy to commit bank fraud. The subject was a member of a group that had obtained credit cards and loans from various lending institutions using false identities, documents, and business names. The defendant obtained or brokered 28 loans from various financial institutions for fictitious businesses totaling approximately $1.5 million.

Earlier this year, in an investigation we conducted jointly with the FBI, another businessman was indicted on five counts of bank fraud and five counts of false statements. The individual was an owner of a group that received loan applications from potential borrowers. The investigation identified that when submitting applications to various banks on 26 loans/lines of credit, the defendant inflated the income information provided by the applicants. Five of these loans were guaranteed by the SBA.

For many years, my office has also identified as a management challenge for SBA the need to establish tracking and enforcement procedures to monitor loan agent activity and kick bad agents out of the program. We are pleased that the Agency has finally issued procedures to implement SBA's regulations at 13 C.F.R. Part 103, which authorize the Agency to suspend or revoke a loan agent's privilege to conduct business with SBA, and that SBA is putting a process in place to develop a loan agent tracking system. But, SBA should make this more of a priority.

My office has also taken steps over the years to help lenders identify fraud trends, including issuing several notices identifying "red flags," and giving fraud presentations at lender conferences, including the recent National Association of Guaranteed Government Lenders conference in April 2011. We are currently working with SBA's Office of General Counsel to help implement a fraud awareness and prevention program in the business loan programs.

Cost Savings at SBA

In mid-March, I wrote to Chair Landrieu and Ranking Member Snowe responding to a request for my office to identify areas of potential cost savings in SBA programs and operations. My letter, a copy of which is attached to my testimony, noted several recent audit recommendations for SBA that could reduce spending:

(1) Improper Payments - An OIG audit estimated the improper payment rate to be 27 percent, or approximately $234 million of the $869 million in 7(a) loan guaranty payments that SBA made between April 1, 2007 and March 31, 2008. The audit recommended that SBA (1) consult with a statistician in developing the sample design and projection methodology for its improper payment reviews, (2) revise the checklists that SBA uses when reviewing loans for improper payments, (3) fully implement a corrective action plan to reduce improper payments, and (4) establish timeframes for the recovery of improper payments.

As background to this issue, the OIG has recommended recovery of improper payments relating to specific loans we reviewed and that SBA implement a process for timely resolving disputed denial and repair decisions on loans. Nevertheless, it has been almost two years and SBA has yet to make final determinations on some of these loans. These determinations are needed to seek recovery of the improper guarantee payments. Of further concern, the person who was making those decisions has been detailed, starting this week, to another agency for two years, which may delay determinations even further. The lack of diligence in monitoring guarantee payments and recovering improper guarantee payments has been a recurring problem and is especially troubling given the amount of potential improper payments at issue.

(2) Use of HUD grants to pay off SBA Disaster Loans – Last Fall, the OIG issued a report identifying potential duplicate benefits in response to the Gulf Hurricanes of 2005 and the Midwest flooding in 2008. In an effort to reduce duplication of disaster assistance benefits, SBA identified when parties that had received disaster loans were also scheduled to obtain, or had previously obtained, grants under the Community Development Block Grant (CDBG) program administered by the Department of Housing and Urban Development. When a potential duplication of benefits was identified, SBA obtained money from certain states that had obtained the CDBG funding, and used these funds to pay down the unpaid balance of the disaster loans. These efforts resulted in $643.8 million of funds being sent to SBA to pay down 19,449 fully-disbursed SBA loans, and the undisbursed balance of 5,675 loans being reduced by $281.8 million. The Agency has addressed some, but not all, of the report's recommendations.

My March letter also identified several issues that the Committee may want to consider as possible ways of cutting costs:

(1) Eliminate the federal subsidy for the business loan programs - In previous years, SBA has relied on fees charged to borrowers and lenders to create the funds necessary to finance the business loan programs, without the need for a taxpayer-funded subsidy. Returning to a "zero subsidy" policy for these programs through fees charged to borrowers and lenders would result in considerable savings. ($215 million requested for FY 2012).

(2) Eliminate or reduce sole source contracts in the 8(a), HUBZone, and Veteran Contracting Programs - Studies have shown that sole source contracts do not generally provide

as good a value for the Government as contracts awarded through a competitive basis. For FY 2009, the Agency advised the following total sole source awards were made government-wide:

- 8(a) Sole Source - $11.6 billion;
- HUBZone Sole Source - $102 million;
- Service Disabled Veteran Sole Source - $671 million;
- Veteran Sole Source - $48 million.

Although we do not have data that would allow us to compute the exact amount of savings, if, for example, competed contracts saved 10% over sole-source contracts, the savings in FY 2009 would have been over $1.24 billion. We also believe that eliminating sole source contracts would reduce the amount of fraud and abuse in these programs.

(3) Adjust the fees charged to lenders making guaranteed loans based upon the risk profile of their 7(a) loan portfolio. Currently, all lenders in the 7(a) guaranteed loan program pay fees to SBA, based upon a percentage of the amount of their loans. Rather than charging all lenders the same percentage, SBA could charge those lenders that had higher default rates a higher fee (i.e., a higher percentage of the loan) than other lenders with better performing portfolios.

(4) Consider charging fees to those contractors that obtain significant financial benefits from the SBA 8(a) and HUBZone programs. Oversight of these programs is essential to reduce the potential for fraud and abuse by ineligible participants who get federal contracts. To offset oversight costs, SBA could charge a fee to those contractors that had obtained 8(a) or HUBZone contracts that exceeded a certain dollar amount during the previous fiscal year.

(5) Reduce duplicative business counseling. Small Business Development Centers, Women's Business Centers, Veteran's Centers, SCORE Chapters, and the Department of Commerce's Minority Business Development Agency Business Development Centers all obtain Federal grants and offer similar services by providing counseling, training and management, technical assistance, and other information to small businesses and would-be entrepreneurs to help them start or grow their businesses. Many of these facilities are located very close to each other. It might be appropriate to consider whether some of these entities could be eliminated or consolidated.

Conclusion

The SBA OIG will continue to investigate fraud in SBA procurement, loan, and other programs and to seek effective solutions to limit waste and inefficiencies and promote the benefits of these programs. Thank you for the opportunity to comment, and I look forward to answering any questions that you may have.

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

March 15, 2011

The Honorable Mary L. Landrieu, Chair
The Honorable Olympia J. Snowe, Ranking Member
Committee on Small Business and Entrepreneurship
United States Senate
428A Russell Senate Office Bldg
Washington, DC 20510

Dear Chair Landrieu and Ranking Member Snowe:

This letter responds to your correspondence of January 25, 2011, in which you asked for input regarding actions that could be taken to reduce or eliminate wasteful, duplicative or ineffective operations of the Small Business Administration (SBA) without undermining the SBA's ability to serve the needs of small business owners. Our responsive suggestions are contained in the Attachment to this letter.

As you may be aware, the SBA Office of Inspector General (OIG) has, over the years, issued numerous audit reports identifying improper payments, questionable expenditures, recommendations that funds be put to better use, and other findings regarding cost-savings and inefficiencies in SBA programs and operations. We discuss several of these recent reports in the attachment. Often, however, it should be noted that that OIG audits have found that waste and inefficiencies occurred not because SBA had expended too many resources, but because SBA had insufficient personnel assigned to some functions, had not expended the resources to develop adequate internal controls, or had cut corners by disregarding the controls that had been put into place.

Please note further that we have not addressed the extent to which SBA programs are duplicative of programs administered by other agencies, other than our discussion of the Department of Commerce Minority Business Development Agency Business Development Centers below, because the Government Accountability Office is currently performing such an analysis. *Opportunities to Reduce Potential Duplication in Government Programs, Save Tax Dollars and Enhance Revenue*, (GAO Rep. No. GAO-11-318SP, March 2011).

We appreciate your interest in hearing our ideas on this subject. If you would like to meet to discuss our analysis or if there are any questions, please call me at 202 205-6586.

Sincerely,

Peggy E. Gustafson
Inspector General

Attachment to Letter to:
The Honorable Mary L. Landrieu, Chair
The Honorable Olympia J. Snowe, Ranking Member
Senate Committee on Small Business and Entrepreneurship

Agency Suggestions

We concur with the Agency's proposed reductions as outlined in the President's budget for Fiscal Year (FY) 2012[1]:

(1) Drug Free Workplace Program ($1 million appropriations for FY 2010).
(2) PRIME Technical Assistance Program ($8 million appropriations for FY 2010).
(3) Special Purpose Counseling Grants
(4) The elimination of congressional line-item earmarks, which received approximately $56 million in funding in FY 2010 and $59 million in FY 2011.

OIG Suggestions based on recent audits

- Improper Payments - An OIG audit estimated the improper payment rate to be 27 percent, or approximately $234 million of the $869 million in 7(a) loan guaranty payments that SBA made between April 1, 2007 and March 31, 2008. The audit recommended that SBA fully implement a corrective action plan to reduce improper payments to include a revision of the checklist that SBA used when reviewing lender requests for payment of loan guaranties. Subsequent to the report, the amount of loan guaranty payments made by the Agency doubled; therefore, the potential savings are likely to be greater than the OIG reported. Although the Agency has agreed to take corrective action, it remains unclear whether these efforts will effectively address this situation. The OIG continues to identify guarantee payments that are improper.

- Use of HUD grants to pay off SBA Disaster Loans - OIG recently issued a report identifying potential duplicate benefits in response to the Gulf Hurricanes of 2005 and the Midwest flooding in 2008.[1] In an effort to reduce duplication of disaster assistance benefits, SBA identified when parties that had received disaster loans were also scheduled to obtain, or had previously obtained, grants under the Community Development Block Grant (CDBG) program administered by the Department of Housing and Urban Development (HUD). When a potential duplication of benefits was identified, SBA obtained money from certain states that had obtained the CDBG funding, and used these funds to pay down the unpaid balance of the disaster loans. These efforts resulted in $643.8 million of funds being sent to SBA to pay down 19,449 fully-disbursed SBA loans, and the undisbursed balance of 5,675 loans being reduced by $281.8 million.

[1] U.S. Small Business Administration FY 2012 Congressional Budget Justification and FY 2010 Annual Performance Report,.

[1] *SBA's Role in Identifying Duplicate Benefits from Community Development Block Grants* (OIG Report # 10-13), http://www.sba.gov/office-of-inspector-general/869/5249.

While SBA's action eliminated duplicate benefits, use of the CDBG funds to replace SBA disaster assistance was inconsistent with Federal Emergency Management Administration (FEMA) regulations regarding the appropriate sequence of delivery of disaster assistance benefits. This transfer of funds also created additional costs for taxpayers because it resulted in the application of grant funds, which do not need to be repaid, to reduce the debts of borrowers that SBA had already determined had sufficient resources to repay their loans.

Among other recommendations, we recommended that SBA coordinate with FEMA and HUD to formalize a memorandum of understanding with HUD which defines each agency's role in a manner that is consistent with the FEMA regulations. While the amount of future savings that would result from implementation of the OIG's recommendation is not quantifiable due to the difficulty in predicting the number and cost of future disasters involving CDBG grants, implementing the recommendation should generate significant savings for taxpayers.

Other OIG suggestions

To the extent the Committee is looking for other ideas to reduce appropriations associated with SBA programs, the OIG offers the following list of possible areas of consideration. Without extensive audit work or other analysis on the issues discussed here, we do not feel we can definitively recommend that these proposed steps be taken. However, there are potential savings to the government to be had here, and the Committee may find the policy issues raised worth discussing.

- Eliminate the federal subsidy for the business loan programs - In previous years, SBA has relied on fees charged to borrowers to create the funds necessary to finance the business loan programs, without the need for a taxpayer-funded subsidy. Returning to a "zero subsidy" policy for these programs through fees charged to borrowers, would result in considerable savings. ($215 million requested for FY 2012,)

- Eliminate or reduce sole source contracts in the 8(a), HUBZone, and Veteran Contracting Programs - Studies have shown that sole source contracts do not generally provide as good a value for the Government as contracts awarded through a competitive basis.

  For FY 2009, the Agency advised the following total sole source awards were made government-wide:

  - 8(a) Sole Source - $11.6 billion
  - HUBZone Sole Source - $102 million
  - Service Disabled Veteran Sole Source - $671 million
  - Veteran Sole Source - $48 million

By law, 8(a) participants may obtain sole source awards of up to $6.5 million for manufacturing contracts or $4 million for all other contracts.[2] Further, 8(a) companies owned by Alaska Native Corporations (ANCs) and other tribal entities are not subject to any cap on the size of sole source contracts they can obtain. HUBZone and veteran-owned businesses also qualify for sole-source contracts. Although we do not have data that would allow us to compute the exact amount of savings, if competed contracts saved 10% over sole-source contracts, the savings in FY 2009 would have been over $1.24 billion. We also believe that eliminating sole source contracts would reduce the amount of fraud and abuse in these programs.

- Adjust the fees charged to lenders making guaranteed loans based upon the risk profile of their 7(a) loan portfolio - Currently, all lenders in the 7(a) guaranteed loan program pay fees to SBA, based upon a percentage of the amount of their loans. Rather than charging all lenders the same percentage, SBA could charge those lenders that had a higher default rates a higher fee (i.e., a higher percentage of the loan) than other lenders with better performing portfolios. Charging a higher fee to lenders with higher default rates would reduce the costs of the 7(a) program, and, we believe, incentivize lenders to exercise greater diligence in making federally guaranteed loans.

- Consider charging fees to those contractors that obtain significant financial benefits from the SBA 8(a) and HUBZone programs - Oversight of these programs is essential to reduce the potential for fraud and abuse through ineligible participants getting federal contracts. To offset oversight costs, SBA could charge a fee to those contractors that had obtained 8(a) or HUBZone contracts over a certain dollar amount during the previous fiscal year. Contractors that earned less would not be required to pay a fee. This type of fee would be analogous to the fees paid by lenders for SBA's oversight of the lending programs.[2]

- Reduce duplicative business counseling - Small Business Development Centers (SBDCs), Women's Business Centers (WBCs), Veteran's centers, SCORE Chapters, and the Department of Commerce's Minority Business Development Agency (MBDA) Business Development Centers all obtain Federal grants and offer similar services by providing counseling, training and management, technical assistance, and other information to small businesses and would-be entrepreneurs to help them start or grow their businesses. In the United States and its territories, there are 63 Lead SBDCs, one in every state (Texas has four, California has six), the District of Columbia, Guam, Puerto Rico, Samoa, and the U.S. Virgin Islands – with a network of more than 900 service locations, 368 SCORE Chapters, 26 Veteran centers, 41 MBDA centers and 109 WBCs.

  SBA's budget request for FY 2012 seeks the following funding for these programs:

  SBDC Grants: $103 million
  SCORE Chapters: $7 million

[2] These thresholds just became effective on March 14, 2011.

[2] Fees that lenders pay to fund SBA lender oversight activities are risk-based unlike the loan fees discussed in the preceding bullet.

WBC Grants: $14 million
Veteran Centers: $2.5 million

Our review of the locations of SBDCs, SCORE Chapters, WBCs, and Veterans Centers found significant overlap. There are 109 WBCs listed on SBA's web site. Of these, 104 are located within 25 miles or less from either an SBDC, SCORE address or both. Likewise, there are 16 Veteran centers, 7 of which are at the same college or university as an SBDC (some even the same address), 6 of which have an SBDC within less than 10 miles (most less than 5 miles), 2 are 20 miles or less, and the last is 33 miles away.

In addition, we note that the U.S. Department of Commerce Minority Business Development Agency (MBDA) maintains 41 Business Development Centers around the country.[3] These centers are designed to provide small business counseling services to minority-owned firms similar to the services provided by SBDCs, SCORE Chapters, WBCs and Veteran centers.[4] Our review found that all 41 MBDA Business Development Centers are located within 25 miles or less of an SBA funded SBDC or SCORE Chapter or both. The MBDA website indicated that annual appropriations for Business Development Centers is approximately $8.7 million.

[3] Excluding MBDA regional centers, the MBDA website lists 42 centers. Two of these centers, however, are identified as being at the same address in Falls Church, Virginia, and we assume that these are duplicative. http://www.mbda.gov/main/offices

[4] MBDA Minority Business Centers provide minority entrepreneurs with one-on-one assistance in writing business plans, marketing, management and technical assistance and financial planning to assure adequate financing for business ventures. (http://www.mbda.gov/main/who-is-mbda.)

CURRICULUM VITAE
PEGGY E. GUSTAFSON
INSPECTOR GENERAL
UNITED STATES SMALL BUSINESS ADMINISTRATION

Prior to becoming the Inspector General for the Small Business Administration in September of 2009, Ms. Gustafson served as General Counsel to Senator Claire McCaskill, advising the Senator on issues relating to homeland security, government oversight, judiciary issues, and ethics. During her tenure working for Senator McCaskill, Ms. Gustafson helped write two bills that have significantly strengthened the federal offices of Inspectors General: the Inspector General Reform Act of 2008 and the legislation that created the office of the Special Inspector General for the Troubled Asset Relief Program.

From 1999-2007, Ms Gustafson served as General Counsel in the Missouri State Auditor's Office. In that capacity, managing a legal office, she worked closely with state auditors on issues of the scope of the auditors' duties, the auditors' need to access records, and all other legal issues arising in the course of the audits. She also represented the State Auditor's Office in litigation relating to fiscal notes prepared for statewide ballot initiatives, up to and including briefs before Missouri Supreme Court.

From 1995 to 1999, Ms. Gustafson served as an assistant prosecutor for Jackson County, Missouri. As a prosecutor, she tried felony criminal cases of every type, including first degree murder cases, had sole responsibility for charging and trying arson cases, and handled certain appeals. She also served as a team leader of a white collar crime trial team, and was appointed as a Special Assistant United States Attorney to work on areas of white collar crime and public corruption.

From 1993 to 1994, Peggy Gustafson served as an assistant county counselor for Jackson County, Missouri, representing the County in civil litigation, including the enforcement of county laws and the defense of county officials and correctional officers in cases arising under 42 U.S.C. Sec. 1983.

A native of Chicago, Illinois, Ms. Gustafson received her Bachelor of Arts from Grinnell College in Grinnell, Iowa in 1989, and her Juris Doctor from Northwestern University in Chicago in 1992. After law school, she was a law clerk to the Honorable Don Kennedy on the Missouri Court of Appeals.

Chair LANDRIEU. Thank you.

Let us go ahead and start with the loan agents issue. Ms. Mills, what would your response be? Do we know how many loan agents are out there? Are they certified by your office? What actions are you all taking to crack down on loan agents that are acting inappropriately securing loans to small businesses?

Ms. MILLS. Well, Senator, as you know, we have implemented the same three-part process that I described for contracting fraud, waste, and abuse on our loan fraud, waste, and abuse. So we are making sure that those who come to get our loans are, in fact, eligible, that we have oversight along the way in the process, and that we go after bad actors.

This falls in the third category where we have partnered on this loan agent issue very closely with the IG's office to ramp up the aggressive enforcement against bad actors, in this case these loan agents.

We are of like mind and aggressively pursuing this and will not stand for it. This has been a problem that existed quite a bit in the past, and when we came on board, we went after it quite seriously.

Chair LANDRIEU. Do we have any idea how many loan agents, unscrupulous loan agents, there may be out there, Ms. Gustafson?

Ms. GUSTAFSON. It is really early in the process to have a handle on that. As noted, we for several years said what we need is a central database such that should SBA or one of our criminal investigators find a loan that just has all kinds of problems, it would be incredibly helpful to know whether there was an agent involved in that process, because sometimes the fraud is happening with the agents. And it has been, I think, 7 years coming that it has been a management challenge, and there is no doubt that the agency agrees with us now that Administrator Mills is very supportive of this process.

My understanding of where we are is they are finally beginning to capture that information. It is finally somewhere. It is beginning to be somewhere. As a side note, at first they were not capturing, for example, the loan numbers along with the loan agent. That becomes not very useful. But that has been fixed.

Chair LANDRIEU. Because we can pinpoint exactly what banks the 1,000 or 1,200 out of the 8,000 banks are making loans through the SBA programs. We know exactly what banks those are.

Ms. GUSTAFSON. That is right.

Chair LANDRIEU. We also know the volume of loans that each of those banks puts out every year. So I think this would be relatively easy to try to track this information and eliminate the bad actors from this program.

Ms. GUSTAFSON. I think so. In general, there has always been a piece of paper somewhere with who the loan agent was. This centralization is new, and it is crucial because I will tell you, we have cases where the loan may be in Mississippi, and the loan agent for some unknown reason is in Florida. So, you know, there has to be a central database; otherwise, they are going to go undetected. Certainly the schemes will.

Chair LANDRIEU. Okay. Well, I will look forward to seeing how we are advancing on that.

On the general programs, in the March 15th letter that we sent to the SBA regarding improper payment rate, which I think is across the whole agency, the Inspector General said the rate could be as high as 27 percent. When you all reviewed the same data, you said the estimate is 1 to 2 percent. So there is a great disparity there, and if we could try to get some clarification on that with you two sitting at the same table this morning, that would be helpful. I do not know which one of you wants to go first.

Ms. MILLS. This is a conversation actually that we have on a fairly routine basis. There is a disagreement about the definition about improper payments. So we are referring to not actually the payment, but a loan that was a loan properly done. And if the T is not crossed and the I is not dotted, in one definition that is improper. In another definition we might draw the line in a different place and say that is a foot fault, and that it can be corrected, and the intent was honest and proper and that the loan guarantee should be honored or the loan was proper.

In the past situation there was no good dialogue on this issue, and when we came on board, we started a very constructive dialogue. We have made tremendous progress. There is still progress and conversation to be had, and we are working, I think—but Peg can tell you—constructively and aggressively on this issue.

Chair LANDRIEU. Okay.

Ms. Gustafson.

Ms. GUSTAFSON. Yes, let me quibble a little bit and then talk about progress that has been made. There is no question that both the agency and the IG did a review of the 7(a) improper payment rate for fiscal year 2008, and what you cited, Senator Landrieu, were the two rates that we came up with—vastly different. And, yes, we did begin a discussion about where we were disagreeing and why, and some of it is fundamental questions of what is and what is not under the law an improper payment. And that is a very constructive conversation to have that I think will inform the next improper payment review, which is going to begin shortly, both by the agency and by ourselves.

The one thing I would note is we have been having this discussion for about 2 years, and so we are slowly getting there. I am concerned about the speed, or lack thereof, that it is taking to reach these decisions, but I do think as we get there, we will come closer. And I would note that, in general, where we go so far, for what it is worth, they are coming closer to us. And so my quibble is we never say it is an improper payment if a T is not crossed or an I is not dotted. It is always a material issue. But we are working through those, and we will get there, but it needs to be done much quicker than it is being done.

Chair LANDRIEU. Okay. And, finally, I know my time has expired, but I will acknowledge Senator Snowe in just a moment. One of my strong beefs with the agency actually is in overcollecting funds, approximately $925 million in CDBG block grant funding that the agency, in my view, collected aggressively without warrant and unnecessarily by requiring victims—in this case of Hurricanes Katrina, Rita, or other natural disasters—to immediately repay back their 30-year SBA loan the minute they received the CDBG grant to rebuild their home. I am going to try to fix this legislatively because while it might be too late for the people of Louisiana, it is very timely for the people of Joplin, Missouri, who are going to be experiencing this exact same horrific nightmare, where they finally after 6 months get an SBA loan to help rebuild their home, which they might have had insurance or might not. The minute they receive a $30,000 grant from some other agency of the Federal Government, the SBA grabs the grant money to repay itself, leaving the homeowner with absolutely nothing to rebuild.

So I am not sure how Joplin, Missouri, which lost 30 percent of their city, 8,000 structures were destroyed, including hospitals, homes, and businesses, but I hope it works better for them than it worked for us.

Chair LANDRIEU. I am going to be pursuing this, and I just want to put everybody on notice that I am going to try to find—because HUD actually agrees with me, and so does either the GAO or the Inspector General, where HUD cites receipt of partial benefit from a major disaster or emergency shall not preclude provision of additional Federal assistance for any part of a loss or need for which benefits have not been provided. This is in the Stafford Act already. So we have had conversations about it, but I just want to go on the record that I think it is something, with the Chairman of the Subcommittee here on Disaster Response and Preparedness, I thought I would bring it up before Senator Pryor, and the two of us are going to work on some sort of appropriate legislative fix.

Senator Snowe.

Senator SNOWE. Thank you. Thank you, Madam Chair.

Just on that last issue on the improper payments, is it difficult to define what an improper payment is?

Ms. GUSTAFSON. Well, it requires some analysis. Especially in the loan area, it is not as easy as just saying did we double pay for a widget or was there some wrongdoing there. So it definitely takes some analysis.

We were able to do it, and as you know, it can be difficult, but we were able to do it.

Senator SNOWE. I guess on a lot of these issues, Administrator Mills and Ms. Gustafson, what is in place, what is actually operational and implemented, because I think that that is still not clear on some of the enforcement mechanisms.

Now, Administrator Mills, you mentioned certification, enforcement, and monitoring procedures that you have put in place to respond to all these issues. Have they been actually implemented? Are they in play now?

Ms. MILLS. Yes, they have.

Senator SNOWE. They have been. Are you satisfied with those procedures?

Ms. GUSTAFSON. We are pleased and on paper are satisfied with the enforcement procedures against loan agents, against third parties who people obtain Government contracts. That is in place. To the best of my knowledge, it has not been implemented yet, but to give credit, that was years in coming. For years the agency just did not even bother to have enforcement procedures in place, and then we would say, "You need to do something against the loan agent." And they would say, "We do not have any enforcement procedures in place so we cannot."

So they are there, and we were very, very pleased by that. They are brand spanking new, but they are there.

Now, what is, I believe, not quite fully in place is the overhaul of the suspension and debarment process, which is to say they have a very strong plan, I think, to get serious about suspension and debarment and to as an agency become more of an enforcement agency than they were before. It is in its nascent stages, which is to say they are doing training, but I do think the agency is going to need to send a strong message that they are serious, hold people accountable for not just knowing this stuff but making sure that referrals are made and things like that. That has not happened yet, and it needs to happen soon.

Senator SNOWE. So, Administrator Mills, on the question of the task force, is that the purpose?

Ms. MILLS. Yes, the task force on——

Senator SNOWE. Right. Is that in play now? Is that implemented?

Ms. MILLS. The task force has been in play for a while. It completed its work and recommendations. We implemented these recommendations. We are, as Peg said, working very closely in the beginning stages. We have begun to demonstrate on the last round of cases that were brought up, every single one has been pursued through these procedures, and we plan to continue to be aggressive.

Senator SNOWE. I think we have to be. I think we have to send a very strong message, and there has to be a clear and delineated process by which this all occurs, both in the implementation of these procedures to detect and to avert any potential fraud, but also on the other end is making sure that the SBA personnel are trained, informed, you know, aggressive in the implementation, and that there is a consistent standard.

Now, in changing this culture—because, you are right, Ms. Gustafson, it has built up over the years. In the article that the Chair was referring to that appeared in the Post back in March, it said, "D.C. insiders can reap fortunes from Federal programs for small businesses" and that Government officials were not monitoring contracts for compliance with rules. There is no question that the report exposed some glaring deficiencies in contract oversight with officials, but what was disturbing in this article—and that is why I want you to answer it, Administrator Mills—was when the Pentagon said that the responsibility for oversight fell to SBA, yet an SBA spokesperson was quoted as saying that the SBA, and I quote, "long ago transferred that authority to the Pentagon and other agencies."

Now, I know that is not your attitude, Administrator Mills, but I think that it is very clear, the Federal Acquisition Regulations require that the SBA be the oversight agency. But can you tell me what is happening to bolster that oversight and that everybody in SBA understands that it is uniquely and singularly their responsibility?

Ms. MILLS. Yes, the oversight for the Government contract program, which, as you know, is $100 billion and multiple—every agency—is SBA's responsibility. I believe the comment was referring to the agencies that actually do the contracts, and we jointly—we are responsible, but we jointly need to monitor. There are

30,000 contracting agents out there making these decisions, and there are 8 million individual contracts that get done every year. So we have in the Small Business Jobs Act and on a continual basis increased and beefed up the way we train our partners at the Federal agencies to detect issues, whether it is in certification issues, whether it is issues in a small business that does not meet the qualifications or anything improper. And then as we have talked about, we go after the bad actors.

So this is an ongoing partnership. We appreciate the fact that the Small Business Jobs Act gave us some additional powers to do this more effectively. We are continuing to implement the improvements in this, and there is no question about the commitment at the SBA to this project.

Senator SNOWE. My time is up. Thank you.

Chair LANDRIEU. Thank you.

Senator Paul.

Senator PAUL. Thank you.

The NFIB did a survey recently of small businesses and found that the number one concern was not really access to capital. It was taxes and regulations. I am a big fan of small business. I think we should do everything possible to help small business. I was in a small business before I came to the Senate.

The President wants to increase taxes on those who make more than $250,000. A lot of those are small businesses. Do you think that is a good idea for small business, Ms. Mills?

Ms. MILLS. Actually only 2 percent of those who make over $250,000 are small businesses or report over $250,000 of business income, and some of that is from unrelated business activities.

But to your point about this survey and removing barriers to small business, I think that is very much a shared goal, particularly on the removal of excess regulation. We are working quite aggressively on that as well.

Senator PAUL. With regard to why we have small business loans, you indicated to me yesterday evening that it is a market failure. I guess the problem I have is that when you say the market fails, it to me seems somewhat arbitrary because if the market is failing to give loans, maybe the market just decided these people were not good credit risks or maybe they went to the bank and the bank said, “You know what? I like so-and-so-’s project better.” And that is sort of how we would do it if we had a voluntary society.

This sort of arrangement, those people who are told no by the bank and then they are told yes by Government because Government decides, “We like your project,” I guess that to me just seems somewhat dictatorial and contradictory to the freedom of the marketplace. How do you define “market failure”? How do you say that the market is failing to give these people loans and they should get loans instead of the rest of us deciding in the marketplace?

Ms. MILLS. Well, I enjoyed our conversation, and, as you know, many of these are economic terms. But specifically to the SBA program, let me give you an example. When the market is functioning and you can get a loan from a bank, there is no reason for you to get an SBA guarantee or taxpayer involvement because you can get a loan. But if you are a good small business and you cannot get access and opportunity, we are able to provide these guarantees. In the market, you go to a bank, the bank makes that decision, and so it is not sort of a top-down from the Government; it is a bottom-up from the small business.

The example is when the credit crunch hit in October 2008, these banks shut their doors to small business. You could not get a loan, even if you had previously been creditworthy. And we were able to put $42 billion into the hands of the small businesses at a very low cost and saved—I travel all around the country, and I was in rural Arkadelphia at a saw mill, and a husband-and-wife team looked at me and they said, "You saved my business." This was a part where their local community bank, whom they had had a long relationship with, just could not make that loan. It is a good loan. We have very low default rates on our loans, as you know. And we are able to step in on these, let us call them "market gaps," to provide access and opportunity to viable, important small businesses who create jobs.

Senator PAUL. I guess my point in response would just be that you can see that and you can see how you helped that person, and it seems really good and we feel good about ourselves because we helped this person whose business would have gone out—you know, they would have gone bankrupt. What we do not see is the $100,000 you gave to them did not go to someone else. The unseen is what we do not see. We see the seen, but we do not see the unseen. And then when the market directs those, they direct them on everybody getting together and interacting in a voluntary way; whereas, the decision by Government is done involuntarily and done by a few select set of people. And I think there is danger for those select set of people making the decisions based on either political reasons or other reasons rather than the validity of whether or not it is a good enterprise.

One of the things that when I hear from people about access to capital they are concerned about is we have just passed thousands of new regulations through Dodd-Frank. Most people think this is making it harder to get capital. Do you think Dodd-Frank is making it easier or harder for small businesses to get capital?

Ms. MILLS. At the moment it is not clear that there is an appreciable effect on small business access to capital from those regulations. We know that small businesses have been concerned by the regulators' making more oversight on banking institutions that had had issues. We are working very hard with third-party regulators to make sure that they give clear direction to their banks so that small businesses who have previously been creditworthy are considered appropriately.

Senator PAUL. And I guess my final—do I have another minute?

Chair LANDRIEU. Go ahead.

Senator PAUL. My final point would just be that when you went in and you intervened in the crisis after the housing market collapsed, that is sort of like putting Band-Aids on things, and you found problems. But it is really not addressing how we got to those problems. Why did we have all these calamities? Why did we have housing prices that were going up 20 percent a year? Why did we have an exponential rise in housing prices? And, really, that had to do with bigger problems. It had to do with the Federal Reserve setting the interest rate below the market rate of interest. It had to do with Congress telling people they should have home loans when they had no downpayment. People would purchase a $160,000 home with no downpayment, and the next year it was worth $180,000, and they said, "Put a swimming pool in. You have got $20,000 in equity."

So we have to diagnose the problem correctly before we just keep giving people loans, and I think there was a rash of failures, and stepping in seemed to be noble. But I think we have to remember the seen and the unseen, and the unseen is the money that has to come from somewhere. We have an enormous debt. Our debt equals 100 percent of our economy. People have estimated we are losing 1 million jobs a year because of the burden of our debt.

So these things cost money. I just hope we will all pay attention to that. Thank you.

Chair LANDRIEU. Thank you, Senator.

The Senator from Arkansas.

Senator PRYOR. Thank you, Madam Chairman.

Let me start with you, if I might, Ms. Mills. On May 10 you wrote me a letter, and you said that you are committed to continuing the review of SBA programs to eliminate overlap and duplication. You also stated that OMB is working with all Federal agencies to better organize Federal programs and functions.

So can you give us an update today on how this review process is being performed and how the members of your staff are involved in the review and whether OMB and SBA are finding program efficiencies?

Ms. MILLS. Well, as you know, we do have a continuous process, and it was driven around the 2012 budget for eliminating duplicative programs and reducing costs and focusing current programs. So we did offer up a series of programs for elimination, and they included the Drug-Free Workplace, they included selected special purpose counseling grants, and they included the PRIME program. It was not because these programs were bad, but it was because we found other ways to deliver some of those services more effectively, notably in PRIME through our micro-loan intermediaries.

We continue to look at how to do the things that we do more effectively and deliver that money. The first criteria is: Does the money go directly into something that gets in the hands of small businesses and improves their situation, allows them to grow and create jobs? And the second criteria that we use is: Or is it creating oversight and elimination of fraud, waste, and abuse? And those are the two criteria. If it does not match that, then that is something that we cannot afford to do.

Senator PRYOR. And do you feel like that your work is done there? Or do you feel like you are still looking for ways to find more efficiencies?

Ms. MILLS. Well, it is a continuous improvement process.

Senator PRYOR. Let me ask about sort of a different area of that continuous improvement that I hope you are working on, and that would be—when I look at your SBA loan data, a few minutes ago you said that you have a very low default rate on SBA loans, which is great. But when I look at your data for fiscal year 2010, you wrote off more than $2.6 billion in bad loans. Am I reading that right?

Ms. MILLS. No, that actually is not that year's loans.

Senator PRYOR. Okay. So tell me how that works.

Ms. MILLS. When I referred to our low default rates, we have a subsidy rate that we calculate that is based on our previous loan rates. Generally that runs around 5 percent. In recent times, because of the economic recession, those loan rates for us and for all financial institutions have climbed. They have more than doubled in many situations. The reason for that is that we take all the collateral, and the collateral that were pledged in the 2005, 2006, 2007 cohorts was on inflated real estate prices. So now, as we go to collect on that collateral, the value is not there. So there are many more losses on those loans than one would have projected when the collateral was high.

I want to make sure that you know that this is not the current loans or the loans that were given in 2009 and 2010. This is really a cohort from a day where things were quite—bank lending was quite aggressive and real estate was quite high. That is a large part of the dollars that you have described. I believe the other piece of the dollars you have described is the tail end of the Participating Securities program which was canceled and eliminated in 2004.

Senator PRYOR. Okay. And even with all that said—and I appreciate that clarification—it looks to me, if I understand your numbers correctly, that you have not been able to recoup on those bad loans. In other words, it just seems like you are writing those off. I think I see a figure here of $107 million that you have been able to recoup. Am I understanding that right?

Ms. MILLS. I am not familiar with the $107 million, but we are happy to look at it. We very aggressively go after recouping, but as I have just said, right now on the real estate portions the value is not there.

Senator PRYOR. Right. But will you ever recoup any of that loss, or do you just write off the entire loan amount?

Ms. MILLS. We collect. The first thing we do is we try to see if the borrower can get back into payment, and if not and we go after the loan, we recoup everything we can.

Senator PRYOR. Okay. Well, we ought to follow up on that more, but, Madam Chairman, I am out of time so thank you.

Chair LANDRIEU. Thank you, and I just want to follow up on that. I was looking at those documents myself in preparation for this meeting. My question is: Do you have all the authority you need under the current law to try to recoup as much debt that is owed to us as possible? And if not, are you prepared to ask for additional authority?

Ms. MILLS. That is a very good question, and I would like to come back to you on that after a consultation.

Chair LANDRIEU. Okay. I would really like to pursue that, because I understand the market collapsed and these loans were made prior to this Administration coming on. But, again, the taxpayers are still on the hook for approximately $2 billion in loans that were made prior to this administration that have gone sour. And we need to try to figure out a way to recoup that money if we can, even if it takes a little extraordinary financial management or oversight or some sort of workout schedule that may not be available to you. So take a look at that and get back to me.

That is my final question, Senator Snowe, and then I would like to go to the second panel, if possible.

Senator SNOWE. Yes, thank you.

Administrator Mills, I just think it is important to understand what exactly the agency is doing with respect to the process on improper payments. Now, I understand Ms. Gustafson is saying that you may have the process in place, but it is not moving quickly. And I think we need to have a response to this Committee, in writing or whatever, to understand fully how this is going to be administered and to respond quickly in dealing with those improper payments, because I do think that that has to be acted upon. And there should not be any ambiguity with respect to that.

Ms. MILLS. Thank you. We are happy to respond. One thing I will note is that we are starting—what we decided to do together to move on exactly the issue you describe is that the agency suggested that we conduct voluntarily another audit, and then after we do our audit, that the IG will audit our audit and see if we can use that process to come to agreement on what is proper, what is improper, where we draw the lines. And so we have actively begun that process to get to the bottom of the questions that you raise.

Senator SNOWE. Well, I know that in a 1-year period the SBA made approximately $234 million in improper payments in the 7(a) loan and the audit recommended a corrective action plan. So do you agree that this is the plan, Ms. Gustafson?

Ms. GUSTAFSON. They are still responding and working, as you noted, and I would also note I agree with Administrator Mills. The concurrent or almost concurrent review of improper payments will be helpful. But, again, we are still waiting for answers on fiscal year 2008, and I am concerned that if we have not reached agreement on fiscal year 2008, that may very well impair our ability to reach agreement on 2010.

Our fiscal year 2008 audit came out in July of 2009, and so they say it has been over a year. I would say it is almost 2 years that we are waiting literally on their decisions on the same loans we looked at.

Senator SNOWE. So what is the problem, Administrator Mills? What is the problem here?

Ms. MILLS. I am happy to look into it, but my impression is that we are working constructively. We just do not agree.

Senator SNOWE. Well, I just hope that we can find some agreement and move forward because, obviously, this is languishing in terms of improper payments, collection, corrective action, enforcement action, and so on. We have got to get a standardized process in place, that this happens, you know, without delay.

Furthermore, on the Inspector General's surveillance review process, again, this is another issue. You made recommendations, Ms. Gustafson, to SBA on deficiencies that were identified by the surveillance review teams.

Ms. GUSTAFSON. Right.

Senator SNOWE. And according to the SBA, there was a lack of staff resources and competing priorities preventing the SBA from doing so. So what is the issue here, Administrator Mills? Do you have enough people to do what you need to do to provide the oversight of these contracting activities?

Ms. MILLS. Well, I——

Senator SNOWE. I mean, I gather that the SBA's contracting office conducted reviews of nearly 30 contracting activities which represented less than 1 percent of all small business contracting activities last year. So that is minuscule in terms of the overall, let alone, you know, the dimension of the dollar amount. So what is the issue here?

Ms. MILLS. Well, I think this is a very interesting new—this is a new finding that the IG has come to us. The IG is referring to surveillance reviews that we do on the rest of our sister agencies. There is no statutory obligation to do any of these reviews. In fact, they were proactively begun by us as a way to make sure that our sister agencies who were doing these procurement activities were on the ball, they were more educated, that they were—it was part of an oversight.

Now, we did this within the resources that we had at the moment so we began, and we think it is a positive step. We have asked for 24 additional personnel across fraud, waste, and abuse to augment these kinds of activities.

Remember, there are 30,000 contracting offices, and there are 8 million of these individual activities. So we have, I think, put a good foot forward to begin this, and we have to understand, you know—we certainly would like to increase it. We think it is a positive thing to do. We are not staffed and it is not part of the overall statutory obligation that we had been staffed to go after. But we do think it is important, and we have begun.

Senator SNOWE. Well, I think the question is on the statutory obligation. As I understand it, the SBA would be the prime agency for SBA contracting. Is that correct?

Ms. MILLS. Yes.

Senator SNOWE. I mean, even if you collaborate with other agencies, but ultimately it is in your purview. Would you agree?

Ms. MILLS. Yes, we agree.

Ms. GUSTAFSON. Let me just briefly, Senator Snowe, kind of talk to your point. What we are talking about here goes directly to what you had mentioned on the Washington Post article, which I think is a huge problem in Government contracting, which is procuring agencies think SBA is doing one thing, and SBA thinks that it is up to the procuring agencies to do it. And SBA has become exponentially smaller since the time when they used to do it. But I do not think it is getting done. I do not think it is getting done well. And so there needs to be a very robust conversation not just with SBA at the table, but I think we need as a Government to figure out how we are going to make sure that these contracts are being monitored and go into the——

Senator SNOWE. That is a good point, and that is the issue here, and that is what is obvious. We have to do something to either clarify that to make sure that this is a primary obligation obviously with the agency, the contracting agency, but the procurement agencies have to commit to it as well.

Ms. GUSTAFSON. Absolutely.

Senator SNOWE. So we will have to figure that out. I would welcome some ideas on that question if we have to change it through legislation.

Ms. GUSTAFSON. We would love to work with you. Procuring agencies want to get their contracts done, and they need their stuff, so——

Senator SNOWE. Right. But they have no responsibility for the ultimate contract. Thank you.

Ms. GUSTAFSON. Thank you.

Ms. MILLS. Thank you.

Chair LANDRIEU. Thank you so much. I appreciate it. Let us move to the second panel. Thank you for your testimony.

Our second panel today will be William Shear, Director of Financial Markets and Community Investment at the U.S. Government Accountability Office. Bill has directed substantial bodies of work addressing the Small Business Administration.

Kevin Baron has been the Director of Government Affairs for the American Small Business League since 2007. In his capacity he coordinated the organization's government affairs activities in Washington, D.C.

Tad DeHaven is a Budget Analyst on the federal and state budget issues for the Cato Institute. Previously he was Deputy Director of the Indiana Office of Management and Budget.

Fran Pastore is the Founder and President and CEO of Women's Business Development Council, for more than 14 years, a leader of entrepreneurial training for women in Connecticut.

And finally we have Mr. Greg Clarkson, who currently serves as Executive Vice President and Manager for BBVA Compass SBA Division, formerly Compass Bank. Clarkson is active in industry trade associations, and the National Association of Government Guaranteed Lenders.

I have asked you all to limit your opening statements to 3 minutes, and then we will do a round of questioning. We will start with you, Mr. Shear. If you could pull the microphone closer to you, please. Thank you.

Mr. SHEAR. Can you hear me now?

Chair LANDRIEU. Yes.

Mr. SHEAR. Okay. Great.

STATEMENT OF WILLIAM B. SHEAR, DIRECTOR OF FINANCIAL MARKETS AND COMMUNITY INVESTMENT, U.S. GOVERNMENT ACCOUNTABILITY OFFICE

Mr. SHEAR. Chair Landrieu, Ranking Member Snowe, and members of the Committee, it is a pleasure to be here today. My written statement discusses our work on potential duplication and fragmentation in economic development programs as well as our work on internal controls in contracting and business development programs. This oral statement is devoted to our work on potential duplication. In Q&A I would be glad to answer questions on either body of work as well as other topics in this hearing where we have conducted evaluations, such as SBA loan guarantee programs.

Our recent work on economic development programs includes the information on 80 programs at four agencies; SBA, Agriculture, Commerce, and HUD. SBA administers 19 of the 80 programs. Absent a common definition for economic development, we had previously developed a list of nine activities most often associated with economic development. For example, the agencies administer 54 programs that fund entrepreneurial efforts, which includes business development. All 19 SBA programs can fund such efforts.

We found that the design of each of these 80 programs appears to overlap with that of at least one other in terms of the economic activities they can fund. Here I want to stress that our focus to date has been on the design of the programs. In other words, we have evaluated the permitted uses of funds and have not as of yet drilled down to see how each program's funds are actually distributed among various uses.

In addition to addressing overlap, we focused on: one, collaborative efforts agencies should consider using to maximize performance; and, two, actions the agencies take to measure outcomes. Here we have found that Commerce, HUD, SBA, and USDA appear to have taken actions to implement some collaborative practices but have offered little evidence so far that they have taken steps to develop compatible policies or procedures with other Federal agencies or to search for opportunities to leverage physical and administrative resources with their Federal partners. And we have found that the agencies appear to collect only limited information on program outcomes—information that is necessary to determine whether the potential for overlap and fragmentation is resulting in ineffective or inefficient programs.

Building on our past work, we are in the planning phase of a new, more in-depth review that will focus on a subset of these 80 programs. Our current thinking is that we may have a focus on the 54 programs that fund entrepreneurial efforts, and this would include all 19 SBA economic development programs.

We plan to evaluate how funds are used, identify additional opportunities for collaboration, determine and apply criteria for program consolidation, and assess how program performance is measured.

Chair Landrieu, Ranking Member Snowe, members of the Committee, this concludes my prepared statement. I would be happy to answer any questions.

[The prepared statement of Mr. Shear follows:]

United States Government Accountability Office

GAO

Testimony

Before the Committee on Small Business and Entrepreneurship, U.S. Senate

For Release on Delivery
Expected at 10:00 a.m. EDT
Thursday, June 16, 2011

SMALL BUSINESS PROGRAMS

Efforts to Address Internal Control Weaknesses and Potential Duplication

Statement of William B. Shear, Director
Financial Markets and Community Investment

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Highlights

Highlights of GAO-11-558T, a testimony before the Committee on Small Business and Entrepreneurship, U.S. Senate

June 16, 2011

SMALL BUSINESS PROGRAMS

Efforts to Address Internal Control Weaknesses and Potential Duplication

Why GAO Did This Study

Economic development programs—administered efficiently and effectively—can contribute to the well-being of the economy at the least cost to taxpayers. Such programs can encompass small business development and contracting. To encourage such contracting, Congress created programs—such as the Historically Underutilized Business Zone (HUBZone), service-disabled veteran-owned small business, and 8(a) Business Development programs—that give contracting preferences to some types of small businesses: in economically distressed communities; to those owned by service-disabled veterans; and to those with eligible socially and economically disadvantaged owners. This testimony addresses (1) potential duplication in economic development programs and (2) internal controls weaknesses in three small business programs. This testimony is based on related GAO work from 2008 to the present and updates it as noted.

GAO examined programs at the Departments of Commerce, Housing and Urban Development, and Agriculture and the Small Business Administration (SBA) to assess program overlap, collaboration, and measures of effectiveness (GAO-11-477R). GAO also reviewed data from SBA and the Department of Veterans Affairs (VA) and conducted site visits. The reports identified opportunities to increase program efficiencies and made recommendations to improve internal controls and develop outcome-oriented measures.

View GAO-11-558T or key components. For more information, contact William B. Shear at (202) 512-8678 or shearw@gao.gov.

What GAO Found

Results of GAO's work on 80 economic development programs at the four agencies indicate that the design of each appears to overlap with that of at least one other in terms of the economic development activities they can fund. For example, the agencies administer 54 programs that fund "entrepreneurial efforts," which include business development. SBA has 19 such economic development programs. To address issues arising from potential overlap and fragmentation, GAO relied on previously identified collaborative practices agencies should consider using to maximize performance and results. GAO found that agencies' collaborative efforts were not comprehensive but conducted on a case-by case basis. Further, the agencies generally have not measured outcomes. For instance, SBA has not yet developed outcome measures that directly link to the mission of its HUBZone program. In 2005 and 2008, GAO made recommendations to Commerce and SBA, respectively, aimed at improving the data and methods they rely on to measure the outcomes of some of their economic development programs. Generating key information on outcomes (that measure effectiveness) could help agencies better manage programs. Such information also would enable decision makers to better identify opportunities to realign resources, and if necessary, consolidate or eliminate some programs.

As GAO has reported, three small business programs have had varying degrees of internal control weaknesses that affected program oversight. First, in a June 2008 report, GAO determined that SBA's mechanisms for certifying and monitoring firms in the HUBZone program gave limited assurance that only eligible firms participated. For certification and recertification (of initial and continued eligibility), SBA requested documentation or conducted site visits to validate self-reported data in limited instances. In response to GAO's recommendations, SBA has issued guidance requiring supporting documentation upon application and conducted site visits to certified firms. Second, in a May 2010 report, GAO reported that VA has faced challenges in effectively responding to a 2006 statutory mandate to verify the eligibility of small businesses owned by service-disabled or other veterans. Although such businesses self-certify their contracting eligibility, VA (unique among federal agencies) must maintain a database of these firms, verify their status, and only give contracting preferences to verified firms. GAO reported that VA had verified only about 14 percent of firms in its database. Since GAO recommended that VA develop a plan for a more effective verification program, VA stated that it has taken steps to improve its verification process, including awarding contracts to expedite the processing of applications. And finally, in a March 2010 report, GAO found that while SBA conducts annual reviews of 8(a) firms to help ensure continued eligibility, GAO found that key controls needed to be strengthened. GAO's review of a sample of 8(a) firms identified an estimated 55 percent in which SBA staff failed to complete required procedures to assess eligibility criteria. In response to GAO's recommendation that SBA provide more guidance to staff on annual review procedures, SBA stated that it issued a new guide in August 2010.

Chair Landrieu, Ranking Member Snowe, and Members of the Committee:

I am pleased to be here to discuss (1) potential duplication in economic development programs and (2) internal controls in place to help ensure that only eligible small businesses participate in federal procurement programs that provide them certain contracting preferences such as set-asides. In March 2011 and more recently in May 2011, we reported on potential duplication among federal economic development programs, and in this statement I will discuss this work.[1] We focused on this area because economic development programs that are administered efficiently and effectively can contribute to the well-being of the nation's economy at the least cost to taxpayers. Absent a common definition for economic development, we previously developed a list of nine activities most often associated with economic development. These activities include: planning and developing strategies for job creation and retention, developing new markets for existing products, building infrastructure by constructing roads and sewer systems to attract industry to undeveloped areas, and establishing business incubators to provide facilities for new businesses' operations.[2]

We recently completed an examination of 80 economic development programs at four agencies—the Departments of Commerce (Commerce), Housing and Urban Development (HUD), and Agriculture (USDA) and the Small Business Administration (SBA)—where we assessed potential for overlap in the design of the programs, the extent to which the four agencies collaborate to achieve common goals, and the extent to which the agencies have developed measures to determine the programs' effectiveness. SBA administers 19 of the 80 programs. According to the agencies, funding provided for these 80 programs in fiscal year 2010

[1]See GAO, *Opportunities to Reduce Potential Duplication in Government Programs, Save Tax Dollars, and Enhance Revenue*, GAO-11-318SP (Washington, D.C.: Mar. 1, 2011); GAO, *List of Selected Federal Programs That Have Similar or Overlapping Objectives, Provide Similar Services, or Are Fragmented Across Government Missions*, GAO-11-474R (Washington, D.C.: Mar. 18, 2011); and GAO, *Efficiency and Effectiveness of Fragmented Economic Development Programs Are Unclear*, GAO-11-477R (Washington D.C.: May 19, 2011).

[2]In commenting on our May 2011 report (GAO-11-477R), the Department of Commerce stated, among other things, that prior GAO reports have focused on the types of investments made without an appropriate definition of economic development. Because federal agencies do not have a standard definition of what constitutes economic development, we identified programs using a list of activities that are generally accepted as being directly related to economic development.

amounted to $6.2 billion, of which about $2.9 billion was for economic development efforts, largely in the form of grants, loan guarantees, and direct loans.[3] The 80 programs and their fiscal year 2010 funding are listed in appendix I.

Small business contracting programs are a subset of the 80 economic development programs we examined. To encourage small business contracting, Congress has created programs—such as the Historically Underutilized Business Zone (HUBZone), service-disabled veteran-owned small business, and 8(a) Business Development programs—that give contracting preferences to specific categories of small businesses. The HUBZone program provides set-aside and other contracting preferences to small businesses in economically distressed communities, or HUBZones, with the intent of stimulating economic development in those areas. The service-disabled veteran-owned small business program permits awards of set-aside and sole-source contracts to any small business owned and controlled by one or more service-disabled veterans. The 8(a) program helps eligible socially and economically disadvantaged small businesses by providing business development support, such as counseling and technical assistance, and providing opportunities to obtain federal contracts on a set-aside basis or noncompetitively up to specified dollar amounts.

SBA is responsible for administering the HUBZone and 8(a) programs. SBA, along with federal procuring agencies, also administers the service-disabled veteran-owned small business program. Pursuant to the Veterans Benefits, Health Care, and Information Technology Act of 2006 (or 2006 Act), the Department of Veterans Affairs (VA) has the unique authority to award contracts to veteran-owned small businesses and service-disabled veteran-owned small businesses on a priority basis. The 2006 Act also requires VA to maintain a database of veteran-owned and service-disabled veteran-owned small businesses and verify the ownership, control, and veteran or service-disabled status of businesses listed in its database.

My testimony today discusses several reports we have issued in the past few years. Specifically, I will discuss our work on (1) potential duplication and fragmentation in economic development programs and (2) internal

[3]In March 2011, we reported that the funding provided for these 80 programs in fiscal year 2010 amounted to $6.5 billion, of which about $3.2 billion was for economic development efforts, according to data received from the agencies (GAO-11-318SP and GAO-11-474R). We are reporting different funding figures in this product because SBA revised the original information they provided to us in December 2010.

controls in small business contracting programs. My discussion of internal controls in small business contracting programs will focus on the HUBZone program, VA's efforts to verify the veteran-owned and service-disabled veteran-owned small businesses to which it awards contracts, and the 8(a) program.

This testimony draws primarily from reports we issued from 2008 through May 2011, and updates that information where noted. For our March 2011 and May 2011 reports on potential duplication and fragmentation in economic development programs, we relied on our previous work, ongoing work following up on recommendations from the previously issued reports, and the preliminary results of our ongoing evaluation of economic development programs at four federal agencies.[4] For example, for the most recent work we gathered new information related to program missions, targeted populations, and funding for the programs. Agency officials self reported the data on program funds, which were determined to be sufficiently reliable for the purposes of this review. We focused on Commerce, HUD, SBA, and USDA. Using the Catalog of Federal Domestic Assistance and other agency documents, we identified 80 federal programs administered by the four agencies that could fund economic development activities. We also met with officials from each of the agencies to discuss each program and the program missions. Because SBA officials view all of their programs as being related to economic development, we included all SBA programs in this review.

For our June 2008 report on internal controls in the HUBZone program, we compared the actions that SBA takes to certify HUBZone firms with its policies and procedures and selected internal control standards.[5] For

[4]See GAO-11-318SP; GAO-11-474R; GAO-11-477R; GAO, *Rural Economic Development: Collaboration between SBA and USDA Could Be Improved*, GAO-08-1123 (Washington, D.C.: Sep.18, 2008); GAO, *Small Business Administration: Additional Actions Are Needed to Certify and Monitor HUBZone Businesses and Assess Program Results*, GAO-08-643 (Washington, D.C.: Jun. 17, 2008); GAO, *Rural Economic Development: More Assurance Is Needed That Grant Funding Information Is Accurately Reported*, GAO-06-294 (Washington, D.C.: Feb. 24, 2006); GAO, *Economic Development Administration: Remediation Activities Account for a Small Percentage of Total Brownfield Grant Funding*, GAO-06-7 (Washington, D.C.: Oct. 27, 2005); GAO, *Economic Development: Multiple Federal Programs Fund Similar Economic Development Activities*, GAO/RCED/GGD-00-220 (Washington, D.C.: Sep. 29, 2000); and GAO, *Economic Development: Observations Regarding the Economic Development Administration's May 1998 Final Report on its Public Works Program*, GAO/RCED-99-11R (Washington, D.C.: Mar. 23, 1999).

[5]GAO-08-643.

example, we reviewed data for 125 applications to determine the extent to which SBA requested documentation from firms to support applications. We also compared HUBZone performance measures with our guidance on the attributes of effective performance measures. For our May 2010 report on VA's efforts to contract with veteran-owned and service-disabled veteran-owned small businesses, we reviewed the agency's verification guidelines and procedures for reviewing applications and conducting site visits to determine VA's progress in verifying the veteran status, control, and ownership of businesses.[6] We also reviewed files for a sample of verified businesses to determine how well VA followed its procedures and to identify any deficiencies in the process. For our March 2010 report on internal controls in the 8(a) program, we visited 5 of the 68 SBA districts and reviewed files of 136 8(a) firms to assess SBA's compliance with its eligibility review procedures.[7] We collected recent annual review information from each file, including evidence supporting eligibility criteria. For more information on our scope and methodology, see the referenced reports.

The work on which this statement is based was performed from August 2007 to May 2011 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.

Background

The purpose of the HUBZone program, established by the HUBZone Act of 1997, is to stimulate economic development in economically distressed communities (HUBZones) by providing federal contracting preferences to eligible small businesses.[8] The types of areas in which HUBZones may be located are defined by law and consist of census tracts, nonmetropolitan counties, Indian reservations, redesignated areas (that is, census tracts or

[6] GAO, *Department of Veterans Affairs: Agency Has Exceeded Contracting Goals for Veteran-Owned Small Businesses, but It Faces Challenges with Its Verification Program*, GAO-10-458 (Washington, D.C.: May 28, 2010).

[7] GAO, *Small Business Administration: Steps Have Been Taken to Improve Administration of the 8(a) Program, but Key Controls for Continued Eligibility Need Strengthening*, GAO-10-353 (Washington, D.C.: Mar. 30, 2010).

[8] HUBZone Act of 1997, Pub L. No. 105-135, Title VI, 111 Stat. 2592, 2627-2636 (1997).

nonmetropolitan counties that no longer meet the criteria but remain eligible until after the release of the first results from the 2010 census or 3 years after they ceased being qualified), and base closure areas.[9]

To be certified to participate in the HUBZone program, a firm must meet the following four criteria:

- must be small by SBA size standards;[10]
- must be at least 51 percent owned and controlled by U.S. citizens;[11]
- principal office—the location where the greatest number of employees perform their work—must be located in a HUBZone; and
- at least 35 percent of the full-time (or full-time equivalent) employees must reside in a HUBZone.

The Veterans Benefits Act of 2003, which established the service-disabled veteran-owned small business program, permits contracting officers to award set-aside and sole-source contracts to any small business concern owned and controlled by one or more service-disabled veterans.[12] Veteran means a person who served in the active military services, and who was discharged or released under conditions other than dishonorable. Service-disabled means that the disability was incurred or aggravated in the line of duty in active service.[13] A firm also must qualify as a small business under the North American Industry Classification System (NAICS) industry-size standards.[14]

[9]See GAO-08-643 for a definition of each type of area.

[10]SBA's size standards are almost always stated either as the average employment or average annual receipts of a business concern and vary by industry.

[11]Qualified HUBZone firms also can be owned and controlled by Alaskan Native Corporations, Indian tribal governments, community development corporations, and agricultural cooperatives.

[12]If the business is publicly owned, at least 51 percent of the stock must be held by one or more service-disabled veterans. The service-disabled veteran(s) must manage and control daily business operations. In the case of a veteran with permanent and severe disability, the spouse or permanent caregiver of such veteran may control the business.

[13]38 U.S.C. §§ 101(2), 101(16).

[14]Federal statistical agencies use NAICS as the standard in classifying business establishments for the purpose of collecting, analyzing, and publishing statistical data related to the U.S. business economy.

A firm must meet several initial eligibility requirements to qualify for the 8(a) program (a process known as certification), and then meet other requirements to continue participation. A concern meets the basic requirements for admission to the program if it is a small business that is unconditionally owned and controlled by one or more socially and economically disadvantaged individuals who are of good character and U.S. citizens, and demonstrates the potential for success.[15]

What GAO Has Found to Indicate Potential Duplication, Overlap, or Fragmentation among Economic Development Programs

Our work involving 80 economic development programs at four agencies—Commerce, HUD, SBA, and USDA—indicates that the design of each of these fragmented programs appears to overlap with that of at least one other program in terms of the economic development activities that they are authorized to fund. For example, as shown in table 1, the four agencies administer a total of 54 programs that can fund "entrepreneurial efforts," which include helping businesses to develop business plans and identify funding sources. SBA accounts for 19 of these 54 programs, and it administers programs contained in six of the nine economic activities. (The 19 SBA programs are listed in the table in appendix I.)

[15]For more information on key eligibility requirements for 8(a) program participation, see GAO-10-353.

Table 1: Overlap and Fragmentation Among Selected Agencies Authorized to Fund Economic Development Activities

	Programs by Agency				
Activity	**Commerce**	**HUD**	**SBA**	**USDA**	**Total**
Entrepreneurial efforts	9	12	19	14	54
Infrastructure	4	12	1	18	35
Plans and strategies	7	13	13	7	40
Commercial buildings	4	12	4	7	27
New markets	6	10	6	6	28
Telecommunications	3	11	2	8	24
Business incubators	5	12	—	7	24
Industrial parks	5	11	—	5	21
Tourism	5	10	—	4	19

Source: GAO analysis of information from Commerce, HUD, SBA, and USDA.

Note: In December 2010, USDA officials provided us information on the economic activities that each of their economic development programs can fund, which we reported in our March 2011 report (GAO-11-318SP). In April 2011, they provided revised information for six of their programs that we incorporated into our May 2011 report (GAO-11-477R).

Our prior work going back more than 10 years also identified potential overlap and fragmentation in economic development programs. Among other things, we found that legislative or regulatory restrictions that target funding on the basis of characteristics such as geography, income levels, and population density (rural or urban) differentiated many programs.

While some of the 80 programs we assessed fund several of the nine economic development activities, almost 60 percent (46 of 80) fund only one or two activities. These smaller, narrowly scoped programs appear to be the most likely to overlap because many can only fund the same, limited types of activities. For example, narrowly scoped programs comprise 21 of 54 programs that can fund entrepreneurial efforts. Moreover, most of the 21 programs target similar geographic areas.

To address issues arising from potential overlap and fragmentation in economic development programs, we previously have identified collaborative practices agencies should consider using to maximize the performance and results of federal programs that share common outcomes.[16] These practices include leveraging physical and administrative resources, establishing compatible policies and procedures, monitoring collaboration, and reinforcing agency accountability for collaborative efforts through strategic or annual performance plans. Preliminary findings from our ongoing work show that Commerce, HUD, SBA, and USDA appear to have taken actions to implement some of the collaborative practices, such as defining and articulating common outcomes, for some of their related programs. However, the four agencies have offered little evidence so far that they have taken steps to develop compatible policies or procedures with other federal agencies or searched for opportunities to leverage physical and administrative resources with their federal partners. Moreover, we found that most of the collaborative efforts performed by program staff on the front line that we have been able to assess to date have occurred only on a case-by-case basis. As a result, the agencies do not appear to be consistently monitoring or evaluating these collaborative efforts in a way that allows them to identify areas for improvement. We reported in September 2008 that the main causes for limited agency collaboration include few incentives to collaborate and lack of a guide on which agencies could rely for consistent and effective collaboration. In that same report, we recommended that SBA and USDA take steps to adopt a formal approach to encourage further collaboration. To date, the two agencies have entered into a memorandum of understanding and USDA has recently taken some action to monitor the collaborative efforts of its field office staff. In failing to find ways to collaborate more, agencies may miss opportunities to leverage each other's unique strengths to more effectively promote economic development and efficiently use taxpayer dollars set aside for that purpose.

In addition, a lack of information on program outcomes has been a long-standing concern. This information is needed to determine if potential overlap and fragmentation has resulted in ineffective or inefficient programs. More specifically:

- Commerce's Economic Development Administration (EDA), which administers eight of the programs we reviewed, continues to rely on a

[16]GAO, *Results-Oriented Government: Practices That Can Help Enhance and Sustain Collaboration among Federal Agencies*, GAO-06-15 (Washington, D.C.: Oct. 21, 2005). Also see GAO-08-1123.

potentially incomplete set of variables and self-reported data to assess the effectiveness of its grants. This incomplete set of variables may lead to inaccurate claims about program results, such as the number of jobs created. Moreover, in only limited instances have EDA staff requested documentation or conducted site visits to validate the self-reported data provided by grantees. We first reported on this issue in March 1999 and issued a subsequent report in October 2005. In response to a recommendation we made in 2005, EDA issued revised operational guidance in December 2006 that included a new methodology that regional offices were to use to calculate estimated jobs and private-sector investment attributable to EDA projects. However, during our recently-completed review we found that the agency still primarily relies on grantee self-reported data and conducts a limited number of site visits to assess the accuracy of the data. While acknowledging these findings, EDA officials stated that they do employ other verification and validation methods in lieu of site visits. These methods include reviews to ensure the data are consistent with regional trends and statistical tests to identify outliers and anomalies.

- SBA has not yet developed outcome measures that directly link to the mission of its HUBZone program, or implemented its plans to evaluate the program based on variables tied to program goals. We reported in June 2008 that while SBA tracks a few performance measures, such as the number of small businesses approved to participate in the program, the measures do not directly link to the program's mission. Therefore, we recommended that the agency further develop measures and implement plans to assess the effectiveness of the program. While SBA continues to agree that evaluating the outcomes of the HUBZone program is important, to date the agency has not yet committed resources for such an evaluation.

- The USDA's Office of Rural Development, which administers 31 of the programs we reviewed, has yet to implement the USDA Inspector General's (IG) 2003 recommendation on ensuring that data exist to measure the accomplishments of one of its largest rural business programs—the Business and Industry loan program, which cost approximately $53 million to administer in fiscal year 2010. USDA officials stated that they have recently taken steps to address the IG's recommendation, including requiring staff to record actual jobs created rather than estimated jobs created. However, an IG official stated that these actions are too recent to determine whether they will fully address the recommendation.

Without quality data on program outcomes, these agencies lack key information that could help them better manage their programs. In addition, such information would enable congressional decision makers and others to make decisions to better realign resources, if necessary, and identify opportunities for consolidating or eliminating some programs.

Building on our past work, we are in the planning phase of a new, more in-depth review that will focus on a subset of these 80 programs, including a number of SBA programs. We plan to evaluate how funds are used, identify additional opportunities for collaboration, determine and apply criteria for program consolidation, and assess how program performance is measured.

More generally, as the nation rises to meet the current fiscal challenges, we will continue to assist Congress and federal agencies in identifying actions needed to reduce duplication, overlap, and fragmentation; achieve cost savings; and enhance revenues. As part of current planning for our future annual reports, we are continuing to look at additional federal programs and activities to identify further instances of duplication, overlap, and fragmentation as well as other opportunities to reduce the cost of government operations and increase revenues to the government. We will be using an approach to ensure governmentwide coverage through our efforts by the time we issue of our third report in fiscal year 2013. We plan to expand our work to more comprehensively examine areas where a mix of federal approaches is used, such as tax expenditures, direct spending, and federal loan programs. Likewise, we will continue to monitor developments in the areas we have already identified. Issues of duplication, overlap, and fragmentation will also be addressed in our routine audit work during the year as appropriate and summarized in our annual reports.

Control Weaknesses Hinder the Effectiveness of Small Business Contracting and Business Development Programs

As GAO has reported, three small business programs have had varying degrees of internal control weaknesses that affected program oversight. For example, in a June 2008 report, GAO determined that SBA's mechanisms for certifying and monitoring firms in the HUBZone program gave limited assurance that only eligible firms participated.

SBA Has Taken Some Steps to Improve Administration of the HUBZone Program, but the Agency Has Yet to Evaluate Its Effectiveness

In our June 2008 report on the HUBZone program, we found that (1) SBA's mechanisms for certifying and monitoring firms provided limited assurance that only eligible firms participated in the program and (2) the agency had not evaluated the effectiveness of the program.[17] Specifically, for certification and recertification, firms self-reported information on their applications and SBA requested documentation or conducted site visits of firms to validate the self-reported data in limited instances. Our analysis of the 125 applications submitted in September 2007 showed that SBA requested supporting documentation for 36 percent of the applications and conducted one site visit. To address these deficiencies, we recommended that SBA develop and implement guidance to more consistently obtain supporting documentation upon application and conduct more frequent site visits to help ensure that firms applying for certification were eligible.

SBA has made some progress in better ensuring that participating firms are eligible for the HUBZone program. According to agency officials, SBA conducted 911 site visits to certified firms in fiscal year 2009 and made 1,142 site visits in fiscal year 2010. In March 2010, SBA issued a guide for analysts to use when reviewing applications to help ensure a standardized and more efficient review of applications. The guidance provides examples of the types of documentation that SBA staff should collect from applicants and also offers tips for identifying fraudulent claims and documents.

We also reported that SBA had not followed its policy of recertifying firms (the process through which SBA can monitor firms' continued eligibility) every 3 years and as a result had a backlog of more than 4,600 firms that had gone unmonitored for more than 3 years. We recommended that the agency eliminate the backlog and take the necessary steps to better ensure recertifications were completed in a more timely fashion. In September 2008, SBA eliminated the backlog by hiring more staff. The agency recently provided us with a flow chart that describes the most recent steps they had taken to recertify firms in a timely manner and the resources that they planned to dedicate to this effort.

Finally, as discussed previously, we found that SBA had not implemented plans to assess the effectiveness of the HUBZone program and recommended that SBA develop performance measures and implement

[17] GAO-08-643.

plans to do so. In August 2008, SBA issued a notice of methodology in the *Federal Register* for measuring the impact of the HUBZone program. However, the proposed methodology was not well developed. For example, it did not incorporate expert input or a previous study conducted by SBA's Office of Advocacy. We do not believe that this effort was useful for addressing our recommendation. While SBA continues to agree that evaluating program outcomes is important, to date the agency has not yet committed resources for such an evaluation.

VA Faced Challenges in Verifying Veteran-Owned and Service-Disabled Veteran-Owned Firms

In May 2010, we reported that VA had made limited progress in implementing an effective verification program.[18] The 2006 Act requires that VA give priority to veteran-owned and service-disabled veteran-owned small businesses when awarding contracts to small businesses and provides for the use of sole-source and set-aside contracts to achieve contracting goals VA must establish under the Act.[19] The Act also requires VA to maintain a database of veteran-owned and service-disabled veteran-owned small businesses and verify the ownership, control, and veteran or service-disabled status of businesses in the database. The database would be available to other federal agencies. Furthermore, businesses conducting contract work for VA must be listed in the database to receive contracting preferences for veteran-owned and service-disabled veteran-owned small businesses. This verification requirement is unique to VA. For other federal agencies, the service-disabled veteran-owned small business program is a self-certification program and therefore is susceptible to misrepresentation (that is, ineligible firms participating in the program).

While the 2006 Act requires VA to use the veteran preferences authorities to award contracts only to verified businesses, VA's regulation did not require that this take place until January 1, 2012. Since our May 2010 report, Congress passed the Veterans Small Business Verification Act requiring VA to accelerate its time frame for verifying all businesses in its

[18]GAO-10-458.

[19]Pub. L. No. 109-461, § 502, 120 Stat. 3403, 3431 (2006), codified at 38 U.S.C. § 8127, as amended.

mandated database. VA has set a target date of July 31, 2011, to do so.[20] In fiscal year 2009, 25 percent of the contracts awarded using veteran preference authorities went to verified businesses. At the time of our report, VA had verified about 2,900 businesses—approximately 14 percent of businesses in its database of veteran-owned and service-disabled veteran-owned small businesses. Among the weaknesses we identified in VA's verification program were files missing required information and explanations of how staff determined that control and ownership requirements had been met. VA's procedures call for site visits to further investigate the ownership and control of higher-risk businesses, but the agency had a large and growing backlog of businesses awaiting site visits. Furthermore, VA contracting officers awarded contracts to businesses that were denied after the verification process. Finally, although site visit reports indicate a high rate of misrepresentation, VA had not developed guidance for referring cases of misrepresentation for investigation and enforcement action. Such businesses would be subject to debarment under the 2006 Act.

To help address the requirement to maintain a database of verified businesses, we recommended that VA develop and implement a plan for a more thorough and effective verification program. More specifically, we recommended that the plan address actions and milestone dates for improving the program, including updating data systems to reduce manual data entry and adding guidance on how to maintain appropriate documentation, on when to request documentation from business owners or third parties, and on how to conduct an assessment that addresses each eligibility requirement. We also recommended that VA conduct timely site visits at businesses identified as higher risk and take actions based on site visit findings, including prompt cancellation of verified status.

According to VA officials, they have taken a number of actions to address our recommendations. For example, VA officials told us they had awarded contracts to help expedite the processing of applications, including

[20]The Veterans Small Business Verification Act, Pub. L. No. 111-275, § 104, 124 Stat. 2864, 2867 (2010), requires that effective October 13, 2010, no new small business applicant may appear in VA's database unless it has been verified as owned and controlled by a veteran or service-disabled veteran. Additionally, VA was required to notify all unverified businesses in its veteran-owned small business and service-disabled veteran-owned small business database as of October 13, 2010, about the need to provide supporting business documents that establish the veteran ownership and control of the small business. Firms were required to do so by 90 days of receipt of the notification in order to avoid removal from VA's database.

conducting site visits and reviewing documentation supplied by applicants. As of March 29, 2011, they said that 607 site visits had been conducted and 195 of the applicants visited (32 percent) did not meet the control requirement. Also, VA officials reported a queue of 6,431 active applications pending verification and said they had acquired the capability to process 500 applications per week and expected to have processed about 15,000 applications by July 31, 2011. Furthermore, VA officials told us that as part of their implementation of the requirements of the Veterans Small Business Verification Act, all applicants are now required to submit specified documents establishing their eligibility with respect to ownership and control before a verification decision can be made. VA officials told us they were in the process of testing a new case management system that will reduce the manual input of data, which they plan to implement by June 1, 2011. VA's development of an effective verification program could provide an important tool for SBA's oversight of the governmentwide contracting program for service-disabled veteran-owned small businesses. That is, VA's database could serve as a resource for federal agencies to use when assessing whether a firm is actually service-disabled veteran-owned.

SBA's Key Controls for Determining Continued 8(a) Eligibility Needed to Be Strengthened

We reported in March 2010 that while SBA relies primarily on its annual reviews of 8(a) firms to help ensure the continued eligibility of firms in the program, we observed inconsistencies and weaknesses in annual review procedures related to determinations of continued eligibility.[21] For example, SBA did not consistently notify or graduate 8(a) firms that exceeded industry averages for economic success or graduate firms that exceeded the net worth threshold of $750,000 (see table 2). We noted that the lack of specific criteria in the current regulations and procedures may have contributed to the inconsistencies that we observed and that SBA had taken steps to clarify some, but not all, of these requirements in a proposed rule change.[22]

[21]GAO-10-353.

[22]The proposed rule has since been finalized. See 76 Fed. Reg. 8222 (Feb. 11, 2011) (to be codified at 13 C.F.R. pts. 121 and 124). This rule became effective on March 14, 2011.

Table 2: Estimated Percentage of Time That SBA Did Not Complete Selected Annual Review Procedures Relating to 8(a) Eligibility

Requirement not met	Estimated percentage
Taking action when a firm exceeded industry averages for economic success by	
• Notifying firms that exceeded four of seven industry averages for 1 year	26%
• Graduating or explaining retention of firms that exceeded four of seven industry averages for 2 consecutive years	4
Reviewing net worth or graduating firms in which individuals exceeded adjusted net worth limitations	7
Performing required eligibility reviews because of a change in the firms' ownership	4
Completing required annual reviews	2
Documenting supervisory reviews	23
Imposing remedial actions or obtaining waivers for firms not meeting business activity targets	10

Source: GAO analysis of a random sample of 123 8(a) firms.

Note: These estimates are based upon a random sample. For information on our methodology, see GAO-10-353.

We also reported that SBA's program offices did not maintain comprehensive data on or have a system in place to track complaints about the eligibility of firms in the 8(a) program. District staff were not aware of the types and frequency of complaints across the agency. As a result, SBA staff lacked information that could be used to help identify issues relating to program integrity and help improve the effectiveness of SBA oversight. Although complaint data are not a primary mechanism to ensure program eligibility, continuous monitoring is a key component in detecting and deterring fraud.

We recommended that SBA provide more guidance to help ensure that staff more consistently follow annual review procedures and more fully utilize third-party complaints to identify potentially ineligible firms. According to SBA officials, they have taken some actions to address these recommendations. For example, SBA officials told us that in August 2010 they had provided staff with a new guide for conducting annual reviews of the continuing eligibility of firms in the 8(a) program. Additionally, SBA officials said they were providing training to staff on the recently published revisions to regulations governing the 8(a) program. These revisions provided more clarification on factors that determine economic disadvantage (such as total assets, gross income, retirement accounts) for continuing eligibility in the program. SBA officials also said that they have been incorporating changes into their Web site that will allow third parties to submit complaints about potentially ineligible firms in the 8(a) program.

Chair Landrieu, Ranking Member Snowe, this concludes my prepared statement. I would be happy to respond to any questions you or other Members of the Committee may have at this time.

Contacts and Staff Acknowledgments

For further information on this testimony, please contact me at (202) 512-8678 or shearw@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this statement. Key contributors to this testimony include Paige Smith, Assistant Director; Tania Calhoun; Andy Finkel; Janet Fong; Triana McNeil; Harry Medina; Barbara Roesmann; Kathryn Supinski; and Bill Woods.

Appendix I: Economic Development Programs

Table 3 lists the 80 economic development programs and provides information about their funding, when available. Using the Catalog of Federal Domestic Assistance and other agency documents, we identified 80 federal programs administered by the four agencies listed below—the Departments of Commerce (Commerce), Housing and Urban Development (HUD), and Agriculture (USDA) and the Small Business Administration (SBA)—that could fund economic development activities. We did not include tax credit programs aimed at economic development in this review.

Table 3: FY 2010 Funding for Economic Development Programs

Agency	Program Name	FY 2010 Funding[a]
Commerce	Community Trade Adjustment Assistance	$0
Commerce	Grants for Public Works and Economic Development Facilities	158,930,000
Commerce	Economic Development/Support for Planning Organizations	31,391,000
Commerce	Economic Development/Technical Assistance	9,800,000
Commerce	Economic Adjustment Assistance	45,270,000
Commerce	Research and Evaluation Program	1,963,000
Commerce	Trade Adjustment Assistance	18,987,000
Commerce	Global Climate Change Mitigation Incentive Fund	25,000,000
Commerce	Minority Business Enterprise Centers	8,601,193
Commerce	Native American Business Enterprise Centers	1,351,500
Commerce	Minority Business Opportunity Center	1,512,500
USDA	Empowerment Zones	500,000
USDA	Woody Biomass Utilization Grant Program	5,000,000
USDA	1890 Land Grant Institutions Rural Entrepreneurial Outreach Program/Rural Business Entrepreneur Development Initiative/BISNET	0
USDA	Distance Learning and Telemedicine Loans and Grants	33,300,000
USDA	Rural Telephone Loans and Loan Guarantees	0
USDA	Public Television Station Digital Transition Grants	4,500,000.00
USDA	Community Connect Program	18,000,000.00
USDA	Rural Broadband Access Loans and Loan Guarantees	29,000,000.00
USDA	Rural Electrification Loans and Loan Guarantees	0
USDA	Assistance to High Energy Cost Rural Communities	17,500,000
USDA	Denali Commission Loans and Grants	0
USDA	State Bulk Fuel Revolving Fund Grants	0
USDA	Small Business Innovation Research	22,000,000
USDA	Biomass Research and Development Initiative Competitive Grants Program	0
USDA	Schools and Roads—Grants to States	0

Agency	Program Name	FY 2010 Funding[a]
USDA	Schools and Roads—Grants to Counties	0
USDA	Community Facilities Loans and Grants	36,800,000
USDA	Water and Waste Disposal Loans and Grants (Section 306C)	489,100,000
USDA	Water and Waste Disposal Systems for Rural Communities	0
USDA	Emergency Community Water Assistance Grants	13,000,000
USDA	Technical Assistance and Training Grants	19,500,000
USDA	Grant Program to Establish a Fund for Financing Water and Waste Water Projects	500,000
USDA	Solid Waste Management Grants	3,400,000
USDA	Value Added Producer Grants	19,400,000
USDA	Biobased Products and Bioenergy Program	2,000,000
USDA	Agriculture Innovation Center	0
USDA	Small Socially-Disadvantaged Producer Grants	3,500,000
USDA	Intermediary Re-lending	8,500,000
USDA	Business and Industry Loans	52,900,000
USDA	Rural Business Enterprise Grants	38,700,000
USDA	Rural Cooperative Development Grants	8,300,000
USDA	Rural Business Opportunity Grants	2,500,000
USDA	Rural Economic Development Loans and Grants	0
USDA	Biorefinery Assistance Program	245,000,000
USDA	Rural Energy for America Program	99,400,000
USDA	Rural Microentrepreneur Assistance Program	9,000,000
HUD	Community Development Block Grant (CDBG)/Entitlement Grants	2,760,223,970
HUD	CDBG/Special Purpose/Insular Areas	6,930,000
HUD	CDBG/States	1,176,594,747
HUD	CDBG/Non-entitlement CDBG Grants in Hawaii	5,791,797
HUD	CDBG/Brownfields Economic Development Initiative	17,500,000
HUD	CDBG/Section 108 Loan Guarantees	6,000,000
HUD	Section 4 Capacity Building for Affordable Housing and Community Development	50,000,000
HUD	Rural Innovation Fund	25,000,000
HUD	CDBG Disaster Recovery Grants	100,000,000
HUD	Indian CDBG	65,000,000
HUD	Hispanic Serving Institutions Assisting Communities	6,250,000
HUD	Alaska Native/Native Hawaiian Institutions Assisting Communities	3,265,000
HUD	Sustainable Communities Regional Planning Grant Program	98,000,000
HUD	Community Challenge Planning Grant Program	40,000,000
SBA[b]	8(a) Business Development Program	56,817,000
SBA	7(j) Technical Assistance	3,400,000

Agency	Program Name	FY 2010 Funding[a]
SBA	Procurement Assistance to Small Businesses	3,164,000
SBA	Small Business Investment Companies	24,262,000
SBA	7(a) Loan Program	95,090,000
SBA	Surety Bond Guarantee Program	1,000,000
SBA	SCORE	7,000,000
SBA	Small Business Development Centers	113,000,000
SBA	504 Loan Program	36,232,000
SBA	Women's Business Centers	14,000,000
SBA	Veterans' Businesses Outreach Centers	2,500,000
SBA	Microloan Program	25,315,000
SBA	PRIME	8,000,000
SBA	New Markets Venture Capital Program	0
SBA	7(a) Export Loan Guarantees	0
SBA	HUBZone	2,200,000
SBA	Small Business Technology Transfer Program	0
SBA	Small Business Innovation Research Program	0
SBA	Federal and State Technology Partnership Program	2,000,000
	Grand Total	**$6,238,641,707**

Source: GAO analysis of information from Commerce, HUD, SBA, and USDA.

[a]According to agency officials, the programs listed above that did not receive funding in fiscal year 2010 are still active programs and are denoted with "0."

[b]SBA officials provided revised fiscal year 2010 funding figures for 18 of their 19 economic development programs since their original submission to us in December 2010.

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Chair LANDRIEU. Thank you very much.
Mr. Baron.

STATEMENT OF KEVIN BARON, DIRECTOR OF GOVERNMENT AFFAIRS, AMERICAN SMALL BUSINESS LEAGUE

Mr. BARON. Thank you, Madam Chair, Ranking Member Snowe, Senator Paul. My name is Kevin Baron. I am the Director of Government Affairs for the American Small Business League. We are an independent small business advocacy organization that focuses on creating the greatest opportunities for small businesses to work with the Federal Government and on ending the diversion of billions of dollars a month in Federal small business contracts to large corporations. The American Small Business League reaches a constituency of approximately 100,000 small businesses nationwide, the majority of whom are small Federal contractors or small businesses that are wanting to work with the Federal government.

Considering the current economic climate, small businesses are a vital asset to the U.S. economy, so we must not only ensure that they are being provided all possible help, but the greatest opportunity to effectively work within the Federal marketplace. According to the latest data from the U.S. Census Bureau, small businesses are currently creating over 90 percent of all net new jobs. Furthermore, small businesses are responsible for over half of the GDP and more than 50 percent of the non-farm private sector workforce. And, historically, small businesses are our Nation's driver for job creation and the creators of the economic growth necessary to pull our country out of times of recession. This is key to understanding the important role that small business contracting programs play to the overall health of our Nation's economy.

In 2005, the Small Business Administration Office of Inspector General released Report 5–15 that stated, "One of the most important challenges facing the Small Business Administration and the entire Federal Government today is that large businesses are receiving small business procurement awards and agencies are receiving credit for these awards." For the past 6 consecutive years, the SBA IG continues to list the same issue as one of the agency's top management challenges.

In addition to Report 5–15, since 2003 there has been a whole series of Federal investigations from the GAO and various other Inspectors General showing areas of fraud and abuse within these small business contracting programs. This fraud and abuse has materialized in the diversion of billions of dollars in small business contracts to large companies, multinational corporations, Fortune 500 firms, and businesses otherwise not qualified as small. We have conducted extensive analysis on our own of this data, a lot of which was submitted with my written testimony, and I would be more than happy to discuss that in greater detail if necessary.

Small business contracting programs are credited with helping millions of small businesses nationwide, and in these times when we are focusing on the area of fiscal responsibility, small business contracting programs are a major answer to this.

Federal small business contracting programs are a deficit-neutral way of creating jobs and stimulating economic growth. The programs are already in place; the infrastructure already exists; the money that the agencies spend is already being budgeted. The Government does not produce computers. It does not construct buildings. So there will always be contracting out for goods and services. Thus, these programs are a vital way to drive demand back into the hands of our small firms.

Senator Landrieu, in February of last year you specifically stated, "Government contracts are perhaps one of the easiest and most inexpensive ways the Government can help immediately increase sales for America's entrepreneurs, giving them the tools they need to keep our economy strong and create jobs. By increasing contracts to small businesses by just 1 percent, we can create more than 100,000 new jobs—and today, we need those jobs more than ever." I could not agree with you more on that statement. Based on that estimate, fixing some of these programs could result in the creation of over 1 million jobs.

I know I am short on time. Let me wrap up really quick, please.

Our understanding is that some agency employees and SBA officials believe that the Government's 23-percent procurement goal is not achievable. I am here to state that that belief could not be further from the truth. And, in fact, the Government's small business goal can be achieved or surpassed by simply implementing a series of targeted reforms to small business programs. I will just outline three real quick steps.

One is to pass a Senate companion version of the Fairness and Transparency in Contracting Act. This was a bill introduced in the previous Congress by Congressman Hank Johnson of Georgia. He plans on reintroducing this bill in the House again this year. It will shut down a major loophole that has allowed large firms to get small business contracts.

Secondly, to establish a small business set-aside program for task orders placed against GSA schedules or other Government Wide Acquisition Contracts, or GWACs, or large Government contract vehicles. Years ago, Congress passed legislation mandating that any contract with a value less than $100,000 be specifically set-aside for small businesses. Shortly after passage, the FAR Council passed a rule exempting GSA schedule contracts from that, and let me say that contracting data shows that over one-fifth of all Federal contract actions are under $100,000; however, a majority of those contracts go to large firms. So simply removing that exemption and putting a set-aside rule in place for other GWACs could significantly increase the pool of opportunities for small businesses to work with the Government and would help in achieving or superseding that 23-percent goal.

Lastly, we ask for and applaud the introduction of S. 633 and push for the passage of that legislation. It creates some teeth within the law and provides tools for various agency officials such as the SBA IG as well as outside advocates to strictly enforce fraud in contracting programs. Contractors need to know that there is punishment for committing fraud and that that will be followed up on.

Let me finish please by stating again——

Chair LANDRIEU. Mr. Baron, you are already 2 minutes over. I am sorry.

Mr. BARON. Okay.

Chair LANDRIEU. It was wonderful testimony, but I have to be fair to everyone, and thank you so much.

Mr. BARON. I understand. Thank you.

[The prepared statement of Mr. Baron follows:]

American small business League

Testimony

An Examination of SBA Programs: Eliminating Inefficiencies, Duplications, Fraud and Abuse

Kevin M. Baron
Director of Government Affairs
American Small Business League

Senate Committee on Small Business and Entrepreneurship
The Honorable Mary Landrieu, Chair

June 16, 2011

Thank you Madam Chairwoman Landrieu, Ranking Member Snowe and committee members for drawing attention to these important small business issues, and for the opportunity to speak before you today.

My name is Kevin Baron, Director of Government Affairs for the American Small Business League (ASBL), an independent small business advocacy organization focused on creating the greatest opportunities for small businesses to work with the federal government, and on ending the diversion of billions of dollars a month in federal small business contracts to large corporations. The ASBL reaches a constituency of approximately 100,000 small businesses nationwide, the majority of whom are small federal contractors or small businesses wanting to work with the federal government.

Considering the current economic climate, small businesses are a vital asset to the U.S. economy. We must ensure is not only provided all possible help, but the greatest opportunity to effectively work within the federal marketplace.

According to the latest data from the U.S. Census Bureau, small businesses are currently creating over 90 percent of all net new jobs. Furthermore, small businesses are responsible for over half of GDP and more than 50 percent of the non-farm private sector workforce. Historically, small businesses have driven our nation's job creation, and created the economic growth necessary to pull America out of times of recession.

This is key to understanding the important role small business contracting programs play in the health of our nation's economy.

In 2005, the Small Business Administration Office of Inspector General (SBA IG) released Report 5-15 stating, "One of the most important challenges facing the Small Business Administration (SBA) and the entire Federal Government today is that large businesses are receiving small business procurement awards and agencies are receiving credit for these awards." For the past six consecutive years, the SBA IG continues to list the same issue as one of the agency's top management challenges.

In addition to Report 5-15, since 2003 a series of federal investigations have uncovered rampant fraud and abuse in small business contracting programs. This fraud and abuse has materialized in the diversion of billions of dollars a year in small business contracts to: large companies, Fortune 500 firms, multinational corporations and businesses otherwise not qualified as small. To further illustrate the magnitude of the problem, the ASBL has conducted a series of investigations into contracting data, as provided by the government's own Federal Procurement Data System – Next Generation (FPDS-NG). FPDS-NG is a repository of federal contracting data maintained by the General Services Administration (GSA). Using data pulled directly from FPDS-NG, the ASBL was able to conduct analyses of the top 100 recipients of federal small business contracts for the past three fiscal years (FY).

- During FY 2008, the ASBL found 60 out of the top 100 recipients of federal small business contracts were actually large businesses. Those 60 firms received $9.7

billion in small business contracts or 64.36 percent of the total dollars the government claimed to have awarded to small businesses.

- During FY 2009, the ASBL found much of the same with 61 large businesses in the top 100 recipients of federal small business contracts, which received $10.7 billion in small business contracts or 64.5 percent.

- Recently, the ASBL completed its initial analysis of the government's FY 2010 small business contracting data, and found 52 large corporations in the top 100 recipients of federal small business contracts, which received $9.5 billion in small business contracts or 59.5 percent of contracts the government claims to have awarded to small businesses.

The ASBL's investigations into the recipients of small business contracts have yielded household names such as: Lockheed Martin, Raytheon, L-3 Communications, AT&T, Hewlett-Packard, 3M Corporation, General Dynamics, Xerox, Office Depot, Honeywell, Harris Corporation, and ManTech Corporation. Additionally, foreign-owned companies such as British Aerospace Engineering (BAE), Rolls-Royce, QinetiQ, Finmeccanica (Italy), Ssangyong Corporation (South Korea), and Thales Communications (France) have received federal small business contracts.

To further compound the issue, the ASBL has uncovered the yearly awarding of a significant volume of contracts to generic categories such as "Miscellaneous Foreign Contractors," "Small Business Consolidated Reporting," and "Classified Domestic Contractor." Companies classified into these generic categories have received hundreds of millions of dollars in federal contracts with little oversight or accountability. These contract dollars are annually included in the federal government's small business goaling achievement. ASBL requests under the Freedom of Information Act (FOIA) have indicated that there is no government wide monitoring of the awarding of contracts to these generic categories and no public accountability.

Based on these federal investigations, and the ASBL's own internal research, we have long maintained that between 50 and 80 percent of all federal contracts the government claims to have awarded to small businesses actually went to businesses that were not small at the time of award. This equates to more than $100 billion a year, and an aggregate total of more than $1 trillion over the last decade. This also equates to a significant shortfall in the government's achievement of the congressionally mandated 23 percent small business procurement goal on a year-to-year basis.

Adding to the government's shortfall of the 23 percent goal is the loss of an average of $100 billion in contracts through SBA reporting methods that fail to adhere to the Small Business Act. Section 15(g)(1) of the Small Business Act clearly states, "The Government-wide goal for participation by small business concerns shall be established at not less than 23 percent of the total value of all prime contract awards for each fiscal year." However, the SBA calculates the government's small business goal based on "small business eligible" actions and dollars. We are not aware of a legal basis for this method. For example, in Fiscal Year (FY) 2009, the SBA reported that the government awarded approximately $96 billion to small businesses out of a total $442 billion, when in fact, according to FPDS-NG, the total dollar volume of prime contracts awarded in FY 2009 was approximately $545 billion. Twenty-three percent of $545 billion is $125 billion, whereas the SBA claimed that $96 billion was just under 22 percent. By simply taking into account the omitted $103 billion in prime contracts, the government's claimed small business goaling achievement drops by 5 percent, to 17 percent.

Small business contracting programs run through the SBA can be credited with helping millions of small business achieve success. This success translates to real economic growth and job creation at a local level. Without these programs, scores of minority-owned, woman-owned, economically disadvantaged, and veteran-owned businesses would not have been able to grow into thriving economic successes. As we address issues of fraud, abuse and problems within federal small business contracting programs, I must stress again, the vital importance these programs play, not just to small businesses, but to the U.S. economy as a whole.

In these tough economic times, recent discussion in Washington has focused on fiscal responsibility. Small business contracting programs are one major answer. As previously stated, the latest U.S. Census Bureau data shows that small businesses create over 90 percent of all net new jobs. Federal small business contracting programs are a deficit-neutral means of creating jobs and stimulating economic growth. The program infrastructure is in place, and that infrastructure has already been paid for. That said, the ASBL is a major proponent of maximizing the effectiveness of government small business contracting programs by simply ensuring that small businesses are getting the 23 percent of federal funds directed to them by federal law.

The fact is that the government does not make computers, construct buildings or create any of the thousands of goods and services that are contracted for annually. Every federal agency has a procurement budget in place, thus the money is already budgeted to be spent regardless. That is why the small business contracting programs and meeting or exceeding the 23 percent goal is a deficit neutral and vital economic tool to drive demand and growth.

Senator Landrieu, in February of last year you said, "Government contracts are perhaps one of the easiest and most inexpensive ways the government can help immediately increase sales for America's entrepreneurs, giving them the tools they need to keep our economy strong and create jobs. By increasing contracts to small businesses by just 1 percent, we can create more than 100,000 new jobs – and today, we need those jobs more than ever." I could not agree more.

The ASBL's research into the actual recipients of federal small business contracts suggests that the government has consistently failed to award more than 5 percent of the total value of all federal contract dollars to small businesses. This represent's an 18 percent shortfall from the government's 23 percent goal, and a stark contrast from the SBA's claims that it awarded small businesses 21.5 percent during FY 2008, and 21.89

percent during FY 2009. With the aforementioned shortfall in mind, the ASBL has estimated that ending fraud and abuse in small business contracting programs, and meeting the congressionally mandated 23 percent small business procurement goal would create more than 1.8 million jobs.

It is our understanding that some agency and SBA employees believe that the government's 23 percent small business goal is not achievable. I am here to tell you that that belief could not be further from the truth. In fact, the government's small business goal could be achieved or surpassed by implementing a series of targeted reforms to small business programs. The following steps could be taken to easily achieve, and or surpass the government's small business goals:

1. Pass a Senate companion bill to the Fairness and Transparency in Contracting Act. Congressman Hank Johnson (D-GA-4) previously introduced the bill in the 111th Congress. Specifically, the bill would clarify the definition of a small business as stated in the Small Business Act by including the additional requirement that no publicly traded business concern be qualified as a small business. This would mean that a publicly traded business concern, subsidiary of a publically traded business concern, foreign owned business concern, or subsidiary of a foreign owned business concern could no longer be counted as a small business for the purpose of government contracting and subcontracting, including for procurement goals. The ASBL is confident that the passage of the Fairness and Transparency in Contracting Act would end the diversion of billions of dollars a year in federal small business contracts to corporate giants, and redirect those funds to the nation's small business community, creating vital economic growth in every state and a multitude of jobs.

In addition, the bill would strengthen enforcement – requiring timely action on complaints and at least a five-year debarment for a firm that falsely claims to be a small business. It also allows any person to file a complaint with the SBA, and the affected federal agency, if the person feels a small business contract was improperly awarded. Finally, the bill requires the SBA to submit an annual report to Congress detailing the nature of the complaints and their resolution. The ASBL strongly recommends the Fairness and Transparency in Contracting Act as an effective legislative remedy.

2. Establish a small business set-aside program for task orders placed against GSA schedules and other Government Wide Acquisition Contracts (GWAC) or large government contract vehicles. Years ago, Congress passed legislation mandating that any contract with a value less than $100,000 be set-aside for small businesses. Shortly after passage, the Federal Acquisition Regulation (FAR) Council passed a rule exempting GSA schedule contracts from that set-aside. Contracting data shows that over one-fifth of all federal contract actions are under $100,000, however a majority of those contracts go to large firms. Simply removing that exemption and putting a set-aside rule in place for other GWAC's, and government contract vehicles, would significantly increase the pool of contracts available to small businesses. This would have a profound and measurable impact on the government's ability to meet or exceed its 23 percent small business procurement goal.

3. Pass S. 633, the Small Business Contracting Fraud Prevention Act of 2011. As a means of addressing small business contracting programs, it is vital that large companies or firms not qualified as small businesses, who receive small business contracts, are held accountable for their actions with criminal or administrative punishment. To that end, S. 633, as introduced by Ranking Member Snowe and Madam Chairwoman Landrieu, takes a necessary step forward toward addressing fraudulent companies. The ASBL loudly applauds those efforts. In order to prevent fraud and abuse, potential offenders must know that there are real consequences for their actions. S. 633 furnishes existing law with teeth that will facilitate prosecution of offenders, and afford government officials and small business advocates with a new arsenal of tools that may yield prosecutions of fraudulent contractors.

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Over the past several years, investigations from the U.S. Government Accountability Office (GAO) have shown widespread fraud and abuse within federal contracting programs like the 8(a) business development program, the HUBZone program, and the Service-Disabled Veteran Owned Small Business program. As implementation of the women-owned small business program has begun, the ASBL is concerned that problems will begin to arise within that program as well. With that in mind, the ASBL reminds the committee that we must maintain a broad perspective while working towards solutions to the many challenges facing small business contracting programs. While examining the intricacies of each individual program is important; in doing so, we risk losing sight of the important role these programs play in support of small businesses across the country in general. Each of the aforementioned programs plays a vital role for small businesses, and economic growth.

With that in mind, we believe that it should be the committee's first priority to address the broader issue of large businesses and other fraudulent contractors receiving billions of dollars in federal contracts intended for small businesses. Fixing this problem will benefit small businesses in every state across the United States, including small firms operating within the government's small business set-aside programs.

Members of the Committee, it begins with you. Thank you for not only drawing attention to these vital issues, but for your willingness to enhance the quality of the business environment for small government contractors. I would also like to thank you for affording me the time to speak with you, and look forward to responding to any questions you may have.

American small business League

Kevin Baron
Director of Government Affairs

Kevin Baron has been the Director of Government Affairs for the American Small Business League (ASBL) since the summer of 2007. In his capacity he coordinates the Organization's government affairs activities in Washington D.C. and Sacramento. Mr. Baron works with executives and legislators at the state and national level, chambers of commerce, small business advocates, and small business leaders to provide workable solutions for small businesses on a wide variety of issues, including: government procurement, health care, small business lending, job creation, deficit reduction, adherence to small business contracting and subcontracting goals, and the elimination of fraud abuse, and loopholes from small business contracting programs.

During his time with the ASBL, Mr. Baron has successfully navigated the American political environment rendering significant results for the small business community. During the 111th Congress, Mr. Baron worked in cooperation with ASBL President Lloyd Chapman and Congressman Hank Johnson (D – GA) to introduce H.R. 2568, the Fairness and Transparency in Contracting Act of 2009. H.R. 2568 is the first legislation designed to stop the diversion of over $100 billion a year in federal small business contracts to Fortune 500 firms and other clearly large publicly traded companies. Mr. Baron worked with Congressman Joe Sestak (D-PA) on H.R. 4420, the Small Business Contracting Protection Act, which addresses the "pass-through" issue, where large firms use small business fronts to funnel federal small business contracts back to the large business. Most recently, Mr. Baron played a key role in working with members of Congress to request an investigation by the U.S. Government Accountability Office (GAO) into a major small business subcontracting program facilitated by the Department of Defense.

Mr. Baron received his Masters Degree in Public Administration from Sonoma State University in December of 2010, where he also received Bachelors Degree in Political Science. Mr. Baron has been accepted into a PhD program in American Politics at the University of Florida. Mr. Baron is a small business watchdog and passionate professional, who is dedicated to advocating for those without a voice.

Chair LANDRIEU. I really appreciate it.
Mr. DeHaven.

STATEMENT OF TAD DEHAVEN, BUDGET ANALYST, CATO INSTITUTE

Mr. DEHAVEN. Chair Landrieu, members of the committee, thank you for inviting me here to testify today regarding the Small Business Administration.

Chair LANDRIEU. Is your microphone on? Is your button pressed?

Mr. DEHAVEN. There we go. Thank you.

Chair LANDRIEU. There we go.

Mr. DEHAVEN. Most Americans correctly recognize that Washington does a poor job of managing their money. The Cato Institute has documented countless examples of waste, fraud, and abuse at its website, www.DownsizingGovernment.org.

Policymakers on both sides of the aisle recognize that examples of waste, fraud, and abuse do not sit well with the American people and are, therefore, constantly promising that they will work to eliminate Government waste.

What few in Washington want to acknowledge is that waste, fraud, and abuse always comes with Government programs—the same way a Happy Meal always comes with a toy and a drink.

For decades, there have been efforts to end such abuses, but Federal programs are extremely complex and they deliver benefits to thousands or millions of recipients. As a result, Government programs are always chasing their tail. In the private sector, businesses have a financial incentive to stop abuses before they happen. No such incentive exists with Government programs.

The Small Business Administration is no stranger to waste, fraud, and abuse. By the mid-1970s, the agency had earned the nickname "Small Scandal Administration."

Now, we have already discussed today many examples of waste, fraud, and abuse, duplication, and inefficiency, so we will move along, therefore. And as I discussed, however, Government programs and waste go hand in hand. Generally speaking, the more the Government spends, the more taxpayer dollars will be wasted. Therefore, the best way to rein in waste and inefficiencies is to rein in the size and scope of Government.

Economic development subsidies are not a proper role of the Federal Government. Indeed, what policymakers innocuously refer to as "economic development" is just a form of central planning. Central planning can end badly for the general public, as demonstrated by the recent housing collapse and economic downturn, which is a direct result of distortions in the housing market fostered by Government policies.

In addition to the taxpayer costs, there are other problems with SBA-style economic development or what is called "corporate welfare.

First, corporate welfare creates an uneven playing field. By aiding some businesses, corporate welfare puts other businesses at a disadvantage, which distorts markets. For example, small businesses that do not receive a loan backed by the SBA are disadvantaged because they must compete against a business that did receive Government backing.

Second, corporate welfare programs duplicate activities that are routinely, provided in private markets, such as lending. If such commercial-oriented activities are useful, then private markets should be able to perform them without Government help.

Third, corporate welfare generates an unhealthy relationship between businesses and Government. Corporate welfare creates special interests that work to protect their Government-granted privileges. Privileged interests have a strong incentive to build organized groups to lobby Congress to expand their benefits. These groups set up camp near Capitol Hill to advocate their issues, and many policymakers become convinced of the merits of special interest causes after hearing about them year after year.

At the same time, average citizens do not have a strong incentive to battle against particular subsidies because each program costs just a small part of their total tax bill.

In conclusion, many of the problems with the SBA that have been discussed today have been discussed for decades. There is only one way to eliminate those problems, and that is to abolish the Small Business Administration. The United States grew to become the economic envy of the world with a small central Government that largely left business development to the private sector. The dramatic ascent of the American economy did not come about as a result of small business subsidies and central planning from Washington. We should dispense with Government favoritism to small businesses and large businesses, and allow America's entrepreneurs to compete on a level playing field serving their customers.

Thank you very much.

[The prepared statement of Mr. DeHaven follows:]

Waste, Fraud, and Abuse in Small Business Administration Programs

Statement of Tad DeHaven, Budget Analyst, Cato Institute,

before the Senate Committee on Small Business and Entrepreneurship

June 16, 2011

Chairwoman Landrieu and members of the committee, thank you for inviting me to testify today regarding the Small Business Administration.

Waste, Fraud, and Abuse in Government Programs

Most Americans agree that waste, fraud, and abuse in government programs is a problem. A recent poll of likely voters found that those surveyed believe an average of 42 percent of every dollar spent by the federal government is wasted. The same poll also found that 60 percent of those surveyed believe that problems with the federal budget can be solved by simply eliminating waste, fraud, and abuse. In fact, 40 percent *strongly* agreed with this position.[1]

Although the belief that the government's budget problems can be solved by making bureaucracies simply run more efficiently is erroneous, the American people are correct that Washington does a poor job of managing their money. We have documented countless examples of waste at Cato's website, www.DownsizingGovernment.org. And the newspapers seem to have fresh stories every day of federal agencies making poor financial decisions

However, most people know very little about the breakdown of the federal government's $3.8 trillion budget, and many don't accept that huge deficits are caused by programs that benefit them. For example, the same poll found that 49 percent *disagreed* that Social Security and Medicare are a major source of problems for the federal budget. Attempting to reduce waste, fraud, and abuse is fine, but it won't solve our deficit-spending problem.

Policymakers on both sides of the aisle recognize that examples of waste, fraud, and abuse do not sit well with the American people. Therefore, it is hard – if not impossible – to find a policymaker who *doesn't* tell his or her constituents that they'll work to eliminate government waste. For example, previous House Speaker Nancy Pelosi instructed her committee chairs to uncover waste, fraud, and abuse as part of an effort to "ensure fiscal discipline for the long term." The House Republicans' "Pledge to America" included a promise to "root out government waste."

What few in Washington want to acknowledge is that waste, fraud, and abuse always comes with government programs—the same way a Happy Meal always comes with a toy and a drink. This is because the federal government is a vast money transfer machine. It spends hundreds of billions of taxpayer dollars each year on programs—from the massive Medicare to hundreds of more obscure programs that most people have never heard of.

Administrators don't do enough to police these massive transfers because people always tend not to spend other people's money as carefully as they spend their own money. And on the receiving end of programs, a vast number of people use the federal budget as a cookie jar to garner benefits to which they are not entitled.[2] Families seek improper benefits through subsidies such as the school lunch program. Hospitals rip off taxpayers by double-billing Medicare and Medicaid. Criminal gangs loot subsidy programs such as food stamps. Owners of nonprofit groups that are supposed to aid the needy line their own pockets with taxpayer funds.

For decades, there have been efforts to end such abuses, but federal programs are extremely complex and they deliver benefits to thousands or millions of recipients. When it comes to waste, fraud and abuse, government programs are always chasing their tail. In the private sector, businesses have a financial incentive to stop abuses before they happen. No such incentive exists with government programs. Instead, government administrators usually only uncover abuses after the fact, and often only after outside auditors or the media have investigated.

"Small Scandal Administration"

The Small Business Administration is no stranger to waste, fraud, and abuse. Indeed, the SBA was created in 1953 after the demise of the Depression era Reconstruction Finance Corporation, which lost support after allegations of influence peddling during the Truman administration. President Dwight Eisenhower was against creating the SBA in principle, but he signed the legislation as a politically expedient move that would counter criticisms that Republicans were beholden to "big business."

The SBA's problems started right away. In 1958, Eisenhower's Budget Bureau warned that the SBA was "an uncontrollable program," but both parties wanted to convey a message that they supported the "little fellow."[3] Members of Congress enjoyed using the SBA to distribute money and favors to their constituents. Members sometimes leaned on the agency to declare a particular business "small" or have a constituent's competitor declared "not small."

The 1960s and 1970s were marked by scandals and failures, including the reported use of SBA loans to establish "front" companies for the mafia. By the mid-70s, the agency had earned the nickname "Small Scandal Administration."[4]

The SBA has become one of the government's chief instruments for pursuing affirmative action, which has led to numerous scandals. Successive administrations used the agency to direct lending and federal contracts to minority-owned firms. Although stamping out discrimination is a laudable goal, the SBA's set-asides have bred corruption and abuse. For example, President Ronald Reagan supported an expansion of SBA procurement set-asides for minority-owned firms. That decision contributed to the "Wedtech Scandal" in which government officials knowingly assisted a corrupt defense contractor that had fraudulently obtained contracts through SBA minority set-asides.

More recently, the SBA has made headlines over abuses of its 8(a) program, which sets aside federal contracts for minority-owned or other "disadvantaged" small businesses. Alaskan Native Corporations, which were created by a federal law in 1971, were "intended to settle longstanding land claims by Alaska natives and provide economic opportunities." After Congress allowed the ANCs to participate in the 8(a) program in 1986, powerful Alaskan Senator Ted Stevens won them additional contracting privileges.

In the past couple of years, controversy has erupted over the ANCs' ability to subcontract work out to companies all over the country, including companies that are not small or "disadvantaged." Because the 2009 stimulus bill required recipients to publicly report subcontractors, researchers at ProPublica have been able to get a clearer idea of who is benefitting from the ANC privileges:

> An analysis by ProPublica, drawing on detailed reports of federal stimulus projects, shows for the first time that ANCs turned to subcontractors at twice the rate of all other federal contractors and significantly more often than other small, minority-owned firms.
>
> And at least some of this work has gone to large firms—General Electric, Kiewit and Lockheed Martin—the stimulus reports show, echoing government audits that have fueled the criticism of ANCs.
>
> Through September, ANCs had won stimulus contracts worth $823 million for 742 projects, according to the most recent government data. More than 350 projects, or nearly half, rely on subcontractors to do at least some of the work.
>
> By comparison, all other stimulus contractors subcontracted more than 5,600 of nearly 26,000 stimulus projects, or 22 percent. Other minority-owned firms hired subcontractors on 33 percent of their projects.[5]

An investigation by the *Washington Post* found similar abuses with the ANCs and defense contracts.[6] Somewhat humorously, the SBA told the *Post* that it was the Pentagon's responsibility to monitor the contracts, while the Pentagon said the responsibility belonged to the SBA. It's a classic example of bureaucratic ineptitude and finger pointing.

It's also a good example of how well-intentioned programs invariably become corrupted as Washington insiders and well-connected special interests game the system to their advantage. However, instead of trying to "fix" the problems these privileges foster, race-based set-asides should be abolished altogether. And if policymakers want to make life easier for businesses of all races and sizes, they should concentrate their efforts on eliminating burdensome taxes and regulations.

Loan Guarantees

The SBA's flagship 7(a) loan guarantee program guarantees loans issued by private lenders for up to 85 percent of the loss in the event the applicant defaults on the loan. As a result, lenders are more willing to lend money to riskier applicants because the SBA is ultimately responsible for the bulk of any losses. To offset the costs of the SBA's loan programs to the taxpayer, the SBA charges lenders a guaranty fee and a servicing fee for each loan approved and disbursed.

The SBA is supposed to charge fees sufficient to require no annual appropriations from Congress. However, this has not been the case and the program continues to rely on taxpayer subsidies. The recent recession led to an increase in loan defaults, which forced the SBA to increase its purchases of defaulted guaranteed loans from $1 billion in 2006 and 2007 to $3.9 billion in 2009 and $4.8 billion in 2010.[7] In addition, Congress recently passed multiple increases in loans subsidies at the Obama administration's behest in an attempt to goose small business lending.

The purpose of the 7(a) program is to incentivize lenders to provide loans to small businesses that cannot obtain "credit elsewhere."[8] However, the law defines "credit elsewhere" as "the availability of credit from non-Federal sources on reasonable terms and conditions."[9] This broad definition renders false the notion that the SBA only benefits those who literally cannot obtain credit elsewhere.

A recent Government Accountability Office report found that a third of the lenders it sampled "failed to consistently document that borrowers met the credit elsewhere requirement or personal resources test."[10] The GAO noted that for approximately 20 percent of lenders that did provide documentation, "the explanations they provided were generally not specific enough to reasonably support the lender's conclusion that borrowers could not obtain credit elsewhere."[11]

Audits conducted by the SBA's Office of Inspector General have identified "high percentages" of business loans to borrowers who were "ineligible, lacked repayment ability, or did not provide the required support for loan disbursement."[12]

The SBA outsources much of its loan decision-making to private lenders. According to the inspector general, "more than 68 percent of loan dollars guaranteed by SBA are made by lenders using delegated authorities with limited oversight."[13] Not surprisingly, the inspector general reports a long-standing problem with fraud in the 7(a) program:

> For more than a decade, OIG investigations have revealed a pattern of fraud in the 7(a) business loan guaranty program by loan packagers and other for-fee agents. Fraudulent schemes have involved hundreds of millions of dollars, yet SBA oversight of loan agents has been limited, putting taxpayer dollars at risk.[14]

The inspector general has repeatedly found deficiencies in the SBA's oversight of lenders, although it recently noted improvement. Ominously, the inspector general notes that "high-risk lenders now account for more than 80 percent of SBA's 7(a) outstanding portfolio."[15]

The share of guaranteed loans outstanding that the SBA is responsible for currently amounts to over $70 billion.

The inspector general also notes that the SBA "has not aggressively pursued recovery of improper payments."[16] Worse, the SBA appears to be intentionally understating its improper payments problem. For example, the SBA reported an improper payment rate in 2008 of 0.53 percent, but the inspector general found that it was actually 29 percent.[17]

Abolish the Small Business Administration

The Government Accountability Office recently counted 80 economic development programs at four agencies: the SBA, HUD, USDA, and Commerce.[18] The SBA administers 19 of these 80 programs. The four agencies administer a staggering 54 programs involved in "entrepreneurial efforts" alone.

The GAO summarizes its findings as follows:[19]

- The design of each of these economic development programs appears to overlap with that of at least one other program in terms of the economic development activities that they are authorized to fund;

- Commerce, HUD, SBA, and USDA appear to have taken actions to implement some collaborative practices but have offered little evidence so far that they have taken steps to develop compatible policies or procedures with other federal agencies or to search for opportunities to leverage physical and administrative resources with their federal partners; and

- The agencies appear to collect only limited information on program outcomes—information that is necessary to determine whether this potential for overlap and fragmentation is resulting in ineffective or inefficient programs.

The federal government clearly has a problem with duplication and inefficiency with regard to economic development programs. As I discussed, however, government programs and waste go hand-in-hand. Generally speaking, the more the government spends, the more taxpayer dollars will be wasted. Therefore, the best way to rein in waste and inefficiencies is to rein in the size and scope of government.

Economic development subsidies are not a proper role of the federal government. Indeed, what policymakers innocuously refer to as "economic development" is just a form of central planning. In other words, policymakers are substituting their decisions for market decisions on business lending and business investment.

Attempts by policymakers to direct economic activity through the use of subsidies and other privileges granted to particular interests and industries yield political benefits, but they don't benefit the general public. For example, the recent housing collapse and economic downturn was a direct result of distortions in the housing market fostered by government policies.[20]

In addition to the taxpayer costs, the following are some of the problems associated with SBA-style economic development or "corporate welfare:"

1. **Creates an Uneven Playing Field**. By aiding some businesses, corporate welfare puts other businesses at a disadvantage, which distorts markets. That distortion causes resources to flow from higher-valued to lower-valued uses in the economy, which reduces the nation's output.

2. **Duplicates Private Activities**. Many federal programs duplicate activities that are routinely provided in private markets, such as insurance, loans, and marketing. If such commercial-oriented activities are useful, then private markets should be able to perform them without government help.

3. **Harms Businesses and Consumers**. Government support for some businesses damages other businesses and consumers. For example, small businesses that don't receive a loan backed by the SBA are disadvantaged because they must compete against a business that did receive government backing.

4. **Picking Winners Is a Losing Game**. Washington politicians are no more clairvoyant about market trends and scientific breakthroughs than anyone else. Thus, when the government starts choosing industries and technologies to subsidize, it often bets on the wrong horses at taxpayer expense. Note that businesses and venture capital firms make many investments that turn sour as well, but their losses are private and not foisted involuntarily on other people.

5. **Fosters Corruption**. Corporate welfare generates an unhealthy relationship between businesses and the government. As I noted in my testimony, the SBA has a history of scandals that resulted from the government being too cozy with private interests.

Small Business Administration activities – particularly its guaranteed loan programs – display all of these undesirable qualities.

Another undesirable quality is the emergence of special-interests that work to protect their government-granted privileges. Privileged interests have a strong incentive to build organized groups to lobby Congress to expand their benefits. These groups set up camp near Capitol Hill to advocate their issues, and many policymakers become convinced of the merits of special interest causes after hearing about them year after year.

At the same time, average citizens do not have a strong incentive to battle against particular subsidies because each program costs just a small part of their total tax bill. Besides, when average citizens do speak out against particular programs, they are outgunned by the paid professionals who defend each program. These professionals are experts at the complex features of programs, and they are skilled at generating media support for their causes. One technique they use is to cloak the private interests of subsidy recipients in public interest clothing—for example, when government-guaranteed lenders speak of the value of the SBA's 7(a) program to "the small business community" while downplaying the program's value to the lenders' bottom lines.[21]

Another reason it is hard for average citizens to challenge special interest spending is that lobby groups, Congress, and federal agencies rarely admit that any program is a failure or unnecessary. The people in these organizations never admit failure because they become vested in the continued funding of programs since their careers, pride, and reputations are on the line. They battle against any cuts to programs at a personal and emotional level.

The National Association of Government Guaranteed Lenders certainly isn't here today to tell the committee that the 7(a) program ought to be scrapped. It is interesting, though, to note though that the bank lobby was opposed to the government's involvement in business lending back in the 1950s when the SBA was created. The bank lobby eventually had a change of heart after the SBA shifted from directly lending to businesses to guaranteeing loans issued by banks.

Many of the problems with the SBA that have been discussed today have been discussed for decades. There is only one way to eliminate those problems: abolish the Small Business Administration. The United States grew to become the economic envy of the world with a small central government that largely left business development to the private sector. The dramatic ascent of the American economy did not come about as a result of small business subsidies and central planning of economic development from Washington. We should dispense with government favoritism to small businesses and large businesses, and allow America's entrepreneurs to compete on a level playing field to serve consumers, not plunder taxpayers.

Thank you.

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[1] See http://www.politico.com/static/PPM191_poll.html.
[2] See http://www.downsizinggovernment.org/fraud-and-abuse.
[3] For a detailed history of the SBA, see Jonathan J. Bean, *Big Government and Affirmative Action: The Scandalous History of the Small Business Administration*, (Lexington, KY: University Press of Kentucky, 2001).
[4] Bean, p. 89.
[5] Michael Grabell and Jennifer LaFleur, "Alaska Native Firms Shift Stimulus Work to Outsiders," *ProPublica*, January 27, 2011, http://www.propublica.org/article/alaska-native-firms-shift-stimulus-work-to-outsiders.

[6] Robert O'Harrow Jr., "D.C. Insiders Can Reap Fortunes from Federal Programs for Small Businesses," *Washington Post*, March 12, 2011, http://www.washingtonpost.com/investigations/dc-insiders-can-reap-fortunes-from-federal-programs-for-small-businesses/2011/02/09/AB1NRJS_story.html.
[7] Small Business Administration, p. 15.
[8] 15 U.S.C. 636(a)(1)(A).
[9] 15 U.S.C. 632(h).
[10] Government Accountability Office, "Small Business Administration: Additional Guidance on Documenting Credit Elsewhere Decisions Could Improve 7(a) Program Oversight," GAO-09-228, February 12, 2009, p. 4, http://www.gao.gov/new.items/d09228.pdf.
[11] Ibid.
[12] Small Business Administration, "Agency Financial Report – Fiscal Year 2010," p. 101, http://www.sba.gov/sites/default/files/afr_2010_final.pdf.
[13] Ibid., p. 97.
[14] Ibid., p. 99.
[15] Ibid., p. 97.
[16] Ibid., p. 101.
[17] Small Business Administration Office of Inspector General, "Semiannual Report to Congress," Fall 2009, p. 5, http://www.sba.gov/office-of-inspector-general/867/12348.
[18] See Government Accountability Office, "Economic Development: Efficiency and Effectiveness of Fragmented Programs are Unclear," GAO-11-651T, May 25, 2011, http://www.gao.gov/new.items/d11651t.pdf.
[19] Ibid., p. 2.
[20] See Lawrence H. White, "Housing Finance and the 2008 Financial Crisis," Cato Institute, August 2009, http://www.downsizinggovernment.org/hud/housing-finance-2008-financial-crisis.
[21] See Veronique de Rugy, "Banking on the SBA: Big Banks, Not Small Businesses, Benefit the Most from SBA Loan Programs," Mercatus Center, Mercatus on Policy no. 2, August 2007, http://mercatus.org/sites/default/files/publication/Mercatus_On_Policy_Banking_on_the_SBA.pdf.

Tad DeHaven is a budget analyst on federal and state budget issues for the Cato Institute. Previously he was a deputy director of the Indiana Office of Management and Budget and a policy analyst with the National Taxpayers Union. DeHaven also worked as a budget policy advisor to Senators Jeff Sessions (R-AL) and Tom Coburn (R-OK). In 2010, he was named to Florida Governor Rick Scott's Economic Advisory Council.
His articles have been published in the *Washington Post*, *Washington Times*, *New York Post*, *Wall Street Journal Online*, *National Review* and *Politico.com*. He has appeared on the CBS Evening News, CNBC, Fox News Channel, Fox Business Channel, and NPR.

Chair LANDRIEU. Thank you very much.
Ms. Pastore.

STATEMENT OF FRAN PASTORE, CHIEF EXECUTIVE OFFICER, WOMEN'S BUSINESS DEVELOPMENT COUNCIL, STAMFORD, CT

Ms. PASTORE. Thank you, Madam Chair Landrieu, Ranking Member Snowe, and Committee members, for taking the time to bring much-needed attention to this very crucial issue facing entrepreneurs. I am honored to speak before you today regarding the Small Business Administration.

My name is Fran Pastore. I am the Founder, President, and CEO of the Women's Business Development Council. I have been actively engaged in the Women's Business Center program for more than 17 years, and I have a long history of working with SBA and its partners.

I come before you today to provide my testimony on a subject that is obviously not only near and dear to me personally, but also to the more than 160,000 clients that are served by the Women's Business Centers funded by SBA.

My goal is to illustrate that the Women's Business Center program, which provides a wide variety of services, including training, counseling, and mentoring, is vital to women entrepreneurs of all socioeconomic backgrounds—especially minority and low-income women to whom entrepreneurship provides a logical and reachable goal to economic self-reliance. And it is not duplicative of other SBA programs; rather, the Women's Business Center (WBC) program strives to work in concert with its partners.

According to the SBA's Office of Entrepreneurial Development 2010 Impact Report, WBC clients who received 3 or more hours of counseling reported a 47-percent increase in sales. Businesses that receive assistance from Women's Business Center programs have significantly higher survival rates.

Women's Business Center programs offer access to all of SBA's financial programs, which have had a major impact on women-owned microbusinesses. During fiscal year 2009, the SBA backed nearly 10,000 loans worth about $2 billion to women business owners, and women entrepreneurs received $26.8 million in investment capital through the SBA's small business investment companies.

For a Federal investment of $36.5 million between 2001 and 2003, a total of $500 million in gross business receipts were generated—a 14:1 ratio of business revenues to Federal dollars invested.

The WBCs establish long-term relationships with clients and serve them from inception through the life cycle of their businesses; whereas, SBDCs and SCORE chapters are more likely to provide one-time, transactional support.

Women's Business Centers provide a variety of services, including counseling, training, peer groups, and mentoring support; whereas, Small Business Development Centers and SCORE chapters are more likely to provide one solution to their clients.

Given that the Women's Business Center programs are locally designed and embedded within local economic development groups, Women's Business Center support is more customized and tailored to the needs of particular communities; whereas, SBDCs and SCOREs are more likely to look similar regardless of location.

A study conducted by the National Women's Business Council found that there was no difference in program outcomes of Women's Business Centers based on their proximity to Small Business Development Centers or SCORE chapters. The clients they serve and support they provided are different, and the number of firms launched or businesses created are the same.

I draw your attention to the 2007 GAO report, which specifically outlines issues within SBA that impede the effectiveness of its relationship with Women's Business Centers.

I recommend that SBA continue to implement strategies that eliminate the silos that currently exist between those three organizations: the Women's Business Center program, the SCORE chapters, and the Small Business Development Centers. It is worth a closer look at the SBA organizational infrastructure and how institutional processes can be streamlined for each program rather than simply eliminating an already underfunded program for women that has a proven track record.

Let us not destroy the hopes and dreams of women entrepreneurs, many from low-income and minority backgrounds, many of whom are single mothers, working multiple minimum wage jobs, who see the dream of entrepreneurship as a game changer for their future and the future of their families. Owning and operating a microenterprise and developing good financial habits empowers these women to achieve their humble goals: a roof over their heads, a secure future for their children, and a way up. Thus, it has a positive impact on their children and on their communities because they become active contributors to the American economy as taxpayers and by creating jobs for themselves and others.

If we eliminate the SBA's valuable programs specifically targeted for women, what are we saying about the value that we place on women in our country and our belief in their ability to play a vital role in turning this economy around?

Cutting the Women's Business Center program will compromise SBA's legacy and its ability to help lead the Nation out of this recession and will call into question the fundamental reason for their existence.

Chair Landrieu, this concludes my prepared statement. Thank you for your commitment to women-owned businesses and for giving me the opportunity to speak before you today.

[The prepared statement of Ms. Pastore follows:]

WBDC
Women's Business Development Council

The Leader of Entrepreneurial and Financial Training for Women in Connecticut

June 16, 2011

Testimony

An Examination of SBA Programs: Eliminating Inefficiencies, Duplications, Fraud and Abuse

Fran Pastore

CEO

Women's Business Development Council, Stamford CT

Senate Committee on Small Business and Entrepreneurship

The Honorable Mary Landrieu, Chair

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Thank you Madam Chairwoman Landrieu, Ranking Member Snowe and committee members, for taking the time to bring much needed attention to a crucial issue facing women microentrepreneurs. I would also like to recognize Karen Mills, SBA Administrator, and Ana Harvey, Assistant Administrator for Women's Business Ownership, and thank them for leading the SBA into a new decade. I am honored to speak before you today.

My name is Fran Pastore and I am the Founder, President and CEO of the Women's Business Development Council in Stamford, CT. I have been actively engaged in the WBC program for 17 years and have a long history of working with SBA and its partners.

Today I come before you to provide my testimony on a subject that is not only near and dear to me personally, but also to the more than 160,000 clients served annually throughout the United States by the 110 Women's Business Centers.

My goal is to persuade you and your colleagues on both sides of the aisle that the WBC program, which provides a wide variety of services, including training, counseling and mentoring, is vital to women entrepreneurs of all socio-economic backgrounds - especially minority and low-income women to whom entrepreneurship provides a logical and reachable goal to economic self-reliance.

Women's Business Centers Have Significant and Measurable Economic Impact
According to the SBA's Office of Entrepreneurial Development 2010 Impact Report, WBC clients who received 3 or more hours of counseling reported a 47% increase in sales. Businesses that receive assistance from WBCs have significantly higher survival rates than those businesses not receiving similar support.

WBCs offer access to all of SBA's financial programs, which have had a major impact on women-owned microbusinesses. During FY 2009, the SBA backed nearly 10,000 loans worth about $2 billion to women business owners and women entrepreneurs received $26.8 million in investment capital through the SBA's small business investment companies.

For a Federal investment of $36.5 million between FY 2001 to 2003, a total of $500 million in gross business receipts were generated – a 14:1 ratio of business revenues to Federal dollars invested. In addition, these firms generated a total estimated profit of $51.4 million.

WBC Services Are Not Duplicative; WBCs Differ From SBDCs and SCORE in Very Important Ways:

1) The WBCs establish long-term relationships with clients and serve them from inception through the life cycle of their businesses, whereas SBDCs and SCORE are more likely to provide one-time, transactional support such as a short-term course, after which a prospective business owner is on her own.
2) WBCs provide a variety of services (counseling, training, peer groups, mentoring), whereas SBDCs and SCORE are more likely to provide 1 solution to their clients.
3) Given that WBC programs are locally designed and embedded within local economic development groups, WBC support is more customized and tailored to the needs of a particular community, whereas SBDCs and SCORE are more likely to look similar regardless of location.
4) A study conducted by the National Women's Business Council found that there was no difference in program outcomes of WBCs based on their proximity to an SBDC – the clients they serve and support provided are different and number of firms launched or businesses created are the same. Thus, they are not duplicative.

Observations

I draw your attention to the 2007 GAO report, which specifically outlines issues within SBA that impede the effectiveness of its relationship with WBCs.

I recommend that SBA implement a strategic operating plan that eliminates the silos that currently exist between WBCs, SCORE and SBDCs. It is worth a closer look at the SBA organizational infrastructure and how institutional processes can be streamlined for each program, rather than simply eliminating an already underfunded program for women that has a proven track record and a documented return on investment of 14:1.

Let's not destroy the hopes and dreams of women entrepreneurs, many from low-income and minority backgrounds, many of whom are single mothers, working multiple minimum wage jobs, who see the dream of entrepreneurship as a game changer. Owning and operating a microenterprise and developing good financial habits empowers these women to achieve their humble goals: a roof over their heads, a secure future for their children, and a way up. Thus, it has a positive impact on their children and their communities because they become active contributors to the American economy as taxpayers and by creating jobs for themselves and others.

If we eliminate the SBA's valuable programs specifically targeted for women, what are we saying about the value that we place on women in our country and our belief in their ability to play a vital role in turning this economy around?

Cutting the WBCs will compromise SBA's legacy and its ability to lead the nation out of the recession and will call into question the fundamental reason for its existence.

Chairwoman Landrieu, this concludes my prepared statement. Thank you for your commitment to women-owned small business and for giving me the opportunity to speak to you today. I would be please to answer your questions.

Women's Business Centers: For Women, For Communities, For America

Women like Dina Elliot, who after spending time in prison, found hope and new opportunity through a WBC FastTrac New Venture program. Dina says, "I have gone from one to ten clients in the last year, which I completely attribute to the planning work that I did with the WBC staff in my class... And that's just the business side of what the WBC provided. I will never forget the support and positive reinforcement coming from them."

Women like Marta Cuminotto, who expanded the offerings of her wellness business after attending WBC programs. She said, "Before I enrolled in the class, I felt uncomfortable in networking situations. Now, it comes so naturally to me! I was surrounded by incredible women and learning alongside of them built my confidence."

Fran Pastore

Fran Pastore is the Founder, President & CEO of the Women's Business Development Council (WBDC), and for more than 14 years the leader of entrepreneurial training for women in Connecticut. A devoted facilitator for women seeking economic self-reliance through small business ownership, personal financial education and professional development, she and the WBDC team have helped create thousands of jobs, thereby increasing the number of revenue-generating taxpayers in Connecticut.

Fran's entire career has been dedicated to helping women achieve their dreams of economic empowerment for themselves and their families. Since 1999, she has served on former Stamford mayor, now governor of Connecticut, Dannel P. Malloy's Economic Development Commission in the City of Stamford since 1999, and in October 2010, was appointed to the Governor's Advisory Board for Small Business. An ardent supporter of equality for women, in 2000, the U.S. Small Business Administration honored her as the Women in Business Advocate of the Year. She is, as well, a board member of the Association of Women's Business Centers (AWBC), a political advocacy group to the U.S. Congress, as well as a member of the original steering committee of the Fairfield County Foundation's Fund for Women and Girls. Most recently, she received a congressional appointment to the National Women's Business Council (NWBC), a bi-partisan Federal organization created to serve as an independent source of advice and counsel to the President, Congress, and the U.S. Small Business Administration on economic issues of importance to women business owners.

In May 2010 when she visited Rwanda, her impact became global as she helped women genocide survivors launch and operate a micro business. The business, an ice cream shop, is profitable today, providing the women she trained with their first predictable source of income in their lives. She is a an appointed member of the Executive Council of The Business Council for Peace (BPeace), whose mission is to foster stability in formerly war-torn countries by creating jobs through business development. Fran is also a member of both the Connecticut and International Women Fourm's.

Fran has been a resident of Stamford for more than twenty years, where she lives with her husband and two daughters.

Chair LANDRIEU. Thank you very much, Ms. Pastore.
Mr. Clarkson.

STATEMENT OF GREG CLARKSON, EXECUTIVE VICE PRESIDENT–SBA LENDING DIVISION OF BBVA COMPASS BANK AND CHAIRMAN OF NAGGL BOARD OF DIRECTORS

Mr. CLARKSON. Chair Landrieu, Ranking Member Snowe, and members of the Committee, thank you for holding this hearing and inviting me to testify today on the inefficiencies in the SBA process. Thank you also for your ongoing support of the SBA and the recognition that this lending program is vital to economic growth and job creation during good times and bad.

The SBA loan programs keep credit flowing and fill a critical gap for small businesses, particularly startup and early stage companies—those that need access to longer-term loans. Since the banking industry is highly regulated as opposed to a free-market environment, arbitrary parameters have limited qualified small business owners' access to credit on reasonable terms. The lender is the one that says yes to the loan. The SBA then in turn says yes to the partial guarantee.

The SBA, through its private sector lending partners, now accounts for approximately 70 percent of the outstanding balance of all long-term small business loans made in America, making the agency the single largest provider of long-term capital to U.S. small businesses. That is not a duplication of lending efforts, but it is a vital component to overall capital access.

The importance of SBA lending to small businesses is clearly evidenced by the demand for the programs. In the last 2 years the SBA loan programs have delivered $42 billion to small business owners. The 7(a) guarantee program has worked so well and the need is so great that the SBA risks exceeding the authorization level of $17.5 billion this fiscal year. Without legislative relief, this could result in a curtailment of vital credit to small businesses or possibly a shutdown of the 7(a) program availability until that authority is restored.

The SBA must have an environment that continues to foster responsible participation by its lending partners. A key component in that effort is an effective lender oversight program. Lender oversight should be a means for the agency to identify variances from established lender benchmarks and to provide a reasonable process for lenders to remedy deficiencies.

NAGGL has long advocated an oversight program that is timely, consistent, and constructive while it provides value to the agency, lenders, and taxpayers. Loan risk and losses cannot be eliminated from any lending program; however, they can be managed to reasonable tolerances.

The SBA has established a lender oversight structure that combines off-site monitoring and on-site reviews. However, NAGGL believes that there are correctable weaknesses in the current program that need to be addressed. We have some recommendations.

First, the SBA should establish and publish commercially reasonable lender performance benchmarks and periodically update them as economic conditions warrant.

Second, the SBA should use existing data that is provided by lenders on a monthly basis and that is derived from loan origination to develop an early-warning system that detects on a real-time basis risk in any lender's portfolio. Currently they are using a third-party contractor that uses a predictive scoring model that has questionable results and is expensive to the lenders.

Third, the lender oversight program should reach all of the lending partners—large banks, community banks, high-volume and low-volume.

NAGGL has raised concerns about the timeliness and transparency of the existing lender oversight program. That includes the timeliness of written on-site reports, PLP renewal timeliness, and also accuracy of lender portal information and ratings.

I commend Administrator Mills and Associate Administrator Smits for their efforts to improve the oversight program. What they have done, they have taken some managerial and administrative changes to help improve those issues.

The public-private partnership that exists in SBA's lending programs has been and continues to be an example of what can be achieved when the Federal Government and the private sector work together. It is vital to economic growth and job creation to keep SBA's loan programs available to meet the capital needs of tens of thousands of creditworthy small businesses that have limited options. These loan programs merit continued bipartisan support in Congress.

Chair Landrieu and Ranking Member Snowe, this concludes my oral statement. I have also submitted written testimony for the record. Thank you for all that has been done for America's small businesses through this Committee and through your efforts.

[The prepared statement of Mr. Clarkson follows:]

NATIONAL ASSOCIATION
OF GOVERNMENT GUARANTEED LENDERS

"An Examination of SBA Programs: Eliminating Inefficiencies, Duplications, Fraud and Abuse"

Testimony before the U.S. Senate Committee
On Small Business and Entrepreneurship

June 16, 2011

Submitted by
Gregory A. Clarkson,
Executive Vice President, BBVA Compass
and
Chairman of the Board of Directors,
National Association of Government Guaranteed Lenders

Chairwoman Landrieu, Ranking Member Snowe, and members of the Committee, my name is Greg Clarkson.

I am the Executive Vice President and SBA Division Manager for BBVA Compass. As manager, I am responsible for the various aspects of originating, closing, funding, servicing and liquidating a multi-state Preferred Lending Program. Our SBA loan portfolio is approximately $970 million, consisting of 7(a) guaranteed loans and 504 first lien mortgages. BBVA Compass is an active SBA lender centrally administered in Dallas, Texas. We participate in the regular 7(a) program, as well as SBA Express and 504 first mortgage loans. BBVA Compass was awarded SBA's Large Bank 7(a) Lender of the Year in 2009 and 504 First Mortgage Lender of the Year in 2010.

BBVA Compass is the brand name for Compass Bank, a Sunbelt-based $65 billion financial services company headquartered in Birmingham, Alabama. We operate over 700 branches in Alabama, Arizona, California, Colorado, Florida, New Mexico and Texas. Through three major business units – Corporate Banking, Retail Banking and Wealth Management – we offer clients innovative and industry leading products and services to meet their financial goals. Additionally, as a subsidiary of the BBVA Group, our clients have access to a full range of international products and services in more than 30 countries. BBVA Group is headquartered in Madrid, Spain with approximately $750 billion in total assets, 48 million clients, 7,400 branches and over 100,000 employees.

I am also the volunteer Chairman of the Board of Directors of the National Association of Government Guaranteed Lenders (NAGGL), a trade association of approximately 700 banks, credit unions, and non-depository lenders that participate in the Small Business Administration's 7(a) loan guarantee program. Our members are dedicated to providing critical capital to our nation's small businesses so that these businesses can grow, create more jobs, and contribute to our nation's economic vitality. NAGGL's lender members are responsible for approximately 80% of the annual SBA 7(a) loan volume as well as most of the first mortgage portion of SBA 504 loans.

Thank you for inviting me to testify today on inefficiencies in the SBA process, specifically related to the SBA's current lender oversight program.

A vibrant SBA lending program is essential to economic growth and job creation. The 7(a) program keeps credit flowing to small businesses and fills a critical gap for those businesses, particularly startup and early stage companies—those that need access to longer-term loans. SBA, through its private sector lending partners, accounts for well over 70% of all long-term small business loans made in America, making the agency the single largest provider of long-term capital to U.S. small businesses.

The importance of SBA lending to small businesses is clearly evidenced by the demand for the programs. According to SBA statistics, in the last two years the agency has helped deliver $42 billion to small business owners through its 7(a) and 504 guarantee loan programs. When the dollar value of the private sector first mortgage portion of the 504 loans is included, the total volume goes even higher. It is also important to note that more lenders are participating in the 7(a) program. SBA Administrator Karen Mills recently stated that SBA had brought more than 1,200 lenders back to SBA lending over the last two years. This increased participation, combined with the existing lender base, provides more access and more opportunity for more small businesses in more communities.

In order to continue the positive impact of SBA lending programs, the agency needs to create an environment that fosters responsible participation by its lending partners. A key component in that effort is an effective lender oversight program. Lender oversight should be a means for the agency to identify variances from established lender benchmarks and to provide a reasonable process for lenders to remedy deficiencies. The oversight program should be timely, consistent, and constructive, while it provides value to the agency, lenders, and taxpayers. Risk and losses cannot be eliminated from any lending program; however, they can be managed to reasonable tolerances. For a lending program that has at its core a public policy goal, such as the SBA 7(a) and 504 programs, these risk tolerances should be higher than conventional lending tolerances.

To create a truly meaningful lender oversight program, SBA should establish and publish performance benchmarks and periodically update them as economic conditions warrant. These performance benchmarks need to provide an appropriate measurement of risk with *definable* correlation between public policy initiatives and commercial bank standards.

Any SBA oversight program should be designed to address systemic risk versus SBA's payment risk on an individual defaulted loan. SBA's guarantee is a conditional guarantee, which means that if a lender fails to fully meet its responsibilities, the SBA can—and does—reduce the amount of the guarantee payment to lenders. In the most egregious cases of imprudent lending, the SBA denies its liability under the guarantee. Therefore, the very nature of the guarantee relationship serves to assure that lenders comply with SBA's various program requirements while engaging in quality lending. In considering appropriate oversight for the 7(a) program, it is important to remember that loss risk on individual loans is shared between SBA and the lender: it is not a complete transfer of risk away from the 7(a) lending community. Lenders have an ongoing responsibility to their bank's regulatory oversight entity, as well as to shareholders, to ensure that safe and sound lending practices are maintained.

NAGGL recognizes the benefit of a quality lender oversight program and continues to be a strong proponent of such efforts. Since the introduction of federal credit reform which fixed program pricing based on anticipated losses, our member institutions have witnessed the impact that portfolio performance has on subsidy rates and program fees. We are acutely aware that when individual lenders do not engage in appropriate loan underwriting, servicing and internal control practices, the impact on the program can be detrimental in terms of the future access to capital for small businesses and the overall cost to borrowers and lenders.

A quality lender oversight program should provide a cost effective, statistically valid means of detecting increased risk in the overall SBA portfolio as well as in individual lenders' portfolios. Initially, this is typically accomplished with a properly functioning offsite monitoring program. Upon detection of adverse trends, the offsite oversight program should direct additional investigation, including contact with the lender and possibly an onsite review of the institution's asset quality and lending practices to validate concerns, provide corrective actions, or issue enforcement directives. And, in the case of the 7(a) program, which has a public policy purpose, devising an appropriate oversight strategy must also include consideration of how well those public policy goals are being met.

Current practice of the SBA is to update a lender's program performance data quarterly through the Lender Portal. The SBA also conducts periodic onsite reviews of a lender's loan files, policies, and practices. This review is conducted approximately every two years on each lender that has an SBA loan portfolio in excess of $10 million. The SBA may conduct an onsite review of lenders with other problems or issues that may come to SBA's attention. The SBA also conducts safety and soundness examinations for the SBA-supervised lenders that participate in the 7(a) program. The SBA lender oversight program should be used to detect systemic risk in the overall SBA portfolio or risk in individual lender's portfolio. Loss risk associated with individual defaulted loans is monitored and controlled through the SBA guarantee purchase process.

The SBA has established an infrastructure that can support an effective lender oversight program; however, management of the program has not created the needed value for the lenders and the agency. Lenders have raised serious concerns to NAGGL about timeliness and transparency of the agency's existing lender oversight program. Among these concerns include the following: the timeliness with which lenders received their written onsite review reports; inconsistencies with findings in the report versus onsite exit summaries; timeliness of Preferred Lender status renewals; ability for certain lenders classified by SBA as "higher risk" to timely complete secondary market sales; transparency of the application of the rules under which lenders are expected to perform;

and accuracy of Lender Portal information and ratings. In addition, lenders have expressed ongoing concerns about the fees that are charged for various aspects of SBA's oversight program and question whether appropriate value to the SBA and lenders is received for these costs. These issues have been noted by the agency and corrective managerial and administrative action has begun. NAGGL would be remiss if it did not acknowledge the commitment and leadership shown by Administrator Mills and Associate Administrator Smits in their efforts to improve the SBA's oversight program.

NAGGL does not believe the current offsite monitoring program being employed by the SBA provides a cost effective, statistically valid method for detecting increased risk in the portfolio. The SBA has access to significant amounts of data relating to historical loan performance, delinquencies, geographic diversity, concentrations, and overall lender activity. However, it does not appear that this information is routinely utilized as part of an early warning risk assessment system. Instead, SBA relies upon a contractor-provided computer program that uses loan performance data provided by SBA, together with credit scoring for the individual loans in a lender's portfolio, to forecast a percentage of loans in a lender's portfolio at high, moderate, and low risk of default. Due to the proprietary nature of the contractor's program, a lender is unable to determine whether it agrees with the analysis, and if it does agree to take appropriate action. While lenders are required to pay an annual fee equal to their share of the total contractor charges based on their outstanding loan portfolios, there is little evidence that appropriate value is provided for this expense. Moreover, portfolio performance forecasts by the contractor model are highly questionable. It appears that SBA's internal analysis of ongoing information obtained by the SBA through the lenders' monthly reporting would provide a more meaningful and timely assessment of any systemic risk in the portfolio without creating duplication and inefficiency in the process.

The results of the ongoing offsite analysis should be supplemented with higher lender interaction and onsite reviews for any participating lenders deemed to be 'high risk'. It is imperative that the onsite activity provides timely feedback and meaningful analysis to the participating banks and to the SBA. It is also important that this oversight does not result in duplication of existing oversight activities from other regulatory agencies (and a duplication of the cost already associated with those activities).

It is an established fact that the bank and credit union industries already have substantial lender oversight from the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation (FDIC), the National Credit Union Administration, the Federal Reserve Board, and various state banking regulators. NAGGL believes that before initiating its own onsite lender oversight activities, the SBA should be required to demonstrate that it is adding value to current federal and state oversight efforts and not just duplicating existing efforts. It would appear reasonable for the SBA to work with the existing regulatory agencies to accomplish its onsite examination objectives, something that NAGGL has long-recommended. A partnership of this nature would ensure consistent application of examination procedures as well as regulatory experts to provide safety and soundness testing of SBA portfolios.

We recognize that an inter-regulatory agency partnership will require the commitment and cooperation of several agencies; however, we believe that this type of arrangement is necessary to provide the most cost effective and meaningful determination of risk.

This type of cooperation would certainly support the ongoing efforts to reduce regulatory burdens and eliminate duplicative federal processes. We would hope that the SBA is willing to pursue this avenue prior to arbitrarily requiring that participating lenders bear the cost of additional regulatory examination.

As this Committee is aware, over the past decade the SBA has delegated to lenders significant authority to process, close, service, and liquidate 7(a) loans. Appropriate oversight of these delegated efforts should not amount to second-guessing the specific actions that a lender takes on an individual loan. Rather, NAGGL and its members believe that any onsite review of a participating lender's SBA portfolio should focus on whether the lender's overall 7(a) credit practices are prudent, commercially reasonable, and consistent with actions taken on its unguaranteed loans. In addition, the oversight should focus on whether the lender has appropriate internal controls to manage risk and whether the lender is in compliance with SBA specific program requirements. The oversight program should provide an objective process to proactively identify lender risk and provide a methodology to work with the lender to manage the risk.

Most importantly, SBA's lender oversight function should provide the necessary results without unduly increasing the regulatory burden on lenders. The SBA should use information that is already available to identify on a real-time basis those lenders whose portfolios are exhibiting a form of stress, to determine whether an onsite review is warranted due to such stress, and to work with the lender to address any portfolio problems. This is similar to other regulatory oversight programs conducted by the banking agencies.

In closing, on behalf of my bank and other 7(a) and 504 lenders, I want to thank Chairman Landrieu, Ranking Member Snowe, this Committee and the SBA for the leadership to support the SBA's loan programs and make credit more accessible and cost-effective to small business borrowers and lenders during these economically trying times. Over the past several years, working together on a non-partisan basis, SBA and Congress have crafted a number of excellent short- and long-term solutions aimed at jump-starting lending to small businesses. The success of those solutions is readily illustrated by the dramatic increase in SBA lending that occurred subsequent to enactment of the Recovery and Small Business Jobs Acts. The results are clear — unprecedented lending levels in the SBA 7(a) and 504 programs realized last fiscal year, and that are on track to be realized again this fiscal year.

The public-private partnership that exists in SBA's lending programs has been, and continues to be, a shining example of what can be achieved when the federal government and the private sector work together. We know that small businesses lead the way in creating new jobs and we know that having a vibrant small business segment in our economy is vital to continuing the fragile economic recovery that we are seeing today. We also know that keeping SBA's 7(a) and 504 loan programs available to meet the capital needs of the tens of thousands of creditworthy small businesses that have nowhere else to turn is equally important. These loan programs merit continued bipartisan support in the Congress.

Chairwoman Landrieu, this concludes my prepared statement. Thank you for all you have done to support America's small businesses, and for giving me the opportunity to testify before you today. I would be pleased to answer any questions.

Greg Clarkson
Executive Vice President & SBA Division Manager

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Greg Clarkson currently serves as Executive Vice President and Manager for BBVA Compass' SBA Division. Clarkson has 25 years of banking experience, the last 17 years in the SBA industry. As a member of the original team that established BBVA Compass' SBA Division (formerly Compass Bank) in 1996, he has managed the growth in SBA 7(a), 504, and Express products to over $250 million annually. Prior to becoming Division Manager, Clarkson was BBVA Compass' National Sales Manager with responsibilities that included managing a company wide SBA sales and underwriting force. Clarkson was previously responsible for all operational aspects of the SBA Division including closing, funding, accounting, servicing and liquidation.

Clarkson is active in the industry trade association, National Association of Government Guaranteed Lenders (NAGGL), currently serving as the Chairman of the Board of Directors. He has served in various national and regional NAGGL leadership roles including committee membership in the Executive, Large Bank, Government Relations, and Region VI Technical Issues Committees. He frequently works with Congress and SBA Central Office staff to resolve issues surrounding the delivery of capital to the nation's small businesses. In 2008, Clarkson received the trade association's highest honor, the Distinguished Service Award.

In addition to his industry work, he is on the Board of Trustees for the North Texas Leukemia and Lymphoma Society. Clarkson received his Business degree from the University of Oklahoma.

Chair LANDRIEU. Thank you very much, and thank you for being specific in your recommendations on how to improve this program, which I believe is very important.

Let me start with you, Mr. Shear. You have outlined the duplication across agencies of many different economic development programs. It is my understanding that based on your report, SBA and USDA have entered into some sort of memorandum of understanding to better coordinate their programs. Is that your understanding? And if so, could you give us an update, if you are knowledgeable about that arrangement between Agriculture and SBA?

Mr. SHEAR. Yes, I can. We are aware of the MOU, and we think that it is very broad, it is general, where many times what we are looking for for comprehensive collaboration are more specific MOUs.

When we reach out to each agency to ask them what type of collaborative practices are actually evolving, the one agency that has responded to us is USDA. SBA has not provided us information that would suggest the type of collaboration that was conveyed in the first panel of this hearing, and it is disturbing to us because we have heard about plans to collaborate, yet we observe that USDA seems to be the one agency that is interested, and collaboration cannot be a unilateral action.

What USDA is doing at this stage is it is reaching out to its own field offices to try to assess how much collaboration is occurring out in the field rather than trying to develop more collaborative practices at the agency-wide level.

Chair LANDRIEU. Okay. We will follow up on that.

Mr. Baron, you gave a fairly strong statement supporting the notion—and we agree—that the Federal government does have a particular role and obligation to make sure that the 26 million small businesses have access to Government contracting; otherwise, they could be muscled out or squeezed out by big businesses that have potentially greater access in terms of lobbyists, et cetera, et cetera. But there are some members, and even on this Committee, that would disagree with that.

What are your best one, two, or three arguments as to why this contracting program—a special set-aside, if you will—for small business is necessary? Some people think business is business. Small businesses should compete against large businesses for government contracts. What would you give as your best arguments as to why this program should be continued and supported and improved?

Mr. BARON. Sure. Essentially in looking at these contracting programs, we kind of view it as looking at the health of the economy as a whole. We see the Small Business Act that was established in 1953 as being one of the greatest stimulus plans for the economy put into place.

There has been a lot of research done not only by our organization but by others showing that small firms more often than not can compete in providing products, goods, and services of a higher quality at a cheaper price. We look at the fact that small firms are not going to build tanks, boats, and a lot of the big-ticket items. For example, Boeing was awarded the tanker contract. However, small firms contribute as subcontractors to all of those items quite a bit. And in looking at the fact that one out of every $5 being spent by the Federal government in contract actions is on contracts under $100,000. Those are well within a range for small firms to easily compete with and should be used. If we see right now that small firms are creating the majority of net new jobs and are the most vibrant part of our economy, we should be doing everything possible to help provide demand, drive demand for them.

We have been hearing more and more from small businesses that what they are looking for right now is they need business walking in the door. They need demand to increase. So we see these contracting programs as a way of literally bringing that demand to them and having them—we see that multiplier effect. When small firms get Federal contracts, they hire out of the local community. That money gets spent back within the local community that grows and builds from the ground up, which is exactly what we need going forward to help rebuild our economy, get us stabilized, and move forward again.

So I think, you know, when we are looking at this, historically speaking these programs have provided for thousands of small businesses, taken a business from just a few employees and helped it grow into a very successful company that employs lots of Americans today.

Chair LANDRIEU. Thank you.

Mr. Clarkson, some members have indicated that they do not believe Government should be choosing who to lend money to. It is my understanding—and I want to ask you if it is yours—that under the current lending programs, isn't it the community bankers in the community that are making those decisions as to who to lend to and the Government is just providing a guarantee? How would you describe that? Is it Government choosing or is it the local community bankers that are in the communities that must know the people very well or know them more than the Federal Government would know them?

Mr. CLARKSON. It is the lenders that are actually making the credit decision as to whether the loan is made or not made, and so that includes not only the community lenders, but all of the other lenders that are out there, the 3,000 lenders that are participating in this program.

We do our credit analysis. We evaluate the structure of the loan, and we are the ones that are making the decision. In turn, the SBA provides the guarantee, so it is not even a straight dollar out of that the SBA is having to commit. It is a guarantee of potential losses on that transaction. And to note, it is a sharing of the risk. It is not a complete transfer of the risk over to the SBA or the Government. And as lenders, we not only collect fees from the borrower that are remitted to the SBA, but we in turn also remit fees to the SBA for our participation in that program. So it is a well-run program——

Chair LANDRIEU. A public-private partnership really from the community lending perspective.

Mr. CLARKSON. That is exactly what that is.

Chair LANDRIEU. And my final—and I will get to the Senators. I beg your forbearance here.

Ms. Pastore, I am considering very strongly trying to review and look out into the country the best entrepreneurial training programs that exist because I do believe that America's strength is in entrepreneurial activity and trying to figure out who is doing that well, who is doing it better than others for some potential legislation.

You mentioned in your testimony that, unlike SCORE, Women's Business Centers are there helping a business to grow, et cetera, et cetera. How many volunteers, either in numbers or in volunteer hours, are associated with the Women's Business Centers? And if you do not know that, if you could get that information. Because my understanding is that a SCORE model is really more volunteer driven; yours is more 100 percent Government funded. And I am trying to find what model is the best, et cetera. So what would you say to that? And then I will get to the other Senators in a moment.

Ms. PASTORE. I would say to that, in terms of the number of volunteer hours and the numbers of volunteers across the country, across all 110 Women's Business Centers, that is a very big part of the operation. I can get you those specific numbers. But I can tell you that in Connecticut we have over 150 volunteers, because when you are thinking about a small——

Chair LANDRIEU. Statewide or——

Ms. PASTORE. Statewide. We have two Women's Business Centers in our state, and I represent both of those, and we have about 150 volunteers that teach, train, counsel, and mentor, because with a very limited budget—usually a shoestring—we have a small staff, and we have to leverage community resources.

What the Women's Business Centers provide is an opportunity for professionals in the community to volunteer their area of expertise, and I bring a volunteer with me here today, actually, from Connecticut, who volunteers her time and her expertise to clients. We make it very easy and very comfortable for them to do that.

So it is a very similar—it is similar in some degrees, but the oversight and the training that we provide to our counselors and our mentors and our volunteers is pretty rigorous. And not just anybody can volunteer. There are serious qualifications that have to be reviewed.

Chair LANDRIEU. Thank you.

Senator Risch, who has taken over for Senator Snowe or Senator Paul.

Senator RISCH. There goes your battlefield promotion.

[Laughter.]

Mr. Baron, have you heard about—well, I am sure you have heard about the proposal from the President by Executive order to require anyone who is doing Government contracting to disclose their political contributions, not only the company but also the directors and that sort of thing. Have you heard about that proposal that is on the table?

Mr. BARON. Yes, I have.

Senator RISCH. Okay. What is the position of your organization on that?

Mr. BARON. Well, our organization has not come out with an official position, but essentially the way that we have fallen in discussion with several congressional offices on this is that we are always pushing in favor of greater transparency. And we believe that the Presidential Executive order, while not perfect, does offer greater transparency into how some of the money is being spent when it comes to contractors' connection with Members of Congress or members within the Administration.

What we see frequently, I think, based on several websites that you can go to that track a lot of money, is just seeing how money is being spent and influenced and trying to determine whether or not campaign contributions or things of that nature have a direct impact on companies' abilities to land Federal contracts and is that really having an impact in helping skew, so that contracts are not being awarded based on who can provide a better, a superior product at the best price but who has connections.

Senator RISCH. Are you worried about the reverse of that, that is that those who are awarding the contracts want to see that their money is going to the right place as far as they are concerned?

Mr. BARON. Are we worried about that?

Senator RISCH. Yes.

Mr. BARON. I would say at this point not as much. From what we are hearing from our members, small businesses do participate in contributing to various candidates, campaigns as well. They do not seem to have a concern as far as that information being public.

Senator RISCH. My constituents would disagree with the membership of your organization.

Mr. DeHaven, I think I probably know what Cato's position is on this, but have at it.

Mr. DEHAVEN. Well, yes, I mean, we believe that the SBA should be abolished. We believe that there is absolutely no role for the Federal Government in the credit markets.

Actually, if you look at history, the SBA is an interesting character because it is actually one of those few Government programs——

Senator RISCH. Mr. DeHaven, I got that. Could you go back to the issue of the President's Executive order to disclose campaign contributions, without the force of law? He is doing an Executive order as opposed to having a congressional statute.

Mr. DEHAVEN. Cato has written books on the abuse of Executive power. It has been building for years. The Bush Administration took it to new levels, and the Obama Administration is basically building on what came before him.

As to the specifics of that issue, I am not completely familiar.

Senator RISCH. Ms. Pastore, does your organization have a position on that particular Executive order?

Ms. PASTORE. We do not.

Senator RISCH. Okay. Thank you very much.

Mr. Clarkson, you are in the lending—you represent the lenders so I assume you do not have a position on that.

Mr. CLARKSON. We do not.

Senator RISCH. Thank you very much.

Thank you, Madam Chairman.

Chair LANDRIEU. Thank you.

Senator Brown, thank you for joining us, but Senator Paul has been here. Do you mind if he does his questioning? Then we will go to you.

Senator BROWN. No, no. I just came from SASC. We are in our SASC hearing.

Chair LANDRIEU. Thank you so much.

Senator PAUL. I still get to assume some sort of authority and seniority here.

Senator BROWN. We will see.

Senator PAUL. We will see.

[Laughter.]

Chair LANDRIEU. First to come, first to question.

Senator PAUL. All right. Thank you very much.

Mr. DeHaven, if the SBA exists to give loans to firms that are—there is this market failure, firms are not getting loans, this is sort of—in other words, these are firms that I guess the marketplace has already voted against, the marketplace voted not to give them funds, so the Government is going to give them funds.

If so, I guess we are kind of lucky the SBA is only giving out about 1 to 5 percent of business loans because if they were giving out loans at the rate, for example, of the home mortgages—80 percent of them were owned by the Government, by Fannie Mae and Freddie Mac—we set sort of sub-standard ideas for who we gave the money to, and because of that it led to an enormous problem in our economy.

So I guess the only thing I can think of is that we are lucky maybe the SBA gives a few loans and that they are giving them to people who are less creditworthy by definition because this is supposedly the market failure.

Now, my other question and what I would like you to comment on is that we are told, well, SBA is not making the decisions, this is just the banks who are making the decision on the creditworthiness. But, also, if we look closely at the requirements here, 23 percent of Federal contracts have to go to small businesses. We are dictating how the Federal contracting policy works. We are also dictating that the small business loans are either women or minority owned, and they get preferential treatment, not based on creditworthiness but just based on their chromosomes or the color of their skin.

I would like you to make a comment on the market failures and also how SBA loans are being dictated not based on creditworthiness.

Mr. DEHAVEN. There was an interesting comment made by Mr. Clarkson about the community lender, the community banks. They have relationships with the folks closest to the community and the Federal Government does not, so, therefore, the Government is not dictating.

But that argument in itself mitigates against there being a market failure because you are saying that we are closest to the lender, we have a relationship, therefore, we can make the decision.

This idea of market failure—you know, I was out in the State of Indiana, and one day I tried out a new pizza place, and up on the wall is a newspaper article that says "we got started with a small business loan." And that really set off bells in my head. I thought, well, there are thousands of pizza places in Indianapolis. Why are they getting an SBA loan that helps them compete against somebody else?

Now, that is inherently discriminatory, and I am not sure what the constitutional basis for the SBA is. Some might say the general welfare, but that is not the general welfare. You are discriminating against other businesses.

Senator PAUL. I guess the question would be how good is the pizza. You know, the other people got their loan and are successful based on the taste of their pizza and pleasing their customers. This person got a loan because they were connected somehow to Government.

The other question I have for you, Mr. DeHaven, would be: Right now do you think it is a good idea to increase taxes on individuals and businesses that earn over $200,000 a year?

Mr. DEHAVEN. No, of course not, and I accidentally started answering Senator Risch's original—is that when the SBA was created, the small business community was either ambivalent or did not even want it. What they were concerned about at the time in the 1950s was the increase in government in terms of regulation and taxes as a result of the New Deal in World War II. So what was the response from the Government? Instead of addressing those problems and fixing those problems, we will create a Government bureaucracy. And the rest is history. Once that bureaucracy became entrenched—and, again, we are having a hearing today about waste, fraud, and abuse in Government programs. I staffed a hearing for Senator Coburn 5 years ago on the SBA. William Shear was there to testify. This is like Groundhog Day for me. The only difference between 5 years ago and today is that I am sitting and talking to you instead of sitting behind you.

Senator PAUL. May I have a few seconds?

Chair LANDRIEU. Go right ahead.

Senator PAUL. One last question would be: Mr. DeHaven, do you think that Dodd-Frank is going to help with small businesses getting loans, or do you think it is going to hurt with small businesses getting private loans?

Mr. DEHAVEN. Our regulatory experts are dead set against it. As you mentioned, just yesterday the NFIB, the National Federation of Independent Businesses, came out with their latest survey: 3 percent of their small business respondents said that credit was their number one concern—3 percent. And that has been consistent throughout even the recession.

When you look at the combination of taxes and regulations, that is their biggest issue, and yet we persist, as we have for 50 years, trying to address the interests of small business through bureaucracies and Government programs. And then we wonder why we have waste, fraud, abuse, and inefficiency.

Senator PAUL. Thank you, Madam Chairman.

Chair LANDRIEU. Thank you so much.

Senator Brown.

Senator BROWN. Thank you, Madam Chair.

Mr. Shear, I know your GAO report suggested that agencies should leverage physical and administrative resources, establish compatible policies and procedures, monitor collaboration, basically streamline, consolidate, et cetera, et cetera. I know the SBA has taken some initial steps. Are you satisfied that they have taken rigorous steps to incorporate your suggestions on how to address the issues from overlapping programs and the like?

Mr. SHEAR. At this stage we have identified potential duplication, potential overlap, so it is not like we have gotten down to specifically what programs might be those most prone for consolidation. But where we have taken very strong positions based on rigorous audit work in the past has been that when multiple agencies and multiple programs are providing at least compatible programs and services, there should be—collaboration can improve the leveraging of resources and can lead to more efficient distribution of those resources. And when it comes to SBA and USDA particularly in rural areas, we have been, in all honesty, disappointed by the lack of action of the two agencies to work together to come up with collaborative practices that could provide some structure for them delivering their services.

Senator BROWN. So, in other words, not much has been done to basically address those issues.

Mr. SHEAR. I would agree with that, that they have established an MOU without taking it further.

Senator BROWN. I get it. Thanks. All right.

Just to go back to you, Mr. DeHaven. You indicated that you went to the pizza place, and you wondered how they got the loan. And then you also said you felt it was discriminatory that they would actually get the loan. How can you make that statement based on the fact that you know nothing about the loan? You do not know what circumstances at all that they got the loan. They may have been the only one who applied for the loan. They may have rehabilitated the building. They may have taken a chance in an area that nobody else did. How do you make that statement and stand behind it?

Mr. DEHAVEN. The discrimination occurs against those pizza shop entrepreneurs who did not get Government backing.

Senator BROWN. But they could have applied, potentially, just like everybody else.

Mr. DEHAVEN. I do not. They could have, but they did not.

Senator BROWN. You do not know, but you are claiming that that is discriminatory based on basically having no basis in fact.

Mr. DEHAVEN. Unless every single pizza shop in that area in the State of Indiana, and I would say across the country, is getting their start with a Government-backed loan, then there is necessarily discrimination.

Senator BROWN. But they potentially could have done that had they sought the application and applied for it.

Mr. DEHAVEN. Not necessarily because the SBA is capped in how much loans—and I think that actually brings up an interesting issue. If it is such a great program and such a good idea, why is there a cap on 7(a) lending volume?

Senator BROWN. To take it a step further, I find it kind of inappropriate that you would make a statement that it is discriminatory for that pizza place to get a loan without having the facts, and I think it is the kind of rhetoric like that, as you throw it around—and we hear those things in a whole host of areas in Washington. It does not help solve the problem and basically step up and, you know, make it better and encourage people to take a shot in business. That is just my thoughts on that.

Mr. Clarkson, back to you, if I could shift gears a little bit. I also find it disconcerting that the SBA's lending program has not specifically been directed to find ways to minimize expenditures and losses in a way that a bank tries to do. Do you think it would work or could work if the SBA were to engage the CDC in a collection process in order to stop surrendering that money that we otherwise could recover?

Mr. CLARKSON. Are you talking about under the 504 program? You had said the CDC——

Senator BROWN. Any program where it is applicable.

Mr. CLARKSON. Under the guaranteed program, what we do as lenders, we are the ones that liquidate the collateral, and then we request from the SBA their sharing, their pro rata sharing of the loss in the residual. And we as lenders do not give up all of the risk, so we do have our capital at risk. We do have our personnel and our process involved in the collection of those loans. So, yes, I mean, the system in and of itself in my mind is working appropriately.

Senator BROWN. Okay. And, Mr. Shear, back to you a little bit. I know you have the reports, and you have noted the duplication, and you commented that they really have not done anything. At what point do you—or what role do you play to say, you know what, you really have to start to do this? Because every other—I mean, I am in SASC right now. We have been in there for 2 days. We are cutting billions and billions of dollars from the military budget at a time when we are in two and a half wars. And yet we have other agencies that, you know, they note these duplications and overlaps and ways that they could consolidate and streamline to save the taxpayers money, and they are not doing anything. At what point do you or other agencies, you know, say, hey, guys, it is time, you have got to really kind of get with the program here?

Mr. SHEAR. One of the reasons why we are undertaking this work and devoting resources to it to look at economic development programs and why as an agency we are looking across the Federal Government and the Comptroller General has made a commitment that we will reach across the Federal Government by 2013 to look for duplication, overlap, and fragmentation in Federal programs is to try to inform Congress as far as how programs are operating and where there might be chances for efficiencies, for better program delivery, an also for efficiencies that could reduce Federal costs.

Senator BROWN. Madam Chair, thank you. I would hope that we could, in fact, find a mechanism to put some teeth into some of these recommendations to have these agencies actually get cracking and save us some taxpayer money.

Chair LANDRIEU. Thank you, Senator Brown. I really appreciate your sincerity, and I would like to close with just two comments.

One, the defense budget is about $649 billion; homeland security is $42 billion. The entire SBA program is less than $900 million. Now, that is not an excuse to not make it as efficient and as effective as it can be. But, you know, if we did take Mr. DeHaven's recommendation to completely eliminate it, it would save $900 million. A small percentage cut in defense would double or triple that in one fell swoop.

Having said that, that is what this hearing is about. Senator Snowe and I are committed to eliminating waste, fraud, abuse, and exploitation of government programs.

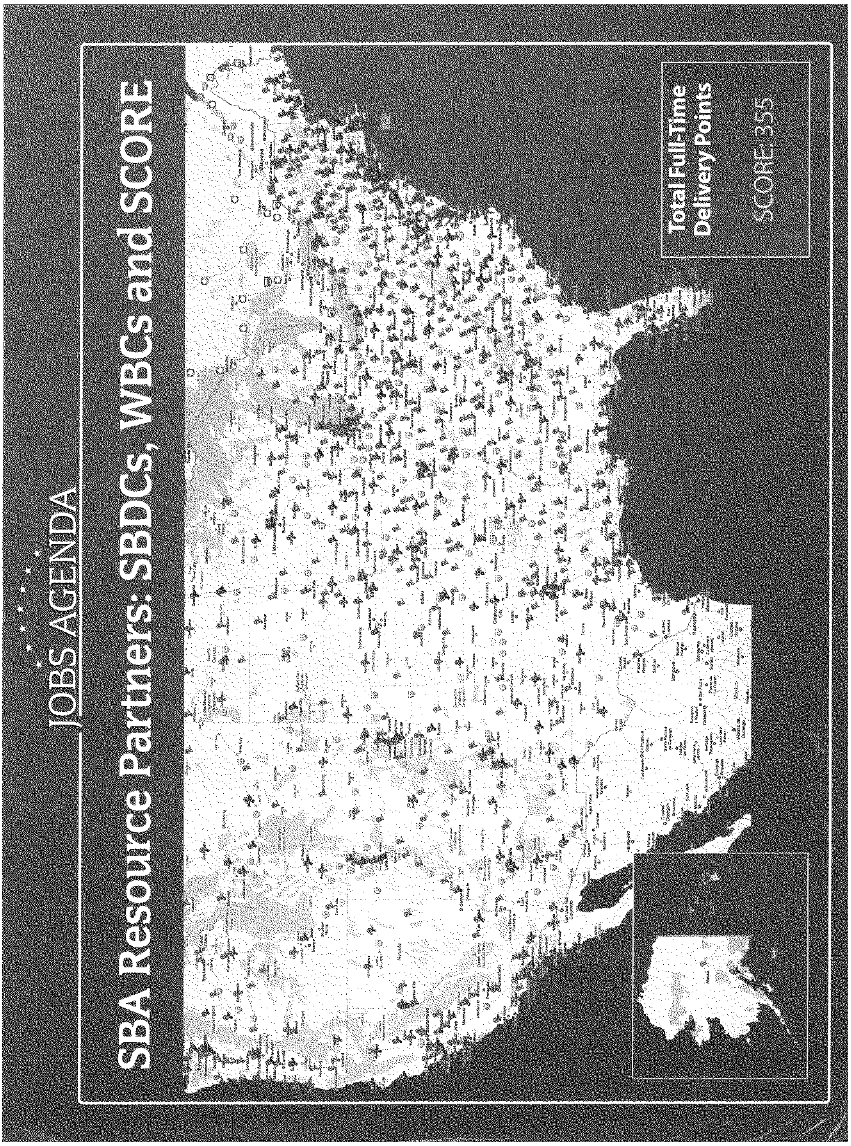
Finally, in conclusion, I am going to present this to all of our members because I carry this around with me. These are the private sector partners of the SBA. Some of them are private sector partners. SCORE is for the most part private sector. The government funds it at a small amount, but it leverages an extensive volunteer network which is private. The SBDCs are supported by the government and the Women's Business Centers. So you can see they are represented all over the country.

There are other partners—that would be state economic development offices—that are not on here. There are city economic development offices. In the city of New Orleans, there is the Idea Village, which is run privately by entrepreneurs, with some government funding.

Mr. Shear, what I am getting at is I really want to try to get to a position where we can identify which of these are working well, leveraging taxpayer money well, and which are absorbing a lot of taxpayer money without working well, so that I can do my job in this Committee to eliminate those that are not living up to the mark.

So I want to share this with you for the record, and I look forward to working with you so we can identify, again, out there in the country what entities are really doing a very good job and which ones are not and trying to do our job by eliminating those that are weaker.

[The information follows:]


JOBS AGENDA
SBA Resource Partners: SBDCs, WBCs and SCORE
Total Full-Time Delivery Points
SCORE: 355

Thank you so much, and we will end the hearing. Thank you all very much for coming. I appreciate it.

[Whereupon, at 11:53 a.m., the Committee was adjourned.]

APPENDIX MATERIAL SUBMITTED

Post-Hearing Responses for the Record
Submitted by Mrs. Karen Mills
To Senator Olympia J. Snowe
Ranking Member

1. On Monday June 13th, President Obama announced a proposal to combat government waste, fraud, and abuse. The "Campaign to Cut Waste" will be lead by Vice President Biden and I applaud the President for acknowledging this glaring problem and the need for consolidation and oversight within the federal government.

The GAO testified at the recent Small Business Committee hearing about their March report that details billions of dollars in savings that can be realized by ending these duplicative programs. Although the SBA is a very small piece of our massive Federal budget, it is imperative that we examine every dollar that is spent by the Agency and justify the need for individual programs. The SBA Inspector General's office has showed a great deal of leadership in this area by providing this Committee specific and thoughtful recommendations for areas to streamline the SBA's programs.

What will be your involvement in the President's Campaign to Cut Waste, and what specific recommendations does the SBA have for finding areas of consolidation? What programs or other offices within SBA are the most likely areas to be consolidated or eliminated?

What discussions have transpired between the SBA and other Agencies on areas where there may be overlap within programs and what strategies are you employing to streamline while ensuring that the needs of small businesses are being protected?

SBA Response:

Deputy Administrator Marie Johns is working with Vice President Biden's office to explore cost-cutting measures that the Agency has taken—as well as those we would like to take—in the Campaign to Cut Waste. In terms of specific recommendations for SBA program eliminations, we are undertaking a thorough review of all SBA programs as we work with the White House and the Office of Management and Budget to develop our Fiscal Year 2013 budget. However, one change has been made recently. As of October 1, SBA's Office of Policy and Strategic Planning has been folded into our major program offices to eliminate redundant costs and inefficiencies.

With regard to inter-agency coordination, SBA is working with the Department of Homeland Security (DHS), the Department of Agriculture and the Department of Treasury, among others, to maximize collaborative efforts and minimize duplication within our programs and operations.

2. In the March GAO report, "Efficiency and Effectiveness of Fragmented Economic Development Programs are Unclear," the GAO states that, "Agencies need to collect accurate and complete data on program outcomes and use the information to assess each program's effectiveness." The report further explains that a similar recommendation was made to the SBA regarding its HUBZone Program in June, 2008, yet the Agency has taken limited action since. The SBA responded to that point saying that, while the GAO's report provided an initial starting point by, "presenting a road map for further investigation into individual programs, it does not attempt to set forth specific data about the differences in focus, target recipients, delivery mechanisms, and other features of each program." Ultimately, the GAO agreed that more work is required before they could conclude that duplication and related waste or inefficiencies exist at SBA.

Without timely, accurate data regarding program participants and results it is practically impossible for the GAO to make recommendations to Congress on how one initiative copies another, or to what extent that program is successful in meeting its objectives.

In light of the programming results-based data you have seen, can you determine what the successes or failures of SBA programs are, and thus can you determine their inefficiencies? If so, what inefficiencies do you foresee or have you determined already?

The GAO has reported that they are challenged in their efforts to identify duplication or inefficiencies due to a lack of information regarding program outcomes at the SBA. What metrics have you put in place to better define specific program outcomes thus increasing the ability to identify any duplications and inefficiencies that exist?

SBA Response:

SBA does routinely track and monitor program results. For instance, SBA's Office of Entrepreneurial Development (OED) measures the impact of its counseling and training programs every year through OED's Entrepreneurial Development Information System (EDMIS) and a Resource Partner Impact Study. SBA technical assistance programs are not only differentiated on content, but also on the place of delivery and the demographic of the client. SBA uses the following data collection tools to measure the impact of the resource partners counseling and training efforts:

1. EDMIS: This information system is SBA's system of record for counseling and training data that provides a standard methodology of collecting information across OED resource partners and SBA District Offices. Resource partners collect information from clients during each counseling session or training activity. Resource partners then report their activities to SBA. Recently OED started collecting more detailed training information as part of the EDMIS modernization project. The following information is collected.
    - Location of service delivered

- o Type of technical and management support delivered
- o Demographics of client
- o Number of Nascent Entrepreneur, In-Business Clients, In-Business Clients Exporting, Business Start-Ups Clients and Online Counseling Clients served by location
- o Number of Jobs Created, Jobs Retained, and New Business Starts by location
- o Amount of Gross Revenues/Sales Revenue Growth, SBA Loans, Non-SBA and Loans Equity Infusion by location

2. Resource Partner Impact Study: Now in its seventh year, the resource partner impact study measures the outcomes and attitudes of clients receiving face-to-face counseling from SCORE, Women Business Centers and Small Business Development Centers. This study measures the following:
   - o Relationship between clients' survival rates and rate of transition to the In-Business segment as compared to firms surveyed in the Panel Study of Entrepreneurial Dynamics (PSED II)
   - o Relationship between clients financial growth compared to the S&P SmallCap 600 Index, Gross Domestic Product (GDP), and Entrex Private Company Index (PCI)
   - o Relationship between the assistance received and the client's perception of the usefulness/value of the assistance received
   - o Relationship between the assistance provided and the client's decision to start a business
   - o Relationship between the assistance provided and the client's decision to implement/change management/marketing practices in their businesses
   - o Relationship between the assistance provided and the client's business having a positive financial impact on job creation and retention and increase in sales

   The report demonstrates that SBA resource partner clients have higher revenues, stay in business longer, create jobs and start new businesses. To better understand the outcomes of our various training programs a new training impact study will be released in the coming months. This study will focus on objective metrics as well as an attitudinal study of training services delivered by the resource partners.

SBA continues to identify opportunities to collaborate, save resources, and work efficiently. As a result, the agency is taking a three-prong approach to ensure we continue to support America's small businesses in the most efficient and effective ways by:

1. Working with GAO to understand and identify any issues related to duplication, and to collaboratively identify a detailed way to address concerns and opportunities for improved structuring of programs.

2. Working proactively with SBA's entrepreneurial development resource partners to find ways to leverage our vast network of 14,000 business counselors and

mentors through sharing best practices, coordinating services, and avoiding duplication.

3. Working with other federal agencies to identify opportunities for collaboration across programs, through cross educational opportunities and referrals, and technology sharing activities and solutions. We are already working with federal agencies including: U.S. Department of Agriculture, U.S. Department of Labor, and U.S. Department of Commerce.

This process has already resulted in the following improvements:

- SBA's HUBZone Program and HUD signed an MOU to provide a standard, consistent source of geo-coded data for SBA's HUBZone program.
- SBA collaborated with the Employment & Training Administration and the Economic Development Administration to provide one complete Federal Funding Opportunity (FFO) for the Jobs Accelerator initiative.
- SBA participated with the President's Task Force on Advancing Regional Innovation Clusters (TARIC) to build the Jobs Accelerator Challenge based on lessons learned from the Energy Regional Innovation Cluster (E-RIC) initiative.
- SBA signed an MOU with several other Federal agencies to coordinate efforts to support the Appalachian Regional Development Initiative.

3. In November of last year, the SBA's Office of Inspector General (IG) released a report on the Agency's efforts to update the SBA's TechNet database, which provides detailed information on Small Business Innovation Research (SBIR) and Technology Transfer (STTR) awards and the companies receiving them. There has long been concern over the SBA's management and maintenance of the TechNet database, including several Government Accountability Office (GAO) reports critical of the Agency's efforts to improve its functionality and usefulness. The November OIG report concluded that, "SBA had made limited progress in enhancing TechNet since the 2006 GAO audit," which was titled, "Agencies Need to Strengthen Efforts to Improve the Completeness, Consistence of Award Data."

The IG report also noted that the SBA has allocated $1.25 million to begin enhancing and expanding the TechNet database. What is the status of this work? What improvements are being made to TechNet to make it easier to use and a more comprehensive tool with better and more data? Where did the funding come from to undertake this project?

In addition to the public-use TechNet database, the SBA was tasked by Congress in the 2000 reauthorization of the SBIR program with creating a government-only database to improve evaluation of SBIR. Yet, 11 years later, no such database exists. While this is clearly not the fault of the current Administration, is any of the $1.25 million previously

mentioned being used to once and for all establish this government-specific database? If so, what will it look like, and when do you estimate having a finalized product?

SBA Response:

The TechNet database was incorporated into SBIR.gov, and the newly revamped site was released in August 2011. Entrepreneurs can now search across all open solicitation topics and past awards, see reporting of agencies' annual SBIR performance, and access a unified calendar of events across all agencies.

The new SBIR.gov/TechNet has several features to enhance usability; a better search interface of past awards and current open solicitations from agencies; improved display and download capabilities of award information for all visitors; an updated "look and feel" to match innovated aspects of the SBIR program, and advance collection of commercialization outcomes.

SBA is also making improvements to the government-specific database. This database is designed to consolidate commercialization information of awardees with process metrics from agencies to generate performance management scorecards for agencies' operation of the program. The database also allows agencies to view the commercialization results of past awardees from across other agencies. The government-specific view will allow agencies direct feedback on their awardees and program and be able to make comparisons to other agencies. These features for the government-view part of the database are already available in some instances. In other instances, the features will be rolled out early this fall. Agencies will be given training sessions to review the new features and use the government-specific database.

4. In each SBA district office there is a business development specialist who is supposed to provide technical assistance and business development services to firms in the 8(a) program. Additionally, there are Small Business Development Centers (SBDCs), Women's Business Centers, Veterans Business Outreach Centers (VBOCs), the 7(j) technical assistance program, and Procurement Technical Assistance Centers (PTACs) all of which provide technical resources for small business.

Specifically related to contracting assistance, I understand that resources are limited and we are asking the SBA to do more with less, but I am concerned that the SBA field offices are not providing these services. I have heard from many businesses as well as SBA office employees that the SBA simply does not have the technical capacity to provide contracting assistance. In many instances, the SBA offices refer small businesses to their local PTACs for any contracting related questions – even the most simple inquiries. In fact, at a Small Business Committee hearing on March 3, witnesses testified that the SBA does not provide the business development and technical assistance portion of their portfolio.

This seems like an area where the SBA can further streamline its budget; there is just too much overlap between the many technical assistance programs. Do you agree? Why or why not? If the local SBA offices and the local SBDCs all refer businesses to PTACs, would you support cutting these budget requests and consolidating all the government

contracting services budgets into the PTACs? If you would not support this, please explain why.

What kind of training are you providing to your field offices so they can be yet another resource for local businesses?

SBA Response:

One of the ways the SBA is statutorily required to assist small businesses is through its wide variety of resource partners including Small Business Development Centers, Women's Business Centers, and Veterans Business Outreach Centers. The SBA also makes referrals to the Procurement Technical Assistance Centers (PTACs), which are funded in part by the Department of Defense and are not part of the SBA. Each of these resource partners is Congressionally-mandated to focus on a different sector of the small business community. By leveraging our resource partners, the SBA is able to assist a broad range of small companies.

While the SBA is supportive of the PTACs, and makes referrals to this important resource, the SBA has concerns about consolidating funding for all of the SBA's resource partners into PTAC funding. At issue is the role of the SBA partners listed above, most of which are not focused on government contracting. In this regard, the business development services provided by SBA to 8(a) Business Development program participants are not limited to government contracting related topics. The role of the Business Development Specialist is to provide the services described in the Small Business Act. In doing so, it is anticipated that in some instances these services may be provided directly by the Business Development Specialist. In others, it is anticipated that they will facilitate the small business' receipt of the requested services through SBA's various resource partners, as well as the PTACs.

With respect to field staff training, the SBA has devoted significant resources in the past year developing and conducting training for field staff. Two intensive training conferences were conducted that focused on the Business Development Specialists (BDSs) who work with 8(a) BD program participants. These sessions included training pertaining to the implementation of new and/or revised program regulations; conducting comprehensive annual reviews; proper review and monitoring of Mentor-Protégé and Joint Venture Agreements; and, forensic accounting techniques to help identify and mitigate fraud, waste and abuse.

5. Last year the SBA began rolling out what has been termed SBIR 2.0, or the next generation of administrative improvements to the Small Business Innovation Research (SBIR) program. Particular goals of this initiative include reducing the timeframe between selection of a proposal and award to an applicant to 60 days, and streamlining and improving common performance metrics across the eleven Federal agencies and departments that administer the program.

Additionally, I applaud you for seeking ways to share and disseminate best practices as part of this initiative. As we heard from several witnesses in our February 17th hearing on

the SBIR program, agency flexibility is key to the program, but improvements can and must be made by accumulating best practices from the various agencies.

As you are well aware, we are in the process of attempting to reauthorize the SBIR and Small Business Technology Transfer (STTR) programs. What is the latest update on the progress of SBIR 2.0?

Where are you making good headway, and in what areas are you finding resistance or difficulty in implementing these changes?

Are there plans for the SBA to work on an STTR 2.0 as well? If so, please describe them.

SBA Response:

Under SBIR 2.0, we have six main goals: clarify data rights; build a unified web portal; intramural technology transfer topics; expand bridge financing programs; impellent and publish performance management metrics; and decrease timelines to award. We have made significant progress in each of the following areas:

- Data rights: We have developed draft language internally to clarify data rights and will continue to work with agencies to integrate this into new drafts of the SBIR Policy Directive.
- Unified web portal and performance management: The SBIR.gov/TechNet project is working to provide the SBIR program with a unified web presence with a wealth of data for performance management. It was released on August 1, 2011.
- Intramural technology topics: These topics continue to be a part of solicitations from several agencies.
- Bridge financing program: At least six agencies are participating in this program. We are encouraging other agencies to adopt use of the bridge financing program as a best practice.
- Performance management metrics: Through the annual report submitted by Agencies and the new SBIR.gov/TechNet project, the ability to collect a centralized set of performance metrics has been made much easier. These performance metrics have been submitted to Agencies, and we will be following up on those metrics later this year.

The most challenging aspect of SBIR 2.0 has been the ability of Agencies to drive down timelines between a solicitation's close to selection and contract/grant award. For many structural reasons, this has been a challenge, but we can also look to programs like the Qualifying Therapeutic Discovery Project Program as a valid model for granting money to taxpayers for investing in qualified technologies.

At this time, we are looking for ways to improve the STTR program. All of the SBIR initiatives can be applied to the STTR program, but we are also exploring ways to specifically leverage university commercialization programs to improve the STTR program.

6. As discussed in the hearing, the Office of the Inspector General (IG) issued a report in March regarding the effectiveness of the SBA's surveillance review process. The audit sought to determine whether the SBA's small business surveillance reviews adequately assessed the small business programs of contracting activities, and whether appropriate action was taken following these audits to rectify the areas of non-compliance in a timely manner.

Regrettably, the OIG determined that these reviews were "superficial;" relied on small judgment samples; were limited in scope, because review teams did not consistently gather information needed to conduct assessments; and poorly documented, as report deficiencies were not clearly explained in supporting documents. Reviews were also deemed *untimely* as reports sat in headquarters for a significant amount of time before being released to contracting activities.

The OIG was additionally concerned that the SBA's government contracting office conducted reviews of merely 30 contracting "activities," which represented less than one percent of all small business contracting activities that year. Moreover, the SBA did not follow-up on prior recommendations to ensure deficiencies identified by surveillance review teams were corrected in a timely manner. According to the Agency, "a lack of staff resources and competing priorities prevented the SBA from doing so."

How would you describe the level of oversight the SBA exercises over its contracting activities? Based upon the results of the Inspector General's reporting, how do you plan to address the concerns and ineffectiveness described?

How many and which of the IG's recommendations have you committed to implementing and what is the status of each? What process are you using to determine the relative significance of each suggestion?

Do you have the resources you need to resolve the problems identified by the IG? If not, what specific changes must be made at the SBA to ensure effective and efficient resolution to the identified issues?

SBA Response:

The SBA, in an effort to be more proactive, took the initiative to implement a process to actively partner with, motivate and assist Federal procuring agencies in their efforts to meet negotiated government-wide small business goals. Although Federal agencies are ultimately responsible for meeting such goals, the "Surveillance Review (SR)" initiative provided a process by which SBA could better assist in evaluating a contracting activity's small business program and its impact on small businesses.

SBA has reviewed the Inspector General's recommendations from the March 2011 audit report on surveillance reviews and is currently in the process of developing a robust, systematic and analytical methodology and process for surveillance reviews. This methodology will establish clear, concise and standardized selection criteria for determining contracting activities to review. Additionally, the enhanced process will include more effective monitoring of the surveillance reviews by establishing and implementing a standard approach to conducting surveillance reviews. We will also ensure that surveillance review reports are issued to the contracting activity and establish a formal process to ensure Procurement Center Representatives receive copies of final reports and follow up on deficiencies and recommendations. Finally, we are adopting IG's recommendations by incorporating them into our revision of the Standard Operating Procedures to ensure all staff is aware of the enhanced methodology and process. A more standard and analytical approach will ensure a more robust level of oversight.

The SBA has requested funding in the Fiscal Year 2012 budget to combat fraud, waste and abuse in our contracting programs. We also believe that a more standardized approach and the utilization of technology based tools will significantly improve and enhance our ability to conduct more robust surveillance reviews. The SBA has begun taking the following actions:

- Re-writing the current SOP governing surveillance reviews;
- Modifying how buying activities will be selected for review;
- Developing a comprehensive communication and reporting platform;
- Developing a more comprehensive database to capture actual outcomes for historical comparison for out year selections and follow-ups.

7. Administrator Mills, I am concerned that the SBA is spending money and resources on its Regional Innovation Cluster Initiative without establishing proper metrics for evaluating the impact this program is having on bolstering entrepreneurship, job creation, and economic development. According to the SBA's budget request, the Agency spent $6 million in Fiscal Year 2010 to support 10 regional economic clusters. Yet, without providing any adequate data on the success of these investments, the SBA's budget is seeking $12 million, "...to continue and further develop these initiatives that are creating jobs and developing businesses."

Further, the Agency has not requested statutory authority for this initiative, which means that while Congress appropriates funding for Clusters, we have no ability to provide direction over what Federal funds can be used for, how applicants are selected, what kind of private sector or non-Federal leverage is required, and what outcomes are expected from these initiatives. The Administration essentially operates this program like earmarks, with complete discretion over who it contracts with.
Can you please provide specific performance metrics that show how the $6 million SBA invested last year in clusters is paying dividends through job creation and business development, and why the Agency should be doubling that investment in Fiscal Year 2012?

SBA Response:

SBA's clusters are promoting the development of interconnected businesses, suppliers, and service providers, not just providing counseling and training. SBA is fostering collaboration not only between businesses, but also connecting small businesses with federal and local government entities, chambers of commerce, universities, and investors. Because clusters come together to address complex regional needs over an extended period of time, SBA has developed a process to collect both interim measures of success and long-term outcomes. Many interim measures are qualitative in nature and are structured to capture the strengths of collaboration, networking and partnering in each cluster.

The SBA has implemented a two-pronged approach to track the performance data on cluster success:

- **Quarterly Reports:** Cluster managers provide quarterly narrative progress reports to SBA. In these reports, managers highlight the successes the cluster is having with small businesses and other partners. This includes new partnerships and contact awards among a few.
- **Data Collection Tool:** Cluster managers will provide end of the year quantitative outcome measures directly from the small businesses participating in the cluster. The measures being tracked are:
  - The number of firms receiving assistance in Business Development, Intellectual Property (license, patents, etc.), Export/Import, Finance (venture, angel, small business loans, other), Marketing, Commercialization of new technology, Partnerships/Alliances/Collaborations, and Contracting Opportunities Increase in revenue
  - Amount and type of financing obtained
  - Increase or retention of jobs
  - Number of new businesses created
  - Number of new business partnerships or alliances created
  - Increase in supply chain opportunities

During the first quarter of FY 11 SBA clusters created action plans, put their organizational structure in place, and reached out to small businesses. In the second and third quarters of FY 11 the clusters demonstrated greater successes in making linkages and strengthening their collaborations and partnerships. Some highlights include:

- Over 5000 hours of services delivered to small businesses (i.e. management counseling, proposal team development, export assistance, new market development, access to capital)
- Over 1200 activities conducted with small businesses (i.e. outreach, networking, training, supply chain match-making)
- Over 2100 businesses assisted
- Over 65 businesses created
- Over 400 jobs created

In general SBA's clusters have:

- Become the respective regions' recognized "go to" points for aid in the selection and evaluation of small business innovative technologies or services;
- Provided small businesses with greater access to federal government information, connections and resources;
- Facilitated small business mentor-protégé and teaming relationships with larger contractors; and,

Some key examples include:

- The Illinois Smart Grid Regional Innovation Cluster (ISG-RIC) in the first three quarters of funding has provided 54 companies with technical and business development services. O-H Community Partners, a cluster partner providing counseling and advisory services to a small business which enabled that business to receive an equity financing offer of $400,000. Additionally the cluster is working with Clean Energy Trust to establish a $6 million venture capital fund to invest in small businesses in the cluster.
- The Minnesota (MN) Defense Alliance Advanced Defense Technology Cluster assisted a small business to in winning two new Defense SBIR contracts from the Air Force for $100,000 and $750,000.
- Northeast Electrochemical Energy Storage Cluster supported new small business, SiEnergy Systems LLC, working on solid oxide fuel cells.
- Advanced Power & Energy Cluster (Minnesota, North Dakota, South Dakota, and Wisconsin) helped two small firms form partnerships to develop energy-saving solutions for temporary military structures and loading dock areas in federal buildings.

If funded at the level requested in FY 2012, SBA expects to fund over 35 cluster programs. The 2012 program will reach additional fast-growing entrepreneurial businesses known as gazelles.

If Clusters is such a critical initiative for the Administration, why has the SBA not asked Congress for statutory authority to make Clusters grants, rather than operating this costly initiative as earmarked contracts to recipients of the Agency's choosing?

SBA Response:

The Cluster grants program is not operated through earmarked contracts. Rather, grants are awarded through a competitive process. While SBA is interested in obtaining the statutory authority to make Cluster grants, under its current authority, SBA must use the competitive contract vehicle to distribute Cluster funding. In awarding these competitive contracts, SBA solicited proposals in accordance with the Federal Acquisition Regulation and evaluated the competitive proposals on a number of criteria which included, the impact the services have on the region's economic growth, creation of sustainable jobs and the opportunities the regional innovation cluster will provide for small businesses, and the region's experience. SBA awarded

10 firm fixed-price contracts, each with a one-year base term with an option for an additional year.

8. In the SBA IG report on Surveillance Review Process, it was noted that, in 50% of the selected cases reviewed, the rationale for selecting files was either based on commuting distance, budgetary consideration, or reasons unrelated to the SBA's standard operating procedures. Frankly, it is unlikely this selection process identified the best candidates for review.

For example, interviews with Area Directors disclosed that two activities undergoing base realignment/closure were selected because the SBA wanted to determine how to reassign Procurement Center Representatives (PCR) given expected changes in contracting activity. Three were selected based on low expectations related to travel costs, and four were selected because the PCRs assigned to the activities were new.

While convenient for the Area Directors, this selection methodology is unrelated to the determination of whether or not a contracting activity deserves review, or whether it presents an elevated risk to the achievement of small business goals in the contracting arena.

Moreover, the SBA's selection approach did not outline ways to determine the relative importance of review candidates; rather, it allowed wide discretion in which criteria to use in selecting activities for review.

How do you plan to address the rationale behind selection of the contracting activities reviewed by the IG? How would you describe the methodology associated with selecting awards for review; i.e. based on distance or staff inexperience? Do you foresee waste or fraud associated with contracts awarded when oversight is infrequent, or inconsistent?

SBA Response:

The SBA is currently in the process of implementing an analytical methodology for selecting buying activities with the most small business opportunity (small business eligible dollars versus actual dollars spent by contracting activity) to target for Surveillance Reviews. In FY 2011, the SBA continued to mine data from the Federal Procurement Data System and other sources to capture detailed information regarding small business and federal procurement contracts.

The SBA's top priority is to ensure that the benefits of our programs flow to the intended recipients. We have no tolerance for fraud, waste and abuse in these programs and have therefore implemented a comprehensive three-pronged strategy to ensure appropriate oversight is in place across all our government contracting programs. The three prongs of our strategy are as follows:

1. Effective certification processes
2. Continued surveillance and monitoring

3. Robust and timely enforcement.

The first prong is designed to ensure there are effective certification processes that provide clear and comprehensive eligibility screening on the front-end to make sure only qualified, eligible firms participate in our programs. For example, if a firm would like to participate in the 8(a) Business Development program, it must be certified by SBA through an application process that determines whether it meets all the requirements of the program. We saw opportunities for fundamental improvements in how this certification was conducted. Therefore, for the first time in over a decade, SBA recently published a comprehensive revision to the 8(a) program regulations. The new regulations now clearly define the economic thresholds that 8(a) applicants must meet to become certified. They also tighten the requirements for joint ventures to make sure that non-disadvantaged firms do not unduly benefit from the program.

The second prong of our strategy is conducting continued surveillance and monitoring on firms once they are in our programs. Only those firms entitled to benefit from SBA's programs should remain in them. We therefore conduct ongoing reviews and monitoring of firms in our programs, including those which have been certified by SBA, as well as those which have self-certified (in those programs which permit self-certification). Review and monitoring confirm that only eligible firms have been certified, and identify firms whose eligibility may have lapsed since certification. We use several tools in this stage, including site visits, eligibility reviews and eligibility protests.

The last prong of the strategy is taking robust and timely enforcement on any non-compliant or fraudulent firms. We have a range of enforcement tools to use when we have identified a firm which is ineligible (or no longer eligible) to participate in our programs. SBA has no tolerance for a firm found to be acting fraudulently, and where appropriate we will act to oust them from our programs and from doing business with the government generally. We also refer fraudulent activity to the SBA's Suspension and Debarment officials, the SBA's Inspector General, and/or the Department of Justice.

We have also recently assembled a Suspension and Debarment Task Force at the SBA, which is chaired by our General Counsel. The Task Force has developed a strategic framework for suspension and debarment of firms that use fraud or other wrongful practices to gain improper access to programs intended to benefit small business. The Task Force is working closely with every SBA program office and with the Agency's Inspector General to identify bad actors, vigorously pursue them, and suspend or debar them from further government business.

Additionally, SBA has a team of Procurement Center Representatives co-located at major buying activities that are fully responsible for reviewing all contracts not set-aside for small business and subcontracting plans associated with prime contracts.

9. The IG released a report in March titled; "Effectiveness of the Small Business Administration's Surveillance Review Process," disclosing that "deficiencies and

problems" were not consistently reported by review teams. Specifically, auditors did not always prepare interview notes or contract files supportive of the information reported on surveillance review checklists. Further, some of the checklists were not fully completed, with some auditors refraining from identifying deficiencies that supported their conclusions. Overall, the IG deemed the quality of the documentation to be poor due to a lack of clarity in the SBA's standard operating procedure, which fails to guide staff on how to perform surveillance reviews.

Review teams were expected to fully complete these review checklists, however, the IG found that, in FY 2009, they generally modified and created their own checklists, or, in seven documented instances, *didn't use a checklist at all.* The IG also found that the checklists themselves were vague in their instructions and frequently review teams were uncertain as to how they should properly complete it. Completed checklists are only a *small portion* of the overall review process, yet the issues that have arise throughout this process appear indicative of the entire surveillance review process.

How will you clarify the Standard Operating Procedures in this process to ensure proper documentation, and efficiency, uniform expectations, and explicit audit process instructions are followed thus reducing fraud in the SBA's contracting resources? Since the release of the IG's report, what steps have been taken to ensure that the Standard Operating Procedure is clearly defined and understood by Review Teams? If changes have not been made, when, specifically do you plan to begin taking on and implementing the procedural suggestions made by the IG?

SBA Response:

In response to the IG's audit, SBA put together a team to analyze and address IG's findings in relation to the existing Standard Operating Procedures. The team was comprised of Procurement Center Representatives stationed in our Area offices with significant experience and expertise in conducting Surveillance Reviews. In July of 2011, this team was brought to the Headquarters Office to review the IG's audit findings and recommendations and to develop new Standard Operating Procedures (SOP) governing Surveillance Reviews reflecting those recommendations. The new SOP will standardize all procedures, documents, forms and reports associated with Surveillance Reviews.

10. The SBA's IT systems play a vital role in the Agency's management of its operations and programs, including the guaranteed loan portfolio which is currently valued at approximately $90 billion, and the Loan Management and Accounting System (LMAS) project is one in a series of attempts by the SBA to upgrade existing financial software and application modules, migrating them off the mainframe. As you are aware, LMAS remained in the planning phase until September 2008 when the SBA awarded 3 blanket purchase agreements for $7.5 million, $5 million, and $250 million for monitoring and oversight, project management support, and systems integration.

<u>To date, the IG has repeatedly designated the LMAS project as a critical risk facing the SBA</u>. In fact, two of the most recent IG reports found that the SBA had yet to establish either an effective enterprise-wide or project-level quality assurance (QA) function to ensure that LMAS project deliverables meet SBA requirements and quality standards. The most recent audit found that the project-level QA process was not independent from project management staff and that *<u>the project lacked a defined process for accepting deliverables</u>*.

In March 2010, the SBA began revising its plans for the LMAS project and elevated governance of the project. The LMAS Program Manager position was *<u>eliminated and then replaced</u>* with a LMAS Project Director that reports to SBA's Chief Operating Officer. Also, at the request of the Office of Management and Budget, the SBA is reviewing the project's roll-out strategy with a focus on providing a defined return on investment, and an incremental approach for building the system. Also in March 2010, the SBA changed its Loan Management LMAS strategy to move the existing computer COBOL programs and interfaces off a mainframe computer to coincide with the expiration of its existing mainframe hosting contract. Beginning in March 2010, these efforts were to be completed within a two-year time frame.

With all the financial investment and personnel setbacks, what will the SBA do to make its planned target date to complete the conversion plausible so that it will not have to enter into another mainframe contract? Is the project currently on target? If so, what is the current status of the project? If not, why has it fallen behind, and what must the SBA do to get back on track?

<u>SBA Response:</u>

In September 2010 the LMAS investment was reviewed by the OMB Financial Services Advisory Board (FSAB) as part of its implementation of an information technology management reform project as outlined in OMB Memorandum M-10-26 (June 28,2010). During that review, SBA presented its revised approach for the LMAS Incremental Improvement Projects (IIP), which consisted of an incremental approach for improving the SBA's financial systems. OMB formally accepted in January 2011. SBA initiated the supporting procurement actions in February 2011. The revised approach includes the following two efforts that support migrating off the mainframe:

- The Incremental Migration of User Interfaces to existing SBA web applications, which is based on integrating functionality as well as delivering incremental deliverables that would support budget changes. SBA awarded the contract for this effort in March 2011. In FY 2011, SBA retired 275 COBOL TIP and batch programs which has resulted in 25% overall reduction in mainframe user transactions. To ensure minimal impact to users, SBA has developed a change management process that includes training, providing adequate notice of changes, and supporting the union to transition workers to the new environment. SBA is on track to complete the incremental migration of Mainframe User interfaces by March 2012.
- The Port to a New Version of COBOL is the porting of the nightly batch loan accounting subsystem (LADUC). SBA has broken this effort into 2 phases; Analysis of the current

COBOL LADUC process and Porting of the COBOL code. Due to funding considerations, this effort was initially delayed, however SBA has adjusted its procurement approach and is aggressively working to award a contract to cover both phases. Based upon SBA's prior market research SBA expects this effort to also be completed by September 2012 with a planned cut over at the end of the calendar year.

The Incremental Migration of User Interfaces project reduces the agency's footprint on the mainframe while the agency assesses the best way to migrate the accounting functions off the mainframe with minimal impact to the business. The Porting of the Accounting Functions to New Version of COBOL project will support the agency's migrating from the mainframe environment to a platform independent environment. The current Unisys Mainframe contract is set to expire December 2011. From the start of this incremental project SBA has understood that some additional Unisys Mainframe support would be required and therefore SBA has budgeted for support until December 2012. SBA is in the process of extending the current contract until June 2012.

Could you please provide the status of key interim milestones such as planning, conversion of the computer programs and acceptance testing?

The table below identifies the milestones for planning, conversion of the computer programs, and acceptance testing.

Project	Milestone	Planned Completion Date	Status
Incremental Migration of User Interfaces	Planning	8-9-2011	Planning was completed on August 26, 2011 after the first key resources were cleared.
Incremental Migration of User Interfaces	Conversion of Programs	Migrated in five phases. The first phase will be completed 9-30-2011 and the last phase will be completed 3-27-2012.	The first phase was initially composed of migrating PMQD, 1416 Disbursements, Notes, and LLTS. Based on user comments and requirements, phase one was rescoped to include LAU collateral as well as expanding the notes requirements to include the

			Microloan program. The new end date for phase one is November 21, 2011. To date PMQD, LLTS, and LAU collateral have been placed into production. The last phase is targeted to be completed 3-27-2012.
Incremental Migration of User Interfaces	Acceptance Testing	Tested in five phases. The first phase will be completed 9-15-2011 and the last phase will be completed 3-13-2012.	Testing for the first set of screens in phase 1 ended August 26th. All phase 1 testing will end November 21st. The last phase will complete testing 3-13-2012.
Port to New Version of COBOL	Planning	Completed 11/05/2010.	Completed 11/05/2010.
Port to New Version of COBOL	Conversion of Programs	Integrated testing and completion of data migration will begin on 8-22-2012.	N/A
Port to New Version of COBOL	Acceptance Testing	Parallel production processing and cutover to the newly ported COBOL is planned for completion 12 -11-2012. Documentation and post production support is planned to be complete by 4-02-2013.	N/A

Do you agree with the IG's findings? Why or why not? If so, what is the SBA doing to implement their findings? If not, how will the Agency manage this seemingly off-track yet vital and long-overdue project?

SBA Response:

To address the IG finding related to QA, SBA has hired a government QA Lead in the Office of the Chief Information Officer. The QA Lead is independent of the LMAS project and provides enterprise-wide guidance.

To address the IG finding related to the deliverable tracking process, SBA created a LMAS deliverable tracking process. The process is tailored for the LMAS IIPs.

What is the final cost for the taxpayer for this initiative? How much more do you expect to need in order to complete the LMAS project?

SBA Response:

The SBA estimates that the development costs for the new approach will total $39 million as compared to the original LMAS development budget of $156 million, and that work will be completed in approximately 2.5 years, as compared to the original LMAS schedule of 9 years. In addition, SBA estimates that the total life cycle costs for the new approach will be $94 million as compared to $217 million for the original approach.

In the September 2010 report to the Office of Management and Budget's Financial Systems Advisory Board (FSAB), SBA estimated that the revised LMAS Incremental Improvement projects' (LMAS IIP) development costs would total $42.67 million. The LMAS IIP strategy was approved by FSAB in January 2011. With the approval of the strategy, SBA initiated market research that resulted in the development cost estimate being reduced from $42.67 million to $39 million.

Based on the current estimate of $39 million for development, SBA has obligated $15 million as of September 30, 2011. SBA plans to spend an additional $23.96 million from unexpired FY 2010 and 2011 funds. For FY 2012, SBA will need $3.86 million to complete development.

With approval from OMB, SBA has re-scoped the LMAS initiative, LMAS-IIP, which includes the following projects:

- Oracle R12 Upgrade - Complete the upgrade of the Agency's Joint Administrative Accounting and Management System (JAAMS) to Version R12 of Oracle Federal Financials.
- Incremental Migration of User Interfaces - Accelerate the migration of user interfaces from the legacy platform (Unisys) to the Agency's current application infrastructure (i.e. ColdFusion / Java / Oracle).
- Port to New Version of COBOL - Port the batch COBOL systems from the legacy platform (Unisys) to a more up-to-date and platform independent COBOL environment.
- Migrate from Sybase to Oracle - Migrate the Agency's legacy Sybase systems to the Agency's current database infrastructure (i.e. Oracle).
- Perform Root Cause Analyses - Analyze remaining issues and develop plans to prioritize additional projects to address the Agency's most important business needs.

- Implement Improvements.
- Document New Environment.

The development costs for the projects related specifically to migrating off the mainframe total $6.81M (Incremental Migration of User Interfaces-$2.76M and Port to New Version of COBOL-$4.05M).

AEO Association for EnterpriseOpportunity
[THE VOICE OF MICROENTERPRISE]
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Testimony of the Association for Enterprise Opportunity

Before the Senate Committee on Small Business & Entrepreneurship

Hearing Entitled "An Examination of SBA Programs: Eliminating Inefficiencies, Duplications, Fraud and Abuse"

June 16, 2011

The Association for Enterprise Opportunity (AEO) is pleased to submit testimony on the subject of SBA programs and their effectiveness. AEO is the national member organization and voice of microbusiness in the United States. For two decades, AEO and its members – more than 450 non-profit lenders and business development service providers – have helped more than two million entrepreneurs contribute to job growth and economic growth as they support themselves, their families, and their communities.

In response to the June 16, 2011 hearing, titled "An Examination of SBA Programs: Eliminating Inefficiencies, Duplications, Fraud and Abuse," AEO strongly disagrees with the assessment that SBA's Program for Investment in Micro-Entrepreneurs (PRIME Program) should be eliminated. Specifically, it has been suggested that the PRIME Program is duplicative of other entrepreneurial development programs at the SBA that provide counseling, training, and technical assistance. In fact, AEO and its members have found that the PRIME Program is a solid investment of government funding. The counseling and technical assistance services offered via PRIME grants are not duplicative, but rather provide best-value business resources to very low- and low-income entrepreneurs in underserved and rural communities. This distinct target population is not reached by other SBA entrepreneurial development programs or other commercial services.

The PRIME Program delivers big returns on small investments. In FY2010, $8 million was awarded to 92 organizations in 43 states, Puerto Rico and the District of Columbia with an average grant award of $87,000. On average, each organization used its grant funding to serve 210 clients, typically providing 15 hours of counseling per client. This works out to $415 per client, or about $27 per counseling hour. Studies show that the five-year survival rate for businesses that receive this kind of counseling is 30% higher than those of businesses who do not receive counseling.[1] Not only is this a wise investment in future job-creators, but the elimination of the PRIME Program would create a disproportionate burden on already disadvantaged populations – a segment that more than any other lacks adequate access to alternative forms of coaching and business services. For many of these low-income individuals, self-employment is likely their most viable economic option, especially low-income rural entrepreneurs who would otherwise be left with few options for economic self-sufficiency.

Background

A microbusiness is defined as a business with fewer than 5 employees and a microloan is a working capital loan of up to $50,000. According to the latest available data, there are 25 million microbusinesses in the United States with receipts totaling $2.4 trillion (17% of US GDP) and employing over 31 million Americans.[2] Yet despite their truly impressive impact, microbusinesses are especially challenged to succeed. Microbusinesseses were hit harder in this

[1] FIELD/The Aspen Institute, "Facts About Business Ownership," http://fieldus.org/Stories/FastFacts.html.
[2] U.S. Census Bureau, Survey of Business Owners and Self-Employed Persons, 2007, 2008.

recession and are more fragile than larger firms.[3] These challenges are magnified for the estimated 3 million low-wealth business owners who are disproportionately African American, Latino, Native American and/or female. And yet, the stakes for business ownership are high. The median net worth of business owners is almost two and a half times higher than for non-business owners. For an African-American woman, the difference is more than ten-fold. For a Latino man, the difference is five-fold. There is no shortage of determined, committed, and capable low-wealth entrepreneurs who need to be appropriately capitalized and coached. There are not, however, enough services, products, or opportunities that meet the unique needs of these businesses and their owners.

Over the last 25 years, microenterprise development organizations (MDOs) have emerged across the country to help meet the two primary needs of these underserved entrepreneurs: (1) to provide coaching and intensive technical assistance, and (2) to make small dollar loans to entrepreneurs. MDOs serve individuals who do not have access to mainstream financial products and other services. A lack of wealth often prevents individuals from accessing what might be available to others; sometimes it is lack of business experience. In fact, recent surveys of MDOs, conducted by the Aspen Institute's FIELD Initiative, have found that the majority of microentrepreneurs served are female (59%), nearly two-thirds are people of color or members of traditionally disadvantaged racial or ethnic groups (60%), and nearly three-quarters of those served come from low-to-moderate income communities (68%).[4] Regardless of the factors that bring clients to microenterprise development organizations in their communities, these MDOs tend to serve individuals that mainstream financial institutions, commercial service providers, and other government programs, including SBA programs, are neither willing, nor particularly well equipped to serve.

The Program for Investment in Micro-Entrepreneurs (PRIME)

The PRIME program, created in 1999, is a technical assistance and capacity building initiative designed to support and expand the services offered to low-income and very low-income entrepreneurs located in underserved and rural communities. The PRIME Program awards competitive grants of up to $250,000 to MDOs in one of the following tracks: technical assistance (TA), capacity building, and for research & development to develop best practices. Funded at $8 million in FY2010, the SBA made 92 PRIME grants in 2010 to MDOs across the country. Although FY2012 funding – and the program's future – remain uncertain, PRIME grantees make the most with modest means. PRIME grants, which average around $90,000, provide TA in some of the following forms: basic business management and planning, financial literacy education, personal financial planning and goal-setting, marketing and financial management skills, networking and leadership skills, and in some cases provide bi-lingual

[3] Kiva Visa Partnership for U.S. Small Businesses, "KIVA and VISA Study Of Small Business Trouble Spots," June 2011, http://media.kiva.org/SmallBusinessInAmericaEIUReport.pdf.
[4] FIELD/The Aspen Institute, "MicroTest Measures 2008 Data," http://www.fieldus.org/MicroTest/FY08PerformanceOverview.pdf.

services and/or translation support services. And the results are evident: A recent Aspen Institute study found that the investment in MDOs pay off: 80% of businesses that received some form of technical assistance from an MDO, many of which receive PRIME grant funding, were still in business after five years. This compares to an overall five-year business survival rate of approximately 50%.[5]

In October 2010, during the last round of PRIME grant announcements, SBA Administrator Karen Mills said, "PRIME grants remain a major source of funding for providing small businesses with essential training and technical assistance. We are very pleased that this year we have been able to provide this funding, which will translate into new jobs and stronger local economies."[6]

PRIME Is Not Duplicative Of Other SBA Programs

Recently, it has been suggested that the PRIME program and the services provided by PRIME grant recipients are duplicative of other entrepreneurial development products and services housed within the SBA. AEO strongly disagrees with this suggestion. It would appear that the conclusion has been drawn between the services provided by PRIME recipients and the availability of other SBA programs to provide those services. This is not the case. Although AEO and its members recognize the value of these organizations – and work closely with them – we do not believe that they are equipped to provide underserved business owners and aspiring entrepreneurs with the services they require. What differentiates the PRIME program from other SBA programs – indeed, the common differentiator among all of them – is not necessarily the distinctiveness of the counseling and TA itself, but rather the unique requirements of the target populations and the ability to serve them.

The PRIME program provides grants to conduct rigorous, intensive one-on-one counseling and technical assistance for people who need substantially more support, training, encouragement, and engagement than other target populations. Very often, MDO clients have never been exposed to the concept of microbusiness and have therefore never considered starting a business. Many of these clients, especially those in rural areas, are multi-generational families living at or below the poverty line. AEO Member and PRIME recipient Good Work Network, an MDO located in New Orleans, LA, tells the story well: of its clients counseled, 92% were African American, 69% were female, and 67% were low-income. The median age of their clients is 38 and the average household income is just $25,665. Clearly, the requirements of these microentrepreneurs will be different than those of more established business owners who have access to a wider range of resources.

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[5] FIELD/The Aspen Institute, "Facts About Business Ownership," http://fieldus.org/Stories/FastFacts.html.

[6] Karen Mills, Administrator, U.S. Small Business Administration, Press Release October 5, 2010, http://www.sba.gov/about-sba-services/7367/5515.

AEO Member and MDO MaineStream Finance of Bangor, ME is a compelling example of the positive returns on investment in the PRIME Program. With its PRIME grant, MaineStream Finance provides rigorous one-on-one business technical assistance to microentrepreneurs in combination with a 12-session course ("Incubator Without Walls") that exposes participants to all facets of starting and operating a business. In FY2010, MaineStream Finance received a $67,000 PRIME grant, which it used to serve 350 individuals, each of whom received an average of 15 hours of counseling and technical assistance. As a result, 200 jobs were created or protected at a cost of just $335 per job. As the economy struggles to recover from the financial crisis and subsequent recession, this seems like money well spent.

PRIME grants have also enabled MDOs to expand their reach into surrounding rural areas, which oftentimes lack access to any other form of business counseling services. For example, AEO member Business Resource Center in Corpus Christi, TX, was able to expand its service area into nine surrounding counties. In another example, Unlimited Future, Inc. of Huntington, WV, was able to expand its service area beyond city limits to serve thirteen counties in three states with a $90,000 PRIME grant in FY2010. In MaineStream Finance's case, its counselors are located outside of the major service centers and actively conduct programs in communities that are 1-2 hour drive from the nearest SBA supported center.

In addition to technical assistance, another PRIME Program differentiator is the grant money available to MDOs for capacity building initiatives and for research and development of best-practice/best-value products and services. The PRIME Program is designed to set aside 25% of grant award for these two tracks.

Grant funding for capacity building supports innovations in technical assistance programming, which is not available to MDOs via other SBA programs. For example, MDOs have used PRIME grants in this track for seed money to design new technology-enabled platforms. AEO member and MDO Credit Builders Alliance, located in Alexandria, VA, used PRIME grant funding to create the "CBA Reporter," an online credit reporting platform. This new technology allows low-wealth individuals with little or no credit scores to report repayment history to the major credit bureaus, thus building their credit and eventually allowing them to access mainstream financial institutions. In another example, AEO member and MDO Renaissance Entrepreneurship Center located in San Francisco, CA, used a PRIME grant to scale their award-winning curriculum by creating a long-distance learning model for entrepreneurs located outside the San Francisco Bay Area, as well as for persons with disabilities for whom online training was a more effective option. The Oregon Microenterprise Network (OMEN) in Portland, OR, also an AEO member, received a $33,500 PRIME grant in FY2010 for capacity building. With that grant, OMEN helped other MDOs across Oregon to better serve minority, women, and low-income entrepreneurs. With that $33,500 PRIME grant, OMEN helped train 207 entrepreneurs, at an average cost of just $160 per person. The other track, the research and development grant, provides grant money to MDOs interested in developing best practices in the microenterprise development field, including new ways to provide high-impact technical assistance to disadvantaged entrepreneurs.

It has also been suggested recently that the SBA's network of microlenders and lenders enrolled in its new Community Advantage Pilot Program (CA Pilot Program) would be able to fill the gap left by the elimination of the PRIME Program. This is simply incorrect. Whereas PRIME provides grant funding for technical assistance, the Microloan Program and the CA Pilot Program are lending programs. Both the Microloan Program and CA Pilot Program provide counseling; however, it is lending-specific assistance geared towards businesses and business-ready entrepreneurs. These two programs are targeted for entrepreneurs and small businesses that are at more advanced stage in the business creation process, and therefore have a different set of unique assistance requirements. The difference between objectives and target population requirements is underscored on SBA's very own website, which uses the following definition for the PRIME program:

"The SBA's Program for Investment in Micro-Entrepreneurs (PRIME) provides assistance to [MDOs]. These organizations help low-income entrepreneurs who lack sufficient training and education to gain access to capital to establish and expand their small businesses."[7]

This testimony is in no way intended to discredit the valuable work SBA Microlenders do. In fact, a significant number of AEO members are SBA Microlenders. Other AEO members are in the process of becoming SBA Community Advantage Pilot Program-certified lending intermediaries. The work these lenders perform is a vitally important piece of the microbusiness ecosystem, albeit for a different target population. AEO does not believe that PRIME should be rolled into the Microloan or CA Pilot Programs. Rather, they should work hand-in-hand as complimentary programs designed to support our nation's entrepreneurs to create jobs.

Conclusion

As of April 2011, small businesses created 93% of new jobs in the preceding ten months. It is clear that these businesses provide much needed job growth, especially now during our economic recovery. For many entrepreneurs located in rural areas and low income communities, starting a business is employment. These entrepreneurs contribute to their communities, providing jobs and financial security to their families. AEO research has shown that if just one in three microbusinesses were to add one additional employee, the U.S. economy would return to full employment.[8] But they cannot do it alone. They need the assistance from the microenterprise development organizations that are dedicated to their success. The SBA's PRIME Program

[7] U.S. Small Business Administration, PRIME Program, "What is PRIME," http://www.sba.gov/content/prime-program.
[8] Association for Enterprise Opportunity, "The Power of One In Three," http://www.aeoworks.org//pdf/one_in_three.pdf.

provides a vital lifeline to low income, rural, and underserved entrepreneurs struggling to start a business and succeed. AEO believes that continued support of the PRIME Program is a wise investment in our nation's entrepreneurs.

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An Examination of SBA Programs: Eliminating Inefficiencies, Duplications, Fraud and Abuse

United States Senate

Committee on Small Business and Entrepreneurship

June 15, 2011

Thank you, Chairman Landrieu, Ranking Member Snowe, and Members of the Senate Committee on Small Business and Entrepreneurship, for the opportunity to submit a statement for the record as part of the Committee's June 15th hearing entitled " An examination of SBA Programs: Eliminating Inefficiencies, Duplications, Fraud and Abuse."

I am President of Northern Initiatives, a non-profit Community Development Financial Institution (CDFI), created in 1991 to provide business lending, investing and technical assistance to communities and businesses throughout rural Northern Michigan. Since Northern Initiatives began its lending program in 1994, we have made nearly 600 business loans totaling nearly $32 million and 272 of these loans, totaling $5.5 million have been made through the SBA Microloan Program.

I submit this statement, on behalf of Northern Initiatives and 19 other non-profit, mission driven community development organization that like Northern Initiatives finance and support new and emerging small businesses in economically distressed communities across the country. When I use the term 'mission driven lenders' I am referring to the fact that one of the core goals of community development organizations like Northern Initiatives is to create, grow and sustain small businesses that, for a variety of reasons, are unable to secure the financing and technical assistance they need from conventional lenders. Many of us worked with the SBA and Congress in crafting the SBA Microloan Program in 1991 and are now some of the most seasoned, high volume lenders participating in the SBA Microloan Program

The statement I share submit today focuses on three points that we hope will be discussed and considered as the Committee evaluates the impact and efficiencies of existing SBA programs. We ask that you consider:

First, the successful track record of non-traditional, mission driven lenders in financing small businesses in the distressed and underserved markets where we believe SBA resources are most needed and should be directed;

Second, the success of the SBA Microloan Program model which hinges on the fact that Intermediary Microlenders operate 'one-stop-shops' providing their borrowers direct financing and individualized technical assistance when and as needed; and

Third, the unique market niches that SBA loan programs, like the SBA Microloan Program and the Intermediary Lending Pilot, are designed to address and how these 'direct' SBA loan programs compliment SBA's loan guarantee programs – as opposed to duplicating them.

1. **Our Target Market: Small Businesses in Distressed and/or Underserved Markets:**

Policy discussions regarding the needs of small businesses often focus on business ventures that meet SBA's standard definition of a business venture with 500 or fewer employees - even though SBA acknowledges that over 80 percent of all businesses in this country employ 10 or fewer employees.

In my home State of Michigan, unemployment is still among the highest in the nation, and the adjustments in the auto industry have stressed small and medium sized manufacturers and rippled through the entire economy. Yet over the past eight years, there has been one area of growth, small Stage One businesses (1 to 9) employees. Recovery for Michigan and other states across the country may very well be found in nurturing, cultivating and growing those business ventures with ideas, energy, ability, and the potential to create jobs.

The type of lending that Northern Initiatives and other non-traditional, mission driven lenders provide is vital to distressed urban and rural communities across the country. The Global Entrepreneurship Monitor assesses the entrepreneurial capacity for various countries and considers the attitude and aptitude of the populations to run a business. Their assessment found that 11 percent of Americans possess this entrepreneurial capacity. This is a valuable insight and points to the challenges we face in encouraging and cultivating new small businesses which we know will be a critical source of employment in years to come.

But not every entrepreneur with a viable business plan or every established and successful small business is bankable. Some businesses lack cash, some have insufficient net worth to offer collateral, some have experienced bankruptcy related to an unexpected medical expense, and others have credit problems associated with a lost job or an unemployed spouse. Our mission at Northern Initiatives, a mission shared by other mission driven lenders, is to provide the financing and other supports that these businesses need to succeed. Assessing character and verifying the conditions that created the blemishes is what we do, and in so doing we help businesses and communities to reach their entrepreneurial peak. In many cases, our involvement with a business, either as a lender and/or as a technical assistance provider, will facilitate the participation of a bank and by doing so we help the businesses become bankable.

As conventional lenders have pulled back on business lending over the last several years, non-traditional, mission driven lenders have seen an increase in demand for loan products. While we have traditionally been seen as the 'lenders of last resort' we are now being approached by previously 'bankable' businesses that have had their lines of credit pulled or are unable to get a working capital loan from the bank they had traditionally relied on for financing. Northern Initiatives is working on the recovery of these businesses who have suffered due to a lessening of collateral values and losses that there business has experienced during the Great Recession. Often these are referrals coming from community bankers who too want to see these businesses succeed. More than ever alternative loan funds are supporting job additions and retentions and filling a key economic recovery gap, which is the delay of credit availability that would support renewed growth.

2 Preserving the Successful and Unique SBA Microloan Model

The SBA Microloan Program was authorized in 1991 with the mission of providing small loans and technical assistance to start-up and emerging businesses that conventional banks are unable to serve. Since the program was launched 20 years ago, participating Intermediary Microlenders have made over 39,000 loans, totaling $464 million, to qualified small businesses and the businesses financed have created more than 47,000 jobs, and retained an additional 65,000 at a cost of approximately $3,500 per job.

SBA Intermediary Microlenders receive two streams of funding from the SBA: Intermediaries borrow SBA funds to finance their loans to qualified businesses and SBA grant funds help support the technical assistance and support that Intermediaries provide to microbusiness borrowers. Since the Microloan Program was launched the SBA has experienced less than a 1 percent loss rate on loans made to Intermediary Microlenders. The fact that Intermediary Microlenders provide businesses with financing as well as ongoing technical assistance and support – something no other SBA program provides – is the linchpin of the SBA Microloan Program's success and must be preserved.

The SBA Microloan Program has enabled Northern Initiatives to finance strong businesses with job creation potential, even if the business lacked the balance sheet strength that a traditional lender required. We manage this risk through the extensive technical assistance that we provide directly to our borrowers – and that we believe is essential to serving our borrowers. I mentioned earlier that Northern Initiatives has made 272 microloans, totaling $5.5 million – with losses of around 3%. We attribute this low loss rate to our ability to offer direct and individualized support to our borrowers.

We provide technical assistance to more than 100 businesses annually. If one of our borrowing businesses experiences serious cash flow problems, we are able to respond quickly as needed – to offer loan restructuring, bridge financing or 'hands on' business assistance to aid in a turnaround. It is this ability to proactively step in to assist a borrower that distinguishes us from other SBA lenders and technical assistance providers and is the primary reasons we are able to maintain healthy loan portfolios and low default rates.

Despite the demonstrated success of the SBA Microloan Program, the President's FY 2012 Budget calls for a 54 percent reduction in Microloan Technical Assistance grants. The President's budget recommends $10 million for Microloan TA grants in FY 2012 which is down from the $22 million provided in FY 2011 and also in FY 2010. In an effort to consolidate, the SBA has suggesting that other SBA entrepreneurial training programs and providers could to provide technical assistance and entrepreneurial support to our SBA Microloan borrowers.

We urge the Committee to support nothing less than a freeze in funding for the SBA Microloan Program at the FY 2011 level of $25 million – and oppose the President's proposed cut in TA funding. We also urge the Committee to oppose any recommendations that decouple the lending and technical functions provided by Intermediary Microlenders. Both the proposed funding cut and proposed outsourcing of microloan TA would put existing SBA Intermediary Microlenders and their borrowers at risk and severely compromise the success of the SBA Microloan Program and its ability to reach distressed and underserved businesses and markets .

3 The Unique Market Niches Addressed by SBA Direct Loan & Loan Guarantee Programs

Northern Initiatives was proud to work with our Senator, Senator Carl Levin, to craft the Intermediary Lending Pilot (ILP) Program that was signed into law last year as part of the Small Business Jobs Act of 2010. We first approached Senator Levin in 2003 to discuss credit gap facing small businesses needing medium sized loans between $50,000 and $200,000. As an SBA Intermediary Microlender Northern Initiatives could make microloans, which at the time were capped at $35,000, but we were limited in our ability to help businesses as they graduated from the Microloan Program or business with financing needs that exceeded the SBA Microloan cap. We worked with Senator Levin to develop the Intermediary Lending Pilot, with the idea Northern Initiatives and other SBA Microlenders could provide seamless financing and assistance to small businesses needing medium sized loans as they grow and eventually become bankable.

Our loan portfolio at Northern Initiatives tends to have a lot of churn, much of which occurs as borrowers become bankable and move to a community bank portfolio or become attractive to a conventional 7(a) lender. This is often a 3 to 5 year process and our challenge is to keep the business adequately capitalized and supported as until they are bankable. The ILP will enable Northern Initiatives to make larger start up loans to launch innovative ideas as well as "follow on financing" to micro borrowers who are not ready to move to a community bank.

I would be remiss if I failed to mention that at present, despite our efforts and the efforts of Senator Levin, SBA Intermediary Microlenders, including Northern Initiatives, have been deemed by the SBA as ineligible to apply for ILP lending status. We believe SBA is misinterpreting the intent of the program in its rule and have registered our concern and requested that SBA reconsider and amend the rule. Senator Levin has made a similar request of the SBA.

Until the ILP was signed into law in 2010, the Microloan Program was the only SBA program through which the SBA provided direct loans to non-profit, mission driven lenders to capitalize small business revolving loan funds – and financing businesses that conventional lenders cannot reach even with the backing of an SBA guarantee.

I do want to applaud the SBA for launching the Community Advantage pilot –an important step in making SBA loan guarantee authority available to non-profit, mission driven lenders like Northern Initiatives through the new Community Advantage (CA) Loan Pilot Program launched on February 15th. Along with Northern Initiatives who submitted its first Community Advantage loan in late February, others including Kentucky Highlands and Coastal Enterprises are participating and we look forward to working with the SBA to refine and hopefully expand this initiative.

Considering the current debate over duplication or perceived duplication within SBA programs - we wanted to be on the record defending both programs and stressing the fact the ILP Pilot, as a direct loans program, and the Community Advantage, as a loan guarantee program, target two very distinct markets and business needs. While both are designed to facilitate business loans of under $250,000 – the ILP allows mission driven lenders use SBA funds (borrowed funds) to make direct loans to businesses whereas the Community Advantage Pilot provides qualified mission driven lenders with an SBA guarantee on loans of $250,000 or less made to qualified businesses using funds the lender has secured from non-SBA sources.

Both programs are critical tools that will enhance the ability of Northern Initiatives and others to finance and support new and emerging small businesses in distressed and underserved communities and we encourage the Committee to support these new SBA initiatives

Thank you once again for this opportunity to submit some of our thoughts and concerns on these important matters and please let me know if you have any questions or would like additional information on the work of Northern Initiative or the mission driven lenders in our network (list attached).

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