

**REDUCING DUPLICATION AND PROMOTING  
EFFICIENCY AT THE SBA: THE INSPECTOR  
GENERAL'S VIEW**

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**HEARING**  
BEFORE THE  
**COMMITTEE ON SMALL BUSINESS**  
**UNITED STATES**  
**HOUSE OF REPRESENTATIVES**  
**ONE HUNDRED THIRTEENTH CONGRESS**

FIRST SESSION

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None.	



## **REDUCING DUPLICATION AND PROMOTING EFFICIENCY AT THE SBA: THE INSPECTOR GENERAL'S VIEW**

**WEDNESDAY, JUNE 5, 2013**

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

The Committee met, pursuant to call, at 1:00 p.m., in Room 2360, Rayburn House Office Building. Hon. Sam Graves [chairman of the Committee] presiding.

Present: Representatives Graves, Chabot, Luetkemeyer, Hanna, Collins, Velázquez, Schrader, Chu, Hahn, Schneider, and Murphy.

Chairman GRAVES. Good afternoon. And we will call the hearing to order.

Today's hearing is going to address an issue that first seems unusual, which is Federal Government efficiency. Congress established a framework for improving the operations of all federal agencies. It is this framework that we are going to be looking at in today's hearing.

Although the Small Business Administration's budget is small, in the context of the overall Federal Government, its \$100 billion loan portfolio, presents a significant risk to the taxpayer if it is not properly managed. The Inspector General's statutory responsibility to investigate and recommend changes in the SBA's operation of its lending programs provides significant protection to the federal taxpayer, namely that they will not have to absorb losses associated with mismanagement of that loan portfolio.

The SBA's government contracting programs do not present the same financial risk to the federal taxpayers of the agency's capital access portfolio. However, improper insight of the contracting programs can lead to the award of contracts to other than eligible small businesses. This harms small businesses that are eligible for such awards. The inspector general's obligation to undercover fraud and abuse helps ensure that the small business contracting programs assist those businesses designated by Congress.

On April 23rd, this Committee heard testimony from the Administrator concerning a number of new pilot programs that she intended to create, even though they had not yet been authorized by Congress. Absent appropriate measures of performance, it is unclear whether these programs will be effective. If they are not effective, then the SBA is simply wasting taxpayer dollars.

To combat an effective use of federal funds, Congress enacted the Government Performance and Results Act in 1993 and strength-

ened the Act with amendments in 2010. The act requires federal agencies to develop appropriate performance criteria to determine whether the programs are effective. The Inspector General, using her audit powers, assesses whether the agency has appropriate performance measures to ensure that the SBA's unauthorized pilot programs will be effective or a simple waste of federal tax dollars.

Given the current deficit, it is imperative that SBA operate in the most efficient manner possible. And I am glad to welcome SBA's Inspector General, Peggy Gustafson, to further expand on ensuring that the agency operates in a cost-effective manner in reducing the possibility of fraud, waste, and abuse. And with that I turn to Ranking Member Velázquez.

Ms. VELAZQUEZ. Thank you, Mr. Chairman.

The Small Business Administration provides a wide range of services to hundreds of thousands of entrepreneurs each year. From loans to contracts to training, these programs are critical to both start-ups seeking to build a future and to existing companies trying to forge ahead. Making sure that these initiatives function as Congress intended them to, while also ensuring that they are free from fraud and abuse is absolutely critical. This important job falls to the inspector general. In this capacity, the IG functions as both an evaluator and as an investigator. They assess performance across the agency's operation, providing valuable insights into what is working and what is not. As a result, SBA management can take steps to improve its program and services. Similarly, the IG also acts to investigate serious problems arising from poorly written policies or improper personnel actions, including potentially criminal behavior.

As a result of the IG's efforts, programmatic flaws are remedied, while would-be fraudsters are put on notice that they will be caught. Taken together, the IG's role is vital to the SBA's ability to achieve its mission. Through its work, the IG recovered and saved the agency \$90 million last year. This included issuing 22 reports and the indictment of 59 individuals, all of which were convicted. These actions show that the IG has a full plate before it, which is great news if you are employed there, but far more troubling if you are a taxpayer. To this point, the Office of the IG is growing, while the SBA itself is shrinking. This raises a serious question about whether the agency is able to effectively implement its programs, and I hope to gain a better understanding of this from the IG's testimony today.

The agency's lending programs play a significant role in allowing entrepreneurs to secure capital at affordable rates. However, the SBA now makes the largest loans that it ever has in its history, while also expanding its use of delegated authorizations to lenders. Such moves are questionable policy goals for an agency that is supposed to serve small businesses and at the same time safeguard taxpayers' dollars.

They also raise programmatic administration issues. For instance, larger loans may increase the likelihood that criminals tried to obtain financing through the SBA fraudulently. Delegated authority without sufficient oversight raises similar questions, namely who is watching the piggy bank. Ensuring that these policy

changes are not Trojan horses is a paramount concern to this committee.

On a similar note, SBA's procurement programs also play an important role in helping speed our economic recovery. When small and disadvantaged firms are awarded further contracts, the additional revenue allows them to add staff, creating jobs. Unfortunately, as we have seen time and again, front companies and large corporations too often find ways to masquerade as small businesses, depriving legitimate entrepreneurs of promising work. The GAO has identified numerous instances where firms failed to meet the appropriate standard and won procurement work. It is my hope that together we can identify ways to close these gaps and ensure this type of behavior is curtailed.

While the SBA's lending and contracting programs are but only two areas of the agency, the IG's efforts are critical across the entire agency. Ensuring that all SBA initiatives are well run and free of fraud and abuse is essential not only to the small businesses they serve directly, but also to the taxpayers who are responsible for footing the final bill. By identifying how the SBA can improve in its function, the inspector general is instrumental in the agency achieving its mandate of assisting small businesses. Without a robust, effective, and well-managed IG, it is doubtful that the Small Business Administration could perform its mission of fostering entrepreneurship, which is critical to our economy. I therefore look forward to hearing the witness and thank her for being here today.

I yield back.

Chairman GRAVES. Thank you. We would again like to thank Inspector General Peggy Gustafson back to the Committee. And please take as much time as you would like. We would love to hear what you have to say.

**STATEMENT OF PEGGY GUSTAFSON, INSPECTOR GENERAL,  
UNITED STATES SMALL BUSINESS ADMINISTRATION**

Ms. GUSTAFSON. Thank you very much. Chairman Graves, Ranking Member Velázquez, and distinguished members of the Committee, thank you for the opportunity to be here today and for your continued support of our work. I am extremely proud to represent the dedicated men and women of the SBA OIG.

As you know, we are an independent office within SBA that conducts and supervises audits, inspections, and investigations related to SBA programs and supporting operations. We seek to detect and to prevent waste, fraud, and abuse, and promote economy, efficiency, and effectiveness in the administration and management of those programs.

I believe our investigations and report recommendations are having a positive impact on the integrity of SBA programs and that the results are measurable. During fiscal year 2012, as already noted, and thank you very much, the OIG issued 22 reports, containing 126 recommendations for improving SBA operations, reducing fraud and unnecessary losses, and recovering funds. And again, thank you as noting our investigations last fiscal year led to 59 indictments and 59 convictions of subjects who had defrauded the government.

In all, the OIG efforts resulted in more than \$90 million in office-wide dollar accomplishments during fiscal year 2012. To put that into perspective, our fiscal year 2012 operating budget was \$17.3 million, which included a \$1 million transfer from the Agency's Disaster Loan Program account. The total office-wide dollar accomplishments therefore represent a more than five-fold return in the investment in the Office of Inspector General to the American taxpayers.

Though these figures are reassuring that our work is focused on areas of high risk within the Agency, they do point to the fact that significant improvements are still needed in SBA's planning, implementing, and assessing of programs assisting small businesses across the nation. The GPRA Modernization Act of 2010, the Act, was signed into law in January 2011, and as noted, the Act emphasizes the use of goals and measures to improve outcomes and requires the Federal Government to adopt a limited number of cross-cutting goals defined as objectives that cut across organizational boundaries.

Now, currently, my office does have ongoing work to determine the Agency's compliance with GPRA requirements, but even while that work is ongoing, recently conducted reviews have evidenced a concern relative to accountability and performance management in SBA. Many of our recent reviews, which are highlighted in the written statement that I have asked to be introduced into the record, found SBA programs lacking measurable performance goals. It is vital that accountability and performance metrics be incorporated into each of SBA's programs and activities so that managers can appropriately assess their performance and make any necessary adjustments to achieve efficiency of operations.

While SBA's programs are essential to strengthening America's economy, the Agency does face a number of challenges in carrying out its mission, including fraudulent schemes affecting all SBA programs, significant losses from defaulted loans, procurement flaws that allow large firms to obtain small business awards, excessive improper payments in some of these programs, and outdated legacy information systems. The Agency also faces significant management challenges which, as you know, we report on every year to the Congress in October. This management challenge report represents our current assessment of agency programs and/or activities that pose significant risks, including those that are particularly vulnerable to fraud, waste, error, mismanagement, or inefficiencies.

Overall, in fiscal year 2012, the Agency made improvements across all of these management challenges, with the exception of one of the recommended actions under Management Challenge 6 and three of the recommended actions under Management Challenge 8. Specifically, just to point out Management Challenge 8, which was most concerning to us at the time of that report, this is the challenge on SBA needing to modernize its loan accounting system and migrated off the mainframe, the large LMAS project. That, in our last management challenge report, was downgraded from a rating of orange, which meant limited progress, to a rating of red, which meant no progress.

Now, despite the two management challenges where there had been a reduction or a lowering of the ratings, the progress made



on all the other management challenges in the last report was notable. The effort made by agency staff and leadership throughout fiscal year 2012 on the recommended actions demonstrated commitment to improving the Agency's programs and operations.

With the support of this Committee, the OIG will continue to promote economy, efficiency, and effectiveness, and work to deter and detect waste, fraud, and abuse in the Agency's programs and operations. We certainly anticipate that our ongoing work will be met with a significant return on investment to the taxpayer and result in a better SBA.

Again, thank you very much for inviting me back. It has been a while since I have been here, so thank you very much. And I look forward to your questions.

Chairman GRAVES. Absolutely. I turn to Ranking Member Velázquez to open up.

Ms. VELAZQUEZ. The sequester has taken effect and has not spared the SBA IG's Office. In fact, the estimated cost is going to be \$800,000. How will this affect your ability to stop further fraudulent practices at SBA?

Ms. GUSTAFSON. It has already affected our ability. As you noted, we took a cut of over \$800,000, which as you know, my office is all people. We are salaries and expenses. We do not have any programs. And so the net effect of that was basically to take away the salary of, I believe we worked out to, 10 people for seven months that we could not sustain. Anticipating that sequester was going to happen, we have been under a self-imposed hiring freeze. I am not anticipating furloughing employees, but the only way I was able to do that was as we have lost people as normally happens, we have not replaced them. So we are by the numbers lower than we were a year, year and a half ago. And obviously, I am auditors and I am criminal investigators with a little support staff. So the minute that I lose those people I am losing some of our ability to do our mission.

Ms. VELAZQUEZ. Can we talk about how the IG and GAO have identified repeated occurrences of fraud in the SBA contracting programs? Some of the reports were issued by GAO at my request. Why does it seem to be a recurring problem with these programs? And if there is one step that the agency could take right now to reduce fraud and abuse, what would that be, what is your recommendation?

Ms. GUSTAFSON. You are absolutely right. There is always—

Ms. VELAZQUEZ. Especially in the area of contracting.

Ms. GUSTAFSON. Yes, there is always a concern about the contracting programs. As you know, the Federal Government has a goal of 23 percent of all federal contract dollars are supposed to be going to small business. SBA has several set aside programs for 8(a), HubZone, programs like that that they administer.

One of the reasons, of course, that there is always fraud is there is always money. You know, where there is money and there is federal dollars there are going to be people trying to find a way to get that money even if they do not deserve it. As you noted, the rules for each program are slightly different. The way that you get into each program is slightly different, but the key really is—and some of the concerns that we have seen is they need to make sure that

the wrong people are not getting in this program. Pass-throughs, as you noted in your opening statement, are always a problem. You know, the shell companies put up specifically to get a big business—the small business contracting dollars is an issue. Enforcement is the key. Taking their role seriously as far as making sure the wrong people do not get into the program is key.

For example, the HubZone. You know, they have made some improvements. I will say in the HubZone program, that was a series of very hard-hitting reports, and so I know that they have upped their enforcement actions. They have to be very serious, as do the procuring agencies. Everybody has a role in this.

Ms. VELAZQUEZ. And do you believe that the site visits play an important role?

Ms. GUSTAFSON. The site visits play a crucial role. So absolutely. And on 8(a), the annual reviews. That can never be left to the wayside because it will always be there.

Ms. VELAZQUEZ. Okay. Thank you.

The LMAS project seems to be the project that never ends, costing taxpayers millions of dollars. Why is this taking so long in your judgment?

Ms. GUSTAFSON. Well, the LMAS project has been going on a very long time, and I think, for the record, that is a very large IT project that we first noted—my office first noted very strong concerns about the possibility that this project was not going to work in 2005 when it was an even bigger project and they were trying to do it all at once. I think the LMAS project is kind of symbolic of a lot of very large government IT projects in that back then not the best planning was happening. There were things—it has been scrapped a couple times and started over. I think, to be fair, the LMAS project seems to be on the right track now. One of the things, the Agency has scaled it down. They have broken it down into more doable components and are doing it in stages. I think it is, unfortunately, just an example that I think a lot of agencies have of a big IT project going off the rails and needed to be reset.

Ms. VELAZQUEZ. So do you feel that SBA has the capability to take on another IT project of this magnitude?

Ms. GUSTAFSON. I think the key for SBA—because we are very pleased with the direction that LMAS is going. We are very pleased at how they are doing it. I think that the key for SBA is to take those lessons from LMAS—and there are a lot of lessons to have been learned as far as the proper planning, the proper scaling of that project, and you know, what you intend for a project to do. If they take those lessons, I think—and do it in that incremental process, there is no reason for me to think that they could not do it.

Ms. VELÁZQUEZ. Lessons at what cost? But that is a discussion for another day.

Ms. GUSTAFSON. The cost, yes, I understand.

Ms. VELAZQUEZ. In 2010, changes were made to increase the loan sizes of 7(a) and 504 loans. Are these larger loan sizes making SBA products more attractive to criminals interested in defrauding the government?

Ms. GUSTAFSON. The increase in loan size was a concern to us when it happened simply because it just puts so much more of tax-

payer dollars at risk. I think it is, in fairness, premature to see if this has caused an uptick in fraud. I do not think that I am prepared to say that that has happened. Very often the lending—even the fraudulent loans quite frankly tend to go for a while before they default for numerous reasons, and so I would not be prepared to say that. But it is something that we have definitely emphasized to the Agency that they need to make sure they are doing all they need to do as far as their oversight of lenders to make sure that does not happen.

Ms. VELÁZQUEZ. Responding to large scale disasters, like Hurricanes Katrina and Sandy, is perhaps the most critical role that SBA plays. In this regard, the IG reported in January that the SBA did not have sufficient research staff and human resources to effectively respond to such massive disasters. Do you believe that this lack of trained staff is the reason that SBA performance in the aftermath of Hurricane Sandy has been below average?

Ms. GUSTAFSON. First off, I want to take this opportunity to thank the Congress. My office has received additional funding to perform—

Ms. VELÁZQUEZ. I know \$5 million—

Ms. GUSTAFSON.—oversight. So that we can perform oversight of Sandy, which I think was absolutely crucial because Sandy, as you know, is the first big task for SBA after Katrina. There certainly have been large disasters between then and now but nothing along this scale.

You are correct that we had some staffing concerns that resulted in an audit in January. We are beginning our work. I think there is a lot, you know, we are just now beginning our work to see if they have learned those lessons from Sandy to see if there were new challenges. And so I cannot say that that is what happened, but it is certainly something that is on our radar.

Ms. VELÁZQUEZ. Well, I issued a report regarding the decline rate by SBA of small businesses that were impacted by Sandy. And the decline rate was much higher than during Hurricane Katrina. So I just need to know if you are planning to look into this area as well.

Ms. GUSTAFSON. We are. And I want to thank you for the report, Representative Velázquez. It is going to be very informative for us. There were several things in that report that were very telling. The increase in the time. There was a huge delay for a while there that the time in processing the applications once again got pretty large and the denial rates and also the withdrawal rates, which I believe is something GAO is looking at. We are certainly coordinating with GAO. We are not going to duplicate their work, but that is going to be something very useful to us as we are doing our audit work. Thank you.

Ms. VELÁZQUEZ. Thank you.

Chairman GRAVES. Mr. Leutkemeyer.

Mr. LUETKEMEYER. Thank you, Mr. Chairman.

Ms. Gustafson, to follow up on what the ranking member was talking about a minute ago with regards to some of the contracting problems that were had, in today's Washington Post there is an article about the inspector general for the GSA that found a number of problems with some of the contracting they were doing. And one

of the comments that was made, the staff members told investigators that they feared for their jobs because they were trying to do the right thing and protect taxpayers by whistleblowing on some of the pressure that was being put on them with regards to giving some favorable treatment to certain contractors. Did you find any of that with regards to what was going on with the SBA and the contracting problems that you found?

Ms. GUSTAFSON. Well, Representative Leutkemeyer, one of our biggest criminal cases we have ever had is a contracting case that was involving kickbacks actually with the Army Corps of Engineer, which resulted in at least \$20 million simply being skimmed off the top by everybody being involved in steering the contracts both—to certain small—to certain companies. And so it is a very large issue. There are a lot of pressures in the contracting industry or in the contracting arena that often do not help us with fraud. Sometimes there is pressure steering. Sometimes there is just a pressure to get the contract out. Sometimes we often find, you know, the procuring agency wants their stuff. You know, they want their stuff and they want it now. Very often, going small business is faster because you do not go through the whole full and open competition. That is another pressure that happens very often. And so all of those pressures I think add to it being a very lucrative area for somebody to try to get.

Mr. LUETKEMEYER. In response to what you found, did you put some recommendations—did you put out some recommendations or did they put some recommendations in place that you suggested to try and solve this problem or improve it?

Ms. GUSTAFSON. Well, as far as our investigation, they are all going to prison for a very long time, so that is the best—

Mr. LUETKEMEYER. Good for you.

Ms. GUSTAFSON. That is the best result we could have.

Mr. LUETKEMEYER. We can keep you busy in a few other agencies.

Ms. GUSTAFSON. But I do think that one of the key things, especially in the 8(a) arena, which is one of the biggest small business contracting programs, one of the things that we have really focused on is making sure that somebody is taking responsibility for making sure that these 8(a) companies are legitimate. I think when you have that kind of divided among the SBA has the program but the Army or the Navy or Ag has the contract, a lot of times whether this company is legitimate will sometimes fall through the cracks, which is a huge problem. That has been something we have been focused on certainly since I have been the inspector general. Because although the government gets their stuff, first off, a lot of times they get it at a much greater cost because there are either kickbacks or, you know, there is no competition and therefore, we are not getting the best deal. And quite frankly, those programs are not doing what they are supposed to be doing. If the money is not going to legitimate small businesses, then the money is not doing the good that it is supposed to be doing anyway. So, you know, I think it is a very big problem.

And to your point I think the oversight has to be key and the enforcement has to be key. And people need to go to jail. And I am very proud of the fact that people are beginning to go to jail, even

though the government got their widgets. So I think that is important.

Mr. LUETKEMEYER. Very good. Thank you.

Just also I have got a curious question here.

We found also in the last couple weeks that a lot of directors of different agencies have multiple e-mail accounts. Did you find that problem existed with the SBA director as well?

Ms. GUSTAFSON. I have not found anything like that.

Mr. LUETKEMEYER. Okay. Just curious.

Also, in some of the information you gave us you talk about unauthorized commitments by the SBA and what an extremely high number it is compared to other agencies. Is there a problem there or is it just some really, really small things that are being overlooked? What is your analysis?

Ms. GUSTAFSON. The SBA Procurement office and their whole procurement process, their method of buying things is actually something that we added to the management challenges list because that was a process that had kind of fallen apart and was not going very well. And what you found in these unauthorized commitments—and I would argue that it is an important thing because in the end maybe it was not that much money and maybe in the end we got our services. But there are many internal controls. You are basically not supposed to commit the government to paying money unless everything is in place, you know, such that the money is rightfully committed. That is what an unauthorized commitment is.

So when you are paying something when you have not really done all of the work that needs to be done, it is an internal control problem. You know, it is a problem that the auditors get very worked up about because it could in theory lead to things like violations of the Anti-Deficiency Act. You know, because you are, by definition, not doing the planning and having everything kind of all tied up before the money is going out the door. And so that is why we issued the report.

The Procurement office has undergone a lot of changes. They actually moved it from Washington, D.C., to Denver, so they are kind of in a building period but they need to be showing—one of the aspects of the report was to emphasize they need to be showing progress now that they have kind of restarted, you know, what they do on them.

Mr. LUETKEMEYER. To me this is a head scratcher from the standpoint in the private sector, you know, if you have a procurement procedure, you know, you can have somebody do the work and have a supervisor sign off. I mean, it is very simple to get this done, and yet that seemed like a procedure that is not even in place here.

Ms. GUSTAFSON. I do not know that I would ever say that federal procurement is simple. I think it can be amazingly convoluted.

But to your point, absolutely. There is supposed to be the process. And then, you know, then it becomes routine. I mean, you are buying—you have a copier contractor, a BlackBerry contract. It is all—

Mr. LUETKEMEYER. To me it blows my mind that we are having this problem, that you can even find it. I mean, I can under-

stand a couple of oversights, but the numbers you cite here are just off the charts. I mean, to me that just shows incompetence up and down the procurement procedure process or so.

My time is over. Thank you very much.

Ms. GUSTAFSON. Thank you.

Chairman GRAVES. Mr. Schrader.

Mr. SCHRADER. Thank you, Mr. Chairman. And thank you, Ms. Gustafson, for being here.

At the outset, when the ranking member started talking about reductions in budget and then sequester on top of reductions in budget, how have you prioritized your audits and investigations as a result of that? How have you changed what you were doing to what you are going to be doing in the future?

Ms. GUSTAFSON. Well, we always have to prioritize, of course, our audits, because I am basically at full staff. I am about 102 people. And again, the loan portfolio is about \$103 billion. Small business contracting is about 97 billion. And then I have not even talked about all the other programs in there. So we always go through a priority process looking at high risk areas, areas of congressional interest, how long it has been since we have been in a program. We naturally end up not having to focus, but certainly, focusing on the contracting and the loan programs because of the sheer volume of money that goes through there.

Basically, what sequester has caused us to do is we always go through that process but whereas maybe my list was this long, was six long, maybe it is five long. You know, everything is going to take longer to get to when I am smaller.

Mr. SCHRADER. And again, the ranking member talked about the computer system, the antiquated and the long. Has the Agency or has the IG, have you set targets for when this should be done given all the new information, lessons learned that you alluded to so that we could monitor this a little bit better?

Ms. GUSTAFSON. They definitely have set targets for LMAS, which is the project that has been ongoing for many years. And there are targets that are due for each step, which is exactly what we wanted. They do not always meet them. They come close but, I mean, that is definitely available. They are doing it. We do interim reports on it. GAO is looking at it very carefully, too, but they definitely do that. Yes.

Mr. SCHRADER. Okay, good.

The other thing that we learned to begin this new budget coming forward that we are going to end up—it looks like SBA is suggesting they reduce the number of site visits going forward in order to fund some other programs that they feel are more beneficial. You indicated a moment ago that the site visits are extremely important for the contracting stuff, all the fraud that goes on with regard to misrepresentation, being a small business when indeed you are a shell. What do you think about that reallocation?

Ms. GUSTAFSON. I think that in general—and there are several different kinds of iterations of site visits that they do and loan programs and the contracting programs. I think two things are crucial. One, that they continue to happen. I definitely think site visits need to continue to happen.

Mr. SCHRADER. Should they continue at a decreased level or an increased level?

Ms. GUSTAFSON. Well, without getting into it, I am not ready to say that they are doing too many. I certainly do not think that they are doing too many. The other key is though—

Mr. SCHRADER. Therefore, a reduction would not be good?

Ms. GUSTAFSON. A reduction would probably not be helpful.

Mr. SCHRADER. Okay.

Ms. GUSTAFSON. The other key is I do think that they definitely need to be targeted. You know, I think it is key that the Agency always be taking in the lessons learned from before. They are always going to have to do a risk-based approach, and I think that is going to be the key, too, so that when they are doing that they are going to the right places. I think that is crucial, too.

Mr. SCHRADER. In this era of budget limitations that we all have, you indicated that they were not doing very well on setting up performance metrics, much less even achieving certain outcomes. Certainly, I happen to be a fan of the recent administrator and moved things along in the fraud, waste, and abuse thing. But we have not made that progress in performance outcomes. And to be that is critical. And in an era where we theoretically are supposed to determine, not the administrator, what the priorities are or at least with her or he, we should be able to get into that. We do not have that at this point in time. Are there certain metrics you would suggest to this body that we should be focusing on and, you know, setting a target like we did with the computer stuff? Setting some dates, setting some intermediary dates, and some actual results by then?

Ms. GUSTAFSON. I am not prepared to offer metrics. I think that they are beginning to use metrics, you know, come up with metrics. You know, some of our reports that I mentioned raise some concerns about maybe some of the metrics listed. I think you are absolutely right; that is your role. And in all fairness to the Agency, that is their role as well. And so I think, you know, as you said, they are beginning to do that. You know, their metrics are coming out in the GPRA. I will be looking at that but—

Mr. SCHRADER. Should not Congress help them? Should not this Committee help them? I mean, theoretically, Congress is in charge, you know, not the Agency. And they execute our design. Should we not help them or be developing metrics that we think are important as a group and suggesting to the administrator, whoever he or she may be, about what they maybe want to look at?

Ms. GUSTAFSON. First off, I certainly think that that is up to you. Like you said, you are in charge, so you can do whatever you want. I think that sometimes, for example, in the STEP program, I think sometimes Congress does do that, or at least it tells the administration or the administrator and the Agency we want you to do metrics. We want you to report to us. And then certainly it would behoove Congress to look at that and see if you are hitting the right thing; if you are getting the right measures and whether they are helpful. This is a lengthy process, I think, because I think the next step will be are they acting on those metrics and is it being run better? And so this is a multi-year process, I think. But

absolutely, your role is crucial right now while they are doing it as well.

Mr. SCHRADER. Thank you.

I yield back my time.

Chairman GRAVES. Mr. Hanna.

Mr. HANNA. Thank you, Chairman.

Hi, thanks for being here.

A couple of things. You mentioned that you had 55 or 59 cases, 59 prosecutions. Along the notions that Mr. Schrader mentioned and Ms. Velázquez, it is easy for Congress to be penny wise and dollar foolish. What did you learn from those 59 cases? Is there a theme? Are there consequences for people who spend government money outside of arms length transactions? In other words, I like this guy. I am going to hire this guy. Regardless of corruption or anything illegal, just generally, are there consequences? And you talked about the payback for the work that you do, which, you know, is interesting because it is an investment if you want to look at it. I mean, that is the way we should. I think we should look at it.

Can you talk generally about a theme along those lines and why it is beneficial to fund your agency more and what we could expect in return, along with the idea of if you have structural consequences, which I do not know that we have now for individuals who would be sloppy, for lack of a better word. Maybe you can just get me up to speed.

Ms. GUSTAFSON. So as far as the results of our investigations, you know, the investigations that make me happiest are the ones that not only do they go to jail, and I really like when they go to jail because that is a pretty strong message. Of course, I also like when they are getting hit hard with a really big fine because sometimes that hurts people more.

But there are definitely times when as a result of some of these investigations, especially some of the very complex ones that we do, there are a lot of very complex schemes out there. The ones that find where there are weaknesses in the system that we can then go to the Agency and say these are things that need to be shored up. Again, some of the contracting, some of the contracting fraud cases will show where the weakness is at. For example, in the HubZone program. You know, what is it? You know, what part of the HubZone program are they kind of taking advantage to get into the program when they should not be. You know? Is it the attempt—is it the residency requirements for the companies or things like that?

One of the biggest things that we have seen in the last several years that had become a management challenge is the fact that we were seeing a lot of very big loan fraud schemes involving loan brokers. So people who were out there saying let me help you package your loan and get it through. And I am going to get you an SBA loan. And that broker was deeply involved in getting the document falsified and making everything pretty and getting a loan that never should have been made that immediately defaulted. It was basically, you know, a theft. And doing that dozens and dozens of times because, you know, they just did that. And one of the things that we had recommended to the Agency—it has been a manage-



ment challenge for a long time and they are beginning to make progress on that—is let us track these guys. And let us make sure that we know for each loan who this loan broker is such that, you know, maybe if we begin to have a really bad case, just an egregious case, let us see if this person has been involved in other loans and let us see how the other loans are doing.

Mr. HANNA. I understand that. It makes perfect sense.

But also, you mentioned that you have a number of problems and a large number I think you said of people who are inside the system just basically being sloppy. What are the consequences for that, if any? I mean, one of the things that works well is advertising; right? You know, we own a Helmsley and tax evasion, all of those things that we remember. What do you do along those lines? What can Congress help you in terms of creating consequences for—you know, maybe well intentioned but that is really kind of irrelevant when they are doing something wrong—that we can help you with?

Ms. GUSTAFSON. Well, I think—

Mr. HANNA. And are there enough consequences?

Ms. GUSTAFSON. Yeah, I do not know that there are a lot of consequences, for example, for contracting that is done sloppily. You know, for contracting where maybe they did not do quite the due diligence that they should have done as far as what that company is. I actually do not know that there are many consequences.

Mr. HANNA. But should there be? I guess that is the question. Do you feel as though there is a lack of authority and severity in terms of them taking their job seriously enough? Or is this such a casual process that sloppiness goes uncorrected?

Ms. GUSTAFSON. I think that maybe even the bigger issue with that—and I will tell you sometimes some of the things that we have encountered in cases that are very frustrating is we have encountered cases when the Agency—our contracting cases basically, they involve an SBA program but 99 times out of 100 the contract was let by a different agency. And a lot of times what we will find is that agency is not as nearly as angry as we are that that company should not have been getting that contract because they liked that company and they liked what they got from that company. And that has sometimes been a big roadblock for us because we would like, you know, Agency X to come in and say we are as mad as SBA about this and we would not have let this contract, if we had known this. And we do not always get that response. And that is very frustrating. Maybe that is where the consequences should be before you talk about sloppy contracting.

Mr. HANNA. Thank you, Chairman. Thank you.

Chairman GRAVES. Mr. Murphy.

Mr. MURPHY. Thank you, Mr. Chair. Thank you, Ms. Gustafson.

In your testimony you spoke briefly about the Disaster Assistance Loan Program. It looks like there have been some improvements from 28 percent down to 18 percent of these that have been fraudulent. What are you continuing to do to bring this level down, and is there anything we can do to help you?

Ms. GUSTAFSON. So the numbers that you are referring to is the rate of improper payments in the disaster loan program, which

is to say that payments that for one reason or another should not have been made; so loans that should not have gone out.

In all candor that is an extremely high number, but given the nature of disaster loans, we are very pleased by the progress that the Agency has made because those loans—there is always a pressure kind of to get money out the door, but especially, for understandable reasons, in the disaster arena. And very often you are dealing with people whose records have been washed away or something like that. And so while that is a very high rate, that is a good example, actually, of where the agency—that part of the management challenge has gone away. They have set their quality assurance process and their improper payment review process in the disaster loan arena is something we are very pleased to see. That 28 to 17 percent; that happened in the course of a year, I think.

So they are going in the right direction. I do not know that anything needs to be done. Again, Sandy is going to be a big test for them because that was a big influx of applications. But I definitely think the Agency has done a good job in the improper payments arena, especially in disaster loans. So.

Mr. HANNA. Okay. So nothing specific there.

Ms. GUSTAFSON. No.

Mr. HANNA. To keep pushing.

Ms. GUSTAFSON. Right.

Mr. HANNA. The next question is on sort of priorities. I guess your 2014 budget submission is around 20.4 million. This is 3.1 million or about 20 percent higher than fiscal year 2012.

Ms. GUSTAFSON. Right.

Mr. HANNA. If you were to receive the full funding, you know, what are the priorities there? What would receive more or less funding?

Ms. GUSTAFSON. Yeah, so our budget request has been kind of same request for the last couple years. We are still hopeful at some point that we get it. But a couple of our priorities for that, one of the things that we are—because we are as small as we are, I think one of the places where I would like us to do more work is to do some work, for example, on early defaulted loans. We have a very good process. Early defaulted loans are very often or more likely than not, an indicator that something was very wrong, either in the way that loan was made, either through fraud or just very bad—or bad underwriting.

Very often we see that indicator but we cannot do more with that once we get there. We simply do not have enough. I think that there is a lot to be learned if we were able to spend more time looking at these early defaulted loans. I think we are going to find a fair amount of fraud, which very often the money gets back to the government that way. And I think we may also find some process improvements. So that has been something that is very on our kind of wish list, as is the hotline. One of the things that I did, we have a hot line where this is very often the only place where citizens will call with allegations of waste, fraud, or abuse. That is their contact with my office. When I got there it was my secretary, basically. That was it. We are up to two people. I am very pleased about that because, again, sometimes that is where we learn about the fraud,

and sometimes that is where the people who are directly reaching out to us. That is how they reach out to us. And I want to be sure that we are, again, learning what we need to learn from there, and getting those allegations to the right places. So that was something that was also in my budget request.

Mr. HANNA. Excuse my ignorance here but are there any sort of whistleblower programs?

Ms. GUSTAFSON. The whistleblowers report to the hotline. We, as the inspector general, have a role under the Whistleblower Protection Act. We certainly have a role. When somebody comes with an allegation, we would investigate. And the hotline plays a big role in that because everything gets funneled through the hotline. But often the counselor investigations will take over an actual investigation of a whistleblower complaint.

Mr. HANNA. Okay. And just to the LMAS. It was brought up a couple times. What have you done to get it sort of back on track?

Ms. GUSTAFSON. Well, LMAS has again been a series of reports. You know, we do not get it on track, of course, but we have been paying a lot of attention to it. The Agency has gotten it back on track. Again, we do interim reports on LMAS. It is always a subject on our management challenges. And so that is kind of a constant discussion with the Agency where we kind of have a dedicated "how is LMAS going" kind of thing. It is not just a function of one report and then we go. That is something that we are always working on.

Mr. HANNA. Okay. All right. Thank you.

Chairman GRAVES. I have a question on these pilot programs. The administrator has proposed some of these pilot programs in her budget. Do you think that they have enough performance standards to be able to evaluate these at this time or even what are your thoughts on them implementing those given the tight budget situation we are obviously in?

Ms. GUSTAFSON. In all candor, Chairman Graves, we are aware of the pilot programs, obviously. We are aware of the budget request. I guess I would phrase my answer more akin to my opening statement. We are worried in general about performance measures because some of the work that we have done in programs already instituted have shown that they need to be strengthened and more thought needs to be put into it. As far as looking at any of those new programs, I have not done so, and so I am really not ready to opine.

Chairman GRAVES. Mr. Schneider.

Mr. SCHNEIDER. Thank you, Mr. Chairman. And I thank you for joining us here today with your testimony. I am sorry I had to step out, if I am being redundant.

But I know we have seen an increase of 7(a) and 504 loans, which is a good thing. But with the increase, and you touched on it earlier, you mentioned these early default loans. What impact is the growth of those programs having on your office's ability to do proper oversight? What resources, if any, would you need to push it further?

Ms. GUSTAFSON. Thank you for your question because, again, we are worried about the risk associated with the \$5 million—with the much bigger loans. And I am the same size I was when the

loans were smaller so, you know, it is really a function of that is certainly an area of concern for us. It is something we are monitoring. Again, these loans tend to be—you do not know if there is a problem right away so this is something that I think if it is going to be a problem, we are going to be seeing it soon. Loans are always a priority. Lending is always a very big priority for us because of the \$102 billion loan portfolio. So I think it remains to be seen, but we anticipate, especially given our concerns in the past about lender oversight. They have made improvements, but lender oversight was a management challenge for a long time. Quality control in the centers was a concern and as part of our management challenges. We will be there. We are going to be there. It is on our radar and if something else falls by the wayside it will. It is a big priority for us.

Mr. SCHNEIDER. As you make that case going forward, you know, lack of oversight leading to waste, fraud, and abuse here, are there metrics in place for the work that you do that tracks the return on investment we are making in oversight that captures fraud, that adding one more person would result in X dollars of savings so to speak?

Ms. GUSTAFSON. Well, we, certainly, in our semi-annual reports and every time I testify in front of you I am always touting what our dollar accomplishments are and how it compared to our size. Again, it was about a fivefold. If you want to do the quick math, the math that I could do, it is about a fivefold return on the investment when you look at our appropriation and the money, the savings that we have.

You know, I kind of hate to break it down into one person just because I do not know that that is the most accurate thing. My audit at any given time, every auditor, you know, every audit is three or four people. I try not to get too much into that but there is absolutely no question that like every IG office, I am very proud of our accomplishments and we definitely can show a return on our investment. There is no question in my mind that 103 people is small for the amount of risk that is in SBA programs, and so the budget request, that was my number. You see a lot of transparency in the IG's budget and that is what we requested. We are hoping to grow because I do think in general more oversight is needed and more return on the money is not a bad thing.

Mr. SCHNEIDER. And this is my concern obviously with across the board cuts, like sequester is where you lost I think you said 10 people for seven months. But that is a direct savings if you are on sequester, but the indirect cost of that could be a lot of fraud and abuse that is not being captured, which is a concern.

Changing subjects and real briefly on the LMAS system, and you said you are getting, you know, you cannot change the implementation but you get reports on progress. How frequently are you getting reports on progress?

Ms. GUSTAFSON. The nice thing about SBA in a way is we are all in one building and we are all kind of the headquarters. We are co-located with headquarters, and my audit division is basically three separate groups, one of which is an IT group. And so it is not even a function of getting reports. It is really a constant commu-

nication. They talk to the LMAS people all the time. We do the interim reports. And so—

Mr. SCHNEIDER. But is there a formal oversight so you are tracking progress against milestones?

Ms. GUSTAFSON. We do issue those interim reports, and so that is how—and the management challenges, and when you will look at our management challenge report, which has LMAS's challenge number—I forget, but they are one of them—you know, we have very specific things that we are looking at and we are rating them on and they get a color grade. And so that is once a year. The interim reports come when we have enough work to show. There are some milestones coming up that I think they are expected to—I think one of their milestones is in September of 2013. They are hoping to migrate almost everything off the mainframe. That is something we will be looking at. And so we do get the reports and then we issue them—when there is enough to say we issue them. When we have enough to say we issue those reports. And they are public and on our website.

Mr. SCHNEIDER. Great. Thank you.

Ms. GUSTAFSON. Thank you.

Mr. SCHNEIDER. Thank you. I appreciate your time here.

Chairman GRAVES. Mr. Collins.

Mr. COLLINS. Thank you. I am sorry I was late. I was at an Immigration hearing.

I guess I may have missed some things. I am just more curious when we talk about efficiency and waste, fraud, and abuse as one piece, an important piece. If I walked into the director's office or when the director comes to work, is there a dashboard with colors like red, green, yellow? If there is 50 things to track that you might see 35 greens, you know, and eight yellows and so many reds to know where we put our attention that day? I mean, that level of metrics and dated, does that exist?

Ms. GUSTAFSON. Well, in all candor, I have no idea what is on the administrator's desk. I do not know what she has, so I cannot really speak to actually how they track. I do know that, for example, in our management challenges report, that is a report that we issue annually with the color ratings of the most serious management challenges and the specific things that we need to see improvement that actually have red, green, and yellow. I will tell you that those meetings do not happen at the administrator level except for maybe when it is issued. But those are meetings that happen often. Not daily. I am talking more about my work, you know, where we will again stay in contact with them and have kind of in-process meetings. Where are we? Where do you think we are going? What is the next report going to look like? But quite frankly, as far as what she faces when she wakes up in the morning, I just do not know.

Mr. COLLINS. That would be interesting to know because we would like to think the focus was on return.

Ms. GUSTAFSON. Right.

Mr. COLLINS. So on, you know, what we would call efficiency or process mapping, does that go on or do you look at that to say here is a department processing loan applications. You know, I am thinking the Lien Six Sigma Model of process mapping to take

waste out or make it more efficient and therefore, reduce the need for people so maybe we could do it with fewer or do more with less?

Ms. GUSTAFSON. Well, I think that a lot of our audit reports are focused on that type of—given the fact that one of the things the IG Act says we are to promote economy and efficiency I think in government programs. It says something almost directly like that. That is something that we look at very often, is whether the programs are running as efficiently. So I do not know again how they do it but I certainly hope and think that our audits will touch on that and talk about efficiencies that can be had and whether the process needs to be changed. Like any agency, you know, SBA is slow. You know, I think there are some things being done at SBA that have been done that way a long time, you know, and so I think they are—that is always something that we try to look at and to see if there are improvements that can be made.

Mr. COLLINS. You know, I think perhaps if you asked the question and said give me a list of 50 processes and which ones you can tackle, and then you go back in with an audit and say how many steps does it take to process this loan application? Now, first, they are probably going to say they do not know. So then you make them process map it and it comes back that there are 57 steps.

Ms. GUSTAFSON. Right.

Mr. COLLINS. And then you say, okay, we can cut that down to 23. That makes it more efficient, less prone to mistakes. And if you held them accountable for that—

Ms. GUSTAFSON. Right.

Mr. COLLINS.—over a period of time they would become more efficient because they know you are asking the questions to which initially they probably do not have the answers. Right?

Ms. GUSTAFSON. Just, you know, in looking at that piece of efficiency where you can do more with less because people cost a lot of money, you know, just a suggestion that that kind of process mapping, process improvement could make it so they could get their job done with less folks.

Ms. GUSTAFSON. Well, it is an interesting idea, and my head of audits is right behind me and is probably chomping at the bit. He loves that kind of stuff, so I am sure that we will have a discussion further on what we can do.

Mr. COLLINS. Because I can tell you I have never yet seen a buffet line that you cannot reorganize, make efficient. So every process can be, I think, made more efficient. I think there is a rule of thumb. You can probably reduce 22 percent of the personnel costs and probably cut most of the steps almost in half. But the key thing there is it takes the waste out and also the errors. The more time someone touches that piece of paper, the more opportunity is for someone to make a mistake.

Ms. GUSTAFSON. Right.

Mr. COLLINS. And sometimes you have to implement technology to get rid of the people side, but technology, if it is done right, is less prone to mistakes.

Ms. GUSTAFSON. Sure.

Mr. COLLINS. Just a couple suggestions. Thanks for keeping your eye on our tax dollars.

Ms. GUSTAFSON. Well, thank you.

Mr. COLLINS. And keep up the good work. Thank you.

Ms. GUSTAFSON. Thank you.

Mr. COLLINS. I yield back.

Chairman GRAVES. With that I would like to thank the Inspector General for coming in today, taking the time to testify before the Committee.

Ms. GUSTAFSON. Thank you very much.

Chairman GRAVES. And I would ask unanimous consent that all members have five legislative days to submit statements or supporting materials for the record. Without objection that is so ordered. And with that the hearing is adjourned. Thank you.

Ms. GUSTAFSON. Thank you.

[Whereupon, at 2:04 p.m., the Committee was adjourned.]

APPENDIX



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

**BEFORE THE**

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

**JUNE 5, 2013**



## INTRODUCTION

Chairman Graves, Ranking Member Velázquez, and distinguished members of the Committee, thank you for giving the Small Business Administration (SBA or Agency) Office of Inspector General (OIG) an opportunity to discuss our oversight activities of SBA programs and operations. The SBA was established to maintain and strengthen the nation's economy by protecting the interests of and assisting small businesses, and by helping families and businesses recover from disasters.

The OIG was established within SBA by statute to promote economy, efficiency, and effectiveness and to deter and detect waste, fraud, and abuse in the Agency's programs and operations. Every year, our staff of approximately 104 employees—which includes criminal investigators, auditors and program analysts, attorneys, and support staff—conduct criminal investigations, audits, and other reviews, resulting in numerous indictments, convictions, debarments, monetary payments by fraud perpetrators and many recommendations to the Agency for improvement and elimination of wasteful or inefficient practices.

During Fiscal Year (FY) 2012, the OIG issued 22 reports containing 126 recommendations for improving SBA operations, reducing fraud and unnecessary losses, and recovering funds in FY 2012. In addition, OIG investigators obtained 59 indictments and 59 convictions of subjects who defrauded the government. In all, OIG efforts resulted in more than \$90 million in office-wide dollar accomplishments during FY 2012.

## AGENCY PERFORMANCE

On January 4, 2011, the GPRA Modernization Act of 2010 (the Act) was signed into law (Public Law 111–352). The Act modernizes the Federal Government's performance management framework, retaining and amplifying aspects of the Government Performance and Results Act of 1993 (GPRA) while also addressing some of its weaknesses. On April 9, 2013, the OIG initiated a review of the SBA's compliance with GPRA requirements as described in OMB Memorandum M–11–31, *Delivering an Efficient, Effective and Accountable Government* and OMB Circular A–11, Part 6, *Preparation and Submission of Strategic Plans, Annual Performance Plans, and Annual Program Performance Reports*. The review is in its preliminary stages, and we anticipate publishing our findings later this year.

The Act emphasizes the use of goals and measures to improve outcomes, and requires the Federal Government to adopt a limited number of crosscutting goals, defined as objectives that cut across organizations (such as agency) boundaries. These goals are expected to focus on outcomes in a limited number of crosscutting policy areas, as well government-wide management objectives in the areas of financial management, human capital, procurement and acquisition, information technology, and real property. The Act

also requires agencies to report performance against those goals through a single Federal website.

Effectively measuring performance is important to support agency management resource allocation and other policy decisions to improve service delivery, compliance monitoring and program effectiveness. Importantly, performance measurement, because of its ongoing nature, can serve as an early warning system to management and as a vehicle for improving accountability to the public.

Although we currently have ongoing work to determine the Agency's compliance with GPRA requirements, recently conducted reviews have evidenced concern relative to accountability and performance measurement within certain programs:

- Audit Report 13–15: Briefing Report for the FY 2012 Federal Information Security Management Act Review

This report presents the results of the OIG's Federal Information Security Management Act (FISMA) review of the SBA. Under FISMA, agencies report their compliance with information security requirements. The OIG reports on the effectiveness of the agency's information security program in accordance with OMB criteria. For Fiscal Year (FY) 2012, the OIG was required to report on the following 11 areas: 1) continuous monitoring management; 2) configuration management; 3) identity and access management; 4) incident and response reporting; 5) risk management, 6) security training; 7) plan of actions and milestones; 8) remote access management; 9) contingency planning; 10) contractor systems, and 11) security capital planning.

The OIG found that the SBA continues to show improvement in its IT Security Program. Specifically, the SBA showed improvement in the areas of Incident Response and Risk Management, continues to meet requirements in the area of Security Capital Planning, and needs to make significant improvement in the area of Configuration Management. The OIG also recommended the SBA update its Telework SOP, which contained outdated technical procedures. However, significant concerns remain regarding SBA's IT security operations, and the OIG has a longstanding management challenge to the Agency identifying key concerns.

Audit Report 13–14: *The SBA's 417 Unauthorized Commitments Impacted Mission-Related Services and Increased Costs*

This report presents the results of the OIG's audit of the Small Business Administration's Unauthorized Commitments. An unauthorized commitment occurs when a government official agency procures goods or services without the necessary authority. The audit objective was to determine the extent and reasons unauthorized commitments occurred. The OIG determined that the SBA received invoices associated with 417 unauthorized commitments, valuing more than \$1.4 million between November 2010 and May 2012. The OIG found that the total number of unauthorized commitments at the SBA in the last two fiscal years greatly exceeded the total number of un-

authorized commitments at six other federal agencies of a similar size. Further, the OIG believes that the 417 unauthorized commitments directly affected the ability of the Agency to procure goods and services for its daily operations legally and efficiently, and limited its ability to provide needed support to small businesses.

The SBA continues to improve its acquisition process and preventing unauthorized commitments, however, transformation of the culture needs to occur. In order to implement a successful culture change, the SBA needs to hold its employees accountable for their actions, have detailed policy and guidance readily accessible to all employees, and provide meaningful training to all employees. The OIG recommended seven actions to improve contract management at the SBA and significantly decrease the total number of future unauthorized commitments.

- Audit Report 13–13: *Evaluation of SBA's Progress in Reducing Improper Payments in FY 2012*

The objective of this audit was to determine the adequacy of SBA's compliance with IPERA and OMB's implementing guidance. To achieve the audit objective, the OIG determined whether the SBA addressed required provisions, and performed limited testing of compliance with these provisions. The OIG also reviewed the completeness of improper payments disclosures in the SBA's Agency Financial Report for fiscal year (FY) 2012, and assessed the Agency's efforts to prevent and reduce improper payments.

The OIG found that the SBA was generally compliant in meeting the minimum requirements, in accordance with OMB guidance. Further, the OIG found that the SBA's efforts to prevent and reduce improper payments have resulted in significant progress since the FY 2011 assessment. Specifically, the Disaster Assistance Loan Program made progress through the deployment of improved controls and process improvements, which reduced their improper payments rate from 28.4 percent in FY 2011 to 17.9 percent in FY 2012. In addition, the 7(a) and 504 programs improved their testing procedures for loan guaranty approvals. The revised procedures were more robust and led to the identification of more improper payments during the testing process. As a result, the improper payments estimate increased from \$0 in FY 2011 to \$233 million and \$105 million, respectively, in FY 2012. Notwithstanding these accomplishments, further improvement is still needed in the effectiveness and development of SBA improper payment controls and processes for all of the programs or activities.

The OIG also assessed whether the SBA complied with IPERA reporting requirements, as specified in OMB guidance. This guidance requires a limited review of controls over Agency reporting. This evaluation found that the SBA generally met all the IPERA reporting requirements. However, the Disaster Assistance Loan program was not compliant because their improper payment rate exceeded the 10 percent threshold. In ad-

dition, three of the five programs or activities did not achieve their annual reduction targets. The OIG was unable to evaluate the accuracy and completeness of the improper payments rate reported for the Acquisition Program.

- Audit Briefing Report 13–11: *The SBA’s Loan Management and Accounting System-Incremental Improvement Projects*

This report presents the results of the OIG’s review of the SBA’s efforts to modernize its loan management system and migrate off the mainframe environment. Since 2004, a significant challenge facing the SBA is the modernization of the loan accounting process. Specifically, this report addresses issues identified in the planning, management, and oversight of SBA’s ongoing migration efforts.

The OIG found that the SBA successfully migrated the data-entry of over 44% of its loan and lending transactions from mainframe data entry to web-based data entry. This was the first step in fully migrating off SBA’s legacy mainframe and utilizing updated technology. During the review, the OIG also found that the:

- SBA did not have an incremental improvement project to migrate its newly created COBOL code into production.
- Root Cause Analysis Project was altered from its initially approved project.
- User Interface Migration Project screens were not security tested and validated.
- Quality Assurance and Independent Verification and Validations programs did not exist.

The OIG identified five findings that put the development of this project at risk for not meeting the needs and expectations of the SBA, the Office of Management and Budget (OMB), and Congress. The OIG also issued six recommendations. As discussed below, the OIG has issued a management challenge to SBA regarding LMAS system.

- Audit Report 13–03: *Benefits of Mentor Protégé Joint Ventures are Unknown: Robust Oversight is Needed to Assure Success and Avoid Abuse*

This report presents the results of the OIG’s audit on Protégé Benefits from Joint Venture Agreements with Mentors. The audit objectives were to (1) determine the extent to which the joint venture agreement between a mentor and protégé resulted in substantial benefits to the 8(a) participant, and (2) assess the SBA’s oversight of Mentor Protégé Joint Venture Arrangements.

The OIG found that the SBA lacked performance measurements for joint venture arrangements and did not effectively oversee 8(a) firms that have joint venture agreements. As a result, the SBA did not have the information necessary to determine whether mentor protégé joint ventures benefitted the 8(a) participant. This lack of information weakened SBA’s ability to effectively oversee and assess the development of 8(a) partici-

pants with mentor and protégé joint venture agreements and increased the risk of program abuse by participants. The OIG made six recommendations.

- *Audit Report 12–21: Review of SBA’s State Trade and Export Promotion (STEP) Grant Program*

This report presents the results of our audit, Review of SBA’s State Trade and Export Promotion (STEP) Grant Program, a three year pilot that will end in FY 2014. We reviewed the five largest grants, awarded to California, Pennsylvania, Washington, Michigan, and Illinois, in order to determine whether grant recipients were measuring program performance, as well as the results of those measurements. In addition, we reviewed the overall management and effectiveness of the STEP grant program.

We found that grant recipients’ performance measures did not demonstrate whether STEP program goals were achievable. Specifically, grant recipients’ metrics were not adequate to measure performance. In addition, SBA personnel did not meet with Congress to identify and clarify the FY 2011 STEP program measures for success. Personnel from the SBA Office of International Trade and the Office of Grant Management awarded a grant to an ineligible applicant, provided untimely and inaccurate responses to inquiries, and failed to enforce grant terms and conditions. The audit team recommended a total of nine specific actions that we believe will improve the accountability and performance of the STEP grant program.

- *Report 11–11 - Effectiveness of the Small Business Administration’s Surveillance Review Process*

This report presents the results of our audit of the effectiveness of the SBA’s Surveillance Review Process. Our audit objectives were to determine whether: (1) SBA’s small business and 8(a) surveillance reviews adequately assessed the small business programs of contracting activities; and (2) appropriate action was taken to ensure that areas of non-compliance were corrected in a timely manner.

SBA undertakes on-site visits, known as surveillance reviews, to review procuring agency files to determine, among other things, whether contracting offices are properly awarding and monitoring preferential contracts consistent with applicable regulations. 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 delegated its 8(a) execution authority to procuring agencies over 10 years ago, and said that it would monitor procuring agency compliance with 8(a) requirements through its surveillance reviews, our audit of surveillance reviews found that this had not been done. Lastly, there are regulatory limits on subcontracting which serve as an important control to preclude small business set-aside con-

tracts from becoming “pass-throughs” to large businesses. However, our audit found that the SBA review teams generally did not evaluate whether small businesses and 8(a) firms were performing the percentage of work that is required by these regulations. The OIG made 12 recommendations.

The policies and procedures that guide SBA officials in considering OIG-issued reports are set forth in OMB Circular A-50. This Circular appropriately indicates audit follow-up is an integral part of good management and is a shared responsibility of agency management officials and of auditors. For our part, OIG officials are responsible for undertaking independent audits and reviewing the agency’s responses to recommendations made in these reports. SBA management officials are responsible for receiving and analyzing OIG reports, providing timely responses, and taking corrective action, where appropriate. OMB Circular A-50 indicates that management officials are responsible for identifying and providing the OIG dates for achieving corrective action as part of their written comments on reported findings and recommendations. Significant disagreements in this process are addressed with the audit follow-up official—the SBA Deputy Administrator.

There are 47 open recommendations associated with the reports highlighted above, several of which recommend establishing meaningful performance metrics and periodically assessing the same. We have noted the increased cooperative efforts with SBA officials to root out fraud, waste, and abuse in SBA programs, and timely implementation of corrective action demonstrates commitment to improve the effectiveness and efficiency of SBA programs, though challenges persist.

## **TOP MANAGEMENT CHALLENGES**

While SBA’s programs are essential to strengthening America’s economy, the Agency faces a number of challenges in carrying out its mission, including fraudulent schemes affecting all SBA programs, significant losses from defaulted loans, procurement flaws that allow large firms to obtain small business awards, excessive improper payments, and outdated legacy information systems. The Agency also faces significant management challenges.

In accordance with the Reports Consolidation Act of 2000, the OIG released its *Report on the Most Serious Management and Performance Challenges Facing the Small Business Administration in FY 2013* in October 2012. This report represents our current assessment of Agency programs and/or activities that pose significant risks, including those that are particularly vulnerable to fraud, waste, error, mismanagement, or inefficiencies. Our report is based on specific OIG, Government Accountability Office (GAO), and other official reports, as well as our general knowledge of SBA’s programs and operations.

**Summary of the Most Serious Management and Performance Challenges Facing the  
SBA in FY 2013**

	Challenge	Color Scores					
		Status at End of FY 2012				Change from Prior Year	
		Green	Yellow	Orange	Red	Up ↑	Down ↓
1	Small Business Contracting	1		2		1	
2	IT Security		3	2			
3	Human Capital		1	3		1	
4	Loan Guaranty Purchase		1				
5	Lender Oversight	1	1	1		1	
6	8(a) Business Development Program		1	1	1		
7	Loan Agent Fraud	1	1			1	
8	Loan Management and Accounting System		1		3	1	3
9	Improper Payments – 7(a) program		2	2		1	
10	Improper Payments – Disaster Loan program		1				
11	Acquisition Management (NEW)						
	<b>TOTAL</b>	<b>3</b>	<b>12</b>	<b>11</b>	<b>4</b>	<b>6</b>	<b>3</b>

Overall, in FY 2012, the Agency made improvements across all the challenges, with the exception of one of the recommended actions under Management Challenge #6 and three of the recommended actions under Management Challenge #8. Specifically, Management Challenge #6—The Section 8(a) Business Development program needs to be modified so more firms receive business development assistance, standards for determine economic disadvantage are justifiable, and the SBA ensures that firms follow 8(a) regulations when completing contracts—remains at a rating of Red or no progress. Management Challenge #8—SBA needs to modernize its Loan Accounting System and migrate it off the mainframe—was downgraded from a rating of Orange, or limited progress, to a rating of Red, or no progress.

The progress on most Management Challenges was notable. The effort made by Agency staff and leadership throughout FY 2012 on the recommended actions demonstrated commitment to improving the Agency's programs and operations. The Agency's efforts are reflected in the overall elevation of Management Challenge ratings.

### CONCLUSION

The SBA OIG continues to focus on the most critical risks facing the SBA. Our resources are directed at key SBA programs and operations, to include financial assistance, government contracting and business development, financial management and information technology, disaster assistance, Agency management challenges, and security operations. Using a risk-based approach, we believe our reviews and investigations and ensuing recommendations for corrective action will result in greater effectiveness and efficiency of SBA programs and operations. We value our relationship with this Committee, and with the Congress at large, and look forward to working together to address identified risks and the most pressing issues facing the SBA.

