Report on the Most Serious Management and Performance Challenges in Fiscal Year 2016

October 15, 2015 **REPORT NUMBER 16-01**

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

Memorandum
Management Challenges

DATE: October 15, 2015

TO: Maria Contreras-Sweet
Administrator

FROM: Peggy E. Gustafson /s/
Inspector General

SUBJECT: Report on the Most Serious Management and Performance Challenges Facing the Small Business Administration in Fiscal Year 2016

In accordance with the Reports Consolidation Act of 2000, we are providing you with the Office of Inspector General's (OIG) *Report on the Most Serious Management and Performance Challenges Facing the Small Business Administration (SBA) in Fiscal Year (FY) 2016*. The overall goal is to focus attention on significant issues with the objective of working with Agency managers to enhance the effectiveness of SBA's programs and operations. We have prepared similar reports since FY 2000.

Within each management challenge is a series of recommended actions to enhance the effectiveness of agency programs and operations. Each recommended action is assigned a color score to indicate its status. The scores are as follows: green for "implemented," yellow for "substantial progress," orange for "limited progress," and red for "no progress." If a recommended action was added since last year's report, no color score was assigned, and the recommended action has been designated as "new." Actions that were scored green last year, which remained green this year, have been moved up to the "history bar" above the recommended actions. The history bar highlights any progress that the Agency has made on a challenge over the past 4 fiscal years (or as long as the challenge has existed, if shorter) by showing the number of actions that have moved to green each year. In addition, an arrow in the color box indicates that the color score went up or down from the prior year.

The following table provides a summary of the most serious management and performance challenges facing SBA in FY 2016.

Table 1. Summary of the Most Serious Management and Performance Challenges Facing the SBA in FY 2016

		Color Scores					
		Status at End of FY 2015				Change from Prior Year	
	Challenge					Up ↑	Down ↓
1	Small Business Contracting		1				
2	IT Security		2	3			1
3	Human Capital	1	2			1	
4	Lender Oversight		2				
5	8(a) Business Development Program			2	1		
6	Loan Agent Fraud	1	2	1		2	
7	Loan Management and Accounting System	4				4	
8	Improper Payments – 7(a) program	1	3			1	
9	Disaster Loan program (NEW)						
10	Acquisition Management	1		4		1	
	TOTAL	8	12	10	1	9	1

A significant change in this year's report involves small business contracting (Challenge 1). SBA is responsible for managing and overseeing the small business procurement process throughout the Federal Government. Last year, we reported that procurement flaws allow large firms to obtain small business awards and allow agencies to count contracts performed by large firms towards their small business goals. While large firms continue to receive contracts that are counted towards small business goals, we have realigned the discussion to include our concerns regarding weaknesses in small business contracting programs and the reliability of data used to calculate contracting goal achievements.

In addition, we added a new challenge regarding SBA's Disaster Assistance Program (Challenge 9). SBA's disaster assistance helps people and businesses recover from disasters by providing affordable, timely, and accessible loans to homeowners, renters, and businesses. However, there is an inherent risk of non-repayment for disaster loans because these loans repair or replace existing property, which means that loan recipients may be paying twice to maintain the same assets. In carrying out its mission, SBA must balance competing priorities to deliver timely assistance and reduce the risk of fraud and default.

We also removed the challenge pertaining to SBA's implementation of a quality control program in its loan centers (previously Challenge 4). SBA has made progress in implementing a quality control program for all of its loan centers. SBA's program is designed to verify and document compliance with the loan process, from origination to close-out, and to identify where material deficiencies exist so that the Agency can take remedial action. While SBA has made progress in implementing a quality control program, further improvement is needed for SBA to continue to demonstrate that all elements of the program are being completed and that the program is effective at identifying and correcting material deficiencies. We will continue to monitor SBA's quality control program during FY 2016 to verify that reviews are completed and effective at identifying and correcting material deficiencies.

The management challenge process is an important tool that we hope will assist the Agency in prioritizing its efforts to improve program performance and enhance its operations. We look forward to continuing to work with SBA's leadership team in addressing the Agency's management challenges.

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

The Small Business Act established a Government-wide goal that 23 percent of all prime contracts be awarded to small businesses each fiscal year. As the advocate for small business, SBA should strive to ensure that only eligible small firms obtain and perform small business awards. Further, SBA should ensure that procuring agencies accurately report contracts awarded to small businesses when representing their progress in meeting small business contracting goals. However, over the years, Congress has expressed concerns about the accuracy of the *Small Business Goaling Report*; this has been substantiated by OIG audits and other Government studies, which have shown widespread misreporting by procuring agencies, since many contract awards that were reported as having gone to small firms have actually been substantially performed by larger companies. Awards made to ineligible firms impact procurement opportunities for small businesses and damage SBA's credibility in reporting accurate small business contracting goals achievements. While some contractors may misrepresent or erroneously calculate their size, the incorrect reporting also results from errors made by Government contracting personnel, including the misapplication of small business contracting rules. Without reliable data, SBA cannot accurately measure the Federal Government's small business procurement goals achievements, which in turn weakens the ability of Congress and other Federal policy makers to determine whether the Government is maximizing contracting opportunities for small businesses.

In September 2014, we issued Report 14-18, which identified over $400 million in FY 2013 contract actions that may have been awarded to ineligible firms. We also found that over $1.5 billion dollars in FY 2013 contract actions went to firms that were no longer in the 8(a) Business Development or Historically Underutilized Business Zone (HUBZone) Programs. SBA regulations permit procuring agencies to claim small disadvantaged business and HUBZone goaling credit on certain contract actions, even after firms have left the program. In our opinion, the amount of dollars that SBA reports to Congress and the public as being performed by 8(a) and HUBZone firms in the *Small Business Goaling Report* is overstated by including contract actions performed by former program participants. Further, in Report 13-03, we identified weaknesses in the 8(a) Mentor Protégé Program that could also allow procuring agencies to include in their small business goal achievements contracts awarded to small businesses in which large businesses perform most of the work. In addressing deficiencies identified in these reports, SBA has begun to correct weaknesses within its small business information systems that impact the accuracy of goaling data. While SBA has taken steps to address reporting accuracy, further progress is needed.

In addition, OIG and GAO have both recently reported weaknesses in SBA's controls that would ensure only eligible firms receive contracts set-aside for the Women Owned Small Business Federal Contracting Program (WOSBP). The National Defense Authorization Acts (NDAA) for FY 2013 and FY 2015 made major programmatic changes to WOSBP. Specifically, the NDAA for 2013 removed previously existing contract caps on set-aside awards for which WOSB and economically disadvantaged WOSB firms were able to compete. The NDAA for 2015 granted contracting officers the authority to award sole-source awards to firms in WOSBP and required firms to be certified by a Federal agency, a State government, the Administrator, or a national certifying entity approved by the Administrator. However, SBA has opted to implement the sole-source authority provision first—separate from a certification program. We believe allowing sole source contracting authority in WOSBP, without implementing the contemporaneously required certification program, is inconsistent with SBA's statutory authorization and exposes the program to abuse. Absent a certification program, the Government is more likely to award WOSBP contracts to ineligible firms.

Likewise, SBA failed to reduce the size standard of businesses it defines as small when the Agency's own analysis indicated it was appropriate to do so. Because SBA has not adhered to its own analysis, small businesses will need to compete against larger companies within certain North American Industry Classification System (NAICS) codes.[1] Within those NAICS codes, the benefits intended for small business contractors may instead go to larger concerns. Similarly, small businesses will compete against larger concerns within those NAICS codes so that the goaling numbers may be further distorted.

SBA performs surveillance reviews to assess Federal contracting agencies' compliance with small business programs' requirements and to verify that agencies are properly measuring their small business goal achievements. SBA has implemented a new Standard Operating Procedure (SOP) to ensure consistency in conducting its surveillance reviews. According to SBA, it has conducted over 60 surveillance reviews using the new SOP, and it continues to improve its surveillance review process. We are working with the Agency to verify that the reviews are conducted in a thorough and consistent manner.

Although SBA relies on Federal agencies to implement its programs and maximize procurement opportunities for small businesses, SBA is ultimately responsible for ensuring that small businesses receive a fair and equitable opportunity to participate in Federal contracts. As such, SBA needs to enhance its controls and continue to collaborate with other agencies to improve procurement data accuracy supporting small business contracting goals. Similarly, SBA needs the full range of Federal program enforcement tools at its disposal. To this end, the Agency should modify its Program Fraud Civil Remedies Act (PFCRA) regulations so that SBA can pursue any small business contracting program violations, subject to the PFCRA's jurisdictional limits, under that statute.

Number of Actions Accomplished (Green Status) During Last Four Fiscal Years (Challenge first reported in FY 2005)	2011: 1	2012: 1	2013: 0	2014: 1
Recommended Actions for FY 2016				Status at end of FY 2015
1. Revise the surveillance review process to ensure that reviews are conducted in a thorough and consistent manner. *(Previously action 2)*				Yellow
2. Strengthen controls to ensure the accuracy of the Federal Government's annual small business procurement goals achievements reported in the *Small Business Goaling Report*.				New
3. Implement a certification process for WOSBP.				New
4. Revise SBA's Program Fraud Civil Remedies Act regulations so that SBA can pursue violations of its Federal contracting programs and demonstrate a capacity for taking enforcement actions under that statute.				New

Green-Implemented **Yellow**-Substantial Progress **Orange**-Limited Progress **Red**-No Progress

[1] NAICS classifies business establishments for the purpose of collecting, analyzing, and publishing statistical data related to the U.S. economy. SBA uses NAICS as a basis for its size standards.

Challenge 2. Weaknesses in Information Systems' Security Controls Pose Significant Risks to the Agency

Recent Government-wide security breaches have heightened the importance of continuously monitoring networks and software applications. OIG and its external auditor have identified weaknesses when on-boarding and separating SBA personnel. In addition, SBA needs to address long-standing security weaknesses in the following areas:

- SBA's system software controls have long-standing recommendations relating to timely baseline configurations of SBA's IT platforms and patching operating systems, devices, and database management systems.
- SBA's segregation of duty controls continue to have open recommendations relating to restricting access to system software and effectively reviewing system and application logs.
- SBA's IT security management program continues to have open recommendations relating to IT security oversight as well as improvements in SBA's compliance with guidance provided in the Federal Information Security Management Act of 2002 (FISMA).

To show improvement in the above areas, SBA's Office of the Chief Information Officer, in conjunction with SBA's various program offices, will need to implement tools and capabilities to provide effective oversight and continuously monitor computer security controls.

Number of Actions Accomplished (Green Status) During Last Four Fiscal Years (Challenge first reported in FY 1999)	2011: 1	2012: 0	2013: 1	2014: 0

Recommended Actions for FY 2016	Status at end of FY 2015
1. Access controls are in place and operating effectively, and contractors are not granted system access until they have obtained the required background investigations and/or security clearances.	Orange ↓
2. System software controls are in place and operating effectively.	Orange
3. Segregation of duty controls are in place and operating effectively.	Orange
4. The plan of action and milestones accurately report all computer security weaknesses and corrective actions.	Yellow
5. The IT security management program effectively addresses information security in systems that support the operations and assets of the organization.	Yellow

Green-Implemented **Yellow**-Substantial Progress **Orange**-Limited Progress **Red**-No Progress

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

The Office of Human Resource Solutions (OHRS) made significant progress toward its workforce and succession planning goals during FY 2015. By the beginning of the fiscal year, the Agency had contracted the services of the Office of Personnel Management's (OPM) fee-for-service arm, HR Solutions, who would review existing competency models, related job materials, and job analysis information in order to provide feedback for SBA's existing competency models. OPM will then facilitate focus groups to update and validate the model based on HR Solutions' feedback. Using the updated and validated competency model, OHRS will also perform a competency gap analysis for each mission-critical occupation and provide a report on the gaps existing in the workforce, recruitment, retention, and employee development program decisions. HR Solutions is expected to complete its work in FY 2016. In order to complete this recommended action, SBA's workforce and succession planning goals should establish appropriate metrics to gauge its success at having the right people, in the right jobs, at the right time.

OHRS also continues to make substantial progress to update and establish standard operating procedures (SOP) for human capital management. In FY 2015, OHRS issued one SOP and advanced two other critical SOPs into the final stages of the clearance process. In addition, OHRS issued the Merit Promotion Plan SOP, updated the *Delegation Examination Handbook*, and moved two other SOPs into the formal clearance process not previously identified in this challenge. OHRS plans to work on updating the last SOP included in OIG's recommended actions—Discipline and Adverse Actions—in FY 2016.

The Agency has implemented the third recommended action under this management challenge. In FY 2015, OHRS established an employee engagement working group to complement the ongoing SBA Way Initiative established in FY 2013. The employee engagement working group meets bi-weekly and is responding to the White House, Office of Management and Budget (OMB), and OPM guidance with a four-pronged approach: (1) individual accountability, (2) organizational performance, (3) communication, and (4) initiative and activity.

Number of Actions Accomplished (Green Status) During Last Four Fiscal Years (Challenge first reported in FY 2001, revised FY 2007)	2011: 0	2012: 0	2013: 1	2014: 0

Recommended Actions for FY 2016	Status at end of FY 2015
1. Ensure the Agency has an effective, comprehensive workforce and succession plan that aligns talent needs and capabilities with SBA's FY 2011-2016 strategic plan. SBA's workforce and succession planning goals should reflect the need to recruit and retain the appropriate talent, and should establish appropriate metrics to gauge SBA's success at having the right people, in the right jobs, at the right time.	Yellow
2. Ensure that human capital management SOPs are updated and appropriately structured to support the Agency's long-term goals and objectives and Government-wide human capital management initiatives. *(Previously recommended action #3)*	Yellow
3. Demonstrate sustained progress toward a high-performing, employee-driven culture through activity and effort as prioritized by SBA's employee engagement initiative for two consecutive years (end of FY 2015) *(Previously recommended action #4, modified in February 2014).*	Green ↑

Green-Implemented **Yellow**-Substantial Progress **Orange**-Limited Progress **Red**-No Progress

Challenge 4. SBA Needs to Further Strengthen its Oversight of Lending Participants

Prior OIG and GAO reports disclosed weaknesses in SBA's oversight of lenders that participate in its programs. The risks inherent in delegated lending require an effective oversight program to (1) monitor compliance with SBA policies and procedures and (2) take corrective actions when a material noncompliance is detected. However, in prior years, we have found that SBA had not established sufficient controls that would identify—and safeguard against—the risks some lenders pose. For example, in a September 2012 audit report, OIG found that SBA did not always recognize the significance of lender weaknesses or determine the risks they posed to the Agency during its onsite reviews (Report 12-20R). The Agency also did not link the risks associated with these weaknesses to the lenders' corresponding risk ratings and assessments of operations. Further, SBA did not require lenders to correct performance problems that could have exposed SBA to unacceptable levels of financial risk.

However, since this management challenge was first issued in 2001, SBA has made substantial progress in its oversight of lending participants. In FY 2013, SBA (1) developed risk profiles and lender performance thresholds, (2) developed a select analytical review process to allow for virtual risk-based reviews, (3) updated its lender risk rating model to better stratify and predict risk, and (4) conducted test reviews under the new risk-based review protocol. These efforts have demonstrated that onsite reviews are now conducted on the highest-risk lending participants based on expanded selection criteria.

Further, in FY 2014, SBA improved its monitoring and verification of lender corrective actions by: (1) developing corrective action assessment procedures, (2) finalizing a system to facilitate the corrective action process, and (3) populating the system with lender oversight results requiring corrective action. In FY 2015, SBA's Office of Credit Risk Management (OCRM) engaged contractor support to expand on its corrective action follow-up process. Additionally, OCRM issued its FY 2015 Risk Management Oversight Plan, which included plans to conduct 170 corrective action reviews between 7(a) and 504 lenders.

Number of Actions Accomplished (Green Status) During Past Four Fiscal Years (Challenge first reported in FY 2001)	2011: 0	2012 7(a) loans: 1 504 loans: 1	2013 7(a) loans: 2 504 loans: 2	2014 7(a) loans: 0 504 loans: 0

Recommended Actions for FY 2016	Status at end of FY 2015	
	7(a)	504
1. Monitor and verify implementation of corrective actions to ensure effective resolution prior to close-out. *(Previously Recommended Action #3)*	Yellow	Yellow

Green-Implemented **Yellow**-Substantial progress **Orange**-Limited Progress **Red**-No progress

Challenge 5. SBA Needs to Modify the Section 8(a) Business Development Program So More Firms Receive Business Development Assistance, Standards for Determining Economic Disadvantage are Justifiable, and Firms Follow 8(a) Regulations When Completing Contracts

SBA's 8(a) Program was created to provide business development assistance to eligible small disadvantaged businesses seeking to compete in the American economy. SBA's challenge has been to ensure that 8(a) guidance, controls, and practices truly prepare participating firms for a competitive market. In the past, SBA had not placed adequate emphasis on business development to enhance the ability of 8(a) firms to compete and did not adequately ensure that only 8(a) firms with economically disadvantaged owners in need of business development remained in the program.

SBA continues to address issues that hinder its ability to deliver an effective 8(a) Program. For example, SBA has made its assistance more readily available to program participants by using resource partners such as small business development centers. SBA has also taken steps to ensure business opportunity specialists assess program participants' business development needs during site visits. SBA also revised its regulations, effective March 2011, to ensure that companies deemed "business successes" graduate from the program, rather than allowing them to remain in the program and receive 8(a) contracts, which caused fewer companies to receive the majority of 8(a) contract dollars and many to receive none. These regulations also establish additional standards to address the definition of "economic disadvantage."

However, for the third consecutive year, SBA has not finalized its 8(a) Program SOP to reflect the March 2011 regulatory changes. In October 2015, SBA submitted the SOP through its internal clearance process. Further, although the March 2011 regulations establish the threshold for "economic disadvantage," we have concerns that SBA's standards for determining economic disadvantage are not justified or objective because they are not based on economic analysis. Agency officials stated that the rule-making process served as an adequate proxy to objectively and reasonably determine effective measures for economic disadvantage, and were not aware of any reliable sources of data to determine economic disadvantage. However, we continue to maintain that SBA's standards for determining economic disadvantage are not justified or objective based on the absence of an economic analysis. Finally, monitoring efforts have made limited progress. For example, although SBA awarded a $1.9 million contract in December 2011 to develop and deploy a new IT system to assist in monitoring 8(a) Program participants, in 2014, SBA decided not to deploy this new system. Instead, SBA is now attempting to develop and implement another IT system.

Number of Actions Accomplished (Green Status) During Past Four Fiscal Years (Challenge first reported in FY 2003)	2011: 0	2012: 0	2013: 0	2014: 0

Recommended Actions for FY 2016	Status at end of FY 2015
1. Develop and implement a plan, including SOP provisions, which ensures that the 8(a) Business Development Program identifies and addresses program participants' business development needs on an individualized basis.	Orange
2. Update and issue the 8(a) Business Development SOP to reflect the March 2011 regulatory changes.	Orange
3. Establish objective and reasonable criteria that effectively measure "economic disadvantage," and implement the new criteria.	Red

Green-Implemented **Yellow**-Substantial Progress **Orange**-Limited Progress **Red**-No Progress

Challenge 6. Effective Tracking and Enforcement Would Reduce Financial Losses from Loan Agent Fraud

For years, OIG investigations have revealed a pattern of fraud by loan packagers and other for-fee agents in the 7(a) Loan Program, involving hundreds of millions of dollars. Since 2005, SBA OIG has investigated at least 22 cases with confirmed loan agent fraud totaling at least $335 million. Further, OIG has determined that loan agents were involved in approximately 15 percent of all 7(a) loans and resulted in increased risk of default. Yet SBA's oversight of loan agents has been limited, putting taxpayer dollars at risk. Prior OIG audits and investigations have identified that SBA does not have a way to effectively identify and track loan agent involvement in 7(a) portfolios, does not adequately list suspended loan agents to prevent their involvement in the program, and may have outdated enforcement regulations. As loan agent involvement in the 7(a) Program continues to increase, it will become all the more important for SBA to have oversight tools in place to identify and track loan agent involvement in this sizeable program.

In response to this challenge, SBA has made gradual progress. First, to track loan agent activity, SBA eventually decided to have lenders fax a loan agent disclosure form (Form 159) to SBA's fiscal and transfer agent (FTA) and require the FTA to enter the data into a database accessible to SBA. SBA also began linking Form 159 information with its loan data. However, as a recent OIG report identified significant issues in the data quality on the Form 159 information, SBA will likely need to make further modifications to this process. For example, the FTA is testing an automated Form 159. Additionally, in response to OIG concerns that SBA loan agent enforcement regulations are outdated, SBA drafted revised regulations, which the Office of Management and Budget is reviewing.

Lenders need to ensure that agents involved with their loans have not been subject to enforcement action by SBA. SBA now lists the names of loan agents and others named in SBA enforcement actions on its website, and updated an SOP in FY 2014 to instruct lenders to consult this list to avoid problematic loan agents. However, SBA also needs to develop a system to assign a unique identifier to loan agents that participate in the 7(a) Program. Otherwise, suspended agents could circumvent SBA by simply changing their name and continuing participating in the program. In response to our loan agents report, SBA stated it will explore the feasibility of implementing a registration system (Report 15-16).

Number of Actions Accomplished (Green Status) During Past Four Fiscal Years (Challenge first reported in FY 2000)	2011: 0	2012: 1	2013: 0	2014: 0

Recommended Actions for FY 2016	Status at end of FY 2015
1. Develop an effective method of disclosing and tracking loan agent involvement in SBA business loan programs.	Yellow
2. Update regulations (13 CFR Part 103) regarding loan agents to provide effective enforcement procedures.	Yellow ↑
3. Issue guidance that lenders must (1) review SBA's webpage list of loan agents that have been subject to an enforcement action and (2) refrain from doing business with any agent appearing on the list during the time that an agent is suspended or revoked from the 7(a) Program.	Green ↑
4. Implement a loan agent registration system, including the issuance of a unique identifying number for each agent.	Orange

Green-Implemented **Yellow**-Substantial Progress **Orange**-Limited Progress **Red**-No Progress

Challenge 7. SBA Needs to Modernize its Loan Accounting System and Migrate it Off the Mainframe

The Loan Accounting System is the core system of record used to account for SBA's $115 billion loan portfolio. In November 2005, SBA initiated the loan management accounting system (LMAS) project, intended to update and modernize the old system and migrate it off the mainframe. Since 2010, the LMAS modernization effort has been structured into multiple components, or incremental improvement projects (IIPs).

SBA successfully migrated its Loan Accounting System off its legacy mainframe in January 2015, thereby ending SBA's reliance on the proprietary mainframe platform. The most recent transition to production planning IIP included testing the new system and migrating code and financial data to the new production environment. This project was critical to SBA's overall effort to move off the proprietary mainframe. Our most recent review found that SBA's multiple tests—including system, integration, performance, and user acceptance tests—successfully ensured that the new system operated correctly. We also found that SBA completed nearly all outstanding recommendations related to the recommended actions below.

While SBA has successfully closed out the LMAS project, we have observed that the Agency needs to complete additional, complex IT projects timely and successfully. This effort may pose a challenge for the Agency because SBA does not have experienced IT program managers and also lacks continuity within the Office of the Chief Information Officer. Consequently, it will be difficult for the Agency to consistently ensure that its IT investments yield the intended results. As a result, OIG will continue to evaluate whether SBA's capital investment controls adhere to system development methodologies and criteria.

Number of Actions Accomplished (Green Status) During Past Four Fiscal Years (Challenge first reported FY 2010)	2011: 0	2012: 0	2013: 0	2014: 0

Recommended Actions for FY 2016	Status at end of FY 2015
1. Migrate LMAS to a new operating platform before the current mainframe contract expires in 2015.	Green ↑
2. Modify the LMAS quality assurance/independent verification and validation (IV&V) contract and establish an effective quality assurance (QA) process which provides senior management independent assurance that LMAS development activities and related project deliverables meet SBA quality standards.	Green ↑
3. Establish a process for reviewing and accepting LMAS deliverables that complies with quality assurance and systems development methodology requirements. This includes hiring or fully staffing an IV&V entity to validate deliverable acceptance.	Green ↑
4. Implement a quality assurance process in LMAS in accordance with SBA's Enterprise QA Plan.	Green ↑

Green-Implemented **Yellow**-Substantial Progress **Orange**-Limited Progress **Red**-No Progress

Challenge 8. SBA Needs to Accurately Report, Significantly Reduce, and Strengthen Efforts to Recover Improper Payments in the 7(a) Loan Program

Previous OIG audits have determined that SBA has significantly understated its improper payment rates for 7(a) loan approvals and purchases because it did not adequately review loans, used flawed sampling methodologies, and did not accurately project review findings. In FY 2011, SBA reported a 1.73 percent improper payment rate for 7(a) purchases, or $40.7 million, when the rate could have been as high as 20 percent, or about $472 million. Similarly, even though SBA in FY 2011 reported no improper payments for 7(a) loan approvals, an OIG audit estimated that at least 1,996 Recovery Act 7(a) loans were not originated and closed in compliance with SBA requirements, resulting in at least $869.5 million in inappropriate or unsupported loan approvals.

Recent OIG audits have also identified 7(a) loans that were ineligible, lacked repayment ability, or were not properly closed. In 2012, we reported that the limited reviews of lender underwriting performed during guaranty purchase reviews were contrary to SBA procedures, resulting in improper payments. We also reported that high-dollar, early-defaulted loans were not reviewed with the scrutiny required to identify improper payments. In 2014, we reported that six SBA-approved loans with material underwriting deficiencies defaulted, resulting in $4.8 million in unnecessary losses. In 2015, we reported another $1.8 million in recommended recoveries on purchased 7(a) loans. Additionally, we reported that due to a change in testing procedures, SBA missed identifying improper payments and, consequently, its FY 2014 reported improper payment rate for 7(a) purchases was understated.

The Office of Capital Access (OCA) has taken actions to accurately report and reduce improper payments in SBA's 7(a) Loan Program. OCA has (1) formalized its improper payment sampling, (2) demonstrated that its review process is effective for 7(a) loan approvals, (3) formalized its process to review disputed cases, (4) formalized the recovery process and time standards for 7(a) purchases, (5) developed appropriate corrective action plans for 7(a) loans, (6) established repayment ability review requirements that are effective at identifying improper payments, (7) revised improper payment review checklists, and (8) demonstrated recovery from lenders in a timely manner during FY 2015. However, OCA still needs to demonstrate that its process over disputed cases ensures adequate and timely resolution.

Actions Accomplished (Green Status) During Past Four Fiscal Years (Challenge first reported FY 2010)	2011: 0	2012: 0	2013 7(a) Approvals:1 7(a) Purchases: 0	2014 7(a) Approvals:1 7(a) Purchases:1

Recommended Actions for FY 2016	Status at end of FY 2015	
	7(a) Approvals	7(a) Purchases
1. Reassign responsibility for final approval of disputed denial, repair, and improper payment decisions from the Office of Financial Assistance (OFA) to the Office of Credit Risk Management (OCRM) to ensure an adequate and timely resolution of disputes.	N/A	Yellow
2. Establish a process and time standards to expeditiously recover improper payments identified during Agency reviews and OIG audits.	N/A	Green ↑
3. Demonstrate that corrective action plans are effective in reducing improper payments in the 7(a) Loan Program.	Yellow	Yellow

Green-Implemented Yellow-Substantial Progress Orange-Limited Progress Red-No Progress

Challenge 9. Disaster Assistance Must Balance Competing Priorities to Deliver Timely Assistance and Reduce Improper Payments

SBA's disaster loans are vulnerable to fraud and losses because (1) loan transactions are often expedited in order to provide quick relief to disaster survivors, (2) lending personnel hired in connection with a disaster declaration may lack sufficient training or experience, and (3) the volume of loan applications may overwhelm SBA's resources and its ability to exercise careful oversight of lending transactions. Both OIG and GAO audits have determined that because SBA had not taken sufficient steps to prepare for large-scale disasters, such as properly preparing and training a new workforce for high application volumes, the program has often been unable to provide timely assistance in the aftermath of major disasters. Even in the wake of disasters like Hurricane Sandy, SBA did not effectively develop and utilize programmatic innovations intended to assist in disbursing funds quickly and effectively. For instance, SBA did not implement three new guaranteed disaster loan programs mandated by Congress in 2008 that would provide expedited disaster loans in partnership with private sector lenders. SBA solicited feedback from lenders on these proposed programs and they objected to the requirements regarding loan terms, interest rates and loan fee limits. Further, the expedited loan processes implemented in response to Hurricane Sandy did not significantly reduce loan approval times.

Additionally, in FY 2014, the default component of the disaster direct loan program subsidy rate was 15 percent, and the program's improper payment rate was 12 percent. While the improper payment rate represents a gradual decrease compared to the past several years, it remains above the 10 percent level required to be in compliance with the Improper Payments Elimination and Recovery Act of 2010 (IPERA). In addition, the Disaster Direct Loan Program exceeds the threshold for significant improper payments defined by IPERA ($10 million and 2.5 percent of program outlays)—Improper payments were $70 million of the $585.6 million in program outlays in FY 2014. To reduce improper payments with disaster loans, SBA's Office of Disaster Assistance (ODA) should strengthen controls related to verification and documentation of loan eligibility, insurance coverage, and other program requirements that have been identified as the most prevalent errors in the program. If properly addressed, SBA can effectively reduce the improper payment rate in future years.

Actions Accomplished (Green Status) During Past Four Fiscal Years (Challenge first reported FY 2015)	2011: N/A	2012: N/A	2013: N/A/	2014: N/A

Recommended Actions for FY 2016	Status at end of FY 2015
1. Implement pilot programs of the new guaranteed disaster programs mandated by Congress.	OCA New
2. Demonstrate that the Agency has adequately trained loan processing resources that can be quickly mobilized in the event of the disaster.	ODA New
3. Reduce the improper payment rate to 9.5 percent or lower in FY 2016, in accordance with the reduction targets established in the FY 2014 Agency Financial Report.	ODA New

Green Implemented Yellow-Substantial Progress Orange-Limited Progress Red-No Progress

Challenge 10: SBA Needs to Effectively Manage Its Acquisition Program

SBA improved its acquisition process by reducing its improper payment rate for contract disbursements, providing training to acquisition personnel, conducting annual advanced strategic acquisition planning, and using the Contract Review Board for making acquisition decisions. However, challenges still exist, including: (1) inadequate acquisition planning, (2) poorly defined requirements, (3) incomplete systems interface, (4) lack of effective controls for interagency acquisition, and (5) an incomplete acquisition SOP.

We identified instances where SBA inadequately planned its requirements for procuring IT products and services. While SBA, for the most part, interfaced the contract management system with the financial system, it has not completed the interface for blanket purchase agreements and indefinite delivery indefinite quantity contracts—potentially exposing an internal control deficiency. SBA also did not comply with Federal regulations when determining whether using interagency acquisitions was the best procurement approach. Further, its acquisition SOP does not include procedures on the use of modular contracting for major system acquisitions, interagency acquisitions, or post-award contract administration requirements.

In July 2014, the Office of the Chief Financial Officer (OCFO) awarded a contract to assess its acquisition function. The assessment was completed in March 2015; however, as of September 2015, OCFO had not implemented a comprehensive improvement plan to address deficiencies identified by the assessment. Until SBA can demonstrate that it has developed and implemented a comprehensive improvement plan to address the control deficiencies within its acquisition function, it will continue to experience challenges.

Actions Accomplished (Green Status) During Past Four Fiscal Years *(Challenge first reported FY 2013)*	2011: N/A	2012: N/A (New)	2013: 0	2014: 0

Recommended Actions for FY 2016	Status at end of FY 2015
1. Complete an assessment of the Agency's acquisition activities using OMB's *Guidelines for Assessing the Acquisition Function*.	Green ↑
2. Create and implement a comprehensive improvement plan—based on the results of the acquisition function assessment—that has measurable goals, objectives, prioritized actions, and timeframes to address deficiencies identified in the organizational alignment and leadership assessment area.	Orange
3. Create and implement a comprehensive improvement plan—based on the results of the acquisition function assessment—that has measurable goals, objectives, prioritized actions, and timeframes to address deficiencies identified in the acquisition policies and processes assessment area (i.e. acquisition management SOP).	Orange
4. Create and implement a comprehensive improvement plan—based on the results of the acquisition function assessment—that has measurable goals, objectives, prioritized actions, and timeframes to address deficiencies identified in the acquisition workforce assessment area.	Orange
5. Create and implement a comprehensive improvement plan—based on the results of the acquisition function assessment—that has measurable goals, objectives, prioritized actions, and timeframes to address deficiencies identified in the knowledge management and information systems assessment area.	Orange

Green-Implemented **Yellow**-Substantial progress **Orange**-Limited Progress **Red**-No progress