



**STATEMENT OF**

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**BEFORE THE**

**COMMITTEE ON SMALL BUSINESS**  
**AND ENTREPRENEURSHIP**  
**U.S. SENATE**

**APRIL 9, 2014**

## INTRODUCTION

Chairwoman Cantwell, Ranking Member Risch, 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 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. During Fiscal Year (FY) 2013, the SBA OIG operated at an enacted budget level of \$17.30 million, which included a \$1.00 million transfer from the SBA Disaster Loan Program Account. As a result of sequestration, our combined total operating budget was reduced from \$17.30 million to \$16.36 million. Approximately 84 percent of our expenditures are attributed to payroll expenses for our employees.

During FY 2013, the OIG issued 19 reports with 129 recommendations for improving the Agency's operations, recovering improper payments, and reducing fraud and unnecessary losses in SBA programs.) In addition, OIG investigations resulted in 64 indictments/informations, 51 convictions, and almost \$280 million in potential recoveries, fines, asset forfeitures, civil fraud settlements, or loans/contracts not being approved or being canceled. In all, the OIG achieved \$348 million in monetary recoveries and savings—a more than a twenty-fold return on investment to the taxpayer for FY 2013.

## BUDGET REQUEST

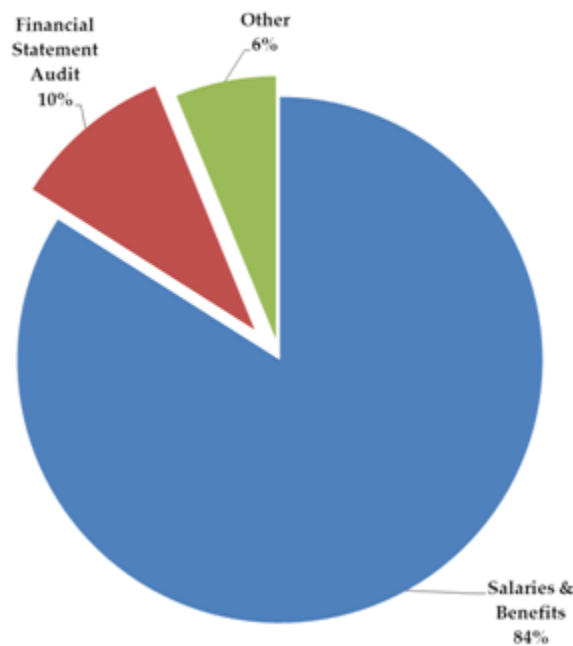
As with FY 2014, the President's FY 2015 Budget requests \$19.4 million for the OIG, plus an additional \$1 million to be transferred from the Disaster Loan Program, for a total of \$20.4 million.

<i>Dollars in Millions</i>	<b>FY 2013 Actual<sup>1</sup></b>	<b>FY 2014 Enacted</b>	<b>FY 2015 Request</b>	<b>FY 2015 Incr/Decr</b>
New Budget Authority	\$16.3	\$19.0	\$19.4	0.4
Transfer from Disaster Loan Program	1.0	1.0	1.0	--
<b>Total</b>	<b>\$17.3</b>	<b>\$20.0</b>	<b>\$20.4</b>	<b>0.4</b>

The majority of the funds requested for FY 2015 will be used for salary and benefits for approximately 112<sup>1</sup> OIG employees and the annual audit of the Agency's financial statements by an Independent Public Accountant.

<sup>1</sup> Includes positions funded from supplemental appropriations provided by the Consolidated Security, Disaster Assistance, and Continuing Appropriations Act of 2009 and H.R. 152—An Act

### FY 2015 Estimated Obligations



The OIG resources are necessary to provide independent oversight of SBA's programs and operations, including continuation of an initiative to effectively target early defaulted loans for fraud and lender negligence.

With the funds requested for FY 2015, the OIG will:

- Work an active caseload of about 250 criminal and civil fraud investigations of potential loan and contracting fraud and other wrongdoing. Many of these investigations involve complex, multimillion dollar fraudulent financial schemes perpetrated by multiple suspects.
- Conduct audits and reviews of high-risk SBA activities with a focus on systemic, programmatic, and operational vulnerabilities.
- Contract with an independent public accountant to perform the audit of the SBA's financial statements. (In FY 2015, the financial statement audit is projected to cost \$2 million-10 percent of the OIG's budget request.)

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making supplemental appropriations for the fiscal year ending September 30, 2013, to improve and streamline disaster assistance for Hurricane Sandy, and for other purposes.

- Provide oversight and monitoring of the SBA's information technology (IT) security and application development activities, including new systems under development and the Agency's compliance with the Federal Information Security Management Act (FISMA). The OIG has identified systemic problems with SBA's IT systems, and this remains one of the most serious management challenges facing the Agency.
- Maintain a robust Hotline operation to receive and process allegations of waste, fraud, abuse, or serious mismanagement in the SBA or its programs from employees, contractors, and the public. (During FY 2013, the Hotline processed 853 complaints, which were reviewed and analyzed by Hotline staff to determine the appropriate course of action. This represented almost a 60 percent increase over the previous year.)
- Through a Whistleblower Ombudsman established pursuant to the Whistleblower Protection Enhancement Act of 2012, educate SBA employees about prohibitions on retaliation for whistleblowing, as well as employees' rights and remedies if anyone retaliates against them for making a protected disclosure.
- Perform required background investigations of SBA employees to achieve a high level of integrity in the Agency's workforce. New Office of Personnel Management regulatory changes issued pursuant to Executive Order 13488 mandate that agencies reinvestigate individuals in public trust positions (both high risk and moderate risk) every five years. It is estimated that several hundred SBA employees will be required to undergo reinvestigation to meet this requirement, effectively increasing the OIG's workload.
- Adjudicate SBA employees and contractors for issuance of Personal Identity Verification (PIV) cards pursuant to Homeland Security Presidential Directive 12 (HSPD-12) background investigation requirements.
- Conduct name checks and, where appropriate, fingerprint checks on program applicants to prevent known criminals and wrongdoers from participating in SBA programs. (During FY 2013, more than \$25 million in loans were not approved as a result of the OIG's name check program, effectively protecting the taxpayer from potential loss.)
- Review proposed revisions to SBA regulations, policies, procedures, and other directives with an emphasis on strengthening internal controls to preclude potential fraud and wasteful, confusing, or poorly planned initiatives. (During FY 2013, the OIG provided recommendations to improve 60 of the 115 proposed revisions it reviewed.)

- Recommend debarments, suspensions, and other administrative enforcement actions to foster integrity in SBA programs. (During FY 2013, the OIG recommended 65 administrative enforcement actions to the Agency.)

## OVERSIGHT PRIORITIES

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. 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 2014* in October 2013. 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.

**Table 1. Summary of the Most Serious Management and Performance Challenges Facing the SBA in FY 2014.**

Number	Challenge	Green	Yellow	Orange	Red	Up #	Down#
1	Small Business Contracting		2			2	
2	IT Security	1	2	1	1	1	1
3	Human Capital	1	3			3	
4	Loan Guaranty Purchase		1				
5	Lender Oversight	4		2		2	
6	8(a) Business Development Program		1	1	1		
7	Loan Agent Fraud		1				
8	Loan Management and Accounting System		1	3		3	
9	Improper Payments– 7(a) Program	1	5			4	
10	Improper Payments-Disaster Loan Program		1				
11	Acquisition Management			5			
	<b>TOTAL</b>	<b>7</b>	<b>17</b>	<b>12</b>	<b>2</b>	<b>15</b>	<b>1</b>

In FY 2013, the Agency made improvements across six of the challenges. For one recommended action under management challenge #2—Weaknesses in information systems security controls pose significant risks to the Agency, the lack of corrective action resulted in a reduction from Orange (i.e., Limited Progress) to Red (i.e., No Progress) status. Overall, the effort made by Agency staff and leadership throughout FY 2013 on most of the recommended actions demonstrated commitment to improving the Agency’s programs and operations.

Pursuant to P.L. 113-2, the OIG was appropriated \$5 million to provide effective oversight of the SBA’s disaster response to Superstorm Sandy. This funding level is based on experience with major disasters in the past, such as the Gulf Coast Hurricanes in 2005. The supplemental funding will be used to support approximately 5 auditors and 5 criminal investigators and associated operating costs for a period of at least 4 to 6 years. Availability of funds for this timeframe is particularly important because many times fraudulent loans are not immediately identified, have a deferment period for repayment, and take years to default. There is a five-year statute of limitations (from the date of the last false statement) to prove a false statement to the SBA.

## **PLANNED ACTIVITIES**

In addition to conducting audits and reviews that are required by statutes and other directives, the OIG plans to focus on the most critical risks facing the SBA. Several areas of emphasis are discussed below.

### *Financial Assistance*

The SBA paid guaranty claims totaling \$3.8 billion during FY 2012 and FY 2013 for defaulted 7(a) loans and 504 debentures. Some of the SBA losses correlate to similar root causes reported in the mortgage industry, such as limited SBA oversight of lenders and loan agents, poor lender loan processing, unscrupulous borrowers, and complicit brokers and lenders.

The OIG to will continue to address financial losses in SBA lending due to lender errors and various fraud schemes. The OIG will utilize an Early Defaulted Loan Review Group to perform in-depth analyses of loans that default within 18 months of final disbursement. When lender negligence is found, this group will recommend non-payment of the guaranty (or recovery if the guaranty is already paid). The OIG will also target the most offending lenders to attain corrective actions and identify trends for operational improvement by the SBA. When suspected fraud is identified, those loans will be investigated.

The OIG will continue to focus on detecting fraud committed by loan agents, such as packagers and brokers. A loan agent is sometimes hired by an applicant or

lender to assist the applicant in obtaining an SBA loan. Although honest loan agents help small businesses gain access to capital, some dishonest ones have perpetrated fraudulent schemes involving tens of millions of dollars in loans. These fraudulent loans often default for non-payment, and the SBA is forced to use taxpayer funds to purchase the guaranteed portions of the loans. In a recent case, an OIG investigation led to the indictment of three loan brokers and their company for conspiring to provide false information to the SBA in order to obtain SBA loans. This is a complex fraud scheme involving over 120 loans valued at \$100 million. Over the past decade, the OIG has obtained convictions and guilty pleas on numerous cases involving loan agent fraud on SBA-guaranteed loans, totaling in excess of \$458 million.

The OIG will also continue to conduct audits of SBA's internal loan program operations and oversight, including audits of SBA's loan origination, servicing and liquidation processes, as well as audits of SBA's oversight of loan agents and loan officers. Past work has shown that loans were not always properly originated and that effective controls and procedures were not in place to prevent improper payments.

The OIG's audits will continue to focus on loan origination, disbursement, repayment, servicing, and liquidation activities related to disaster loans. In October 2012, Superstorm Sandy struck the northeastern United States. It was the second costliest storm in U.S. history. The OIG received \$5 million in appropriated funds to conduct oversight of SBA disaster loan making to businesses and individuals. To meet this oversight responsibility, the OIG will investigate and audit disaster loans made in the aftermath of Superstorm Sandy to prevent and minimize losses in this program. Such audits will assess whether the SBA processed homeowner and business loans in accordance with the Agency's procedures and established goals, verified uses of loan proceeds before loans were fully disbursed, and appropriately identified duplicate benefits. The OIG will also perform targeted reviews of Superstorm Sandy loans to identify errors in SBA's loan processing and indications of fraud. When suspected fraud is identified, those loans will be investigated.

The OIG also will continue to investigate allegations of unauthorized use of loan proceeds; overstatement of financial losses; material false statements in the application process; false or counterfeit supporting documentation; and false assertions regarding primary residency in affected areas at the times of the disasters. As of September 30, 2013, the OIG had 19 open cases involving disaster loans with potential dollar losses of over \$10.1 million.

In response to the increase in fraud following Hurricanes Katrina, Wilma, and Rita, the OIG joined other law enforcement organizations in establishing the National Center for Disaster Fraud. From FY 2006 through FY 2013, the OIG, in conjunction with other law enforcement agencies, has produced 86 arrests, 96 indictments/informations, and 96 convictions related to wrongdoing in SBA's

Disaster Loan program for these three hurricanes. Investigations for these disasters—to date—have resulted in over \$6.6 million in court-ordered restitution and related recoveries, as well as the denial of nearly \$4.5 million in loans to potentially fraudulent borrowers. In addition, the OIG has investigated fraud related to 2008 Hurricanes Ike and Gustav.

### *Government Contracting and Business Development*

The SBA directs significant efforts toward helping small businesses obtain Federal contracts and providing other business development assistance. The SBA's Office of Government Contracting and Business Development is tasked with helping small businesses obtain Federal contracting opportunities and helping small, disadvantaged, veteran-owned, and women-owned businesses build their potential to compete more successfully in a global economy. During FY 2015, the OIG will focus on the SBA's oversight of and current issues affecting Government Contracting and Business Development programs, including investigating allegations that ineligible companies are fraudulently benefitting from these programs (as of September 30, 2013, the OIG had 88 open government contracting cases, with potential dollar losses of over \$2 billion based on the total dollar value of the contracts). The funding requested for FY 2015 will allow the OIG to continue investigating fraudulent schemes that take improper advantage of SBA's contracting assistance programs. In addition, the OIG will continue to investigate qui tam False Claims Act suits filed by private sector parties alleging fraud in SBA government contracting programs and will assist the Department of Justice in prosecuting claims when warranted.

Aside from these issues, there are other reasons to be concerned about government contracting programs.

- There is a high level of congressional interest in the government meeting its small business contracting goals. The OIG will continue to assess whether the SBA is taking adequate steps to ensure the integrity of small business contracting. The OIG's work will focus on issues such as: the accuracy of reporting small business contract activity; large businesses being classified as small businesses; adherence to regulations to protect small businesses; training of government contracting personnel; deterring fraudulent acquisition of government contracts; and bundling of contracts.
- The Section 8(a) Business Development program continues to be susceptible to major vulnerabilities. These include limited program oversight; inequitable distribution of contracting opportunities among participants; a lack of reasonable, measurable, consistent, and mandatory criteria pertaining to economic disadvantage; a lack of implemented criteria defining business success for purposes of program graduation; and misrepresentation by companies as small, minority-owned, or disadvantaged businesses to gain an unfair advantage in the Federal



marketplace. The OIG will continue to review these issues and the SBA's management of the Section 8(a) program. The OIG is currently conducting a number of fraud investigations relating to the Section 8(a) program and will continue to devote resources to these investigations in FY 2015.

- The HUBZone program provides Federal contracting assistance to small businesses located in economically distressed areas with the intent of stimulating economic development. The SDVOSB program provides more opportunities in Federal contracting for disabled veterans who own small businesses. The GAO has identified significant control weaknesses in these programs that have allowed ineligible firms to receive millions of dollars in contracts. The OIG is examining the SBA's claim that it has implemented a more rigorous HUBZone certification and recertification process in the hopes of preventing ineligible firms from achieving certification. In addition, the OIG plans to review the HUBZone decertification process once the SBA completes its reengineering of this process. The OIG is currently investigating numerous fraud cases under the HUBZone and SDVOSB programs and will continue to pursue prosecution, civil fraud recovery, and debarment of contractors who improperly obtain HUBZone, SDVOSB, and other preferential contracts.
- The OIG has conducted a number of fraud investigations involving the mentor/protégé programs under the Section 8(a) program. The SBA is close to implementing a statutory mandate by issuing regulations that will expand mentor protégé programs to other disadvantaged contractors. The OIG anticipates that these arrangements will create opportunities for additional fraud by large, non-disadvantaged contractors, requiring OIG resources to investigate this fraud.

#### *Financial Management and Information Technology*

The OIG will continue to oversee the audits of the SBA's financial statements, as well as FISMA and Federal Information Systems Controls Audit Manual (FISCAM) reviews, which are conducted by an independent public accountant under a contract with the OIG. The financial statement audit contract will expire in FY 2015, and the OIG will work with the Agency on a new contract solicitation. The OIG also will continue its review of the SBA's compliance with IPERA. The OIG anticipates that the scope and cost of financial statement audits will continue to expand as a result of growing direct and guaranteed loan portfolios. The OIG will continue its review of SBA's actions to implement the requirements of the GPRA Modernization Act of 2010. The review will examine the sources and use of performance information in program decision-making and evaluate the effectiveness of corrective actions deployed to address long-standing challenges, needs, and problems.

The OIG also will continue to monitor systems development activities related to improvements to LMAS, a system that is critical to SBA's ability to administer its \$106 billion loan portfolio. The OIG's efforts will include determining whether adequate system development lifecycle controls are in place as the SBA endeavors to move its recently developed software from the mainframe to a new hosting environment. We will also assess the adequacy of testing and quality assurance processes. As threats to disrupt cyber-based systems continue to escalate, the Agency must take steps to improve controls to prevent outages and loss of sensitive data and to ensure the continuity of mission critical operating systems. The OIG will conduct audits to assess the security of the SBA's computer operating system, network, and hosted applications by performing assurance reviews. The OIG also will review the sufficiency of SBA resources used to manage computer security, maintain systems, provide technical support, and administer security training.

### *Security Operations*

The OIG's Office of Security Operations will continue processing name checks and, where appropriate, fingerprint checks to ensure that applicants meet certain character standards before participating in programs involving business loans, disaster assistance loans, Section 8(a) certifications, surety bond guarantees, SBICs, and CDCs. As a result of OIG referrals during FY 2013, SBA business loan program managers declined 39 applications totaling over \$21.9 million, and disaster loan program officials declined 58 applications totaling over \$3.9 million, due to character issues of loan applicants. In addition, the Section 8(a) program declined 10 applications for admission. Over \$310 million in loans have been declined during the last 10 years due to character problems identified by the OIG, thereby making credit and SBA assistance available to other applicants with no such issues. The OIG will also perform required background investigations for covered SBA employees and adjudicate SBA employees and contractors for issuance of PIV cards pursuant to HSPD-12 background investigation requirements. During FY 2013, the OIG initiated 322 background investigations and issued 36 security clearances for SBA employees and contractors.

### *Review of Proposed Regulations and Initiatives*

As part of the OIG's proactive efforts to promote accountability and integrity and reduce inefficiencies in SBA programs and operations, the OIG reviews changes that SBA is proposing to make to its program directives such as regulations, internal operating procedures, policy notices, and SBA forms that are completed by lenders and the public. Frequently, the OIG identifies material weaknesses in these proposals and works with the Agency to implement recommended revisions to promote controls that are more effective and deter waste, fraud, or abuse. During FY 2013, the OIG reviewed 115 proposed revisions of program management or SBA reorganization documents.

### *Debarment and Administrative Enforcement Actions*

As a complement to the OIG's criminal and civil fraud investigations, the OIG continually promotes the use of suspensions, debarments, and other administrative enforcement actions as a means to protect taxpayer funds from those who have engaged in fraud or otherwise exhibited a lack of business integrity. The OIG regularly identifies individuals and organizations for debarment and other enforcement actions and submits detailed recommendations with supporting evidence to the responsible SBA officials. During FY 2013, the OIG sent 65 suspension and debarment referrals to SBA. Most OIG administrative referrals involve the abuse of SBA's loan and preferential contracting programs. When appropriate, the OIG recommends that the SBA suspend the subject of an ongoing OIG investigation given program risk presented by the continued participation of those individuals and entities.

### *Fraud Awareness Briefings*

The OIG will continue to conduct briefings on topics related to fraud in government lending and contracting programs. During FY 2013, the OIG provided 19 fraud awareness presentations for more than 900 attendees, including SBA and other Government employees, lending officials, and law enforcement representatives. Topics included types of fraud; fraud indicators and trends; and how to report suspicious activity that may be fraudulent.

## **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. We also will continue to partner with the Agency to ensure that taxpayer and small business interests are protected and served well by reviewing proposed regulations and initiatives, pursuing debarment and administrative enforcement actions, and providing fraud awareness briefings. 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.