Report on the Most Serious Management and Performance Challenges Facing the Small Business Administration in Fiscal Year 2020

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SUBJECT: Report on the Most Serious Management and Performance Challenges Facing the Small Business Administration in Fiscal Year 2020

In accordance with the Reports Consolidation Act of 2000, we are providing you with the Office of Inspector General's (OIG's) Report on the Most Serious Management and Performance Challenges Facing the Small Business Administration in Fiscal Year (FY) 2020. The overall goal is to focus attention on significant issues with the objective of working with Agency managers to enhance the effectiveness of the Small Business Administration's (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, and 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 2020.

Summary of the Most Serious Management and Performance Challenges Facing SBA in FY 2020

		Color Scores					
		Status at End of FY 2019				Change From Prior Year	
	Challenge	Green	Yellow	Orange	Red	Up ↑	Down ↓
1	Small Business Contracting		2				
2	IT Leadership	1	5			1	
3	Human Capital	1				1	
4	SBA Loan Program Risk Management and Oversight	2*				1	
5	8(a) Business Development Program		3	2			2
6	Ensuring Quality Deliverables and Reducing Improper Payments at SBA Loan Operation Centers	1					
7	Disaster Assistance Program	1	3			1	
8	Grant Management Oversight	3	1				
	TOTAL	9	14	2		4	2

* For challenge 4 recommendation 1, 7(a) was rated green, while 504 was rated yellow. For challenge 4 recommendation 2, 7(a) was rated yellow, while 504 was rated green. For simplicity, they are reflected as green in this table.

Overall the Agency made progress addressing this year's management challenges. We believe this progress is in large part attributable to the Agency's concerted effort to address outstanding internal control recommendations that are reflected in many component challenge corrective action areas. As a result, the above table identifies 23 of 25 challenge areas as "fully implemented" or having shown "substantial progress." Notwithstanding these efforts, our audits and investigations continue to find the Agency facing significant risks in loan program oversight and controls, oversight of its statutory programs to promote small business development and government contracting, and deploying information technology and related cybersecurity controls.

For example, an ongoing OIG audit identified additional significant issues regarding internal control weaknesses for lender oversight. The audit report has been issued to SBA in draft and includes recommendations to address internal control weaknesses and SBA's oversight of lenders. We anticipate receiving SBA's comments and issuing the final report at the end of October 2019.

In summary, 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 most serious management and performance challenges.

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

The Small Business Act established a governmentwide goal that 23 percent of all prime contracts be awarded to small businesses each fiscal year. In its annual Small Business Goaling Report, the Small Business Administration (SBA) has reported since fiscal year (FY) 2013 that the federal government met or exceeded its goal of awarding 23 percent of federal contracting dollars to small businesses. However, SBA excludes certain contracts, such as those awarded under the Javits–Wagner–O'Day Act, UNICOR, and some Department of Defense contracts from the small business goaling baseline. SBA asserts that these exclusions should not be considered when calculating the overall 23 percent small business procurement goaling achievement. SBA provides a goaling memorandum each year that identifies the excluded contracting actions and SBA's rationale for each exclusion. While SBA has taken steps to increase transparency in its reporting, these exclusions lead to overstatement of small business goaling achievements. OIG disagrees with SBA's underlying interpretation of the Small Business Act pertaining to the exclusions and asserts that SBA must include the total value of all prime contract awards for each fiscal year in the goaling baseline.

In addition, over the years, Congress has expressed concerns about the accuracy of the report. These concerns have been substantiated by Office of Inspector General (OIG) and Government Accountability Office (GAO) audits, which identified widespread misreporting by procuring agencies, since contract awards reported as having gone to small firms have been substantially performed by larger companies. If a firm's status as a small business changes after award and it is no longer small or in an SBA preference program, SBA's regulations allow dollars awarded to that firm to be counted as dollars to small business. As a result, agencies continue to receive credit towards achieving their small business procurement goals for some contracts awarded to firms that are either no longer small or in SBA's preference programs. Furthermore, SBA still has not implemented a certification process for the Women-Owned Small Business (WOSB) program, which can also affect the accuracy of the goaling achievements.

As the advocate for small business, SBA must strive to ensure that only eligible small firms obtain and perform small business awards. Since the goaling achievements SBA reports do not portray federal contract dollars awarded only to small businesses, SBA should continue to ensure transparency regarding the contracting dollars to businesses that are no longer small. Further, SBA should ensure that procuring agencies clearly and accurately report contracts awarded to and performed by small businesses when representing their progress in meeting small business contracting goals. SBA should also include the value of all prime contracts when calculating the governmentwide small business goaling achievements. By excluding certain contract dollars from the goaling achievements report, SBA weakens the ability of Congress and other federal policymakers to determine whether the government is maximizing contracting opportunities for small businesses.

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

Over the last several years, SBA has amended its goaling guidelines and removed many exclusions that existed prior to FY 2013. Further, SBA recently eliminated all exclusions related to contracting actions with nonappropriated funds. In April 2019, SBA added language to its goaling website, which provides a link to the FY 2018 goaling guidelines and explains prime contract awards excluded from the goaling. While this addition aids in the transparency of the exclusions, OIG maintains that the Small Business Act does not provide for excluding prime contract awards when calculating governmentwide small business achievements. Additionally, by continuing to exclude certain types of contracts from the goaling baseline, SBA overstates the federal government small business goal achievements on a percentage basis. We further maintain that exclusions weaken the ability of Congress and other federal policymakers to determine whether the government is maximizing contracting opportunities for small business awards and participation in meeting small business goals. This is evidenced in the General Services Administration FY 2018 Goaling Without Exclusions Report, which reported small business contract expenditure data without goaling exclusions applied, resulting in a small business procurement goal achievement of 22.4 percent—2.6 percent lower than the 25 percent reported by SBA. SBA has made strides in transparency by adding more information to its goaling website and, according to SBA officials, by including new language to its draft FY 2018 Remediation Actions and Analysis Report to Congress. However, OIG disagrees with SBA's underlying interpretation of the Small Business Act. OIG asserts that the statutory language for SBA to report on all small business contracts means the 23 percent goal calculation should not consider any exclusions. By excluding certain contracts, SBA's reports are not an accurate reflection of the percentage of small business participation accomplished. OIG further continues to emphasize that SBA should include the appropriate universe of federal procurement opportunities into the goaling guidelines baseline to ensure policymakers and other interested parties receive the most accurate and transparent picture of small business participation in federal contracting.

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

OIG audits continue to identify federal agencies that may have received credit towards their small business goals for small disadvantaged businesses (e.g., those firms certified in the 8(a) program), and for Historically Underutilized Business Zone (HUBZone) firms, because procuring agency contracting officers incorrectly reported ineligible firms as either certified in the 8(a) or HUBZone programs in Federal Procurement Data System – Next Generation. In Report 14-18, we identified that more than $1.5 billion dollars in FY 2013 contract actions were included towards small business contracting goals, even though the firms were no longer in the 8(a) or HUBZone programs. Through additional analytics, we also determined that of approximately $3.1 billion in contracts awarded to the top 100 individually owned firms in the 8(a) program in FY 2016, approximately $1.5 billion was awarded to firms no longer in the program. Similarly, in a September 2018 audit report (Report 18-22), we identified that SBA did not consistently detect ineligible firms in the 8(a) program and did not always act to remove firms it determined were no longer eligible for the program. We found that 20 of 25 firms we reviewed should have been removed from the 8(a) program. These firms received $126.8 million in new 8(a) set-aide contract obligations in FY 2017 at the expense of eligible disadvantaged firms. In a March 2019 report (Report 19-08), we also found that SBA did not ensure that only eligible firms entered the HUBZone program. We found that 2 of 15 firms we reviewed did not meet the principal office eligibility requirement and 1 of 15 firms did not meet the HUBZone employee residency requirement. These firms received $589,000 in HUBZone contract obligations at the expense of eligible firms.

The amount of dollars SBA reports to Congress and the public as being performed by 8(a) and HUBZone firms in the Small Business Goaling Report is affected by the inclusion of contract actions performed by ineligible program participants. SBA needs to strengthen its oversight to ensure only eligible firms participate in these preference contract programs.

SBA revised its regulations in 2004 to permit procuring agencies to claim small disadvantaged business and HUBZone goaling credit on certain contract actions, even after firms have grown to be no longer small or have left the program. SBA added these regulations to codify the existing "practice" of the agencies to include these firms even though they were no longer in an SBA preference program or were no longer small. Additionally, in 2006, SBA revised its regulations to address small business size status representations and reporting for long-term federal contracts.[1] Since 2013, SBA has made additional changes to allow procuring agencies to receive credit for dollars awarded to a small business for the first 5 years of a long-term contract, based on the size status of the firm at the time of the offer for 8(a), and at the time of application and award for HUBZone. A firm is required to recertify its small status before the end of the fifth year. If the firm is no longer small when it recertifies, the awarding agency must immediately revise all applicable federal contract databases to reflect the new size status and will not receive credit for the additional years. Therefore, in cases where a small business grows to be other than small within 5 years, the procuring agency may exercise options and still count the award as an award to a small business.

OIG contends that more transparent reporting of those awards to firms that grow to be other than small after award is necessary to portray a true picture of the small business goaling achievements. While the regulations allow procuring agencies to receive credit for dollars awarded to firms no longer in SBA preference programs, or that are other than small, by including those contract obligations in the reported small business goals, SBA cannot accurately reflect or measure true program impact. SBA has included additional information in its Small Business Goaling Report to be more transparent; however, it should still consider accurately reflecting small business participation by specifying the amount awarded under long-term small business contracts to firms that have since left the program, or are other than small.

Women-Owned Small Business Federal Contracting Program Susceptible to Abuse

SBA's WOSB program provides greater access to federal contracting opportunities to WOSBs and economically disadvantaged WOSBs that meet the program's requirements. Both OIG and GAO have reported weaknesses in SBA's controls that would ensure only eligible firms receive WOSB program set-aside contracts. While SBA stated that it examines a sample of firms for eligibility and has conducted a compliance review of all four SBA-approved third-party certifiers, these processes and procedures have not yet been formalized.

The National Defense Authorization Act for FY 2015 granted contracting officers the authority to award sole-source awards to firms in the WOSB program and required firms to be certified by a federal agency, a state government, SBA's Administrator, or a national certifying entity approved by the Administrator. However, SBA implemented the sole-source authority provision first without a certification program. OIG considers allowing sole-source contracting authority in the WOSB program, without implementing the contemporaneously required certification program, inconsistent with SBA's statutory authorization. In a June 2018 audit report (Report 18-18), OIG identified that due to SBA's implementation of sole-source authority without a certification program, contracting officers at various federal agencies made sole-source awards without having the necessary documentation to determine eligibility. This implementation resulted in the awarding of approximately $52.2 million to potentially ineligible firms. SBA has made progress toward addressing this shortcoming by ensuring timely completion of the remaining steps involved in the creation of a final rule for and implementation of a certification process for the WOSB program. SBA published a proposed rule in May 2019 to amend its WOSB program regulations and is currently reviewing the public comments it received at the close of the comment period in July

[1] SBA defines long-term contracts as "contracts with durations greater than 5 years (including options), including all existing long-term contracts, Multiagency contracts, Governmentwide Acquisition Contracts, and Multiple Award Contracts." 13 CFR 121.1004(a)(3).

2019. SBA officials stated they were exploring the use of contractors to conduct prescreening in advance of the final rule, which is estimated for June 2020. SBA officials also plan to implement part of the WOSB certification process using certify.SBA.gov. However, this system has limited functionality, and SBA did not make progress in enhancing it for the WOSB certification process in FY 2019. As noted below in Challenge 5, as of August 2019, SBA had spent more than $27 million on this system. Because SBA still has not implemented a certification process for the WOSB program as required, firms continue to self-certify, exposing the WOSB program to potential fraud and abuse, as well as overstating SBA WOSB contracting goals.

Number of Actions Accomplished (Green Status) During Last 4 Fiscal Years (Challenge first reported in FY 2005)	2015: 0	2016: 1	2017: 0	2018: 0

Recommended Actions for FY 2020	Status at End of FY 2019
1. Strengthen controls in SBA preference programs to detect ineligible firms and remove those firms timely to ensure the accuracy of the federal government's annual small business procurement goals achievements reported in the Small Business Goaling Report.	Yellow
2. Implement a certification process for WOSB program.	Yellow

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

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

Annually, OIG monitors the effectiveness of the Agency's Information Technology (IT) controls and related cybersecurity processes against control frameworks established by statutory federal guidance, the Federal Information Systems Controls Audit Manual (FISCAM), and the Federal Information Security Modernization Act (FISMA). During the past year, OIG's independent public accountant found the Agency had a significant deficiency in IT security controls and the OIG assessed the Agency as "not effective" against criteria established by FY 2018 Inspector General FISMA Reporting Metrics.

Notwithstanding these assessments, the Office of the Chief Information Officer (OCIO) improved its deployment of IT controls through resolution of outstanding OIG recommendations. OCIO also made improvements in several security areas including access controls, continuous monitoring, and configuration management.

OCIO Made Progress in Deploying FITARA Criteria

The goal of the Federal IT Acquisition Reform Act (FITARA) was to realize long-term cost savings through improved IT risk management, transparency, and more effective IT investment oversight. During this past year, OCIO implemented a human resource planning process to include competency and workforce plans around IT requirements. These efforts resulted in OCIO fulfilling all FITARA workforce development standards. As a result of these efforts, OIG has assessed the FITARA human resource planning requirements as implemented.

In the areas of IT investment oversight and accountability, we identified three areas for improvement. We recommended that OCIO develop a process for capturing performance goal estimates and actual cost savings/avoidance for IT initiatives. We also recommended that cloud migration decisions require approved business cases through SBA's IT governance boards. Moreover, we recommended system owners and contract officers ensure cloud services contracts specify system interoperability, portability, and data ownership. OCIO stated they have implemented controls in these three areas, and we will validate progress in future reviews.

Long-Standing Weaknesses in IT Security Controls Are Being Addressed

Our evaluations of SBA's systems and networks indicate that significant effort has been expended to formalize and document policies, procedures, and strategies. During this fiscal year, we made 35 new recommendations in IT security control areas. OCIO initiated corrective actions that resulted in 44 recommendation being resolved. This effort included 10 from prior fiscal years dating back to 2014. In summary, OCIO demonstrated progress; however, we continue to identify critical control issues in areas such as audit logging, network vulnerability management, access controls, and segregation of duties.

Number of Actions Accomplished (Green Status) During Last 4 Fiscal Years (Challenge first reported in FY 1999, revised in FY 2016)	2015: 0	2016: 0	2017: 0	2018: 0

Recommended Actions for FY 2020	Status at End of FY 2019
1. Establish an OCIO human resource planning process that allows full deployment of FITARA.	Green ↑
2. The OCIO performs independent oversight of IT investments consistent with guidance.	Yellow
3. The OCIO facilitates enterprise architecture and demonstrates accountability for IT investments.	Yellow
4. The OCIO establishes and implements information security and continuous monitoring practices, and contractor systems policies and standards to ensure ongoing effectiveness of information systems.	Yellow
5. The OCIO maintains effective risk management, contingency planning, and incident response practices to minimize vulnerabilities.	Yellow
6. The OCIO establishes configuration management and identity and access management controls and procedures.	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

Over a decade ago, we identified human capital management as a top challenge for SBA. Since that time, SBA made substantial progress to address this long-standing challenge. Specifically, SBA developed and implemented plans that aligned talent needs and capabilities with its strategic plan. The Agency also implemented strategic workforce and succession plans to identify competency gaps, strengthen its leadership capacity, and address the challenges of its aging workforce.

Nonetheless, according to GAO, agencies need to do further work to fully use workforce analytics to evaluate actions taken to demonstrate progress in closing the competency gaps. According to GAO, mission critical skill gaps within the federal workforce pose a high risk to the nation. Long-term fiscal pressures and the changing nature of the workforce, compounded with a potential wave of employee retirements, could produce gaps in leadership and institutional knowledge.[2] The Office of Personnel Management (OPM), in a recent May 2019 evaluation of SBA's human capital operations, noted that SBA should regularly assess the effectiveness of human capital strategies and workforce plans on addressing gaps and surpluses and use the assessments to adjust strategies and plans.[3] As a result, as noted in the previous year's management challenge, OIG is currently planning to assess the effectiveness of SBA's actions to mitigate its workforce challenge risk. OIG also plans to evaluate the Agency's use of workforce analytics to evaluate its progress in closing its competency gaps.

SBA Has Made Progress to Update Human Capital Management Policies

SBA has made significant progress in addressing our recommendation to update its human capital management policies. In addition to updating the policies identified by OIG, SBA also responded to numerous regulatory changes initiated by the White House and OPM resulting in the update of the Telework and the Discipline and Adverse Actions policy and the development of guidance for weather and safety leave provisions. The Agency made the decision to revise the Employment standard operating procedure (SOP) by migrating the sections into separate policies. This decision resulted in the creation of 11 distinct human capital management policies. Since 2009, the Agency has updated and implemented the 11 policies.

Number of Actions Accomplished (Green Status) During Last 4 Fiscal Years (Challenge first reported in FY 2001, revised in FY 2007)	2015: 1	2016: 0	2017: 1	2018: 0

Recommended Action for FY 2020	Status at End of FY 2019
1. Ensure that human capital management SOPs are updated and appropriately structured to support the Agency's long-term goals and objectives and governmentwide human capital management initiatives.	Green ↑

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

[2] GAO, High-Risk Series: Progress on Many High Risk Areas While Substantial Efforts Needed on Others, GAO-17-317, dated February 2017.
[3] OPM, U.S. Small Business Administration, Human Capital Management Evaluation, dated May 21, 2019.

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

SBA's Office of Credit Risk Management (OCRM) manages credit risk for a $120 billion loan portfolio originated by lenders and certified development companies that have various degrees of expertise regarding SBA loan program requirements. Most SBA loans are originated by lenders with delegated approval authority, resulting in limited SBA oversight and quality control reviews until a default occurs. Many lenders rely on the services of "for-fee" and other third-party agents to assist in the origination, closing, servicing, and liquidating SBA loans.

Previous OIG audits identified that SBA did not recognize significant lender weaknesses, develop an effective portfolio risk management program, or effectively identify and track third-party agent involvement in its 7(a) and 504 loan portfolios. Since the audits, SBA initiated actions to address identified issues with its oversight of lenders and made progress in implementing a portfolio risk management program. Also, SBA made substantial progress in identifying and tracking third-party agents.

While SBA took actions to address previous concerns regarding its oversight of lenders, an ongoing OIG audit identified additional significant issues regarding internal control weaknesses for lender oversight. The OIG expects to issue this audit at the end of October 2019 with recommendations to improve SBA's oversight of lenders. Additionally, SBA needs to continue to show that the portfolio risk management program is used to support risk-based decisions and implement additional controls to mitigate risks. Moreover, SBA needs to further enhance its tracking of loan agents within the 7(a) program.

SBA's Oversight of Lending Participants

The risks inherent in delegated lending require an effective oversight program to monitor compliance with SBA policies and procedures and take corrective actions when a material noncompliance is detected. However, in a prior audit, OIG found that SBA did not always recognize the significance of lender weaknesses or determine the risks that lender weaknesses posed to the Agency during its onsite reviews. The report also found that SBA did not link the risks associated with the 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.

From FY 2013 to FY 2018, SBA took actions to address identified issues with its oversight of lending participants. For example, SBA developed risk profiles and lender performance thresholds, developed an analytical review process to allow for virtual risk-based reviews, updated its lender risk rating model to better stratify and predict risk, and conducted test reviews under the new risk-based review protocol. Additionally, OCRM revised its review methodologies for 7(a) and 504 program lenders and engaged contractor support to expand on its corrective action followup process.

However, an ongoing audit found additional significant matters regarding SBA's oversight of lenders. The draft audit report has been sent to SBA, and we anticipate issuing the final at the end of October 2019, recommending actions to address the internal control weaknesses and improve SBA's oversight of lenders.

SBA Improved Portfolio Risk Management Program

A prior OIG report noted that SBA traditionally focused on loan approval volume and loss rates to evaluate overall program performance with risk being assessed at the lender level. As a result, SBA had not developed an effective portfolio risk management program that monitored portfolio segments to identify risk based on default statistics. Our analysis showed that SBA continued to guarantee loans to high-risk franchises and industries without monitoring risks, and where necessary, implementing controls to mitigate those risks.

From FY 2016 to FY 2018, SBA made substantial progress in demonstrating that information from the portfolio risk management program was used to support risk-based decisions, and implementing additional controls to mitigate risks in SBA loan programs. Specifically, SBA established performance measures and risk mitigation goals applicable to each loan program and the entire lending portfolio. OCRM also conducted portfolio analyses of problem lenders with heavy concentrations in SBA 7(a) lending and sales on the secondary market. In response, OCRM proposed actions to mitigate SBA exposure on the secondary market. SBA also performed an evaluation of the Community Advantage Pilot Program. Based on this analysis, SBA determined that changes were necessary to improve the performance of the Community Advantage Pilot Program. In FY 2019, SBA conducted extensive analyses on 7(a) and 504 loan program performance, which included franchise and industry concentrations and various loan characteristics. Based on these analyses, the 7(a) loan portfolio and 504 loans greater than $2 million were beginning to show signs of declining performance. However, SBA deemed that no action was required apart from continued monitoring of the portfolio performance.

SBA maintains that the current program tracks performance to support risk-based decisions at the portfolio, subprogram, and lender level, and that identified risk issues are presented to SBA executive leadership at Lender Oversight Committee meetings. SBA will need to continue to demonstrate during FY 2020 that information from this program is used to support risk-based decisions and implement additional controls to mitigate risks.

Increased Risk Introduced by Loan Agents

Prior OIG audits and investigations identified that SBA did not have a way to effectively identify and track loan agent involvement in its 7(a) and 504 loan portfolios and had outdated enforcement regulations. Additionally, 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 FY 2005, OIG has investigated at least 22 cases with confirmed loan agent fraud, totaling approximately $335 million. Further, OIG has determined that loan agents were involved in approximately 15 percent of all 7(a) loans increasing the risk of default. Despite the prevalence of fraud in its loan portfolios, SBA's oversight of loan agents was limited.

SBA implemented a process that requires lenders to provide a loan agent disclosure form (Form 159) to SBA's fiscal and transfer agent (FTA) for 7(a) loans. Additionally, the FTA must enter the data into a database accessible to SBA. SBA also began linking 7(a) loan Form 159 information with its loan data. However, a September 2015 OIG report on SBA's loan agent oversight (Report 15-16) identified significant issues in the data quality on the Form 159. Additionally, the report found that SBA had not implemented tracking of the Form 159 in the 504 loan program.

In response to our loan agent report, SBA stated that it would explore the feasibility of implementing a registration system for the 7(a) program. Subsequently, SBA determined that the optimal way to gather information is the enhanced Form 159. The enhanced Form 159 was approved by OMB and rolled out with official notification and lender training. In addition to the enhanced Form 159, SBA's upcoming FTA contract will require the FTA to develop application and followup controls over 7(a) lender submissions, to ensure that critical fields on each form are completed. SBA expects the enhanced controls to be fully implemented during FY 2020.

In FY 2019, SBA also implemented an effective method of disclosing and tracking loan agent involvement within the 504 loan program. Specifically, SBA requires 504 lenders to electronically submit Form 159 directly into SBA's electronic lending platform. Additionally, SBA provided training to lenders during 2019 on the enhanced Form 159.

In addition, a March 2015 audit (Report 15-06) noted that the outsourcing of traditional lender functions to Lender Service Providers (LSPs), a type of loan agent, has significantly increased in recent years. Specifically, in 2014, more than 770 lenders—or approximately 28 percent of the active 7(a) lenders—had an approved agreement with at least one LSP. Additionally, SBA loan portfolios associated with the three largest LSPs exceeded that of many of the top 100 active SBA 7(a) program lenders.

Since our 2015 report, the number of SBA-approved LSP agreements has reached almost 2,900, due in part to SBA's effort to better control access by LSPs to its systems. Specifically, SBA assigns an identifying number for all LSPs that access SBA systems and records all SBA-approved LSP agreements. This trend has enabled OCRM to develop initial metrics on LSP participation in SBA's 7(a) program, but oversight is still limited. Specifically, the SBA loan agent performance analysis does not aggregate LSP loan level information in order to identify high risk LSPs. As loan agent involvement in the 7(a) program continues to increase, it will become especially important for SBA to have oversight tools in place to identify and track loan agent involvement in this sizeable program.

Number of Actions Accomplished (Green Status) During Past 4 Fiscal Years (Challenge first reported in FY 2001)	2015 7(a) loans: 1 504 loans: 1	2016 7(a) loans: 0 504 loans: 0	2017 7(a) loans: 1 504 loans: 1	2018 7(a) loans: 2 504 loans: 1

Recommended Actions for FY 2020	Status at End of FY 2019	
	7(a)	504
1. Demonstrate that information from the portfolio risk management program is used to support risk-based decisions and implement additional controls to mitigate risks in SBA loan programs.	Green	Yellow
2. Develop an effective method of disclosing and tracking loan agent involvement in SBA business loan programs.	Yellow	Green ↑
3. Enhance the analysis of loan agents to monitor and identify high-risk LSPs.	New	New

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

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

SBA's 8(a) Business Development Program was created to provide business development assistance to eligible small disadvantaged businesses seeking to compete in the American economy. A major benefit of the 8(a) program is that 8(a) firms can receive sole source, as well as set-aside, competitive federal contracts so that small businesses do not need to compete with large businesses that may have an industry advantage. SBA's challenge has been to ensure that it is providing effective business development assistance to 8(a) firms and that only eligible firms are admitted into and remain in the program. Additionally, SBA faces the challenge of developing objective and reasonable criteria for determining at which point socially disadvantaged individuals are deemed economically disadvantaged.

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

SBA has made its assistance more readily available to program participants by using resource partners, such as small business development centers, SCORE, and procurement technical assistance centers. SBA also has taken steps to ensure business opportunity specialists assess program participants' business development needs during site visits. During FY 2018, SBA implemented additional measures for business opportunities specialists to assess 8(a) firms' development for those firms participating in the 8(a) mentor-protégé program. Despite these improvements, SBA has not fully implemented an IT system that, among other functionalities, it had initially designed to aid its monitoring efforts to track 8(a) participants' business development. SBA made previous attempts to revamp its IT systems for monitoring 8(a) firms that have been unsuccessful. SBA's most recent attempt to implement an IT system, certify.SBA.gov, is intended to be a more comprehensive approach to service delivery and broader in scope than just the 8(a) program. It includes the WOSB, HUBZone, and mentor-protégé programs. According to program officials, although the system is not fully operational, they have gained efficiencies by collapsing the functionality of two previous systems they were using to manage the program—E-8(a) and the Business Development Management Information System.

Since last fiscal year, SBA did not make progress in enhancing the functionality of certify.SBA.gov for the 8(a) program. As of August 2019, SBA had spent more than $27 million on this system. Program officials stated that the initial goal was to integrate 8(a) business development functions into the certify.SBA.gov platform; however, their strategy changed. In FY 2019, SBA decided to only use certify.SBA.gov as the certification management system and plans to develop a separate system to monitor 8(a) participants' business development outside of certify.SBA.gov. In lieu of an IT system, SBA created a manual workaround for business opportunity specialists to assess the 8(a) participant's individual business development during the annual review and input results in an Excel spreadsheet. This file is retained in the firms certify.SBA.gov case file, which lacks reporting functionality. Currently, SBA has no system to assist program officials in monitoring 8(a) participants' business development to assess the effectiveness of the program. To address this, SBA formed a Tiger Team to develop a solution in FY 2020.

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

Since 2010, there had been a steady decline in the number of firms participating in the 8(a) program, from about 7,000 in 2010 to about 4,900 as of August 2016. Consequently, in

FY 2016, SBA leadership developed an aggressive growth plan to increase the number of participants in the 8(a) program by 5 percent over the previous year through a streamlined application process. Despite the changes to the application process, the program continues to experience a decline in firms participating in the program. As of August 2019, SBA reported the 8(a) program included 4,450 firms, which is a decline of about 10 percent over the 4,903 firms reported participating in the program as of April 2018.

According to SBA officials, the streamlined application process is less burdensome for firms applying to the 8(a) program. As part of this modified process, various documents previously used to determine an applicant's eligibility to participate in the 8(a) program would no longer be requested or would be required in a modified version. For example, SBA no longer required that applicants submit an Internal Revenue Service tax verification form, information about the applicant firm's business structure, and information on tax liens, judgements, or lawsuits. However, shortening the review process by eliminating documents may erode core safeguards that prevented questionable firms from entering the 8(a) program. At the request of SBA's former Deputy Administrator, we conducted a follow-on audit to a report issued in FY 2016 (Report 16-13) to determine whether SBA resolved eligibility concerns for the 30 firms. We determined that SBA resolved eligibility concerns for 20 of the 30 firms that we reviewed. However, we questioned the eligibility of 10 of the 30 firms (Report 17-15). Based on the audit, SBA updated its 8(a) program SOP to reinstate the requirement that applicants submit the Internal Revenue Service tax verification form. Additionally, SBA added a requirement to include a statement of difference in the review notes of each application when a final decision to approve or deny a firm's admittance into the program differs from the lower-level reviewer's recommendation.

While the updates to the SOP demonstrate substantial progress in mitigating the risk of ineligible firms being admitted to the program, SBA currently does not have a fully functional information system to assist them in monitoring whether these procedures are operating effectively. SBA is responsible for the integrity of the 8(a) program, and it should ensure that only eligible firms are admitted into and remain in the program, and that the documentation supporting 8(a) program application approvals is maintained in a method ensuring clear eligibility of the applicant. A lack of documentation clearly demonstrating eligibility of applicants or a lack of due diligence by SBA program managers can present evidentiary challenges when pursuing fraud against SBA and its program participants.

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

While SBA continues to consider corrective actions to improve safeguards throughout the initial 8(a) eligibility review process, SBA also needs to implement corrective actions to improve its continuing eligibility review process. In FY 2018, we reported that SBA's oversight was insufficient to ensure that 8(a) Business Development Program participants met continuing eligibility requirements (Report 18-22). We found SBA did not consistently identify ineligible firms in the 8(a) program and did not always act to remove firms it determined were no longer eligible for the program. In addition, SBA did not perform required continuing eligibility reviews when it received specific and credible complaints regarding firms' eligibility and did not log all complaints. We found that 20 of 25 firms we reviewed should have been removed from the 8(a) program. These firms received $126.8 million in new 8(a) set-aside contract obligations in FY 2017 at the expense of eligible disadvantaged firms. SBA drafted updates to its 8(a) program SOP governing the 8(a) continuing eligibility review process and evaluation standards, as well as the process for removing firms deemed ineligible for program assistance. SBA has submitted its draft SOP for review and expects a final SOP to be implemented early in FY 2020. Until SBA makes improvements and implements corrective actions to ensure it delivers an effective 8(a) program, 8(a) firms that are ineligible will continue to compete with and receive federal awards that were intended to develop disadvantaged small businesses.

SBA Dollar Threshold for Economic Disadvantage Not Justified

In March 2011, SBA revised its regulations and established additional standards to address the definition of “economic disadvantage” as an individual with a net worth of less than $250,000. In FY 2018, a contractor completed a study to assist SBA in defining or establishing criteria for determining what constitutes “economic disadvantage.” According to Agency officials, the study concluded that individuals with an adjusted net worth of $375,000 should constitute “economically disadvantaged.” However, SBA concluded that the $375,000 net worth standard may not be appropriate because it did not consider “economic disadvantage” as an element of continuing eligibility. Therefore, SBA published a proposed rule in May 2019 to address increasing the “economic disadvantage” to adopt the $750,000 net worth continuing eligibility standard for all economically disadvantaged determinations. SBA has requested comments to the proposed rule on whether the $375,000 or $750,000 net worth standard should be used and plans to use those to determine the definition of “economic disadvantage.” OIG contends that SBA should develop objective and reasonable criteria based on quantitative research and finalize and implement that criteria for determining the threshold where socially disadvantaged individuals face economic disadvantage due to diminished credit and capital opportunities.

Number of Actions Accomplished (Green Status) During Past 4 Fiscal Years (Challenge first reported in FY 2003)	2015: 0	2016: 0	2017: 2	2018: 0

Recommended Actions for FY 2020	Status at End of FY 2019
1. Establish objective and reasonable criteria that effectively measure “economic disadvantage” and implement the new criteria.	Orange ↓
2. Augment and Implement controls that ensure only eligible firms are admitted into the 8(a) program.	Yellow
3. Develop and implement a system to assist program officials in monitoring participants’ progress in the 8(a) Business Development Program and providing business development needs on an individualized basis.	Orange ↓
4. Measure 8(a) Business Development Program participant’s progress on achieving its individualized business development goals and assess program effectiveness.	Yellow
5. Implement controls to detect ineligible firms in the 8(a) program during the continuing eligibility reviews, effectively address complaints received regarding 8(a) firms, and remove ineligible firms from the 8(a) program timely.	Yellow

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

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

In FY 2018, the dollar amount of SBA's 7(a) loan approvals reached $25.4 billion. Most of these loans are made by lenders with delegated approval authority. When a loan goes into default, SBA conducts a review of the lender's actions on the loan to determine whether it is appropriate to pay the lender the guaranty, which SBA refers to as a "guaranty purchase." For loans sold on the secondary market, SBA is obligated to purchase the guarantee from the investor and performs a review of the lenders' actions after payment is made. Pursuing recovery from a lender on sold loans is generally a more difficult task for SBA.

Previous OIG audits noted that quality control activities were not being performed at the Centers in accordance with SBA's overall Quality Control and Center specific guidance. Since the audits, the Office of Capital Access (OCA) improved the quality control program for its loan centers and took actions to accurately report and reduce improper payments. While OCA made substantial improvements, OCA needs to continue to provide evidence that the developed corrective action plans are effective in reducing improper payments.

OIG established a High Risk 7(a) Loan Review Program to evaluate lender compliance with SBA requirements for high-dollar/early-defaulted 7(a) loans (loans approved for $500,000 or more that defaulted within the first 18 months of initial disbursement). During FY 2019, OIG identified material lender noncompliance in five of the eight loans reviewed, totaling approximately $8.7 million in questioned costs. Although OCA staff completed purchase and quality control reviews on these eight loans, they did not identify or fully address the material deficiencies noted in the subsequent OIG review. Therefore, OCA needs to assess its purchase and quality control reviews to determine why the reviews did not identify or mitigate the lenders' noncompliance with SBA requirements.

SBA Improved Its Quality Control Program to Reduce Improper Payments

OCA has made significant progress in developing and implementing a quality control program for all its loan centers to verify and document compliance with the loan process, from origination to closeout. Additionally, OCA has taken actions to accurately report and reduce improper payments in SBA's 7(a) program. Specifically, OCA has formalized its improper payment sampling, demonstrated that its improper payments review process is effective for 7(a) loan approvals, and formalized the recovery process and time standards for 7(a) purchases. In addition, OCA developed enhanced improper payments reporting to monitor root causes, identify operational risk, and create corrective action plans for 7(a) loans. Corrective actions included conducting training, collaborating with OCRM, and collecting funds from lenders.

For the FY 2018 improper payments evaluation, OIG found that SBA did not meet its reduction targets for 7(a) loan guaranty approvals for 2 consecutive years. However, preliminary FY 2019 estimates from the Agency's statistician indicate that they met their published improper payment reduction target for 7(a) loan guaranty approvals. FY 2019 preliminary results for 7(a) loan guaranty purchases indicate that SBA did not meet their published reduction target. However, the dollar value of estimated improper payments decreased. OIG did not validate SBA's preliminary improper payment estimates. OCA needs to continue to demonstrate in FY 2020 that the developed corrective action plans are effective to reduce improper payments.

Improvements Needed to Ensure Quality Deliverables and Mitigate Loss

As noted above, OCA has taken actions to accurately report and reduce improper payments in SBA's 7(a) program. However, OIG audits have identified 7(a) loans that were ineligible, lacked repayment ability, or were not properly closed, resulting in improper payments. These improper payments occurred in part because SBA did not adequately review the related loans.

In FY 2014, OIG established its High Risk 7(a) Loan Review Program to evaluate lender noncompliance with SBA's requirements. OIG uses an internal scoring system to prioritize loans for review based on known risk attributes. This evaluation includes a review of high-risk loans purchased by SBA to determine whether lenders materially complied with SBA requirements and to identify suspicious activity. As of September 2018 (Report 18-26), under OIG's High Risk 7(a) Loan Review Program, we'd reviewed 27 loans with purchase amounts totaling almost $23.2 million. We recommended recoveries on 11 loans totaling more than $8.5 million. In addition, we identified suspicious activity on five loans totaling nearly $4 million, resulting in formal referrals to our Investigations Division.

Also, this program identified concerns with change of ownership transactions and SBA's identification of improper payments. We recommended that SBA evaluate the time loan specialists must review complex early-defaulted loans. In response to this recommendation, OCA modified the production standards to allow loan specialists more time to review complex early defaulted loans. In addition, OCA made improvements to its review of loans by providing training to loan specialists and updating the loan review checklist.

During FY 2019 (Report 19-22), OIG identified material lender noncompliance in five of the eight loans reviewed, totaling approximately $8.7 million in questioned costs. Lenders did not provide adequate documentation to support that the borrowers met requirements related to eligibility, repayment ability, size standards, franchise agreements, business valuations, appraisals, equity injection, and debt refinance. OCA staff completed purchase and quality control reviews on these eight loans. However, these reviews did not identify or fully address the material deficiencies noted in the subsequent OIG reviews.

OCA needs to evaluate its purchase and quality control reviews to determine why the reviews did not identify or mitigate the lenders' noncompliance with SBA requirements.

Actions Accomplished (Green Status) During Past 4 Fiscal Years (Challenge first reported in FY 2010)	2015 7(a) Approvals: 0 7(a) Purchases: 1	2016 7(a) Approvals: 0 7(a) Purchases: 0	2017 7(a) Approvals: 0 7(a) Purchases: 1	2018 7(a) Approvals: 2 7(a) Purchases: 2

Recommended Actions for FY 2020	Status at End of FY 2019	
	7(a) Approvals	7(a) Purchases
1. Demonstrate that corrective action plans are effective in reducing improper payments in the 7(a) Loan Program.	Green	Green
2. Conduct an evaluation to determine why material lender noncompliance was not identified or mitigated during purchase and quality control reviews on recently reported high-dollar/early-defaulted loans and implement any necessary improvements to mitigate risks.	N/A	New

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

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

The disaster loan programs play a vital role in the aftermath of disasters by providing long-term, low-interest loans to affected homeowners, renters, businesses of all sizes, and nonprofit organizations. SBA’s FY 2018 year-end disaster assistance loan portfolio balance was $9.6 billion. SBA must continually balance the priority of delivering timely assistance to disaster survivors in the immediate aftermath of a devastating life event against the need to ensure program integrity.

In 2008, following Hurricane Katrina, new private sector disaster loan programs were statutorily authorized and were intended to assist in disbursing funds quickly and effectively. SBA has not fully implemented all these programs due to lack of interest by private lenders. In October 2017, SBA announced the implementation of the Express Bridge Loan Pilot Program. The pilot program provides a streamlined approach to quickly get emergency financial relief of up to $25,000 to small businesses in presidentially declared disaster areas. The pilot program was scheduled to run for 3 years, from October 16, 2017, through September 20, 2020.

We also remain concerned that SBA does not sufficiently limit the proportion of a borrower’s gross income that may be relied on to service debt, potentially leaving borrowers with insufficient income to cover living expenses, taxes, and loan payments. Loans to borrowers with high debt burdens are more likely to default.

Additionally, disaster loans are vulnerable to improper payments, fraud, and default because loan transactions are often expedited to provide quick relief to disaster survivors. We noted in 2018 that lending personnel hired in connection with a disaster declaration may lack sufficient experience. SBA has made progress in this area. In response to Hurricanes Harvey, Irma, and Maria, Office of Disaster Assistance (ODA) increased trained staff from 800 to its peak of 5,094 in December 2017. They conducted after-action reports to identify successes, challenges, and strategic improvements. To address the improvements needed, ODA provided targeted training to 3,655 lending personnel. ODA asserts that the focused training allowed them to reduce the FY 2018 improper payment rate from the FY 2017 rate, despite the increased staff size. Therefore, we do not have any recommendations regarding training for lending personnel. However, continued diligence in this area is necessary to ensure improved integrity and trust in the federal payment system.

Finally, while the desktop loss verification process contributed to SBA meeting its timeliness goals for disaster applications, controls needed strengthening to mitigate the risk of fraud and ensure program integrity. Specifically, SBA did not always validate the cause and extent of damages and repair and replacement costs prior to disbursing loan funds, relied on reports from the Federal Emergency Management Agency (FEMA) that did not contain pertinent information needed to validate damages and losses reported in the initial loss verification, and loan files did not contain sufficient documentation to support loan-making decisions. Without an adequate loss verification, loans could be made to individuals that do not qualify for the loan or do not have damages that justify the amount of the loan.

Private Lender Programs Intended to Quickly Disburse Disaster Funds Not Implemented

Following Hurricane Katrina, congressional representatives expressed concern that SBA did not effectively develop and use programmatic innovations intended to assist in disbursing funds quickly and effectively. The Small Business Disaster Response and Loan Improvements Act of 2008 required SBA to establish three new guaranteed disaster programs using private sector lenders—

the Expedited Disaster Assistance Program (EDAP), the Private Disaster Assistance Program (PDAP), and the Immediate Disaster Assistance Program (IDAP). Together, these programs are collectively known as the "Guaranteed Disaster Assistance Programs."

While SBA established regulations and procedures to deliver IDAP, it did not do so for the EDAP and PDAP. SBA officials planned to use IDAP as a guide to develop EDAP and PDAP, and until the challenges with IDAP were resolved, it did not plan to implement these two programs. SBA notified Congress that it had sought advance public comment on proposed rulemaking for IDAP and received limited responses, most of which were opposed to their implementation. SBA also reported that its partner lenders chose not to participate. Therefore, SBA sought to cancel program funds and rescission of programs in their entirety. As SBA requested in the Appropriations Act of 2018, Congress cancelled the funds appropriated in the Consolidated Appropriation Act of 2018 for IDAP, EDAP, and Appropriations Act of 2019 repealed the statutory authority of EDAP. SBA has requested rescission of the remaining IDAP and PDAP program in its FY 2020 Congressional Budget Justification. SBA officials expect that Congress will follow the precedent set last year and permanently cancel IDAP and PDAP in the Appropriations Act of 2020. After that, SBA plans to seek congressional support for cessation of program authority for these two guaranteed disaster loan programs. OIG notes that GAO has closed all audit recommendations related to these programs.

SBA indicated that it has improved its disaster assistance delivery channel and is now better equipped to provide more timely disaster assistance. The Agency also indicated that its larger unsecured disaster loan limit, now at $25,000, allows more funds to be disbursed quickly following a disaster.

Express Recovery Opportunity Loan Program Not Implemented

The RISE After Disaster Act, enacted November 25, 2015, introduced the Express Recovery Opportunity Loan Program that was intended to leverage private sector resources to quickly provide up to $150,000 loans to disaster survivors. The Act required SBA to promulgate regulations for this loan program within 270 days, which was not done.

In FY 2017, SBA studied this proposed program and concluded that it duplicates the existing SBA Express Loan Program, and cannot be delivered as designed without subsidy costs, which puts the entire SBA Express Loan Program at risk due to an extended eligibility period. SBA determined that this program could not be delivered at zero subsidy with the fee structure that was enacted. SBA also believes that the proposed 5-year disaster eligibility period will cause lenders to shift ordinary Express loans to Recovery Express loans due to the higher guarantee rate, exposing SBA to greater risk and endangering the program. SBA requested rescission of the program in its FY 2019 Congressional Budget Justification and has again requested repeal in the FY 2020 Congressional Budget Justification. Therefore, SBA has deferred creation of program regulations. SBA plans to seek congressional support for cessation of this program.

On October 16, 2017, SBA announced the implementation of the Express Bridge Loan Pilot Program. The pilot program adopts some of the objectives included in the RISE Express Recovery Opportunity Loan Program, without duplicating or endangering the existing SBA program. It provided a streamlined approach to quickly get emergency financial relief of up to $25,000 to small businesses in presidentially declared disaster areas. This is in the form of expedited guaranteed bridge loan financing for disaster-related purposes, while small businesses apply for and await long-term financing. SBA is running the pilot program for 3 years from October 16, 2017, through September 20, 2020. As of August 13, 2019, SBA has approved or disbursed only two loans for $25,000 each under the pilot program.

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

SBA uses the fixed debt method to determine disaster home loan affordability. This method assumes that there is a debt threshold, known as the maximum acceptable fixed debt (MAFD) beyond which loans become unaffordable and likely to default. Prior to November 2012, there were two MAFD tiers: (1) 36 percent for incomes below $25,000 and (2) 40 percent for incomes above $25,000. A November 2012 policy memorandum increased the number of tiers and raised MAFD to 50 percent for incomes of $60,000 and above. The policy memorandum, later incorporated into SOP 50 30 8 in July 2015, also diminished the level of authorization required to approve loans that do not conform to the established MAFD percentages.

On September 6, 2017, ODA issued Memo 17-22, New Credit Model Pilot, effective for all disasters declared on or after August 25, 2017. The memo increased the acceptable MAFD to 75 percent for all income levels without the need to provide justification. On May 31, 2018, ODA issued SOP 50 30 9, which incorporated the MAFD provisions of Memo 17-22.

ODA believes that credit score is more of an indicator of default likelihood than any other factor. Further, ODA believes the data supports decreasing emphasis on debt to income (DTI) when ODA is making loan decisions. It is for this reason that ODA now considers credit score and income as the primary factors to determine repayment ability. When ODA is unable to decide based on these factors, it will use a DTI calculation, allowing up to 75 percent, without justification based on compensating factors. In comparison, it should be noted that Fannie Mae and Freddie Mac allow DTI ratios as high as 45 percent for manually underwritten loans and up to 50 percent on desktop underwritten loans with strong compensating factors on a home mortgage.

Despite ODA's assertion that they can aid an additional 10 percent of disaster loan applicants through the decreased emphasis on DTI/MAFD, it comes at a significant risk. In FY 2018, ODA stated that nearly 22 months have passed since the increase in the MAFD threshold and it has found a minimal impact on the portfolio charge-off rate. However, we have noticed that the data for FY 2019 indicates an increase in the charge-off rate of 3.84 percent, a 27 percent increase over the 3.01 percent for FY 2018. We believe the full effect of this policy change cannot be determined until the loans approved subsequent to the policy change have had sufficient time to perform, which is around FYs 2020 and 2021.

Additionally, ODA's policy change contributed to a significant increase in the percentage of approved borrowers with MAFD over 50 percent, increasing from 18.2 percent in FY 2013 to 28.9 percent in FY 2018. We also noted that the occurrence of Hurricanes Harvey, Irma, and Maria created a large increase in the volume of loans approved and disbursed to applicants with MAFD between 50 percent and 75 percent during the latter part of FY 2017 and all of FY 2018. Specifically, the dollars disbursed to borrowers with MAFD over 50 percent in FY 2018 was $823.2 million, which more than doubled the $390.8 million disbursed to borrowers with MAFD over 50 percent in the 5 previous FYs combined. In 2018, we began an audit of SBA's reliance on the increased MAFD and its effect on the default rate; however, we terminated the project in 2019, as many of the loans had not had time to mature. Therefore, we were unable to assess the effect of the policy change on the default rate. We plan to perform a review of this policy change on the default rate once the loans have had sufficient time to perform.

Reserve Staff Require Training to Sustain Productivity During Mobilization

During large-scale disasters such as Hurricanes Sandy and Harvey, SBA must bring on new loan officers and loss verifiers to match the volume of loan applications and prevent processing backlogs that delay the delivery of disaster assistance. In response to Hurricanes Harvey, Irma, and Maria, ODA increased trained staff from 800 to its peak of 5,094 on December 13, 2017. This included the Processing and Disbursement Center, which increased staff by more than 700, Field Operations Centers East and West combined increased by more than 360, the Damage Verification Center increased by more than 200, and the Customer Service Center increased by more than 130. ODA trained more than 1,000 loan processing staff and 600 loss verifiers to mobilize in response to the hurricanes. In addition, ODA deployed 1,500 field personnel and staffed more than 443 disaster centers in response to the three hurricanes.

On May 31, 2018, ODA completed an after-action report for Hurricanes Harvey, Irma, and Maria, which identified successes, challenges, and action items. As a result, ODA launched a cross-functional training plan development team that is developing core training modules, as well as online and automated tutorials. In FY 2019 SBA should monitor its results and refine its training approach, if needed, depending on the results of the Hurricanes Harvey and Irma disaster cycles.

Improper Payment Rate Was Reduced to Compliant Level

In FY 2018, SBA's improper payment rate for the disaster loan disbursements decreased from a reported rate of 13.65 percent ($123.38 million) in FY 2017 to 8.91 percent ($274.4 million). SBA determined this decrease was due in part to a greater focus on what makes a payment improper and improving controls over the underwriting and disbursement process. However, we noted that ODA eased controls for one of the root causes attributed to the reported rate being above the acceptable threshold for FY 2017. One cause of the higher improper payment rate during the FY 2017 reporting period was the lack of appropriate justifications for disbursements to borrowers who may not have repayment ability based on a MAFD percentage exceeding SBA's recommended limit. During September 2017, SBA increased the allowable threshold for justifications of loan repayment ability from the standard 40 percent to 75 percent. Additionally, ODA diminished the level of authorization required to approve loans that do not conform to the established MAFD percentages. To effectively reduce disaster loan improper payment rate, ODA should strengthen and implement new controls as opposed to lessening the requirements. SBA should expand corrective actions to proper and complete documentation prior to disbursement in order to significantly lower improper payment rate in FY 2019. We are currently conducting an audit of the improper payment quality control process.

Inadequate Verification of Cause and Extent of Damages

The desktop loss verification process uses a two-pronged approach: an initial desktop loss verification and a post desktop review. The initial desktop loss verification is used to estimate the cost of repairs. Information is gathered and evaluated through telephonic interviews with applicants in conjunction with third-party information, such as tax assessors' websites, Google Earth, and Zillow. Following the initial desktop loss verification, SBA requires a post desktop review to validate the total damage estimates obtained from the initial desktop loss verification.

A critical part of the disaster loan-making process is evaluating the cause and extent of property damages, which provides SBA the information necessary to make appropriate decisions when establishing eligibility for disaster loan funds. In the past, loss verifiers conducted damage assessments solely through on-site inspections. On January 31, 2017, ODA issued Memo 17-06, Desktop Verifications. After increased use of electronic loan applications, SBA implemented the desktop loss verification process to expedite assistance to disaster survivors. The desktop loss verification process contributed to SBA meeting its timeliness goals for processing disaster loan applications for Hurricanes Harvey, Irma, and Maria.

However, controls needed strengthening to mitigate the risk of fraud and ensure program integrity for the loss verification process. Specifically, SBA did not always validate the cause and extent of damages and repair and replacement costs prior to disbursing loan funds. Further, SBA inappropriately relied on FEMA reports that did not contain pertinent information needed to validate damages and losses reported in the initial loss verification, and loan files did not contain sufficient documentation to support loan-making decisions.

As a result, SBA disbursed 36,869 of the 73,313, or 50 percent, loans included in our scope, totaling $594,286,878 of $1.4 billion, without validating the cause, extent, or cost of damages, and there was no assurance that disaster loans were only provided to individuals impacted by Hurricanes Harvey, Irma, or Maria.

We provided four recommendations to strengthen controls to mitigate the risk of fraud and ensure program integrity. Management agreed with two recommendations and partially agreed with the other two. Management plans to explore substitutes to the post desktop review and ensure they contain the appropriate information needed to support the damages estimated during the initial desktop loss verification. Further, management stated that it will implement additional controls to require loss verifiers to provide documentation that sufficiently supports the post desktop review conclusions. We will continue to work with management to seek resolution for the remaining two recommendations.

Actions Accomplished (Green Status) During Past 4 Fiscal Years (Challenge first reported in FY 2015)	2015: 0	2016: 0	2017: 0	2018: 1

Recommended Actions for FY 2020	Status at End of FY 2019
1. Promulgate regulations for the new guaranteed disaster loan programs mandated by Congress in 2008.	OCA Yellow
2. Promulgate regulations for the Express Recovery Opportunity loan program provided by the RISE After Disaster Act.	OCA Yellow
3. Strengthen internal controls to minimize the risk of charge-offs associated with the increased MAFD threshold.	ODA Yellow
4. Reduce the improper payment rate to meet the reduction targets in FY 2019 in accordance with the FY 2018 Agency Financial Report to comply with the Improper Payments Elimination and Recovery Improvement Act of 2012.	ODA Green ↑
5. Strengthen internal controls to mitigate the risk of fraud and ensure program integrity for the loss verification process.	ODA New

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

Challenge 8: SBA Needs Robust Oversight of Its Grant Management

In FY 2020, SBA budgeted $180 million to administer grants and cooperative agreements to its resource partners and other nonfederal entities to provide technical assistance and training programs to develop small businesses. With recent governmentwide emphasis on grants management reform, and a priority initiative to modernize the government in the President's Management Agenda of 2018, it is SBA's responsibility to maximize the value of its grant funding to ensure its grant programs effectively and efficiently accomplish program objectives. In OIG's review of past audit findings (Report 19-02), we identified systemic issues with SBA's accuracy of grant data for both financial and performance reporting, ineffective oversight, and inadequate standard operating procedures. We continue to identify grant management deficiencies in our recent reviews of SBA grant programs.

SBA Has Made Progress to Address Its Grants Management Issues

In FY 2019 SBA conducted an analysis of SBA's organizational structure and determined that SBA needed to centralize its oversight of its grant management. Further, SBA took action to identify, develop, and implement training for all personnel responsible for grants management. On September 24, 2019, the Agency issued its revised SOP for grants management to standardize policies for compliance, management, and administration of all grants awarded by SBA and to apply to all offices within SBA with grant-awarding authority. The SOP, among other things, established the Office of Grants Management as the authority for oversight and compliance of grant policy for the Agency, clarified roles and responsibilities for personnel responsible for grants management, defined warrant authority and training requirements for grants personnel, and established plans and timeframes for incorporating other grant-related policies and procedures into one centralized directive. While the Agency has addressed three of OIG's recommended corrective actions, the Agency needs to continue its efforts to implement the grants management system to enforce compliance and improve oversight and management of the grants program. Without this system, SBA has limited ability to assess the effectiveness of the recently implemented corrective actions.

Grants Management System

SBA continues to rely on its current grant management system to report on its grant programs. The current system requires substantial manual data inputs that are prone to errors. In March 2018 we issued a management advisory memorandum (Report 18-15), in which we reported on material weaknesses identified by an independent accounting firm regarding SBA's controls over the accuracy of data reported in USASpending.gov. Further, in its own internal A-123 review on the grant management process, SBA's internal auditors found that 100 percent of the sampled transactions contained inaccuracies. These data inaccuracies inhibit policymaker's and the public's ability to effectively track federal spending and affects the Agency's ability to report timely, complete, and accurate information as required by the Digital Accountability and Transparency Act (DATA) of 2014.

To modernize its grants management system, during FY 2019, SBA approved funding totaling $2.5 million (over 5 years) to implement grant solutions. SBA believes the investment would help the Agency to

- improve funding management, awarding of grants, processing payments, and closeouts;
- enhance ability to develop accurate performance metrics reporting;

- reduce compliance violations; and
- increase auditability, accountability, and transparency.

SBA is currently in the initial stages of transitioning to the system. In 2019, the Agency entered into an interagency agreement with the Office of Health and Human Services to provide transition analysis, infrastructure setup, and training services. The Agency plans to fully implement the system by October 2020.

Actions Accomplished (Green Status) During Past 4 Fiscal Years (Challenge first reported in FY 2018)	2015: N/A	2016: N/A	2017: N/A	2018: N/A

Recommended Actions for FY 2020	Status at End of FY 2019
1. Conduct an overall evaluation of its grant management organizational structure with an emphasis on centralizing the oversight of these programs in order to reduce and ultimately eliminate systemic issues for maximum program success.	Green
2. Implement a system to effectively manage and monitor grant awards, to include a process for ensuring the data submitted to USASpending.gov complies with DATA Act requirements.	Yellow
3. Update grant management policies and procedures to ensure grant officers enforce grant recipients comply with financial and performance requirements, verify that reported information is accurate and complete, and ensure applicants' proposals include plans to measure performance in a way that will help SBA achieve program outcomes.	Green
4. Establish training requirements for all grants officers and program personnel responsible for monitoring grant recipients' performance to enforce compliance with SBA's established procedures for grant management and best practices for administering grant awards and monitoring performance. The training should address the systemic issues we identified in this summary report.	Green

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