

Challenge 7. Insufficient and outdated SBA controls continue the excessive risk of the SBIC program.

The Small Business Investment Company (SBIC) Program is designed to stimulate and supplement the flow of private equity capital and long-term debt to small business concerns. SBA uses both guaranteed debt (debentures) and equity interest (participating securities) to provide government-backed financing to SBICs. No new participating security SBICs have been licensed since funding for this program ended on September 30, 2004. As of September 2008, SBA had about \$9.5 billion of such financings at risk. The financial performance of participating security SBICs between FY 1993 and FY 2008 is estimated to have resulted in as much as \$2 billion in losses to the Federal Government. Government Accountability Office (GAO) and OIG audits attributed these losses to the structure of the participating security funding process, and the lack of focus on limiting costs when liquidating SBICs. The audits determined that: (1) the subsidy model underestimated the cost of the program; (2) SBA's profits were not proportional to its investments in the participating security SBICs; (3) insufficient incentives existed to encourage participating security SBICs to repay principal debt as quickly as possible; (4) SBA allowed too much time for financially troubled SBICs to attempt rehabilitation; (5) better performance goals and indicators were needed to show how well and how timely recoveries were maximized for liquidated SBICs; (6) SOPs for SBIC operations and liquidations were outdated; and (7) existing guidance did not provide a systematic approach for estimating the level of financial risk, implementing restrictive operations, transferring capitally-impaired SBICs to liquidation status, liquidating SBICs with participating securities, and monitoring the liquidation of SBIC receiverships.

To address this Management Challenge, the Agency developed a new subsidy estimation methodology, issued revised SOPs for SBIC operations and SBIC Liquidations, revised contracts for receivership agents, and filled staff vacancies. Additional actions needed include demonstrating: (1) that SBICs are transferred timely into liquidation status in accordance with revised guidance; (2) that quarterly risk assessments are performed and documented; and (3) that financially troubled participating security SBICs are placed timely into restrictive operations status. The Agency also must issue performance goals and indicators for the SBIC liquidation process and implement procedures for liquidation of participating security SBICs and monitoring of SBICs in receivership.

Challenge History Fiscal Year (FY) Issued: 2004	Actions Accomplished (Green Status) during Past 4 FYs			
	04-2	05-0	06-1	07-1
Remaining Recommended Actions for FY 2009				Status at end of FY 2008
1. Develop systematic criteria and implement a timely approach for transferring SBICs to liquidation status. <i>(Previously action #2)</i>				Yellow
2. Revise SOP 10 06 to include a process to perform and document quarterly risk assessments, including an analysis of repayment potential, and recommended actions. <i>(Previously action #3)</i>				Green ↑
3. Incorporate into SOP 10 06 a requirement for the timely and consistent implementation of restrictive operations. <i>(Previously action #4)</i>				Yellow
4. Develop and implement performance goals and indicators that address the efficiency, cost-effectiveness, and timeliness of the SBIC liquidation process. <i>(Previously action #5)</i>				Yellow ↑
5. Develop and implement procedures, to be included in a revised version of SOP 10 07 that address the liquidation of participating security SBICs and SBA monitoring of the liquidation of SBICs in receivership. <i>(Previously action #6)</i>				Yellow ↑

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

Challenge 8. Effective tracking and enforcement would reduce financial losses from loan agent fraud.

For years, OIG investigations have revealed a pattern of fraud in the 7(a) business loan guaranty program by loan packagers and other for-fee agents. Fraudulent schemes have involved hundreds of millions of dollars. Yet, SBA oversight of loan agents is limited, putting taxpayer dollars at risk. The Agency could reduce this risk if it established effective loan agent disclosure requirements, a database or equivalent means to track loan agent involvement with its loans, and a more effective agent enforcement program.

In response to this Challenge, SBA proposed to revise its E-Tran system (which is designed to collect loan data electronically from participating lenders) to collect information on loan agent involvement. However, after further examination, the Agency concluded that this process had limitations that would not address the problem due to limitations in the E-Tran system and communication issues between lender personnel involved in loan decisions and those performing E-Tran data entry, and because many lenders were not using E-Tran. Late in FY 2007, SBA proposed a new approach to address the Challenge. The Agency intends to integrate the collection of data from the Form 159 (which asks for information about loan agents) into the Form 1502 process. The Form 1502 is an electronically-submitted report that lenders submit to SBA's Fiscal and Transfer Agent (FTA) to describe the status of all SBA-guaranteed loans in their portfolios. This method of capturing the data is superior to using the E-Tran system because the 1502 is first submitted after the initial loan disbursement, so a lender should be aware of and able to report on loan agent activity, and because it is submitted by all 7(a) lenders. In FY 2008, the OIG consolidated three actions from this Challenge into the revised recommended action #1 below. SBA made no progress on this action during FY 2008, in part due to a protest of the award of the FTA contract to what would have been a new vendor.

In FY 2007, the Agency made progress by issuing its Lender Oversight SOP and by previously revising the guaranty purchase checklist (which lists the records that lenders need to provide when requesting SBA to pay a guaranty) to include the submission of the Form 159. The Agency must also make certain that it captures loan agent information electronically and links it to individual loans. SBA could then identify patterns of loan agent fraud and assess the various risks that loan agents present to the SBA's portfolio of guaranteed loans. SBA also needs to establish a more effective enforcement program to deter fraudulent loan agent activity.

Challenge History Fiscal Year (FY) Issued: 2000	Actions Accomplished (Green Status) during Past 4 FYs			
	04-0	05-0	06-0	07-1
Remaining Recommended Actions for FY 2009				Status at end of FY 2008
1. Develop an effective method of disclosing and tracking loan agent involvement in the SBA business loan programs. <i>(Previously actions #1, 3, and 4)</i>				New
2. Review loans for irregularities that could indicate loan agent fraud and abuse, and show that SBA is promptly and effectively exercising its regulatory authority to deter loan agent misconduct when warranted. <i>(Previously action #6)</i>				Green
3. Implement procedures for enforcement actions against loan agents for improper and fraudulent conduct.				New

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

Appendix: Relevant Reports

Most of the SBA OIG reports listed can be found at: www.sba.gov/ig/igreadingroom.html.

Challenge 1:

- SBA Advocacy, Analysis of Type of Business Coding for the Top 1,000 Contractors Receiving Small Business Awards in FY 2002, December 2004.
- The Center for Public Integrity, The Big Business of Small Business: Top defense contracting companies reap the benefits meant for small businesses, September 29, 2004.
- The Center for Public Integrity, The Pentagon's \$200 Million Shingle: Defense data shows billions in mistakes and mislabeled contracts, September 29, 2004.
- SBA OIG, Audit of SBA's Administration of the Procurement Activities of Asset Sale Due Diligence Contracts and Task Orders, Report #4-16, March 17, 2004, pp. 8-9.
- GAO, Contract Management: Reporting of Small Business Contract Awards Does Not Reflect Current Business Size, GAO-03-704T, May 7, 2003.
- The Small Business Committee, U.S. House of Representatives Hearing, Are Big Businesses Being Awarded Contracts Intended for Small Businesses? Testimony of Mr. Fred C. Armendariz, Associate Deputy Administrator, SBA, May 7, 2003.
- The Small Business Committee, U.S. House of Representatives Hearing, Are Big Businesses Being Awarded Contracts Intended for Small Businesses? Testimony of Mr. Felipe Mendoza, Associate Administrator, Office of Small Business Utilization, U.S. General Services Administration, May 7, 2003.
- SBA OIG, SBA Small Business Procurement Awards Are Not Always Going to Small Businesses, Report #5-14, February 24, 2005.
- SBA OIG, Review of Selected Small Business Procurements, Report #5-16, March 8, 2005.

Challenge 2:

- SBA OIG Audit of SBA's FY 2007 Financial Statements, Report #8-03, November 15, 2007.
- SBA OIG, Audit of Controls Over Access to Employee Emails by SBA Managers, Report #8-02, October 19, 2007.
- SBA OIG, Results of KPMG Vulnerability Assessment, Report #7-16, March 6, 2007.
- SBA OIG, FISMA Independent Evaluation for FY 2006, Report #7-14, February 9, 2007.
- SBA OIG, Memorandum Advisory Report on SBA's Protection of Sensitive Information, Report #7-13, February 9, 2007.
- Audit of SBA OIG, Audit of SBA's Financial Statements for FY 2006, Report #7-03, November 15, 2006.
- SBA OIG, FISMA Independent Evaluation for FY 2005, Report #6-01, October 7, 2005.
- SBA OIG, Memorandum Advisory Report on SBA Needs to Implement a Viable Solution to its Loan Accounting System Migration Problem, Report #5-29, September 30, 2005.
- SBA OIG, Audit of SBA's Information System Controls for FY 2004, Report #5-12, February 24, 2005.
- SBA OIG, Audit of SBA's Exchange Email System, Report #4-42, September 10, 2004.
- SBA OIG, Audit of Selected SBA General Support Computer Operating Systems, Report #4-41, September 10, 2004.
- SBA OIG, Audit of SBA's Information System Controls for FY 2003, Report #4-19, April 29, 2004.
- SBA OIG, Audit of SBA's Information System Controls for FY 2002, Report #3-20, March 31, 2003.

Challenge 3:

- SBA OIG, Non-Native Managers Secured Millions of Dollars from 8(a) Firms Owned by Alaska Native Corporations through Unapproved Agreements that Jeopardize the Firms' Program Eligibility, Report #8-14, August 7, 2008
- OPM, 2006 Federal Human Capital Survey (FHCS), <http://www.fhcs2006.opm.gov/>
- SBA OIG, Audit of Two 8(a) Sole-Source Contracts Awarded to Contractors in SBA's Mentor Protégé Program, Report #7-19, March 30, 2007
- SBA OIG, Management Advisory Report on the Transfer of Operations to the National Guaranty Purchase Center, Report #4-39, August 31, 2004
- GAO, Small Business Administration: Progress Made, but Transformation Could Benefit from Practices Emphasizing Transparency and Communication, GAO-04-076, October 2003
- OMB, The President's Management Agenda and OMB's Human Capital Scorecard, <http://www.results.gov/agenda/fiveinitatives.html>
<http://www.results.gov/agenda/departmentupdates12.html>
- GAO, Results Oriented Cultures: Implementation Steps to Assist Mergers and Organizational Transformations, GAO-03-699, July 2003
- GAO, Small Business Administration: Workforce Transformation Plan is Evolving, GAO-02-931T, July 16, 2002
- SBA OIG, Modernizing Human Capital Management, Report #2-20, May 31, 2002
- GAO, Small Business Administration: Current Structure Presents Challenges for Service Delivery, GAO-02-17, October 2001
- GAO, Small Business Administration: Steps Taken to Better Manage its Human Capital, but More Needs to be Done, GAO/T-GGD/AIMD-00-256, July 20, 2000
- SBA OIG, A Framework for Considering the Centralization of SBA Functions, November 1996

Challenge 4:

- SBA OIG, Audit of Six SBA Guaranteed Loans, #8-18, September 8, 2008
- SBA OIG, Audit of Loan Classifications and Overpayments on Secondary Market Loans, #8-09, March 26, 2008
- SBA OIG, Audit of UPS Capital Business Credit's Compliance with Selected 7(a) Lending Requirements, #8-08, March 21, 2008
- SBA OIG, Audit of the Guarantee Purchase Process for Section 7(a) Loans at the National Guaranty Purchase Center, Report #7-23, May 8, 2007
- SBA OIG, Audit of an SBA Guaranteed Loan, Report #7-17, March 12, 2007
- SBA OIG, Audit of an SBA Guaranteed Loan, Report #7-15, February 12, 2007
- SBA OIG, Audit of an SBA Guaranteed Loan, Report #7-10, January 16, 2007
- SBA OIG, Audit of an SBA Guaranteed Loan, Report #7-09, January 9, 2007
- SBA OIG, Audit of an SBA Guaranteed Loan, Report #7-07, December 29, 2006
- SBA OIG, Audit of an SBA Guaranteed Loan, Report #7-06, December 28, 2006
- SBA OIG, Audit of an SBA Guaranteed Loan, Report #7-05, December 20, 2006
- SBA OIG, Audit of an SBA Guaranteed Loan, Report #7-02, October 23, 2006
- SBA OIG, Audit of Deficiencies in OFA's Purchase Review Process for Backlogged Loans, Report #6-35, September 29, 2006
- SBA OIG, Survey of the Quality Assurance Review Process, Report #6-26, July 12, 2006
- SBA OIG, Audit of SBA's Implementation of the Improper Payments Information Act, Report #6-25, June 21, 2006