AUDIT REPORT

AUDIT OF SBA'S MICROLOAN PROGRAM

September 28, 2017

REPORT NUMBER 17-19

EXECUTIVE SUMMARY

AUDIT OF SBA'S MICROLOAN PROGRAM

Report No. 17-19

September 28, 2017

What OIG Reviewed

This report presents the results of our audit of the Small Business Administration's (SBA's) Microloan Program. The Microloan Program assists women, low-income, veteran, and minority entrepreneurs, as well as other small businesses in need of financial assistance. Under the program, SBA makes direct loans to intermediaries that, in turn, use the proceeds to make small short-term loans (microloans) up to $50,000 to eligible small businesses. SBA also awards grants to intermediaries to provide training and technical assistance to microloan borrowers. From fiscal year (FY) 2014 to 2016, intermediaries closed 12,168 microloans totaling approximately $170 million.

Our objectives were to determine (1) whether SBA effectively implemented actions to improve oversight of the Microloan Program and (2) the extent that SBA oversight is sufficient to measure program performance and ensure program integrity.

What OIG Found

We last conducted an audit of SBA's Microloan Program in 2009 and made several recommendations to SBA to improve its program oversight. However, SBA management did not effectively implement all prior audit recommendations to improve oversight. Furthermore, SBA management did not conduct adequate program oversight to measure program performance and ensure program integrity. These internal control weaknesses were due to SBA not having an overall site visit plan, an adequate information system, available funding for system improvements, or clear Standard Operating Procedures (SOPs). Additionally, SBA management focused on output-based performance measures instead of outcome measures.

In our review of a statistical sample of 52 microloan files, we found that data contained in SBA's information system for 27 of the loans did not match the information included in the intermediaries' loan files.

In addition, we found that intermediaries did not have sufficient documentation to support that it originated and closed 44 of the 52 microloans, or 85 percent, totaling approximately $910,000, in accordance with SBA's requirements. These deficiencies affect the reliability of the data reported to SBA by the intermediaries. When projecting these findings to the microloan population, we estimated that intermediaries did not have adequate documentation for at least 9,196 microloans approved from FY 2014 to FY 2016 for approximately $137 million.

As a result, SBA's ability to validate microloan data, conduct analyses across multiple programs and systems, and capture outcome-based measures was impaired, and there was no way to ensure program integrity or measure program success. These internal controls over the Microloan Program are critical as Congress considers expanding the program.

OIG Recommendations

To improve SBA's oversight of the Microloan Program, we recommended the Associate Administrator for the Office of Capital Access (1) continue efforts to improve the information system for effective monitoring of the Microloan Program, (2) develop a site visit plan to further monitor microloan portfolio performance, (3) update SOP 52 00A to clarify requirements regarding evidence for use of proceeds and credit elsewhere, and (4) update the microloan reporting system manual to reflect current technology capabilities.

Agency Response

SBA management agreed with the four recommendations. Specifically, SBA plans to study and recommend solutions to replace its microloan information system. SBA also will develop a comprehensive site visit review program and will update SOP 52 00A to clarify requirements regarding evidence for use of proceeds and credit elsewhere. Additionally, SBA will update the microloan reporting system user's manual to reflect current technology capabilities.

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

Final Report Transmittal
Report Number: 17-19

DATE: September 28, 2017

TO: Linda E. McMahon
Administrator

FROM: Hannibal "Mike" Ware
Acting Inspector General

SUBJECT: *Audit of SBA's Microloan Program*

This report presents the results of our audit on the Small Business Administration's Microloan Program. We conducted this audit in accordance with Generally Accepted Government Auditing Standards.

We considered management comments on a draft of this report when preparing the final report. SBA agreed with all four recommendations.

We appreciate the courtesies and cooperation extended to us during this audit. If you have any questions, please contact me at (202) 205-6586 or Andrea Deadwyler, Director, Credit Programs Group, at (202) 205-6616.

cc: Mary Anne Bradfield, Chief of Staff
William Manger, Associate Administrator, Office of Capital Access
John Miller, Deputy Associate Administrator, Office of Capital Access
Timothy E. Gribben, Chief Financial Officer and Associate Administrator for Performance Management
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Introduction

The Small Business Administration's (SBA's) Microloan Program was established to assist women, low-income, veteran, and minority entrepreneurs, as well as other small businesses in need of financial assistance. Under the program, SBA makes direct loans to intermediaries that, in turn, use the proceeds to make small short-term loans (microloans) up to $50,000 to eligible small businesses. The microloans may fund working capital and the purchase of materials, supplies, furniture, fixtures, machinery, and equipment. The program's mission is to integrate microlevel financing with training and technical assistance for start-up, newly established, existing, and growing small businesses. SBA awards grants to intermediaries to provide this training and technical assistance.

Intermediaries are responsible for determining whether a small business is qualified to receive a microloan using SBA's eligibility and program guidelines as well as its own lending policies. SBA loans made to the intermediaries have averaged a 2 percent charge-off rate over the life of the Microloan Program. Critical information about the microloans such as borrower information and payment status are self-reported by intermediaries in the Microloan Program Electronic Reporting System (MPERS).[1]

The Office of Capital Access (OCA) Microenterprise Development Division is responsible for reviewing intermediary loan requests and reports. Seven financial analysts oversee approximately 140 intermediaries. From fiscal year (FY) 2014 to FY 2016, intermediaries closed 12,168 microloans totaling approximately $170 million (Table 1).

Table 1. Microloans Closed From FY 2014 to FY 2016

Fiscal Year	Number of Microloans	Microloan Amount (in millions)	Average Microloan Size
2014	3,974	$56.5	$14,214
2015	3,708	$52.3	$14,106
2016	4,486	$60.7	$13,533
Totals	**12,168**	**$169.5**	

Source: MPERS data provided by SBA.

This audit of SBA's Microloan Program (current audit) was initiated in response to the Senate Committee on Small Business and Entrepreneurship requesting that the SBA Office of Inspector General (OIG) complete the planned second phase of the 2009 audit to confirm whether program oversight by SBA was sufficient. The Committee also requested that OIG determine whether oversight was adequate to prevent intermediaries from imposing excessive requirements on microloan borrowers or making loans at terms that were not in the best interest of borrowers.

SBA Actions Taken

It is important to note that during the period of the current audit, SBA took steps to improve its oversight of the Microloan Program. Those steps included the following:

[1] During the period of our current audit, MPERS was the reporting system for microloans.

- Developed a justification to request funds for technology improvements.

- Conducted a time study to evaluate staff time spent on tasks in support of technology improvements.

- Developed a module within the program information system for new loan request analysis which replaced the use of spreadsheets.

Prior Work

On December 28, 2009, SBA OIG issued a memorandum ROM 10-10, *SBA's Administration of the Microloan Program under the Recovery Act.* The audit found that SBA had not conducted adequate program oversight, validated the reliability of program data, accurately reported program performance, or established meaningful outcome-oriented performance measures. We made six recommendations, all of which are closed, to the OCA's Associate Administrator to ensure that microloans made with Recovery Act funds are properly monitored and the program has meaningful performance measures.

Objectives

Our objectives were to determine (1) whether SBA effectively implemented actions to improve oversight of the Microloan Program and (2) the extent that SBA oversight is sufficient to measure program performance and ensure program integrity. See Appendix I for information on our scope and methodology.

Finding: Improvements Are Needed in SBA's Oversight of Its Microloan Program to Measure Performance and Ensure Integrity

SBA management did not effectively implement all prior audit recommendations to improve its oversight of the Microloan Program. Furthermore, SBA management did not conduct adequate program oversight to measure program performance and ensure program integrity. These internal control weaknesses were due to SBA not having an overall site visit plan, an adequate information system, available funding for system improvements, or detailed Standard Operating Procedures (SOPs). Additionally, SBA management focused on output-based performance measures instead of outcome measures. In our review of a statistical sample of 52 microloan files, we found that data in MPERS for 27 of the loans did not match the information included in the intermediaries' loan files.

We also found that intermediaries did not have sufficient documentation to support that it originated and closed 44 of the 52 microloans, or 85 percent, totaling approximately $910,000, in accordance with SBA's requirements. These deficiencies affect the reliability of the data reported to SBA by the intermediaries. When projecting these findings to the microloan population, we estimated that intermediaries did not have adequate documentation for at least 9,196 microloans approved from FY 2014 to FY 2016 for approximately $137 million. (See Appendix II for a schedule of our questioned costs.) As a result, SBA's ability to validate microloan data, conduct analyses across multiple programs and systems, and capture outcome-based measures was impaired, and there was no way to ensure program integrity or measure program success.

Implementation of Prior Recommendations to Improve Program Oversight

SBA OIG last conducted an audit of SBA's Microloan Program in 2009. We made several recommendations to SBA management to improve its oversight of intermediaries and their compliance with program requirements, collect and validate intermediary-reported data supporting program performance, and develop additional performance metrics to measure program achievement. Although SBA officials provided documentation evidencing that corrective actions were implemented in FY 2011 (Table 2) for the previous six recommendations, we found in our current audit that management did not effectively implement corrective actions for Recommendations 3, 5, and 6.

Table 2. Microloan Program Audit Recommendations Closed in FY 2011

Number	Recommendation
1	Require intermediaries to provide 3 months' worth of bank statements with each quarterly financial report submitted to SBA and revise the review process to include an analysis of the sources and uses of the Microloan Revolving Fund and Loan Loss Reserve Fund.
2	Develop a staffing plan and hire and train the additional staff required to provide an adequate level of program oversight.
3	Examine, verify, and test microloan data reported by the intermediaries in MPERS.
4	Provide guidance to intermediaries and correct the processes used to calculate the number of small businesses assisted and jobs created and retained under the Microloan Program.
5	Develop additional performance metrics to measure the program's achievement in assisting microloan borrowers in establishing and maintaining successful small businesses.
6	Require intermediaries to report in MPERS the technical assistance provided in relation to each microloan made and use this data to analyze the effect technical assistance may have on the success of microloan borrowers and their ability to repay microloans.

Source: OIG Report ROM 10-10, *SBA's Administration of the Microloan Program under the Recovery Act* (December 2009).

Data Verification (Recommendation 3)

In response to Recommendation 3, SBA expanded its quarterly performance reviews to include verification of microloan data. During our current audit, we determined that SBA used site visits to verify data reported by intermediaries in MPERS. Site visits were performed by SBA district offices and included interviews with intermediary personnel, reviews of sampled microloans to determine whether SBA requirements were being met, and a comparison of microloan files to MPERS. However, we found that site visits were not performed regularly for all intermediaries, and no formal plan existed to ensure all intermediaries received a site visit. Further, no summary data of site visits was available for programwide analysis of noncompliance. As a result, if issues were found, SBA could not identify financial impact and determine appropriate ways to address the noncompliance across the program. This could have included requiring an action plan for remediation, additional microloan file reviews, and increased monitoring through more frequent reporting. In addition, although site visits are an important method used to verify data and compliance with program requirements, SBA's SOPs did not require them.

Performance Metrics (Recommendations 5 and 6)

To respond to our prior recommendations and better measure the program's success, SBA required intermediaries to capture in MPERS the status of operation for microloan borrowers and technical assistance the intermediaries provided to those borrowers. However, during our current audit we identified some intermediaries were not reporting whether small businesses were still in operation, making this data element unreliable to measure the effectiveness of the program. For example, during our review of microloans, we identified a business that was no longer in operation, but MPERS did not reflect its current operating status. In addition, improvements programmed by a contractor in FY 2011 to have MPERS capture technical assistance were never completed and therefore never implemented. Nonetheless, the MPERS manual still illustrates steps to document this information. In FY 2015, SBA management developed a list of basic information technology requirements that would improve MPERS. According to SBA management, however, funding to address these types of system issues was not available. SBA management is in the process of requesting funds to make necessary technology improvements.

According to the General Accounting Office's Standards for Internal Control in the Federal Government, control activities must be established within all Federal agencies to monitor performance.[2] This may include the validation of source information that supports the data used to measure performance. As noted above, we identified irregular site visits, inadequate SOPs, ineffective reporting by intermediaries, and an insufficient information system, indicating that SBA is not meeting this standard.

Measuring Program Performance and Ensuring Its Integrity

We reviewed a statistical sample of 52 microloans approved for approximately $1 million by 14 intermediaries to validate data input in MPERS. We also assessed whether intermediaries originated and closed these microloans in accordance with SBA's requirements for use of proceeds, credit elsewhere, interest rates, fees, and insurance. In our review of these microloan files, we found that data in MPERS for 27 of the loans reviewed did not match the information included in the intermediaries' loan files.

[2] GAO-14-704G, Standards for Internal Controls in the Federal Government (September 2014).

We also found that intermediaries did not have sufficient documentation to support that it originated and closed 44 of the 52 microloans, or 85 percent, totaling approximately $910,000, in accordance with SBA's requirements. Specifically, we found inadequate support for use of proceeds, unsupported credit elsewhere, interest rate charges above SBA guidelines, and fees exceeding SBA guidelines (Table 3). When projecting these findings to the microloan population, we estimated that intermediaries did not have adequate documentation for at least 9,196 microloans approved from FY 2014 to FY 2016 for approximately $137 million.

Table 3. Type of Exceptions from Microloan File Review

Exception	Number of Loans*
MPERS data did not match loan file	27
Inadequate evidence for use of proceeds	32
Unsupported credit elsewhere	20
Interest rate charges above guidelines	13
Fees exceeding guidelines	7

Source: Generated by OIG based on microloan file reviews.
*Some microloans had multiple exceptions.

MPERS Data Matching

The agency's SOPs required intermediaries to report microloan information in MPERS.[3] However, when we compared the information in the loan files to what was in MPERS, the information did not match for 27 of the microloan files. In most instances, the jobs creation and retention data in MPERS was different from the information contained in the microloan files.

Use of Proceeds

The agency's SOPs required intermediaries to maintain evidence that the proceeds of the microloan were used for the purpose for which the application was made. However, 32 microloan files did not contain adequate evidence. For example, receipts or copies of checks related to purchases were not retained. In some cases, intermediaries only relied on follow-up visits to the business for verification, without obtaining documentary evidence to support the use of proceeds.

Credit Elsewhere

The agency's SOPs stated microloan files must contain documentation supporting that borrowers applying for $20,000 or more could not obtain similar rates and terms from private sector lenders. This documentation could include a bank denial letter, a survey of local loan products available at the time of application, or marketing materials listing terms the borrower was unable to meet. We identified 20 microloan files that did not have adequate support for credit elsewhere. For example, intermediaries relied on a borrower certification or an application question and in some cases the borrower indicated on the application that they were not denied elsewhere.

[3] During our audit, the SOPs that controlled the microloans we reviewed were SOP 52 00, *Microloan Program*, dated March 1, 2013, and SOP 52 00 A, *Microloan Program*, dated April 28, 2016.

Interest Rates

The agency's SOPs restricted intermediaries to a maximum interest rate it can charge microloan borrowers based on its cost of funds and the microloan amount. However, in 13 loan files, we found that intermediaries charged a range of 0.15 to 1.15 percent above SBA requirements. For example, one intermediary used another loan program in conjunction with microloan funds to fulfill the borrower's request. This led to an interest rate that exceeded SBA requirements.

Fees

The agency's SOPs allowed intermediaries to charge reasonable loan fees up to 3 percent depending on the approval date and term of the loan. Three intermediaries, however, charged fees above those requirements. For example, one intermediary used a state program for loan loss reserves, which it then charged its microloan borrowers to enroll in. This program, called the California Capital Access Program for Small Business (CalCAP), charges a fee between 2 and 3.5 percent of the loan amount, which can be passed on to the borrower. Four microloan borrowers for this intermediary were charged an origination fee of 2 percent plus a CalCAP fee of 4 percent. We reviewed microloan policies for the 14 intermediaries, and the CalCAP fee was the only requirement deemed excessive.

These exceptions occurred because SOP guidelines did not provide detail regarding what qualified as appropriate documentary evidence for use of proceeds and credit elsewhere. In addition, intermediaries used incorrect policies to charge fees and interest rates contrary to SBA requirements.

Additional MPERS Enhancements

We identified additional issues with the agency's ability to monitor the Microloan Program using MPERS. The issues we found included concurrent use of the Microloan and Community Advantage Programs, ownership of and responsibility for microloans, and accuracy of use of proceeds data in MPERS.

Combined Use of Microloan and Community Advantage Program

We found that some small businesses received separate loans from SBA's Community Advantage Program and Microloan Program to support one project. For example, one intermediary had two small businesses that requested loan amounts within the $250,000 limit of the Community Advantage Program. Instead of using only the Community Advantage Program, the intermediary split each of the loans between the Community Advantage and Microloan Programs. This intermediary stated it used the programs simultaneously to provide the best terms to the borrowers. However, we found the intermediary used a higher interest rate microloan in combination with a Community Advantage loan for one borrower. With another borrower, it used a shorter term microloan with the Community Advantage loan. These actions resulted in higher loan payments for both borrowers.

One intermediary that used both programs stated it was difficult to find borrowers for the Microloan Program. SBA management noted intermediaries may use both programs to allow them to obtain a grant under the Microloan Program.[4] We found MPERS did not include information that

[4] An intermediary may be eligible to receive grant funding from SBA to provide microloan borrowers with marketing, management, and technical assistance.

would capture intermediaries' use of the Community Advantage Program, which could be used for analysis and monitoring. Monitoring of the two programs is important to ensure each is being used as intended and intermediaries are providing loans that are in the best interest of small businesses that need their assistance.

SBA's Ownership of and Responsibility for Microloans

When intermediaries exit the Microloan Program, SBA's Birmingham Loan Processing Center inherits the responsibility of billing and collecting on those active microloans. However, MPERS does not capture these microloans, and management indicated it was difficult to monitor the debts. SBA management has to use a report from another system to compare to MPERS data; however, there is no common identifier to assist in this analysis. As a result, SBA management is required to take multiple steps to get an accurate understanding of these microloans, which increases the possibility of errors.

Accuracy of Use of Proceeds Data in MPERS

We also identified that MPERS could not accurately capture use of proceeds. For example, debt refinance was an allowed use of proceeds under the program but could only be considered when it improved the debt position of the microloan borrower. However, debt refinance was not a selection option in the system. Debt refinance was identified as a use of proceeds in our sample, so this omission makes it difficult for SBA management to fully assess the program.

We found that the internal control weaknesses identified in this report preventing SBA from providing adequate oversight were due in large part to the limited capabilities of MPERS. In addition, we found SBA measured program performance using output indicators in lieu of outcome metrics. For example, SBA focused on the number of small businesses assisted and number of jobs supported by microloans. Outcome based measures would include the success of microloan borrowers which would consider the operation status of small businesses and the technical assistance provided. According to OMB's Policies for Federal Credit Programs and Non-Tax Receivables (OMB Circular A-129), outcome-based measures are a necessary component for measuring program performance. Absent the capturing of key outcome metrics, success of the Microloan Program cannot be fully determined. SBA management recognized that outcome-based measures are needed and that the indicated system improvements will help accomplish this.

Conclusion

The Microloan Program's mission is to integrate microlevel financing with training and technical assistance for start-up, newly established, existing, and growing small businesses. Improvements are needed in SBA's oversight to validate microloan data, conduct analyses across multiple programs and systems, and capture outcome-based measures. Furthermore, because Congress introduced two bills to expand the program, adequate oversight is necessary to sufficiently measure program performance and ensure the integrity of the program. The exceptions we identified on the microloans demonstrate that SBA must continue to improve its oversight to ensure the program is meeting its intended purpose. When projecting our findings in the 44 microloans to the microloan population, we estimate that at least 9,196 of 12,157 microloans, totaling $137 million, had deficiencies.

Recommendations

We recommended that the Associate Administrator for the Office of Capital Access:

1. Continue efforts to improve the information system to include outcome-based performance measurements and ensure the data captured can be used to effectively monitor the Microloan Program compliance, performance, and integrity.

2. Develop and implement a site visit plan to comprehensively monitor microloan portfolio performance and ensure program results can be evaluated programwide.

3. Update SOP 52 00A to clarify requirements regarding evidence for use of proceeds and credit elsewhere.

4. Update the microloan reporting system manual to reflect current technology capabilities.

Analysis of Agency Response

SBA management concurred with the four recommendations and stated that the agency will target September 30, 2019, for full implementation. Management also provided additional comments regarding improvements made to the Microloan Program since SBA OIG's last audit in 2009. The Agency's response is included in its entirety in Appendix III.

Summary of Actions Necessary to Close the Report

The following provides the status of the recommendations and the necessary actions to close them.

1. **Resolved**. SBA management concurred with our recommendation and plans to continue efforts to improve the information system to effectively monitor the Microloan Program. This recommendation can be closed upon management providing evidence that a replacement for MPERS has been implemented. The replacement should include outcome-based performance measurements and ensure the data captured can be used effectively to monitor the Microloan Program compliance, performance, and integrity.

2. **Resolved**. SBA management concurred with our recommendation and plans to develop and implement a comprehensive site visit plan. This recommendation can be closed upon management providing evidence that a comprehensive site visit plan has been developed and implemented.

3. **Resolved**. SBA management concurred with our recommendation and plans to update SOP 52 00A to clarify requirements regarding evidence for use of proceeds and credit elsewhere. This recommendation can be closed upon management providing evidence that SOP 52 00A has been updated.

4. **Resolved**. SBA management concurred with our recommendation and plans to update the microloan reporting system manual to reflect current technology capabilities. This recommendation can be closed upon management providing evidence that the MPERS user's manual has been updated.

Appendix I: Objective, Scope, and Methodology

Our objectives were to determine (1) whether SBA effectively implemented actions to improve oversight of the Microloan Program and (2) the extent that SBA oversight is sufficient to measure program performance and ensure program integrity. The scope of this audit included recommendations from our previous report issued December 28, 2009, and microloans approved from FY 2014 to FY 2016. To accomplish our objectives we:

- Reviewed the actions taken in response to prior recommendations to determine if they were still in place and operational.

- Reviewed a statistical sample of 52 microloan files from 14 intermediaries to determine if microloans were approved and closed in accordance with SBA requirements. The sample was selected from a universe of 150 intermediaries and 12,157 microloans approved for approximately $169 million. The review also included the validation of MPERS data.

- Reviewed microloan policies from 14 intermediaries to determine if the policies contained excessive requirements. We searched for requirements including, but not limited to, interest rates above SBA limits, application and origination charges above 2 percent, closing costs unrelated to the loan closing, required insurance provided by the intermediary, credit life insurance, disability insurance, and late fees exceeding 5 percent of the payment amount.

- Reviewed applicable laws and SBA's SOP including 52 00 and 52 00A. In addition, we reviewed Office of Management and Budget (OMB) guidance on internal controls and program reviews as well as the General Accounting Office's Standards for Internal Control in the Federal Government.

- Interviewed intermediaries as well as SBA management and personnel responsible for managing and monitoring the Microloan Program.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Use of Computer-Processed Data

We relied on specific data elements from SBA's MPERS to select our statistical sample of intermediaries and microloan borrowers and to analyze the microloan portfolio. We conducted reliability tests on those data elements provided by SBA. For example, we verified that the microloan approval dates and amounts were within the scope of our requests and did not include material data errors. Further, data elements associated to the reviewed microloans were verified against source documents. As a result, we believe the information is reliable for the purposes of this audit.

Review of Internal Controls

SBA's SOP 00 02 2, *Internal Control Systems,* provides guidance on implementing and maintaining effective internal control systems, as required by OMB Circular A-123.[5] According to OMB, agencies are responsible for establishing and maintaining internal controls to operate effectively and efficiently, report reliable financial data, and comply with applicable laws and regulations. We limited our assessment of internal controls to the oversight of the Microloan Program. We identified weaknesses and deficiencies, which are addressed in the report.

[5] SOP 00 02, *Internal Control Systems* (January 1986).

Appendix II: Questioned Costs

Table 4. OIG Schedule of Questioned Costs[6]

Description	Amount	Explanation
Projected total approval value of microloans	$137,199,806	Unsupported documentation for microloans closed by intermediaries projected over total microloan population
Total Questioned Costs	**$137,199,806**	

Source: Generated by OIG based on review of microloan files.

[6] Questioned costs are expenditures that are not supported by adequate documentation at the time of the audit or otherwise do not comply with legal, regulatory, or contractual requirements.

SBA

DIRECTOR, OFFICE OF ECONOMIC OPPORTUNITY

RESPONSE TO AUDIT REPORT

U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

Date: September 20, 2017

To: Hannibal "Mike" Ware
Acting Inspector General

From: Manuel "Manny" Hidalgo
Director, Office of Economic Opportunity

Subject: Audit of SBA's Microloan Program

Thank you for the opportunity to review the draft audit report on the U.S. Small Business Administration (SBA) Microloan Program. We appreciate the role the Office of Inspector General (OIG) plays in assisting management in ensuring that programs are effectively managed, and for the feedback provided in this draft report.

The OIG draft audit report mentions that SBA has taken steps to improve its oversight of the Microloan Program including:

- Developed a justification to request funds for technology improvements;
- Conducted a time study to evaluate staff time spent on tasks in support of technology improvements; and
- Developed a module within the Microloan Program Electronic Reporting System (MPERS) to automate the analysis of new loan requests, replacing the manual and labor intensive past practice of using spreadsheets to complete the analysis.

The Office of Economic Opportunity (OEO) agrees that significant progress has been made in the oversight of the Microloan Program and is committed to its continual improvement.

OEO takes oversight of the Microloan Program very seriously. Numerous improvements to the Microloan Program have been made over the past several years to protect the integrity of the Program and minimize cost to the taxpayer. These improvements are summarized in the following paragraphs.

In 2010, the program office implemented a comprehensive quarterly reporting analysis, which has been completed on a quarterly basis for each active Intermediary in the Microloan Program since that time. This analysis consolidates each Intermediary's outstanding debt balance to SBA, the value and status of the Intermediary's microloan portfolio, and the deposit balance of each Intermediary's microloan revolving fund (MRF) and loan loss reserve fund (LLRF) bank accounts. This information enables SBA to understand each Intermediary's relative health by displaying historical default rate, delinquency rate, collateral coverage rate, loan loss reserve coverage rate and other valuable risk indicators. Performing this quarterly analysis on every Intermediary has enabled SBA to minimize its losses due to Intermediary non-payment by providing warning signs well before performance issues reach a non-recoverable level. As an example, SBA will not approve new loan requests, or make new loan disbursements to an Intermediary that has failed to provide collateral equal to 115% of its outstanding debt balance to SBA, until additional funds are contributed to restore this ratio back to the required 115% level.

Also in 2010, OEO implemented an annual financial statement analysis that OEO staff has completed annually for each Intermediary. This analysis also allows SBA to see potential financial issues well in advance of becoming a problem in order to limit the risk of Intermediary non-payment to SBA.

Further, in 2012 OEO designed its first Site Visit Checklist to be used by SBA District Office personnel when conducting annual site visits to the Microloan intermediaries. The Site Visit Checklist has undergone numerous revisions as a result of input from the SBA District Offices, the Office of Credit Risk Management and the Office of General Counsel. The current checklist is used to guide the District Office personnel through the onsite review of a Microloan Intermediary. It asks simple yes/no questions related to both oversight issues, and compliance issues.

In 2013 OEO published its first Microloan Standard Operating Procedure (SOP) since the Program's inception in 1992. This SOP provides guidance to both SBA staff who are involved in managing the Program and the Intermediary lenders who participate. This SOP was updated in 2015 to incorporate changes made to the Microloan Program regulations.

In 2014 the Microloan Program Office designed and implemented a grant calculator spreadsheet that is used by both OEO staff and each Intermediary as a project management tool for the technical assistance grants and the Intermediary's quarterly expense billings and performance reports. This spreadsheet incorporates every document required for an Intermediary to complete their required requests and reports. Further, it allows for the input of all required expense and performance data into a single input sheet which then imbeds the needed data into each of the required forms. The grant calculator allows the Intermediary to manage the reimbursement and performance reporting process more efficiently (with greatly reduced errors), which in turn allows SBA to review and approve their expense reimbursements more quickly and with greater accuracy.

OEO conducts monthly webinar sessions with all participating lenders in order to provide Program-related updates, ongoing training and allow for presentation of best practices. Time is set aside each month during these webinars to allow participants to ask questions and make recommendations. OEO also conducts a national training conference every two years where it requires each active Intermediary lender to participate. The most recent national training conference was held in April, 2016 in Chicago. OEO is currently planning its national training conference that will take place in May, 2018.

The OIG performed audits of 14 Intermediary lenders and 52 microloan files and found documentation deficiencies, or differences between the information contained in the lender's loan file vs. that in the SBA Microloan Program Electronic Reporting System (MPERS) system in 44 of the 52 files. The audit revealed that inadequate documentation exists to show that the "no credit elsewhere" test had been properly administered. The audit showed in some cases that inadequate supporting documentation existed to show how the microloan funds were used by the borrower. Further, the audit showed that in some cases interest rates and fees were charged that exceeded the limits allowed under the program rules and regulations. To correct these findings, OEO will complete the following:

1. Institute a comprehensive site visit plan ensuring each Intermediary is visited by local District Office staff on an annual basis and that the information they are reporting to SBA are properly and accurately documented in their loan files;
2. Update the Microloan SOP to provide more detailed examples of the types of documentation required for evidence of the "no credit elsewhere" test, microloan use of proceeds and reporting of jobs created and retained;
3. Continue to provide monthly webinar training and a national training conference every 2 years for microloan program Intermediary lenders to ensure a thorough understanding of reporting, compliance and documentation issues; and
4. Replace the Microloan Program Electronic Reporting System (MPERS) with a modern IT platform that will better enable accurate and efficient reporting and enable SBA to report on outcomes instead of outputs.

Since the Microloan Program's inception in 1992, it has completed in excess of 68,000 microloans totaling over $840 million with a charge-off percentage to SBA of less than 2%. OEO believes that this demonstrates that the Microloan Program is performing well.

Management's response to the recommendations in the draft report is noted as follows:

1. **Continue efforts to improve the information system to include outcome-based performance measurements and ensure the data captured can be used to effectively monitor the Microloan Program compliance, performance and integrity.**

   OEO concurs with this recommendation and has presented its recommendation to replace the Microloan Program Electronic Reporting System (MPERS) to SBA's Business Technology Investments Committee (BTIC). BTIC approved OEO's request and has committed $150,000 to study and recommend the best possible cloud-based IT solution to replace MPERS. OEO has already selected a contractor and is scheduling to begin this work in early FY2018. OEO targets having a replacement for MPERS completed by the end of FY2019.

2. **Develop and implement a site visit plan to comprehensively monitor microloan portfolio performance and ensure program results can be evaluated program-wide.**

OEO concurs with this recommendation. It will continue to update its existing site visit review checklist. Further, OEO will coordinate with the Office of Field Operations to visit each Intermediary lender and complete a site visit checklist at least annually. OEO in partnership with the Office of Credit Risk Management will provide detailed training (at least annually) to all SBA Field Office staff who will be conducting the site visits. OEO targets having a comprehensive site visit review program in place by the end of FY2018.

3. **Update SOP 52 00A to clarify requirements regarding evidence for use of proceeds and credit elsewhere.**

OEO concurs with this recommendation and has already begun drafting updates to SOP 52 00A. In addition to other updates, the SOP sections covering use of proceeds and performance of the credit elsewhere test will be updated to more closely mirror the language used in the 7(a) program SOP 50 10 5. OEO targets a completion date for updating the SOP by the end of FY2018.

4. **Update the microloan reporting system manual to reflect current technology capabilities.**

OEO concurs with this recommendation. OEO will consult with the Office of Performance and Systems Management (OPSM) to ensure that the MPERS User Manual is updated to reflect current system capabilities. OEO targets a completion date for completing revisions to the MPERS user's manual by the end of FY2018.

Again, thank you for the opportunity to review and comment on the draft report. Please let us know if you need additional information or have any questions regarding our response.