U.S. Small Business Administration

Office of Inspector General

FY 2014 CONGRESSIONAL BUDGET JUSTIFICATION

Overview

In fulfillment of the Inspector General Act, the Small Business Administration (SBA) Office of Inspector General (OIG) provides auditing, investigative, and other services to support and assist SBA in achieving its statutory mission.

The SBA was established to maintain and strengthen the nation's economy by protecting the interests of and assisting small businesses, and by helping families and businesses recover from disasters. While SBA's programs are essential to strengthening America's economy, the Agency faces a number of challenges in carrying out its mission, including fraudulent schemes affecting all SBA programs, significant losses from defaulted loans, procurement flaws that allow large firms to obtain small business awards, excessive improper payments, and outdated legacy information systems. The OIG plays a critical role in addressing these and other challenges by conducting audits to identify wasteful expenditures and program mismanagement, investigating fraud and other wrongdoing, and taking other actions to deter and detect waste, fraud, abuse, and inefficiencies in SBA programs and operations.

Two recent developments in SBA's 7(a) loan guaranty program highlight the need for continued vigilance in the OIG's oversight of the Agency. First, SBA's payments of guaranties on defaulted loans are significantly higher than a baseline of Fiscal Year (FY) 2007—$1 billion in FY 2007 compared to $5 billion in FY 2010, $3.4 billion in FY 2011, and $2.6 billion in FY 2012—although, it is noted these figures are moving in the right direction. While some defaults are likely due, in part, to economic conditions, many OIG audits and investigations of loans that have defaulted early have identified problems with the loan origination, including lender negligence and fraud. Second, as a result of statutory changes in 2010, the size of loans that SBA guarantees has more than doubled—from $2 million to $5 million—thus dramatically expanding the potential exposure to the taxpayer. This exposure, combined with a swollen portfolio and limited Agency oversight, increases the possibility of future losses.

The President's FY 2014 Budget requests $19.4 million for the OIG, plus an additional $1 million to be transferred from the Disaster Loan program, for a total of $20.4 million. These resources are needed by the OIG to continue to provide effective independent oversight of SBA's programs and operations, including the following initiatives to (1) effectively target early defaulted loans for fraud and lender negligence, and (2) meet increased demands placed on OIG investigative personnel.

- <u>Establish a dedicated Early Defaulted Loan Review Group to identify problem loans</u>. When lender negligence is found, this group will recommend non-payment of the guaranty (or recovery if the guaranty is already paid), target the most offending lenders to attain corrective actions, and identify trends for operational improvement by SBA. When suspected fraud is identified, those loans will be investigated. The additional resources will be used to hire auditors, investigators, and analysts and pay for related travel and other expenses.

- <u>Enhance investigative capacity</u>. As discussed below, the OIG handles an average of 250 criminal and civil fraud investigations per year and annually obtains multiple indictments and convictions and recoveries of tens of millions of dollars. However, investigative capacity has been limited by staffing constraints, which have prevented the OIG from initiating or continuing a number of investigations. For instance, over the last three years, the OIG has administratively closed 171 allegations—with potential losses estimated at over $136 million—which may have met prosecutorial thresholds but could not be further investigated due to staffing constraints. Also, over the last three years the OIG proactively identified over 574 suspect loans—with potential losses estimated at over $503 million—that contained characteristics typical of problem loans. Due to staffing constraints, most of these loans could not be further reviewed to identify lender deficiencies or indications of fraud. In comparison, as of September 30, 2012, the OIG had 114 open cases related to SBA financing of small businesses (other than disaster loans) with potential dollar losses of almost $400 million. The President's FY 2014 Budget supports additional investigative support personnel (i.e., non-criminal investigators or financial analysts), which will increase investigative capacity and allow more effective utilization of existing investigative resources in a cost effective manner.

- Enhance the OIG's Hotline operations. During FY 2012, the OIG received 535 complaints through its Hotline. Also during this period:

    - 234 complaints were referred to SBA program offices or other entities;
    - 115 complaints were referred to the OIG's Investigations Division;
    - 106 complaints were reviewed by the Hotline staff;
    - 29 complaints were referred to the OIG Counsel or Auditing Divisions; and
    - 81 complaints needed no action.

  The FY 2014 Budget supports additional staff resources that are needed to expeditiously and effectively analyze incoming complaints for possible referral for investigation or other resolution.

In addition to these initiatives, the funding requested for FY 2014 will enable the OIG to continue to address critical areas and issues, including:

- Working an active caseload of about 250 criminal and civil fraud investigations of potential loan and contracting fraud and other wrongdoing. Many of these investigations involve multiple suspects perpetrating complex fraud schemes. (Continuing the success of the OIG in prosecuting complex, multimillion dollar fraudulent financial schemes, during FY 2012, OIG investigations resulted in 59 indictments, 59 convictions, and over $42 million in civil fraud settlements, asset forfeitures, potential recoveries, fines, and loans/contracts not being approved or being canceled.)

- Conducting audits and reviews of high-risk SBA activities with a focus on systemic, programmatic, and operational vulnerabilities. (During FY 2012, the OIG issued 22 reports with 126 recommendations for improving the Agency's operations, recovering improper payments, and reducing fraud and unnecessary losses in SBA programs.)

- Contracting with an Independent Public Accountant to perform the audit of the SBA's financial statements. (In FY 2014, the financial statement audit is projected to cost $2 million—or 10 percent of the OIG's budget request.)

- Providing oversight and monitoring of the SBA's Information Technology (IT) security and application development activities, including new systems under development and the Agency's compliance with the Federal Information Security Management Act (FISMA). OIG reports have identified systemic problems with SBA's IT systems.

- Performing required background investigations for SBA employees to achieve a high level of integrity in the Agency's workforce and adjudicating SBA employees and contractors for issuance of Personal Identity Verification (PIV) cards pursuant to Homeland Security Presidential Directive 12 (HSPD-12) background investigation requirements.

- Reviewing proposed revisions to SBA regulations, policies, procedures, and other directives with an emphasis on strengthening internal controls to preclude wasteful, confusing, or poorly-planned initiatives.

- Promoting debarments, suspensions, and other administrative enforcement actions to foster integrity in SBA programs. (During FY 2012, the OIG recommended 45 administrative enforcement actions to the Agency.)

- Conducting name checks and, where appropriate, fingerprint checks on program applicants to prevent known criminals and wrongdoers from participating in SBA programs. (During FY 2012, more than $39 million in loans were not approved as a result of the OIG's name check program.)

Budget Request

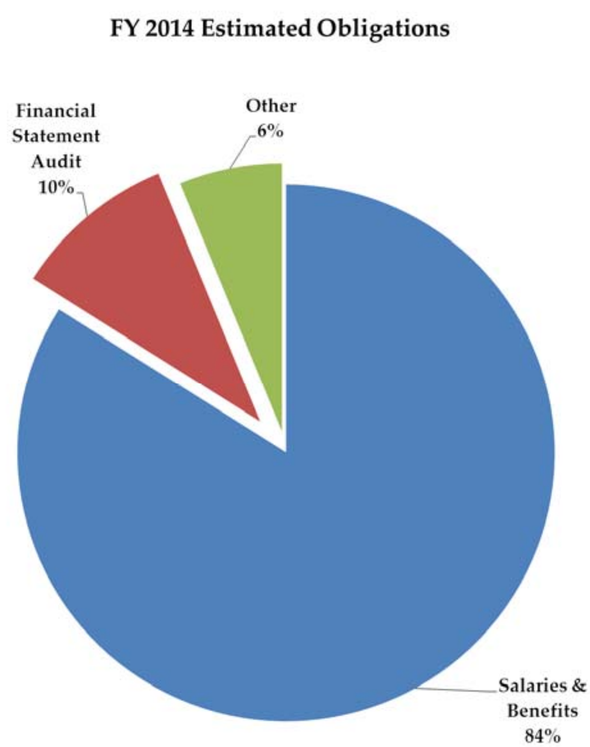
To address the challenges and risks discussed above and in the Critical Risks section below, the President's FY 2014 Budget requests a total of $20.4 million for the OIG—a direct appropriation of $19.4 million and $1.0 million to be transferred from the SBA's Disaster Loan program account for work on disaster program issues.

FY 2014 Budget Request

Dollars in Millions	FY 2012 Actual	FY 2013 Annualized CR Level[1\]	FY 2014 Request	FY 2014 Incr/Decr vs FY 2012
New Budget Authority	$16.3	$16.3	$19.4	$3.1
Transfer from Disaster Loan Program	1.0	1.0	1.0	--
Total[2\]	**$17.3**	**$17.3**	**$20.4**	**$3.1**

1\ The impacts of sequestration and across the board rescission included in the full year FY 2013 continuing resolution are not included in the FY 2013 Annualized CR column.
2\ Amounts do not include funding provided under the Disaster Relief Appropriations Act of 2013.

The majority of the funds requested for FY 2014 will be used for salary and benefits for approximately 112 OIG employees and the annual audit of the Agency's financial statements by an Independent Public Accountant.



Critical Risks Facing the SBA

Within available resources, the OIG must focus on the most significant risks to the SBA and the taxpayer. Some of the critical risks facing the SBA are discussed below. Many of these risks are addressed in the OIG's *Report on the Most Serious Management and Performance Challenges Facing the SBA*, which the OIG issues annually in accordance with the Reports Consolidation Act of 2000.

Risks Due to Limited Oversight and Controls in SBA Lending Programs

The SBA faces a heightened risk of losses and improper payments due to expedited loan processing initiatives and its considerable reliance on outside financial institutions over which the Agency does not always exercise adequate oversight. This trend has been exacerbated by increases in the level of SBA guaranties and loan defaults in recent years. For instance, SBA's payments of guaranties on defaulted loans are significantly higher than a baseline of FY 2007—from $1 billion in FY 2007 to $5 billion in FY 2010, $3.4 billion in FY 2011, and $2.6 billion in FY 2012—although it is noted these figures are moving in the right direction.

The Agency's business loan programs include (1) the Section 7(a) program, in which the SBA guarantees loans to small businesses made by lenders, and (2) the Section 504 program, in which the SBA guarantees repayment of debentures that are sold by Certified Development Companies (CDCs) to investors to create funds for loans to small businesses. The majority of loans made under the 7(a) program are made with little or no review by the SBA prior to loan approval because the Agency has delegated most of the credit decisions to lenders originating these loans.

Audits of early defaulted loans and improper payments have noted a number of lender errors in originating loans. In addition, OIG reviews have detected vulnerabilities in recent changes to the SBA's Standard Operating Procedure for the 7(a) program. These changes include a new provision that allows financing of large amounts of intangible assets, including goodwill, in change-of-ownership transactions where the entire equity injection can be provided in the form of seller take-back financing. The OIG believes that the SBA needs to revise its procedures to reflect additional controls that may be required for the different loan types that may now be guaranteed by SBA given the increased loan amounts. The OIG also has identified Management Challenges relating to the Agency's quality control process at the loan servicing centers and the National Guaranty Purchase Center (NGPC), oversight of lenders and CDCs, oversight of loan agent participation in the 7(a) program, and improper payments under the 7(a) program.

In addition, numerous OIG criminal investigations have identified fraud by borrowers, loan agents, lenders, and other participants in SBA business loan programs. Criminals fraudulently obtain—or induce others to obtain—SBA-guaranteed loans through a variety of techniques, such as submitting fraudulent documents, making fictitious asset claims, manipulating property values, using loan proceeds contrary to the terms of the loans, and failing to disclose debts or prior criminal records. The result is a greater chance of financial loss to the Agency and its lenders.

Adding to these risks, in 2010 the amount of 7(a) loans subject to an SBA guaranty was increased from $2 million to $5 million, and Section 504 loans were increased from $2 million to $5 million for regular projects, and from $4 million to $5.5 million for manufacturing-related projects. These higher loan limits are likely to attract additional attention by criminals and increase the consequences of improper lending decisions.

Through the Disaster Loan program, the SBA makes direct loans to homeowners and businesses harmed by disasters to fund repair or replacement of damaged property and to businesses to provide needed working capital. This program is vulnerable to fraud and unnecessary losses because (1) loan transactions are often expedited in order to provide quick relief to disaster victims; (2) lending personnel hired in connection with a disaster declaration may lack sufficient training or experience; and (3) the volume of loans may overwhelm SBA resources and its ability to exercise careful oversight of lending transactions. OIG reviews of the SBA's loan processing activities have disclosed significant problems in making, disbursing, servicing, and liquidating disaster loans, and OIG investigations have led to numerous convictions of disaster loan borrowers for making fraudulent statements to obtain loans or misusing loan proceeds. In addition, previous OIG audits of the SBA's Disaster Loan program determined that the improper payment rates reported for this program were significantly understated, and the OIG has identified a Management Challenge relating to improper payments in the Disaster Loan program. It is noted, however, that the Agency has developed a corrective action plan which specifically addresses root causes and provides specific remedies that, if properly implemented, should effectively reduce the rate in future years.

Under the Small Business Investment Company (SBIC) program, the SBA licenses and funds venture capital firms that provide financial assistance to small businesses. The SBA is at risk for significant losses in this program due to the deterioration in the economic environment in recent years, the decline in asset values of participating securities, and the increasing amount of debenture obligations made by the Agency. Past OIG investigations have identified fraud by certain SBIC managers and others participating in this program.

Risks Affecting the SBA's Oversight of Contracts for Small and Disadvantaged Businesses

The Small Business Act directs the SBA to promote the award of Federal contracts to small businesses and firms owned by disadvantaged individuals (such as minorities, service-disabled veterans, women, firms from areas of low economic activity, and others). For FY 2011 (the last year for which a final number is available), the SBA reported that small and disadvantaged firms were awarded $91.5 billion government-wide in prime contracting assistance. OIG audits and investigations have identified numerous instances where firms that do not meet the criteria to be either "small" or "disadvantaged" have improperly obtained contracts under these SBA contracting programs. In addition, the Government Accountability Office (GAO) has recently issued a series of reports documenting that ineligible companies had been admitted to these SBA contracting assistance programs and were seeking set-aside contracts. These improprieties have resulted from a variety of factors, including fraud by company managers; excessive control over small or disadvantaged firms by large companies or non-disadvantaged individuals; weak oversight by the SBA and Federal procurement personnel; and regulatory ambiguities and loopholes. The OIG has identified Management Challenges for the SBA to promote integrity in small business contract awards and oversight of the Section 8(a) Business Development program.

Risks Associated with the SBA's Information Security Controls and Other Operations

The SBA's IT systems play a vital role in the management of the Agency's operations and programs, including a loan portfolio in excess of $102 billion. OIG audits and other reviews have identified serious shortcomings in the SBA's information systems and related security controls. Most critical, the SBA's principal data processing and data collection tool for loan servicing, monitoring, and accounting—the Loan Accounting System—uses significantly outdated technology that increases vulnerability and security issues. This outdated technology undercuts the SBA's ability to meet the expanding requirements of new initiatives, such as the Small Business Jobs Act of 2010, and the reporting requirements of the Credit Reform Act. The Loan Management Accounting System (LMAS) is a system development project to move the agency off its legacy mainframe environment to an updated web based environment. While the LMAS project recently moved 44 percent of legacy mainframe data entry to the updated web based environment, which improves security of data entry of SBA transactions, major portions of this project remain to be completed. The SBA must reprogram its mainframe COBOL-based accounting software to run on a web based operating platform, a project that is currently underway. Additionally, OIG reviews have found that the SBA has not fully implemented adequate oversight of its IT systems; has not established an effective process to remediate security vulnerabilities; and has not developed an effective process to upgrade IT capabilities. The OIG has issued Management Challenges recommending corrective action in the SBA's IT security and acquisition processes.

OIG Oversight Activities

Through audits, investigations, and other reviews, the OIG provides independent oversight of critical aspects of the SBA's programs and operations to improve the Agency's efficiency and effectiveness. The OIG prioritizes its activities in response to legislative mandates or requests from sources outside the OIG, or through OIG assessments of the SBA's risks and vulnerabilities. An important aspect of this work is identifying and following up on the SBA's major management and performance challenges, as required by the Reports Consolidation Act. In addition, the OIG increasingly focuses available resources on new legislative and other mandates.

The OIG also supports the SBA's mission by detecting, investigating, and deterring fraud and other wrongdoing in the Agency's programs and operations. OIG activities also help to ensure that SBA employees, loan applicants, and program participants possess a high level of integrity. This is critical to the proper administration of the SBA's programs because it helps ensure that the Agency's resources are utilized by those who deserve and need them the most.

FY 2012 Accomplishments

During FY 2012, the OIG issued 22 reports containing 126 recommendations for improving SBA operations and reducing fraud and unnecessary losses in the Agency's programs. In addition, OIG investigations resulted in 59 indictments and 59 convictions. Overall, the OIG achieved monetary recoveries and savings of over $90 million from recommendations that funds be put to better use agreed to by management, disallowed costs agreed to by management, court ordered and other investigative recoveries and fines, and loans or contracts not made as a result of investigations and name checks. This reflects a significant return-on-investment as compared to the resources that are available for OIG operations.

Following are summaries of some key reports and investigations that demonstrate the complex nature of the OIG's work. It is noted that OIG investigations often involve multiple subjects, large dollar losses, various joint agencies, and substantial restitution and forfeiture monies returned to the Government.

Improving Stewardship through Compliance, Procedures, and Training

In a number of reports issued in FY 2012, the OIG identified instances in which SBA did not comply with laws or established procedures. Other instances included the need for improved processes and additional training. For example:

- In a review of Disaster Loans in liquidation status, the OIG identified that the National Disaster Loan Resolution Center did not transfer all debts delinquent over 180 days to Treasury for cross servicing and offset as required because it had not charged the loans off. This delayed the recovery of $171 million of defaulted loans and could potentially preclude the agency from collecting on some of the loans as the statutes of limitations begin to expire.

- In a review of the SBA's State Trade and Export Promotion (STEP) program, the Office of International Trade awarded a grant in the amount of $1.1 million to a recipient that was ineligible to receive the grant. This resulted in eligible grant recipients receiving a lesser portion of the available funds for the FY 2011 STEP program.

- In another review of the NGPC and early-defaulted loans, the OIG identified instances of purchase errors or deficiencies in guaranty purchase reviews. These instances resulted in approximately $3.3 million in improper payments.

- In a follow-on limited scope audit of the SBA's analysis of repayment ability during guaranty purchase reviews at the NGPC, the OIG found that that the assessment of delegated lender underwriting performed on early-defaulted loans was not effective in identifying whether lenders were clearly negligent in determining the borrowers' repayment ability. As a result, the NGPC made improper payments by inappropriately purchasing the SBA guaranties on early-defaulted loans that did not have repayment ability, which resulted in unnecessary losses to the Agency. Based on previous audit work, the OIG's analysis indicated that improved reviews for repayment ability could result in a cost savings to the SBA of at least $43 million over the next two years.

For these four reports, the OIG recommended that that the SBA take specific corrective action to transfer debts, terminate the grant that should not have been made, and develop a specialized early-default purchase review process. The OIG also recommended that the SBA update established procedures and provide appropriate training in an effort to ensure compliance and reduce the risk to the Agency of future monetary loss and questioned costs. (OIG Reports 12-18, 12-14, 12-12, and 12-11R)

Preventing and Reducing Improper Payments

The SBA's efforts to prevent and reduce improper payments for 7(a) loan approvals, 7(a) loan purchases, Section 504 loans and disbursements for its contacting activities were the focus of two OIG audits. The OIG found that the SBA reported $41 million in improper payments for 7(a) loan purchases, whereas the OIG's independent statistical sample disclosed that there were a least $232 million in improper payments for 7(a) loan purchases. In addition, despite finding an improper payment rate for contracting activities that approached 89 percent, SBA did not provide the required payment disbursement details in the Annual Financial Report (AFR), and did not determine the root cause for the improper payments or develop either a corrective action plan or a payment recapture plan. The OIG made recommendations focused on improving the completeness and accuracy of reported information, identifying root causes, and improving corrective action plans. (OIG Reports 12-10 and 12-07)

Improving Systemic Reporting and Data Control Weaknesses

In a review of the SBA's controls and oversight over certain information technology systems and processes, the OIG identified systemic reporting issues and data control weaknesses. These deficiencies resulted in an estimated $956 million overstatement of unpaid loan balances with an estimated $5.2 million effect on program subsidy. In addition to recommending that the SBA take action to correct the overstatement and collect outstanding late penalty fees, the OIG recommended that the SBA adhere to quality standards for systems development projects and ensure that systems are authorized to operate prior to being put into production. (OIG Report 12-08)

Major Bribery Case Involves Over $2 Billion in Government Contracts

As of September 30, 2012, a total of 12 individuals, including two former program managers from the Army Corps of Engineers, had pled guilty to federal charges for their roles in one of the most brazen corruption schemes in the history of federal contracting. This is a multi-agency investigation into a scheme allegedly involving more than $30 million in bribes and kickback payments, the use of a $1.3 billion Alaska Native Corporation (ANC) sole source contract to pay for the bribes, and the planned steering of a $780 million government contract to a favored Section 8(a) program participant. Another individual has been charged with various crimes involving bribery, conspiracy to commit bank fraud, and willful failure to file a tax return. In the overall investigation, as of September 30, 2012, the United States has seized for forfeiture or recovered approximately $7.5 million in bank account funds, cash, and repayments, 19 real properties, six luxury cars, and multiple pieces of fine jewelry. This is a joint investigation with the Federal Bureau of Investigation (FBI), the Internal Revenue Service Criminal Investigations (IRS CI), the U.S. Army Criminal Investigation Division (CID), and the Defense Criminal Investigative Service (DCIS). The investigation is ongoing.

Investigation Uncovers More Federal Contract Fraud

In a matter related to the above bribery case, the executive vice president of an information technology firm pled guilty to conspiracy to commit wire fraud and was sentenced to 15 months in prison. The investigation revealed that he conspired with the executive vice president of a second technology firm, employees and representatives of his own firm, and others to defraud the U.S. Government by submitting false information to procure and set prices on federal contracts. In addition, the executive vice president of the second firm was indicted for conspiracy, making false statements, mail fraud, and wire fraud. According to the investigation, he allegedly conspired with employees and representatives of his company and others to defraud the U.S. Government by submitting false information to the SBA for the purposes of (1) securing a federal contract in which a competitor protested his firm's service-disabled veteran-owned self-certification and (2) obtaining Historically Underutilized Business Zone (HUBZone) status. He also allegedly misled other federal agencies in an attempt to procure and set prices on federal contracts. This is a joint investigation with the FBI, IRS CI, U.S. Army CID, DCIS, U.S. Department of Labor OIG, General Services Administration (GSA) OIG, and Department of Veterans Affairs (VA) OIG.

Firm Seeks Contracting Preferences by Falsifying Eligibility

Two Florida men were each sentenced to 36 months in prison, 36 months supervised release, and 500 hours of community service. The court also ordered them to forfeit over $10.9 million, the proceeds of their criminal conduct. The two men were previously convicted of conspiracy and wire fraud. The investigation disclosed that the men created a company for obtaining a $100 million small business set-aside language instruction contract with the Department of Defense (DoD). They used a nominee owner to create the appearance that this company was not affiliated with another business that they controlled and that had been the incumbent contractor on the previous DoD language instruction contract. The men submitted false and misleading information about the two companies' relationship after the affiliation was challenged during a size protest submitted to the SBA Office of Government Contracting. This is a joint investigation with the DCIS.

Loan Agents' Fraudulent Activity Leads to Losses of $52 Million in the 7(a) Program

As of September 30, 2012, a Maryland investment firm and six individuals had been indicted for their involvement in a scheme to fraudulently obtain SBA-guaranteed business loans, which had resulted in losses of over $52 million. Four of the individuals pled guilty. One of the four was sentenced to 33 months in prison, 24 months of probation, $715,000 in restitution, and was ordered to forfeit $1.3 million. The investigation revealed that the investment firm specialized in securing loans for individuals interested in purchasing or refinancing small businesses in the Mid-Atlantic area. The scheme involved encouraging prospective borrowers to apply for Section 7(a) business loans through the firm. The firm's owners would then submit SBA loan applications and supporting documentation allegedly containing fraudulent personal financial statements, bank statements, tax documents, and other financial documents to loan originators and underwriters on their clients' behalf, thereby falsely enhancing the creditworthiness of the borrowers and their businesses. This is a joint investigation with the FBI and United States Postal Inspection Service (USPIS).

False Equity Injection Places Business Loan Programs at Risk

A Texas loan broker was sentenced to 36 months in prison, 36 months supervised release, and restitution of nearly $8.6 million for her role in a conspiracy to commit bank fraud. She worked directly with 200 borrowers by instructing them on how to prepare their loan paperwork and by obtaining the necessary financial records from them. On 45 loan packages, she represented to various financial institutions that the borrowers had made their required cash injections when they had not. She also instructed the borrowers to write checks to her company in the amounts of their required equity injections. The broker then photocopied and returned the checks to the borrowers and presented the copies at the closings as having been paid. Both she and the borrowers knew the checks would not be cashed, and in most cases, the borrowers did not have the funds in their accounts. For each loan closed, the broker would receive one to three percent of the loan value. The OIG conducted this investigation jointly with the FBI.

Additional information on the OIG's accomplishments during FY 2012 are provided in the Statistical Highlights section of this document and in the OIG's *Spring 2012 and Fall 2012 Semiannual Reports to Congress*.

FY 2014 Planned Performance

During FY 2014, in addition to conducting audits and reviews that are required by statutes and other directives, the OIG will continue to focus on the most critical risks facing the SBA. Several areas of emphasis are discussed below.

Financial Assistance

Over the last several years, losses in the SBA's loan programs have increased substantially. Some of the increases in SBA losses correlate to similar root causes seen in the mortgage industry, such as limited SBA oversight of lenders and loan agents, poor lender loan processing, unscrupulous borrowers, and complicit brokers and lenders. The SBA paid guaranty claims of $6 billion over the last two years.

The funding requested for FY 2014 will be used by the OIG to more effectively address the growing financial losses in SBA lending due to lender errors and various fraud schemes. The OIG will utilize an Early Defaulted Loan Review Group to perform in-depth analyses of loans that default within 18 months of final disbursement. From this, the OIG will either make recommendations for loan guaranty recoveries, or if fraud is apparent, conduct criminal investigations to refer suspected fraud for prosecution. The OIG will also assess trends of lending problems.

The OIG will also continue its national initiative to detect fraud committed by loan agents, such as packagers and brokers. A loan agent is sometimes hired by an applicant or lender to assist the applicant in obtaining an SBA loan. Although honest loan agents help small businesses gain access to capital, some dishonest ones have perpetrated fraudulent schemes involving tens of millions of dollars in loans. These fraudulent loans often default for non-payment, and the SBA is forced to use taxpayer funds to purchase the guaranteed portions of the loans. In a recent case, an OIG investigation led to the indictment of three loan brokers and their company for conspiring to provide false information to SBA in order to obtain SBA loans. This is a complex loan fraud scheme involving over 51 loans valued at $37 million. Over the past decade, the OIG has obtained convictions and guilty pleas on numerous cases involving loan agent fraud on SBA-guaranteed loans, totaling in excess of $358 million.

The OIG has recently initiated a review of the examination process for the SBIC program. In addition, the OIG will continue to conduct audits of business loans that default quickly because past work has shown that such loans were not always properly originated and that effective controls and procedures were not in place to prevent improper payments. Future OIG efforts will focus on: (1) SBA's loan origination process to determine its compliance and effectiveness; (2) SBA quality control programs to determine the extent to which programs are mitigating the risk of loss; (3) SBA's management of certain loan programs; and (4) the reliability of data in the Agency's Loan Accounting System.

Government Contracting and Business Development

The SBA directs significant efforts toward helping small businesses obtain Federal contracts and providing other business development assistance. The SBA's Office of Government Contracting and Business Development is tasked with helping small businesses obtain Federal contracting opportunities and helping small, disadvantaged, and women-owned businesses build their potential to compete more successfully in a global economy. During FY 2014, the OIG will focus on the SBA's oversight of and current issues affecting Government Contracting and Business Development programs, including investigating allegations that ineligible companies are fraudulently benefitting from these programs (as of September 30, 2012, the OIG had 62 open government contracting cases, with potential dollar losses of over $1.5 billion based on the total dollar value of the contracts). The funding requested for FY 2014 will allow the OIG to continue investigating fraudulent schemes that take improper advantage of SBA's contracting assistance programs.

The OIG has in the past year received a significant increase in the number of qui tam False Claims Act suits that have been filed by private sector parties alleging fraud in SBA government contracting programs. In light of increases in qui tam claims that the government has experienced over the past several years, the OIG expects the volume of this work to increase. This will require expenditure of additional resources to investigate these allegations.

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

- There has been a high level of congressional interest in small businesses receiving a greater share of Federal contracts. The OIG will continue to assess whether the SBA is taking adequate steps to ensure the integrity of small business contracting, with an emphasis on issues such as the accuracy of reporting small business contract activity, large businesses being classified as small businesses, adherence to regulations to protect small businesses, training of government contracting personnel, deterring fraudulent acquisition of government contracts, and bundling of contracts.

- The Section 8(a) Business Development program continues to be susceptible to major vulnerabilities. These include limited program oversight; inequitable distribution of contracting opportunities among participants; a lack of reasonable, measurable, consistent, and mandatory criteria pertaining to economic disadvantage; a lack of implemented criteria defining business success for purposes of program graduation; and misrepresentation by companies as small, minority-owned, or disadvantaged businesses to gain an unfair advantage in the Federal marketplace. The OIG will continue to review these issues and the SBA's management of the Section 8(a) program.

- The HUBZone program provides Federal contracting assistance to small businesses located in economically distressed areas with the intent of stimulating economic development. The Service-Disabled Veteran-Owned Small Business (SDVOSB) program provides more opportunities in Federal contracting for disabled veterans who own small businesses. The GAO has identified significant control weaknesses in these programs that have allowed ineligible firms to receive millions of dollars in contracts. The OIG will examine the SBA's claim that it has implemented a more rigorous HUBZone certification process in the hopes of preventing ineligible firms from achieving certification. In addition, the OIG plans to review the HUBZone decertification process once the SBA completes its reengineering of this process. The OIG also will continue to pursue prosecution, civil fraud recovery, and debarment of contractors who improperly obtain HUBZone, SDVOSB, and other preferential contracts.

Financial Management and Information Technology

The OIG will continue to oversee the audits of the SBA's financial statements, as well as FISMA and Federal Information Systems Controls Audit Manual (FISCAM) reviews, which are conducted by an Independent Public Accountant under a contract with the OIG. The OIG also will continue its review of the SBA's compliance with the Improper Payments Elimination and Recovery Act. The OIG anticipates that the scope of financial statement audits will continue to expand as a result of growing direct and guaranteed loan portfolios. The OIG plans to review SBA's actions to implement the requirements of the GPRA Modernization Act of 2010. The review will survey the sources and use of performance information in program decision-making and evaluate the effectiveness of corrective actions deployed to address long standing challenges, needs, and problems.

The OIG also will continue to monitor systems development activities related to improvements to the SBA's Loan Management and Accounting System, a system that is critical to SBA's ability to administer its loan portfolio, which in FY 2012 totaled over $102 billion. OIG efforts will include determining whether adequate System Development Lifecycle Controls are in place as the SBA endeavors to move its batch COBOL systems from the mainframe to a new hosting environment. As threats to disrupt cyber-based systems continue to escalate, the Agency must take steps to improve controls to prevent outages and loss of sensitive data and to ensure the continuity of mission critical operating systems. The OIG will conduct audits to assess the security of the SBA's computer operating system, network, and hosted applications by performing assurance reviews. The OIG also will review the sufficiency of SBA resources used to manage computer security, maintain systems, provide technical support, and administer security training.

Disaster Assistance

OIG audits will continue to focus on loan origination, disbursement, repayment, servicing, and liquidation activities related to disaster loans. Such audits may assess whether the SBA processed homeowner and business loan applications in accordance with the Agency's procedures, verified uses of loan proceeds before loans were fully disbursed, and appropriately identified duplicate benefits. Future efforts will focus on the loss verification process, and analyzing, through cross cutting projects, whether there are redundancies among agencies providing various forms of assistance to disaster victims. Such efforts would focus on determining whether there is potential to reduce costs across agencies while streamlining and consolidating processes for disaster victims. The OIG also will continue to investigate allegations of unauthorized use of loan proceeds; overstatement of financial losses; material false statements in the application process; false/counterfeit supporting documentation; and false assertions regarding primary residency in affected areas at the times of the disasters. As of September 30, 2012, the OIG had 26 open cases involving disaster loans with potential dollar losses of over $12.8 million.

In response to the increase in fraud following Hurricanes Katrina, Wilma, and Rita, the OIG and other law enforcement organizations established the National Center for Disaster Fraud. From FY 2006 through FY 2012, the OIG, in conjunction with other law enforcement agencies, has produced 86 arrests, 95 indictments, and 91 convictions related to wrongdoing in SBA's Disaster Loan program for these three hurricanes. Investigations for these disasters— to date— have resulted in over $6.6 million in court-ordered restitution and related recoveries, as well as the denial of nearly $4.5 million in loans to potentially fraudulent borrowers. In addition, the OIG has investigated fraud related to 2008 Hurricanes Ike and Gustav.

Agency Management Challenges

As required by the Reports Consolidation Act, the OIG annually develops the *Report on the Most Serious Management and Performance Challenges Facing the SBA*. The Management Challenges focus on areas that are particularly vulnerable to fraud, waste, error, and mismanagement, or otherwise pose a significant risk and generally have been the subject of one or more OIG or GAO reports. The OIG will continue to identify serious Management Challenges facing the SBA and will work throughout the year with Agency management to resolve identified issues as quickly and efficiently as possible.

Security Operations

The OIG's Office of Security Operations will continue processing name checks and, where appropriate, fingerprint checks to ensure that applicants meet certain character standards before participating in programs involving business loans, disaster assistance loans, Section 8(a) certifications, surety bond guarantees, SBICs, and CDCs. As a result of OIG referrals during FY 2012, SBA business loan program managers declined 54 applications totaling over $37.2 million, and disaster loan program officials declined 26 applications totaling over $2.1 million, due to character issues of loan applicants. In addition, the Section 8(a) program declined 31 applications for admission. Over $300 million in loans have been declined during the last 10 years due to character problems identified by the OIG, thereby making credit and SBA assistance available to other applicants with no such issues. The OIG will also perform required background investigations for covered SBA employees and adjudicate SBA employees/contractors for issuance of PIV cards pursuant to HSPD-12 background investigation requirements. During FY 2012, the OIG initiated 333 background investigations and issued 49 security clearances for SBA employees and contractors.

Review of Proposed Regulations and Initiatives

As part of the OIG's proactive efforts to promote accountability and integrity and reduce inefficiencies in SBA programs and operations, the OIG reviews changes that SBA is proposing to make to its program directives such as regulations, internal operating procedures, policy notices, and SBA forms that are completed by the public. Frequently, the OIG identifies material weaknesses in these proposals and works with the Agency to implement recommended revisions to promote controls that are more effective and deter waste, fraud, or abuse. During FY 2012, the OIG reviewed 136 proposed revisions of program management or SBA reorganization documents and submitted comments on 79 of these initiatives.

Debarment and Administrative Enforcement Actions

As a complement to the OIG's criminal and civil fraud investigations, the OIG continually promotes the use of suspensions, debarments, and other administrative enforcement actions as a means to protect taxpayer funds from those who have engaged in fraud or otherwise exhibited a lack of business integrity. The OIG regularly identifies individuals and organizations for debarment and other enforcement actions and submits detailed recommendations with supporting evidence to the responsible SBA officials. During FY 2012, the OIG sent 45 suspension and debarment referrals to SBA. Most OIG administrative referrals involve the abuse of SBA's loan and preferential contracting programs. When appropriate, the OIG recommends that the SBA suspend the subject of an ongoing OIG investigation given program risk presented by the continued participation of those individuals and entities.

Fraud Awareness Briefings

The OIG will continue to conduct briefings on topics related to fraud in government lending and contracting programs. During FY 2012, the OIG provided 24 fraud awareness presentations for more than 1,100 attendees, including SBA and other Government employees, lending officials, and law enforcement representatives. Topics included types of fraud; fraud indicators and trends; and how to report suspicious activity that may be fraudulent.

Statistical Highlights

Office-Wide Accomplishments

During FY 2012, the OIG's efforts resulted in over $90 million in savings, cost avoidances, and potential recoveries and fines.

Office-Wide Dollar Accomplishments

As a Result of Investigations & Related Activities:	
– Potential Investigative Recoveries & Fines	$26,245,428
–Asset Forfeitures Attributed to OIG Investigations	$16,086,069
–Loans/Contracts Not Approved or Canceled as a Result of Investigations	$32,844
–Loans Not Made as a Result of Name Checks	$39,424,884
Investigations Sub-Total	**$81,789,225**
As a Result of Audit Activities:	
–Disallowed Costs Agreed to by Management	$4,774,425
–Recommendations that Funds Be Put to Better Use Agreed to by Management	$4,020,000
Audit Sub-Total	**$8,794,425**
TOTAL	**$90,583,650**

Efficiency and Effectiveness of SBA Programs

During FY 2012, the OIG issued 22 reports with significant recommendations for improving Agency operations, reducing fraud and unnecessary losses, and recovering funds.

Efficiency and Effectiveness Activities Related to Audit, Other Reports, and Follow-Up Activities

Reports Issued	22
Recommendations Issued	126
Dollar Value of Costs Questioned	$172,137,969
Dollar Value of Recommendations that Funds be Put to Better Use	$50,700,000
Recommendations for which Management Decisions Were Made	113
Recommendations Without a Management Decision	95
Collections as a Result of Questioned Costs	$4,309,407

Fraud Detection and Deterrence in SBA Programs

The OIG conducts criminal, civil, and administrative investigations in a nationwide program to prevent and detect illegal and/or improper activities involving SBA programs, operations, and personnel. OIG special agents utilize a full range of investigative techniques including arrest warrants, search warrants, and electronic monitoring. The OIG also performs a deterrent function through educational outreach to lenders and employees.

Indictments, Convictions, and Case Actions

Indictments from OIG Cases	59
Convictions from OIG Cases	59
Cases Opened	65
Cases Closed	89

SBA Personnel Actions Taken as a Result of Investigation

Dismissals	1
Resignations/Retirements	2
Suspensions	2
Reprimands	0
Other	0

Legal Reviews and Debarment and Suspension Actions*

Legislation, Regulations, Standard Operating Procedures, and Other Issuances Reviewed	136
Suspensions and/or Debarments Recommended to the Agency	45
—Pending at the Agency as of 9/30/12**	30
Suspensions Issued by the Agency	17
Proposed Debarments Issued by the Agency	21
Final Debarments Issued by the Agency	14
Proposed Debarments Declined by the Agency	0
Actions by Other Agencies Resulting from Investigations in which the OIG Participated	35

*These include policy notices, procedural notices, Administrator's action memoranda, and other Agency initiatives, which frequently involve the implementation of new programs or policies.
**The SBA had initiated administrative proceedings in 14 of the 30 pending cases.

Reporting Requirements Under the Inspector General Reform Act of 2008

The following information is provided in accordance with the Inspector General Reform Act of 2008, as amended (P.L. 110-409.)

Dollars in Millions	**FY 2012 Actual**	**FY 2013 Annualized CR Level[1\]**	**FY 2014 Initial Agency Submission**	**FY 2014 President's Budget**
New Budget Authority	$16.3	$16.3	$19.4	$19.4
Transfer from Disaster Loan Program Account	1.0	1.0	1.0	1.0
Total[2\]	**$17.3**	**$17.3**	**$20.4**	**$20.4**

1\ The impacts of sequestration and across the board rescission included in the full year FY 2013 continuing resolution are not included in the FY 2013 Annualized CR column.
2\ Amounts do not include funding provided under the Disaster Relief Appropriations Act of 2013.

The OIG's FY 2014 budget request includes $115,000 for training, which is sufficient to satisfy all training needs for the fiscal year, and $58,000 for the operation of the Council of Inspectors General on Integrity and Efficiency.

OIG Organizational Structure

The OIG is comprised of the immediate office of the Inspector General and four divisions: Auditing, Investigations, Counsel, and Management and Policy.

The **Auditing Division** performs and oversees audits and reviews to promote the economical, efficient, and effective administration of SBA programs and operations. Key areas of emphasis are SBA's loan programs, disaster assistance, business development and government contracting programs, as well as mandatory and other statutory audit requirements involving computer security, financial reporting, and other work. The balance of the engagements is discretionary and focuses on high-risk activities and management issues facing the SBA.

The **Investigations Division** manages a program to detect and deter illegal and improper activities involving SBA programs, operations, and personnel. The criminal investigations staff carries out a full range of traditional law enforcement functions. The security operations staff ensures that SBA employees and contractors have appropriate background investigations and security clearances to achieve a high level of integrity in the Agency's workforce, and that loan applicants and other potential program participants are of good character.

The **Counsel Division** provides legal and ethics advice to all OIG components; represents the OIG in litigation arising out of or affecting OIG operations; assists with the prosecution of criminal, civil, and administrative enforcement matters; processes subpoenas; responds to Freedom of Information and Privacy Act requests; and reviews and comments on proposed policies, regulations, legislation, and procedures.

The **Management and Policy Division** provides business support (e.g., budget and financial management, human resources, IT, and procurement) for the various OIG functions; coordinates preparation of the OIG's *Semiannual Report to Congress* and other OIG-wide reports and documents; maintains the OIG website; and operates the OIG's Hotline.

An organizational chart for the OIG is provided on the next page.

Small Business Administration
Office of Inspector General