

Congress of the United States
U.S. House of Representatives
Committee on Small Business
2361 Rayburn House Office Building
Washington, DC 20515-6315

Memorandum

To: Members, Committee on Small Business
From: Committee Staff
Date: September 8, 2014
Re: Hearing: "Small Business Administration: Management and Outlook"

At 1:00 p.m. in Room 2360 of the Rayburn House Office Building, the Committee on Small Business will meet for the purpose of examining the ability of the United States Small Business Administration (SBA) to meet its statutory obligations, now under the leadership of recently confirmed Administrator Maria Contreras-Sweet. This will be Administrator Contreras-Sweet first appearance before the Committee. The enclosed memorandum¹ is designed to provide snapshots of the performance of the various programs offered by the SBA as well as discuss certain management issues that if resolved, could enhance the effectiveness of such programs while reducing risk to the taxpayer.²

I. The SBA Budget and Agency Management

A. FY 2015 Budget Request

For Fiscal Year 2015, the SBA asked for \$710 million, a decrease of nearly \$100 million from its FY 2014 request, and \$60 million less than current operating levels.³ Salaries and expenses make up the largest single line item from the FY 2015 request at \$256 million; by comparison, administration of the business loan and entrepreneurial development programs

¹ For a complete description of the SBA's capital access, contracting, and entrepreneurial development programs, one should turn to the Committee's memorandum for an April 2013 hearing on the budget outlook for the agency, available at http://smallbusiness.house.gov/uploadedfiles/revised_hearing_memo_4-24-2013.pdf.

² The data in this memorandum are obtained from various SBA financial reports and budget justification documents filed with the Committee on an annual basis. For the sake of brevity (being the soul of wit according to Polonius), the memorandum omits citations to these documents. Should any Member or staffer wish to identify the specific source of data, please contact the Committee.

³ This is largely due to a decrease from the FY 2014 budget request for subsidies to cover the cost of SBA loan programs.

tallies \$147 million and \$197 million respectively. Although the SBA's budget has gone down, that does not debar the possibility of improving agency management and overall operations.

B. Issues with Agency Management and Operations

In the face of the agency's planned January 2015 roll out of SBA One, designed to be a single portal for eligibility, underwriting, closing, loan modification and servicing where borrowers and lenders can upload documents,⁴ the information technology needed to manage the SBA's guaranteed loan portfolio is outdated. A system to provide updated information on its loan portfolio (including its then extant loan management accounting system or LMAS) was required by 1997; that system has yet to be developed. Moreover, both the SBA Office of Inspector General (OIG) and the Government Accountability Office (GAO) found that the SBA's current LMAS constituted a significant agency vulnerability. Despite starting the revamp process in 2005, the SBA has yet to complete even the first task in this modernization; migration of the software off a proprietary system. The SBA individual in charge of the modernization stated to Committee staff that the migration would be completed by January 1, 2012. Yet the only mention of the LMAS in the SBA's most recent budget justification is that it completed a quality assurance review on investments and projects associated with the project.⁵ It is unclear why the SBA would move forward with its planned SBA One while not having updated the technology critical to the basic functionality of its core loan programs. Nor has the SBA explained the process by which the SBA One platform would integrate, if at all, with its LMAS. This is emblematic of any agency that jumps headfirst into various technology projects without appropriate planning as GAO found in a study requested by Chairman Graves and in subsequent reviews by the Inspector General.⁶

While poor management of information technology is not solely a problem for the SBA within the federal government, its personnel management allocation and practices appear to be unique to the agency. For nearly two decades, the SBA has ranked as one of the worst places to

⁴ <http://www.sba.gov/content/entrepreneurial-equality-new-tools-more-inclusive-sba>.

⁵ SBA, FY 2015 CONGRESSIONAL BUDGET JUSTIFICATION AND FY 2013 ANNUAL PERFORMANCE REPORT 105 (2014) [hereinafter FY 2015 Budget Justification], available at [http://www.sba.gov/sites/default/files/files/FY%202015%20CBJ%20FY%202013%20APR%20FINAL%20508\(1\).pdf](http://www.sba.gov/sites/default/files/files/FY%202015%20CBJ%20FY%202013%20APR%20FINAL%20508(1).pdf).

⁶ GAO, SBA NEEDS TO STRENGTHEN OVERSIGHT OF ITS LOAN MANAGEMENT AND ACCOUNTING SYSTEM MODERNIZATION (January 2012) (GAO-12-295). In December 2013 the OIG released a report showing the SBA did not adequately manage IT hardware and software contracts awarded to iTechnologies in accordance with 8(a) program policies and requirements. OIG, THE SBA MISMANAGED CERTAIN 8(A) INFORMATION TECHNOLOGY CONTRACTS (December 2013), available at [http://www.sba.gov/sites/default/files/oig/Report%2013-08%20SBA%20Mismanaged%20Certain%208\(a\)%20Information%20Technology%20Contracts.pdf](http://www.sba.gov/sites/default/files/oig/Report%2013-08%20SBA%20Mismanaged%20Certain%208(a)%20Information%20Technology%20Contracts.pdf). In February 2012 the OIG found in an audit of SBA's Fiscal Transfer Agent controls over the loan reporting and servicing process that the agency did not adequately address systemic data control weaknesses; provide adequate oversight of the First Mortgage Loan Pooling System development; ensure that an outside technology provider's operation of SBA systems met minimum federal security requirements; and adequately enforce collection of secondary market late penalty fees. OIG, SBA'S LENDER LOAN REPORTING PROCESS HAS SYSTEMIC REPORTING ISSUES AND DATA CONTROL WEAKNESSES (February 2012), available at <http://www.sba.gov/sites/default/files/oig/Audit%2012-08%20Loan%20Reporting%20Process%20Systemic%20Reporting%20Issues%20and%20Data%20Control%20Weaknesses%20redacted.pdf>.

work in the federal government.⁷ However, the immediate declarations by Administrator Contreras-Sweet relate to increasing the number of entrepreneurial development programs and modifying the operation of its lending portfolio for smaller loans. While such initiatives may be admirable (although as this memorandum will detail, there are concerns about these pronouncements), the failure to even address the workforce problems at the SBA is problematic since an agency's ability to meet the obligations delegated to it by Congress are first and foremost carried out by agency personnel.

Not only are there problems related to the overall workforce, it is unclear whether those individuals are properly positioned to maximize assistance to America's small business owners. For instance, the agency's ten regional offices are fully staffed⁸ yet most of the offices' functions are not managed by the staff there, but directly by SBA headquarters. Of the SBA's roughly 2,200 employees, not including those involved in the disaster loan program,⁹ 600 are based in the nation's capital, with the remaining approximately 1,600 around the nation, interacting with and assisting small businesses.¹⁰ When considering the fact that there are about 28 million small businesses around the nation, it seems odd that nearly 30 percent of the SBA's workforce is based not around the country but at agency headquarters in Washington, DC.

II. Capital Access Programs

A. Recent Statistics

Annual levels of lending and subsidy amounts required to operate SBA's core financing programs are listed below.

7(a) Loan Program

Fiscal Year	2010	2011	2012	2013	2014
7(a) Lending (in millions of \$)	\$ 12,407	\$ 19,638	\$ 15,153	\$ 17,868	\$ 16,979
7(a) Subsidies (in millions of \$)	\$ 10	\$ 90	\$ 139	\$ 270	\$ 0

Certified Development Company (CDC)/504 Loan Program

⁷ In each of the last ten annual rankings of the best places to work in the Federal Government issued by the Partnership for Public Service, the SBA has ranked in the bottom tier, if not at or near the bottom, of all midsize agencies. <http://bestplacetowork.org/BPTW/rankings/detail/SB00#scores>.

⁸ These federal regions have regional administrators, regional communications officials, and concomitant support staff. COMMITTEE ON SMALL BUSINESS, 113TH CONG., 2ND SESS., VIEWS AND ESTIMATES OF THE COMMITTEE ON SMALL BUSINESS ON MATTERS TO BE SET FORTH IN THE CONCURRENT RESOLUTION ON THE BUDGET FOR FISCAL YEAR 2015 16 (2014), [hereinafter FY 2015 Views and Estimates], available at http://smallbusiness.house.gov/uploadedfiles/3-25-2014_revised_budget_views_and_estimates_fy_2015_v2.pdf.

⁹ UNITED STATES SMALL BUSINESS ADMINISTRATION, AGENCY FINANCIAL REPORT, FISCAL YEAR 2013, at 22 (2013), available at

<http://www.sba.gov/sites/default/files/files/FY%202013%20AFR%20from%20CV%20Dec%2016.pdf>.

¹⁰ FY 2015 Views and Estimates, *supra* note 8, at 17.

Fiscal Year	2010	2011	2012	2013	2014
504/CDC Lending (in millions of \$)	\$ 4,433	\$ 4,845	\$ 6,712	\$ 5,227	\$ 3,654
504/CDC Subsidies (in millions of \$)	\$ -	\$ -	\$ 67	\$ 105	\$ 107

Microloan Program

Fiscal Year	2010	2011	2012	2013	2014
Microloan Lending (in millions of \$)	\$ 47	\$ 47	\$ 45	\$ 53	n/a
Microloan Subsidies (in millions of \$)	\$ 3	\$ 5	\$ 4	\$ 7	\$ 5

Small Business Investment Company (SBIC) Debenture Program

Fiscal Year	2010	2011	2012	2013	2014
SBIC Debenture Capital to Small Businesses (in millions of \$)	\$ 1,587	\$ 2,589	\$ 2,950	\$ 3,256	\$ 4,123
SBIC Debenture Subsidies (in millions of \$)	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0

B. Issues with Program Management

Prudent management of the capital access programs is necessary to ensure that the agency can provide maximum assistance to small businesses while reducing the risk to the taxpayer. Decisions by SBA management call into question the agency's capacity to meet the needs of small businesses while protecting the federal fisc. The matters discussed herein are in addition to those already addressed concerning the LMAS.

In addition to regulations,¹¹ SBA issues standard operating procedures (SOPs) that provide specific, step-by-step guidance to program participants on how to comply with program requirements.¹² The SBA does not treat these SOPs as regulations despite the fact that outside parties are affected and must comply with these SOPs. As a result, the SBA need not (and often does not) obtain public input through the notice and comment procedures mandated by the Administrative Procedure Act (APA) and the SBA's own rules. Since the purpose of notice and comment is to obtain input from the public in order to educate the agency on the effect of their proposed rules,¹³ the SBA's reliance on SOPs for making policy undermines their ability to learn

¹¹ The Small Business Act and the Small Business Investment Act of 1958 provides SBA's Administrator with the authority to promulgate rules and regulations to carry out its statutory authority. Most of the rules issued by the SBA would be exempt from the public participating requirements mandated by the Administrative Procedure Act (APA) for the promulgation of rules. However, the SBA has waived this exemption, 13 C.F.R. § 101.108, and thus must comply with the notice and comment requirements of the APA. *FCC v. Fox Television Stations, Inc.*, 556 U.S. 502, 515 (2009) (noting that agencies cannot ignore their own rules).

¹² <http://www.sba.gov/about-sba-services/7481>.

¹³ See, e.g., *North Carolina Growers Ass'n v. United Farm Workers*, 702 F.3d 755,764 (4th Cir. 2012); *Prometheus Radio Project v. FCC*, 652 F.3d 431,449 (3d Cir. 2011), cert. denied sub. nom., *Tribune Co., v. FCC*, 133 S. Ct. 64 (2012); *International Union, United Mine Workers of America v. Mine Safety and Health Administration*, 407 F.3d 1250, 1259 (D.C. Cir. 2005).

from the affected public thereby almost nullifying the agency's own decision to seek notice and comment for their regulatory issuances. The lack of transparency potentially undermines the SBA's ability to convince their lending partners of the value of changes to the operation of the capital access programs.

The regulation by SOP is bad enough. It is made worse when the agency does not promptly update those SOPs to take account of new statutory mandates or changes in agency procedures. For example, the SBA issues licenses to SBICs. However, the procedures formally adopted by the SBA in a SOP were promulgated in 1984 and the agency has never updated those procedures (despite the fact that an entirely new type of SBIC was created almost a decade after the 1984 SOP was issued). In fact, the SBA does not even follow the 1984 SOP which means that the procedures for issuing a license are ad hoc and subject to the whims of agency personnel – something the APA was enacted to prevent.¹⁴ For instance, perhaps in part because of the lack of clear guidelines, the time it takes the agency to license new SBIC applicants has increased significantly this fiscal year, despite the number of applications received by the agency thus far being half of the number received in previous years.¹⁵ If the SBA was created to provide capital for small businesses and protect the federal taxpayer from unwise allocations of capital, the SOP process (or non-process as the case may be), fails to accomplish these goals.

The ability of the agency to mitigate internal risk in the management of its loan programs also should be scrutinized closely. A recent OIG report found that there are a number of areas where SBA falls short in its management of the 7(a) loan guaranty approval process, and specifically, that SBA's Loan Guaranty Processing Center (LGPC) emphasized quantity over quality in its 7(a) loan reviews.¹⁶ The report went on to find that further training is needed for staff at the LGPC, citing an instance in 2011 where, in an effort to reduce loan screen-outs, LGPC management directed staff to cease requesting certain eligibility documents from borrowers.¹⁷

Earlier this year, and without using the notice and comment process (or even issuance of SOPs), the SBA announced two new policy changes. First, the agency, via an Information Notice sent to all employees in June, revised underwriting requirements for borrowers seeking loans of less than \$350,000.¹⁸ Under the new credit standards, lenders now can rely on a credit score generated by SBA that is based on a mix of both personal and business credit of the

¹⁴ See *Morton v. Ruiz*, 415 U.S. 199, 232 (1974). It is important to note that the enactment of the APA predates the creation of the SBA by more than half a decade.

¹⁵ The average number of months it takes the SBA to license new SBICs has risen from 5.8 at the end of FY 2012 to 7.5 thus far in FY 2014. Moreover, this increase in licensing processing times is happening all-the-while the number of SBIC applicants thus far in FY 2014 (35) is just more than half of the number in FY 2012 (61). http://c.ymcdn.com/sites/www.sbia.org/resource/resmgr/Docs/SBIC_Overview_-_July_2014.pdf 2.

¹⁶ OIG, SIGNIFICANT OPPORTUNITIES EXIST TO IMPROVE THE MANAGEMENT OF THE 7(A) LOAN GUARANTY APPROVAL PROCESS 9 (June 2014), available at [http://www.sba.gov/sites/default/files/oig/\[c\]%20Audit%20Report%2014-13.pdf](http://www.sba.gov/sites/default/files/oig/[c]%20Audit%20Report%2014-13.pdf).

¹⁷ *Id.* at 12.

¹⁸ <http://www.sba.gov/sites/default/files/5000-1314.pdf>.

borrower.¹⁹ Second, Administrator Contreras-Sweet also announced in June that the agency is developing SBA One.

There are many unknowns in how these initiatives will affect the integrity of existing underwriting standards and loan programs. Of course, had SBA followed its own rules and sought notice and comment rather than simply issuing diktats from Washington, DC, it might uncover operational concerns about these programs. However, in the absence of such back and forth between the regulator and the regulated community, the SBA's lending partners have expressed trepidation about both aforementioned initiatives of the agency.

III. Entrepreneurial Development Programs

A. Recent Statistics

Annual performance indicators for various SBA entrepreneurial development programs are found below.

Small Business Development Centers

Fiscal Year	2010	2011	2012	2013	2014
SBDC Clients Counseled	589,352	557,698	543,512	532,337	n/a
SBDC Program Levels (in thousands of \$)	\$ 112,624	\$ 120,916	\$ 114,558	\$ 104,854	\$ 113,625

Women's Business Centers

Fiscal Year	2010	2011	2012	2013	2014
WBC Clients Counseled	160,735	138,923	136,951	133,765	n/a
WBC Program Levels (in thousands of \$)	\$ 13,997	\$ 13,866	\$ 13,721	\$ 12,887	\$ 14,000

SCORE

Fiscal Year	2010	2011	2012	2013	2014
SCORE Clients Counseled	407,240	356,837	458,773	345,902	n/a
SCORE Program Levels (in thousands of \$)	\$ 7,000	\$ 6,986	\$ 7,000	\$ 6,440	\$ 7,000

B. Issues with Program Management

Despite continued objection from Congress, SBA has taken its general authority to aid small business and created several initiatives that have not received specific authorization from Congress; to exacerbate the problem, some of these programs appear to duplicate already existing offerings from the SBA or from the private sector. These SBA-initiated programs

¹⁹ *Id.*

represent nearly 20 percent of the overall entrepreneurial development budget.²⁰ SBA requested \$39 million dollars for five outreach programs that it created under its general authority: Boots to Business; Entrepreneurship Education; Growth Accelerators; Regional Innovation Centers; and contributions to BusinessUSA.gov.²¹ SBA states that with these programs it “will continue to lead and build partnerships with other agencies and organizations to provide services and foster the growth of entrepreneurial ecosystems across the country,” but fails to note that other agencies are already carrying out such programs, have bigger budgets and operate with greater efficiency.²²

Not only did SBA fail to mention that their agency-created programs are duplicative of pre-existing federal programs (including some of those overseen by the SBA), SBA failed to provide sufficient data to support their funding request for such programs. Unlike the metrics provided for 7(a), 504, SBDC, and other programs with specific statutory authorizations, SBA uses words like “potential” and “possibility” when referring to the achievements of its programs created under its general authority to provide education and outreach to small businesses. These programs lack specific statistics that speak to the success of the program and the need for further funding.²³ The reliance on forward-looking statements appears to run contrary to the principles of an agency that supposedly relies on thorough underwriting and assessing in other aspects of its operations.

IV. Contracting Programs

A. Recent Statistics

The annual performance of SBA’s core contracting programs can be seen below:

Fiscal Year	2010	2011	2012	2013	2014
8(a) Contracts (in millions of \$)	\$ 18,466	\$ 16,678	\$ 15,837	n/a	n/a
HubZone Contracts (in millions of \$)	\$ 11,969	\$ 9,915	\$ 8,140	n/a	n/a

Congress establishes government-wide procurement goals for various types of small businesses, including those owned by service-disabled veterans, women, and other small disadvantaged businesses. In turn, the SBA is responsible for ensuring that the goals are established annually and agencies’ achievements are relative to the goals.²⁴ Although in FY 2013 the federal government exceeded the statutory goal for small businesses to receive 23 percent of all federal prime contracts for the first time since FY 2005, it still fell short of achieving the overall small business subcontracting goal.²⁵ Additionally, the number of prime contacts that

²⁰ FY 2015 Budget Justification, *supra* note 5, at 8.

²¹ *Id.*

²² *Id.*

²³ *Id.* at 52.

²⁴ <http://www.sba.gov/content/statutory-guidelines-0>.

²⁵ According to the most recent data, 23.39 percent of all federal prime contracts went to small businesses in FY 2013, exceeding the statutory goal of 23 percent. It is important to note that the SBA, in making this calculation, excludes contracts performed overseas even though § 15 of the Small Business Act provides no such exception. On

went to women-owned small businesses and those in the HUBZone program fell short of the statutory goals, while the number of subcontracts going to both Service-Disabled Veteran-Owned Small Businesses and HUBZone businesses also missed the marker.²⁶

B. Issues with Program Management

There is much to be desired concerning the agency's management of its contracting programs. For instance, during the last two years, Congress sought to improve the federal procurement process for small businesses by requiring the SBA take a variety of actions – some 40 were required. Among the requirements are those that mandate the SBA to issue new small business contracting guidelines; file an annual report describing why agencies have not met their contracting goals; promulgate regulations to improve the agency's mentor-protégé program; issue rules to permit more teaming arrangements through modification of subcontracting limitations; adjust its databases to identify large businesses misclassified as small; and establish a website for large businesses to post subcontracting opportunities for small businesses.²⁷ Despite the directive of Congress, the agency has performed none of the aforementioned tasks, some of which are now more than a year behind schedule. Despite its failure to comply with these tasks, the SBA made no request for additional resources to complete these tasks but did ask for \$39 million for entrepreneurial development programs that have little or no congressional support and certainly were not specifically mandated to be established.

The SBA's handling of its contracting personnel also deserves a closer examination. Both Procurement Center Representatives (PCRs) and Commercial Marketing Representatives (CMRs) play an important role in assisting small businesses find and obtain contracting opportunities, but the number of PCRs and CMRs at the agency is well short of what is required.²⁸ In spite of this, the SBA did not request any additional funding for hiring PCRs or CMRs in its FY 2015 budget request, even though it has in previous years.²⁹

V. Conclusion

In fulfilling its statutory obligations, the SBA manages a number of programs designed to assist small businesses. To ensure these programs are operated in a manner that does not place an undue risk on the taxpayer, the agency must more closely follow the intent of Congress,

the other hand, during the same time period only 34 percent of all federal subcontracts went to small businesses, falling short of the goal of 36 percent. http://www.sba.gov/sites/default/files/files/FY13_Government-Wide_SB_Procurement_Scorecard_Public_View_2014-04-28.pdf.

²⁶ Women-owned small businesses received 4.32 percent of all prime contracts, falling short of the statutory goal of 5 percent, while HUBZone businesses received 1.76 percent of prime contracts, lagging behind the statutory goal of 3 percent. Additionally, Service-Disabled Veteran Owned Small Businesses and HUBZone businesses respectively received 1.7 and 1.2 percent of all subcontracts, lower than the statutory goal of 3 percent. *Id.*

²⁷ There also are provisions requiring SBA to promulgate regulations creating a safe harbor for small businesses who make a good faith effort to comply with the complex agency size-standard rules; publish a plain English guide for small businesses on how to comply with the agency's size standard rules; issue regulations on its authority to suspend or debar (temporarily or permanently prohibit a business from obtaining government contracts); and issue a SOP on how the agency will conduct suspension and debarment proceedings. FY 2015 Views and Estimates, *supra* note 8, at 14.

²⁸ *Id.* at 13.

²⁹ FY 2015 Budget Justification, *supra* note 5.

particularly in regards to the creation of new policies and SBA-led initiatives; managing its capital access portfolio, entrepreneurial development and contracting programs; and with the management of its information technology systems. Ultimately, the job of the SBA, under the Constitution, is to carry out the laws enacted by Congress; recent efforts by the SBA show that the agency is more interested in legislating than faithfully executing the laws enacted by Congress.