

U.S. SMALL BUSINESS ADMINISTRATION

OFFICE OF INSPECTOR GENERAL

Verification Inspection of SBA's Microloan Program



Verification Inspection

Report 24-24

September 17, 2024



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Pursuant to the James M. Inhofe National Defense Authorization Act for Fiscal Year 2023, Public Law 117-263, Section 5274, any nongovernmental organizations and business entities identified in this report have the opportunity to submit a written response for the purpose of clarifying or providing additional context as it relates to any specific reference contained herein. Comments must be submitted to AIGA@sba.gov within 30 days of the final report issuance date. We request that any comments be no longer than two pages, Section 508 compliant, and free from any proprietary or otherwise sensitive information. The comments may be appended to this report and posted on our public website.



OFFICE OF INSPECTOR GENERAL
U.S. SMALL BUSINESS ADMINISTRATION

Date: September 17, 2024

To: Isabella Casillas Guzman
Administrator

From: Hannibal "Mike" Ware
Inspector General

A handwritten signature in black ink, appearing to read "H. Ware".

Subject: Verification Inspection of SBA's Microloan Program (Report 24-24)

This report represents the results of our verification inspection of the U.S. Small Business Administration's (SBA) corrective actions for the four recommendations from SBA Office of Inspector General's (OIG) audit report SBA's *Microloan Program* (Report 17-19). A verification inspection is a review that focuses on closed recommendations from prior OIG reports.

We determined that SBA fully implemented recommendations 1, 2, 3, and 4 in OIG Report 17-19.

We appreciate the cooperation and courtesies provided by your staff. If you have any questions or need additional information, please contact Stephen Chow, Director, Audit Operations, at (202) 235-5465, or Andrea Deadwyler, Assistant Inspector General for Audits, at (202) 205-6586.

cc: Dilawar Syed, Deputy Administrator
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Tonia Butler, Director, Office of Internal Controls

Background

The U.S. Small Business Administration's (SBA) Microloan Program provides loans to nonprofit intermediary lenders (microlenders) that subsequently lend funds, in amounts of \$50,000 or less, to small businesses and startups. The program targets new and early-stage businesses in underserved markets, including borrowers with little or no credit history, low-income borrowers, and women and minority entrepreneurs who generally do not qualify for conventional loans or other larger SBA-guaranteed loans. In fiscal year (FY) 2023, microlenders approved microloans totaling \$86.4 million for over 5,500 small businesses.

The Office of Inspector General (OIG) issued Report 17-19, *Audit of SBA's Microloan Program*, on September 28, 2017.¹ The audit 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. OIG found that SBA management did not effectively implement actions to improve its oversight of the Microloan Program, specifically, failing to 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 (SOP). Additionally, SBA management focused on output-based performance measures instead of outcomes.

We initiated this verification inspection to follow up on all four recommendations in Report 17-19 and determine whether SBA's corrective actions were still operating as intended.

Summary of Results

SBA's corrective actions were still operating as intended for all four OIG recommendations as follows:

- Recommendation 1: SBA improved the information system to include outcome-based performance measurements and ensured the data captured could be used to effectively monitor Microloan Program compliance, performance, and integrity;

¹ Report 17-19, *Audit of SBA's Microloan Program* (September 28, 2017).

- Recommendation 2: SBA Implemented a site visit plan to comprehensively monitor microloan portfolio performance and ensured program results could be evaluated program-wide;
- Recommendation 3: SBA issued SOP 52 00B, Microloan Program, effective July 1, 2018, which clarified evidence requirements for use of proceeds and credit elsewhere; and
- Recommendation 4: SBA updated the microloan reporting system manual to reflect current technology capabilities.

Report 17-19: Audit of SBA’s Microloan Program

The following information details the earlier report’s findings, recommendations, and SBA’s corrective actions for recommendations 1 through 4.

Recommendation 1

OIG Finding	OIG Recommendation	SBA Corrective Action(s)
Improvements are needed in SBA’s oversight of its Microloan Program to measure performance and ensure Integrity. Specifically, SBA management focused on output-based performance measures instead of outcome-based performance measures.	Continue efforts to improve the information system to include outcome-based performance measurements and ensure the data captured can be used to effectively monitor Microloan Program compliance, performance, and integrity.	OIG closed this recommendation on June 7, 2022. Management updated their Portfolio Assessment Committee Report (PAC) with microloan outcome-based performance measures that included loan default rate, stress rate, and portfolio balance sheet. Additionally, they provided microlender performance reports, which included analysis of intermediary and micro borrower performance.

Inspection Result

We verified that SBA continued to report outcome-based performance measures on the PAC report, as recommended.² Specifically, SBA reported the Microloan Program’s stressed loan rate to be 6.38 percent and the last 12-month charge-off rate to be 5.11 percent as of May 8, 2024.³ The PAC report also noted on the portfolio balance sheet the current outstanding gross balance to microlenders to be \$174,231,391 as of May 8, 2024, compared to the prior year’s balance of \$162,975,995.

We verified that SBA’s lender user manual for the Microloan Program Electronic Reporting System (MPERS) required microlenders to capture outcome-based information at the inception of the microloan and again when the microloan status changes to either charged off or paid-in-full. This included the borrower business status, gross annual revenue sales for most recently completed year, and actual jobs created/retained.

We verified that SBA continued to review microlender performance using quarterly reports submitted by each microlender. Additionally, we judgmentally selected five microlenders to conduct on-site reviews and verified that 94 percent of the data captured in MPERS matched the loan data in these microlender’s loan management systems.

SBA’s corrective actions to address recommendation 1 were fully implemented and operating as intended.

Recommendation 2

OIG Finding	OIG Recommendation	SBA Corrective Action(s)
SBA management did not conduct adequate program oversight to measure program performance and ensure program integrity due to SBA not having an overall site visit plan.	Develop and implement a site visit plan to comprehensively monitor microloan portfolio performance and ensure program results can be evaluated program wide.	OIG closed this recommendation on June 4, 2018. Management developed and implemented a site visit plan which included the following:

² PAC report provides SBA a high-level overview of how the Office of Credit Risk Management views performance risk in the microloan portfolio.

³ Stressed loan rate is an interest rate used to evaluate how a loan would perform under adverse economic conditions. Charge-off rate is the percentage of unpaid principal balance amounts at the end of the fiscal year.

OIG Finding	OIG Recommendation	SBA Corrective Action(s)
		<ul style="list-style-type: none"> • site visit procedures training • annual site visit requirement for all intermediaries • standard microloan site visit checklist • database to capture and analyze site visit data to determine site visits performed and identify compliance and oversight issues for intermediaries and the Microloan Program.

Inspection Result

We verified that SBA developed a site visit plan and implemented annual site visits at each microlender site as recommended. SBA captured the data from each site visit using a standardized checklist to track and analyze microlender performance. We reviewed SBA’s annual site visit plans for FY 2024 and verified that SBA has completed 50 site visits, with 26 currently in process and 71 to be completed by September 30, 2024. We verified that SBA completed FY 2024 annual site visits at four of the five microlenders that we visited during this inspection. Additionally, officials at all the microlenders we visited confirmed that SBA performs these site visits annually.

SBA’s corrective actions to address recommendation 2 were fully implemented and operating as intended.

Recommendation 3

OIG Finding	OIG Recommendation	SBA Corrective Action(s)
Microloan files did not contain adequate evidence to support use of proceeds for the loan or documentation supporting applicants applying for \$20,000	Update SOP 52 00A to clarify requirements regarding evidence for use of proceeds and credit elsewhere.	OIG closed this recommendation on April 24, 2018. Management issued SOP 52 00B, effective July 1, 2018, with updated procedures

OIG Finding	OIG Recommendation	SBA Corrective Action(s)
<p>or more who could not obtain credit elsewhere. These exceptions occurred because SOP guidelines did not provide <u>sufficient</u> details regarding what qualified as appropriate documentary evidence for use of proceeds and credit elsewhere.</p>		<p>clarifying requirements for documenting support for use of loan proceeds and credit elsewhere. Specifically, including examples of acceptable evidence (e.g., payroll, utilities, cancelled check or electronic funds transfer confirmation, or credit denial letter from lender) for use of loan proceeds and credit elsewhere.</p>

Inspection Result

We verified that SBA clarified the requirements regarding documentary evidence for use of proceeds and credit elsewhere by updating SOP 52 00B. Specifically, SBA noted relevant examples of acceptable documentary evidence for use of proceeds and credit elsewhere to be maintained in the microloan file in the SOP.⁴

SBA’s corrective actions to address recommendation 3 were fully implemented and operating as intended.

Observation

Although SBA established directives in SOP 52 00B that clarified requirements for evidence of credit elsewhere and use of proceeds, we found during our site visits that some microlenders were not following these program requirements. Specifically, only 42 percent (19 of 45) of microloan files had the required documentation for use of proceeds. Proper documentation for use of proceeds is significant because it provides microlenders the only opportunity to ensure borrowers used loan proceeds for an eligible microloan purpose.

We also found that only 63 percent (22 of 35) of microloan files had documentation that was required as evidence of no credit elsewhere. Proper documentation for no credit elsewhere allows the microlender to ensure the borrower was not able to secure a loan for \$20,000 or

⁴ SOP 52 00 B, *Microloan Program*, pg. 47, Section 3.F.2; pg. 50, Section 3.F.7; and pg. 55, Section 3.F.17 (July 2018).

greater at comparable interest rates from non-federal sources meeting the microloan no credit elsewhere requirement.

Suggested Action

To ensure microlenders comply with program requirements, review microloan files during annual site visits for proper use of proceeds and sufficiency of no credit elsewhere documentation.

Recommendation 4

OIG Finding	OIG Recommendation	SBA Corrective Action(s)
Improvements are needed in SBA’s oversight of its Microloan Program to measure performance and ensure integrity. Specifically, SBA’s ability to monitor the Microloan Program using MPERS was limited due to the system manual not reflecting current technology capabilities.	Update the MPERS manual to reflect current technology capabilities.	OIG closed this recommendation on August 23, 2022. SBA provided the updated MPERS manual with the appropriate revisions to reflect the capabilities for microlenders to capture outcome-based performance measures.

Inspection Result

We verified that SBA’s current MPERS manual, effective June 2022, reflects the current technology capabilities for microlenders to capture outcome-based information at the inception of the microloan and when the microloan status changes to either charged off or paid-in-full. SBA officials also stated that there had been no changes to their technology capabilities at the time of our inspection.

SBA’s corrective actions to address recommendation 4 were fully implemented and operating as intended.

Scope and Methodology

The scope of this verification inspection included a review of all four recommendations made in SBA OIG Report 17-19, *Audit of SBA's Microloan Program*. We previously closed these recommendations based on evidence SBA provided to OIG showing that it implemented corrective actions which addressed issues identified in the audit. For this verification inspection, we reviewed SBA management's documentation and justification of the corrective actions taken to close the four recommendations.

Our objective was to follow up on recommendations from Report 17-19 and determine whether SBA's corrective actions were still operating as intended. To answer our objective, we reviewed relevant legislation, SBA SOPs for the Microloan Program and its Lender's User Manual for MPERS, and guidance for microlender annual site visits. We interviewed microlenders and SBA management responsible for managing and monitoring the Microloan Program. We conducted site visits at five judgmentally selected microlenders to examine use of proceeds and no credit elsewhere documentation, performance reports, and loan files. We selected the microlenders based on location and whether their microloan portfolio met two or more of the following selection criteria: loan count of 100 or greater; gross dollar balance greater than \$5.8 million; average loan approval amount of \$20,000 or greater; and average adverse loan status of 40 percent or greater. Finally, we performed testing to determine whether SBA's processes for addressing the recommendations were operating as intended.

We performed this review in accordance with the Council on Inspectors General on Integrity and Efficiency's *Quality Standards for Inspection and Evaluation*. Those standards require we plan and perform a review to obtain sufficient and appropriate evidence to provide a reasonable basis for our conclusions and observations based on our objective. We believe the evidence obtained provides a reasonable basis for our conclusions and observations based on our objective.

Evaluation of Agency Response

While formal comments are not required for verification inspections, the agency elected to provide formal comments that are included in their entirety in this report. SBA's comments are responsive to our inspection results.

Regarding our suggested action, management noted they were pleased to read in the Inspection Results section that, "SBA provided relevant examples of acceptable documentary evidence for use of proceeds and credit elsewhere to be maintained in the microloan file in the SOP. SBA's corrective actions to address recommendation 3 were fully implemented and operating as intended."

Management stated that during site visits of microloan lenders, SBA regularly examines documentary evidence for use of proceeds and sufficiency of no credit elsewhere documentation. SBA conducts periodic comprehensive file reviews either on-site or virtually. These reviews include, but are not limited to, eligibility determination — including no credit elsewhere —and evidence of use of proceeds.

Although SBA stated that it regularly examined documentation for use of proceeds and no credit elsewhere, we found during our site visits that some microlenders did not have the required documentation for these program requirements. Specifically, only 42 percent (19 of 45) of microloan files had the required documentation for use of proceeds and only 63 percent (22 of 35) of microloan files had documentation that was required as evidence of no credit elsewhere. As a result, we suggested and still believe that SBA should review microloan files during annual site visits to ensure proper use of proceeds and sufficiency of no credit elsewhere documentation.

Agency Response

SBA RESPONSE TO THE VERIFICATION INSPECTION



U.S. Small Business
Administration

To: Hannibal Ware
Inspector General
U.S. Small Business Administration

From: Susan Streich **SES**
Director, Office of Credit Risk Management

Subject: Management Response:
Verification Inspection of SBA's Microloan Program Response (Project 24012)

Date: September 10, 2024

We appreciate the role the Office of Inspector General (OIG) plays in working with management to ensure that our programs are effectively managed, and for the suggested action provided in this draft report titled, "Verification Inspection of SBA's Microloan Program Response (Project 24012)."

Additionally, we were pleased to read in the Inspection Results section that, "SBA provided relevant examples of acceptable documentary evidence for use of proceeds and credit elsewhere to be maintained in the microloan file in the SOP. SBA's corrective actions to address recommendation 3 were fully implemented and operating as intended."

During SBA's site visits of microloan lenders, SBA regularly examines documentary evidence for use of proceeds and sufficiency of no credit elsewhere documentation. SBA conducts periodic comprehensive file reviews which may be carried out either on-site or virtually. These reviews include, but are not limited to, eligibility determination (including no credit elsewhere) and evidence of use of proceeds.

Thank you for allowing SBA the opportunity to comment on OIG's draft report on the Verification Inspection of SBA's Microloan Program Response and for taking SBA's views into consideration.