STATEMENT OF

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U.S. SMALL BUSINESS ADMINISTRATION

BEFORE THE

COMMITTEE ON SMALL BUSINESS
U.S. HOUSE OF REPRESENTATIVES

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INTRODUCTION

Chairman Chabot, Ranking Member Velázquez, and distinguished members of the Committee, thank you for the opportunity to be here today and for your continued support of the Office of Inspector General (OIG).   We recently published the results of our audit of the Small Business Administration's (SBA's) evaluation of 7(a) loans made to poultry farmers. I am happy to discuss our findings with you today.

OIG's ROLE

OIG was established within SBA by statute to promote economy, efficiency, and effectiveness and to deter and detect waste, fraud, abuse, and mismanagement in the Agency's programs and operations. During fiscal year (FY) 2017, OIG achieved over $82 million in monetary recoveries and savings and made 72 recommendations for improving SBA's operations and reducing fraud and unnecessary losses in the Agency's programs.

OIG audits are conducted in accordance with Federal audit standards established by the Comptroller General, and other reviews generally are conducted in accordance with standards established by the Council of the Inspectors General on Integrity and Efficiency (CIGIE). In addition, we coordinate with the Government Accountability Office to avoid duplicating Federal audits. We also establish criteria to ensure that the non-Federal auditors that OIG uses (typically, certified public accountant firms) comply with Federal audit standards.

OIG's EVALAUTION OF 7(A) LOANS MADE TO POULTRY FARMERS

OIG report 18-13, titled *Evaluation of SBA 7(a) Loans Made to Poultry Farmers* presents the results of our review of loans made to poultry farmers under SBA's 7(a) Loan Program. The 7(a) Loan Program is SBA's primary program for helping startup and existing small businesses, offering financing guarantees for loan amounts up to $5 million to fund startup costs, expand existing businesses, purchase equipment, repair existing capital, and other uses. Participating lenders enter into an agreement with SBA to make loans to small businesses in accordance with SBA rules and regulations. Some 7(a) loans are made by lenders using delegated authority, which undergo limited review by SBA prior to loan disbursement. Other 7(a) loans are subject to more extensive underwriting and eligibility review and approval by SBA before the loan is disbursed.

Our evaluation objective was to determine whether 7(a) loans made to poultry farmers (growers) met statutory, regulatory, and SBA requirements for eligibility. To accomplish our objective we reviewed Federal laws and regulations, SBA policies and procedures governing the 7(a) Loan Program, files of performing and defaulted loans, as well as grower–integrator contracts, agreements, and communications. We further reviewed U.S. Department of Agriculture's (USDA) loan program guidance, industry-related economic and analytic publications, relevant publications from state university agricultural extensions, and publications from industry trade associations. We also reviewed SBA internal communications, guidance, and selected SBA Office of Credit Risk Management lender reviews.

We interviewed officials and staff from the SBA Office of Capital Access, SBA Office of General Counsel, USDA Economic Research Service, USDA National Agricultural Statistics

Service, USDA Farm Service Agency, USDA Office of Rural Development, and the USDA Office of Inspector General. We also interviewed executives and loan officers at various lending institutions, certified assessors, integrators, and growers.

We analyzed the population of 7(a) loans made to agricultural enterprises, and to the agricultural subset of poultry farmers, to obtain an understanding of the SBA loan portfolio, and its characteristics, for FYs 2012 through 2016. This population was limited to approved regular 7(a), Certified Lender Program, and Preferred Lender Program loans. Further, for this analysis, we defined agricultural enterprises to include North American Industry Classification System (NAICS) codes 111110 through 114210. The subset of poultry farmers was defined with NAICS codes 112320 and 112390. From this population, we judgmentally selected a sample of 11 loans; this sample was populated by loans at either the median size or the largest size for its fiscal year. We used this sample to guide a review of loan files, grower contracts, and grower–integrator communications, and interview parties to these loans. Further, we reviewed a sample of defaulted poultry loans to understand the degree to which integrator contracts affect facility value.

We conducted this evaluation in accordance with the Council of the Inspectors General on Integrity and Efficiency's quality standards for inspection and evaluation. These standards require that we adequately plan inspections; present all factual data accurately, fairly, and objectively; and present findings, conclusions, and recommendations in a persuasive manner. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our evaluation objective.

What OIG Found

We found that 7(a) loans made to growers did not meet regulatory and SBA requirements for eligibility. SBA requirements state that the small business applicant must be small under SBA size standards. The applicant combined with its affiliates must not exceed the size standard designated for either the primary industry of the applicant or the primary industry of the applicant and its affiliates, whichever is higher.

The large chicken companies (integrators) in our sample exercised such comprehensive control over the growers that the SBA Office of Inspector General believes the concerns appear affiliative under SBA regulations. Therefore, SBA and lenders approved 7(a) loans that were apparently ineligible under SBA size standard regulations and requirements. Specifically, in our review of a sample of 11 7(a) loans made to growers, as well as review of defaulted 7(a) loans to growers, we found integrator control exercised through a series of contractual restrictions, management agreements, oversight inspections, and market controls. This control overcame practically all of a grower's ability to operate their business independent of integrator mandates. A grower's failure to comply with these requirements could result in a significant decrease in integrator payments, a reduction in flock placements, or a cancellation of the contract. A grower's economic viability was based upon a performing production contract with an integrator and is the true basis for grower income and facility value. As a result, from FY 2012 to FY 2016, SBA guaranteed approximately $1.8 billion in loans that may be ineligible.

OIG Recommendations

To improve SBA's oversight of the 7(a) Loan Program, we recommended the Associate Administrator for the Office of Capital Access (1) review the loans cited in the evaluation sample to determine whether SBA loan specialists and lenders made a proper size determination given the apparent affiliation based upon comprehensive contractual, oversight, and market control, and take the appropriate corrective action(s), and (2) review the arrangements between integrators and growers under the revised regulations, and establish and implement controls, such as supplemental guidance, to ensure SBA loan specialists and lenders make appropriate affiliation determinations.

Agency Response

SBA management agreed with both recommendations made by OIG. Regarding Recommendation 1, SBA will perform a review of the loans cited in the evaluation to determine whether SBA loan specialists and lenders made proper size determinations. For Recommendation 2, SBA will review the arrangements between integrators and growers in light of the current affiliation rules and regulations. If needed, SBA will establish additional controls to ensure SBA loan specialists and lenders make the appropriate affiliation determinations.

CONCLUSION

I am proud of the work performed by our auditors to raise awareness of this growing segment of SBA's 7(a) loan portfolio. In performing this work, they obtained a deep understanding of the operations of this industry and the practical application of SBA's regulations for loans to farmers within the industry. We found that 7(a) loans made to growers did not meet regulatory and SBA requirements for eligibility. Integrators were ineligible to participate in the SBA 7(a) Loan Program due to their size; however, integrators exercised such comprehensive control over the growers that the SBA OIG believes the concerns were affiliated. Therefore, SBA and lenders approved 7(a) loans to growers that appear ineligible under SBA size standard regulations and requirements.

OIG will continue to provide independent, objective oversight to improve the integrity, accountability, and performance of the SBA and its programs for the benefit of the American people. Our focus is to keep SBA leadership, our congressional stakeholders, and the public currently and fully informed about the problems and deficiencies in the programs as identified through our work. We value our relationship with the Committee and the Congress at large, and we look forward to working together to address identified risks and the most pressing management challenges facing SBA.