



Office of Inspector General Small Business Administration

May 1998 Update

Business Loans

Audit of Business Loans Finds Processing Deficiencies in Loans Assigned to SBA's Atlanta District Office. A May 13, 1998, audit of Section 7(a) loans processed by the Preferred Lender Program (PLP) Processing Center or the Atlanta District Office and assigned to SBA's Atlanta District Office found processing deficiencies in 15 out of 30 loans reviewed. Guarantees for 7 of the 15 loans had deficiencies that required some corrective actions to protect the Government's interests. The most frequent deficiencies involved **lack of IRS verifications, insufficient equity injections, non-use of credit reports, and improper use of loan proceeds.** IRS verifications were either not obtained or obtained after disbursement. Equity injections

were not made or verified, or consisted of borrowed rather than personal assets. Business and personal credit reports were not obtained and evaluated. Loan proceeds were used to pay personal debt and, in one case, to fund an equity injection on another SBA (Section 504) guaranteed loan.

The majority of the loans with deficiencies were originated when SBA had limited or no oversight of the lender's loan processing and disbursing. Of the 20 deficiencies identified, 16 were processing or disbursing actions not normally reviewed by or reported to SBA under existing procedures.

The report recommended that the Atlanta District Office and the PLP Processing Center either obtain the documentation needed to satisfy the

deficiencies noted in the audit report or obtain guarantee releases, reductions or indemnification agreements. The Atlanta District Director agreed to take action on some of the recommendations but not others on the basis that the loans in question were not considered to be at risk and reduction of the guarantees would not serve a meaningful purpose.

The Director of the PLP Center Florida Couple Indicted for Making False Statements and Concealing Loan Collateral. The owners of an import/export firm in Longwood, Florida, were indicted on May 21, 1998, on four counts of **making a material false statement** to SBA, **making a false statement to influence a Federally-insured financial institution**, and **converting SBA collateral**. The firm had obtained a \$75,000 SBA-guaranteed loan in March 1996. The OIG's investigation confirmed that the couple falsely stated on their SBA loan application that neither had ever been involved in a bankruptcy; in fact, they both had filed for bankruptcy in April 1995 in Canada. They also allegedly had submitted a forged Lessor's Agreement to the participating lender bank in support of their loan application. Furthermore, according to the indictment, before filing for bankruptcy in the U.S., the applicants concealed inventory and equipment that was pledged as collateral for the loan. This investigation was initiated based on a referral from the participating lender bank.

California Businesswoman Found Guilty of Making False Statements. A trial jury found the former owner of a retail furniture store in Garden Grove,

stated that no actions could be taken because SBA does not have a procedure to recommend denial of a guarantee until a loan repurchase action is received from the lender. The OIG is working with SBA's Office of Financial Assistance to identify circumstances which may lead to partial or full denial of liability for a guarantee prior to a request for purchase.

California, guilty on May 26, 1998, on five counts of **making false statements to influence a Federally-insured financial institution**. The woman was the fifth individual convicted as a result of an extensive investigation, conducted jointly with the FBI, of a southern California loan packager and his clients. The investigation found that she obtained a \$250,000 SBA-guaranteed loan for her business by providing "copies" of income tax returns altered to substantially overstate her income. She diverted loan proceeds to the purchase of a personal residence and subsequently defaulted on the loan, leaving an outstanding balance of \$242,380. The OIG initiated its investigation based on information provided by SBA's Santa Ana District Office.

California Loan Broker Investigation Continues to Yield Results. The number of individuals charged with crimes in the wake of the investigation of an Inglewood, California, loan brokerage firm has risen to nine. Recent results from this case include:

① A couple, the former owners of a West Covina, California, gas station, was indicted on May 27, 1998, on four counts of **making false statements to**

influence a Federally-insured financial institution. The OIG's joint investigation with the FBI disclosed that they submitted to a participating lender bank altered income tax returns for the years 1988 and 1989 with their application for a \$1 million SBA-guaranteed loan. They subsequently defaulted on the loan, and after all liquidation efforts had been completed, SBA charged off a loss of approximately \$500,000.

② A former principal of the loan
③ A Harbor City, California, tax preparer was charged in a criminal information on April 22, 1998, with three counts of aiding and abetting the **making of false statements to a Federally-insured lender.** The man allegedly assisted principals of the loan brokerage firm by preparing fraudulent tax returns (some fictitious, others altered), fraudulent personal financial statements, fictitious profit and loss statements, and other false documentation for clients of the firm. According to the information, he knew that the false documents would be included in application packages being submitted to the participating lender bank for SBA-guaranteed loans. The charges address the preparation of false documents in three loan application packages, which resulted in the approval of SBA-guaranteed loans totaling \$2.5 million.

④ The former owner of a Burbank, California, gas station was sentenced on May 18, 1998, to 4 months home detention, 3 years supervised release, and \$10,200 restitution. He previously pled guilty to one count of **making false statements to a Federally-insured**

brokerage firm pled guilty on March 26, 1998, to one count of aiding and abetting the **making of false statements to a Federally-insured lender** by causing the submission to the participating lender bank of individual income tax returns which he knew had been altered to overstate the applicants' adjusted gross income. The loans applied for totaled \$1,850,000.

lender by submitting altered individual income tax returns for the years 1988-90 while applying for a \$160,000 SBA-guaranteed loan. The man subsequently defaulted on the loan, leaving an unpaid principal balance of \$151,472.

All of these actions resulted from an extensive investigation, conducted jointly with the FBI and the IRS, based on allegations from an anonymous complainant. The investigation focused on loans submitted to one specific participating lender bank. The loan brokerage firm's portfolio at that bank totaled approximately 170 loans, originally valued at more than \$60 million. Partially as a result of the default rate of these allegedly fraudulent loans, the bank was closed by the Office of the Comptroller of the Currency in April 1994. The investigation has focused on a sample of these loans and is continuing.

Pennsylvania Corporate President Indicted for Making False Statements.
The president of an automotive repair corporation in Philadelphia, Pennsylvania, was indicted on May 14,

1998, on three counts of **making false statements** to SBA. He had applied for a \$252,000 SBA-guaranteed loan in 1996 to buy a new building for his automobile repair business. As part of the loan application, the man submitted purported copies of his 1994-95 corporate tax returns, which the participating non-bank lender found to contain significant discrepancies when compared to information on file with the IRS. According to the indictment, each President of Carolina Computer Consulting Firm Indicted for Making False Statements. The president of a Charlotte, North Carolina, computer consulting firm was indicted on May 5, 1998, on counts of aiding and abetting the **making of a material false statement in a loan application to a Federally-insured bank** and the **making of a false statement to influence SBA**. The man was charged with knowingly causing the submission of false documents, including a balance sheet that understated his firm's accounts payable by more than 55 percent. Based on this and other allegedly material representations regarding the firm's financial condition, the participating bank approved a \$93,000 SBA-guaranteed term loan and a \$75,000 SBA-guaranteed line of credit. The firm failed to repay any of the \$128,145 that was disbursed to it. The OIG's investigation was based on a referral from SBA's Charlotte District Office.

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Disaster Assistance

California Physician Indicted for Making

tax return claimed considerably more income than he had reported to the IRS. Another count of the indictment charged that, in applying for the loan, he had failed to disclose his 1992 arrest for kidnaping and assault. The participating lender withdrew its loan commitment when the tax return discrepancies were discovered. A warrant has been issued for his arrest.

False Statement. A Beverly Hills, California, medical doctor who had received home and business disaster loans was indicted on May 7, 1998, on two counts of **making a false statement** to SBA. The indictment charges that the doctor claimed to have incurred both personal and real property damage at his residence following the 1994 Northridge earthquake, when in fact the property was a rental and the personal property damage was actually incurred by his tenant. The indictment also charges that he submitted an invoice that overstated the extent of real property damage incurred at the rental. The SBA/OIG conducted this investigation at the request of the U.S. Attorney's Office after a Medicare fraud investigation uncovered indications that the doctor may have made a false statement to obtain his SBA loans. He was indicted in February 1998 for allegedly overbilling Medicare by more than \$216,000 and was free on \$250,000 bail. After he was advised that his second indictment (on the SBA violations) was imminent, the U.S. Attorney's Office learned that he had withdrawn \$2.39 million from his savings account. In anticipation of his potential flight, a criminal complaint based on the SBA violations was issued on May 1,

1998. The doctor was arrested the same day and, during a search incident to the arrest, the \$2.39 million was seized as evidence of his intent to flee. This indictment was a follow-up to the arrest. A bail revocation hearing was also held on May 7, 1998, and his bail was revoked. He remains in custody pending trial.

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Agency Management and Financial Activities

SBA's Phoenix District Director Found Guilty of Conspiracy and Bribery. A trial Agency's FY 1997 Financial Statements Audit Yields Management Letter Expressing Auditors' Concerns.

Internal control issues were identified in the management letter for the **audit of SBA's 1997 financial statements**, issued May 20, 1998, by the OIG. SBA officials agreed with the findings and recommendations and, in some instances, had already initiated corrective action. The findings in the management letter were not material enough to require inclusion in the auditors' report on the financial statements. Most of the issues concerned reconciliation problems in cash balance with Treasury, SBIC loan balances, SBDC grant expenditures, and payroll. The management letter also discussed weaknesses in valuation of foreclosed property, deficiencies in documentation, and receipt procedures by Collateral Agent Cashiers.

Former SBA Employee Sentenced for Theft of Government Property. A former SBA employee from Van Nuys,

jury found the District Director of SBA's Phoenix District Office guilty on May 26, 1998, on one count of **conspiracy** and two counts of **bribery**. The FBI had conducted an extensive investigation which found that the Director and an associate conspired to solicit bribes from a Section 8(a) contractor in a Phoenix suburb. The pair received two \$2,500 payments. Following the Director's May 1997 indictment, the OIG was asked to provide assistance in his prosecution by the U.S. Attorney's Office for the District of Arizona.

California, was sentenced on May 11, 1998, to 15 months imprisonment, 5 years probation, \$64,929 restitution to SBA, and a \$150 special assessment. He previously pled guilty to two counts of **theft of Government property**. The SBA/OIG's joint investigation with the OIG of the Federal Deposit Insurance Corporation (FDIC), where the man was also previously employed, found that after he was hired as a loan specialist by SBA's Los Angeles District Office in 1995, he embezzled at least \$64,929 in disaster loan payments due SBA. In most of the cases, he falsely told delinquent borrowers that SBA had turned over their files to a collection agency to which he directed the borrowers to make their payments. The collection agency was actually an entity which he owned. The investigation also found that he had attempted to embezzle \$5,883 from the FDIC while he was employed there. The SBA/OIG initiated its investigation based on a referral from SBA's Santa Ana Home Loan Servicing and Liquidation Center,

to which the employee transferred in 1996.

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OIG Management Activities

Training Conference for OIG Administrative Support Staff Held in Charleston, South Carolina. The OIG conducted its annual training conference for its administrative support

personnel in Charleston, South Carolina, during the second week of May. Topics of instruction included Internet Fundamentals, Listening and Memory Development, and Access (database management) Fundamentals. Acting Inspector General Karen S. Lee addressed the attendees and presented the Support Employee of the Year award to Ms. Zarah Cole of the OIG's Auditing Division in Washington, DC.

Editor's Notes:

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The following identifies the use of adjectives in these **Updates** to describe tax returns fraudulently submitted in support of loan applications:

Fictitious tax returns: The applicant submits "copies" of tax returns never filed with the IRS.

Altered tax returns: The applicant submits altered copies of tax returns actually submitted to the IRS.

Bogus tax returns: The applicant submits tax returns containing false information to both the IRS and SBA.

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WWW.SBAONLINE.SBA.GOV/IG/REPORTS.HTML

Other IG related material can be found at:

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The Activity Update is produced by the SBA/OIG, Karen S. Lee, Acting Inspector General.

Comments or questions concerning this update or requests for copies of OIG audits, inspections, or other documents should be directed to Johnny Cahn, SBA/OIG, 409 Third Street, SW, Washington, DC, 20416-4110.

Telephone number: (202) 205-6580
FAX number: (202) 205-7382