



## Office of Inspector General U.S. Small Business Administration

September 2006 Update

### *Disaster Loan Program*

#### OIG Issues Audit of Disaster Loan Disbursements.

On September 19, 2006, the OIG issued an *Audit of Loan Disbursements Following the 2005 Gulf Coast Hurricanes Katrina, Rita, and Wilma*. The overall objective of the audit was to determine the reasons for the low rate of disaster loan disbursements and to identify impediments in the loan closing and disbursement processes which affected SBA's ability to provide timely assistance to disaster victims.

A review of loan processing data in SBA's Disaster Credit Management System (DCMS) for 220 loans disclosed that no problems were encountered relative to 81 – or 37 percent of the loans. Of the 139 remaining loans, 136 – or 62 percent of the loans reviewed – involved processing delays that were primarily attributable to borrower actions, including borrower delays in filing loan closing documents and difficulties in getting SBA assistance during the closing process (49 loans), borrower indecision or reluctance to assume the loans (47 loans), and borrower requests to modify the loan terms and conditions or to update borrower information (40 loans). Because loan processing times were within expected ranges and were largely borrower driven, the OIG did not make any recommendations.

#### OIG Issues Advisory Memorandum on Controls Over the Coordination of Disaster Assistance Benefits.

On September 25, 2006, the OIG issued an Advisory Memorandum, *Preliminary Assessment of Controls over the Coordination of Disaster Assistance Benefits Distributed by Mississippi Development Authority's Grant Assistance Program*. The purpose of the report was to inform SBA of the OIG's preliminary assessment of controls to prevent duplication of benefits resulting from Department of Housing and Urban Development (HUD) grants. The OIG made recommendations related to the following financial

and operational areas: coordinating aid distribution efforts with HUD and Gulf Coast State agencies; complying with Federal mandates of the Stafford Act and Small Business Act that prohibit SBA from providing disaster loan assistance to borrowers who have already been compensated for their losses from other sources; and ensuring that related loan modifications and financial transactions are properly initiated, recorded, processed and reported in the Agency's financial statements.

SBA's Office of Disaster Assistance (ODA) generally agreed with the recommendations, noting that preventing duplicate payments is the responsibility of the entity providing the additional funding. ODA said it was completing necessary Memorandums of Understanding with each State receiving HUD grants to establish necessary data exchange protocols needed to determine the amount of any duplicate benefits.

#### OIG Issues Advisory Memorandum on SBA Staffing During Emergencies or Catastrophes.

On September 25, 2006, the OIG issued an Advisory Memorandum, *Flexible Staffing of SBA Personnel During Times of Emergencies or Catastrophes to Aid Disaster Loan Processing*. The OIG observed that SBA could further enhance DCMS to expand the system's potential user base to include both additional SBA staff and third party contractors to assist loan victims. The OIG recommended that SBA (1) establish a catastrophic disaster plan that includes flexible staffing of SBA personnel assets Agency-wide, and (2) identify the infrastructure requirements that would be needed in the event of full activation of the flexible staffing catastrophic disaster plan. The Agency concurred with the two recommendations.

#### Louisiana Woman Charged for Filing False Applications for Disaster Benefits.

On September 8, 2006, a Louisiana woman was charged via a criminal information filed in the Eastern District of Louisiana with one count of false statements for filing fraudulent

applications for SBA and Federal Emergency Management Agency (FEMA) disaster benefits as a result of Hurricane Katrina. She fraudulently claimed to have lived at a nonexistent residence when, in fact, she resided with her parents at the time of the hurricane and did not suffer any damages. Based on the false claim, she was approved for a \$40,000 SBA disaster loan and received an initial disbursement of \$10,000. She also received FEMA expedited assistance as a result of the false claim. The SBA OIG is conducting this joint investigation with the Department of Homeland Security (DHS).

## ***Business Loan Programs***

OIG Issues Audit of Purchase Review Process. On September 29, 2006, the OIG issued an *Audit of Deficiencies in OFA's Purchase Review Process for Backlogged Loans*. The OIG found deficiencies in the purchase reviews of 9 of the 13 loans sampled, which resulted in a total of \$1,044,567 in improper payments. The OIG determined that SBA's Office of Financial Assistance (OFA) did not identify: (1) \$107,261 in overpayments on two CAPLines loans and missing information on another CAPLines loan that was needed to accurately determine the guaranty purchase amount; (2) inadequate support for equity injection on four loans; (3) unsupported use of proceeds on three loans; and (4) unsecured collateral and a lender's over-accrual of interest on one loan. The OIG recommended that SBA re-examine backlogged loans with a high risk of improper payments and develop a purchase review Form 327 for CAPLines loans to ensure these types of loans are adequately reviewed in the future. OFA indicated that it generally concurred with our findings and recommendations, but did not provide a written response for inclusion in the final report.

OIG Issues Management Advisory Report on SBAExpress and CommunityExpress Programs. On September 29, 2006, the OIG issued a Management Advisory Report, *Policies and Procedures for the SBAExpress and CommunityExpress Loan Programs*. The report raised five concerns about the Express Programs: (1) although the SBAExpress Program has been in existence for over 11 years and was made permanent in 2004 by Congress, SBA had not issued any regulations to govern the program; (2) the Agency's program guide contained credit requirements

for lenders that may conflict with the Small Business Act, and contained provisions in conflict with SBA regulations; (3) the criteria in the program guide for lenders seeking admission to the program may not have provided SBA with sufficient information to identify whether an applicant lender presented an undue risk to the Agency, and appeared to impose more stringent criteria upon lenders who have previously participated in SBA loan guarantee programs than for lenders with no SBA program experience; (4) certain provisions in the program guide were ambiguous, or in conflict with other Agency policies, and did not provide meaningful guidance to lenders or guidance that SBA could rely upon to use enforcement to correct lender noncompliance; and (5) the Agency was relying on a program guide for the CommunityExpress Program that was never officially cleared or issued by SBA, contrary to Agency procedures, and indeed had posted this Guide on the SBA lending website as official SBA policy. The Office of Capital Access agreed with many of the recommendations, either completely or in part.

Guarantor Indicted for Bank Fraud and False Statements. On September 19, 2006, the guarantor on an SBA 504 loan to a marina located in Fort Pierre, South Dakota, was indicted in the District of South Dakota on one count of bank fraud and one count of false statements on a loan application. It is alleged that, in support of the loan application, the guarantor submitted false Personal Financial Statements and false tax returns representing that he had no tax liability and had filed tax returns for 2001, 2002, and 2003. The 504 loan was approved by the SBA in the amount of \$239,000, but was not funded because of the guarantor's legal problems. This case was initiated based on a referral from the SBA District Office, Sioux Falls, South Dakota. The OIG is conducting this joint investigation with the Internal Revenue Service.

Business Owner Charged/Pleads Guilty for False Statements. On September 15, 2006, the former owner of a cabinet making business in the State of Washington was charged via a criminal information filed in the U.S. District Court, Western District of Washington, with one count of false statements to SBA and one count of false statements to a bank. On September 20, 2006, he pled guilty to both charges. The OIG's investigation found that the man inflated his Personal Financial Statement and failed to disclose a prior bankruptcy when he applied for a \$1.5 million SBA-guaranteed business loan to purchase the cabinet making business. He also

submitted the same false financial statement to a federally-insured financial institution to obtain a \$400,000 line of credit for the business. This matter was referred to the OIG by the lender.

## ***Government Contracting and Business Development***

OIG Issues Report on 8(a) Participant's Status. On September 25, 2006, the OIG issued a Management Advisory Report, Economically Disadvantaged Status of an 8(a) Program Participant's Owner. The OIG received an anonymous complaint regarding a company's owner in the 8(a) Business Development program. To be eligible, participant owners need to be both socially and economically disadvantaged. An economically disadvantaged individual's ability to compete is impaired due to diminished capital and credit opportunities. Among other things, after admission to the program, the owner's net worth must be less than \$750,000 to be considered economically disadvantaged. However, while researching this complaint, the OIG determined that the company's owner was the future beneficiary of a trust, a portion of which was valued at well over \$750,000. SBA was unaware of the trust's existence when making initial and continuing eligibility determinations for the company.

The trust had provided the owner with \$100,000 in capital and the company with \$865,000 in credit. Despite the fact that capital and credit opportunities were available to the owner, the trust was not considered a current asset since the company's owner did not have direct access to the funds most of the time because the trustees must authorize the release of funds to the owner. A loophole exists in SBA's regulations because this situation allows a company owned by an individual that has access to capital and credit, i.e. non-disadvantaged, to obtain 8(a) contracts. Participation by non-disadvantaged individuals reduces the opportunities available to those who are legitimately disadvantaged, diverts the energy and efforts of the SBA, and could undermine public support for the program.

The OIG recommended that the Agency perform a review to reassess the owner's economically disadvantaged status after he receives a portion of the trust, determine whether contingent assets such as trusts should be considered when assessing economic disadvantage, and determine whether any regulation

changes on this are needed. The Agency agreed to implement the recommendations.

## ***Agency Management***

OIG Issues Report on Acquisition Personnel Education and Training. On September 29, 2006, the OIG issued a Management Advisory Report, *Concerns Related to SBA's Acquisition Personnel Education and Training.* The OIG reviewed SBA's implementation of Office of Management and Budget (OMB) policy directives pertaining to the Agency's acquisition workforce and found that SBA had not completed the basic steps necessary to comply with OMB policy, including identifying its acquisition workforce, collecting experiential and training information on its acquisition workforce, and assessing the skill level of its workforce. Consequently, SBA could have difficulty meeting the required deadline for having complete and current training, education, and experience data on its acquisition workforce in the Federal Acquisition Institute's Acquisition Career Management System. Additionally, SBA could not provide assurance that it had a highly-qualified and well-trained acquisition workforce that possessed the core competencies specified by OMB. The OIG recommended that the Associate Deputy Administrator for Management and Administration (ADA/MA) develop a plan to assist the Agency in ensuring compliance with OMB requirements. The ADA/MA agreed with the OIG's recommendation.

OIG Issues Audit of Contract Awards. On September 25, 2006, the OIG issued an audit report, *Office of the Chief Information Officer Contract Awards for Agency Mission-Critical Services.* The OIG found that SBA did not properly plan for the re-competition of replacement Office of Chief Information Officer (OCIO) contracts as the original contracts approached their expiration dates. As a result, the original contracts were extended beyond their performance periods. While this was not in violation of the Federal Acquisition Regulations (FAR) or SBA policies because the services were deemed mission-critical, the extensions were clearly not the best option, nor a desirable contracting practice. In addition, although 1-year 8(a) sole-source replacement contracts were eventually awarded, the OIG was concerned that SBA would not complete the steps needed to re-compete the interim contracts before their expiration in March 2007. We also found that, while

awarding the four sole source replacement contracts did not violate Federal law or SBA regulations, the awardees could have difficulty meeting certain 8(a) requirements related to the amount of work required to be performed due to their teaming relationships with much larger firms. Finally, we found that SBA should have requested a current size certification for one firm prior to executing a task order for services as it appeared the firm no longer met the applicable size standard.

The OIG recommended that SBA's Chief Operating Officer (COO) ensure that the CIO and ADA/MA develop a plan for re-competing the four interim replacement contracts prior to their expiration on March 31, 2007, and jointly provide increased scrutiny over the awardees to ensure continued compliance with 8(a) regulations. The COO generally agreed with the OIG's recommendations.

Agency Completes Final Action on Recommendation Made in the Report – Audit of SBA's FY 2005 Financial Statements – Management Letter (Report 6-10). The Agency reported that it completed the following final action. The Office of the Chief Financial Officer (OCFO) reviewed the programmatic and administrative net obligations and net costs of operations to eliminate inconsistency in SBA's proprietary and budgetary accounting. The review determined that the June 30, 2006, interim statements were based on general ledger accounts that were consistent between proprietary and budgetary activity. The Agency will maintain this consistency going forward through its quality assurance process. Eleven recommendations contained in the audit report remain open.

Agency Completes Final Actions on Recommendations Made in Report – Audit of SBA's FY 2005 Financial Statements (Report 6-04). The Agency reported that it completed the following final actions. (1) OCFO worked with OFA to enhance internal controls over the loan charge-off process, and started working with OFA and other Agency program offices to implement the enhanced internal controls enhancements over financial reporting per OMB Circular A-123. As of June 30, 2006 they had processed \$238 million of the estimated \$892 million in loan charge-offs, and the remaining balance will be adjusted based on a report of the Herndon Charge-Off project. (2) OCFO completed its review of accounting transactions, including budgetary accounts and

transactions, to determine conformance with Federal accounting standards, and met regularly with KPMG (the Certified Public Accounting firm that audits the Agency's financial statements) to discuss audit issues. Additionally, in July 2006, OCFO added two senior accountants to the quality assurance staff. Five recommendations contained in the audit report remain open.

Agency Completes Final Action on Recommendation Made in Report – Audit of SBA's Information System Controls for FY 2002 (Report 3-20). The Agency reported that it completed the following final action. The updated Headquarters Continuity of Operations Plan (COOP) was approved by the COO. The document's executive summary supported the identification of the personnel and resources needed in a recovery process, provisions for annual plan testing, plan distribution, and external vendor contracts. Two recommendations contained in the audit report remain open.

Agency Completes Final Action on Recommendation Made in the Single Audit of Federal Assistance Programs Bronx Museum of the Arts (Report 4-35). The Agency reported that it has completed the following final action. The Office of Procurement and Grants Management reported that as of July 1, 2004, the grantee started using a new employee timesheet which has a separate section to report the percentage of time spent on SBA projects and non-SBA projects. One recommendation contained in the report remains open.

## ***Statutory/Regulatory/Policy Reviews***

In an effort to proactively identify and correct potential Agency inefficiency and management problems at the onset of policy and regulatory development, the OIG reviewed, cleared, and/or provided comments, as appropriate, on 10 Agency initiatives, including proposed legislation, Agency Standard Operating Procedures, and Agency notices containing directives to its employees.

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