

# **Fraud Detection in SBA Programs**

**November 1997**

## ***Inspection Report***

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U.S. Small Business Administration**

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## ABBREVIATIONS

CDC	Certified Development Company
CFR	Code of Federal Regulations
DELTA	Defense Loan and Technical Assistance
DOJ	Department of Justice
FBI	Federal Bureau of Investigation
GC	Office of Government Contracting
IRS	Internal Revenue Service
LowDoc	Low Documentation
MED	Office of Minority Enterprise Development
NCIC	National Crime Information Center
ODA	Office of Disaster Assistance
OFA	Office of Financial Assistance
OIG	Office of Inspector General
PLP	Preferred Lender Program
SBA	Small Business Administration
SBIC	Small Business Investment Company
SOP	Standard Operating Procedure

## FORMS

Form 912	Statement of Personal History used for loan, surety, and 8(a) applicants
Form 1081	Statement of Personal History used for SBA lenders such as Certified Development Companies and non-banks
Form 415A	Statement of Personal History used for Small Business Investment Companies
Form 4506	Request for Copy or Transcript of Tax Form
Form 8821	Tax Information Authorization used for Disaster Assistance applicants

## EXECUTIVE SUMMARY

The Office of Inspector General (OIG) initiated this inspection because of indications that two procedures essential for deterring and detecting fraud in Small Business Administration (SBA) programs--completion of a personal history statement and verification of tax return and financial information--are not being used in a consistent manner. To support the Agency's policy of providing loans, loan guarantees, or contractual benefits only to persons of good character, program applicants must submit a Statement of Personal History (Form 912), which includes specific questions about prior criminal records and requests the information necessary for the OIG to conduct a criminal history check with the Federal Bureau of Investigation (FBI). SBA also uses Internal Revenue Service (IRS) verification of tax return and financial statement information to detect fraud by program applicants or participants. These two documents not only help the OIG detect program applicants and participants who have made false statements to secure SBA benefits, but they also serve as a deterrent to applicants who may be contemplating fraud.

The purpose of this inspection was to determine whether the information requested in SBA program application and participant materials provides sufficient criminal history and tax verification information to detect and deter fraud. In addition, the OIG wanted to ascertain if the Agency's tax verification policy is being honored by program personnel when making decisions on applicant approval and continuing eligibility. The inspection team examined the Agency's application packages and interviewed SBA program officials responsible for managing loan or contractual benefit programs. These included Disaster Assistance, Financial Assistance, Government Contracting (Certificate of Competency and Size Standards), Investment (Small Business Investment Companies), Minority Enterprise Development (8a), and Surety Bond Guarantees.

Although Standard Operating Procedure (SOP) 50 10 3 requires that a Form 912, Statement of Personal History, be submitted by all business loan borrowers, the inspection team found that the following 7(a) loan programs neither require the submission of a signed Form 912 in all cases nor request sufficient information for the FBI to perform criminal history checks on individual borrowers: LowDoc, FA\$TRAK, Women's Prequalification, Minority Prequalification, Export Working Capital, and Capital Access.

Given SBA's objective of reducing paperwork and the fact that criminal history checks were only being performed for applicants who admitted having a criminal record, program officials began to limit the use of the Form 912. The form, however, includes the information necessary for conducting an FBI criminal history check (name, social security number, date of birth, place of birth). Since 1993, a series of random sample

criminal history checks by the OIG have found instances where significant numbers of applicants had failed to disclose their prior criminal records when applying for SBA financial assistance. For one of the OIG random samples, checks could not be performed on LowDoc borrowers, who represent a substantial portion of SBA-guaranteed loans, because SBA does not require them to complete the Form 912. Although the revised draft SOP states that the Form 912 is not necessary if the information is available elsewhere, the inspection team found that, in fact, not all of the information is provided elsewhere. Moreover, the OIG recently found that loans are almost three times more likely to be “charged-off” or placed “in liquidation” if a borrower has an undisclosed criminal record. There are also indications that a borrower with an undisclosed criminal record is more likely to default in the early stage of a loan. Given this relationship between performance and criminal history, the OIG plans to regularly conduct criminal history checks on 7(a) loans that are placed in liquidation while the loan is still maturing, i.e., within the first two or three years.

SBA officials responded to our concerns by revising the LowDoc application to include the necessary elements as well as warnings that should serve as a deterrent to applicants contemplating fraud. The OIG has agreed that including the information required by the Form 912 on the specialized 7(a) program applications is an acceptable substitute for submitting a Form 912. **The OIG recommends that the Office of Financial Assistance (OFA) either require all its financial assistance applicants to submit the completed Form 912 or include the necessary information fields on the application form. In the latter case, the application form must contain: (1) the data elements required to perform a criminal history check on each principal; (2) criminal history questions answered by each principal, accompanied by each principal’s signature; (3) a statement authorizing SBA to request criminal records from other agencies; and (4) a warning concerning false statements.** Appendix B, Revised LowDoc Application Form, shows an acceptable method for incorporating these elements in an application form.

Lenders in the 7(a) Preferred Lender Program (PLP) are not required to include the completed Form 912s in loan information sent to SBA and, as a result, the OIG is unable to perform criminal history checks on most PLP loans. Applicants who admit to having a criminal record are eliminated as candidates for PLP loans and must apply under SBA’s regular loan program, which requires Agency approval of each loan. **The OIG recommends that OFA require PLP lenders to include the completed Form 912 in the loan materials submitted to SBA’s PLP Processing Center.**

Because the Office of Disaster Assistance (ODA) does not require all applicants to submit the Form 912, the OIG is unable to perform criminal history checks to determine the potential for fraud in the program. The Disaster Assistance Program is unique among SBA loan programs in many ways, including its mission to replace or repair damaged property without adding value. Nevertheless, the Disaster Assistance Program faces the

same potential for fraud as other SBA lending programs and should require comparable fraud deterrence and detection measures. Neither the disaster home nor business loan application contains all the information necessary to conduct a criminal history check. Because the OIG intends to perform criminal history checks on a random sample of charged-off disaster business loans each year, **the OIG recommends that ODA either require all disaster business loan applicants to complete a Form 912 or incorporate the necessary information into the application form.** Appendix B, Revised LowDoc Application Form, provides an example of an acceptable way to meet this requirement.

The Statement of Personal History (Form 1081) used in the application process for 7(a) non-bank lenders and Section 504 Certified Development Companies does not currently request all the information required for a criminal history check. The applicant's social security number was inadvertently omitted when the Form 1081 was revised in 1991. **The OIG recommends that OFA revise the Statement of Personal History (Form 1081) to ensure that all information necessary for the OIG to conduct a criminal history check is included.**

Although IRS verification is required for all tax returns and financial statement information submitted by applicants in the 7(a) business loan program, it is not always used for making decisions on loan approvals. A 1996 audit of a random sample of LowDoc loans, as well as preliminary information from a follow-up audit, indicates that a significant number of lenders either did not request IRS verification information for all LowDoc loans or requested it after the loans had been disbursed. Therefore, **the OIG recommends that OFA develop procedures to ensure that all applicants' tax returns and financial statements are verified with IRS information prior to loan disbursement.**

Although IRS verification information is also required for all tax returns and financial statements submitted by applicants and participants in the 8(a) minority assistance program, it is not always used by Minority Enterprise Development (MED) personnel when making decisions on applicants and on 8(a) continuing eligibility. Because IRS responses sometimes fail to meet the ten working day response target, 8(a) program officials handling the new electronic application pilot program do not wait for the IRS to send the verification information. In addition, MED's district officials making continuing eligibility decisions often fail to obtain the signed waivers and/or send them to the IRS. **To ensure that financial information verification procedures are applied consistently, the OIG recommends that MED enforce SBA policy by amending the 8(a) SOP to include a requirement that information from the IRS be obtained and used to verify financial statements and/or tax returns for the electronic application process and for establishing a firm's continuing eligibility for the 8(a) program.**

While SBA's size standard specialists request the tax verification waiver from applicants and use tax returns and financial statements to determine whether firms meet size criteria, they are not required to obtain verification information from the IRS because of occasional delays in IRS responses and the need to approve contracts within ten days. To verify the financial information submitted by a firm to support a size claim, regardless of whether the size determination involves a contract, the waiver forms should be forwarded to the IRS in all cases. If the IRS fails to meet the ten day time limit on size determinations, the award can be made without verification from the IRS and appropriate measures can be taken by the OIG if evidence of fraud is found.

**The OIG recommends that the SBA Policy Notice on tax verification be revised to include the Size Standards program.**

Although SBA's Office of Surety Guarantees relies on an applicant's financial statements to determine a contractor's credit worthiness, IRS information currently is not used to verify the accuracy of the financial information. We believe that SBA should not provide bonding to applicants who fail to file tax returns or to contractors who falsify their financial information. There is sufficient evidence of fraud and of non-filers in SBA loan programs to warrant a pilot test to determine whether fraud is occurring in the Surety Guarantees program. **The OIG recommends that the Surety Guarantees program conduct a one-year pilot test to obtain tax verification information from the IRS and compare it to applicant financial statements.**

Some lenders and SBA program officials are reluctant to use the IRS tax verification process due to periodic and inconsistent delays among IRS field offices in obtaining verification information. Therefore, **the OIG recommends that the Associate Administrator for Financial Assistance, the Associate Administrator for Government Contracting, the Associate Administrator for Minority Enterprise Development, and the Associate Administrator for Surety Guarantees assign appropriate personnel to work with the IRS to streamline the tax verification process.**

Disaster assistance officials provide the names of all non-filers to the OIG, which in turn sends them to the IRS for use in tax collection enforcement. The 7(a) program has also been diligent in contacting the OIG in instances of fraud. Nevertheless, SBA officials need to emphasize to the participating lenders that it is the lenders' responsibility to report cases of fraud directly to the OIG. Furthermore, MED program officials advised the inspection team that, while non-filers are denied entry to the 8(a) program, their names are not currently provided to the OIG. **The OIG recommends that all SBA programs using IRS tax verification be required to provide the OIG the names of program applicants and/or participants who have failed to file tax returns or who are found to have provided false financial information.**

Information on SBA 7(a) loan programs on the Agency's Internet site (1) does not provide a clear statement of SBA's "good character" policy, (2) appears misleading and confusing regarding the requirement to submit the Form 912, and (3) fails to state SBA's policy requiring IRS tax verification as a precondition for obtaining Agency guarantees. Because the Internet site is SBA's "window to the world," **the OIG recommends that OFA revise the loan program information on SBA's Internet site to clarify the Agency's "good character" policy and to inform potential applicants of the measures taken to enforce this policy.**

## **SBA Program Comments**

### Office of Economic Development

The Associate Deputy Administrator concurred with the need for both criminal history checks and Federal income tax verification in each of SBA's lending programs. He did not agree, however, with conducting a one-year pilot test to obtain IRS tax verification in the Surety Guarantees program. The Associate Administrator of the Surety Guarantees program believes the tax verification process will place an additional paperwork burden on his customers at a time when surety and contractor participation has been declining. He suggests that a study be conducted to prove fraud exists in the program prior to imposing the tax verification requirement.

The OIG agrees that a study would be appropriate prior to establishing any permanent requirements. The OIG is unable to determine the extent of surety bond fraud, however, without the surety companies obtaining tax verification information and comparing it to the financial statements of the applicants. Based on a one-year trial period, SBA could determine whether there is sufficient fraud to justify tax verification on a permanent basis. The evidence of fraud and individuals not filing tax returns in the loan programs was disclosed only through use of the tax verification procedure, and we believe a similar test should be applied to the Surety Guarantees program.

Rather than being a paperwork burden, the verification information provided by the IRS would be a useful tool for the surety companies in verifying financial statements and making their bonding decisions. The burden on the contractors would be minimal; only their name, address, social security number, and signature on the Form 4506 are needed to allow the surety companies to obtain their tax records from the IRS. Moreover, the verification process would not cause a delay in the bonding process. As noted in the report, bonds can be



approved prior to receiving a response from the IRS, and if evidence of fraud is found, the OIG can pursue a civil or criminal remedy.

#### Office of Disaster Assistance

The Associate Administrator for Disaster Assistance did not concur with the recommendation to require all disaster business loan applicants to complete a Form 912 but has agreed to consider revising the disaster business application to include the additional data items needed for a background check. The OIG has requested that the application also include the waiver statement on the application authorizing the OIG access to the applicant's criminal record information.

#### Office of Government Contracting (GC) and MED

The Acting Associate Administrator for GC/MED responded that he did not have any formal comments on this report.

## BACKGROUND

Good character is a requirement for Small Business Administration (SBA) assistance.<sup>1</sup> Consequently, SBA uses personal history statements and Federal tax information submitted by program applicants and/or participants to assist in determining good character and to deter and detect fraud in Agency programs that provide monetary or contractual benefits (excluding grants and cooperative agreements). The Office of Inspector General (OIG) initiated this inspection because of indications that these procedures were not being used consistently.

Standard Operating Procedure (SOP) 50 10 3, Policies and Procedures for Financing Functions, requires that the Form 912, Statement of Personal History, be submitted by all business loan borrowers.<sup>2</sup> The Form 912 includes three questions on prior criminal records and requests the information necessary for the Federal Bureau of Investigation (FBI) to conduct a criminal history check. In August 1996, the SBA OIG Investigations Division reported that of over 3,300 repurchased loans handled by district offices between 1990 and 1993, 11.6 percent of the borrowers did not disclose their criminal records in the application process. More recently, an OIG check of a sample of performing and non-performing loans approved between October 1993 and August 1996 found, however, that the 7(a) Low Documentation (LowDoc) loan program did not require either the Form 912 or sufficient information to conduct a criminal history check.

In the early 1990s, as loan officers in California referred questionable loan applications to the OIG, its investigators began to discover significant numbers of fraudulent tax returns submitted by borrowers. A pilot program of tax verification in selected areas of the country demonstrated that the problem was national in scope. Since October 1994, SBA has thus required that all applicants for, and/or participants in, the disaster assistance, financial assistance, and Minority Enterprise Development (MED) programs sign a release form allowing SBA or its lenders to obtain tax verification information directly from the Internal Revenue Service (IRS).<sup>3</sup> The information is to be used in making decisions on applicants' eligibility. There have been indications, however, that these fraud prevention measures are not being applied in a consistent manner across SBA's programs. In the LowDoc program, for example, a 1996 OIG audit found that some

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<sup>1</sup> See, for example, Standard Operating Procedure (SOP) 50 10 03, Policies and Procedures for Financing Function, p.33; SOP 50 45 2, Surety Bond Guarantee Program, p. 40; SOP 50 30 3 Disaster Loans, pp. 35 and 140; SOP 80 05 2 Minority Small Business and Capital Development Program: Volume I, pp. 88 and 439.

<sup>2</sup> Disaster business loans are covered by a separate SOP.

<sup>3</sup> "Obtaining IRS Tax Return Information to Verify Financial Information Submitted in Program Applications," SBA Policy Notice, Control No. 9000-941, Effective 10/7/94.

lenders did not always verify tax return information prior to approving a loan. Given its mandate to detect and prevent fraud, the OIG has an obvious interest in having SBA tighten its procedures to ensure compliance on the part of all program participants.

## **OBJECTIVES, SCOPE, AND METHODOLOGY**

The purpose of this inspection was to determine whether the information requested in SBA program application and participant materials provides sufficient criminal history and tax verification information to detect and deter fraud. The OIG also sought to determine if tax verification information was being used by program personnel in making decisions on the approval of applicants and the continuing eligibility of participants. The OIG inspection team examined program application packages and interviewed officials of the following SBA programs that provide small businesses with monetary or contractual benefits:<sup>4</sup> Disaster Assistance, Financial Assistance, Government Contracting (Certificate of Competency and Size Standards), Investment (Small Business Investment Companies), Minority Enterprise Development (8a), and Surety Bond Guarantees. To determine whether correct forms were being provided to applicants, a small judgmental sample of SBA lenders and surety companies was contacted to request copies of the application forms they used.

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<sup>4</sup> For this inspection, the OIG did not address the issue of either character eligibility or tax verification in grant or cooperative agreement programs.

## CRIMINAL HISTORY CHECKS

**Form 912.** The completion of SBA Form 912, “Statement of Personal History,” by program applicants is an important safeguard against fraud. First, it identifies who must submit the form.<sup>5</sup> Without the Form 912, one applicant is put in the untenable position of having to respond for all of the business associates regarding their criminal backgrounds. Second, the Form 912 requests information that is key to determining good character and program eligibility, i.e., whether the applicant is presently under indictment, on parole or probation, or has ever been charged or convicted of any criminal offense other than a minor motor vehicle violation. Third, it asks for personal data essential for the FBI to conduct a criminal history check: name, place of birth, date of birth, and social security number; it also requests additional information that can facilitate the check (company name and address). Finally, a revised edition of the Form 912, soon to be in circulation, clearly informs the applicant that “it is against SBA’s policy to provide assistance to persons not of good character. . . .” and underscores this warning by including a statement authorizing the OIG to request information from criminal justice agencies for the purpose of determining eligibility for SBA programs (See Appendix A).

Prior to 1987, all loan applicants underwent a complete criminal history check by the FBI before loan disbursement. Because the FBI cannot guarantee the identity of an individual without using fingerprints, the FBI changed its policy to also require an applicant’s fingerprints to perform its checks. Based on the results of previous criminal history checks, the OIG recommended that SBA’s loan application process be modified to include the submission of fingerprints by all applicants.<sup>6</sup> Citing the intrusive nature of fingerprints, SBA management declined to adopt the recommendation.

With the approval of the Department of Justice (DOJ), the FBI continued limited criminal history checks without fingerprints. Business loan program officials, however, decided that requesting a criminal history check for every applicant caused undue delays in the lending process. Consequently, since the late 1980s, while the loan processing SOP has required the submission of a Form 912 by every applicant, SBA has required a criminal history check (and the submission of fingerprints by the applicant) only in those cases where an associate, e.g., “a principal” or “officer,” of the applicant business admits to

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<sup>5</sup> Form 912 must be filled out and submitted by: (1) in the case of a sole proprietorship, the proprietor; (2) in a partnership, each partner; (3) in a corporation or a development company, each officer, director, and holder of 20 percent or more of the voting stock; and (4) any other person, including a hired manager, who has authority to speak for and commit the borrower in the management of the business.

<sup>6</sup> According to OIG Investigation numbers, in the three years prior to 1987, over \$29 million in potentially fraudulent loans was identified through criminal history checks.

having a criminal record.<sup>7</sup> This procedure is also followed by the MED and Surety Bond Guarantee programs.

In recent years, program officials have made further changes in the requirement for submitting a Form 912 to reduce the amount of paperwork on SBA loans. The latest (1997) draft of the loan processing SOP attempts to codify these changes for “specialized programs” by stating that the Form 912 must be used “. . . in all business loan programs unless a special program specifically excepts use of the form because the information is provided elsewhere in the application.”

The OIG is working to obtain a Special Purpose Code from DOJ allowing direct access to NCIC records. In addition, the OIG is exploring the feasibility of lenders electronically submitting the necessary criminal history data fields found on the Form 912 to minimize turnaround time. The OIG has proposed to the SBA Administrator that the OIG initiate a pilot test in the fourth quarter of FY 1998. Assuming satisfactory completion of the pilot test, the criminal history checks would be implemented program-wide in FY 1999.

***Conclusion 1:***        ***The following 7(a) loan programs neither require the submission of a signed Personal History Statement (Form 912) in all cases nor request sufficient information for the FBI to perform criminal history checks on individual borrowers: LowDoc, FA\$TRAK, Women’s and Minority Prequalification, Export Working Capital, and Capital Access.***

**7(a) Loan Programs.** The inspection team reviewed the application packages of all financial assistance programs and found that (1) not all of the programs require a Form 912 and (2) those that do not require the form also fail to obtain the information needed for the FBI to conduct criminal history checks on individual applicants.<sup>8</sup> While the regular 7(a), Capline, Defense Loan and Technical Assistance (DELTA), International Trade, and Section 504 programs require that a Form 912 be submitted by every applicant

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<sup>7</sup> SOP 50 10 3, pp. 85-86. According to the Code of Federal Regulations (CFR), an associate of a small business is: (1) an officer, director, owner of more than 20 percent of the equity, or key employee of the small business; (2) any entity in which one or more individuals referred to in (1) owns or controls at least 20 percent; and (3) any individual or entity in control of or controlled by the small business (except a Small Business Investment Company licensed by SBA). 13 CFR, §120.10, January 1, 1997, p. 141.

<sup>8</sup> The application packages received from the Central Office and from the judgmental sample of individual lenders and surety companies did not always include Form 912. Either the particular program did not require Form 912 or, like the application packages received from the Central Office, several packages were often consolidated into one, making it difficult to determine which forms were used in each 7(a) program.

prior to loan approval,<sup>9</sup> the LowDoc program and other specialized 7(a) programs do not use the regular 7(a) application form and have not been requiring the submission of a Form 912 by every applicant. (See Appendix C for brief descriptions of SBA programs mentioned in this report.)

In summary, the Form 912 is currently not required of applicants to the LowDoc, Women's Prequalification, or Minority Prequalification programs; each program relies on the applicant's honest response to the criminal history question(s) on the application form itself. If an individual responds that he/she or any business associates have a criminal history, the application must be submitted to the Agency's regular 7(a) program, which requires the submission of a Form 912. In the Export Working Capital Program, only applicants who admit on the application form that they or their business associates have a criminal history must submit a Form 912. None of the application packages for the above referenced programs requires sufficient information for the FBI to conduct a criminal history check absent a Form 912, although the LowDoc application is currently missing only one field necessary for performing the check. The 18 lenders participating in the FA\$TRAK pilot program use their own forms and SBA Form 1919, which asks if the applicant has a criminal record. Again, if the response is affirmative the applicant may not apply for a FA\$TRAK loan. The OIG obtained application packages from one-third of the FA\$TRAK lenders, and none contained sufficient information to conduct a criminal history check on an applicant. In addition, the Capital Access pilot program uses only the lender's forms and does not collect all of the required background data. In short, while these specialized 7(a) programs are not available to applicants who admit they have criminal records, those who hide their criminal history enjoy access to these same programs.

Given SBA's objective of reducing paperwork and the fact that criminal history checks were only being performed for applicants who admitted having a criminal record, program officials began to limit the use of the Form 912. In FY 1993, however, the OIG began to notice that after a number of borrowers became subjects of fraud investigations, their criminal backgrounds came to light. A random 1993 sample of 250 loans selected from all 7(a) loans indicated there might be a significant number of applicants who failed to disclose their criminal histories. As a consequence, the OIG Investigations Division conducted Operation Clean Sweep I, which sought to (1) identify and prosecute individuals who had defrauded SBA through false statements and (2) determine the extent of fraud perpetrated against the SBA through the nondisclosure of prior criminal records. A statistical sample was taken from a universe of over 5,000 repurchased loans handled

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<sup>9</sup>Capline, DELTA and International Trade loans are 7(a) or Section 504 loans and use their respective application forms. The DELTA program, however, is funded by Defense Appropriations, while International Trade loans are 7(a) or 504 loans coupled with separate Export Working Capital loans.

by SBA districts between 1990 and 1993.<sup>10</sup> Of the 3,352 borrowers who were examined, 11.6 percent in 23 districts had not disclosed their criminal records at the time they submitted their application for financial assistance.

At the request of the Deputy Administrator, the OIG conducted Operation Clean Sweep II to determine the relationship between the performance of the overall loan portfolio and the criminal history of its borrower population. From a universe of 148,405 loan guarantees made between October 1993 and August 1996, a stratified statistical sample of 1,200 loan guarantees was selected--600 performing and 600 non-performing. Non-performing loans were defined as "charged-off" or "in liquidation." Copies of the Form 912 were provided by SBA district offices and servicing centers for 504 of these loans--226 performing and 278 non-performing, and criminal history checks were conducted on 966 individuals associated with these loans. Unfortunately, checks could not be performed on 494 LowDoc loans collected in the sample because those applicants were not required to submit a Form 912.<sup>11</sup> This is a significant exclusion because LowDoc loans account for a substantial part of SBA's business loan portfolio--more than one-third of all 7(a) loans approved in FY 1996.

In Operation Clean Sweep II, the OIG found that almost 8 percent of the loans that were either "charged off" or "in liquidation" as of September 1996 were associated with borrowers who had not disclosed their criminal records; however, only 3 percent of the performing loans were associated with borrowers with such records. As a predictor of performance for loans less than three years old, there is nearly a 6 percent likelihood of loans being "charged-off" or placed "in liquidation" if borrowers have an undisclosed criminal record, but only slightly more than a 2 percent chance for borrowers without any criminal history. As loans made during this period become more seasoned, i.e. mature enough to reflect losses (three to four years), additional loans will become non-performing, and the predictive value of an undisclosed criminal record is expected to be greater.

Increasingly, the OIG has found a relationship between non-performing loans and borrowers who conceal criminal records. The Audit Division is currently conducting individual reviews of loans approved from October 1993 to September 1995, with disbursed amounts greater than \$100,000, that were placed in liquidation within 12

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<sup>10</sup> Because we cannot corroborate the information provided by the borrower, and the FBI cannot guarantee the identity of an individual without the use of fingerprints, the OIG takes a very conservative approach in verifying that the subject identified by the FBI is the same person as the SBA borrower. Thus, some individuals may escape detection by using other names or identification.

<sup>11</sup> Twelve of the 509 LowDoc loan files (15 applicants) drawn in the sample contained a Form 912, indicating that some district offices or lenders may be requiring them.



months of origination. Out of a universe of 132 loans, the borrowers of almost 14 percent of the loans failed to disclose criminal records.

As a result of the Clean Sweep Operations and indications that a borrower with an undisclosed criminal record is more likely to default in the early stage of a loan, the OIG plans on performing criminal history checks on 7(a) loans that are placed in liquidation while the loan is still unseasoned. To accomplish this goal, the OIG will need the information contained on the Form 912. Given SBA's objective of requiring only one SBA form for the LowDoc and FA\$TRAK programs, the OIG agrees that if all the necessary information is incorporated into the applications, the Form 912 may be omitted. A problem arises when there is more than one principal in the firm applying for a loan. In such cases, each principal will need to answer the criminal history questions and provide a signature acknowledging that the warnings were read and the questions answered honestly. The application form must include the following:

- A prominent notice that the criminal history information is required for each principal of the applying firm (see top of Form 912 in Appendix A for principals list).
- All four data elements required for a criminal history check for each principal (full name, social security number, date of birth, and place of birth).
- A prominent warning that the criminal history question(s) must be answered truthfully and that knowingly making a false statement is a violation of Federal law (see Appendix A).
- The criminal history question(s) with Yes/No response(s) completed by each principal in the applying firm (see Appendix A).
- A statement authorizing the SBA to request criminal record information from other agencies (see Appendix A).
- A signature block in close proximity to the criminal history question(s).

7(a) program officials responded to our concerns by revising the LowDoc application form to include the above required elements. While still in draft, OIG officials concurred with the changes (see Appendix B, Revised LowDoc application form).

**Recommendation 1: The OIG recommends that the Office of Financial Assistance (OFA) either require all its financial assistance applicants to submit the completed Statement of Personal History (Form 912) or include the necessary information fields on the application form. In the latter case, the application form must contain: (1) the**

**data elements required to perform a criminal history check on each principal; (2) criminal history questions answered by each principal, accompanied by each principal's signature; (3) a statement authorizing SBA to request criminal records from other agencies; and (4) a warning concerning false statements.**

***Conclusion 2: Lenders in the 7(a) Preferred Lender Program (PLP) are not required to include the completed Statement of Personal History (Form 912) in loan information sent to SBA and, as a result, the OIG is unable to perform criminal history checks on most PLP loans.***

Approximately 29 percent of the 7(a) program's loan volume is made through the PLP, under which lenders are authorized to analyze borrowers' credit factors and make loan guarantees without prior SBA approval. Lenders submit their analysis and selected information on the borrower's eligibility to SBA's PLP Processing Center. For example, one item of interest to both OFA and the OIG is whether the applicant answered the criminal history questions on the Form 912 affirmatively. If the applicant admits to having a criminal record, the application must be made under the regular 7(a) loan program and the entire package is sent to an SBA district office for approval. Although some lenders apparently submit the Form 912 to the PLP Processing Center, there is no requirement that they do so. Consequently, the OIG cannot readily obtain the form to verify the borrower's statement if the loan is purchased or used as part of a random sample of borrowers.

**Recommendation 2: The OIG recommends that the OFA require PLP lenders to include the completed Statement of Personal History (Form 912) in the loan materials submitted to SBA's PLP Processing Center.**

***Conclusion 3: Because the Office of Disaster Assistance does not require all applicants to submit a Statement of Personal History (Form 912), the OIG is unable to perform criminal history checks to determine the potential for fraud in the program.***

**Disaster Assistance Program.** SBA's Disaster Assistance program provides direct home and business loans to victims of disasters declared by the President or the SBA Administrator.<sup>12</sup> According to the Associate Administrator for Disaster Assistance, the disaster home loan program has never required the submission of a Form 912 by every applicant. Moreover, the home loan application does not contain any of the criminal

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<sup>12</sup> See Appendix C for additional information on the Disaster Assistance program.

history questions that appear on the Form 912. Instead, as required by the Housing and Urban Development Act of 1968, each applicant is asked whether he/she has ever been convicted of a felony in “connection with a riot or civil disorder.” Applicants answering affirmatively must submit a Form 912 and a set of fingerprints.

The disaster business loan program required the submission of the Form 912 by every applicant until 1993, when the entire disaster loan application process was streamlined and paperwork reduced. The business loan application form now includes one comprehensive criminal history question. Only those applicants answering the question affirmatively must complete a Form 912 and submit a set of fingerprints.

The disaster program serves a unique socioeconomic purpose: to provide fast, low-cost loans as a rehabilitation measure to replace damaged property. Contrary to the objective of SBA’s other lending programs, disaster assistance is not intended to add value to a home or business. To respond to the urgent needs of disaster victims, the program does not, therefore, use the same underwriting standards that other SBA loan programs use.<sup>13</sup> Thus, while other SBA lending programs prohibit Agency assistance to applicants who can receive credit elsewhere, the disaster program can provide them with loans--but at a higher interest rate than those disaster victims who cannot obtain credit elsewhere. In addition, disaster loans were exempted when the Debt Collection Improvement Act of 1994 barred delinquent Federal debtors from obtaining Federal loans.

**Importance of Criminal History Checks in the Disaster Assistance Program.** Due to an unprecedented number of significant natural disasters, the OIG investigations workload has steadily increased over the last five years. The percentage of investigative work devoted to the disaster program has increased from approximately 6 percent of the caseload in FY 1991 to over 25 percent currently. In the past three years, the OIG has initiated 95 disaster-related investigations involving \$22.5 million in loans and obtained 52 indictments. Projections indicate that the level of disaster fraud referrals will continue to increase because, in addition to cases initiated as the result of new disasters, the OIG will receive new fraud referrals as loans generated by the numerous disasters of the past three years begin to default.

Although the disaster program is unique among SBA loan programs in many ways, it faces fraud problems that are similar to those of other SBA lending programs. Therefore, the OIG believes it too should require comparable fraud deterrence and detection measures. A requirement for a Form 912 that clearly states SBA’s character policy would serve as a strong signal to all applicants that SBA may verify their backgrounds with law enforcement agencies and, therefore, deter fraud in an efficient manner. At this time,

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<sup>13</sup>U.S. House of Representatives, Hearings before the Committee on Banking and Currency, First Session on HR 6645 and HR 7474, May 1957.

however, the OIG does not have sufficient resources to check the criminal histories of large numbers of disaster assistance borrowers. Nevertheless, because the dollar value of individual disaster business loans is much greater than that of home loans and the risk to the Government therefore more substantial, the OIG intends to perform criminal history checks on a sample of charged-off disaster business loans each year. As resources permit, sample checks will also be performed periodically on all disaster business loans.

Currently, neither the disaster home nor business loan application contains all the information necessary for conducting an FBI criminal history check. Although such checks would be performed after loan disbursement and the money, therefore, may not be recoverable, the SBA would gain from knowing how many defaulted loans were approved for borrowers with criminal histories. The prospect of a check on business loans could also be an effective deterrent; disaster loan officers could refer the applicant to the warning on the Form 912 concerning criminal prosecution for false information.

The OIG does not believe that the use of the Form 912 for business loans would add a significant burden to either the disaster program staff or the applicants. For the Disaster Assistance program, the deterrent value of the Form 912 should outweigh its minimal paperwork requirement. If the Associate Administrator for Disaster Assistance prefers to add the necessary data fields and warnings to the loan application form instead of requiring the Form 912, the revised LowDoc application form in Appendix B illustrates an acceptable method for doing so.

**Recommendation 3: The OIG recommends that the Office of Disaster Assistance either require all disaster business loan applicants to complete a Form 912 or incorporate the necessary information in the application form.**

***Conclusion 4: The Statement of Personal History (Form 1081) used in the application process for 7(a) non-bank lenders and Section 504 Certified Development Companies does not currently request all the information required for a criminal history check.***

**Other SBA Personal History Statement Requirements.** The Form 912 must be submitted by individual applicants for guarantees used in the Surety Guarantees program and for certain cases in the Certificate of Competency program in the Office of Government Contracting. Applications by institutions to become 7(a) non-bank lenders, Section 504 Certified Development Companies (CDCs), 7(m) microloan intermediaries, and Small Business Investment Companies (SBICs) are required to include either a Form 912 or its equivalent for specified associates.<sup>14</sup> The Statement of Personal History, Form

1081, submitted by CDCs and non-bank lenders does not, however, request the applicant's social security number, which is necessary information for conducting a criminal history check. While it may have been inadvertently omitted when the Form 1081 was revised in 1991, the form should be modified to include the applicant's social security number. This addition would preclude the practice of program officials having to ask each applicant to "write in" his/her social security number.

**Recommendation 4: The OIG recommends that the Office of Financial Assistance revise the Statement of Personal History (Form 1081) to ensure that all information necessary for the OIG to conduct a criminal history check is included.**

**Minority Enterprise Development--8(a)--Program.** The Form 912 is required of all applicants for 8(a) certification, and an applicant who indicates a prior criminal history must also submit a fingerprint card. In an effort to streamline the certification process, the Office of Minority Enterprise Development (MED) recently completed a pilot project using an electronic application. Although program officials initially sent the Form 912s only to applicants who responded affirmatively to criminal history questions on a diskette, they found that this delayed the process and decided to request the Form 912 of all applicants. The revised electronic application, accessible through the Internet, directs applicants to complete the Form 912 and submit it with their application package.

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<sup>14</sup>The equivalent forms (Form 1081 for CDCs and non-bank lenders and Form 415A for SBICs) request additional information appropriate to those particular programs.

## FEDERAL INCOME TAX VERIFICATION

**Tax Return Verification Program.** The purpose of SBA's tax verification policy is to detect fraudulent financial information so that applications from persons whose character and financial integrity are suspect can be declined. Also, the SBA can determine instances of non-filed tax returns and report such "non-filers" to the IRS. As indicated in the background section, the importance of tax verification information was clearly demonstrated in the early 1990s when the OIG found the submission of fraudulent tax return information to be a recurring scheme for perpetrating fraud against SBA loan programs. Since 1992, the OIG has received allegations of fraudulent tax returns involving \$122 million in loans for 1,194 individuals. To date, 99 individuals have been indicted for submitting fraudulent tax returns, 91 of those have pled or been found guilty, and over \$20 million in criminal and civil fines and court-ordered restitutions have been levied. Since October 1994 alone, the OIG has received allegations involving 559 individuals with requested loan amounts of \$32.6 million. Most of that amount was not disbursed as a result of the verification program, thus helping to ensure sufficient subsidy authority for loans to honest applicants.

Since October 1994, SBA lenders and program officials have been required to obtain Federal income tax information from the IRS to verify the tax returns and financial statements of all financial assistance, disaster assistance, MED--8(a)--program participants when making program decisions. Program applicants or participants must sign an IRS release form authorizing SBA or the participating lender to obtain tax data directly from the IRS.<sup>15</sup> The release is forwarded by the lender or SBA to a designated IRS field office which, in turn, provides SBA or the lender with selected information from the applicant's business and/or personal tax return. Depending on the SBA program, either the lender or an SBA official is responsible for comparing the data received from the IRS with the financial data submitted by the loan applicant or participant to determine whether there are significant discrepancies. If the applicant or participant cannot provide a satisfactory explanation, or the discrepancy is significant enough to indicate possible fraud, the SBA loan, loan guarantee, or benefit is denied and, in the case of applications for financial assistance, the financial discrepancies and analysis are to be submitted to the OIG. This referral procedure is a major element in the Agency's and the OIG's effort to deter and detect fraudulent financial data.

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<sup>15</sup> Financial assistance and 8(a) applicants and participants submit IRS Form 4506, Request for Copy or Transcript of Tax Form. Disaster assistance applicants submit IRS Form 8821, Tax Information Authorization, which permits disaster officials to request additional information from the IRS, if necessary. See Appendix D and E for copies of the two forms.

**Conclusion 5.** *Although IRS verification information is required for all tax returns and financial statement information submitted by applicants in the 7(a) business loan program, it is not always used for making decisions on loan approvals.*

**Business Loan Programs.** All participating lenders are required to submit an applicant's tax verification waiver (Form 4506) to the IRS and use the information received in making loan decisions. Nevertheless, a 1996 OIG audit using a random sample of 70 LowDoc loans approved from the program's inception in December 1993 to May 1995 found that, for almost 13 percent of the loans, IRS verification was either not requested, requested after loan disbursement, or not reconciled with the applicant's financial data.<sup>16</sup> As of March 1997, one of the nine loans was in liquidation and two others were past due. Preliminary data from a more recent audit of 120 LowDoc loans approved between December 1993 and September 30, 1996, indicates that lenders failed to obtain IRS verification of applicants' tax returns or disbursed the loans before an IRS response was received for almost 23 percent of the loans. Of those 26 loans, five (valued at \$285,000) were non-performing at the time of the audit.

The Form 750, Loan Guaranty Agreement (Deferred Participation), is the Agency's basic agreement with all SBA-guaranteed business lenders. SBA should take steps to ensure that lenders verify financial information with IRS data by incorporating the Agency's tax verification policy into the basic agreement; the agreement should also stipulate that participating lenders refer all cases of potential fraud to the OIG. A reference to the tax verification policy should also be included in the SOP used for the Preferred Lender Program (PLP) review. OFA should further ensure the lenders' compliance with the policy by requiring that they submit the signed waiver form, complete with the date on which it was sent to the IRS, along with the other loan documentation they provide to SBA. Moreover, prior to purchasing a loan, OFA should check to determine if the tax verification requirement was met and emphasize to lenders beforehand that failure to complete all "due diligence" requirements, i.e., ensuring that all conditions are met prior to disbursement, can result in denial of liability on the guarantee if a loan defaults.

**Recommendation 5: The OIG recommends that Office of Financial Assistance develop procedures to ensure that applicants' tax returns and financial statements are verified with IRS information prior to loan disbursement.**

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<sup>16</sup> SBA OIG, "Audit Report on the LowDocumentation Loan Program," (Audit Report No. 6-5-E-002-022, September 30, 1996), p. 7 and Appendix C, pp. 1-3.

**Conclusion 6.** *Although IRS verification is required for all tax returns and financial statements submitted by applicants and participants in the 8(a) minority assistance program, it is not always used by MED personnel when making decisions on applicants and on 8(a) continuing eligibility.*

**8(a) Program.** At this point, the OIG has not independently determined whether signed tax verification waivers are always submitted to the IRS or if the information provided by the IRS is always used for verification purposes in the SBA's 8(a) program. Nevertheless, the inspection team was informed by 8(a) program officials that in the recent electronic application pilot program, they did not wait for the IRS to send the verification information because the IRS does not always provide the information within the 15 day limit for processing completed electronic applications; MED officials indicated that IRS verification can take as long as three to five weeks. MED officials should ensure that the Form 4506 is completed and sent to the IRS, and if the IRS fails to meet the 15 day limit the applicants should be conditionally approved, pending tax verification.

According to the October 1994 SBA Policy Notice on tax verification, the waiver form is also required for verifying the annual financial information used in establishing a company's continuing eligibility in the business development stage of the 8(a) program. The 8(a) program staff handling continuing eligibility told us that the IRS process usually takes 10 to 15 days. This difference in IRS response time from the electronic application is due to procedural variations among the IRS field offices in handling requests. The tax waiver is not used consistently, however. In response to our request for information on the use of the waiver form for determining continuing eligibility, 8(a) program officials called ten district offices. Each of the offices had either the largest 8(a) portfolio in their respective regions or were otherwise considered significant in their regions. The use of the waiver form varied by district but appeared to fall into three categories: (1) districts that obtain signed copies of the form from all the companies in the portfolio during the annual continuing eligibility update and send them to the IRS; (2) districts that obtain signed copies of the form from all companies, but send them to the IRS only when there appears to be a problem; and (3) districts that rarely, if ever, obtain or use the form. To correct the deficiencies and ensure that verification procedures are applied consistently, 8(a) managers should include tax verification on the list of items that their program officials must check off as a part of the continuing eligibility process.

**Importance of Tax Verification.** Clearly, the SBA cannot accept the notion that everyone applying for a loan is honest. The IRS estimates that self-employed individuals who operate businesses other than farms report only about 68 percent of their business



income.<sup>17</sup> While there is no data on the number of potential borrowers who decide not to execute an SBA loan application once they learn of the tax verification requirement, the OIG has heard a number of anecdotal accounts of such behavior patterns. Similarly, SBA has no data on loans that are not made as a result of the verification information lenders receive from the IRS. Nevertheless, while SBA's total loan portfolio (financial and disaster assistance) increased by 5 percent in FY 1996, the number of reported instances of fraudulent tax returns declined by 27 percent. While the OIG has no data to indicate this decrease is a function of deterrence, logic suggests a significant impact.

**Recommendation 6: To ensure that financial information verification procedures are applied consistently, the OIG recommends that MED adhere to SBA policy by amending the 8(a) SOP to include a requirement that information from the IRS be obtained and used to verify financial statements and/or tax returns for the electronic application process and for establishing a firm's continuing eligibility for the 8(a) program.**

**Conclusion 7:** *While SBA size standard specialists request the tax verification waiver from applicants and use tax returns and financial statements submitted by the applicant to determine whether firms meet size criteria, they are not required to obtain verification information from the IRS because of experienced delays in IRS responses.*

**Size Standard Program.** SBA programs rely on self-certification by each business to determine size. When a protest is lodged by a third party or a specific request is made, however, one of the Government Contracting (GC) program's six area offices makes a "size determination."<sup>18</sup> The Size Determination program began to use tax returns to verify company size in March 1996; financial statements had been used previously. While a requirement for the submission of a tax verification waiver by the business whose size is to be determined by average annual receipts was added recently, program officials advised the field in a Procedural Notice dated March 25, 1997, that the waiver will not be sent to the IRS in every instance because SBA is to ". . . make a formal size determination within ten working days, if possible."<sup>19</sup> The IRS verification process can take longer, and contracting officials are reluctant to delay the award process beyond the

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<sup>17</sup> General Accounting Office (GAO), "Taxpayer Compliance: Analyzing the Nature of the Income Tax Gap," Testimony (GAO/T GGD-97-35), p. 3.

<sup>18</sup> Most size determinations are made for SBA's Government Contracting and 8(a) programs.

<sup>19</sup> 13 CFR, § 121.1009, January 1, 1997, p. 216.

ten days. Thus, size specialists have been told that a request for IRS verification will be made only when the size specialist believes the tax returns need verification.

Because of the importance of verifying the financial information submitted by a firm to support a size claim, regardless of whether the size determination involves a contract, the waiver forms should be forwarded to the IRS in all cases where size determination is based on average annual receipts. If the IRS fails to meet the ten day time limit on size determinations, the firm should be notified that if evidence of fraud is found, SBA's OIG can pursue a civil or criminal remedy through the Justice Department, which may include asset forfeiture in applicable situations. When the information sent by the IRS clearly indicates an error in a size determination that has already been made, the OIG and the appropriate SBA or other Federal agency official should be notified immediately. If an SBA benefit is involved, all possible steps should be taken to rescind the benefit. If a contract has already been provided by another Government agency on the basis of the size determination, SBA should notify the agency and recommend cancellation of the contract. The contractor should then be ineligible to receive future contracts or other assistance from the SBA.

**Recommendation 7: The OIG recommends that the Size Standards program obtain IRS tax verification for all determinations that are based on average annual receipts.**

***Conclusion 8: Although SBA's Surety Guarantees program relies on an applicant's financial statements to determine a contractor's credit, IRS information is not used to verify the accuracy of the financial information.***

According to program officials, the three main factors used when underwriting an SBA surety bond are character, credit, and capacity. To provide an SBA-guaranteed bond to a contractor, a surety company must provide sufficient information so that the financial condition of the firm, its cash flow needs during the period of the contract, and the availability of monies necessary to maintain contract performance can be evaluated. For this purpose, current financial statements (not tax returns) are always required. The Surety Guarantees program does not require that contractors complete a tax return waiver or that the surety request IRS verification information. Agency officials should not provide bonding to applicants who fail to file tax returns or to contractors who falsify financial information. Moreover, there is sufficient evidence of fraud and of non-filers in SBA loan programs to warrant the institution of this fraud detection and deterrence measure in the Surety Guarantees program, which poses similar financial risk to the Government. Because the extent of fraud in the Surety Guarantees program has never been measured, however, the OIG would like the program to conduct a one year pilot to assess the degree of fraud in the program.

Therefore, surety companies or their agents should require all firms to complete the IRS Form 4506 when applying for first time bonds and every year thereafter with the submission of year-end financial statements, send them to the IRS, and compare the tax verification information to the financial statements. While some differences are likely to exist between non-tax financial statements and tax data from the IRS, sizeable differences should always be explained by the applicant.<sup>20</sup> As with the Size Standards Program, if the IRS fails to provide a response before a bond must be provided, the contractor should be notified that if evidence of fraud is found, SBA's OIG can pursue a civil or criminal remedy through the Department of Justice, which may include asset forfeiture in applicable situations. If a 10 to 15 percent discrepancy is found between corporate tax summaries provided by the IRS and financial statements, the surety company should ask for a full explanation from the applicant. If the applicant is unable to explain the discrepancy or failed to file tax returns, the surety company should notify the OIG and the appropriate SBA official and cease underwriting new guaranteed bonds on behalf of the applicant. Notification should also be placed in the SBA database to indicate that the contractor is ineligible for future SBA bonds.

**Recommendation 8: The OIG recommends that the Surety Guarantees program conduct a one-year pilot test to obtain tax verification information from the IRS and compare it to applicant financial statements.**

**Conclusion 9:** *Some lenders and SBA program officials are reluctant to use the IRS tax verification process due to delays in obtaining verification information from a number of IRS offices.*

Although IRS officials had hoped to provide verification data within ten business days, the continuing reorganization of the IRS has led to confusion and delays in the process for the 7(a) and 8(a) programs. Verification forms have to be sent to a variety of IRS service centers and district offices; consequently, address and fax number changes and the abolishment of some IRS offices have caused some verification forms to be sent to wrong addresses. IRS personnel changes and staff shortages have also played a role in the delays; however, the IRS has recently centralized the process for the 7(a) and 8(a) programs in ten of its service centers, which should help speed up verification.

SBA program officials could assist in streamlining the verification process by working more closely with the IRS. This approach has already paid dividends to the Disaster Assistance program, which has devoted resources and time to establishing a close

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<sup>20</sup> "Obtaining IRS Tax Return Information to Verify Financial Information Submitted in Program Applications," SBA Policy Notice, Control No. 9000-941, Effective 10/7/94.

working relationship with the IRS. The result has been an effective centralized process wherein the IRS is able to turn around disaster verification requests in 24 to 48 hours. 7(a) officials have also attempted to speed up the verification process by offering funding to the IRS. While this report was in preparation, however, IRS determined that the funding would not accomplish SBA goals and the offer was subsequently withdrawn. The OIG believes that the timeliness of the verification process for SBA programs could be improved if the respective program managers within the SBA worked more closely with the IRS.

Although some programs have taken steps to report instances of fraud, more could be done to ensure that the OIG is informed whenever a question of abuse is raised. Disaster assistance officials also provide the names of all “non-filers” to the OIG which, in turn, forwards them to the IRS for use in tax collection enforcement. The 7(a) program has also been diligent in contacting the OIG in instances of fraud and in providing the names of “non-filers” to the OIG. Nevertheless, SBA officials need to emphasize to participating lenders that it is the lenders’ responsibility to report cases of fraud directly to the OIG. Furthermore, MED program officials advised the inspection team that, while “non-filers” are denied entry to the 8(a) program, their names are not currently provided to the OIG.

**Recommendation 9: The OIG recommends that the Associate Administrator for Financial Assistance, the Associate Administrator for Government Contracting, the Associate Administrator for Minority Enterprise Development, and the Associate Administrator for Surety Guarantees assign appropriate personnel to work with the IRS to streamline the tax verification process.**

**Recommendation 10: The OIG recommends that all SBA programs using IRS tax verification be required to provide the OIG the names of program applicants and/or participants who have failed to file tax returns or who are found to have provided false financial information.**

## INTERNET INFORMATION

***Conclusion 10: Information on SBA’s 7(a) loan programs on the Agency’s Internet site (1) does not provide a clear statement of SBA’s “good character” policy, (2) appears misleading and confusing regarding the requirement to submit the Statement of Personal History (Form 912), and (3) fails to state SBA’s policy requiring IRS tax verification as a prerequisite for obtaining Agency loan guarantees.***

There is a variety of information on SBA’s Internet site that discuss the Agency’s financial assistance programs. In the last few months, SBA officials have greatly improved the once overlapping and sometimes redundant descriptions of SBA loan programs by reducing the various pages offered. While “good character” was previously mentioned on the 22<sup>nd</sup> page of one document containing 46 pages, this criterion is now mentioned as a primary consideration in the loan decision process under the page titled “7(a) Loan Guarantee Programs: What SBA Seeks in a Loan Application.” The “General Description” page on the LowDoc program also states that “the loan decision process relies heavily upon the strength of the principals’ character.” There are other pages on this site, however, that also need to place appropriate emphasis on SBA’s “good character” policy.

The “General Description” of the FA\$TRAK program does not mention character as a criterion. The “Eligibility” page for the regular 7(a) program and the specialized programs refer to the Form 912, Statement of Personal History, but do not explain its purpose or what information is required on the form. Moreover, the information provided in the pages regarding principals who are not eligible for most of the specialized programs because of current or prior criminal history is misleading and confusing. For example, the discussion of the LowDoc and FA\$TRAK programs, among others, includes the following statement:

Applications will not be accepted from firms where a principal (defined as any one of those required to submit a personal history statement, SBA Form 912): 1) is currently incarcerated, on parole, or on probation; 2) is a defendant in a criminal proceeding; or 3) whose probation or parole is lifted expressly because it prohibits an SBA loan.<sup>21</sup>

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<sup>21</sup> SBA Home Page, “Financing,” “Loan Programs,” “7(a) Loan Guaranty Program,” p. 5, as well as “FA\$TRAK,” p. 4 and “LowDoc,” p. 4-5.

This is misleading because, as discussed earlier, the LowDoc program and most of the other specialized programs no longer require the submission of a Form 912 by any applicant. Instead, they require only a response to a single criminal history question to determine if an applicant is eligible for the program.<sup>22</sup> The discussion on the pages is also confusing because, after telling potential applicants that their applications will not be accepted if they have a prior criminal history, it proceeds to inform them that an affirmative answer “. . . to any one of the [criminal history] questions on the Statement of Personal History would not necessarily preclude a loan to a business. . . .” In fact, an affirmative answer would not necessarily preclude a ‘regular’ 7(a) loan to the business.

The page “What Businesses Are Eligible” lists restrictions including applicants who are currently incarcerated, on probation, or on parole, but it does not mention restrictions on applicants who have been charged, arrested, or convicted of certain felony crimes. The “Appendix of Application Forms” lists the Form 912 as a required document but does not list the IRS Verification Form 4506. In another page titled “Loan Forms,” the Form 4506 can be downloaded, but the Form 912 is not listed. No other page mentions the Form 4506 and none state that all applicants for SBA loans must authorize SBA or the participating lender to verify their income tax returns and/or financial statements with the IRS.

The other SBA programs appear to have sufficient reference to the Form 912 and Form 4506 where applicable on their program pages. The Internet page for the 8(a) program clearly states that an “individual character review of the applicant(s)” is a program requirement. In addition, the personal history and tax waiver forms are listed with the other forms needed to apply for 8(a) certification. The Internet pages on the Surety Guarantee program also list the Form 912 as a required application document.

As the Agency’s “window to the world,” SBA’s Internet site should show consistency across all Agency programs and within pages of the same programs. It should clearly state SBA’s policy of providing program benefits only to persons of good character and inform potential applicants that certain application requirements must be met to ensure against fraud. Moreover, it would be useful to include the Form 912 with the other application forms that can be downloaded from the Internet. In the future, as SBA moves toward a completely electronic application, all of the information on the Form 912 should be included in all its Internet application files.

**Recommendation 11: The OIG recommends that the Office of Financial Assistance revise the loan program information on SBA’s Internet site to clarify**

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<sup>22</sup> See page 5 of this report.

**SBA’s “good character” policy and to inform potential applicants of the measures taken to enforce this policy.**