

SEMIANNUAL REPORT OF THE INSPECTOR GENERAL

OFFICE OF INSPECTOR GENERAL

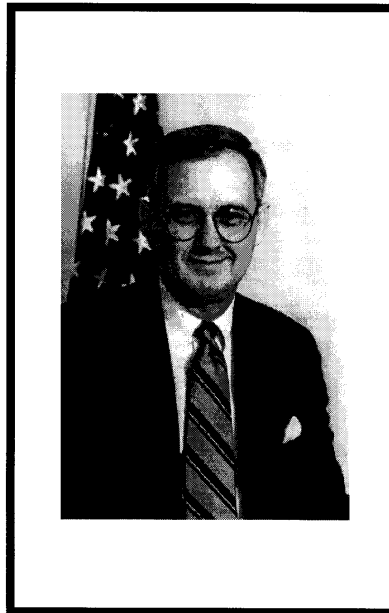


COVERING THE PERIOD • OCTOBER 1, 1997 • MARCH 31, 1998 • PURSUANT TO PUBLIC LAW 95-452

In Memory

Inspector General James F. Hoobler, a distinguished and innovative public official for over 35 years, died of acute respiratory failure on December 22, 1997, at Georgetown University Hospital. He was appointed Inspector General of the Small Business Administration in 1991. He was 59 years old.

Dr. Hoobler's public service career spanned three decades during which his leadership and management skills have been widely recognized. He personified the professional Government manager who was able to bring his expertise and intelligence to a diverse range of public policy arenas. He began his career at the Central Intelligence Agency and moved to a series of progressively senior positions at the Department of Justice, the Department of Energy, the Veterans Administration, the Office of Management and Budget, the Department of State, and the Small Business Administration.



James F. Hoobler
1938 - 1997

Throughout his remarkable career, Dr. Hoobler was a consistent advocate for making public employees more professional and for making public institutions more accountable. As a recognized authority on strategic planning and resource management, Dr. Hoobler was a frequent writer and lecturer on public policy and performance management. His greatest contribution to public service is the legacy of his former employees and colleagues whom he has mentored and who continue in Dr. Hoobler's tradition of dedicated public service.

Dr. Hoobler was born in Rochester, New York, and received his B.S. degree from Kent State University and his M.A. and Ph.D. from the University of Maryland at College Park. He is survived by his wife, Mary; his parents, Frank and Jean; and his sister, Gail.

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Executive Summary

This report on the activities of the Office of Inspector General (OIG) of the Small Business Administration (SBA) is submitted pursuant to Section 5(b) of P.L. 95-452, the Inspector General Act of 1978, as amended. It summarizes OIG activities for the 6-month period from October 1, 1997, to March 31, 1998.

Summary of Accomplishments

OIG audits, inspections, and investigations over the last 6 months achieved \$18,229,077 in potential dollar results, 43 indictments, and 26 convictions. The dollar results consist of \$3,858,627 in potential recoveries, including judicially-awarded fines and restitution; \$13,302,630 in management avoidances; \$1,055,820 in disallowed costs agreed to by SBA's management; and \$12,000 in management commitments to use funds more efficiently.

The OIG alone could not have achieved the accomplishments set forth in this report to the Congress. The results for this reporting period reflect the cooperation and support of other Federal audit, inspection, and investigative organizations such as the Federal Bureau of Investigation (FBI); U.S. Secret Service; U.S. Marshals Service; Internal Revenue Service (IRS); other Federal OIGs; Department of Justice (DOJ) prosecutors; and, most importantly, the

actions of SBA program managers and employees. Indeed, much of our success is due to referrals made by conscientious SBA employees.

OIG Performance Plan for FY 1998

The OIG's performance plan for 1998 is derived from its Strategic Plan for Fiscal Years 1997-2002. As is done by many OIGs, this office will publish an outline (below) of its plan in every Semiannual Report to the Congress. The first two goals of the strategic plan and their associated objectives provide a roadmap for the execution of the OIG's mission. The OIG's first goal is to **improve the economy, efficiency, and effectiveness of SBA programs** through the Agency's adoption of recommendations resulting from the OIG's oversight activities. Achievement of this goal will be accomplished by meeting the following objectives:

1. Find opportunities for the reduction of operating costs (salaries and expenses) associated with and supporting activities of SBA's programs.
2. Identify means for reducing the subsidy cost of SBA programs.
3. Ensure that SBA programs are meeting mandated public policy goals, high performance standards, and the needs of targeted participants.
4. Improve the accuracy of SBA accounting and management information.
5. Assure Agency implementation of accepted OIG recommendations and, to the extent that OIG resources allow, provide assistance to program managers in implementing recommendations.
6. Reduce the opportunity for loan packager fraud through cooperation with Agency officials in the registration of loan packagers and the pursuit of packager investigations.
7. Review proposed legislation, regulations, standard operating procedures, and other SBA issuances to improve Agency programs and to eliminate the potential for mismanagement.
8. Identify program vulnerabilities or systems weaknesses found during investigations and alert appropriate SBA program managers.

The OIG's second goal is to **reduce fraud and abuse in Agency programs and foster integrity** in SBA's personnel and the Agency's resource partners. This goal will

be accomplished by meeting the following objectives:

1. Assist the SBA in its efforts to deter fraud and abuse by auditing a sample of defaulted loans and Section 8(a) program participants suspected of abusing the contracting assistance program.
2. Assist the SBA in deterring waste, fraud, and abuse by responding to complaints concerning such activities with OIG staff assistance and consultation.
3. Recommend actions to reduce any program vulnerabilities uncovered as a result of OIG oversight activities.
4. Conduct investigations into allegations of fraud in SBA programs according to the perceived level of risk to the Agency and the potential for program impact or increased deterrence.
5. Pursue asset forfeiture proceedings in all applicable cases.
6. Participate in development of SBA's fraud and corruption awareness training programs and emphasize cooperation of Section 7(a) lenders in combating fraud through fraud awareness briefings and outreach contacts with lenders.
7. Refer an average of 75 cases annually to the Department of Justice for Affirmative Civil Enforcement (ACE) and increase the value of civil fines imposed.
8. Preclude persons of poor character from participating in SBA programs or employment through the use of name check requests, fingerprint requests, pre-

employment screening, and required background investigations.

The OIG's last two goals involve communicating its findings, recommendations, and results to all SBA stakeholders and ensuring the economical, efficient, and effective operation of the OIG. The extent to which the OIG will be able to achieve its objectives depends, in part, on the sufficiency of resources available to fund its operations.

Highlights of the Past Six Months

Efforts to Improve SBA Program Management

Inspection Identifies Ways to Minimize Loan Agent Fraud

The OIG issued an inspection report that identifies cost-effective ways to prevent loan agent fraud in the Section 7(a) program. While loan agents can provide valuable assistance to small businesses seeking access to capital, some have perpetrated fraudulent schemes resulting in defaulted loans that had to be purchased by SBA. The OIG recommended that the Agency (1) establish a loan agent registration process to provide accountability, (2) expand current legislation to include loan agents among those subject to National Crime Information Center criminal history checks, and (3) develop a system for monitoring loan agent performance to provide early warning of any potential problems. The criminal history checks should be performed for each prospective loan agent as part of the registration process

to identify and/or deter unsuitable candidates. The OIG also recommends that SBA maintain two lists on the Internet: currently registered agents, and agents whose privilege to conduct business with the Agency has been suspended or revoked. This would allow borrowers and lenders to verify the status of agents they are considering using. The Agency has not yet responded to OIG recommendations, however, its response is expected soon.

Audit of FY 1994 Loan Liquidations Estimates \$28 Million Under-Recovered

An audit of 71 loans liquidated in FY 1994 showed that 12 of the loans were under-recovered. The auditors found that liquidation procedures were not applied consistently, and SBA did not effectively monitor lenders nor identify opportunities to recover losses when lenders did not follow approved procedures. Based on the sample, under-recoveries were estimated at \$28 million. The audit was inconclusive as to whether it was more effective for loans to be liquidated by lenders or by SBA. The audit recommended that the Agency ensure that SBA loan officers be made aware of their responsibility for monitoring lender liquidations, and that SBA initiate recovery actions on specific loans where lender deficiencies were identified. The Acting Associate Administrator for Financial Assistance agreed with the recommendations.

Summary Audit Report on Low Documentation (LowDoc) Loan Program Affirms Prior Findings

A follow-up audit of the SBA's LowDoc program found results that were similar to an earlier audit of the program. After the first

audit of a nationwide sample of 70 loans was issued in September 1996, the former SBA Administrator requested that a larger sample be drawn to validate the results. Consequently, the OIG completed a second audit of 120 loans. The auditors concluded in both audits that 10% of the sampled loans should not have been made because of loan origination deficiencies. The OIG and the program office are in discussions concerning findings and recommendations.

Inspection Examines Agency Fraud Detection Practices

The OIG issued an inspection report that assessed the use of criminal history and tax verification information to detect fraud in SBA programs. To correct the deficiencies found during the inspection, the OIG recommended that (1) the Office of Financial Assistance and the Office of Disaster Assistance obtain all information necessary for the OIG to perform criminal history checks, (2) Preferred Lenders in the business loan program include completed Personal History Statements in the loan materials submitted to the Agency's Preferred Lender Program Processing Center, (3) SBA develop procedures to ensure that all loan applicants' tax returns and financial statements are verified with IRS information prior to loan disbursement, (4) Minority Enterprise Development officials revise program procedures to require IRS verification in processing electronic applications and in establishing a firm's continuing eligibility for the Section 8(a) program, and (5) the Size Standards program use tax verification on a permanent basis and the Surety Guarantee program conduct a one-year pilot test of tax verification, with the provision that both be

allowed to issue conditional approval in cases where the IRS does not meet the programs' time constraints. The ODA concurred with the OIG's first recommendation and is currently revising its business loan application to include the information needed to perform criminal history checks. The OFA generally concurred with the recommendations concerning SBA loan programs. It has revised one of its applications to obtain the information necessary for the OIG to perform criminal history checks and is awaiting approval from the Office of Management and Budget. OFA did not concur with the OIG's recommendation concerning the Surety Guarantee program, citing time sensitivity of the bonding process, and the paperwork burden involved in obtaining tax verification information.

Audits Identify Two Ineligible Firms in the Section 8(a) Program

An OIG audit found that a Maryland computer manufacturing firm exceeded the net worth limitations for both initial and continuing Section 8(a) program eligibility. The owners were admitted into the program in 1994 inappropriately when investment property was incorrectly represented as part of the owners' personal residence.

Another audit determined that the owner of a Virginia computer consulting firm understated his assets substantially for 4 years and became ineligible for the Section 8(a) program in 1996 and 1997. Two contracts with a total estimated award amount of \$4.1 million were therefore inappropriately awarded to the firm during those years.

Audit of SBA Rebate and Refund Disbursements Finds Processing Errors

An OIG audit found that a lack of coordination between different elements of the Office of Financial Operations (OFO) caused errors in the manual processing of SBA rebate and refund disbursements in FY 1996. The audit identified manual processing errors, primarily payments which were not recorded in SBA's loan accounting system within the required 30 days. The auditors determined that SBA's accounting records reflected incorrect information and SBA was due approximately \$96,000 from overpaid payees. The OFO concurred with the findings and recommendations and has already begun their implementation.

Activities to Enhance Fraud Detection and Deterrence

Results of False Tax Return Cases Increase

Over the last 7 years, the OIG has received 389 allegations that false tax returns were submitted in support of SBA business or disaster loan applications. These fraud referrals now involve loan applications submitted to 51 SBA district offices, totaling \$124 million and involving 1,251 individual subjects. To date, 112 individuals have been **indicted on criminal charges**; 103 have been **adjudicated guilty**, 3 indictments were dismissed, and 6 others have not yet gone to trial.

Affirmative Civil Enforcement Program

The OIG continues to produce results from

its participation in the Department of Justice's Affirmative Civil Enforcement (ACE) program. This program, which is implemented by U.S. Attorney offices around the country, targets cases which might not be prosecuted criminally because of the minimal dollar amounts involved, absence of financial loss to the Government, or because other facts of the case might not support a criminal prosecution. During the time that the OIG has been involved with the ACE program, we have had a total of **104 successful cases**, resulting in **\$3,057,884 in civil penalties** and **\$4,359,683 in recoveries** by SBA. Individual ACE outcomes are reported in the program area chapters, as appropriate.

Investigation of California Loan Brokerage Firm Yields Host of Charges

Criminal charges of **making false statements to a Federally-insured lender** were filed against six Californians for alleged fraud in connection with loan packages submitted to a now-defunct participating lender bank by an Inglewood, California, brokerage firm. The firm's portfolio at the bank totaled approximately 170 loans, originally valued at more than \$60 million. In the charges filed to date, a former principal of the brokerage firm was charged with three counts for allegedly causing the submission of individual income tax returns which he knew had been altered to overstate the applicants' adjusted gross income. The loan applications covered in these three counts totaled \$1,850,000. Five borrowers were charged with one count each for allegedly submitting altered "copies" of individual income tax returns in connection with SBA-guaranteed loans totaling \$2,035,000. Two of the borrowers have pled guilty to the charges against them. All these

actions resulted from an extensive investigation, conducted jointly with the FBI and the IRS, based on allegations from an anonymous complainant. Partially as a result of the default rate of the allegedly fraudulent loans, the participating bank was closed by the Office of the Comptroller of the Currency in April 1994.

Business Loan Program

SBA's small business loan programs serve one of the most important missions of the Agency: to ensure that Federal funds and resources are used to help finance qualified small enterprises. Under the **Section 7(a) Guaranteed Loan Program**, SBA guarantees loans to small businesses that are unable to obtain private financing. These loans must be of such merit, or be so secured, as to reasonably ensure repayment to the lending institution. No loan may be made unless the financial assistance is not otherwise available on reasonable terms from elsewhere in the credit market. Under the guarantee program, SBA agrees to purchase the guaranteed portion of the loan upon default by the small business. SBA's guarantee share of loans by private lenders averages about 75 percent.

More than 8,000 lenders have made at least one Section 7(a) loan in the past 5 years. Currently, approximately 42 percent of these loans are being made by participants in the Agency's **Certified Lender Program (CLP)** or its **Preferred Lender Program (PLP)**.

Lenders who are heavily involved in the SBA guarantee program and meet the Agency's criteria can participate through the **CLP**. Over 1,000 participating lenders, approved for the **CLP** program, are permitted to assume greater authorities and responsibilities in processing, closing, servicing, and liquidating loans. As a result, SBA can process loan guarantee applications in 3 days, rather than the 2 weeks that it may take for a thorough analysis by Agency staff. About 8 percent of all business loan guarantees are made through the **CLP** process.

As permitted by Section 5(b)(7) of the Small Business Act, SBA delegates even wider authority to preferred lenders, i.e., lenders who can commit the Agency to guarantee eligible business loans and decide the level of SBA participation. This program, with over 350 participants, reduces processing time on strong credit applications and uses the resources of SBA's best lenders to the maximum. About 34 percent of all business loan guarantees are made through the **PLP** process.

The **504 Loan Program** provides long-term, fixed-rate financing through certified development companies (CDCs) to small businesses to acquire real estate, machinery, and equipment for expansion of business or modernizing facilities. Typically, 504 loan proceeds

are provided as follows: 50 percent by an unguaranteed first mortgage bank loan, 40 percent by an SBA-guaranteed debenture, and 10 percent by the small business customer. The maximum SBA debenture is \$1 million.

With the creation of the Agency's Low Documentation (**LowDoc**) application process, lenders are now able to use their own internal loan application documents, plus a single page, two-sided SBA form to apply for an SBA guarantee on a loan of \$100,000 or less. The demand for this program continues to exceed 25 percent of all Section 7(a) loan approvals.

Summary of OIG Activity / Business Loan Program	
Audits Underway	10
Audit Reports Issued	6
Indictments Resulting from Investigations	29
Convictions Resulting from Investigations	12
Investigations Closed / Remaining Inventory	26 / 149
Investigations: Restitutions / Fines / Other Recoveries	\$1,051,786 / \$222,049 / \$37,225
Investigations: Loan Declinations Due to Name Checks	\$12,928,704
Investigations: Cases Referred to Other Agencies	7
Inspections Underway	1
Inspection Reports Issued	1
Reviews of Proposed Regulations	2
Reviews of Standard Operating Procedures	1

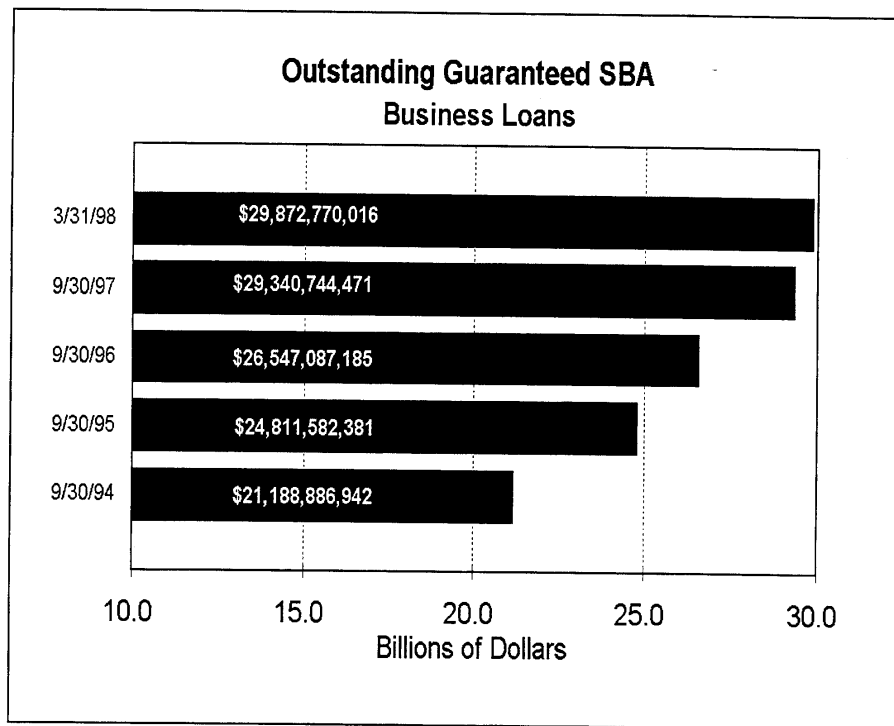


Figure 1

Efforts to Improve SBA Program Management

New LowDoc Audit Verifies Findings of Previous Audit

A second audit of the SBA's Low Documentation loan program (LowDoc) produced results similar to an initial audit conducted in September 1996. After the first audit of a nationwide sample of 70 loans was published, the former SBA Administrator requested that a larger sample be drawn to

validate the results. Consequently, a second audit of 120 loans in Atlanta, Santa Ana, Washington, and Dallas was performed. The results were very similar:

	<u>First Audit</u>	<u>Second Audit</u>
Loans with processing deficiencies	79 %	70 %
Loans with deficiencies that should have precluded approval	10 %	11 %
Average number of		

deficiencies per loan
with deficiencies 2.0 2.04

The sample was drawn from loans approved from inception of the program in December 1993 through September 1996. A deficiency was defined as an instance of noncompliance by lenders or SBA district offices with either the Authorization and Loan Agreement or other SBA processing and disbursing procedures.

Deficiencies were found in 84 of the 120 sampled loans, with 171 deficiencies in all. For 13 loans, there were 14 deficiencies serious enough that the loans should not have been made under LowDoc procedures. These "fatal" deficiencies involved problems in repayment ability, character, credit worthiness, or eligibility. In addition, lenders had a conflict of interest on two loans. Other deficiencies related to IRS verifications, equity injections, verification of use of loan proceeds, and use of joint payee checks. All but 11 of the 157 "non-fatal" deficiencies involved non-compliance with general Section 7(a) program requirements as opposed to LowDoc-specific requirements.

Lenders said the primary reasons for deficiencies were loan officer error or lack of knowledge of requirements. The auditors noted that performance improved after SBA issued detailed program guidance in April 1996.

The report recommended that the Acting Associate Administrator for Financial Assistance (AA/FA) (1) review those cases where district offices disagreed with repair of guarantees on defective loans, and (2) develop a training program for new LowDoc

lenders. Regarding the first recommendation, the Acting AA/FA stated that the Office of Financial Assistance (OFA) has long held that a guarantee called into question is not addressed in a conclusive manner until the loan is purchased. She further stated that OFA and OIG are currently identifying circumstances which may lead to denial or repair of the guarantee prior to purchase. The Acting AA/FA agreed with the second recommendation to provide training.

Inspection Identifies Ways to Minimize Loan Agent Fraud

An OIG inspection identified cost-effective ways to prevent loan agent fraud in the Section 7(a) program. Loan agents, who provide referral and loan application services for a fee to prospective borrowers and lenders, can provide valuable assistance to small businesses seeking access to capital. Some loan agents, however, have perpetrated fraudulent schemes that have resulted in defaulted loans that had to be purchased by SBA. As of the end of FY 1997, in the Section 7(a) program alone, criminal investigations had been initiated on 354 individuals involving loan applications handled by 18 loan agents. Twenty-eight percent of these agents had prior criminal records.

Over the past few years, SBA officials have been examining ways to make loan agents more accountable. Any approach adopted would have to take into consideration the severe limitations of SBA staff resources and the potential for loan agents to use the Internet to commit fraud on a national scale. An important preventive measure, which was

also recommended by SBA's Committee on Loan Packager Reforms, is the **registration of loan agents**. Without an up-to-date registry, no effective accountability or controls are possible. The OIG recommends, therefore, that SBA establish a loan agent registration process that includes maintaining two lists on the Internet: currently registered loan agents, and agents whose privilege to conduct business with SBA has been suspended or revoked. The **Internet listing** will allow access to these lists by lenders and borrowers who are contemplating using loan agents. SBA should also make clear that loan agent registration is not an Agency endorsement of the listed agents and that SBA is under no obligation to provide guarantees for loans in which suspended or revoked agents were involved.

In addition, **criminal history checks** should be performed on loan agents as part of the registration process. These checks would not only identify candidates who are unsuited for agent work due to their backgrounds but also deter individuals who do not want their records revealed from becoming agents in the first place. To conduct such checks, the OIG recommends that SBA propose amending current legislation to include loan agents among those subject to National Crime Information Center background inquiries.

To provide early warning of potential problems, the OIG also recommends that the Agency establish a **loan agent monitoring system** that holds the lender responsible for the accuracy of data (including electronic data) originated by loan agents and transmitted by the lender to SBA. The system should also establish purchase rate benchmarks that would trigger closer

examination of a loan agent's performance, ensure that all loan data can be linked to the agents involved, and centralize the evaluation of agent performance to provide consistency. The inspection report also discusses the possible use of lenders' bond insurance policies to help protect SBA from losses due to loan agent fraud. The Agency has not yet responded to OIG recommendations, however, its response is expected soon.

Audit of SBA Loan Liquidations Finds Inadequate Recoveries and Procedural Problems

An audit of FY 1994 loan liquidations found that **SBA should have recovered \$28 million more in loan liquidations than it did**. Auditors found that **liquidation procedures were applied inconsistently**, and SBA **did not effectively monitor lenders nor identify opportunities to recover losses** when lenders did not follow approved procedures.

SBA "charged off" \$345 million in FY 1994 from 3,112 loans liquidated. After examining a statistical sample of 71 liquidations with \$12.5 million charged off, the auditors concluded there were errors in 12 of the 71 liquidations that resulted in \$652,608 under-recovered. Based on the sample, the auditors estimated that \$28 million was under-recovered in the full year.

The audit was inconclusive on whether it was more effective for loans to be liquidated by lenders or by SBA. While lenders had a higher recovery rate, the audit found that their recovery rates could have been even higher. The audit recommended that SBA ensure that SBA loan officers be made aware of their responsibility for monitoring lender

liquidations and that SBA initiate recovery actions on specific loans where lender deficiencies were identified. The Acting Associate Administrator for Financial Assistance (AA/FA) concurred and noted that revised SOP 50 51 2 emphasized the importance of lender oversight. The Acting AA/FA also noted that other improvements in procedures resulted from the Agency's Liquidation Improvement Project which started in 1996.

Loan Accounting Audit Identifies Lack of Coordination and Control Weaknesses for Certain Agency Disbursements

An audit of 66,000 automatically processed and 5,500 manually processed "rebate and refund" type disbursements made in FY 1996 identified **no errors in the automated disbursements but 260 errors in manually processed payments, resulting in about \$96,000 in inappropriate payments.**

The manual errors included recording delays -- 237 payments (18 percent of the manual payments made in the first quarter) were not recorded in the Agency's Loan Accounting System until more than 30 days after confirmation by the Department of the Treasury. Of these, 166 were not recorded within 1 year. In addition, incorrect transaction codes were used to record 30 transactions, and 28 duplicate or inappropriate disbursements were identified. The audit found that the errors were caused by a lack of coordination between different activities within the Office of Financial Operations (OFO) and weaknesses in controls for detecting and correcting errors. According to the Office of the Chief Financial Officer (OCFO), the transfer of

accounting operations from Washington, DC, to Denver, CO, and an unprecedented level of disbursement activity following the Northridge earthquake also contributed to the processing errors.

Consequently, SBA's accounting records reflected incorrect information and SBA was due approximately \$96,000 from overpaid payees. The OIG recommended that the OFO develop, document, and implement procedures to improve controls for these types of payments, periodically review associated accounts for abnormal balances and recover funds related to those abnormal balances, and recover the \$96,000 identified during the audit as due SBA. The OFO concurred with the findings and recommendations and has already begun their implementation.

Audits Find Record Keeping and Other Deficiencies at Three Nevada Certified Development Companies (CDC)

Audits of three CDCs in Nevada found problems in project record keeping. While the companies generally complied with Section 504 loan program policies and procedures, their files sometimes lacked evidence of site visits, capital injection, construction phases, borrower repayment ability, and independent project appraisals. The audits covered three CDCs that had made 712 loans valued at over \$228 million since the inception of the program. The OIG sampled 31 loans valued at \$18.2 million.

At one of the three CDCs, compensation practices for two employees gave the appearance of conflict of interest because the employees received compensation directly

related to each loan approval. One employee received commissions, the other received fees.

OIG auditors recommended that the CDCs maintain loan files in accordance with SBA requirements and disclose to SBA any financial arrangements that would give the appearance of a conflict of interest. The Deputy District Director stated he discussed these problems with at least one of the CDC presidents, who has begun to take steps to improve operations.

Auditors also recommended that the Las Vegas District Director (DD) direct each of the CDCs to maintain their loan files in accordance with SBA's SOP 50 22 3. The DD and the CDCs concurred.

Review of Proposed Regulations; Section 7(a) Lenders

The OIG reviewed and commented on a proposed amendment to 13 CFR Part 120 that would allow participating lenders to sell, securitize, or pledge the unguaranteed portion of Section 7(a) loans. The proposed regulations would impose a minimum capital requirement, incorporate a retention requirement, provide for suspension of preferred lender program (PLP) privileges and impose collection of supplemental payments to SBA if the loss rate of securitized loans deteriorate.

While generally concurring with the proposed regulations, the OIG raised several issues for consideration. For instance, when a small business lending company (SBLC) is a subsidiary of a larger corporation, SBA often receives a consolidated financial

statement from only the parent corporation, thereby making a determination of the financial condition of the subsidiary SBLC difficult. The OIG recommended that SBA require audited financial statements from the SBLC itself. Additionally, the proposal states that SBA will "conduct appropriate oversight" of securitizers' compliance with the capital requirement. Because SBA will most likely rely on annual audited financial statements for nondepository lenders, the OIG questioned whether an annual review is sufficient to ensure lender compliance.

The OIG also recommended clarification of the definition of "good standing" and of the relationship between the suspension/revocation of PLP status and the procedures contained in Part 120.455. The OIG further recommended that inconsistencies in the provision governing supplemental payments, and between the preamble and the regulatory language regarding suspension of a PLP's unilateral loan approval privilege, be resolved.

Review of Standard Operating Procedures (SOP); Loan Processing

As part of SBA's initiative to update and streamline its SOPs, the OIG reviewed and commented on SOP 50 10(4), Loan Processing. The review of the SOP led to comments that the applications for the LowDoc and FA\$TRAK loan programs needed revision to capture the information needed by the FBI to conduct criminal history checks (these are the only two business loan programs that do not use the SBA Form 912, Statement of Personal History). Other recommendations included providing examples that illustrate the

assignment of primary SIC codes, because this is important in the size determination process; requiring lenders to secure serial numbers or vehicle identification numbers of collateral; requiring tax return verification for the principals of a start up business if the personal income and assets of the principals are relied upon in approving the loan request; clarifying the provisions on packagers, referral agents, and lender service providers; and adding criteria concerning the timing, nature, and result of certified lender program performance reviews.

Activities to Enhance Fraud Detection and Deterrence

Investigation of California Loan Brokerage Firm Yields Host of Charges

As a result of an investigation of an Inglewood, California, loan brokerage firm, criminal charges were filed against the following individuals:

- ① A former principal of the brokerage firm was charged with three counts of aiding and abetting the **making of false statements to a Federally-insured lender** by causing the submission to a 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.
- ② The former owner of a Burbank, California, gas station was charged with one count of **making false statements to a Federally-insured**

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.

③ The owner of a Manhattan Beach, California, gas station was charged with one count of **making false statements to a Federally-insured lender** by submitting altered Individual Income Tax Returns for the years 1988-90 while applying for a \$350,000 SBA-guaranteed loan. The man also defaulted on his loan, leaving an unpaid principal balance of \$292,617.

④ The former owner of a gas station in Compton, California, was charged with one count of **making a false statement to a Federally-insured lender** by submitting altered Individual Income Tax Returns for 1987-89 with his application for a \$225,000 SBA-guaranteed loan. The man subsequently defaulted on the loan, leaving an unpaid balance of \$225,000.

⑤ The owner of a car wash in Lomita, California, was charged with one count of **making a false statement to a Federally-insured lender** by submitting altered Individual Income Tax Returns for 1987-89 with his application for a \$1,000,000 SBA-guaranteed loan. He also submitted altered Individual Income Tax Returns for 1990 and

1991 in response to the requirement, in his Loan Authorization and Agreement, to provide information about his financial condition throughout the time the loan was in force. The man is currently making loan payments quarterly through the U.S. Trustee's Office pursuant to a bankruptcy reorganization plan.

⑥ The former owner of a gas station in San Bernardino, California, was indicted on four counts of **making false statements to a Federally-insured lender**. Three counts charged her with submitting altered Individual Income Tax Returns for the years 1988-90 and count four charged her with submitting a false financial statement with her application for a \$300,000 SBA-guaranteed loan. The loan was disbursed in June 1991; by April 1992, she had filed for bankruptcy protection. In August 1994, SBA charged off a \$292,189 loss on her loan.

The individuals identified in items 2 and 3 above pled guilty to the charges against them. All 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 a California bank by the brokerage firm. The firm's portfolio at the 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.

Latest Results from Affirmative Civil Enforcement (ACE) Program

Over this reporting period, the OIG's participation in DOJ's ACE program produced eight successful business loan cases, resulting in \$137,216 in recoveries and \$204,624 in civil penalties. All but one of the seven smallest cases, which produced only civil penalties, involved fraudulent representations (primarily bogus tax returns) in applications for loans, most of which were stopped before funds were disbursed. (One of those produced a \$40,000 civil penalty against an unsuccessful applicant for a \$530,000 loan.) The largest result, described on the following page, involved settlement of a lawsuit against a Missouri participating lender and its principal officers.

OIG Briefs Members of Lender Community

During this reporting period, our investigations staff continued its practice of making presentations to groups of participating lenders. The Special Agent in Charge of the OIG's Los Angeles field office gave a presentation to 42 attendees at a conference sponsored by SBA's Los Angeles District Office. Its Financing Division was training incoming intermediaries in the new minority pre-qualification program; the OIG presentation highlighted the benefits to be gained from cooperation between participants and the OIG in combating waste, fraud, and abuse in SBA's loan programs. At a San Antonio lenders' conference, the Assistant Inspector General for Auditing spoke on the

role of the OIG, outcomes of Clean Sweep II criminal history checks, tax verification, agent registration, results of the LowDoc audits, purchases of guarantees audit, early defaults, and the ongoing Section 7(a) loan processing audit.

Idaho Farm Implement Manufacturing Executive Sentenced for Bankruptcy Fraud

A former officer of a Caldwell, Idaho, farm implement manufacturer pled guilty to one count of **bankruptcy fraud** and was sentenced to 5 years probation, 200 hours community service, and \$52,750 restitution to the corporation's bankruptcy trustee. The joint FBI/IRS/OIG investigation found that when the company filed for bankruptcy in 1993, the company officer concealed an asset (a 1987 Ferrari) from the Bankruptcy Court. The man's father--the former president of the company--had previously been indicted on 21 counts of **bankruptcy fraud, bank fraud, money laundering, and criminal forfeiture** in connection with a \$750,000 SBA-guaranteed loan.

Missouri Bank Settles Civil Suit Brought by SBA and Department of Justice

A Missouri bank paid the Government \$200,000 to settle a civil fraud suit brought under the Department of Justice's Affirmative Civil Enforcement program. The suit was filed in 1997 against the bank, its president, and its chairman and chief executive (a father and son) based on the results of an OIG investigation. The suit alleged that the defendants submitted a fraudulent application to obtain SBA's guaranty of a \$150,000 loan to a New

Bloomfield, Missouri, water bottling company. Allegedly, the company's loan application misrepresented the status of the company's prior loans at the bank, which were shown as current when they were actually delinquent. SBA guaranteed the loan, which soon went into default, and subsequently paid the bank \$137,215 for its guaranteed portion. (This is the share of the \$200,000 to be paid to SBA.) The suit sought treble damages, civil penalties, interest, and costs pursuant to the **False Claims Act**. The Government's settlement agreement with the bank and the two bank officers noted that this \$200,000 payment was a compromise and not to be considered an admission of liability by the defendants. In 1996 the bottling company's corporate secretary pled guilty to mail fraud in connection with this loan and was sentenced to 1 year and 1 day in prison. The OIG initiated this investigation based on a referral from SBA's St. Louis District Office.

California Real Estate Agent Sentenced on Charge of Bribery

A Glendale, California, real estate salesperson pled guilty to one count of **bribery** of an SBA employee, and was subsequently sentenced to 4 months home detention, 3 years probation, and a \$5,100 fine. The investigation was initiated based on a referral from SBA's Los Angeles District Office (LADO) on the same day the woman offered compensation to a loan assistant in its Liquidation Division to become the listing agent for an SBA-foreclosed business property. The loan assistant notified his supervisor immediately after receiving the offer. During subsequent telephone calls, and despite warnings that she

and the loan assistant could get into trouble, the Realtor offered the loan assistant \$3,500 for the real estate listing. At a later face-to-face meeting, the woman gave the loan assistant \$1,000 as good faith money, and she and the SBA employee signed the real estate listing agreement. The following day, she was given a letter from the LADO's Legal Division stating that the loan assistant did not have the delegated authority to execute the listing agreement. When given the letter, the woman denied ever personally meeting with the SBA loan assistant, making him any promises, or giving him any money. Other evidence contradicted those denials.

Texas Cellular Phone Distributor Sentenced for Making False Statements

The owner and president of a Plano, Texas, cellular phone distributor was sentenced to 15 months incarceration and \$254,970 restitution to SBA. He previously pled guilty to one count of **making false statements** to SBA. In return, the Government agreed to dismissal of the other two counts on which he was previously indicted. The man obtained a \$230,000 SBA-guaranteed loan by submitting an SBA Form 912, Statement of Personal History, that bore a bogus Social Security number (SSN) and failed to disclose his criminal history. The bogus SSN was used on his SBA Form 413, Personal Financial Statement, as well. He also admitted that he failed to disclose a number of debts in the loan application and provided SBA with altered tax returns and falsified invoices in support of the loan disbursements. The OIG opened this investigation based on a referral from SBA's Dallas District Office and continued it jointly with the IRS.

Texas Automotive School Owners Indicted for Bank Fraud and Conspiracy

The owners of an automotive repair school in Houston, Texas, were indicted on eight counts of **bank fraud, making a false statement to an FDIC-insured bank, and conspiracy**. Their company obtained a \$240,000 SBA-guaranteed loan in 1991. The OIG's investigation found that the couple submitted loan disbursement requests to the participating lender bank that falsely cited \$69,877 of construction work that was never completed. The indictment also charged the husband with fraudulently endorsing loan disbursement checks totaling \$56,540. This investigation was initiated based on information developed during the OIG's Operation Clean Sweep research at SBA's Houston District Office.

Two Kansas Building Material Manufacturers Indicted for Making False Statements

Two former owners and officers of a building-materials manufacturing company were indicted on three counts of **making false statements to SBA and making false statements to a Federally-insured lender** regarding its application for a \$630,000 SBA-guaranteed loan. The loan was intended to finance the opening of a plant in Neodesha, Kansas, to manufacture foam-core construction panels, but the business failed and defaulted on repayment of the loan. The OIG's joint investigation with the U.S. Secret Service determined that, to obtain the loan, the two men misrepresented that the first was the president and 100% owner of the company. It was the second man, however, who actually was the corporation's president

and 100% owner at the time. This investigation was initiated based on a referral from SBA's Kansas City District Office.

Kansas Couple Indicted for Making False Statements

The president and the secretary of a fuel-pellet manufacturing company in Erie, Kansas, were indicted on three counts of **making false statements to SBA and making false statements to a Federally-insured lender** regarding the company's application for a \$147,650 SBA-guaranteed loan. The loan was intended to finance the opening of a fuel-pellet manufacturing plant, but the business failed and defaulted on repayment of the loan. The OIG's joint investigation with the U.S. Secret Service determined that the man failed to disclose a prior defaulted SBA disaster loan and prior bankruptcy, and the couple failed to disclose fuel taxes they owed to the State of Arizona. This investigation was initiated based on a referral from SBA's Kansas City District Office.

California Brokerage Principal Indicted for Bank Fraud and Making False Statements

A principal of a San Jose, California, loan brokerage firm was indicted on December 19, 1997, on 1 count of **bank fraud**, 11 counts of **making false statements on loan applications to Federally-insured financial institutions**, and 6 counts of **making false statements** to obtain SBA-guaranteed loans. The indictment was the result of a joint investigation, conducted by the OIG and the FBI, that was initiated based on information provided by SBA's San Francisco District

Office. In the indictment, the man was charged with submitting false documents to assist his clients in obtaining SBA-guaranteed loans to purchase convenience stores in northern California. The allegedly false documents he submitted generally involved the applicants' eligibility and/or source of down payments and included personal financial statements that overstated the applicants' net worth. The indictment also charged that the man frequently used "straw" applicants to conceal the true identity of principals who would not have been eligible for SBA-guaranteed loans. Some were ineligible because they were not permanent legal U.S. residents, and some would have exceeded SBA's per-person loan maximum. Cited in the indictment are a total of 10 loans made by a Sacramento bank between 1989 and 1995 and 1 loan made by another California bank in 1997. Together, they total nearly \$6 million. To date, SBA has paid out over \$1.8 million to repurchase defaulted loans made to his clients.

Three Georgia Businessmen Indicted for Conspiracy and Making False Statements

Three Georgia businessmen were indicted in connection with a \$155,000 SBA-guaranteed loan for purchase of a grocery business in Kennesaw, Georgia. The buying corporation's president and owner was indicted on one count of **making a materially false statement** in an SBA-related matter. On the Personal History Statement, SBA Form 912, submitted as part of the loan application package, he certified that he had never been arrested. The OIG's investigation revealed, however, that he had been arrested twice. The buyer's corporate secretary and the chief executive officer of the broker for

the sale of the grocery were indicted on seven counts of **conspiracy, making false statements to a Federally-insured bank, and making false statements** to SBA. The investigation, initiated based on a referral from SBA's Atlanta District Office, found that these two men conspired to conceal the true purchase price from the participating lender bank and SBA. The original loan application indicated a purchase price of \$300,000, with the seller financing \$100,000; however, SBA declined the application based on that price, stating that repayment of the debt was unrealistic. According to the indictment, the broker subsequently told the bank's senior vice president that the buyer and seller had agreed to reduce the purchase price to \$200,000; the broker also faxed an Offer to Purchase to the bank indicating a purchase price of \$200,000. The loan application was re-submitted and approved by SBA. This investigation revealed that the purchase price was never reduced to \$200,000, but remained at \$300,000, restructured into \$200,000 for the sale of tangible assets and \$100,000 for the sale of goodwill. SBA and the bank were never informed about the goodwill aspect of the sale, however. Furthermore, at the loan closing the secretary submitted a \$25,000 check as part of the required capital injection; he allegedly did not have sufficient funds to back the check and made arrangements with the seller to exchange the check for a \$25,000 promissory note after the closing. The indictment charges that the secretary concealed this agreement from SBA and the bank.

Texas Couple Charged with Making False Statements

The former owners of a convenience store in San Antonio, Texas, were each charged in an information with two counts of **making false statements** in their application to SBA for a \$131,100 handicapped-assistance business loan. The information charges the couple with not disclosing to SBA that they had previously filed for bankruptcy and had already sold the business for which the loan was obtained. The joint investigation with the Social Security Administration's OIG was based on a referral from SBA's San Antonio District Office.

Washington State Meat Processor Sentenced for Making False Statements

The former owner of a meat processing and packaging business in Endicott, Washington, was sentenced to 5 years probation and \$43,614 restitution for **making false statements** to an SBA/OIG special agent. The investigation found that, to sell his business for an increased price, he provided altered tax returns to both SBA and a participating non-bank lender to show higher income than he had reported to the IRS. When interviewed about the tax returns submitted to SBA and the lender, the man made false statements to the SBA/OIG special agent regarding their accuracy. This investigation, conducted jointly with the IRS, was based on a referral from SBA's Spokane District Office.

New Jersey Restaurant Owner Pleads Guilty to Making False Statements

The owner of a Seaside Heights, New Jersey,

restaurant and bar pled guilty to a one-count information that charged him with **making false statements** in applying for, and accounting for the use of proceeds of, a \$616,000 SBA-guaranteed loan to his corporation. In the plea agreement the man admitted that, on the Statement of Personal History included with his application, he omitted his arrest and conviction for bribing a public official. The owner also acknowledged submitting to the participating non-bank lender and SBA altered tax returns and fraudulently endorsed two-party checks. The case, worked jointly with the FBI, was based on information provided by SBA's Newark District Office.

**Massachusetts Coffee Wholesaler
Charged with Making False Statements**

The president of a Quincy, Massachusetts, wholesaler of specialty coffees and related items was charged with five counts of **making false statements on loan applications to a Federally-insured financial institution**. According to the criminal information, he provided false documents and made false statements in obtaining two loans and a credit line from a participating lender bank during 1995. The larger loan, for \$143,000, was guaranteed by SBA. The business owner is charged with falsely claiming that he had made an equity investment in his business, submitting false documents pertaining to the use of the loan proceeds, and submitting balance sheets containing false financial information about his business. The joint SBA/OIG and FBI investigation originated from a referral to the OIG by SBA's Boston District Office.

**Iowa Manufacturer Pleads Guilty to
Making False Official Certification**

An officer of a manufacturing company in Central City, Iowa, which had produced tent stakes for the Army, pled guilty to one count of **making a false official certification**. He was sentenced to pay a \$2,000 fine and subsequently paid a \$25,000 civil settlement. The SBA/OIG's joint investigation with the Defense Criminal Investigative Service found that, to gain approval of the firm's application for a \$500,000 SBA-guaranteed loan to buy the assets of a debarred defense contractor, the businessman submitted a fraudulent certification of his financial condition to the participating lender bank. The information charged that he falsely certified that he had \$175,000 available from personal savings to invest in the firm and failed to disclose outstanding debts, including a significant loan from the owner of the debarred contractor. This investigation was opened based on information developed in an investigation that resulted in the June 1994 conviction of the former owner and an associate for fraud in connection with an SBA certificate of competency.

**District of Columbia Waste Recycler
Indicted for Making False Statements
and Perjury**

The president of a now-defunct waste-paper recycling company in Washington, D.C., was indicted on four counts of **making false statements in a loan application to a Federally-insured bank**, four counts of **making false statements to SBA**, and two counts of **perjury**. The company had received a \$296,014 SBA-guaranteed loan to purchase equipment to convert waste paper

into fuel pellets. Approval of the loan was based on the company president's projection of the company's income. The indictment charged that the woman made false statements in her loan application when she (1) provided an altered document to support her income projections, (2) lied about her education, (3) failed to inform the bank and SBA that her contract to obtain the required waste paper had been canceled prior to the loan closing, and (4) failed to list on her Personal Financial Statement that she was a personal guarantor on a loan from another lender. The investigation found that, in response to the bank's request for information supporting her income projections, she had directed her secretary to alter a letter to reflect that the company would receive approximately 100 tons of waste paper a day instead of the 16 tons she knew to be the true amount. This letter was then submitted to the bank and SBA to support her inflated projections. The woman was charged with perjury for lying to the U.S. Bankruptcy Court about the alteration of this letter. The company defaulted on the loan without making a single payment. This investigation, conducted jointly with the FBI, was initiated based on a referral from the participating lender bank.

Oklahoma Computer Store Owner Indicted for Making False Statements

The co-owner of a now-defunct Ardmore, Oklahoma, computer store was indicted on one count of **making false statements on a loan application to a Federally-insured financial institution**. The store had received a \$50,000 SBA-guaranteed loan from a participating lender bank. To increase his chances of obtaining the business loan, the

indictment charges, the man indicated on SBA Form 912, Statement of Personal History, that he had never been arrested or convicted other than for minor motor vehicle violations. In fact, he had been arrested for and convicted of extortion in 1976 and, in an incident involving a minor, arrested for sexual assault and convicted in 1989 of indecency and fondling. The OIG's investigation found that both charges were material to approval of the loan application. The loan was disbursed in August 1993. The owner closed the store and filed for bankruptcy in April 1994, and the loan was charged off in July 1996, with a loss to the bank and SBA of \$54,319. The OIG initiated the investigation based on the results of its Operation Clean Sweep inquiries in Oklahoma.

Mississippi Tractor Dealer Indicted for Making False Statement

The owner of a now-defunct tractor dealership in Shubuta, Mississippi, was indicted on one count of knowingly **making a material false statement** to obtain a \$150,000 SBA-guaranteed loan. The indictment charged him with representing on a Schedule of Collateral (SBA Form 4, Schedule A) that he already owned, and would grant the participating lender bank a first security interest in inventory worth \$99,373 when, in fact, he had no such inventory. Supporting information was developed in the OIG's investigation, which was based on a referral from SBA's Jackson District Office.

Results of Previously Reported Investigations

Wisconsin Business Consultant Pleads Guilty to Making False Statement

A business consultant in Menomonee Falls, Wisconsin, pled guilty to one count of **making a material false statement** to SBA to obtain a \$25,000 SBA-guaranteed loan. The woman admitted that she knowingly failed to disclose a recent criminal history and provided a false Social Security number on SBA Form 912, Statement of Personal History, in a LowDoc loan application for her consulting firm. The OIG's investigation found that she had been arrested on a charge of forging company checks the day before she applied for the loan, and she was convicted on that charge after obtaining the loan.

Would-Be Pennsylvania Tavern Owner Sentenced for Making False Statements

A Lansdale, Pennsylvania, businessman was sentenced to 3 years probation and a \$50 special assessment. The man previously pled guilty to **making false statements to influence SBA** to approve a \$200,000 guaranteed loan to his company. In applying for the loan, he had submitted a 1991 tax return altered to substantially overstate his income and fictitious returns for 1992 and 1993. The loan was canceled when the tax return discrepancies were confirmed by IRS.

Georgia Hotel Owner Sentenced to Prison for Making Material False Statements

The former owner of a hotel in Tybee Island, Georgia, was sentenced to 4 months imprisonment, 3 years supervised release, \$213,150 restitution, a \$5,100 fine, and 200 hours community service. He had pled guilty to two counts of **making material false statements** to influence the actions of SBA. Approved for a \$950,000 SBA-guaranteed business loan, he submitted falsified invoices to the participating lender bank, representing \$213,150 in services and equipment, to obtain payment of loan proceeds.

California Grocer Sentenced for Making False Statement

The owner of a grocery store in West Covina, California, was sentenced to 4 months imprisonment followed by 3 years supervised release. He was not ordered to pay a fine or to make restitution due to his financial condition. The man had pled guilty to one count of **making false statements in a loan application to a Federally-insured bank**. He had obtained a \$285,000 SBA-guaranteed business loan based on an application containing altered copies of income tax returns for 1988-90. The grocer was identified during an extensive investigation examining the submission of false documents as part of loan packages prepared by a loan broker who had previously pled guilty to **bank fraud** in connection with this investigation.

California Automobile Repair Shop Owner Sentenced for Making False Statements

The owner of an auto repair center in North Hollywood, California, was sentenced to 5 years probation, a \$5,000 fine, and \$144,000 restitution. He had pled guilty to one count of **making false statements in a loan application to a Federally-insured bank**. The man had obtained a \$276,000 SBA-guaranteed loan based on an application containing altered individual and corporate income tax returns for 1987-89. Information concerning this borrower came to light as part of the extensive investigation involving loan applications prepared by two California brothers acting as loan packagers.

Illinois Machine Manufacturer Sentenced for Making False Statement

The former owner of an industrial machine manufacturing company in Dolton, Illinois, was sentenced to 2 years probation (including 6 months home detention) and \$21,403 restitution to SBA and the participating lender bank. The man previously pled guilty to one count of knowingly **making a false statement** to influence SBA. The company was approved in 1992 for a \$325,000 SBA-guaranteed business loan, of which \$42,500 was to be used to purchase machinery and equipment. The owner subsequently submitted an SBA settlement sheet that certified that he already had spent \$38,500 of the loan proceeds to purchase a milling machine and would spend an additional \$4,000 to purchase more machinery. The investigation documented that his certification was false as he actually spent only \$2,000 on machinery and equipment.

Washington Restaurant Chain Executive Pleads Guilty to Making False Statements

The president of a corporation which owned several sandwich stores in the Tacoma, Washington, area was sentenced to 1 year and 1 day imprisonment, 5 years probation, and \$184,683 in restitution. He had pled guilty to **making false statements on a loan application to a Federally-insured financial institution**. To obtain a \$322,197 SBA-guaranteed business loan, the man provided fraudulent guaranties, financial statements, and other documents to a participating lender bank and SBA. The investigation found that he had forged the signature of one shareholder and had several employees forge the signature of another shareholder on the guaranties, financial statements, and other documents. In addition, the investigation found that the president converted SBA collateral by selling it to a leasing company through a third party and leasing the equipment back from the leasing company.

Two California Business Owners Plead Guilty to Bank Fraud

Two California businessmen—a car wash owner and a grocery store owner—pled guilty on January 12, 1998, to one count each of **bank fraud** committed while applying for an SBA-guaranteed loan. SBA records revealed that the owner of the car wash had received SBA-guaranteed loans for \$700,500 and \$105,000 and that the owner of the grocery had received a \$255,000 SBA-guaranteed loan. The investigation confirmed that the “copies” of their Federal tax returns, submitted to the participant bank with their loan applications, had been altered from those submitted to the IRS in an effort to

substantially overstate their incomes. Both men were clients of the same tax return preparer.

Disaster Loan Program

Pursuant to Section 7(b) of the Small Business Act, as amended, SBA's disaster loans represent the primary form of direct loan Federal assistance for non-farm, private sector disaster losses. Moreover, the Disaster Loan Program is the only form of SBA assistance not limited to small businesses. Disaster loans from SBA also help homeowners, renters, businesses of all sizes, and non-profit organizations to rebuild. SBA's disaster loans are also a critical source of economic stimulation in disaster-ravaged communities, helping to energize employment and stabilize tax bases.

By providing disaster assistance in the form of loans which are repaid to the U.S. Treasury, the SBA program helps to defray Federal costs. When victims need to borrow to repair uninsured damages, the low interest rates and the long terms available from SBA make recovery more affordable. Because SBA tailors the repayment of each disaster loan to each borrower's capability, unnecessary interest subsidies paid by the taxpayers are avoided.

The need for SBA disaster loans is unpredictable. During FY 1997, SBA approved 49,515 loans. Since the inception of the program, SBA has approved more than 1,386,000 disaster loans valued at some \$25 billion. As of the end of FY 1997, the SBA disaster loan portfolio included more than 285,000 loans worth over \$7.1 billion.

SBA is authorized by law to make two types of disaster assistance loans: (1) physical disaster loans, which are a primary source of funding for permanent rebuilding and replacement of uninsured disaster damages to real and personal property homeowners, renters, businesses of all sizes, and non-profit organizations and (2) economic injury disaster loans which provide necessary working capital to small businesses until normal operations can be resumed after a physical disaster. SBA delivers its disaster loans through four specialized Disaster Assistance Area Offices located in Niagara Falls, New York; Atlanta, Georgia; Fort Worth, Texas; and Sacramento, California.

Summary of OIG Activity / Disaster Loan Program	
Audits Underway	3
Indictments Resulting from Investigations	9
Convictions Resulting from Investigations	10
Investigations Closed / Remaining Inventory	9 / 79
Investigations : Restitutions / Fines / Other Recoveries	\$408,567 / \$4,450 / \$0
Investigations : Reductions to the Agency's Financial Risk	\$145,600
Investigations: Declination of Loans Due to Name Checks	\$228,326
Investigations: Cases Referred to Other Agencies	1
Reviews of Proposed Regulations	3
Reviews of Other Issuances	1

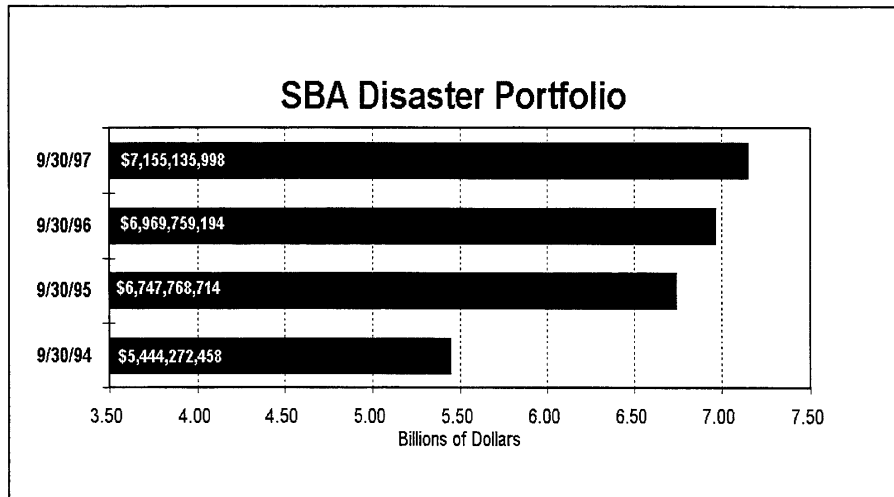


Figure 2

Efforts to Improve SBA Program Management

Audits Underway in the OIG's Disaster Oversight Effort

The following audits are in progress and will be issued when completed:

Disaster Loan Approval Rates. To identify ways to improve the Disaster Assistance home loan application approval rate without increasing the program's delinquency and default loss rates.

Disaster Home Loan Servicing. To determine whether disaster home loan servicing centers are maximizing collections and minimizing losses at the least possible cost.

Early Defaulted Disaster Loans. To determine (1) if cash flow was insufficient to repay the disaster loan at the time of default, (2) if loan proceeds were used for the intended purposes, and (3) if assets or income are available for an SBA recovery. The audit is in the early stages.

Activities to Enhance Fraud Detection and Deterrence

California Disaster Loan Applicant Pleads Guilty to Making False Statements and Misusing Social Security Number

A Culver City, California, man pled guilty to two counts of **making material false statements** to SBA and one count of **misuse of a Social Security number (SSN)**. The man was approved for a \$33,000 disaster home loan following the 1993 Los Angeles

winter storms, but SBA canceled the loan before any funds were disbursed once its tax verification program identified discrepancies between 1990-91 Individual Income Tax returns submitted to SBA and IRS. The OIG's investigation confirmed that the tax return "copies" submitted to SBA had been altered to overstate his income. The investigation also found that the applicant had been the recipient of a \$25,000 disaster home loan following the 1994 Northridge earthquake, using another name similar to his own. The application package for that loan also included altered 1991-92 individual income tax information and a fictitious SSN. The OIG opened the investigation based on a referral from SBA's Disaster Assistance Area 4 Office.

Former U.S. Virgin Islands Resident Indicted for Making False Statements

A current Maryland resident was indicted by a Federal grand jury in the U.S. Virgin Islands on two counts of **making false statements** to SBA in connection with her receipt of a \$34,400 disaster home loan. The indictment charged that the woman submitted documents falsely claiming that on two occasions she had used loan proceeds to purchase furniture and appliances for her former home in the U.S. Virgin Islands. The documents were submitted to obtain the disbursement of the balance of her loan from SBA. The case was based on a referral from SBA's Disaster Assistance Area 1 Office and produced the second indictment for fraud against SBA in the wake of Hurricane Marilyn.

Pennsylvania Businessman Sentenced for Making False Statement

A Lycoming County, Pennsylvania, wholesale computer salesman and telemarketer was sentenced to 3 years probation and a \$3,000 fine. He had pled guilty to one count of **making a false statement** to SBA by omitting from his application for disaster assistance a mail fraud charge to which he had agreed to plead guilty. The false statement was made in connection with his application for disaster loans, totaling \$78,300, relating to floods in the Susquehanna River valley in January 1996. SBA declined the loans after discovering the undisclosed criminal charge. The investigation, which the OIG worked jointly with the FBI, was based on information provided by SBA's Disaster Assistance Area 3 Office.

Pennsylvania Attorney Indicted for Making False Statements

A Harrisburg, Pennsylvania, attorney was indicted on one count of **making false statements** to SBA by overstating his income and omitting a theft conviction on his application for three SBA disaster loans. The man made the allegedly false statements in connection with applications for \$40,000 in disaster assistance relating to floods in Pennsylvania's Susquehanna River valley in 1996. The loans were declined when SBA discovered that his income certification did not match the income reported on his Federal tax returns. The case, worked jointly with the FBI, was based on information provided by SBA's Disaster Assistance Area 3 Office.

Missouri Nautical Consultant Pleads Guilty to Making False Statement

A marina operator/developer in West Alton, Missouri, pled guilty to a one count information that charged him with **making a material false statement** to SBA to obtain disaster assistance for his company. The business was damaged by the Great Midwest Flood of 1993. The man presented bogus invoices to falsely document that he had spent \$12,862 of disaster loan proceeds for repair of a lift well (nautical machinery) when he had actually paid only \$4,500. The investigation also determined that, in applying for the \$93,700 disaster loan, he falsely indicated that certain equipment would be used as collateral for the loan; he actually sold the equipment, however, before he received any disaster assistance.

California Lighting Company Owner Pleads Guilty to Making False Statements

The owner of a lighting company in Los Angeles, California, pled guilty to one count of **making false statements to SBA** and one count of **making a false statement on a bankruptcy petition**. In return, the Government agreed to dismissal of the other six counts on which he was previously indicted. The company owner was approved for a \$25,900 disaster business loan following the 1994 Northridge earthquake; however, no proceeds beyond the first \$10,000 were disbursed because SBA became aware of a foreclosure on a property which he owned (and where he resided) but had not disclosed on his application. The man also applied for a disaster home loan following the 1995 floods in southern California, but this loan was declined due to lack of

repayment ability. The investigation, which the OIG initiated based on information provided by SBA's Disaster Assistance Area 4 Office, found that the man's business had closed before SBA disbursed any funds. It also showed that he used a false Social Security number (SSN) and provided altered income tax returns in support of both applications. The owner filed for bankruptcy to forestall eviction from the property that was in foreclosure and used a second false SSN in the bankruptcy petition.

California Market Owner Indicted for Making False Statements

The owner of a mini-market in Los Angeles, California, was indicted on one count of **making false statements** to SBA. After the mini-mart was burned down during the 1992 civil unrest, the man had obtained disaster loans totaling \$116,000. With SBA approval, he relocated to Oregon City, Oregon, and opened an Asian food restaurant. The SBA/OIG's investigation found that, to receive further disbursements of disaster loan funds, he falsely certified that he had spent the previously-disbursed loan funds in accordance with the Loan Authorization and Agreement. He submitted to SBA a Borrower's Progress Certification with an invoice showing purchases exceeding \$94,000 from a restaurant equipment supplier. The investigation found that he only purchased approximately \$2,000 of items from the supplier and instead used at least \$56,000 of the loan funds as a down payment on a home. The owner subsequently filed bankruptcy, and SBA incurred a loss of approximately \$91,000. The case was referred to the OIG by SBA's Portland District Office.

SBA Recovers Misused Loan Proceeds from Florida Businessman and His Two Companies

SBA recovered \$136,567 from a Homestead, Florida, businessman and two corporations of which he was president. The two businesses, a warehouse business and a "certified process server," had been approved for disaster loans totaling \$212,700, primarily to repair/replace real property, machinery, and equipment damaged by Hurricane Andrew. Based on information from SBA's Disaster Assistance Area 2 Office and the OIG's referral to the U.S. Attorney's Office for Southern Florida, a civil complaint had been filed against the businessman and the two corporations in 1996. The lawsuit alleged that proceeds of both loans had been diverted to unauthorized uses and that Borrower's Progress Certifications, SBA Form 1366, covering earlier disbursements totaling \$132,362 had been falsified so that SBA would continue disbursing loan funds. The man paid the Government \$26,653; subsequently, the Government was awarded a \$109,914 judgment on the **breach of contract** and **default of contract** charges. This matter was handled as part of the Justice Department's Affirmative Civil Enforcement program.

California Liquor Store Owner Sentenced for Making False Statements

The owner of a Lomita, California, liquor store was sentenced to 5 years probation, 1,000 hours community service, and \$87,000 restitution to SBA. The man previously pled guilty to one count of **making false statements in a loan application to a Federally-insured bank** and one count of

making a false statement to SBA. In March 1991, the store owner submitted altered "copies" of 1987-90 income tax returns to a participating lender bank to obtain a \$631,500 SBA-guaranteed business loan. Similarly, he submitted altered copies of tax returns for 1989-91 to SBA to obtain disaster assistance for his business following the 1992 Los Angeles civil unrest. He ultimately obtained a \$71,800 physical damage loan and a \$59,200 economic injury loan. All of the altered tax returns significantly overstated his adjusted gross income and business income. This action resulted from a joint OIG/Secret Service investigation of falsified applications prepared by two southern California brothers acting as loan packagers; the case was opened as a result of a tip from a concerned citizen and a referral from SBA's Disaster Assistance Area 4 Office.

Owner of St. Croix Rental Property Found Guilty of Making False Statements

The owner of rental property in St. Croix, U.S. Virgin Islands, was found guilty on two counts of **making false statements** to SBA in applying for a \$23,000 disaster loan for losses to four rental units she owned on St. Croix. The woman, a Decatur, Georgia, school teacher, was convicted for submitting altered "copies" of tax returns for the years 1993-94 following Hurricane Marilyn. Although the tax returns she submitted to SBA reported rental income, she had reported no such income to the IRS. The loan application was declined when SBA's tax verification program detected the discrepancies. The case was based on a referral from SBA's Disaster Assistance Area 1 Office.

North Carolina Man Pleads Guilty to Stealing Disaster Victim's Check

A resident of Surf City, North Carolina, pled guilty to a one count information that charged him with **stealing Federal property**. The man admitted converting to his own use an improperly-delivered \$6,300 U.S. Treasury check intended for a Surf City disaster victim. The OIG initiated this investigation based on information received from SBA's Disaster Assistance Area 2 Office.

Results of Previously Reported Investigations

Missouri Consultant Sentenced for Making False Statements

A Cuba, Missouri, industrial construction consultant was sentenced to 18 months imprisonment, 3 years supervised release, and \$100,000 restitution. He had pled guilty to **making material false statements** to obtain SBA disaster assistance. In support of the loan application, he submitted three fictitious tax returns for a St. Louis business that he purchased subsequent to the disaster and that received two SBA disaster loans (one for economic injury and one for physical damage) totaling \$407,800.

California Disaster Home Loan Recipient Sentenced for Making False Statements

A Mission Hills, California, disaster home loan recipient was sentenced to 18 months imprisonment, 3 years probation, and a \$100 special assessment. The man previously pled guilty to one count each of **making a false statement to SBA** and **making a false**

statement to the Federal Emergency Management Agency (FEMA). The investigation revealed that he submitted three disaster home loan applications--two under fictitious names. All three applications contained false claims for damages from the 1994 Northridge earthquake. A total of \$27,100 was disbursed in connection with his first two loans, and both loans defaulted without a single payment having been made. The third loan, for \$113,000, was approved but was not disbursed because SBA's Disaster Assistance Area 4 Office detected inconsistencies in supporting documentation.

California Pharmacy Owner Sentenced for Making False Statement

The former owner of a pharmacy in Sherman Oaks, California, was sentenced to 3 years probation, 300 hours community service, and a \$1,050 fine. He was also ordered to continue making timely payments on all his SBA disaster loans. The man had pled guilty to one count of **making a false statement** to SBA. The store owner had received a \$100,000 disaster home loan (following the 1993 severe winter storms), a \$45,000 disaster home loan, and a \$218,000 disaster business loan (following the 1994 Northridge earthquake). In 1996, he requested that SBA release its lien on his business assets. Information supporting the request contradicted information in his loan applications, and the investigation revealed that he had given SBA fictitious Wage and Tax Statements (Form W-2), altered Individual Income Tax Returns, a fictitious S Corporation Income Tax Return, and a fraudulent Corporation Profit and Loss Statement.

Texas Computer Services Company Owner Sentenced for Forgery

The owner of a computer services company in Clute, Texas, was sentenced to 4 months incarceration, 6 months home confinement, 30 months supervised release, \$22,000 restitution, and a \$150 special assessment. He previously pled guilty to three counts of **forging endorsements on U.S. Treasury checks**, which represented a portion of the proceeds of a \$183,400 economic injury disaster loan his business had obtained from SBA. The man fraudulently negotiated three Treasury checks (totaling approximately \$27,000), each jointly-payable to himself (doing business as the computer services company) and another business whose endorsement was falsely made.

Nebraska Businessman Sentenced for Making False Statement

A guarantor of economic injury and physical damage disaster loans received by a Plattsmouth, Nebraska, resort was sentenced to 5 years probation (including 6 months home confinement), \$63,000 restitution to SBA, and a \$100 special assessment. He previously pled guilty to one count of **making a false statement to SBA**. The investigation had shown that the man defrauded SBA by submitting a false invoice in order to cause the release of loan proceeds. The resort received disaster loan proceeds totaling \$206,400 following the 1993 flood of the Platte River; it has made no repayment to SBA.

California Businesswoman Sentenced for Filing False Claim

The owner of a jewelry shop in Norwalk, California, was sentenced to 3 years probation, 125 hours community service, and a \$50 special assessment. She was also ordered to continue making timely payments on her SBA disaster loans. The woman had previously pled guilty to **filing a false claim** with SBA. After her Los Angeles videotape rental store was looted and burned during the 1992 civil unrest, the woman was approved for SBA disaster loans totaling \$185,000 to rehabilitate that business. The investigation revealed that, as part of the loan application, she submitted a copy of a fictitious 1989 Individual Income Tax return and an altered copy of her 1990 Individual Income Tax return. Both of these documents significantly overstated her income. The investigation also revealed that, instead of using the \$159,700 of loan proceeds to reopen the video store, she opened the jewelry shop. (As a result of the investigation, SBA canceled the final loan disbursement of \$25,300.)

California Fashion Store Owner Pleads Guilty to Making False Statement

The former owner of a fashion store in Los Angeles, California, pled guilty to the one count of **making a false statement** to SBA on which he had been indicted. Following the 1992 civil unrest, the man had obtained two SBA disaster loans for the business. The investigation revealed that, in support of his applications for an \$87,300 physical damage loan and a \$28,100 economic injury loan, he had submitted copies of tax returns that had been altered to overstate his income. SBA

would not have made the disaster assistance loans had his true financial condition been known; his fraudulent activity resulted in a \$77,000 loss to SBA.

California Nurse Registry Owner Pleads Guilty to Filing False Claim and Making False Statement

The owner of a nurse registry in Los Angeles, California, pled guilty to one count of **filing a false claim** with SBA and one count of **making a false statement to a Federally-insured lender**. The investigation revealed that the owner submitted fraudulent applications for disaster-related business loans to a participating lender bank and SBA. He obtained a \$50,000 interim loan from the bank; he then obtained an \$89,600 economic injury loan and a \$72,800 physical damage loan from SBA. (Of the SBA loan proceeds, \$50,000 was to be used to repay the bank loan; however, he admitted diverting that amount.) In each of the loan applications, he claimed his business was located in a building damaged by fire during the 1992 civil unrest in Los Angeles. The investigation disclosed, however, that his business sustained no damage because he actually operated the nursing service out of his residence, which was not affected by the civil unrest. The SBA disaster loans went into default after only two payments on each loan were made, and SBA charged off both loan balances in 1993. The owner did not make any payments on the interim loan, which the bank charged off in 1994.

**Mississippi Automobile Parts Franchisees
Plead Guilty to Conspiracy to Defraud
the Government**

A couple who owned an automobile parts franchise in New Hebron, Mississippi, pled guilty to one count of **conspiracy** to defraud the Government. In return, the Government agreed to dismissal of the other six counts of their indictment. Their company obtained a \$120,000 SBA-guaranteed loan in 1991 and a \$42,500 physical damage loan and a \$29,800 economic injury disaster loan in 1992. An investigation found that the couple carried out a scheme, using fraudulent receipts and invoices, to conceal their misuse of proceeds of the SBA loans. The indictment also challenged their claim that a tornado damaged structural improvements, equipment, and inventory of their business.

Small Business Investment Companies

The primary purpose of the Small Business Investment Company Program is to provide a source of long-term debt and equity capital to new or expanding small businesses. **Small Business Investment Companies (SBICs)** are independently-owned and managed, profit-making investment companies which are licensed by SBA to finance small businesses through long-term loans and investments in their equity securities. SBICs often also provide management assistance to the companies they finance.

The role of SBA is (a) to determine which SBICs to license, (b) to oversee and regulate those licensees, and (c) to arrange for Government-guaranteed financing from private sources to add to their capital. Such financing, termed "leverage," is provided through either debentures or participating securities issued by the SBIC. The participating security was created by the Small Business Equity Enhancement Act of 1992 to serve the needs of SBICs investing principally in equity securities, which do not generate sufficient income to cover the interest on debenture leverage. They represent a limited partnership interest in the SBIC, whereby SBA advances the cost of the leverage until profits have been generated from the SBIC's investments. In consideration, SBA participates in approximately 10 percent of the SBIC's profits. The Agency arranges periodic public offerings of trust certificates which are backed by pools of SBIC debentures or participating securities. SBA guarantees the payment of principal and interest on the trust certificates.

As of the end of FY 1997, there were 300 licensed and active SBICs, with a total capitalization of \$6.7 billion (private capital of \$5.1 billion and leverage of \$1.6 billion). Included are 80 Specialized SBICs (SSBICs) which were licensed under Section 301(d) of the Small Business Investment Act to invest only in small businesses owned and managed by socially or economically disadvantaged persons. (Section 301(d) was repealed in 1996, but existing SSBICs were "grandfathered" and continue to operate as before.) At the end of FY 1997 there were 137 SBICs in liquidation owing SBA \$219 million. While the SBIC program level in FY 1997 was \$667 million, the FY 1998 program level is projected to be \$972 million, signaling a continuing expansion of the program.

The SBI Act generally requires that all SBICs licensed by SBA be examined every 2 years to ensure licensee compliance with law and Agency regulations. The Small Business Credit and Business Opportunity Enhancement Act of 1992 transferred the responsibility for examining SBICs from the OIG to the Agency effective October 1, 1992. While SBA's Investment Division is now responsible for these examinations, the OIG continues to have authority to audit the SBIC program pursuant to its responsibility to oversee all Agency programs and activities.

Summary of OIG Activity / Small Business Investment Companies	
Indictments Resulting from Investigations	3
Convictions Resulting from Investigations	3
Investigations Closed / Remaining Inventory	1 / 12
Investigations : Restitutions / Fines / Other Recoveries	\$0 / \$162,550 / \$1,972,000*
Reviews of Proposed Regulations	2
Reviews of Standard Operating Procedures	1

* During this reporting period, two licensees which the OIG investigated negotiated administrative settlements with SBA totaling \$1,972,000.

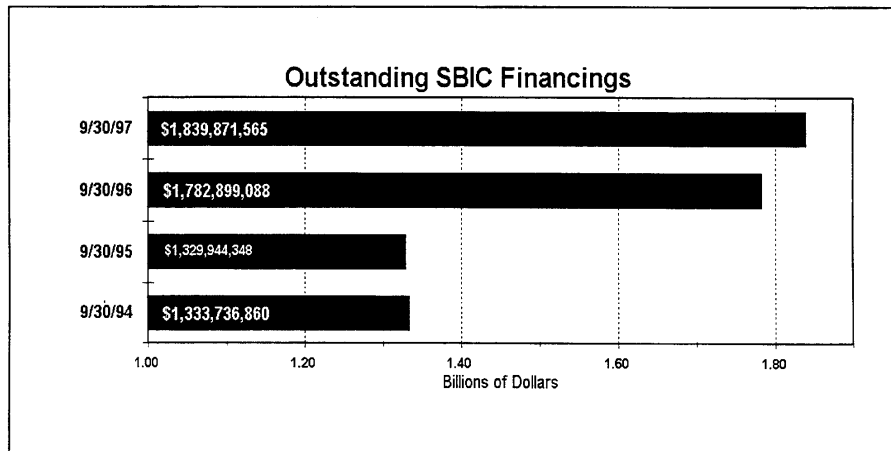


Figure 3

Activities to Enhance Fraud Detection and Deterrence

Officers of Michigan Specialized Small Business Investment Company (SSBIC) Plead Guilty to Misapplying Funds of Financial Institution and Failing to File Required Currency Transaction Report

Two officers and directors of a specialized small business investment company (SSBIC) in Farmington Hills, Michigan, were charged in a misdemeanor criminal information. Each businessman was charged with one count of **misapplying funds of a financial institution** and one count of **failing to file a required Currency Transaction Report**. Both have pleaded guilty to the charges; one was ordered to pay \$325,000 to the Government. Under the civil forfeiture order, the \$325,000 will go to the IRS and the U.S. Secret Service. SBA will receive none of these proceeds even though more than \$100,000 of the misapplied funds came from the SSBIC. The SBA/OIG continues to seek legislation allowing it to participate in the Government's Asset Forfeiture program. With regard to the count of "misapplying funds," the two caused the SSBIC to loan money to a business in Michigan when they knew the funds would be forwarded to a business in California previously denied a loan by the SSBIC. With regard to the count of "failure to file," the pair, as officers of the SSBIC and a related company, caused the related company to accept, in the regular course of business, \$20,000 in cash but failed to file a Currency Transaction Report with the Department of the Treasury. The investigation was conducted jointly by the

U.S. Secret Service, the IRS, and the SBA/OIG; it developed from information uncovered in an investigation of another SSBIC.

California SSBIC Chairman Pleads Guilty to Conspiracy and Misapplication of Funds

The chairman of the board of a now-defunct Westminster, California, specialized small business investment company (SSBIC) pled guilty to one count of **conspiracy** and three counts of **willful misapplication of funds** belonging to the SSBIC. This plea is the culmination of an extensive OIG investigation initiated in 1992, based on information provided by SBA's Investment Division shortly after \$1 million in SBA funds were advanced to the SSBIC. The investigation found that the chairman made false statements with respect to his initial cash injection, the true ownership of the small business concerns to which the \$1 million were loaned, and the disposition of the loan proceeds. He recently repaid \$927,000 of the \$1 million he fraudulently obtained from SBA in April 1992. In addition, based on information developed in the investigation, the SSBIC's receiver negotiated out-of-court settlements with a bank and its operations officer for \$150,000 and \$50,000, respectively, for their assistance to the SSBIC's chairman in manipulating the SSBIC's funds.

The SBA, in response to the criminal plea, has entered a stand still agreement with the two individuals who pled guilty. Pursuant to this agreement, the two are suspended from their positions with the SSBIC and have

agreed to take no part in the operation of the SSBIC. Additionally, SBA has refused to roll over \$2 million of SBA-owned debentures, issued to the SSBIC, which are due and payable.

Surety Bond Guarantees

Small and emerging contractors who cannot get surety bonds through regular commercial channels can apply for SBA bonding assistance under the **Surety Bond Guarantee Program**. Under this program, SBA guarantees a portion of the losses sustained by a surety company as a result of the issuance of a bid, payment, and/or performance bond to a small business concern.

Businesses in the construction and service industries can meet the SBA's size eligibility standards if their average annual receipts (including those of their affiliates) for the last 3 fiscal years do not exceed \$5 million. A contract bond is generally eligible for SBA guarantee if the bond is covered by the Contract Bonds section of the Current Manual of Rules, Procedures and Classifications of the Surety Association of America; required by the invitation to bid or by the contract; and executed by a surety company that is determined by SBA to be eligible to participate in the program and certified acceptable by the Department of the Treasury.

The **Preferred Surety Bond (PSB)** program allows selected sureties to issue, monitor, and service surety bonds without SBA's prior approval. SBA accomplishes two primary objectives through this program: (1) expanding the number of sureties participating in the surety bond guarantee program, and (2) increasing bonding availability to business concerns that would otherwise not be able to obtain bonding in the standard marketplace. Title II of Public Law 100-590 also requires an annual audit of each surety participating in this program.

SBA can guarantee bonds for contracts with a face value of up to \$1.25 million. In FY 1997, SBA contingent liability for new final bond guarantees, including those issued under the PSB program, was \$615 million. The appropriated guarantee authority level for FY 1997 surety bond guarantees was \$1.767 billion; in FY 1998, it is \$1.672 billion.

Summary of OIG Activity / Surety Bond Guarantees	
Audits Underway	5
Investigations Closed / Remaining Inventory	0 / 1
Investigations: Declinations Due to Name Check	3
Reviews of Proposed Regulations	1

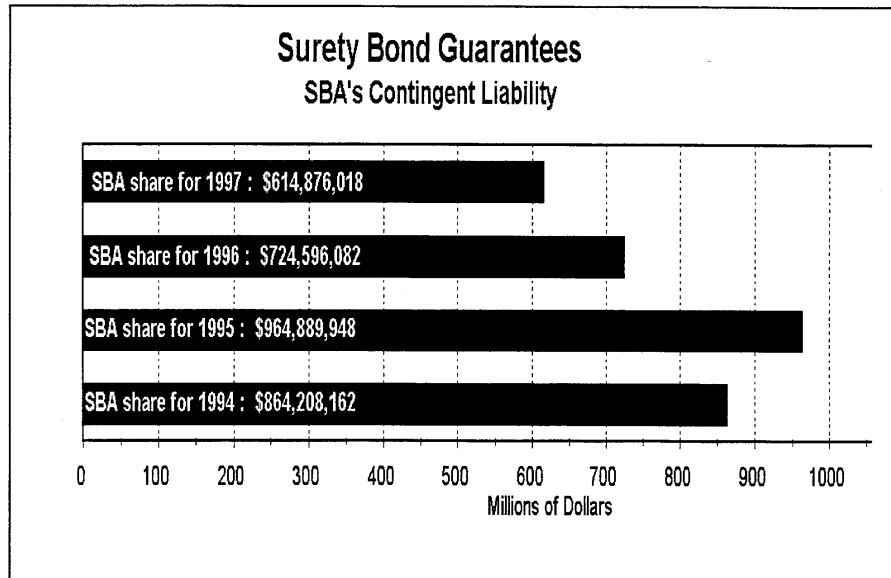


Figure 4

Although several audit and investigative activities were in progress during the reporting period, as indicated in the statistical summary box on the previous page, no reportable outcomes were generated.

determine if SBG fee refunds relating to overpayments, bond cancellations or contract reductions are properly processed.

The OIG's Auditing Division is currently conducting audits of claims by four surety companies and one survey of SBA's process for refunding fees paid to SBA by sureties and bonded companies. The objectives of the claims audits are to determine if (1) surety companies comply with both SBA's and their own policies and procedures in applying for bond guarantees, (2) fees are remitted in a timely manner, and (3) claims and expenses paid by SBA are allowable and reasonable. The objective of the other audit is to

Government Contracting Programs

SBA provides assistance to small businesses in obtaining a fair share of Federal Government contracting opportunities. SBA also works with each department or agency to establish procurement goals for contracting with small, small-disadvantaged, and women-owned businesses. The Agency's Government contracting programs include **Prime Contracts**, **Subcontracting Assistance**, **Certificate of Competency**, **Natural Resources Sales Assistance**, and the **Procurement Marketing Access Network (PRO-Net)**.

The goals of the **Prime Contract Program** are to increase small business opportunities in the Federal acquisition process and to expand full and open competition to effect savings to the Federal Government. Supporting initiatives are carried out by traditional and breakout procurement center representatives assigned to major Federal acquisition activities.

The **Subcontracting Assistance Program** promotes the optimal use of small businesses by the Government's large prime contractors. This program objective is carried out by commercial market representatives who monitor the procurement activities of the large prime contractors.

The **Certificate of Competency (COC) Program** provides an appeal process to assure that small business concerns, especially those new to the Federal procurement market, are given a fair opportunity to compete for and win Government contracts. If a small business is the lowest bidder on a contract but is found to be non-responsible in its ability to fulfill the contract's requirements, it can appeal to SBA. After reviewing a firm's capabilities, SBA can issue a COC that requires the contracting officer to award the contract to that business.

Natural Resources Sales Assistance helps small businesses obtain a fair share of Federal property offered for sale or disposal, with a focus on sales of Federal timber, royalty oil, coal leases, and other mineral leases.

The **Procurement Marketing Access Network (PRO-Net)** is SBA's Internet-based inventory of U.S. small businesses that are interested in Federal procurement opportunities, either directly with the Government or with prime contractors. Federal agencies and large prime contractors both use PRO-Net as a resource in identifying small businesses for procurement opportunities. Small businesses use this interactive mechanism to market their products and services.

Summary of OIG Activity / Government Contracting	
Investigations Closed / Remaining Inventory	2 / 3
Reviews of Proposed Regulations	4

Efforts to Improve SBA Program Management

Proposed HUBZone Regulations Reviewed

The OIG reviewed an early draft of proposed regulations governing the new HUBZone program established by Title VI of the Small Business Reauthorization Act of 1997, Pub. L. 105-135, enacted December 2, 1997. The HUBZone program provides Federal contracting assistance to small businesses located in "historically underutilized business zones" (HUBZones).

The OIG recommended several changes to reduce potential program abuse or inefficiencies. Such changes included strengthening the "non-manufacturing" rule to preclude HUBZone companies from making minor modifications to non-HUBZone manufactured products and then selling the product as a HUBZone product; eliminating double preferences for small disadvantaged businesses located in HUBZones; not limiting HUBZone contracts to only those considered "labor-intensive;" not restricting a company to one-half the size standard for its Standard Industrial Classification (SIC) code at the time of application; requiring small businesses to obtain employees' self-certification as to residency in a HUBZone; and adding SBA Form 912, Statement of Personal History, to

the list of required forms so that the Agency can perform a name and background check during the certification process. The OIG also focused on such issues as verification of eligibility, maintaining HUBZone status, notification of material changes, additional requirements for contract bidding, and penalties.

The Agency changed the proposed regulations to incorporate a significant number of the OIG's recommendations prior to their publication.

Draft of Small and Disadvantaged Business (SDB) Regulations Reviewed

The OIG reviewed a draft of proposed final amendments to 13 CFR Part 124, governing the SDB program, and provided numerous comments to the Agency for its consideration in developing new regulations. The OIG's comments focused on such issues as determinations of disadvantaged status, character determination and tax verification as part of SDB certification, limits on the number of joint ventures, qualification standards and tenure rights of Private Certifiers, Certifier fees, self-certification, the presumption of eligibility of former Section 8(a) firms for SDB certification, and protests of SDB status.

Minority Enterprise Development

Section 7(j)(10) of the Small Business Act established the **Minority Small Business and Capital Ownership Development Program** for the purpose of promoting greater access to the free enterprise system for socially and economically disadvantaged individuals. Under the Act, SBA provides business development assistance to small business concerns that are at least 51 percent unconditionally owned, controlled, and managed by one or more socially and economically disadvantaged individuals and also meet other program eligibility requirements. Such companies may participate in the program for a maximum of 9 years and must enhance their competitiveness during this period so as to prepare for commercial sector competition upon graduation from the program.

One of the business development tools available to participant firms is access to Federal contracting opportunities authorized by **Section 8(a)** of the Small Business Act. Under the Section 8(a) program, SBA contracts with other Government agencies to provide goods and services and subcontracts the performance of these contracts to program participants. As of September 30, 1997, there were more than 5,570 approved program participants. In FY 1997, active Section 8(a) program participants received 5,996 contracts and 21,606 modifications with an aggregate value of \$6.3 billion. Generally, Section 8(a) contracts with estimated values, including all options, of more than \$5 million (manufacturing) or \$3 million (all other industries) must be competed among eligible Section 8(a) program participants. The vast majority of the contracts awarded under the program, however, have estimated values below these two thresholds and are awarded on a sole-source basis.

Under the **Section 7(j) Management and Technical Assistance Program**, which is housed in the Office of Minority Enterprise Development, SBA provides specialized training, professional consultant assistance, and executive development to certified Section 8(a) firms, socially and economically disadvantaged individuals whose firms are not participants in the Section 8(a) program, low-income individuals, and small businesses located in areas of low income or high unemployment.

There are over \$9 billion in Section 8(a) subcontracts currently outstanding and subject to OIG audit, inspection, and investigation oversight activities. These contracts are reflected in other Government agencies' portfolios; therefore, their values are not included in the OIG's \$35 billion audit, inspection, and investigation universe.

Summary of OIG Activity / Minority Enterprise Development	
Audits Issued	2
Audits Underway	3
Indictments Resulting from Investigations	1
Investigations Closed / Remaining Inventory	0 / 17
Investigations: Declinations Due to Name Check	12
Reviews of Proposed Regulations	1

Efforts to Improve SBA Program Management

Maryland Computer Firm Withdraws from Section 8(a) Program After Eligibility Questioned in Audit

A Maryland computer manufacturing firm **withdrew voluntarily from the Section 8(a) program** after an OIG audit concluded the owners **exceeded the net worth limitations** for both initial and continuing eligibility. According to the audit report the owners were inappropriately admitted into the program in 1994 when investment property owned by one of the company's principals was incorrectly represented as part of his personal residence. At the time of the application, three parcels of land adjacent to the owner's home were under a contract for sale to subdivision developers. Had that land not been excluded from his net worth under the exemption for a personal residence, the owner would have exceeded the net worth limit for entry into the Section 8(a) program.

In 1996, the owners kept their net worth below the \$750,000 limit to ensure continuing eligibility by transferring assets

worth a combined \$2.3 million to their wives. The OIG concluded that, under SBA regulations, assets transferred within 2 years of submission of the owner's annual personal financial statement still count as part of the owner's net worth. Consequently, this firm would have been ineligible for continuing participation. Including the transferred assets, the two owners' net worth was \$1.1 million and \$1.2 million, respectively.

The OIG recommended that SBA initiate action to terminate the firm from the Section 8(a) program. The Acting Associate Deputy Administrator for Minority Enterprise Development agreed with the audit's finding on initial eligibility, but stated the continuing eligibility rules in effect in 1996 would not have included the transfer of assets in the continuing eligibility calculation. The owners of the firm disagreed with the audit findings, but satisfied the purpose of the recommendation by voluntarily withdrawing from the program. SBA regulations governing transfer of assets are currently under review for possible clarification and revision.

**Owner of Virginia Section 8(a) Firm
Understates Wealth to Gain Minority
Set-Aside Contracts**

The owner of a Section 8(a) firm in Chantilly, Virginia, was found to have improperly understated his personal net worth by approximately \$600,000 in an effort to participate in the program. For 2 of the 4 years for which he provided the incorrect financial information, OIG auditors found that his true net worth would have excluded him from participation. Through 1997, the firm had been awarded four Section 8(a) contracts with a total estimated value of \$4.4 million. The audit determined that the firm should not have been eligible for two of those contracts. The OIG recommended that SBA suspend the firm immediately from Section 8(a) program participation and initiate action to terminate the company from the program. SBA program officials concurred in the recommendation.

**Proposed Section 8(a) Regulations
Reviewed**

The OIG reviewed and commented on a draft of proposed final amendments to 13 CFR Parts 121, 124, and 134 that would amend both eligibility requirements for and contractual assistance provisions within the Section 8(a) Business Development (8(a) BD) program. While the OIG endorses the efforts to streamline the operations of the program and clarify the eligibility requirements, it raised a number of substantive concerns, including the criteria for determining economic disadvantage; the potential for possible abuse by allowing SBA to accept a SIC code for a Section 8(a) firm that is not

necessarily the most reasonable; the need for clarification in determining when a company should be graduated; and the need for further criteria for granting a waiver of the sole source ceiling in "the best interests of the Government."

**Activities to Enhance Fraud
Detection and Deterrence**

**President of Maryland Section 8(a)
Contractor Indicted for Making False
Statements and Wire Fraud**

The president of a computer and engineering-services contractor in Lanham, Maryland, was indicted on three counts of **making false statements** to SBA and one count of **wire fraud**. The indictment charged that he had submitted a series of false Personal Financial Statements for SBA's 1992-94 annual reviews of his status as a disadvantaged owner of a firm participating in the Section 8(a) program. The man allegedly concealed his true net worth when he failed to disclose that he had, among other assets, ownership interests in two other companies, various pension and retirement accounts, approximately \$500,000 in a Swiss investment account, and approximately \$190,000 in a bank account. He was charged with falsifying his financial statements to hide the fact that his net worth exceeded the Section 8(a) program's limit, making him ineligible for participation in the program. During an SBA/OIG audit of his Section 8(a) eligibility, he voluntarily withdrew his company from the program, through which it had been awarded more than \$10 million in contracts. This investigation, conducted jointly with the OIGs of the Treasury and

Transportation Departments and the National Aeronautics and Space Administration, was initiated based on both a referral from SBA's Washington District Office and the SBA/OIG audit.

Entrepreneurial Development (Business Information Education and Training)

SBA provides assistance to small business owners, managers, and prospective owners through its many counseling and training programs. SBA established the **Small Business Development Center (SBDC)** program to make management assistance and counseling widely available. SBDCs offer "one-stop" assistance to small businesses by providing a wide variety of information and guidance in easily accessible locations. The program is a partnership between the private sector, the educational community, and Federal, State, and local governments. There are SBDCs in all 50 states, the District of Columbia, Puerto Rico, the Virgin Islands, and Guam, with approximately 1,000 subcenters or service locations located at colleges, universities, vocational schools, chambers of commerce, economic development corporations, or in downtown storefronts. In FY 1996, SBDCs provided counseling and training to over 570,000 clients.

The **Service Corps of Retired Executives (SCORE)** is another of the valuable business development resource partners of SBA. Composed of approximately 12,400 volunteers working in over 700 sites, SCORE provides counseling and training to current or prospective business persons. These sessions are free to the public, and formal training is provided at a low cost. Over 293,000 clients were assisted in FY 1997.

The vast majority of SBA business development and education activities in the areas of training, counseling, and the provision of management information materials occur through outreach efforts with external organizations. **Cosponsorship** arrangements, authorized under the Small Business Act, play a key part in this process; the Act gives SBA the authority to cosponsor training and counseling activities for small business concerns with non-profit entities and/or with other Federal Government agencies. In addition, the Act authorizes the Agency to cosponsor training, but not counseling, with for-profit concerns.

Business Information Centers (BICs) provide business owners with access to computers, software, databases, and other resources to assist them in starting and expanding their businesses. All BICs have at least one on-site counselor and can address the varied business start-up and growth issues encountered by small business owners. There are currently 44 BICs in operation.

Summary of OIG Activity / Economic Development	
Audits Issued	1
Investigations Closed / Remaining Inventory	1 / 0
Inspections Underway	1
Reviews of Standard Operating Procedures	1

Efforts to Improve SBA Program Management

Hawaiian Small Business Development Center (SBDC) to Improve Counseling and Fund Raising Practices

Improvements in counseling services and fund raising were recommended by the OIG in an audit of a Hawaiian SBDC's operations. Although counseling services are considered the major service of the SBDC program, the center averaged only 15.6 percent of its total staff hours in providing counseling services. The audit also found that funding cuts by its sponsoring university made it important that the center develop new funding sources.

The audit report recommended that the Honolulu District Director (DD) require the SBDC to submit a plan to increase counseling hours and to increase fund raising from private sector and local government entities. The DD said that the center compared favorably to other SBDCs when counseling, training, advocacy, and research were considered, but he directed the SBDC to develop a plan to maximize client service delivery. The SBDC director disagreed that counseling is the primary SBDC service, but agreed to enhance client service delivery in the next annual strategic plan. The DD and the SBDC director concurred with the fund

raising recommendation.

SBDC SOP Reviewed

As part of SBA's initiative to update and streamline its SOPs, the OIG reviewed and commented on SOP 60 16, Small Business Development Center (SBDC) Oversight. The review led to comments suggesting that guidelines be added to the SOP providing for the frequency of site visits to lead organizations and service delivery locations and specifying what is to be accomplished during the visits; and that prior Agency approval should be required for travel outside the United States by any SBDC employee when the travel is performed during SBDC working hours or is charged to the cooperative agreement.

Agency Management and Financial Activities

Agency Management and Financial Activities include SBA's administration of the loan programs, as well as the full range of its internal administration and financial management operations. OIG audit, investigative, and inspection activities assist SBA managers by reviewing their operations for efficiency and effectiveness. The audits of SBA's financial statements, as required by the Chief Financial Officers Act, review the Agency's cash management and integrity assurance activities.

SBA's management and financial activities are supported by the Agency's \$716.1 million in operating funds, partially provided by FY 1998 appropriations enacted in P.L. 105-119. Of the \$716.1 million available, which includes carry-overs and estimated recoveries, \$254.2 million funds Salaries and Expenses, \$25 million is for Disaster loan servicing, and \$82.7 million is for Disaster loan making. In addition, \$275.2 million is available for Business Loans, \$ million for Disaster loans, and \$3.5 million for the Surety Bond Guarantee program.

Summary of OIG Activity / Agency Management and Financial	
Audit Reports Issued	2
Audits Underway	1
Indictments Resulting from Investigations	1
Convictions Resulting from Investigations	1
Investigations Closed / Remaining Inventory	8 / 9
Inspections Underway	1
Reviews of Proposed Legislation	9
Reviews of Proposed Regulations	3
Reviews of Standard Operating Procedures	6

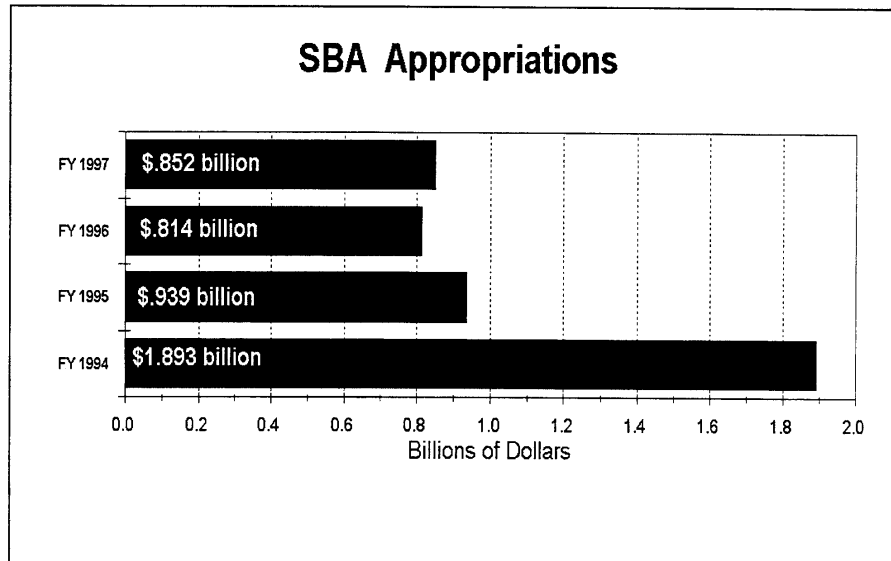


Figure 5

Efforts to Improve SBA Program Management

SBA's Financial Statements Receive Second Unqualified Opinion from Outside Auditors

The SBA's FY 1997 financial statements received an unqualified opinion from its independent auditors, Cotton & Company (Cotton). The unqualified opinion means that the auditors found SBA's principal financial statements to be presented fairly in all material respects in accordance with OMB guidelines and SBA accounting policies. The results of the audit were transmitted to the Chief Financial Officer by the OIG, which

contracted with Cotton to perform the independent audit. This was the second year that the Agency received an unqualified opinion.

Cotton did, however, find three problems that were considered "reportable conditions" in the internal control structure: (1) incorrect calculations were used in the credit reform subsidy modeling and reestimating process for the Section 7(a), 504, and disaster programs, resulting in substantial errors (these calculations were corrected upon discovery by the auditors); (2) lack of planning for financial reporting which resulted in untimely and erroneous draft financial statements; and (3) inadequate SBA

computer security and applications development standards. Cotton considered reportable conditions (1) and (2) to be material control weaknesses.

In the section on compliance with laws and regulations, the auditors found SBA financial management systems were not in compliance with the requirements referred to in the Federal Financial Management Improvement Act of 1996.

The Agency's Chief Financial Officer and Chief Information Officer both concurred with the recommendations and agreed to take corrective actions.

Inspection Finds that Some Agency Programs Fail to Collect Information Necessary to Conduct Criminal History Checks and IRS Tax Verifications on Applicants

The OIG issued an inspection report that assesses the use of criminal history and tax verification information to detect fraud in SBA programs. To support the Agency's policy of providing assistance only to persons of good character, applicants must submit a Statement of Personal History (Form 912), which includes specific questions about prior criminal record and requests the information necessary for the OIG to conduct a criminal history check. SBA also uses Internal Revenue Service (IRS) verification of tax return and financial statement information to detect fraud by program applicants and participants.

The inspection found that the Office of Disaster Assistance (ODA) and several of the specialized loan guarantee programs neither

use the Form 912 nor collect the information necessary for the OIG to conduct criminal history checks on applicants. Given evidence that a significant number of applicants fail to disclose their prior criminal records when applying for SBA financial assistance, OIG recommended that the Office of Financial Assistance (OFA) and the ODA obtain the information necessary for the OIG to perform criminal history checks. In addition, Preferred Lenders in the business loan programs should include the completed Form 912 in the loan materials submitted to SBA's Preferred Lender Program Processing Center.

Although SBA requires that financial data submitted by applicants and participants in the Section 7(a) and 8(a) programs be verified using tax information from the IRS, the OIG found that lenders and Minority Enterprise Development (MED) officials do not always request the IRS verification data. The OIG recommended that the OFA develop procedures to ensure that all loan applicants' tax returns and financial statements are verified with IRS information prior to loan disbursement and that MED officials revise program procedures to require IRS verification in processing electronic applications and in establishing a firm's continuing eligibility for the Section 8(a) program.

The OIG also found that SBA's Size Standards and Surety Guarantee programs, each of which makes decisions that are highly time-sensitive, do not obtain verification information due to the occasional delays expected in IRS responses. The OIG recommended permanent use of tax verification in the Size Standards program and a one-year pilot test in the Surety Guarantee

programs, with the provision that both be allowed to issue conditional approval in cases where the IRS does not meet the programs' time constraints.

The ODA concurred with the OIG's first recommendation and is currently revising its business loan application to include the information needed to perform criminal history checks. The OFA generally concurred with the recommendations concerning SBA loan programs. It has revised one of its applications to obtain the information necessary for the OIG to perform criminal history checks and is awaiting approval from the Office of Management and Budget. OFA did not concur with the OIG's recommendation concerning the Surety Guarantee program, citing time sensitivity of the bonding process, and the paperwork burden involved in obtaining tax verification information.

**Acting Inspector General Testified
Before House Subcommittee on
Benefit Eligibility Verification**

On March 2, 1998, the Acting Inspector General testified before the Subcommittee on Government Management, Information and Technology of the House Committee on Government Reform and Oversight. The Subcommittee hearing examined legislative proposals to improve debt collection and to ensure the accuracy of eligibility information provided by applicants for Federal benefit and credit programs. The Acting Inspector General provided an OIG perspective on the need for Federal benefit and credit eligibility verification and access to information to improve debt collection. She stated that investigating and prosecuting fraud after it

occurs is very resource intensive and does not always result in full recovery of the benefits fraudulently obtained. OIGs have a keen interest, therefore, in deterring and preventing fraud -- stopping it at the front end instead of trying to find it at the back end.

When applicants submit false information on benefit or credit applications, they may be awarded benefits to which they would not otherwise be eligible. To the extent this occurs, the Acting Inspector General stated, the Federal Government unknowingly rewards and encourages dishonesty, taxpayers bear the cost of the fraud committed, and truthful applicants may be denied assistance once program funding is exhausted.

The legislative authority for gaining access to verifying data is a cumbersome, patchwork quilt. Unfortunately, there is currently no omnibus authority for efficiently and effectively addressing the cross-cutting problem. As a result, taxpayers are unnecessarily subsidizing individuals who appear to have no compunction about lying to their Government.

The Acting Inspector General outlined significant limitations in existing Government-wide legislation. The Privacy Act allows an agency to disclose information with the individual's consent. It does not, however, provide an effective and efficient basis for routine up-front eligibility verification. The Computer Matching and Privacy Protection Act, which amended the Privacy Act, allows Federal agencies to conduct computer matches pursuant to written agreement of the agencies involved.

The procedures for negotiating agreements for initial and recurring matches, however, require the expenditure of enormous personnel resources. In addition, most computer matching operations are "back-end file to file" matches occurring after an applicant has been determined eligible and benefit payments have been made. Front end data sharing would avoid overpayments and allow agencies to move from a "pay and chase" mode to one that is far more proactive and efficient.

The Internal Revenue Code (IRC §6103) prohibits the IRS from sharing tax return information with other Federal agencies absent specific statutory authorization. Individual taxpayers may authorize the IRS to disclose their return information and some Federal agencies have access to IRS data for specific programs, without taxpayer consent, through amendments to the Code. These amendments, however, again provide only a piecemeal framework for eligibility verification and do not cover all Federal programs.

The primary goal of a front end verification procedure would be to improve the ability of all Federal agencies to prevent fraudulent and incorrect applications. In addition, stated the Acting Inspector General, a verification procedure using Federal and State data bases could ultimately reduce the amount of paperwork required of an applicant and shorten the response time as more agencies implement electronic application processing. Preventing fraud and ensuring program integrity would also increase public support for these programs because taxpayers would be more confident that only honest, deserving applicants were receiving their hard-earned

tax dollars.

Achieving these reasonable goals involves a three-part solution to providing the necessary authorization for eligibility verification: (1) passage of omnibus legislation that would clearly authorize the use of Federal and State data bases for the this purpose, (2) amendment of IRC §6103 to allow the IRS to share relevant tax information with all Federal agencies administering such programs, and (3) inclusion of a clearly stated consent on all application forms that advises applicants that their data will be verified, they will be given an opportunity to explain inconsistencies, and that consent does not change any statutory eligibility criteria or appeal procedures.

Government-wide legislation would establish as a matter of public policy, the principle of eligibility verification and demonstrate the Government's commitment to preventing fraud. It would also ensure consistency in the treatment of applicants for all programs, foster cooperation between agencies, and assist the IRS in identifying non-filers. In conclusion, the Acting Inspector General stated that given the voluntary nature of Federal benefit and credit programs, it is not unreasonable for applicants to expect that their eligibility will be verified and, as a matter of fiduciary duty, that the Federal Government will take all feasible steps to safeguard the taxpayers' money.

Proposed Legislation Reviewed; Federal Debt Collection

The OIG reviewed proposed legislation entitled the Government Waste, Fraud, and Error Reduction Act of 1998 (a bill to

improve Federal debt collection practice and promote electronic payments), and commented on five provisions. First, the bill requires a contractor to perform a background check on every individual performing collection services. The OIG believes that the bill should further require that the contractor use only those individuals who pass their background checks and are of good character and that the bill set minimum standards to be followed. Second, the bill generally requires an agency head, after terminating collection activity, to sell any nontax debts owed to the U.S. The OIG believes that the bill should define an agency's responsibility to recompute and report to IRS any change in imputed income to the delinquent borrower. Third, the bill prohibits any person with a delinquent outstanding Federal debt from receiving any Federal benefit. The OIG suggested that the definition of "Federal benefit" be broadened. The OIG also suggested that the bill provide a mechanism for Federal agencies to expeditiously obtain information on delinquent debtors from other Federal agencies. Fourth, the bill requires each agency to sell each loan not later than 6 months after the loan is disbursed and the further approval of the Attorney General if the debt is the subject of an allegation of fraud that has been referred to the Department of Justice for litigation. The OIG expressed concerns with these provisions; many loans could be sold before any evidence of fraud appears, the term "fraud" should be broadened to include any criminal activity, and "referred to the Department of Justice [for] litigation" should be clarified. Finally, the bill requires each IG to review and report on each compromise, default, or final resolution in bankruptcy of

any high value debt arising out of agency programs. Given the possible increase in an OIG's workload due to this provision and an OIG's limited resources, the OIG recommended that the requirement that IGs review 100% of such debts be deleted and language be drafted to give OIGs the discretion to review such debts where appropriate. The OIG also recommended that the legislation establish standards or criteria for "rating the performance of the head of the agency in seeking to collect the debt."

Proposed Legislation Reviewed; Paperwork Reduction

The OIG reviewed and commented on H.R. 3310, The Small Business Paperwork Reduction Act Amendments of 1998. Section 1(a) of the bill requires the Director of the Office Management and Budget (OMB) to publish annually in the Federal Register a list of paperwork requirements applicable to small businesses with respect to the collection of information by Federal agencies. The OIG is concerned about the feasibility of publishing such a listing. The provision requires the publishing in advance of paperwork requirements for all collections of information to be undertaken in the upcoming year; however, some reporting requirements are unpredictable and not conducive to this annual reporting requirement. The OIG therefore suggested modifying the language imposing this annual report to require the yearly publication of the paperwork requirements for recurring collections of information, and all other collections for the upcoming year approved by OMB prior to the publication of the annual list. The OIG also recommended that

small businesses be notified that there may be other possible collections of information in the upcoming year, so that the mere exclusion of a given collection from the annual listing would not be a defense by a small business for failure to provide the information sought.

Section 1(b) of the bill requires the suspension of civil fines in the event of a first-time violation of "a requirement regarding collection of information" where the violation does not result in actual serious harm to the public health or safety. The OIG believes that civil fines should be waived only where the violation of "a requirement regarding collection of information" involves the failure to provide a timely response. The OIG also recommended that this provision be amended to prevent waivers of violations that result in a significant threat to the environment. Finally, language should be added to prevent waivers of civil fines where the small business provided false information or otherwise acted in bad faith in response to a collection of information.

**Proposed Legislation Reviewed;
Government Performance and Results
Act Technical Amendments**

In response to a request from the President's Council on Integrity and Efficiency, the OIG reviewed and commented on H.R. 2883, the Government Performance and Results Act Technical Amendments of 1997, which would improve Federal agencies' strategic plans, data accounting systems, and performance reports. The OIG believes that implementation of such oversight functions must be accomplished in a manner that does not adversely affect the IGs' general mission

to improve their host agencies' management effectiveness and to detect and deter fraud, waste, and abuse. We therefore expressed concern that the provision requiring an assessment of agency data sources and information and accounting systems would be particularly burdensome, given the OIG's current staffing levels and limited resources. The OIG recommended that the provision clearly state that OIGs need not assess all of their agencies' data sources and information/accounting systems; rather, OIGs can choose a sampling of data sources and systems to assess each year.

The OIG suggested that language be changed to allow OIGs greater flexibility in determining the type and manner of review and providing the necessary resources to audit, evaluate, and/or assess specific program performance results. In addition to recommending that the OIGs be granted a period of 150 days from the host agencies' submission to complete audits of performance reports, the OIG recommended a phase-in period before requiring OIGs to review a significant percentage of their host agencies' specific performance reports and accounting/information systems.

**Agency Office of General Counsel SOP
Reviewed**

As part of SBA's initiative to update and streamline its SOPs, the OIG reviewed SOP 70 50 3, Legal Responsibilities, setting forth the legal responsibilities of SBA attorneys nationwide. The OIG review led to comments suggesting clarification as to when quality reviews of legal services are to be performed and by whom, deleting the word "audit" and substituting "review" to more

accurately reflect the activity being performed, explaining the meaning of the "Rule of Two" in the internal approval process, and clarifying counsel's responsibility when an actual or apparent conflict of interest arises in a proposed cosponsorship activity.

Activities to Enhance Fraud Detection and Deterrence

Former SBA Employee in California Pleads Guilty to Theft of Property

A former SBA employee from Van Nuys, California, 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), by which he was previously employed, disclosed that after the man 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 the employee owned. The investigation also disclosed that he had embezzled \$5,883 from the FDIC by depositing a payment due the FDIC into a bank account which he owned. The SBA/OIG initiated its investigation based on a referral from SBA's Santa Ana Home Loan Servicing and Liquidation Center.

OIG Conducts Employee Awareness Briefings

In addition to investigating complaints of waste, fraud, and abuse involving SBA programs, OIG Investigations Division staff presented five **Standards of Conduct briefings** to a total of 185 **Agency employees**. The involvement and cooperation of all SBA employees in combating waste, fraud, and abuse is critical to an effective OIG investigations program and to the Agency's overall productivity and efficiency.

During the reporting period, employee contributions to our mission were significant. As Figure 6 shows, more than 61 percent of all investigative referrals originated from within the Agency in the form of referrals either from program heads or from other SBA employees. This cooperation indicates the strong commitment of SBA employees to reducing waste, fraud, and abuse in Agency programs and improving the Agency's management and control of its programs.

Sources of OIG Investigations

October 1, 1997, to March 31, 1998

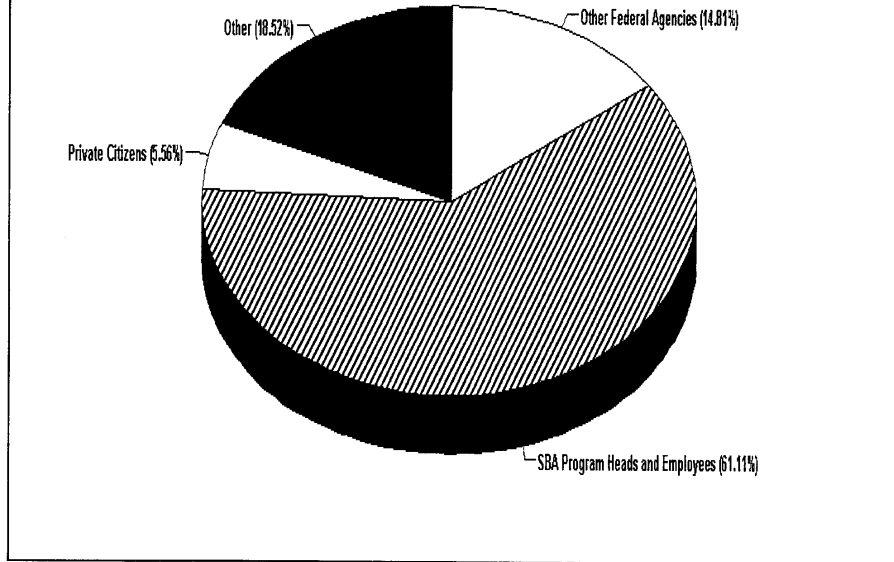


Figure 6

Organization, Resources, and Management Initiatives

The dual missions of the Office of Inspector General are to help improve management in the Agency and to detect and deter fraud in SBA's programs. Mission goals and objectives are accomplished through the provision of audit, investigation, and inspection and evaluation oversight of the Agency's portfolio, programs, and supporting operations. This chapter provides an overview of the OIG's organizational structure and its personnel and financial resources; it also summarizes key internal management initiatives designed to use available resources as effectively as possible.

Organization

The SBA/OIG is organized into four divisions as follows:

- Auditing Division
- Investigations Division
- Inspection and Evaluation Division
- Management and Legal Counsel Division

The Auditing and Investigations Divisions each administer their field activities through field offices and resident offices around the country. The Auditing Division has offices located in Atlanta, Chicago, Dallas, Los Angeles, and Washington. The Investigations Division has offices in those cities as well as in Denver, Houston, Kansas City, New York, Philadelphia, San Francisco, Seattle, and Syracuse. The Investigations Division's Office of Security Operations is located in Washington, D.C. Both the Inspection and

Evaluation Division and the Management and Legal Counsel Division operate out of Washington, D.C. A current OIG organization chart can be found at Figure 7.

Resources

In FY 1998, the OIG is operating with a funding level of \$10.0 million and an authorized personnel ceiling of 104 full-time equivalent (FTE) positions. While this level of funding represents a modest increase from the number of dollars appropriated in FY 1997, it provides only a **minimal level of oversight** to SBA programs and program dollars at risk. Congressionally-mandated law enforcement availability pay, annual cost of living increases, and various locality pay adjustments are still not fully funded by the OIG's authorized spending levels.

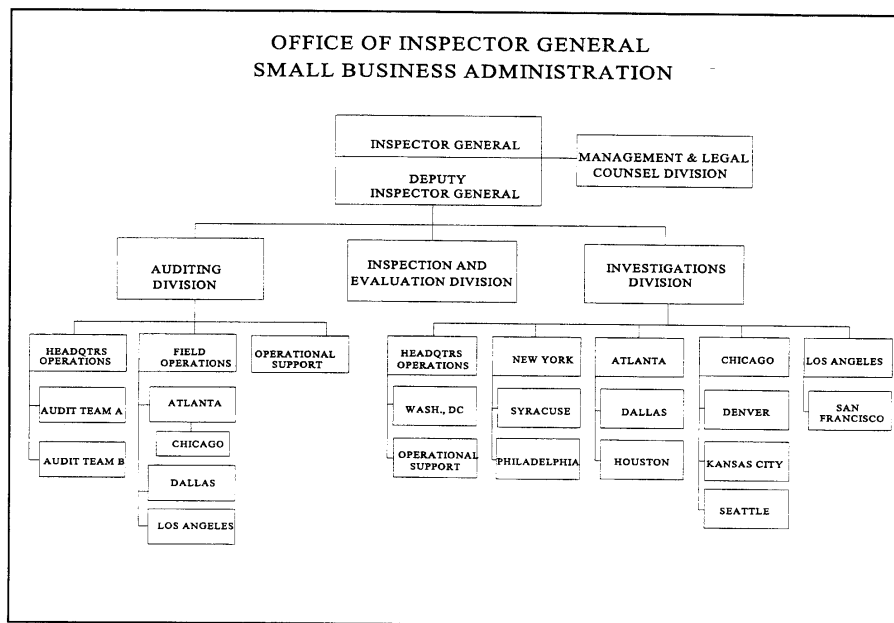


Figure 7

In FY 1994, the OIG received \$3 million in supplemental "no year" disaster funds to be used for activities related to the Agency's expanding disaster assistance program; these funds will remain available until expended (see discussion below). At this time the OIG projects that these no year funds will be completely expended by the end of FY 1998. To ensure continued OIG oversight of the disaster assistance program during FY 1997 and 1998, the Congress authorized transfers of \$500,000 in Agency funds for the OIG in each of those 2 years. At the end of the current reporting period, 7 auditors, 6 investigators, 3 attorneys, and 2 secretaries were serving with the OIG on temporary appointments supported by disaster funding.

Considerable difficulty has been experienced in recruiting, training, and retaining employees serving on temporary appointments. The nature of the special funding for disaster assistance oversight forces the OIG to pursue recruitment of auditors, investigators, and attorneys on a "non-permanent" basis. These temporary employees are understandably eager to obtain more permanent positions elsewhere, and when they are successful, the OIG is deprived of the expertise they have developed, their productivity, and its investment in their training.

The relatively static level of resources over the past 5 years remains troubling. As

depicted in both Figures 1 and 2 (pages 9 and 26, respectively), the dynamics of the Agency's portfolio, and the concomitant demand for oversight, would suggest that the OIG's resources be increased to ensure an adequate level of program oversight. While the increase in resources from FY 1997 to FY 1998 (\$9 million to \$10 million) has been helpful, it did not allow the OIG to "catch up" to its expenses after years of chronic underfunding, and still does not allow the OIG to fully address SBA's portfolio and programs. The OIG continues to experience difficulty in carrying out its mandate to provide meaningful oversight of the Agency's programs and supporting activities and to safeguard the Government's investment in SBA's extensive credit programs. As is apparent from the accompanying narrative, some SBA programs received only modest oversight, while others virtually went without oversight. For FY 1999, the President has requested another small increase in the OIG's budget (to \$11.3 million) in recognition of SBA's burgeoning portfolio, its mandate to transfer much of its responsibility for portfolio management to the private sector, and the projected expenditure of the balance of the OIG's special disaster-oversight funding.

The Acting Inspector General continues to be concerned with the strong demand for investigations of fraud in Agency programs. As evidenced by the table on page 59, both business and disaster loan fraud continue to be the OIG's two priorities, in terms of both active cases carried and time expended on these cases. During this reporting period the lion's share of investigative time (84 percent) was expended on business and disaster loan fraud cases. With demand for SBA business

and disaster loans remaining high, it is expected that the bulk of the OIG's investigative efforts will continue to be devoted to these two programs, stretching resources severely.

The table on page 59 also illustrates the Auditing Division's emphasis on the business loan and disaster assistance programs, as reflected in the increase in the time spent reviewing the disaster assistance program. Available audit hours devoted to disaster assistance has grown from 3 to 27 percent over the last 8 reporting periods. The Acting Inspector General is, of course, also concerned by the modicum of coverage the OIG is able to provide to other Agency programs, supporting operations, and program participants. There has been only minimal audit oversight of the Agency computer systems, and the OIG has been virtually unable to respond to specific Agency requests for other program audit coverage. Key programs such as Section 8(a) have also received only minimal audit oversight coverage over the past year, and other programs such as Small Business Investment Companies, International Trade, and Micro-Loans, have also received only a modicum of OIG oversight.

Management Initiatives

PCIE Committee Issues Two Studies

The Inspection and Evaluation Committee of the President's Council on Integrity and Efficiency (PCIE), which is chaired by SBA's Acting Inspector General, issued two reports. The first, a report on **Prescreening of Federal Grants and Loans by Offices of Inspector General and Their Agencies'**

Grant and Loan Offices, surveyed the procedures used by OIGs and their respective agencies to review Federal assistance projects. The purpose of the report was to assist OIGs in establishing more effective methods for *preventing* as well as detecting waste, fraud, and abuse by Federal grant and loan recipients. The survey also found strong support among OIGs for greater coordination in identifying problem recipients of Federal financial assistance. It recommended that the PCIE consider developing a community-wide clearinghouse to facilitate the exchange of information on problem grantees and loan recipients.

The Committee also issued a report on **Working Relationships of OIG Inspection and Evaluation Units**. It surveyed the working relationships of 15 inspection and evaluation units with components inside and outside their OIGs. Its aim was to identify practices for developing successful working relations between the units and the groups with which they work.

**Direct Investigation Time by Program Area
October 1, 1997, to March 31, 1998**

Program Area	Direct Time %	Number of Investigations	
		Closed	In Progress
Business Loans	55%	26	149
Disaster Loans	29%	9	79
SBIC	3%	1	12
Surety Bond Guarantees	1%	0	1
Government Contracting	*	2	3
Minority Enterprise Development	4%	0	17
Economic Development	*	1	0
Agency Management and Financial	8%	8	9
Total	100%	47	270

**Direct Auditing Time by Program Area
October 1, 1997, to March 31, 1998**

Program Area	Direct Time %	Number of Audits	
		Issued	In Progress
Business Loans	50%	6	10
Disaster Loans	27%	0	3
SBIC	*	0	0
Surety Bond Guarantees	8%	0	5
Government Contracting	*	0	0
Minority Enterprise Development	8%	2	3
Economic Development	1%	1	0
Agency Management and Financial	6%	2	1
Total	100%	11	22

* less than ½ percent

Profile of Operating Results

October 1, 1997, to March 31, 1998

Audit Activities	Totals
A. Reports Issued	11
B. Desk Reviews of CPA Audit Reports Issued	0
C. Audit Recommendations Issued	30
D. Dollar Value of Costs Questioned	\$589,034
E. Dollar Value of Recommendations that Funds Be Put to Better Use	\$0
Audit Followup Activities	
F. Audit Recommendations Closed	35
G. Disallowed Costs Agreed to by Management	\$1,055,820
H. Dollar Value of Recommendations That Funds Be Put to Better Use Agreed to by Management	\$12,000
I. Unresolved Audit Recommendations	50
J. Dollar Value of Unresolved Audit Recommendations	\$11,933,496
K. Settlement Recoveries	\$0
Inspection Activities	
A. Reports Issued	2
Legislation/Regulation/SOP/Other Reviews	
A. Legislation Reviewed	9
B. Regulations Reviewed	16
C. Standard Operating Procedures Reviewed	10
D. Other Issuances Reviewed*	94

* This includes policy notices, procedural notices, Administrator's action memoranda, and other communications which frequently involve the implementation of new programs and policies.

Status of Investigations as of March 31, 1998	Totals
A. Total Cases	317
B. Closed Cases	47
C. Pending Cases	25
D. Open Cases	245
E. Subjects Under Investigation	1,028

Summary of Indictments and Convictions

A. Indictments from OIG Cases	43
B. Convictions from OIG Cases	26

Summary of Recoveries and Reductions of Risk

A. Potential Recoveries and Fines as a Result of OIG Investigations	\$3,858,627
B. Reductions of Financial Risk as a Result of OIG Investigations	\$145,600
C. Reductions of Financial Risk as a Result of the Name Check Program	<u>\$13,157,030</u>
Total:	<u>\$17,161,257</u>

SBA Personnel Actions Taken as a Result of Investigations

A. Dismissals	1
B. Resignations/Retirements	2
C. Suspensions	0
D. Reprimands*	1

Program Actions Taken as a Result of Investigations

A. Suspensions	0
B. Debarments	0
C. Removals from Program	0
D. Other Program Actions	0

Summary of OIG Fraud Line Operation

A. Total Fraud Line Calls/Letters	778
B. Total Calls/Letters Referred to Offices Outside the OIG	751
C. Total Calls/Letters Referred to Investigations Division for Evaluation	27

* A SCORE volunteer.

Investigations Activities - Referral Program

A. Cases Referred to FBI	7
B. Referred to Other Agencies (Excluding FBI)	1
C. Indictments from Referrals	0
D. Convictions from Referrals	0
E. Potential Recoveries and Fines as a Result of Referral Program	\$0
F. Reductions of Financial Risk as a Result of Referral Program	\$0

**Office of Inspector General
Actual Personnel on Board as of March 31, 1998**

A. Immediate Office	2
B. Auditing Division	31
Professional	27
Support	4
C. Investigations Division	45
Professional	36
Support	9
D. Inspection and Evaluation Division	9
Professional	8
Support	1
E. Management and Legal Counsel Division	9
Professional	7
Support	2
 OIG Total	 96

**Additional Temporary Disaster Staffing
Funded from Supplemental Appropriations**

A. Auditing Division	8
B. Investigations Division	7
C. Management and Legal Counsel Division	3
 OIG Disaster Total	 18

FY 1998 Productivity Statistics

First Six Months

Office-Wide Dollar Accomplishments	Totals
A. Potential Investigative Recoveries and Fines	\$3,858,627
B. Management Avoidances as Result of Investigations	\$13,302,630
C. Disallowed Costs Agreed to by Management	\$1,055,820
D. Recommendations that Funds Be Put to Better Use Agreed to by Management	\$12,000
E. Settlement Recoveries	\$0
Total	<u>\$18,149,705</u>
 Auditing Division Activities	
A. Reports Issued	11
B. Disallowed Costs Agreed to by Management	\$1,055,820
C. Recommendation that Funds Be Put to Better Use Agreed to by Management	\$12,000
D. Settlement Recoveries	\$0
 Inspection and Evaluation Division Activities	
A. Reports Issued	2
 Investigations Division Activities	
A. Cases Closed	47
B. Indictments	43
C. Convictions	26
D. Potential Investigative Recoveries and Fines	\$3,858,627
E. Management Avoidances	\$13,302,630
- Investigation Cases	\$145,600
- Name Check Program	\$13,157,030

Statutory Reporting Requirements

The specific reporting requirements as prescribed in the Inspector General Act of 1978, as amended by the Inspector General Act Amendments of 1988, are listed below.

<u>Source</u>		<u>Pages</u>
Section 4(a)(2)	Review of Legislation and Regulations	7 - 56
Section 5(a)(1)	Significant Problems, Abuses, and Deficiencies	7 - 56
Section 5(a)(2)	Recommendations with Respect to Significant Problems, Abuses, and Deficiencies	7 - 56
Section 5(a)(3)	Prior Significant Recommendations Not Yet Implemented	74
Section 5(a)(4)	Matters Referred to Prosecutive Authorities	7 - 56
Section 5(a)(5) and 6(b)(2)	Summary of Instances Where Information Was Refused	None
Section 5(a)(6)	Listing of Audit Reports	69
Section 5(a)(7)	Summary of Significant Audits	7 - 56
Section 5(a)(8)	Audit Reports Containing Questioned Costs	70
Section 5(a)(9)	Audit Reports Recommending that Funds Be Put to Better Use	71
Section 5(a)(10)	Summary of Reports Where No Management Decision Was Made	73
Section 5(a)(11)	Significant Revised Management Decisions	None
Section 5(a)(12)	Significant Management Decisions with Which OIG Disagreed	None

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Part D - Inspector General-Issued Audit Reports with Overdue Management Decision	73
Part E - Significant Audit Reports Without Final Action	74

APPENDIX I

**Audit Reports Issued
October 1, 1997, to March 31, 1998**

TITLE	NUMBER	ISSUE DATE	QUESTIONED COSTS	FUNDS FOR BETTER USE
Business Loans				
New Ventures CDC	86F007006	12/31/97		
First National Bank of Coffee County	87F006001	10/31/97		
Loan Liquidation	85F003009	2/27/98	\$493,034	
Nevada State Development Company	86F007003	11/26/97		
Southern Nevada Certified Development Company	86F007004	12/1/97		
LowDoc Loan Program	87F005002	11/24/97		
Program sub-total:	6 audits		\$493,034	
Minority Enterprise Development				
Section 8(a) Program Eligibility - IDP	87H004007	1/2/98		
Section 8(a) Program Eligibility - Magnum	87H009008	2/18/98		
Program sub-total:	2 audits			
Economic Development				
Hawaii Small Business Development Company	87F004005	12/24/97		
Program sub-total:	1 audit			
Agency Management and Financial				
Disbursement Processing	87H003011	3/11/98	\$96,000	
FY 1997 Financial Statements Audit	87H080010	3/2/98		
Program sub-total:	2 audits		\$96,000	
TOTALS (all programs)	Reports: 11		\$589,034	

APPENDIX II - Part A

**Audit Reports with Questioned Costs
October 1, 1997, to March 31, 1998**

		REPORTS	RECs*	COSTS**	
				QUESTIONED	UNSUPPORTED
A.	For which no management decision had been made by September 30, 1997	7	8	\$3,492,374	\$781,461
B.	Which were issued during the period	2	2	\$589,034	\$0
	Subtotals (A + B)	9	10	\$4,081,408	\$781,461
C.	For which a management decision was made during the reporting period	5	5	\$1,315,389	\$0
	(I) Disallowed costs	4	4	\$1,055,820	
	(a) Due SBA			\$1,055,820	
	(b) Due program participant			\$0	
	(ii) Costs not disallowed	1	1	\$259,569	
D.	For which no management decision had been made by March 31, 1998	4	5	\$2,766,019	\$781,461

* Recommendations

** Questioned costs are those which are found to be improper, whereas unsupported costs may be proper but lack documentation.

APPENDIX II - Part B

**Audit Reports with Recommendations that Funds Be Put to Better Use
October 1, 1997, to March 31, 1998**

		REPORTS	RECs*	RECOMMENDED FUNDS FOR BETTER USE
A.	For which no management decision had been made by September 30, 1997	8	11	\$9,260,477
B.	Which were issued during the period	0	0	\$0
	Subtotals (A + B)	8	11	\$9,260,477
C.	For which a management decision was made during the reporting period	2	2	\$93,000
	(i) Recommendations agreed to by SBA management	1	1	\$12,000
	(a) SBA level			\$12,000
	(b) Program participant level			\$0
	(ii) Recommendations not agreed to by SBA management	1	1	\$81,000
D.	For which no management decision had been made by March 31, 1998	7**	9	\$9,167,477

* Recommendations.

** The recommendations resolved did not address all the recommendations within the reports where they appeared; therefore, the number of reports without management decisions remains unchanged.

APPENDIX II - Part C

**Audit Reports with Non-Monetary Recommendations
October 1, 1997, to March 31, 1998**

		REPORTS	RECOMMENDATIONS
A.	For which no management decision had been made by September 30, 1997	15	36
B.	Which were issued during the period	11	28
Subtotals (A + B)		26	64
C.	For which a management decision was made (for at least one recommendation in the report) during the reporting period	14	28
D.	For which no management decision (for at least one recommendation in the report) had been made by March 31, 1998	13	36

APPENDIX II - Part D

**Overdue Management Decisions
March 31, 1998**

Auditee	Report Number	Date Issue	Status
Business Loan Center	65F002019	9/20/96	One of five recommendations under negotiation with Office of Financial Assistance
LowDoc Loan Program	65E002022	9/30/96	Two of five recommendations under negotiation with Office of Financial Assistance
Maryland SBDC	76H001006	2/6/97	Two recommendations continue under negotiation with District Office
Grant Proposal, WVHTCF	77H001014	4/25/97	Under review by Office of Procurement and Grants Management
Defaulted Loan, Eastside Bank	77F002016	6/30/97	Under review by District Office
LowDoc Loan Program - Atlanta	77F006017	7/7/97	Recommendations continue under review by the District Office
LowDoc Loan Program - Santa Ana DO	77F009020	7/8/97	Two recommendations remain under review by District Office
LowDoc Loan Program - Dallas	77F0008022	7/31/97	Three of five recommendations under negotiation with District Office
Business Loan Guarantee Purchases	75H011026	9/30/97	Under review by Office of the Administrator

APPENDIX II - Part E

Significant Audit Reports Described in Prior Semiannual Reports Without Final Action as of March 31, 1998

REPORT NUMBER	TITLE	DATE ISSUED	DATE OF MANAGEMENT DECISION ON RECOMMENDATION	FINAL ACTION TARGET FOR IMPLEMENTATION
3-2-C-002-033	Administration of 8(a) Program	3/31/93	9/30/94	9/30/95
4-3-H-006-021	8(a) Continuing Eligibility	9/30/94	12/30/94	4/30/95
4-3-H-011-016	SBA's Award of 8(a) Contracts	5/16/94	12/30/94	6/30/95
5-3-H-004-006	SBA Loan Servicing and Debt	3/31/95	4/30/95	9/30/98
5-3-E-010-021	8(a) Competitive Mix	9/29/95	3/29/96	3/29/97
6-6-H-002-011	GeoDemographics, Ltd.	3/29/96	9/30/96	4/01/98
6-5-E-002-022	Low Documentation Loan	9/30/96	3/31/97	6/30/97
6-5-E-001-021	Basic Ordering Agreements	9/25/96	2/10/97	9/25/97
6-5-H-006-017	Section 8(a) Regular Dealers	8/21/96	9/30/96	8/20/97
6-6-H-003-023	Virginia SBDC	9/30/96	5/12/97	1/1/98
6-5-H-007-014	FY 1995 Financial Statements	5/1/96	10/28/96	9/30/97
7-7-F-007-021	LowDoc Loan Program at WDO	7/18/97	11/06/97	12/31/97
7-5-F-002-019	CAIVRS	7/07/97	9/30/97	12/31/97
7-6-F-003-023	Approval of Disaster Home	9/04/97	3/17/98	9/30/98
7-6-H-006-015	FY 1996 Financial Statements	4/29/97	9/30/97	4/30/98
7-7-S-918-018	User Technology Associates	6/06/97	3/26/98	6/05/98