Office of Inspector General
Small Business Administration

July 1997 Update

Business Loans

Review of Subsidy Rate Calculation Error Identifies Internal Control Weaknesses. In June 1997, the General Accounting Office (GAO) uncovered an error in SBA's formula for calculating its loan subsidy rate. This rate is critical in determining the Agency's lending levels and budget requests. SBA Administrator Alvarez asked the Office of Inspector General (OIG) to investigate the source of the error and to recommend future safeguards. The OIG's study concluded that the initial error had resulted from an incorrect formula entry in an SBA spread sheet cell made by an OMB budget examiner. Also, there had been a subsequent failure by SBA to adequately review all changes made to the spreadsheet when it was returned to the Agency for review. The OIG's recommendations included establishment of documentation for changes made to the spreadsheet, protection of critical cells to prevent errors, and the development of a check list to ensure adequate review of all future amendments.

Follow-up Audits of LowDoc Loans in Four District Offices Yield Results Similar to Previous National Sample. In a follow-up to an audit of a national sample of LowDoc loans, the OIG audited LowDoc activity at four SBA District Offices (Atlanta, Dallas, Santa Ana, and Washington). In the earlier review, auditors concluded that 7 of 70 sampled loans should not have been made because of loan origination deficiencies. In the four follow-up audits, a total of 13 of 120 **sampled loans were judged deficient enough that they should not have been made**. The four District Office reports were issued in July 1997. The OIG's Assistant Inspector General for Auditing will issue a summary report in August.

New York Bank Employee Pleads Guilty to Witness Tampering. A former administrator and assistant to the general manager at a participating lender bank in New York City pled guilty on July 2, 1997, to **witness tampering**, in connection with a joint OIG and FBI investigation into kickbacks and fraud involving the bank's SBA loan division. According to her plea, the woman attempted to dissuade and prevent a witness in a grand jury proceeding from testifying. She asked the witness to make false statements to and conceal information from the grand jury concerning the nature of a $5,000 payment he made to the bank officer who headed the bank's's SBA loan division. The man was ultimately convicted of receiving kickbacks from SBA borrowers, and the bank paid a $1,260,033 civil settlement and released SBA from guaranties totaling more than $4.4 million.

Pennsylvania Business Loan Applicant Pleads Guilty to Making False Statements. A Lansdale, Pennsylvania, loan applicant pled guilty on July 8, 1997, to **making false statements to influence SBA** to approve a $200,000 guaranteed loan to his company. In applying for the loan, the man had submitted a 1991 tax return altered to substantially overstate his income and fictitious returns for 1992 and 1993. The loan proceeds were to be used to purchase a tavern, but the loan was canceled when the tax return discrepancies were confirmed by the IRS. The case was based on a referral from SBA's Philadelphia District Office.

* * * * * * *

Disaster Assistance

Audit Finds that SBA Does Not Use Automated System to Check Loan Applicants, and that System is Inefficient. The Credit Alert Interactive Voice Response System (CAIVRS), **a required system for checking delinquent Federal debt, is not used for SBA disaster loans, but it is no longer needed** in the current Federal lending environment, an audit report issued in July concludes. Although SBA policy precludes lending to persons delinquent on Federal debt, the Agency has not used CAIVRS in the past because of problems in CAIVRS and because of the speed necessary for disaster loans.

The audit confirmed that CAIVRS is not a cost-effective tool for identifying other Federal debts. A computer match of 44,047 disaster loans approved in FY 1995 found only 192 loans (0.4 percent) with a CAIVRS record on the borrower. A random sample of 30 of the matches found that 11 (37 percent) were invalid because of bad data on either SBA's or the reporting agency's part. Only one of the other 19 matches in the FY 1995 sample was identified in commercial credit bureau reports.

The Debt Collection Improvement Act of 1996 requires Federal agencies to report delinquent debt to commercial credit bureaus. The audit tested 600 disaster loan applications involving 945 borrowers in process during April and May 1997 and found 10 borrowers with a record in CAIVRS. Eight of these were also found in commercial credit reports, which appeared to confirm the favorable impact of the Act.

The audit found that borrowers are not consistently reporting delinquent Federal debt, but the application forms are not clear regarding loan guarantees and business debt. The audit concluded that SBA should continue its reliance on commercial credit bureaus, but should revise the application forms to clarify that reporting of any delinquent debt is required, including loan guarantees and business debt. The Associate Administrator for Disaster Assistance concurred.

Nebraska Loan Guarantor Pleads Guilty to Making False Statement. A guarantor of economic injury and physical damage disaster loans received by a Plattsmouth, Nebraska, resort pled guilty on July 7, 1997, to one count of **making a false statement to SBA**. A joint investigation by the U.S. Secret Service and the SBA/OIG had shown that the man defrauded SBA by submitting several false invoices and receipts regarding use of the loan proceeds. He admitted submitting one false $24,550 invoice for dredging work. The resort, which featured camping, fishing, and swimming, received SBA disaster loan proceeds totaling $206,400 following the 1993 flood of the Platte River but has made no repayment to SBA. This investigation was based on a referral from SBA's Omaha District Office.

California Nurse Registry Owner Indicted for Filing False Claim and Making False Statement. The owner of a nurse registry in Los Angeles, California, was indicted on July 11, 1997, on one count of **filing a false claim** with SBA and one count of **making a false statement to a Federally-insured lender**. The investigation, based on a referral from SBA's Disaster Assistance Area 4 Office, revealed that the man submitted fraudulent applications for disaster-related business loans to a bank and SBA. He obtained a $50,000 interim loan from the bank; then he 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 allegedly diverted that amount.) In each of the loan applications the owner 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. Allegedly false documents which he submitted with the loan applications include a lease, a telephone installation invoice, and an estimate of the cost of replacing his business' files. 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 business owner did not make any payments on the interim loan, which the bank charged off in 1994.

* * * * * * *

OIG Management

Office of Inspector General Conducts Annual Training in San Diego. The Office of Inspector General conducted its annual training conference in San Diego, California, during the week of July 21, 1997. SBA Administrator Aida Alvarez addressed the attendees during a joint session and highlighted the productive, cooperative, working relationship which has developed between her office and the OIG. She also discussed new Agency initiatives.

Training provided to attendees included interviewing techniques and defense tactics/firearms (investigators), quantitative analysis and risk assessment (auditors and inspectors), and courses in interpersonal skills, ethics, time management, and CPR. The Inspector General’s address to the staff included a summary of accomplishments for the year, and he, along with the Administrator, presented the OIG’s annual awards.

* * * * * * *

Editor's Notes:

Most of the articles appearing in this issue of the **Update** reflect outcomes of OIG investigative efforts. The **Update** generally reports all intermediate outcomes of criminal investigations (charges, pleas, court actions, convictions) as they occur, as well as final results (sentencings, settlements). While audits and inspections produce equally valuable results, they tend to take 6 to 9 months of research, analysis, and production prior to their publication. Consequently, they do not produce intermediate results that lend themselves to monthly reporting. Several audits and inspections are, however, currently underway and will be reported in upcoming issues of the OIG **Update**.

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

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

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

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

Most audit and inspection reports can be found on the Internet at:

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

The Office of Inspector General notes with deep sorrow the passing of Michael Stansberry, supervisory auditor in its Dallas field office. Mike was respected and admired by his many friends and colleagues in the OIG. We will miss him.

The Activity Update is produced by the SBA/OIG, James F. Hoobler, Inspector General.

Comments or questions concerning this update or requests for copies of OIG audits, inspections, or other documents should be directed to Johnny Cahn, SBA/OIG, 409 Third Street, SW, Washington, DC, 20416-4110.
Telephone number: (202) 205-6580
FAX number: (202) 205-7382

If you are aware of suspected waste, fraud, or abuse in any SBA program, please call the OIG Fraud Line.

OIG FRAUD LINE (202) 205-7151
in Washington, DC metropolitan area

TOLL-FREE FRAUD LINE:
(800) 767-0385