



## Office of Inspector General Small Business Administration

April 1996 Update

### *Business Loans*

Pennsylvania Bank Allows Loan Applicant to Conceal Information to Circumvent SBA's "Credit Elsewhere" Rule. An OIG audit revealed that a Reading, Pennsylvania, bank allowed a borrower to **conceal the ownership position and management involvement** of two wealthy investors to qualify for a \$1 million SBA-guaranteed loan. The loan defaulted and SBA honored its \$750,000 guarantee and experienced a net \$558,000 loss after the sale of collateral which had secured the loan.

A 46 percent owner of the applicant firm had \$6.5 million in personal liquid assets, which should have made the firm ineligible for a loan guarantee under the "credit elsewhere" rule. When the bank identified the owner's wealth as a bar to an SBA loan, he reduced his ownership on paper to 14.7 percent just 2 days before the loan closed. Two weeks later, however, he restored his ownership position to the original 46 percent. In collusion with another 20 percent owner, he also made personal guarantees on a side loan (not an SBA-guaranteed loan), which created a prohibited

preference in favor of the bank, by pledging available collateral to the side loan and not the SBA-guaranteed loan. Finally, the firm failed to report the existence of another owner's share in the applicant firm to SBA.

The audit report recommended that SBA deny liability on the loan and rescind the bank's Preferred Lender status. SBA's Philadelphia District Office proposed allowing the bank to transfer to SBA its interest in an insurance policy on the borrower's president and renewing the bank's status for 1 year instead of 2, with closer monitoring by SBA during the year. The OIG's Auditing Division considered this settlement proposal unacceptable and referred the case to the OIG's Investigations Division.

The ensuing investigation confirmed the findings of the audit and developed additional evidence. Subsequent to the investigation, the bank agreed to pay the Government \$1.56 million to settle allegations (without admitting guilt) of **fraud** in the bank's application for the SBA loan guarantee. Approximately \$950,000 will reimburse SBA for its payment and interest on the guarantee. The balance of the settlement (over \$600,000) will

constitute a civil penalty, the proceeds of which will go to the U.S. Treasury. As another condition of the settlement, the bank has agreed to implement a compliance program to preclude similar problems in the future. The issue of the bank's Preferred Lender status has yet to be resolved by SBA.

Houston Management Consultant Reorganizes, Defaults on Loan, and Improperly Causes SBA Writeoff.

Shortly after obtaining a \$200,000 Section 7(a) loan, a management consulting firm in Houston, Texas, reorganized and transferred its assets to Dallas without SBA's knowledge or consent. When the loan later defaulted, SBA thought the borrower had gone out of business and, consequently, charged off \$117,518 in a negotiated settlement of the loan balance. SBA's Management and Technical Assistance Program, unaware of the 7(a) loan default, awarded a \$353,000 contract to the Dallas firm a year later. SBA's Houston District Office agreed with the audit recommendation that SBA withdraw the settlement agreement and pursue collection of the amount written off. This audit was one of a series of reviews of early defaulting loans. An overall report on the audits' systemic findings will be issued at a later date.

Washington Fundraiser Sentenced for Conversion of Collateral.

The former president of a fund-raising service company in Bellevue, Washington, was sentenced on March 22, 1996, to 3 years probation, a \$50 special

assessment, and \$18,008 in restitution to SBA and a participating lender bank. He had pled guilty to **conversion of collateral** pledged for a \$750,000 SBA-guaranteed business loan. The investigation revealed that the man sold more than \$360,000 of his firm's accounts receivable pledged as collateral on the loan. The OIG investigation was based on a referral from the Seattle District Office and was conducted jointly with the FBI.

Missouri Water Bottling Executive Sentenced for Mail Fraud.

The secretary of a water bottling company in New Bloomfield, Missouri, was sentenced on March 22, 1996, to 1 year and 1 day imprisonment, 2 years supervised release, and a \$50 special assessment. He had pled guilty to one count of **mail fraud**. He and his wife, the company's president, had been indicted for using the U.S. mails in a scheme to defraud SBA. (The charges against the wife were dismissed as a condition of her husband's plea agreement.) The investigation showed that the couple made false statements to obtain a \$150,000 SBA-guaranteed loan, diverted loan proceeds to their own use, and sold or traded collateral after the business failed. The company made only one payment before defaulting on the loan. The OIG initiated this investigation based on a referral from the St. Louis District Office.

Texas Convenience Store Owners Indicted for Making False Statements.

A couple from Alvin,

Texas, were indicted on April 4, 1996, on one count of **conspiracy**, five counts of **making false statements to an FDIC-insured bank**, and five counts of **submitting false documents to a Federal agency**. They submitted fraudulent tax returns for their convenience store in Houston, Texas, in an attempt to obtain approval of a \$338,000 SBA-guaranteed loan to finance their purchase of the store. They also submitted false tax returns for a store in LaMarque, Texas, in an attempt to obtain approval of a \$200,000 SBA-guaranteed loan to purchase that store. SBA foiled their scheme by declining the loan applications after the profits reflected on the false returns could not be verified. The charges were the result of an OIG investigation based on a referral from the Office of District Counsel of the Houston District Office.

California Landscaper Sentenced for Making False Statements and Filing False Tax Returns. The owner of a landscape maintenance company in Anaheim, California, was sentenced on April 26, 1996, to 1 year and 1 day imprisonment, 3 years supervised release, and payment of all personal and corporate taxes he owed. He had pled guilty to three counts of **making false statements to Federally-insured lenders** and two counts of **filing false tax returns**. These charges stemmed from two investigations. The OIG initiated the first investigation when the owner's bookkeeper reported that he wanted

her to prepare false tax returns and related financial documents as part of an application for a \$400,000 SBA-guaranteed loan. The loan application was declined by the bank before it became aware of the false financial figures, and the man subsequently pled guilty to one false statement charge. The second investigation began when, suspecting that this was not the first time this individual had used false documents to defraud a bank, the prosecutor requested that the OIG examine the files of his other loans. This led to both the identification of another two bank loans which were obtained with false tax returns and the discovery that he was under investigation by the Internal Revenue Service (IRS) for other suspected crimes. The OIG then joined forces with the IRS which resulted in the four later charges and the second guilty plea.

Florida Swimming Pool Supplier Pleads Guilty to Making False Statements. The president of a swimming equipment seller in Fort Myers, Florida, pled guilty on April 17, 1996, to one count of **making material false statements** to influence actions of SBA. The man submitted personal and corporate tax returns he knew to be fraudulent in an effort to obtain a \$100,000 SBA-guaranteed loan. Approval of his application was canceled because of the considerable discrepancies that existed between information contained in the tax returns he submitted with the loan application and those he filed with the IRS. The OIG initiated the

investigation based on a referral from the Miami District Office.

Utah Motorcycle Dealer Charged with Bank Fraud. An owner of a motorcycle dealership in Salt Lake City, Utah, was charged on April 8, 1996, with one count of **bank fraud**.

The dealership had received a \$185,000 SBA-guaranteed loan in 1979, pledging as collateral three pieces of real property. The felony information charged that in the fall of 1993, when the loan was in serious default, the man caused the filing of reconveyance documents, fraudulently releasing the liens on the properties. Having obtained release of the liens, he pledged two of the properties to another Federally-insured bank to obtain an additional \$150,000 in financing. The OIG investigation also determined that he forged the signature of a former officer of the participating lender bank on the release of lien documents. The investigation was initiated based on a referral from the Salt Lake City District Office.

New York Banker Sentenced for Soliciting Commissions for Procuring Loans. A former vice president of the New York City branch of an Argentine bank was sentenced on April 25, 1996, to 18 months imprisonment, 5 years supervised release, and a \$150 special assessment. He had been convicted of **soliciting commissions for procuring loans** guaranteed by SBA. The \$20,000 in commissions were paid by three loan applicants in return for

his assistance in obtaining loan approvals totaling \$930,000. The banker headed the SBA-guaranteed loan program of the bank, which was at that time one of the largest participating lenders in New York City. The OIG investigation was conducted jointly with the FBI.

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## *Disaster Assistance*

Southern California Loan Packagers' Case Yields Record Results. In the latest results from the continuing investigation of two southern California brothers who acted as disaster loan packagers, three more of their clients have been charged with crimes against SBA, and two of the three and a previously-charged client have entered guilty pleas. All of these actions involve applications for economic injury disaster loans filed in the wake of the 1992 civil unrest in Los Angeles, California.

Three owners of Los Angeles clothing manufacturers were charged in criminal informations filed recently:

- One businessman was charged on March 29, 1996, with **knowingly converting SBA disaster loan proceeds to his own use and the use of others**. This charge emanated from his fraudulent application for a \$180,000 loan for his business. Because he applied for a loan for

which he knew he was ineligible, his expenditure of the proceeds constituted conversion. He pled guilty to the charge on April 16, 1996.

- A second businessman was charged on March 29, 1996, with **making a false statement to SBA** .

In his application for a \$360,000 loan, he claimed to be the sole owner of the company when he actually owned only 65 percent. He concealed the minority owner's interest from SBA due to that owner's poor credit history.

- A third businessman was charged on April 12, 1996, with **filing a false claim** with SBA. He pled guilty to the charge on April 16, 1996. In his application for a \$300,000 loan for his business, the man provided copies of income tax returns which were never filed with the IRS and which significantly overstated his business income.

Another defendant in this case, a resident of Northridge, California, pled guilty on April 1, 1996, to one count of **making a false statement to a Federally-insured lender** . To facilitate the approval of a \$241,500 home loan to his wife, the man submitted a false employment verification form, claiming that his

wife was employed at a salary in excess of \$100,000 per year, when, in fact, she was unemployed. The couple became subjects of the investigation after the Disaster Assistance Area 4 Office questioned their application for a \$300,000 loan for the wife's fashion business following the 1992 civil unrest. SBA declined the application, and the OIG investigation later established that the business did not exist.

These results of the joint OIG/Secret Service investigation, which was opened as a result of a tip from a concerned citizen and a referral from the Disaster Assistance Area 4 Office, bring the current total for this case to 23 persons charged, of which 21 have pled guilty.

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## *OIG Management Initiatives*

The OIG will transmit its Semiannual Report to Congress to the Administrator on May 1st. The report, which covers the period October 1, 1995, to March 31, 1996, will reflect \$54,326,049 in dollar accomplishments for the period as follows:

- \$18,425,315 in potential recoveries,
- \$27,207,418 in management avoidances,
- \$1,120,894 in disallowed costs agreed to by SBA

management,

- \$6,472,422 in management commitments to use funds more efficiently, and
- a settlement of \$1,100,000 based on a quality review of a CPA's audit which resulted in a loss to the Agency.

Moreover, OIG investigations produced 36 indictments and 25 convictions.

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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.

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

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