



## Office of Inspector General Small Business Administration

March 1997 Update

### *Business Loans*

#### California Loan Packager Receives Prison Sentence for Loan-Related Fraud.

A former Garden Grove, California, loan packager was sentenced on January 24, 1997, to 2 years imprisonment, 3 years supervised release, and \$15,000 restitution. He had pled guilty more than 1 year earlier to five counts of **causing false statements to be made in loan applications to Federally-insured financial institutions**, but the plea agreement remained sealed while the investigation of his former clients was completed. The man admitted putting together SBA loan applications containing altered copies of the applicants' income tax returns which were submitted to two southern California participating lender banks. The joint SBA/OIG and FBI investigation, initiated in 1990 on information provided by SBA's Santa Ana District Office, involved 32 loans that he packaged. To date, 20 of those loans have defaulted, resulting in more than \$3.2 million in losses to SBA and its participating lenders. Four of the loan packager's clients have also been prosecuted as a result of this investigation. Two of them who had pled guilty to one count of **making false statements on loan applications to Federally-insured financial institutions** were recently sentenced:

❶ The former owner of a restaurant and billiard club in San Gabriel, California, was sentenced on February 24, 1997, to 6 months home confinement, 3 years supervised release, and \$16,600 restitution to SBA. He had submitted altered income tax returns with his application for a \$150,000 SBA-guaranteed loan, which later defaulted.

❷ The former owner of a beauty salon in Long Beach, California, was sentenced on February 21, 1997, to 6 months home confinement, 3 years supervised release, and \$5,000 restitution of which 80 percent goes to SBA. He had submitted false documents to obtain disbursement of his \$150,000 SBA-guaranteed loan; this loan later defaulted.

#### California Father Sentenced to Prison for Bank Fraud and Loan Fraud.

A Woodland Hills, California, man was sentenced to 41 months imprisonment, 3 years supervised release, and \$524,891 restitution payable 80 percent to SBA and 20 percent to the participating lender bank. He had been convicted on charges of **bank fraud** and **making a false statement to a Federally-insured lender**. His daughter had also been indicted on two felony charges, which

were subsequently dismissed based on her claim that, at only 18 years of age, she had not understood the significance of the documents she signed. The OIG investigation revealed that the daughter's application for a \$665,000 SBA-guaranteed loan to purchase real property for the operation of a nursery contained false financial documents, including altered tax returns. Her father, acting under an alias, had purchased the property for \$450,000 and then immediately sold it to her for \$900,000, thereby doubling its purchase price. The participating bank financed the purchase based on this inflated price. The father also falsely represented to the bank that he was giving his daughter a gift of \$160,000 toward the purchase of the property. The nursery never opened for business, and the loan went into default after only two loan payments had been made. The SBA/OIG initiated this investigation based on a referral from SBA's Los Angeles District Office.

California Loan Broker Clients Sentenced for Making False Statements. Two more clients of a southern California loan broker, who each had earlier pled guilty to one count of **making a false statement on a loan application to a Federally-insured bank**, were recently sentenced:

❶ The former owner of a cafe in Riverside, California, was sentenced on February 24, 1997, to 4 months in a halfway house, 2 years probation, and 50 hours community service. In pleading guilty, the man admitted submitting altered income tax returns for the years 1987-89 with his application for a \$225,000 SBA-guaranteed

loan to purchase the cafe. He also represented on his business plan that his personal capital came from the sale of another business when, in fact, he had borrowed the funds from a friend. The loan applicant also falsely represented that he intended to purchase machinery and equipment totaling \$125,000 from a company that was in fact controlled by the loan broker. The loan broker subsequently returned the funds to the applicant, who then repaid the undisclosed personal loan.

❷ The former owner of a restaurant in Pomona, California, was sentenced on February 27, 1997, to 3 years probation and 200 hours community service. In applying for his \$550,000 SBA-guaranteed loan, the man submitted altered tax returns to the participating lender that significantly overstated his business income; he also submitted a false financial statement to induce the lender to grant a payment deferment and not foreclose on the loan.

The loan broker previously pled guilty as a result of this joint SBA/OIG and U.S. Secret Service investigation, which was initiated after a participating lender and SBA's Los Angeles District Office referred the matter to the OIG.

Georgia Caterer Found Guilty of Conspiracy and Bank Fraud. A co-owner of a now-defunct Atlanta, Georgia, catering company was found guilty of **conspiracy, bank fraud, and submission of false loan documents**

**to SBA.** The man was sentenced to 10 years imprisonment and \$745,115 restitution. The SBA/OIG investigation, based on a referral from SBA's Atlanta District Office, disclosed that the owner and his former wife and business partner defrauded SBA and Federally-insured lenders of more than \$1 million, including a \$650,000 SBA-guaranteed loan from a non-bank participating lender. The couple had fled the country prior to their 1991 indictment, but they were extradited to the United States--she from Russia in 1995 and he from Cyprus in April 1996. As previously reported, his wife negotiated a guilty plea to two counts and agreed to cooperate with the Government's prosecution of her husband.

New York Computer Company Owner Sentenced for Bank Fraud and Making False Statements. The former owner of a computer sales and service business in Binghamton, New York, was sentenced to 5 years probation, 1,000 hours community service, and \$164,025 restitution. He had pled guilty to five counts of **bank fraud** and one count of **making false statements to SBA**. A multi-agency investigation revealed that the businessman had grossly overstated the value of assets in a listing he submitted to forestall a participating lender bank from calling his delinquent \$450,000 SBA-guaranteed loan. He also admitted using personal and business credit cards to obtain approximately \$34,000 in fraudulent cash advances (establishing a false account receivable with his credit card and then withdrawing cash against the credit) and "kiting" approximately \$10,000 in checks drawn on his credit union account. The SBA/OIG and the FBI joined the

investigation initiated by the U.S. Secret Service.

California Businessman Sentenced to Prison for False Statements on a Loan Application. The former owner of a Paramount, California, marble floor company was sentenced on March 28, 1997, to 30 months imprisonment, 10 years supervised release, and \$292,581 restitution. He had been found guilty on seven counts of **making false statements on a loan application to a Federally-insured financial institution** in connection with his \$300,000 SBA-guaranteed business loan. The man was identified in the joint SBA/OIG and FBI investigation examining the inclusion of false tax returns and false invoices in applications submitted to SBA's participating lenders by a southern California loan packager. The OIG initiated the investigation of the loan packager, who, himself, was sentenced to 2 years imprisonment, based on a referral from SBA's Los Angeles District Office.

California Automobile Repair Business Owner Pleads Guilty to Making False Statements. The owner of an automobile repair business in North Hollywood, California, pled guilty to one count of **making false statements in a loan application to a Federally-insured bank**. The investigation revealed that the man submitted altered individual and corporate income tax returns for 1987-89, all of which significantly overstated his income to qualify for two SBA-guaranteed loans totaling \$656,000. The investigation expanded into his acquisition of two additional fraudulently-obtained loans valued at \$2,408,600. After the collateral supporting the

\$3,064,600 in loans was sold, the lenders suffered losses of \$1,062,068. Information regarding this borrower was established by SBA/OIG and U.S. Secret Service agents looking into disaster loan applications prepared by two southern California brothers acting as loan brokers. The repair business owner and his brother were the only businessmen who had obtained Section 7(a) loans.

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### *Disaster Assistance*

California Market Owner Sentenced for Filing False Disaster Claim. The owner of a food market in Reseda, California, was sentenced on March 3, 1997, to 5 years probation, 1,500 hours community service, and a \$2,500 fine. He previously pled guilty to one count of **filing a false claim** with SBA. The OIG's investigation, opened in response to a referral from SBA's Disaster Assistance Area 4 Office, revealed that the man falsely claimed that his business suffered \$180,000 in physical damage and \$260,000 in economic injury following the Northridge earthquake. In fact, the food market had permanently closed nearly 4 months before the earthquake, and all invoices submitted by the applicant to support disbursement of loan proceeds were false.

California Restaurant Owner Indicted for Making False Statements and Misusing Social Security Number. The former owner of a restaurant in Compton, California, was indicted on March 7, 1997, on one count of **making a material false statement** to SBA and one count of **fraudulent use of a Social**

**Security number (SSN).** The man had applied for disaster loans totaling \$240,579 for his business following the 1992 Los Angeles civil unrest. The OIG's investigation disclosed that his application package included a fictitious individual income tax return and a Form 413, Personal Financial Statement, that overstated his income. On those documents, as well as on his Form 912, Statement of Personal History, the applicant allegedly used an SSN that was not his. Relying on this false information, SBA disbursed \$115,800 of his physical damage loan and \$18,200 of his economic injury loan. The investigation was based on information provided by SBA's Disaster Assistance Area 4 Office.

California Tax Preparer Pleads Guilty to Making False Statements. A tax preparer in Glendale, California, pled guilty on February 3, 1997, to one count of aiding and abetting the **making of material false statements**. He had been charged with preparing altered income tax returns that were submitted to SBA in support of a \$450,000 economic injury disaster loan application. The man significantly overstated the incomes of a corporate applicant and its owner. The SBA/OIG's joint investigation with the U.S. Secret Service revealed that the tax preparer also prepared altered income tax returns for two other SBA disaster loan applicants who had previously pled guilty to charges resulting from this investigation. He is the first tax preparer charged in the continuing investigation of disaster loan applications packaged by two California brothers acting as loan packagers.

California Land Developers Sentenced for Filing False Claim. Two owners of a

land development company in Monterey Park, California, each of whom had pled guilty to one count of **filing a false claim** with SBA, were sentenced recently. The first owner was sentenced on February 24, 1997, to 4 months home detention, 3 years probation, and a \$50 special assessment; the second owner was sentenced on March 3, 1997, to 366 days imprisonment and a \$50 special assessment. Together, they were ordered to pay \$109,300 restitution. The investigation leading to these results was based on information provided by the SBA/OIG's Auditing Division. The first owner applied for a \$300,000 economic injury disaster loan following the 1992 Los Angeles civil unrest. The investigation disclosed that the application package, prepared with the assistance of the second owner, included copies of fictitious individual income tax returns for the first owner, as well as an altered copy of the 1991 corporate income tax return. Relying on these documents, SBA approved and disbursed a \$109,300 loan that ultimately went into default without a single payment having been made.

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### *Small Business Investment Companies*

Owner of Defunct California SSBIC Pleads Guilty to Misapplying Funds. A Korean national who had been president and majority shareholder of a now-defunct SSBIC in Los Angeles, California, pled guilty to four felony counts of **misapplication of funds** of an SBIC. In return, the Government agreed to the dismissal of 11 remaining charges on

which he had been indicted in May 1989. At that time, the businessman was believed to be out of the country, and a fugitive warrant for his arrest was issued. The warrant remained outstanding until November 1996 when he re-entered the United States and was arrested. The indictment was a result of a lengthy investigation conducted jointly by the SBA/OIG and the FBI. The case was initiated after allegations of wrongdoing were received from the SSBIC's investment advisor, an individual who had been placed in that position by SBA to monitor the company's operations. The investigation disclosed that the owner made false statements concerning the amount of money he had invested in the SSBIC and that he misapplied more than \$400,000 by pledging company assets for his personal enrichment. To conceal his illegal activities, he also falsely reported in the SSBIC's records that loans totaling at least \$337,500 had been repaid. In 1987, the SSBIC was placed in receivership by SBA. The Agency subsequently obtained a civil judgment in excess of \$5 million against the SSBIC and its owner but still suffered a loss of more than \$3.7 million.

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### *Small Business Development Centers*

University Pays \$122,454 in Administrative Settlement. A university in Puerto Rico paid the Government \$122,454 on March 7, 1997, to settle (without admitting guilt) OIG findings that the university had deposited program income of the small business development center (SBDC) it

administered into a revolving account but had not, as required by cooperative agreement, reported it to SBA. An initial SBA/OIG audit had found **numerous violations of program requirements and unallowable charges** to grant funds; the ensuing OIG investigation uncovered evidence of even more extensive **misuse of SBA funds** and of the university's efforts to conceal program income and unauthorized expenditures. In response to the investigative report, SBA previously terminated its cooperative agreement with the university, whose SBA funding in FY 1997 was slated to be \$1,035,441; SBA awarded \$1.5 million to another Puerto Rico university to administer the SBDC in 1997.

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### *Agency Management and Financial Activities*

West Virginia Grant Audit Reveals Weaknesses in SBA Oversight Procedures. A pre-award audit of an SBA grantee revealed that a West Virginia foundation had not expended nor obligated a \$434,755 advance related to one expired SBA grant, and that a second grant to the foundation had expired. The grantee **had not submitted a final Financial Status Report** for either of the two expired grants, and **SBA had not followed** up with the grantee to obtain the required reports, which are used to determine whether any funds should be returned to the Agency. The OIG auditors found that SOP 00 11 2, Office of Procurement and Grants Management, did not have sufficient procedures to ensure that costs

incurred are reported, unobligated advances are returned, and Financial Status Reports are submitted within the prescribed period. An OIG audit-related memorandum recommended a revision of the applicable SOPs and a review of all grants awarded within the last three years. The Assistant Administrator for Administration agreed with the recommendations. The audit report which generated this audit-related memorandum will be issued next month.

SBA Clerk Pleads Guilty to Defrauding Businesses by Abusing Client's Social Security Number. A former miscellaneous documents clerk in SBA's Disaster Assistance Area 4 Office (DAO-4) pled guilty to one count of **misuse of a Social Security number** (SSN). The OIG initiated the investigation based on information provided by the DAO-4, which had received an anonymous complaint that, while employed by SBA, the clerk had obtained and subsequently misused the SSN of a loan applicant with the same name. The investigation confirmed that the clerk had applied for and received credit and merchandise from four Sacramento-area businesses using her own address, telephone number, and California driver's license, but the loan applicant's SSN. The stores lost a total of \$6,217 as a result of this activity.

OIG Concern Leads Office of Financial Assistance to Clarify Policy on Purging of Loan Files at Servicing Centers. As a result of concerns expressed by the OIG's Investigations Division, SBA's Office of Financial Assistance has clarified its policy concerning the **purging of certain documents from loan files**. In an effort to deal with a

shortage of file storage space, SBA staff had been removing and disposing of duplicates of materials in larger files, routine financial statements not related to any loan servicing action, and "boilerplate" portions of voluminous reports such as appraisals and EPA studies. The OIG was concerned that any misunderstanding on the part of SBA staff as to Agency policy in this area could result in the disposal of records that could be critical to criminal or civil prosecution of false claims. This matter was brought to the attention of the OIG by an employee of the Fresno servicing center.

In response to the OIG's concerns, SBA program managers have clarified Agency policy [regarding the removal of duplicate and boilerplate material from loan files] to assure that all essential loan documentation is properly maintained in the case files.

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## ***OIG Management***

Inspector General Hosts Canadian Government Visitors. The Inspector General hosted a delegation of staff members from **Canada's Auditor General's office**, on March 24-25, 1997. Topics discussed included risk exposure management, cost recovery policies and practices, and a variety of other guarantee and loan-related topics. The visitors also met with the Office of the Chief Financial Officer and the Office of Financial Assistance.

### **Editor's Note:**

The following identifies the use of adjectives in this Update 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.

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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