



Office of Inspector General Small Business Administration

March 1999 Update

Business Loans

Massachusetts Trade Association Officials Plead Guilty in Loan-Packaging Scheme. Two persons associated with a now-defunct trade association in Canton, Massachusetts, pled guilty on the second day of trial to crimes in connection with loan applications submitted on behalf of interstate truckers. The organizer of the association admitted engaging in a scheme to defraud a number of truckers who received SBA-guaranteed loans to purchase their trucks and insurance. The organizer pled guilty to one count each of **conspiracy** and **wire fraud** and nine counts of **making false statements to a Federally insured financial institution**. The court had previously dismissed two counts of **mail fraud**. The organizer was sentenced to 15 months incarceration, 3 years probation, and \$215,546 restitution. The office manager of the association, who was originally charged with the same 13 counts, pled guilty to one count of **theft of money from a bank**. The manager was sentenced to 1 year probation. (Updated from September 1997 Semiannual Report.)

President of Washington Credit Exchange Indicted on Fraud Charges. The president of a credit exchange in Kennewick, Washington, was indicted on one count of **making false statements to SBA** and one count of **bank**

fraud. The charges stemmed from fraudulent statements she allegedly made to SBA and the participating lender to obtain a \$56,000 SBA-guaranteed LowDoc loan in January 1996. The investigation found that the businesswoman failed to disclose that her firm owed more than \$12,100 in Federal payroll taxes at the time she applied for the loan. In addition, when the loan funds were disbursed, she certified that "... all taxes, whether federal, state or local, business or personal, are now current..." Had the unpaid taxes been disclosed, the loan would not have been made. Due to the default of this loan, SBA incurred a loss of \$35,285 and the bank incurred a loss of \$19,319. Officers of the SBA/OIG and the U.S. Marshals Service subsequently arrested the businesswoman. This investigation was based on a referral from SBA's Spokane District Office.

President of Washington Construction Company Charged with Making False Statements on Loan Application. The former president of a construction company in Des Moines, Washington, was charged in an information with **making false statements on a loan application**. The OIG investigation found that the businessman provided false financial statements and made false statements regarding his prior criminal history and lawsuits that were pending against him and his company at

the time he applied for a \$200,000 SBA-guaranteed loan and various other loans from the participating lender. The investigation also found that the man had provided the same false information to SBA in order to get a SBA-guaranteed surety bond and certification as a Section 8(a) contractor. The surety bond was declined and the businessman is no longer in the Section 8(a) program. During the investigation, OIG special agents executed search warrants on the business premises, a storage unit, and his personal residence. The searches confirmed the investigative findings and revealed additional evidence that the man made (or caused to be made) false statements to the IRS and state taxing authorities via mail and facsimile. The total loss to SBA was \$134,906, the loss to the lender was \$309,195, and the loss to state and Federal taxing authorities was \$73,555. This case was referred to the OIG by SBA's Seattle District Office.

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Disaster Assistance

Four Indicted in North Dakota Flood-Loan Negotiate Guilty Pleas. Four people who were previously indicted on charges related to a fraudulently obtained \$122,900 SBA disaster loan to a private business school in Grand Forks, North Dakota, entered guilty pleas. The former corporate secretary and the former controller of the school each pled guilty to one count of **conspiracy** to defraud SBA. Each was sentenced to 6 months home confinement, 3 years probation, and 100 hours community service. A salesman for a computer store in Fargo, North Dakota, pled guilty to one count of **mail fraud**, and was sentenced to 2 years probation, 50 hours community service, and a \$1,000 fine. The fourth defendant was indicted on ten counts (**wire fraud, money laundering, making material false statements, and failure to refund unearned**

Federal student aid funds) in addition to the three counts (**conspiracy and making false statements to SBA**) on which she had previously been indicted. In return for her subsequent guilty plea to one **student-loan refund** count, the Government dismissed all the other charges against her. (*Updated from September 1998 Semiannual Report.*)

Audit Finds Improvement Needed in Loan Origination and Liquidation. An audit of 1994 Northridge, California, earthquake disaster defaulted loans revealed that loan losses could be reduced by improvements in loan origination and loan liquidation.

SBA made 124,000 loans totaling more than \$4 billion after the Northridge earthquake. By December 1997, there were 9,144 loans totaling \$286 million in default.

In a random sample of 75 of the defaulted loans, the auditors found that 59 loans defaulted because the borrowers had unsatisfactory credit or insufficient cash flow. In 40 of the 59 loans, the problems arose after the loan was made. In the other 19, however, the problems existed at loan origination and the loans should not have been made. Based on these results, an estimated 2,316 defaulted loans totaling \$90 million were made to Northridge borrowers with unsatisfactory credit or insufficient cash flow at origination. The Associate Administrator for Disaster Assistance and the Disaster Area 4 director agreed with the finding and said that actions already initiated before the audit would correct the problems. These actions include annual quality assurance reviews of disaster assistance area offices, new automated reports for loan officers, a standardized training manual, and plans to develop a modified form of credit scoring to ensure credit bureau reports will be taken into account. The OIG agreed these actions are responsive to the audit finding.

For 21 of the defaulted loans totaling \$682,251, the auditors found that the borrowers had assets or income available to make payments. After SBA followed up on the audit information, 14 of these borrowers made payments totaling \$58,000 during the audit. Based on the sample results, the auditors estimated that borrowers on 2,560 defaulted loans totaling \$80 million had unidentified assets and income that could be used to repay loans. (In another 15 loans in the sample, SBA had identified borrowers' assets and income prior to the audit.) The Associate Administrator for Financial Assistance and the director of the Santa Ana Loan Servicing and Liquidation Office generally agreed with the finding, but said staffing shortages and other priorities prevented better identification of defaulted borrower assets and income. Staffing had increased from 6 employees to 26 as of October 1997. Other priorities identified were to protect SBA's collateral and lien position by reviewing bankruptcy notices, notices of default, notices of trustee sales, and probate notices and filing appropriate documents. With adequate staffing and effective asset/income identification techniques, program managers believe much of the funds on delinquent loans could be recovered.

California Woman Charged with Making False Statement to SBA. A woman from southern California was charged in an information with one count of **making a material false statement** to SBA for falsely claiming that her personal belongings were destroyed in an apartment complex she did not live at during the January 17, 1994, Northridge earthquake. She had previously been arrested in Indianapolis, Indiana, by special agents from the OIGs of SBA and FEMA and Deputy U.S. Marshals, based on a complaint alleging disaster fraud against both SBA and FEMA. The SBA/OIG's investigation showed that the woman had applied for an SBA disaster home loan for personal property that she claimed

belonged to her and was destroyed during the earthquake. SBA had declined the application based on her adverse credit history. The woman subsequently submitted a new SBA disaster home loan application using an alias and a false Social Security number. Relying on the false Social Security number and a false receipt she submitted from the Southern California Gas Company, SBA approved the second application for \$20,200 and fully disbursed it. The SBA/OIG asked FEMA/OIG special agents to join the investigation after learning that the woman had also received a disaster grant from FEMA for the same location where she falsely claimed to have lived during the earthquake. The SBA/OIG initiated its investigation based on a referral from SBA's Disaster Assistance Area 4 Office.

Surety Bond Guarantees

Audits of Three Surety Bond Companies Found Noncompliance with SBA Procedures.

Audit reports were issued by the OIG on three sureties located in Chicago, Baltimore and Seattle. **All three audits found significant noncompliance with SBA procedures.** More than half of 51 bonds at one surety had deficiencies, which resulted in \$1.3 million owed to SBA. Another surety did not follow proper procedures in 11 of 24 bonds reviewed, with a finding that \$803,926 of loss claims were unallowable because of improper allocation of expenses and unallowable expenditures for claims settlement. The third audit identified \$26,303 in claims for ineligible legal costs, as well as two cases where two bonds were issued for the same project, thereby exceeding the \$1.25 million limit of guaranteed bonds on one project.

In addition to claims issues, the sureties were cited for issuing bonds after project starts and splitting bonds to stay under the dollar maximum for SBA guarantees. The reports rec-

ommended that the Associate Administrator for Surety Guarantees (AA/SG) seek reimbursement on ineligible bonds, deny payment on any future claims on the remaining ineligible bonds, and direct the sureties to revise policies and procedures. The AA/SG concurred with the findings and recommendations on two of the three audits. The AA/SG generally agreed with the findings and recommendations of the third audit, but stated that the recommendations required legal interpretation prior to implementation.

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

Editor's Notes:

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

Other IG related material can be found at:

WWW.IGNET.GOV

The Activity Update is produced by the SBA/OIG, Phyllis K. Fong, Inspector General.

Comments or questions concerning this update or request for copies of OIG audits, inspections, or other documents should be directed to David R. Gray, SBA/OIG, 409 Third Street, SW, Washington, DC, 20416-4110.

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