



Office of Inspector General U.S. Small Business Administration

September 2005 Update

Agency Management

Audit of SBA's Electronic Forms System. On September 23, 2005, the OIG issued a report on a review of SBA's electronic forms system. We found that SBA's electronic forms system was susceptible to unauthorized disclosure of personal or Privacy Act information. This information included individual SBA employees' names, employee identifier or social security numbers, addresses, phone numbers, and dates of birth. The lack of controls to prevent unauthorized disclosure of these records is a violation of the Privacy Act. We made two recommendations to replace the current electronic forms system due to the deficiencies identified in the report. The Chief Information Officer and Chief Privacy Officer agreed with both recommendations in the report.

Audit of SBA's Administration of Its Special Appropriations Grants. On September 21, 2005, the OIG issued a report on a review of SBA's administration of a selected sample of its special appropriations grants. The overall objectives of the review were to determine if: SBA was exercising adequate oversight of its special appropriations grants by following its own policies and procedures; grantees were providing appropriate documentation and SBA was reviewing the documentation to determine compliance with applicable policies and procedures before grantee costs were reimbursed; and SBA was ensuring that the grantees were delivering the services promised in their proposals. The review found that SBA: did not exercise adequate oversight of the three grants reviewed to ensure grantees followed applicable policies and procedures; approved and paid grantee reimbursement requests without requiring evidence that expenditures were allocable, allowable, and reasonable; did not require documentation from the grantees that clearly identified key personnel before awarding the grant; did not enforce the financial and

performance reporting requirements of the grants, thereby ensuring grantees were delivering the services promised in their proposals; and did not have formal written procedures to guide the review, monitoring, and oversight of its portfolio of special appropriations grants. Our report contained three findings and seven recommendations. The Associate Administrator for Administration's response to the draft report indicated agreement with one finding, but did not specifically address the other two findings or any of the recommendations.

Review of SBA Procedures for Cash Gifts. As required by a recent change in the Small Business Act, on September 30, 2005, the OIG issued a report on a review of SBA's procedures for cash gifts. The objective of the review was to determine if the Agency was following established procedures for soliciting, accepting, holding, and utilizing cash gifts. We examined 18 cash gifts, totaling \$20,800, deposited from December 8, 2004, to May 31, 2005. In addition, we examined documentation related to 184 donor solicitations that resulted in the 18 gifts. All the gifts were solicited by the Massachusetts District Office for support of Minority Enterprise Development (MED) Week 2004 and Small Business Week 2005. Our review found that SBA did not perform certain required procedures for soliciting, accepting, and utilizing cash gifts. SBA management generally agreed with the nine recommendations contained in the final report.

Management Advisory Report – SBA Needs to Implement a Viable Solution to its Loan Accounting System Migration Problem. On September 30, 2005, OIG issued a report on a review of SBA's Loan Accounting System (LAS) migration. The objective of the review was to evaluate whether SBA's plans and controls were working effectively to address issues related to migrating from the legacy mainframe operating system that supports LAS. The review disclosed that SBA needed to immediately develop and

deploy an effective LAS migration or modernization plan. The mainframe-based system has been in place for approximately 30 years and significantly contributes to the amount of manual processes in place. We also identified some alternatives to address migrating the LAS that were not considered by the Agency. In addition, we noted that SBA had a number of serious security weaknesses that it has either accepted or could not successfully address within its current mainframe environment due to budget constraints or the abilities of the mainframe system to secure these issues. These security weaknesses were estimated to cost \$3.6 million to correct in SBA's Mainframe Migration Report, issued in December 2004. As a result, SBA's main mission critical information is at risk of exposure or misuse due to a potential lack of confidentiality or integrity within the LAS system. SBA management agreed with the findings and recommendations.

Agency Completes Final Action on One Recommendation Made in Audit of SBA's FY 2001 Financial Statements – Management Letter. The Agency reported that it completed the following final action: the Agency determined that the LAS has adequate capacity for borrower data and that it is the inherent difficulties of obtaining data updates through borrower notification, especially from defaulted borrowers, that limits SBA's ability to utilize the most up-to-date data for its needs. SBA is considering an additional, alternate source of data update from its lending partners, and also will refer non-performing loans to Treasury, whose offset and collection agency handling activities should improve the accuracy of loan data. One other recommendation contained in the report remains open.

Agency Completes Final Action on Two Recommendations Made in Audit of SBA's FY 2004 Financial Statements. The Agency reported that it completed the following final actions: (1) implemented additional transcodes, pro formas, and Budget Object Classes in payroll processing; and (2) issued a written amendment to the grant identified by the audit in order to extend the period of performance. Four other recommendations contained in the report remain open.

Agency Completes Final Action on Ten Recommendations Made in Audit of SBA's FY 2004 Financial Statements – Management Letter. The Agency reported that it completed the following final actions: (1) developed a method to monitor actual to estimated amounts in the Small Business Investment Company (SBIC) Participating Securities model to ensure that future reimbursements are reasonable; (2) updated the Consolidated General Ledger (CGL) to record allotment activity and, since mid-February, has been recording budgetary allotment transaction on a daily basis; (3) received from its Fiscal Transfer Agent (FTA) adequate documentation supporting the validation of the Secondary Market Guarantee (SMG) loan and pool data; (4) includes FTA information in the SMG FY 2005 re-estimate binder; (5) has made all appropriate updates to the 504 model documentation, including some of the items recommended; (6) has documented the process to calculate the Surety Bond Guarantee (SBG) liability and reviewed the documentation of the assumptions and methodology used to estimate the SBG liability; (7) added an additional review to the process used in calculating the SBG liability; (8) agreed with the independent public accountant that SBA should not accrue amounts on loan-related activity as it is already accounted for in the subsidy estimates and re-estimates; (9) includes appropriate documentation in the Agency's budget briefing book; and (10) replaced with a new control file the "findata" file, which contained defective data. Seven other recommendations contained in the report remain open.

Agency Completes Final Action on Two Recommendations Made in Audit of SBA's FY 2003 Financial Statements – Management Letter. The Agency reported that it completed the following final actions: (1) discontinued the practice of funding Preferred Lender Program (PLP) lender reviews through fees assessed to and paid by the PLP lenders, and Congress approved legislation allowing the FTA to collect its fees through interest on the "float" on the fee cash flow; and (2) completed several important tasks regarding intragovernmental reconciliation that helped establish contacts and procedures required to annually perform the intragovernmental reconciliation process. Three other recommendations contained in the report remain open.

Agency Completes Final Action on One Recommendation Made in Audit of Agreed Upon Procedures Report on Sensitive Payments. The Agency reported that it completed the following final action: included an update to procedures for planning conferences its the new Standard Operating Procedure (SOP) on Travel. Three other recommendations contained in the report remain open.

Agency Completes Final Action on One Recommendation Made in Audit of Travel Card and Purchase Card Controls. The Agency reported that it completed the following final actions: (1) the new Travel SOP contains procedures for travel card use while traveling locally within the limits of one's duty station; (2) the new required GSA online training program relating to ATM advances addresses the prohibition of withdrawing cash without prior written approval; (3) SBA Procedural Notice 2000-688 provides procedures for office directors and administrative officers to follow when reviewing travel card transactions, and a policy requiring split disbursements of travel reimbursements between the credit card issuer and the traveler for all travel cardholders having habitually delinquent accounts; and (4) SBA Procedural Notice 2000-673 provides procedures to deactivate travel cards whenever the cardholders are not scheduled for official travel. Final actions have been completed on all recommendations in this report.

Agency Completes Action on One Recommendation Made in Audit of the National Women's Business Council. The Agency reported that it completed the following final action: SBA's Office of General Counsel determined that travelers are liable for the cost of improper foreign travel if the authorization violates SBA's Travel SOP regardless of whether SBA and the travelers mistakenly believed that the travelers did not have to comply with the Travel SOP. Final actions have not been completed on nine other recommendations contained in the report.

Final Action Completed on One Recommendation Made in Audit of SBA's Information System Controls for FY 2004. The Agency reported that it completed the following final action: completed the upgrade to Oracle Federal Financials by implementing version 11.5.9, and implemented an internal patch to the Oracle system which allowed the application to come into compliance with strengthening password controls,

including password history and automatic lock-out after a set number of failed login attempts. Nineteen other recommendations contained in the report remain open.

Final Action Eliminated on One Recommendation Made in Independent Evaluation of SBA's Computer Security Program for FY 2004. The Agency requested that one recommendation be dropped as the Office of Management and Budget (OMB) no longer requires the reconciliation of the Agency Plan of Action and Milestones with the Agency Capital Asset Plans. OIG concurred with this request. One other recommendation contained in the report remains open.

Agency Completes Final Action on Five Recommendations Made in Audit of Puerto Rico & Virgin Islands District Office Cosponsored and SBA-Sponsored Activities. The Agency reported that it completed the following final actions: (1) district office personnel have been made aware of Federal requirements when procuring supplies and services for outreach events; (2) controls have been established to prevent the solicitation and acceptance of gifts from proscribed sources and to ensure conflict of interest determinations are made when needed; (3) existing gift funds were remitted to the Business Assistance Trust (BAT) Fund; (4) district office personnel have been notified of the requirement to deposit all gifts into the BAT Fund; and (5) \$7,000 solicited and accepted from a prohibited source was refunded. Three other recommendations contained in the report remain open.

Agency Completes Final Action on Two Recommendations Made in Audit of Travel of a Former Regional Administrator. The Agency reported that it completed the following final actions: (1) received reimbursement for unallowable travel payments; and (2) provides training on relevant travel rules and regulations. Final actions have been completed on all the recommendations in this report.

Business Loan Programs

Audit of Defaulted SBA-Guarantied Loan. On September 28, 2005, the OIG issued a report on a defaulted SBA-guarantied loan where the lender disbursed the loan without ensuring that the borrower made the required equity injection of \$87,000, as required by the loan authorization. The borrower defaulted on the loan five months after disbursement.

We recommended that SBA recover the \$255,088 paid to the lender when the guaranty was purchased. SBA agreed to request recovery of the guaranty amount unless the lender could substantiate that the borrower injected the required funds into the business.

Management Advisory Report – PLP Processing Restrictions for Paying off Existing SBA Debt in Change of Ownership Transactions. On September 28, 2005, the OIG issued a report on a review of selected paid-in-full (PIF) loans originated by a lender. We found that PLP processing restrictions for paying off existing SBA debt in a change-of-ownership transaction were not followed. The lender did not comply with SBA guidance in seven separate change-of-ownership transactions. Two transactions involved guaranty purchases for defaulted loans totaling almost \$1.5 million. The lender repaid the guaranty purchase amount on one of the loans after the OIG brought this situation to their attention. We recommended recovery of the guaranty purchase amount paid for the second defaulted loan. The other five transactions involved same institution debt, whereby the lender paid off its existing SBA loans. Although the loans were current as of August 31, 2005, we recommended flagging the current loans. In the event of default, guaranty purchase decisions should take into account the restrictions that made these loans ineligible for PLP processing. SBA agreed to pursue full recovery of the guaranty paid on the second loan and to flag the five current loans.

Texas Men Indicted. Five individuals from Houston, Texas, were indicted on September 20, 2005, in the Southern District of Texas, on one count of conspiracy, one count of conspiracy to commit money laundering, one count of bank fraud, and six counts of money laundering. The indictment alleged that a borrower conspired with three other men and a loan broker in a fraudulent scheme to secure a \$1 million SBA-guaranteed loan for the purchase of a gas station. According to the indictment, the defendants allegedly misrepresented the purchase price of the gas station to be \$1,320,000, when the actual price was only \$788,617. To misrepresent the source of the borrower's required equity injection, the defendants allegedly submitted a bill of sale and personal financial statement falsely showing that he sold a gift shop business in New York for \$150,000. It is further alleged that the three other individuals advanced most of the equity funds purportedly injected by the

borrower. An SBA Form 912 statement of personal history was submitted to the SBA lender which misrepresented the borrower's status as a U.S. citizen. Once the loan was funded, the defendants allegedly laundered approximately \$183,519 of the proceeds for their personal benefit.

Two Virginia Individuals Sentenced. The president and vice president of a now defunct Springfield, Virginia, asphalt company, were sentenced on September 9, 2005, to 18 months incarceration, three years of supervised probation, and were ordered to pay restitution, jointly and severally, of \$55,000 to SBA and \$31,000 to an SBA lender. The two individuals were also forbidden to open any new lines of credit after their incarceration without permission of the probation office. They were found guilty by jury trial on June 17, 2005, of one count of conspiracy, one count of bank fraud, and two counts of making material false statements related to a \$100,000 SBA-guaranteed loan. They also misused the loan proceeds on personal items instead of purchasing paving equipment that was to have served as collateral for the loan. This case was referred by the SBA Washington District Office.

Texas Man Pleads Guilty. A Texas business owner pled guilty in the Southern District of Texas on September 12, 2005, to one count of false claim to U.S. Citizenship. Our investigation revealed that the man obtained a \$286,200 SBA-guaranteed loan by providing false information during the loan process. In addition to claiming to be a U.S. citizen, he did not disclose a pending lawsuit, falsified the origin of the required cash injection, and provided invoices in order to receive funds for work that was not accomplished. Sentencing is scheduled for December 12, 2005. SBA OIG is conducting this joint investigation with the Department of Homeland Security, Immigration and Customs Enforcement, and the Texas Alcoholic Beverage Commission.

California Business Owner Charged. The owner of a Glendale, California, telecommunications company was charged in a felony complaint on September 14, 2005, with one count of grand theft. The complaint was filed in the Superior Court of the state of California for the county of Los Angeles. The case was based on a referral from an SBA lender alleging fraudulent conduct during the application and subsequent funding of a \$50,000 SBA Express loan. This case was referred to the SBA OIG by the Glendale, California Police Department.

Disaster Loan Program

Virgin Islands Men Plead Guilty. Two men from the Virgin Islands pled guilty on September 6, 2005, to charges previously filed by criminal information. The first man pled guilty to two counts of making material false statements and one count of misdemeanor participating in fraud upon creditors. The other man pled guilty to one count of misdemeanor compounding a crime. Both men were charged by superseding indictment on August 5, 2005, to one count of conspiracy and eight counts of mail fraud. The indictment alleges that the men, who were co-owners of a house in St. Thomas, Virgin Islands, falsely represented to the SBA, the Federal Emergency Management Agency (FEMA), the Home Protection Roofing Program (funded by FEMA), and insurance companies, that their house had sustained hurricane damage when, in fact, the house had been previously damaged by another hurricane, and they had knowingly purchased it with such damage in an “as is” condition. This investigation was based on a referral from the Department of Justice.

Government Contracting and Business Development

Management Advisory Report – Criteria for Overcoming the Presumption of Social Disadvantage is Needed. On September 28, 2005, the OIG issued a report concerning the lack of criteria for overcoming the presumption of social disadvantage. OIG received an anonymous complaint regarding an 8(a) company’s status in the 8(a) Business Development (BD) program. While conducting research to respond to the complaint, we noted that, although the regulations state that the presumption of social disadvantage for members of groups designated as socially disadvantaged may be overcome with “credible evidence to the contrary,” SBA had not established criteria for “credible evidence.” We believe this criteria needs to be established to determine whether the owner of the 8(a) company being reviewed had overcome his social disadvantage. We made recommendations to the Associate Deputy Administrator for Government Contracting and Business Development and the Associate Administrator for BD, who both agreed that that the

regulations need to be changed. The Associate Administrator for BD agreed to determine whether the owner of the 8(a) company that was reviewed overcame his social disadvantage.

SBA Employee Indicted. An SBA employee in Puerto Rico was indicted on September 28, 2005, on one count of conspiracy and one count of bribery of a public official. The employee was charged with accepting bribe payments with the intent to influence his performance of official acts. Specifically, he used his position to obtain over \$20,000 for his personal benefit from a 8(a) contractor who received over \$3 million in 8(a) contracts. This investigation was based on a referral from the Federal Bureau of Investigation.

Other

California Business Owner Sentenced. The owner of a now defunct business in San Diego, California, was sentenced on July 14, 2005, in the San Diego Superior Court, to three years formal probation and a \$239 fine. The man previously withdrew his not guilty plea and pled guilty to one count of grand theft of personal property. He solicited and received money from investors based on representations that his company had a government contract subsidized by various Federal Government entities, including SBA. Our investigation substantiated the allegation that the man and his company had no officially-sanctioned relationship with the SBA that would have authorized him to solicit funds. The case was referred by the SBA District Office in San Diego, California. SBA OIG conducted this joint investigation with the U.S. Secret Service.

Statutory/Regulatory/Policy Reviews

In effort to proactively identify and correct potential Agency inefficiency and management problems at the onset of policy and regulatory development, the OIG reviewed, cleared, and/or provided comments, as appropriate, on 12 Agency initiatives, including proposed legislation, Agency Standard Operating Procedures, and Agency notices containing directives to its employees.

This monthly update is produced by the SBA OIG,
Peter L. McClintock, Acting Inspector General.

The OIG has established an e-mail address
(oig@sba.gov) that we encourage the public to use to
communicate with our office. We welcome your
comments concerning this update or other OIG
publications. To obtain copies of these documents
please contact:

Theresa McCane, SBA OIG
409 Third Street SW., 7th Floor
Washington, DC 20416
E-mail: OIG@SBA.GOV
Telephone number (202) 205-6586
FAX number (202) 205-7382

Many OIG reports can be found
on the Internet at:

<http://www.sba.gov/IG/igreadingroom.html>

If you are aware of suspected waste, fraud, or
abuse in any SBA program, please call the:

OIG FRAUD LINE at (202) 205-7151

or

TOLL-FREE at (800) 767-0385