



## Office of Inspector General Small Business Administration

June 1997 Update

### *Business Loans*

Georgia Borrower and Participating Lender Withhold Information Which Could Have Avoided Government Loss. In one of a continuing series of **audits of early defaulting loans**, the OIG's Auditing Division discovered that both a borrower (a business with several principals) and an SBA participating lender failed to disclose material information that could have precluded approval of a \$455,000 loan to buy a golf driving range in Georgia in 1994. The loan defaulted in less than one year, resulting in a \$340,000 purchase of the SBA loan guarantee. The audit revealed that the borrower failed to disclose to the lender or SBA prior felony convictions for check fraud and drug possession. This issue has been referred to the OIG's Investigations Division.

Through the SBA's tax verification process with the IRS, the lender learned that a principal's 1992 tax return, showing a liability of \$2,600 had not been filed. The lender, however, did not disclose this information to SBA. After the borrower declared bankruptcy, tax liens totaling \$26,000 were filed by the State of Georgia and the IRS. The OIG recommended that SBA recover the guarantee purchase from the lender because the loan agreement requires that

a borrower be current on all taxes. In addition, the applicable SBA Policy Notice requires that the lender notify SBA if there is any material discrepancy between tax return data submitted by the borrowers and data received from IRS. Finally, SBA regulations state that the Agency is released from its guarantee obligation if the lender has not "substantially complied with all of the provisions" of the regulations and lender agreements.

Neither the lender nor SBA's Atlanta District Office agreed with the recommendation. The lender said it was not required to get IRS verification of principals' tax returns on a new business and that tax return verification on the principals was, nevertheless, acceptable for 1991 and 1993. The District Office agreed with the lender that it did not have to verify personal tax returns of the principals and that there was no basis for action against the lender unless there was ultimately a loss in liquidating the loan. The OIG requested the District Office to reconsider its position because the lender should have disclosed the tax discrepancy once it was known. Further, SBA regulations do not require a monetary loss as a condition of release from the guarantee liability. The issue remains unresolved pending the reconsideration of the District Office and the SBA's Office of Financial Assistance.

Illinois Machine Manufacturer Pleads Guilty to Making a False Statement. The former owner of an industrial machine manufacturing company in Dolton, Illinois, pled guilty on June 17, 1997, to one count of knowingly **making a false statement to influence SBA**. The firm was approved in February 1992 for a \$325,000 SBA-guaranteed business loan, of which \$42,500 was to be used to purchase machinery and equipment. The owner subsequently submitted an SBA Settlement Sheet that certified that he already had spent \$38,500 of the loan proceeds to purchase a milling machine and would spend an additional \$4,000 to purchase more machinery. The OIG's investigation documented that his certification was false, as he actually spent only \$2,000 on machinery and equipment. To carry out this fraud, the man submitted to the participating lender bank fraudulent invoices totaling more than \$43,000 and a \$7,700 check that he falsely represented as a 20 percent down payment on a milling machine. The owner also forged the endorsement of the joint payee of a \$30,800 check the bank gave him to pay the remaining 80 percent cost of the machine. The OIG initiated the investigation based on a referral from a liquidation loan officer in SBA's Chicago District Office.

Montana Clothing Retailer Sentenced for Making False Statements. A partner in a clothing retailer in Whitefish, Montana, was sentenced on May 27, 1997, to 3 years probation and a \$7,500 fine. He had pled guilty to one count of **making false statements** to SBA. In 1993, the man submitted financial statements and other documents purporting to give a true picture of the partnership's financial

situation to persuade SBA and a Montana participating lender to accept a \$27,500 offer-in-compromise for his liability for two defaulted SBA loans (\$780,000) made to the partnership in the early 1980's. The OIG's joint investigation with the FBI found that the man had failed to disclose over \$165,000 in assets, including real estate and corporate stock, in the offer-in-compromise package. Subsequent to SBA's 1993 acceptance of the compromise, the owner (under a corporate name) received three additional SBA-guaranteed loans totaling \$205,000 from another participating lender in Idaho based on a substantially different set of financial statements. These loans have also gone into default. After liquidation of collateral, SBA suffered losses of more than \$90,000. The OIG initiated its investigation based on referrals from SBA's Helena and Boise District Offices.

Pennsylvania Loan Applicant Charged with Making False Statements. A Lansdale, Pennsylvania, man was charged in a criminal information on June 16, 1997, with **making false statements to influence SBA** to approve a \$200,000 guaranteed loan to his company. In support of his loan application, the man had submitted an altered 1991 tax return which substantially overstated his income, as well as fictitious returns for 1992-93. The loan proceeds were to be used to purchase a tavern; however, the loan was canceled when the tax return discrepancies were verified by the IRS. The case was based on a referral from SBA's Philadelphia District Office.

Georgia Motel Owner Pleads Guilty to Making Material False Statements. The former owner of a motel in Tybee Island,

Georgia, pled guilty on June 6, 1997, to two counts of **making material false statements** to influence the actions of SBA. The man, who was approved for a \$950,000 SBA-guaranteed business loan, submitted falsified invoices to the participating lender bank, representing \$213,150 in services and equipment, to obtain the loan proceeds. The OIG initiated this investigation based on information received by the OIG Fraud Line.

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### *Disaster Assistance*

Georgia Equestrian Center Owner Sentenced for Perjury. The president of a Unadilla, Georgia, horse-show arena was sentenced on May 22, 1997, to 15 months imprisonment and 3 years supervised release. He had been convicted on two counts of **perjury**. The charges related to his testimony that his signature had been forged on a personal guaranty submitted to obtain an SBA economic injury disaster loan. As a result of the OIG's early investigative determination that the signature was not a forgery, SBA had obtained a civil judgment in 1992 against the man for the principal amount of the defaulted loan (\$44,200) plus accrued interest of more than \$8,800. The OIG initiated the investigation, which was conducted jointly with the FBI, based on a referral from SBA's Atlanta District Office.

Missouri Consultant Pleads Guilty to Making Material False Statements. A Cuba, Missouri, industrial construction consultant pled guilty on May 28, 1997, to one count of **making material false**

**statements** to obtain SBA disaster assistance. In support of the loan application, he submitted three fictitious tax returns for a St. Louis business that he purchased subsequent to the disaster, and which received SBA disaster loans (one for economic injury and one for physical damage) totaling \$407,800. The OIG initiated the investigation based on information from an anonymous writer.

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### *Agency Management and Financial Activities*

Indirect Rates for SBA Contract Questioned by Audit. On June 5, 1997, the OIG issued a Defense Contracting Audit Agency (DCAA) report on an Arlington, Virginia, technology firm. The report **questioned the contractor's indirect rates for fringe benefits, office overhead, onsite overhead, and general and administrative expenses** for the 3 years audited (1992-94). DCAA provisionally approved the contractor's direct costs pending final acceptance of the work being completed. Based on the report, the OIG recommended that SBA's Director of Procurement and Grants Management ensure that the contractor's indirect rates for the contract it has with SBA reflect the rates determined acceptable by DCAA.

Former SBA Employee Sentenced for Opening and Using Charge Accounts in Other Employees' Names. A former Minority Enterprise Development technician in SBA's New York District Office (NYDO) was sentenced on May 29, 1997, to 3 years probation and

\$2,500 restitution. She had pled guilty to **using unauthorized access device s** (credit cards) in an offense affecting interstate commerce. The investigation was based on a complaint by another SBA employee that her name and Social Security number were being illegally used by someone to open charge accounts and purchase merchandise. The investigation, conducted jointly with the Social Security Administration's OIG, disclosed that, over a period of more than 1 year, the woman used her position to obtain the Social Security numbers of at least three current or former co-workers. She used their names and Social Security numbers to open numerous fraudulent charge accounts and to purchase merchandise valued at over \$3,000. Based on a criminal complaint by the investigating SBA/OIG agent, the employee was arrested in the NYDO on July 18, 1996. She resigned her position with SBA the following month.

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## ***OIG Management***

OIG Annual Training Conferences. The OIG conducted its annual training session for OIG administrative support personnel in New Orleans, Louisiana, during the week of June 9, 1997. There were 19 attendees at the conference, which provided training in computer database management software, communications skills, and procurement and budget procedures. The Inspector General also addressed the conferees and presented the Management Support Employee of the Year award. The annual training conference for all other OIG employees will be held during the

week of July 20, 1997, in San Diego, California.

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### *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 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.

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