



Semiannual Report of the Inspector General

A Report to Congress
October 1, 1999 – March 31, 2000
Pursuant to Public Law 95-452

Foreword

I am pleased to submit our Semiannual Report on the Office of Inspector General's (OIG) activities from October 1, 1999, to March 31, 2000.

We have adopted a new format for this report to tell our story more effectively. The first chapter (Significant Activities and Management Challenges) summarizes OIG activities in the five strategic focus areas identified in our new strategic plan: financial management systems, information systems and computer security, lender oversight, other selected high risk issues, and new Agency initiatives. Included in this section is a discussion of the current top 10 management challenges we have identified for the Small Business Administration (SBA). The second major chapter of the report (OIG Activities) describes other OIG activities that are significant because of their proactive nature, value to SBA program managers, interest to Congress, or other factors. This section is organized by SBA program area for ease of reference. Finally, the charts, tables, appendices, and other background information have been revised to provide information in a more clear and concise way.

This new reporting approach reflects the changes we are making in our planning and budget processes. We must continue to direct more of our limited resources to issues that are strategically important if we are to add value to policy discussions and contribute to the accomplishment of SBA's mission. I believe that this comprehensive approach will make it easier for decision-makers and stakeholders to understand the OIG's views on the key challenges facing SBA. I welcome your comments on any aspect of this approach, as we will be continuously refining our reports and plans. Please e-mail us at oig@sba.gov.

And what did we accomplish over the past 6 months? I invite you to take a look at our new report for a concise answer presented in the context of our strategic plan. In terms of the traditional productivity measures for OIG activities, we see that the Office issued reports on 15 audits; 3 inspections are well underway and should be completed by year end. OIG investigations resulted in 29 indictments and 20 convictions for criminal violations. The Office brought its collective experience to bear in reviewing 178 legislative, regulatory, policy, and procedural proposals concerning SBA and Governmentwide programs. Overall, OIG dollar accomplishments from all activities totaled more than \$21 million. All of this was achieved under an FY 2000 appropriation of \$11.5 million and an average staff level of 110.

Finally, because we do not work in a vacuum, I would like to express my deep appreciation for the ongoing support and interest of the Administrator, Deputy Administrator, and SBA's senior staff. Without their willingness to assist us and take action on our recommendations, we would not be effective. We are also grateful for the full cooperation we have received from SBA employees and for their willingness to refer matters to us. I look forward to continuing these professional and productive relationships.

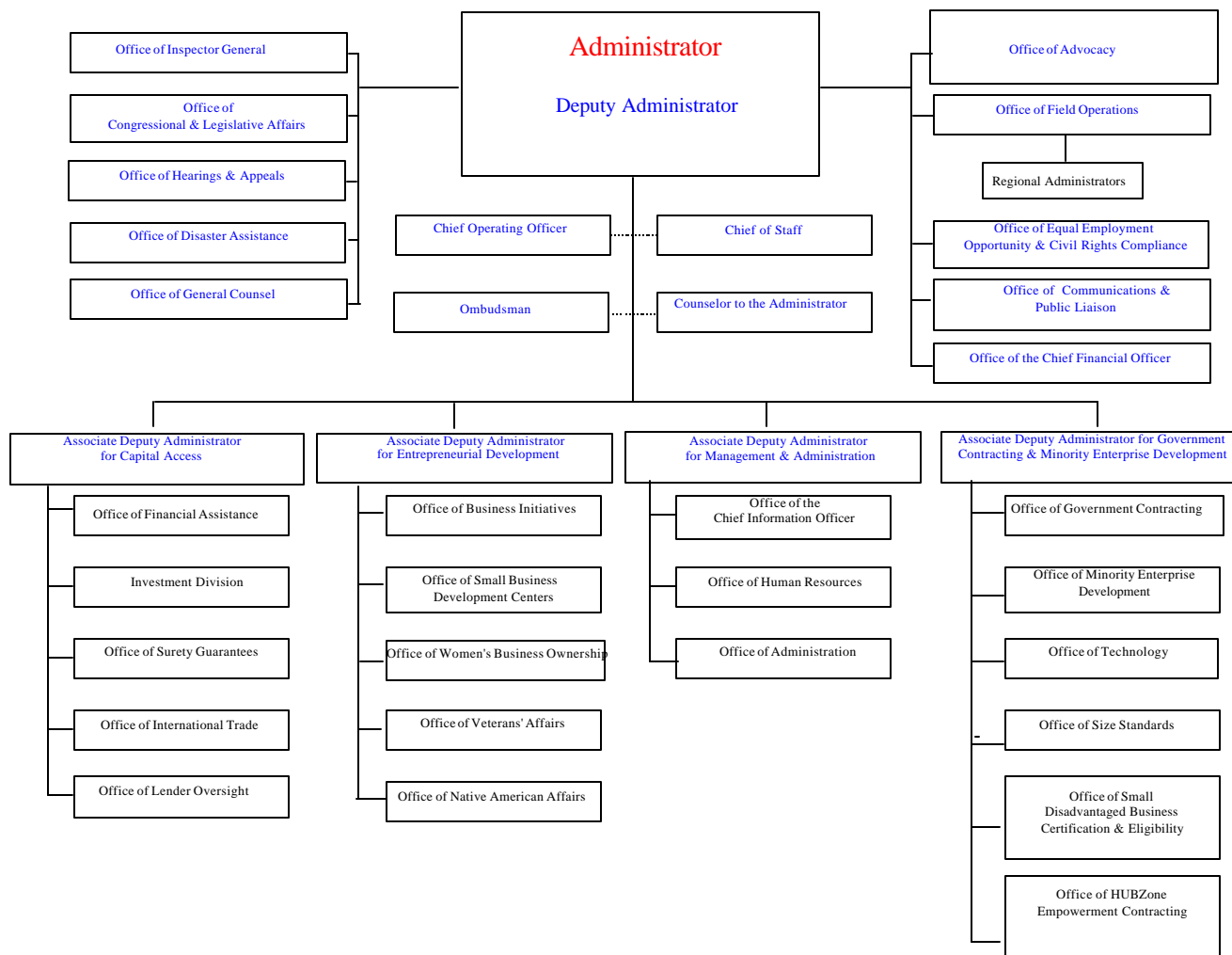

Phyllis K. Fong
Inspector General

Table of Contents

Chapter	Page
SBA Overview	iii
Significant Activities and Management Challenges	1
OIG Profile	8
OIG Activities	10
Statistical Highlights	26
Inspector General Act Statutory Reporting Requirements	28
Table of Appendices	29

SBA Overview

United States Small Business Administration



The Small Business Administration (SBA) was established in 1953 to assist small businesses from startup through the many stages of growth. The SBA's two major goals are helping small businesses succeed and helping Americans recover from disasters. SBA offers many services to new entrepreneurs, including developing a business plan, obtaining financing, marketing products and services, and addressing management issues.

The Office of Capital Access has several loan programs that assist small businesses. The primary business loan program is the Section 7(a) program that guarantees 75 percent of loans up to a maximum guarantee of \$750,000 and 80 percent up to \$80,000 if loans are \$100,000 or less. Through the Section 7(a) authority, SBA also offers the Certified and Preferred Lenders programs, Low Documentation Loan Program (LowDoc), SBAExpress, Pre-Qualification Loan Program, CAPLines, Defense Loan and Technical Assistance, Community Adjustment and Investment Loans, Export Working Capital Program, International Trade Loans, Energy and Conservation Loans, Pollution Control Loans, MicroLoans, and Section 504 Loans. All of the specialized business loan programs were established to provide small business entrepreneurs the assistance that is needed to be successful. In FY 2000, the Office of Lender Oversight was established to effectively coordinate oversight of these programs.

SBA Overview

The Office of Entrepreneurial Development administers programs which offer counseling and assistance through its many resource partners, such as Service Corps of Retired Executives, Small Business Development Centers, Business Information Centers, USEACS, and One Stop Capital Shops. These resource partners provide guidance and expertise to new entrepreneurs.

The Office of Government Contracting and Minority Enterprise Development administers programs that assist small businesses with Federal procurement opportunities. The Office of Minority Enterprise Development provides technical and procurement assistance to eligible businesses through two principal programs: (1) Business Development, which encompasses the Section 8(a) program and the Mentor-Protégé program, and (2) Management and Technical Assistance. The Office of Technology expands the competitiveness of small high technology research and development businesses in the Federal marketplace through two programs: Small Business Innovation Research and Small Business Technology Transfer. The Office of Size Standards reviews and establishes industry size standards. The HUBZone Empowerment Contracting Program is designed to stimulate economic development and create jobs in urban and rural communities by providing contracting preferences to small businesses located in historically underutilized business zones. The Office of Small Disadvantaged Business Certification and Eligibility (SDBC&E) certifies companies applying as small disadvantaged businesses (SDB); oversees a nationwide network of selected private certifiers who help process applications; and maintains a public on-line registry of certified SDBs for access by contracting officers and the general public.

In the wake of hurricanes, floods, earthquakes, wildfires, tornados and other physical disasters, SBA plays a major role. SBA's disaster loans are the primary form of Federal assistance for nonfarm, private sector disaster losses. SBA is authorized by the Small Business Act to make two types of disaster loans: (1) physical disaster loans provide a primary source of funding for permanent rebuilding and replacement of uninsured disaster damages to homeowners, renters, nonfarm businesses of all sizes, and nonprofit organizations; and (2) economic injury disaster loans provide business with necessary working capital until normal operations resume after a physical disaster. The disaster program is SBA's largest direct loan program, and the only SBA program for entities other than small businesses. SBA delivers disaster loans through four specialized Disaster Area Offices located in Niagara Falls, NY; Atlanta, GA, Ft. Worth, TX, and Sacramento, CA.

SBA programs are delivered in every state, the District of Columbia, the Virgin Islands, Guam, and Puerto Rico. SBA has a FY 2000 appropriation of \$873.7 million and has 4,626 employees (including Disaster Assistance and OIG).

Significant Activities and Management Challenges

OIG Strategic Plan

The Office of Inspector General (OIG) recently revised its strategic plan to more clearly articulate its vision to improve SBA's programs by identifying key issues facing the Agency, ensuring that corrective actions are taken, and promoting a high level of integrity. OIG will focus on serving the needs of our customers and stakeholders and on safeguarding SBA resources from waste, fraud, and abuse. We will also provide a work environment in OIG that is conducive to excellent performance by our employees. The vision was translated into a new Strategic Plan for fiscal years 2001-2006 and a companion FY 2001 Annual Performance Plan that expands on the goals and objectives in the Strategic Plan. There are three goals in the Strategic Plan that broadly define our mission as stated in the IG Act of 1978, as amended. In addition, we identified five cross-cutting areas in which we will focus our work: (1) financial management systems, (2) information systems and computer security, (3) lender oversight, (4) other selected high-risk issues, and (5) new agency initiatives. A summary of our strategic plan is provided on the inside cover of this report.

Top Ten List

In response to a request from Chairmen of the House and Senate Government Affairs and Budget Committees, and the House Majority Leader in December 1999, OIG developed a list of ten serious management challenges currently facing SBA. OIG is continuing to work with Agency officials to implement the recommended actions that would resolve these issues, and is monitoring the Agency's progress. A full discussion of these issues can be found on OIG's website, www/sba.gov/ig/topten.

Focus #1
Financial Management →

Focus #2
Information Systems →

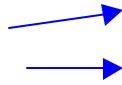
Focus #3
Lender Oversight →

Focus #4
High Risk →

1. SBA needs to develop and implement a program-based cost accounting system.
2. SBA needs to improve its information system controls.
3. SBA district offices do not consistently apply guarantee purchase requirements.
4. SBA needs to improve loan monitoring.
5. SBA needs an effective oversight process for Small Business Lending Corporations.
6. More participating companies need to obtain contracting opportunities in the Section 8(a) program.
7. Participants who become wealthy are allowed to remain in the Section 8(a) Program and be considered economically disadvantaged.
8. SBA does not enforce its rules to limit pass-through procurement activity to non-Section 8(a) Program participants.

Significant Activities and Management Challenges

Focus #4
High Risk



9. SBA needs to put more emphasis on preventing loan agent fraud.
10. Borrowers in SBA's business loan program need to have criminal background checks.

The next section of this chapter details the significant OIG Accomplishments in the five areas of strategic focus. Many of the following articles provide an overview of our accomplishments with additional details or examples in the later chapter entitled, OIG Activities.

Financial Management Systems

Financial Statement Audits

SBA receives fourth unqualified Financial Statement Opinion.

- SBA's FY 1999 financial statements received an unqualified opinion for the fourth straight year from the independent auditors. The unqualified opinion means that the auditors found SBA's principal financial statements to be presented fairly in all material respects in accordance with OMB guidelines and SBA accounting policies. The results of the audit were transmitted to the Chief Financial Officer (CFO) by OIG. The auditors did, however, find two problems that were considered material weaknesses in the internal control structure: (1) SBA's financial reporting process did not ensure that its financial statements were free of material misstatements, and (2) significant general control deficiencies in its information systems continued to exist. OIG will issue separate reports on each of the material weaknesses that will include recommendations for improvement. The CFO agreed with OIG's findings.
- OIG issued a Management Letter describing three conditions identified during the audit of SBA's FY 1999 financial statements. These internal control weaknesses were not included in the audit report on the financial statements because they were not material with respect to the statements. The first condition involved errors in the subsidy rate modeling and reestimating process. This condition was reported in the FY 1998 Management Letter and, while much improved, was not completely eliminated. The second condition was that SBA did not properly control computer equipment. The third condition involved duplicate payments made to Small Business Development Centers. In response to the Management Letter, the CFO indicated that action had already begun to eliminate the three conditions for FY 2000.

Significant Activities and Management Challenges

Collection of Loan Fees

OIG issued an audit report on Section 7(a) fee collections. Under the Section 7(a) loan program, SBA guarantees loans made to small businesses by participating lenders. For loans approved after October 1995, lenders are required to pay SBA a yearly service fee equal to 0.5 percent of the outstanding balance of the guaranteed portion of each loan. The audit objective was to determine if SBA collected the Section 7(a) loan service fees it was due for the period October 1995 through April 1999. Overall, the audit showed that SBA collected the appropriate fees for 95.5 percent of the 140,165 loans approved after October 1995, but that it may not have collected as much as \$4.1 million for the remaining 4.5 percent of those loans. In addition, errors in SBA records precluded accurate calculation of fees due and collected, incorrectly indicating fee overpayments on 5.5 percent of the loans. SBA was not able to ensure the collection of fees due for all loans and the accuracy of its records, because it did not have procedures in place to calculate amounts due for comparison with amounts collected, or to follow up with lenders on loans with significant differences. It did, however, have the information necessary to implement such procedures. OIG recommended that SBA establish receivable accounts and improve the processing management of Section 7(a) loan servicing fees. SBA generally agreed with OIG's recommendations.

Information Systems and Computer Security

SBA's strategic goals depend heavily on the development of new information systems.

OIG issued an audit report on SBA's proposed Systems Development Methodology (SDM). SBA's strategic goals depend heavily on the development of new information systems. In the past, however, SBA has been criticized for inadequate planning and poor systems development procedures. The Office of the Chief Information Officer (CIO) is, therefore, developing SDM to help accomplish its strategic goals and address those criticisms. SDM is a set of procedures and quality controls intended to reduce risks in the development of new systems and ensure that systems function as intended.

The auditors found that the proposed SDM (1) is generally consistent with government and industry standards; and (2) will help ensure that new information systems are developed on time, within budget, and with the intended functionality. OIG recommended minor changes to the plan and that the CIO establish SDM as official Agency policy for system development projects. The report also contained a recommendation that milestones and responsibilities be established to ensure the completion of related standards and procedures. The Agency agreed with the recommendations in the audit report.

Significant Activities and Management Challenges

Eleven percent of the 240 loans had deficiencies that affect the SBA guarantee or required other action to protect the Government's interests.

Using its partnerships and business resource partners more extensively, SBA is moving further away from the direct delivery of products and services, increasing the overall financial risk. Certified lenders receive a partial SBA delegation of authority to approve loans. Preferred lenders receive full delegation of lending authority.

Lender Oversight

Section 7(a) Loan Processing

OIG issued an audit report that evaluated the level of compliance with SBA's Section 7(a) Loan Program processing requirements. This was a summary report compiling results obtained from audits of 240 loans in eight district offices. The purpose of this audit was to: (1) determine whether loans were processed, disbursed, and used in accordance with SBA requirements; and (2) compare the audit results to previous similar audits of the LowDoc Loan Program. The auditors evaluated 22 procedures considered material to the loan approval process to determine whether noncompliance with these procedures resulted in deficiencies that affected the loan guarantee or required other action to protect the Government's interests. The auditors concluded that 11 percent of the Section 7(a) loans had deficiencies in this category. Another 38 percent had noncompliances for which the impact could not be determined during the audit, or had noncompliances that did not result in deficiencies. In the report, OIG recommended that goals and measures be set for lender loan processing performance, that the purchase process be centralized for loans with deficiencies, and that a procedure for district offices to track repairs and report the results be established.

The Associate Administrator for Financial Assistance (AA/FA) generally agreed with the recommendations in the report. To address the recommendations, the AA/FA is: (1) developing a Risk Management System that benchmarks lender performance and compares it to baseline loan portfolio performance goals and allows for comparisons among lenders; and (2) centralizing the quality review process for the purchase of loans with material deficiencies. The Associate Administrator for Field Operations agreed with our recommendation to establish a procedure to track repairs and report the results to the AA/FA.

Early Default Audits

OIG has an ongoing program to audit early defaulted SBA-guaranteed loans. An early default is a loan that is charged off or transferred to liquidation within 36 months of origination. Six early default audit reports were issued from September 1999 through March 31, 2000 (four during this reporting period). Of the six reports issued, five identified loans that were not originated in accordance with SBA rules and regulations or prudent lending practices. The lenders neither evaluated nor validated required elements before approving the loans. These six loans caused a loss to SBA in excess of \$1.4 million. After the facts were revealed in one audit report, SBA's obligation of the entire guarantee was relieved. In two other situations, in response to the recommendations in the reports, the cognizant district office issued demand

Significant Activities and Management Challenges

letters to the lenders requesting money back or reevaluating SBA's guarantee amount. In all instances, the Agency concurred with our findings and is currently implementing corrective actions to address the recommendations. The four most recent audits are described in the chapter, *OIG Activities*.

Preferred Lender Program

OIG is conducting an inspection to determine whether the Agency's formal review process for the Preferred Lender Program (PLP) is effective as an oversight tool. The inspection is focused on the usefulness of the process for monitoring the activities of preferred lenders. It will also review relevant performance measures designated for Government Performance and Results Act reporting. We expect to issue the report in the fourth quarter of FY 2000.

Other Selected High-Risk Issues

OIG focuses on areas of recurrent fraud.

Over the years, OIG investigations of fraud in SBA's loan programs have identified trends or types of fraud. Three major trends in recent years are: (1) fraud involving loan agents, (2) fraud involving false tax returns, and (3) fraud involving borrowers who do not disclose criminal histories.

Fraud Involving Loan Agents

Loan agents provide referral and loan application services to prospective borrowers or lenders for a fee. Some agents, particularly loan packagers, have been involved in a variety of fraudulent schemes, such as submitting false tax returns or other financial data, charging the borrower excessive fees, using fictitious names on SBA forms, exaggerating their ability to gain loan approval, acting in illegal collusion with officials of lending institutions, conspiring with borrowers to submit false loan packages, and performing other illegal acts. These schemes, which have been copied from one fraudulent agent to another, have resulted in loan purchases by SBA and, ultimately, the taxpayers.

During this reporting period, OIG investigations of this type of fraud resulted in six indictments, two convictions, and \$568,379 in restitution and fines. Details of the cases are described in the chapter, *OIG Activities*.

Fraud Involving False Tax Returns

Over the last 9½ years, OIG has received nearly 500 allegations that false tax returns were submitted in support of SBA business or disaster loan applications. These fraud referrals involved loan applications totaling approximately \$130 million that were submitted to more than 50 SBA offices. To date, 150 individuals have been indicted on criminal charges, 136 have been adjudicated guilty, 3 indictments were dismissed, and 11 others have not yet

Significant Activities and Management Challenges

gone to trial. Because of the implicit credibility of Federal tax returns, SBA has traditionally relied heavily on information they contain in making its credit-related decisions, so falsification of “copies” of returns can have a significant negative impact on SBA’s consideration of those applications.

Significant results of investigations of this type of fraud include seven indictments and one conviction during the last 6 months. Summaries of OIG investigations related to the use of altered or fictitious tax returns can be found in the next section, OIG Activities.

Fraud Involving Borrowers Who Do Not Disclose Criminal Histories

Borrowers who do not disclose criminal histories have higher rates of default on SBA loans than those who either disclose their records or have no criminal histories. To address this problem and reduce the loss to the Government, SBA has requested legislative language strengthening the Agency’s authority to require the information needed to run background checks on all loan applicants.

During this period OIG investigations for criminal-record fraud in connection with SBA’s programs yielded the following significant results: six indictments, six convictions, and \$357,220 in restitution and fines. Details of these accomplishments can be found in the chapter, OIG Activities.

New Agency Initiatives

GPRA Audits

GPRA Audits Underway:

- Section 7(a) Loans
- Disaster Assistance
- SBIC
- Surety Bond Guarantee

OIG is focusing considerable attention on the Agency’s implementation of the Government Performance and Results Act (GPRA). The Auditing Division has four audits in progress covering GPRA implementation for the Section 7(a) Loan, Surety Bond Guarantee, Disaster Loan, and Small Business Investment Company (SBIC) Programs. An additional audit covering the Section 8(a) Program is scheduled for later this fiscal year. The objectives of the audits are to determine whether the GPRA goals for the programs reflect the statutory missions, are consistent with the strategic plan, include efficiency and effectiveness measures, have measurable performance measures, and are supported by reliable data. To fulfill these objectives, we sought answers to three basic questions. Do the program’s goals and performance indicators align with its mission? Do the performance indicators show the results of the program in terms of efficiency and effectiveness? How reliable is the supporting data? The results of the four audits in process will be included in the next Semiannual Report.

Significant Activities and Management Challenges

Entrepreneurial Development Inspection

OIG is performing an inspection to assess how well SBA's various entrepreneurial development initiatives are being coordinated in the field. The inspection is focused on possible duplication, overlap, or undercoverage of SBA services designed to assist small businesses in planning, funding, startup, technical development, and management. We expect to issue the report in FY 2000.

Small Disadvantaged Business Certification Program audit in progress.

Small Disadvantaged Business Audit

OIG is nearing completion of its audit of Small Disadvantaged Business (SDB) Certification program obligations and expenditures. The objective of the audit was to determine whether SBA used the funds received under the program for their intended purpose. The SDB program provides Federal procurement benefits to small disadvantaged businesses bidding on Federal contracts by giving them up to a 10 percent price preference on their bids. SBA was approved to certify all SDBs bidding for Federal contracts beginning in FY 1998 and receives reimbursement for the cost of certification from the top 20 agencies utilizing SDBs. The results of the audit will be included in the next Semiannual Report.

OIG Profile

Organization

SBA OIG was established in 1978 under the IG Act. OIG provides nationwide coverage of SBA's programs and activities. In addition to the Immediate Office, OIG's five divisions work together to perform the missions mandated by the Congress.

- **Auditing Division**, which provides comprehensive audit coverage of SBA's operations through program performance reviews, internal controls assessments, and financial and mandated audits to promote the economical, efficient, and effective operation of SBA programs. Audits give SBA managers an objective and systematic assessment of how well their offices are carrying out their programs and operations. Financial audits examine the presentation of financial information, internal controls, and adherence to financial requirements. Performance audits assess operations in terms of economical use of resources.
- **Investigations Division**, an investigative unit that manages a nationwide program to prevent and detect illegal and/or improper activities involving SBA programs, operations, and personnel. The criminal-investigative staff carries out a full range of traditional law enforcement functions, including (in the last 2 years) executing 23 arrest warrants, 9 search warrants, and 13 electronic monitorings. The security operations staff ensures that all Agency employees have the appropriate background investigations and security clearances for their duties. The name check program provides SBA officials with character-eligibility information on loan applicants and other potential program participants.
- **Inspection and Evaluation Division**, which conducts assessments of the effectiveness of SBA programs and activities, analyses of critical program issues, best practices studies, and research on matters concerning SBA performance.
- **Counsel Division**, an in-house legal staff that provides legal advice and assistance to all OIG components, represents OIG in litigation arising out of or affecting OIG operations, processes requests for information, and manages OIG legislative/regulatory review functions.
- **Management and Policy Division**, which provides planning, information systems, budgetary, administrative, personnel, and communications services.

Office Locations

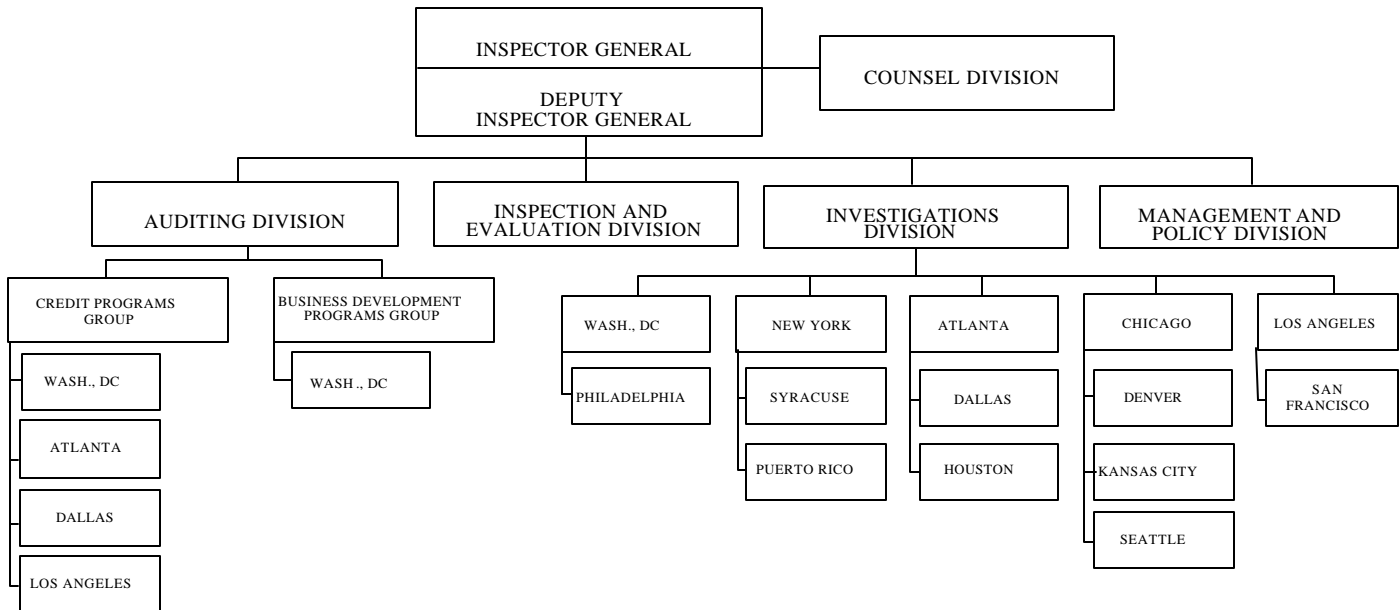
OIG is headquartered in Washington, D.C. Field audit and investigation offices are maintained in Atlanta, Chicago, Dallas, Denver, Houston, Kansas City, Los Angeles, Philadelphia, New York, San Francisco, Seattle, and Syracuse.

Staffing and Budget

As of March 31, 2000, our on-board strength was 110. The OIG FY 2000 appropriation was \$11.5 million (less a .8274% rescission of \$95,000).

OIG Profile

OFFICE OF INSPECTOR GENERAL SMALL BUSINESS ADMINISTRATION



OIG Activities

This chapter includes details of audits and investigations summarized in the Significant Activities and Management Challenges chapter, as well as other significant OIG activities that do not fall under the strategic plan's five focus points. The material in this chapter is organized by major SBA program area.

Business Loan Program

Under the Section 7 (a) Loan Program, SBA guarantees loans to small businesses that are unable to obtain private financing.

Early Default Audits

A synopsis of the results of OIG's ongoing program to audit SBA-guaranteed loans charged off or transferred to liquidation within 36 months of origination (early default) follows. The four audits described below found that the loans were not originated in accordance with SBA rules and regulations or prudent lending practices. Other lender deficiencies were also identified.

Early defaulted loan audits identify the need for adherence to SBA requirements.

- The lender neither evaluated nor notified SBA of a known discrepancy between the tax returns submitted by the borrower in support of his \$965,000 loan application and a verification response from the Internal Revenue Service (IRS). The IRS verification showed that the tax returns submitted with the application had not been filed. SBA inappropriately paid \$485,051 to honor the guarantee of a loan that should not have been made. The Atlanta District Office concurred with OIG's findings and recommendation to issue a demand letter to the lender to repay SBA the loan loss.
- The lender neither verified the borrower's equity injection or personal financial information nor validated the financial information on a \$300,000 loan that defaulted in June 1998. The lender could not provide documentation that loan proceeds were used for the purposes designated by the loan agreement. When these facts were brought to the lender's attention, the lender relieved SBA of its obligation to honor a \$204,866 guarantee on this loan.
- The lender approved a \$350,000 loan to a borrower that lacked the ability to repay the loan, was not creditworthy at the time of loan origination, and lacked the financial assets to survive. The loan proceeds were used for the payment of delinquent taxes, which is an ineligible purpose. Consequently, SBA inappropriately paid the lender \$266,311 to purchase the loan guarantee. The San Francisco District Office agreed with the audit findings and the recommendation to issue a letter to the lender requesting a guarantee adjustment.

OIG Activities

- The lender did not adequately secure a \$628,000 loan although the guarantor had sufficient assets for full collateralization. The lender also reimbursed the borrower for unallowable expenses. The audit also reported that the borrower made an inaccurate statement on the loan application and submitted invoices for personal expenses to support the loan disbursements. As a result, SBA lost \$479,890 when the defaulted loan was purchased. The Santa Ana District Office has issued a demand letter to the lender to repay SBA the loan loss.

The following cases illustrate OIG investigations of fraud involving loan agents.

- Two more defendants have been sentenced in a case in which all 18 individuals criminally charged pled guilty, including the owner of the Inglewood, California, loan packaging firm, his colleague, and a tax preparer. In this period, two brothers who had obtained \$1 million in SBA-guaranteed loans for their car washes in Hemet and Palmdale, California, were sentenced to 2 months in a halfway house, 5 years of supervised probation, and restitution to SBA of \$259,071 and \$164,206, respectively. Each man previously pled guilty to making false statements to a federally insured lender for submitting altered individual income tax returns in support of their separate applications. With 15 defendants sentenced so far, court-ordered restitution and fines in this case total more than \$2.6 million. OIG began the investigation based on allegations from an anonymous complainant.
- A real estate/business/SBA-loan broker from Upland, California, and five others were charged with making false statements to a federally insured financial institution by submitting altered copies of tax returns in support of applications for SBA-guaranteed loans from a now-defunct southern California bank.

OIG began its investigation of this case based on a referral from SBA's Los Angeles District Office.

The broker was charged in a criminal information with two counts in connection with loans of \$700,000 and \$550,000.

A former accountant from Alta Loma, California, and another businessman were indicted on nine counts. The accountant was charged with preparing altered tax returns submitted with four loan applications. The businessman, who owned a mini-mart in California City, California, was charged in connection with his \$550,000 loan and with aiding the accountant's alleged crimes.

The owners of gasoline stations in La Quinta and Hemet, California, respectively, each were charged with and pled guilty to one count, the former for a \$700,000 loan and the latter for a \$320,000 loan. The owner of a gasoline station in Hesperia, California, was charged

OIG Activities

in a criminal information in connection with his application for a \$450,000 loan.

These four loan applications totaled \$2,722,500. OIG began its investigation based on a referral from SBA's Los Angeles District Office.

- The former owner of a furniture store in Garden Grove, California, was sentenced to 2 years in prison, 5 years of supervised release, and \$145,000 in restitution to SBA. A trial jury previously found her guilty of five counts of making false statements to influence a federally insured financial institution. She was the last of the five defendants (a Garden Grove loan packager and four of his clients) to be sentenced as a result of an investigation that found that the store owner obtained a \$250,000 SBA-guaranteed loan for her business by providing "copies" of income tax returns altered to substantially overstate her income. Then she diverted loan proceeds for the purchase of a personal residence and subsequently defaulted on the SBA loan. Of 32 packaged loans examined, 20 had defaulted by the time the packager was sentenced, resulting in more than \$3.2 million in losses to SBA and the participating lender banks. OIG began its investigation based on a referral from SBA's Santa Ana District Office.

The following cases illustrate OIG's work on fraud involving false tax Returns.

- Three persons associated with an automotive repair business in Irving, Texas, were indicted on 1 count of conspiracy and 11 counts of making material false statements to induce SBA and a nonbank participating lender to fund a \$156,000 SBA-guaranteed loan. The firm's proprietor and his daughter, who is an employee, allegedly submitted 3 years of falsified "copies" of tax returns and forged IRS tax return verifications. The part owner of a Grand Prairie, Texas, business that sells automotive repair equipment allegedly provided his coconspirators with bogus sales invoices and other bogus documentation of their required capital injection and equipment purchases.
- The president of a St. Louis, Missouri, realty firm was indicted on one count of money laundering and one count of bank fraud. He allegedly made false statements to both SBA and a participating lender bank to obtain a \$70,000 LowDoc business loan, submitting documents, including his SBA loan application and fictitious tax returns, that contained a false Social Security number (SSN). In addition, a former Missouri accountant was indicted on one count of bank fraud in connection with the loan to the realty company, his former employer. The investigation revealed that the accountant generated false

OIG Activities

documents and submitted them to both SBA and the bank to obtain the \$70,000 loan. These documents included the SBA loan application and fictitious tax returns that contained a false SSN. SBA/OIG initiated its investigation based on a referral from the Department of Housing and Urban Development (HUD) OIG.

- The president of a Glen Burnie, Maryland, realty firm was indicted on one count of making a false statement to SBA, two counts of making material false statements, and two counts of mail fraud in connection with a \$260,000 SBA-guaranteed loan. OIG's investigation established that, on SBA loan-related documents, including "copies" of income tax returns, he listed the name, date of birth, and SSN of his son in place of his own. He used the fraudulent documents to obtain the loan from a nonbank participating lender in order to buy two parcels of commercial real estate. The indictment also charges that the father failed to disclose that he owed approximately \$3 million to IRS and others at the time he applied for the loan. OIG initiated the investigation based on a referral from SBA's Office of General Counsel.
- The owner of a pork packing plant in Herscher, Illinois, was charged with and pled guilty to one count of making false statements to a federally insured financial institution, in connection with a \$490,000 SBA-guaranteed loan. The investigation revealed that he submitted altered tax returns to the participating lender bank and SBA to obtain the loan, failed to make the promised \$150,000 capital injection, and sold a majority of the farmland pledged as collateral. OIG initiated this investigation based on a referral from the bank through SBA's Illinois District Office.

Concealment of
criminal history –
business loan
programs.

Summaries of some criminal-history fraud investigations involving SBA loan programs are listed below.

- The former owner of a Seattle, Washington, chiropractic clinic pled guilty to one count of bank fraud. He was sentenced to 30 months in prison and 5 years of supervised release. He was also ordered to pay restitution of \$21,098 to the participating lender bank and \$54,795 to SBA. In 1994, the businessman had received an \$80,000 SBA-guaranteed loan to purchase chiropractic equipment for his clinic. The investigation found that he made false statements to obtain the loan, including representing that he had no criminal record when he was actually a fugitive from a Federal arrest warrant. On his applications for the SBA loan and for federally guaranteed student loans, He falsely claimed he was a U.S. citizen, and he later converted loan Proceeds to his personal use. OIG joined the Federal Bureau of Investigation's ongoing investigation.

OIG Activities

- The president and secretary of a residential real estate company in Santa Fe Springs, California, were indicted on five counts of making material false statements. The firm had obtained a \$550,000 SBA-guaranteed loan allegedly by using a false SSN, fraudulent checks, submitting false financial statements, and omitting a criminal record from the SBA application. The businessmen also were charged with a scheme involving \$4.5 million in fraudulent Federal Housing Administration-insured loans and with conspiracy, wire fraud, money laundering, and aiding and abetting. OIG joined the investigation at the request of the U.S. Attorney's Office.
- The president of a Kansas City, Missouri, child care business pled guilty to one count of making false statements to SBA in connection with a \$387,000 guaranteed loan she received in 1998 from a nonbank participating lender. According to her indictment, she failed to disclose on her application and related documents that she owed delinquent taxes and had a prior arrest for passing a bad check. The businesswoman also was charged with making numerous false statements to document her required \$111,000 cash injection. In her plea agreement she admitted submitting false documents to the lender at closing, requesting \$12,690 to partially fund the purchase of 50 new computers. SBA/OIG initiated this investigation based on information received from the Department of Treasury Inspector General for Tax Administration.

Cases involving misuse of loan funds, fraudulent pledging of collateral, or both.

Two basic areas of lenders' vulnerability to borrowers are the misuse of loan proceeds and the absence of the collateral that was pledged to the lender. Misuse of loan proceeds occurs when the borrower expends funds not in accordance with the terms of the loan; often the authorized uses are consequently going unmet. The borrower fraudulently pledges collateral, something of value pledged to the lender in case the loan is not repaid, when it doesn't exist or has a lesser value than stated. The following cases involve misuse of loan funds, fraudulent pledging of collateral, or both.

- A businessman who had owned a now-defunct St. Croix, Virgin Islands, construction company pled guilty to one count of conspiracy to commit money laundering and agreed to make full restitution to SBA and the participating lender bank. His 1998 indictment charged that, in applying for an SBA-guaranteed loan in 1992, he had submitted a fraudulent business proposal and other documents listing \$420,000 as the value of machinery to be purchased with the loan funds, when the actual cost of the machinery was only \$120,000. Prior to the first loan disbursement, the owner opened a checking account in the name of the proposed machinery supplier. Through this account, he was able to fraudulently receive the disbursements that were intended for the vendor. After the company relocated to Fort Lauderdale, Florida, the majority of the loan

OIG Activities

funds were spent on expenses not authorized by either the bank or SBA. The company failed in 1995, causing a loss to SBA and the bank of more than \$400,000. This investigation originated from a referral from SBA's Puerto Rico and Virgin Islands District Office.

- An upstate New York dentist pled guilty to a felony and was sentenced to 4 months monitored home confinement and \$147,222 in restitution. He had obtained a \$150,000 SBA-guaranteed loan although he had leased, not purchased, equipment that he pledged as collateral on the loan. He instead used loan proceeds to buy personal items.

The Section 504 Loan Program provides long-term, fixed rate financing through Certified Development Companies to small businesses to acquire real estate and equipment for expansion of a business. 40 percent of a Section 504 loan is secured by an SBA-guaranteed debenture.

The following case involves alleged forgery and other fraud in connection with repayment of a loan from a Section 504 lender.

- A Montgomery County, Ohio, grand jury indicted a local real estate salesman and businessman. One count of the 40-count indictment charged him with aggravated theft by deception in connection with a \$439,000 SBA-guaranteed loan. The man allegedly deposited funds associated with a \$5 million bad check to an escrow account at a title company. He allegedly induced the title company to issue a \$427,074 check from the escrow account, in the name of a Section 504 certified development company, based on his representations that these funds were designated for paying down the outstanding balance on the SBA loan. Allegedly, he forged an endorsement on the check and deposited the money to his business account instead. The prosecutor's request that OIG join the investigation came via SBA's Columbus District Office.

Disaster Loan Program

The following case involves alleged SBA-related identity theft.

- A complaint filed by the Los Angeles County, California, District Attorney's Office charged a man with eight felony counts: three of perjury, three of filing false information with the California Department of Motor Vehicles, one of identity theft, and one of grand theft against SBA. The investigation documented that the man obtained a \$137,300 disaster home loan following the Northridge earthquake using the name and SSN of his brother. The defendant also quitclaimed his disaster-damaged Los Angeles property to his brother's name so the ownership and title vesting of the property would match his forged identity. Lastly, he forged pay stubs and W2 forms with his brother's name, SSN, and income to match the IRS verifications used by SBA to confirm applicants' income. The investigation showed that the man had

SBA's Disaster Loan Program helps homeowners, renters, businesses of all sizes, and nonprofit organizations to rebuild after a physical disaster.

OIG Activities

California driver's licenses (bearing his photograph) concurrently in his own name/date of birth and in his brother's name/date of birth. OIG initiated the investigation based on a referral from SBA's Santa Ana Loan Servicing and Liquidation Office.

The following case resulted from a criminal-record fraud investigation involving the SBA Disaster Loan Program.

Construction president sentenced to 46 months incarceration and \$128,593 in restitution to SBA.

- The president of a Silvis, Illinois, construction company was sentenced to 46 months incarceration, 3 years supervised release, and \$128,593 restitution to SBA. He was previously convicted on four counts of making material false statements to SBA in connection with a \$151,000 physical-damage disaster loan made to an Orion, Illinois, campground and golf course after the Midwest flood of 1993. The businessman, who at the time of the disaster, was an officer of the campground and had a controlling interest in it. However, he did not include his name on the loan application as a manager or officer of the campground to avoid disclosing that he had been convicted of and imprisoned for credit card fraud and was still on supervised release, which made the campground potentially ineligible for SBA disaster assistance. OIG's investigation determined that the man falsified a construction agreement so that the construction company would realize \$70,000 more in profit. Also, he falsely represented that the loan proceeds would be used solely to rehabilitate the campground. Instead, he used disaster loan proceeds improperly to fund preexisting debt, his wife's real property management firm expenses, a trip to Myrtle Beach, South Carolina, and gambling debts. OIG initiated this investigation based on a referral from SBA's Disaster Assistance Area 2 Office.

The following cases involve misuse of loan funds, fraudulent pledging of collateral, or both in connection with SBA's Disaster Loan Program.

- The owner of a Denver, Colorado, telemarketing company was sentenced to 2 ½ years in prison, 2 years on supervised release, and \$1.5 million in restitution. He was previously convicted on two counts of making false statements to SBA. The businessman obtained a \$1.5 million SBA disaster loan after his company sustained damage from the Northridge, California, earthquake. He relocated his business to Denver and falsely reported (submitting invoices and other documents to SBA as "proof") that he used \$1.2 million of the loan proceeds to purchase new equipment from a supplier. OIG's investigation found that he controlled the supplier and that most of the equipment listed on its invoices was salvaged from the earthquake-damaged building in California or was already owned by the man or his other companies. OIG initiated the investigation based on an anonymous telephone call.

OIG Activities

Small Business Investment Companies

The following case involves improper loans made by an SBIC.

- Four men who were officials of an incorporated Rockland County, New York, community which has been the recipient of millions of dollars in benefits from Federal programs including SBA's specialized small business investment company (SSBIC) program, were sentenced. The first was sentenced to 78 months incarceration, 3 years probation, and \$11,179,513 in restitution to defrauded Government entities, including \$100,000 to SBA. The second man was sentenced to 70 months incarceration, 3 years probation, and \$10,118,182 in restitution. The third man was sentenced to 57 months incarceration, 2 years probation, and \$11,089,721 in restitution. The fourth man was sentenced to 30 months incarceration, 2 years probation, and \$522,977 in restitution. The men had previously been convicted on 21 counts of conspiracy, embezzlement of Federal program funds, making material false statements, mail fraud, wire fraud, mortgage fraud, and money laundering. They had been indicted in 1997 along with the fourth man's father, who was one of the community's founders, and the son of its mayor. Those two defendants fled the United States after being indicted. The investigation disclosed that the defendants had participated in a number of fraudulent schemes to obtain millions of dollars through SBA's SSBIC program and other Federal and state grant, loan, and subsidy programs. The fourth man's father, a board member of the SSBIC, allegedly misappropriated SBA funds through the SSBIC, to which SBA had provided \$1.2 million of leverage funding. (SBA's liquidation of the SSBIC had already resulted in repayment of \$1.1 million of that total.) In violation of Federal regulations, he participated in extending loans to small businesses affiliated with the SSBIC's officers and directors, and concealed these improper loans by submitting fraudulent documents to SBA. He also loaned SBA funds to enterprises that were not independently controlled by private business owners but affiliated with a religious school in the village, a nonprofit entity ineligible to receive SBA funds. The SSBIC also made loans to small businesses that, in turn, improperly paid a portion of the loan proceeds to the religious school or related entities. The other defendants conspired to facilitate these illegal transactions. The U.S. Attorney's Office asked OIG to join its ongoing investigation.

Small Business Investment Companies (SBIC), are independently owned and managed, profit-making investment companies licensed by SBA to finance small business through long-term loans and investments in their equity securities.

OIG Activities

Small and emerging contractors who cannot get surety bonds through regular commercial channels can apply for SBA bonding assistance under the Surety Bond Guarantee Program. SBA guarantees a portion of the losses sustained by a surety company.

Surety Bond Guarantees

The case below describes the results of a criminal-record fraud Investigation involving the SBA Surety Bond Guarantee Program.

- The president of an Austin, Texas, pipe-installation contractor was indicted on one count of making material false statements to fraudulently influence SBA to guarantee a \$510,000 surety bond. On the SBA application, he allegedly answered “No” to questions as to whether he had ever been arrested or convicted of a crime. The investigation documented that he had been charged with, arrested for, and/or convicted of at least nine criminal offenses. His company completed only a fraction of its bonded contract with a Department of Veterans Affairs hospital before defaulting. OIG initiated the investigation based on information forwarded by its Office of Security Operations concerning the results of a surety bond audit.

The Minority Enterprise Development Program promotes greater access to the free enterprise system for socially and economically disadvantaged individuals.

Minority Enterprise Development Program

The following articles describe the result of a criminal-record fraud Investigation involving the SBA Minority Enterprise Development Program.

- A defunct Philadelphia, Pennsylvania, construction company and its president and vice president were indicted on charges including 1 count of conspiracy to defraud the Government, 12 counts of false claims, 1 count of major fraud against the United States, and 3 counts of making a material false statement in connection with alleged schemes to defraud SBA and two other Federal agencies. Two false statement counts relate to the vice president denying in his SBA Section 8(a) application that he had a criminal history. The investigation disclosed that he had seven prior arrests and three convictions. One count of making a false statement relates to the president representing his assets at \$40,000 to SBA on the same day that he represented his assets at more than \$1.6 million to a bonding company. The Naval Criminal Investigative Service invited OIG to join the ongoing investigation. Following indictment of the two corporate officers, warrants for their arrests were issued; the businessmen thereafter surrendered to Federal authorities.

The following case involves alleged fraud in connection with bonds on Section 8(a) contracts.

The project manager of a construction company in Long Island City, New York, was arrested by OIG on one count of altering, forging, or

OIG Activities

counterfeiting a bond to defraud the Government. The underlying criminal complaint states that the company entered into a \$379,079 Section 8(a) contract with the Federal Bureau of Prisons (BOP). As a condition of the contract, the company was required to obtain payment and performance bonds to cover any cost resulting from its failure to perform adequately and/or pay its subcontractor. The project manager submitted a bond purportedly issued to the construction company by an insurance company. The investigation produced evidence that the insurance company never issued the bond and the signatures on it were forged. The construction company did not pay its subcontractor. The president of the company previously pled guilty to conspiracy for his role in the company's submission of fraudulent payment and performance bonds. He stated that the project manager was responsible for obtaining bonding and insurance for company contracts. OIG initiated the case based on a referral from BOP.

Entrepreneurial Development

Women's Business Ownership Program

Audit of a Women's Development Center identifies unallowable costs.

An audit of a Women's Business Development Center identified \$167,448 of claimed costs that were unallowable. The audit also found that the grantee used grant funds to purchase equipment and supplies and entered into consulting agreements with board members. In addition, the grant period had expired and there were unexpended Federal funds totaling \$60,007. Of the amount identified as unallowable, \$142,779 was attributed to lack of documentation to support the expenditures. The cooperative agreement required the grantee to maintain complete and accurate records, including supporting documentation. Furthermore, the grantee did not meet the cash match requirements. The audit recommended reimbursement for the unallowable cost. Since the project had ended, no recommendation was necessary to address the conflicts of interest. The Assistant Administrator for Administration agreed with the findings and recommendations.

Small Business Development Center Program

Audit of SBDC identifies unallowable costs and several procedural findings.

An audit of a Small Business Development Center (SBDC) identified \$31,892 of claimed costs that were unallowable under program guidelines. The costs included an improper travel reimbursement and unsupported in-kind contributions and payments to consultants. No repayment to SBA was necessary because the SBDC had provided more than the required 50 percent match of Federal funds. The audit report also noted that the SBDC: (1) Overstated training and counseling accomplishments; (2) did not perform client followup within the required time frame; (3) made various errors in reporting program income; and (4) did not maintain

OIG Activities

complete records for training activities, revenue deposits, and conference room rental agreements. The Idaho District Director agreed with all five findings identified in the audit and is currently taking corrective action.

Agency Management and Financial Activities

Management Letter identified nonmaterial weaknesses.

OIG issued the FY 1998 Management Letter to SBA outlining the two conditions identified during the audit of SBA's Fiscal Year 1998 financial statements but were not required to be included in the Auditor's Report as they were nonmaterial weaknesses. The first condition involved inappropriate transfer of SBDC funds between fiscal years. SBA did, upon questioning by the auditors, reverse the accounting transaction. The second condition identified was that SBA did not conduct periodic inventories of their capitalized equipment. SBA agreed with the findings and recommendations in the Management Letter.

The following cases involve criminal conduct by SBA employees.

SBA employee integrity cases.

- A former voucher examiner in the Denver, Colorado, Finance Center of SBA's Office of Chief Financial Officer (OCFO) was sentenced to 6 months of home detention, 5 years on probation, and \$21,284 in restitution to SBA. She previously pled guilty to one felony count of embezzlement. OIG's investigation determined that the voucher examiner fraudulently obtained more than \$21,000 in SBA funds by means of false electronic travel vouchers and false electronic vendor invoices. Her scheme involved entering false information via her work computer in order to have Government funds electronically deposited into her bank account. After being contacted by OIG, she resigned from her position at SBA. An internal review by OCFO of their procedures following OIG's investigation revealed that substantially more funds were embezzled than OCFO was initially aware of. OIG initiated this investigation based on a referral from OCFO's Denver Finance Center.
- A former economic development specialist in SBA's Sacramento District Office pled guilty to one count of knowingly possessing visual depictions of minors engaged in sexually explicit conduct and was immediately taken into custody by deputy U.S. marshals. The man had retired just after being indicted. OIG initiated the investigation after receiving complaints that he was accessing pornographic sites using the computer SBA had assigned him. OIG and FBI agents arrested the man at SBA's Sacramento District Office in FY 1999.

OIG Activities

Legislation reviewed.

OIG reviewed and commented on a revised version of H.R. 1827, the “Government Waste Corrections Act of 1999.” As it had in earlier comments, OIG recommended that the terminology “recovery audits” be changed to avoid confusion with the statutory audit function of Inspectors General (IGs) pursuant to the Inspector General Act. OIG suggested substituting terminology such as “recovery examinations,” “recovery reviews,” or “payment matching review” to distinguish between the differing roles and functions. OIG also advocated that language be added requiring department or agency officials or contractors performing recovery reviews to immediately report to the IG any indication of fraud or other criminal activity discovered during the course of reviews.

OIG reviewed and commented on two bills dealing with safeguarding Government information: H.R. 2413, the “Computer Security Enhancement Act of 1999” and S. 1993, the “Government Information Security Act of 1999.” Regarding H.R. 2413, which deals with the security of unclassified (but perhaps sensitive) information in Federal computer systems and would require a study of Public Key Infrastructures (PKI), OIG recommended that any study also consider whether there are more effective alternatives to PKI, such as biometric identification methods. Any study should also take into account that many Federal electronic transactions are likely to be routine matters that do not require the most sophisticated security. S. 1993 deals with Governmentwide information security controls and annual independent evaluations of agencies' information security practices. OIG commented that, while this bill should greatly improve overall Government efficiency and effectiveness, any legislation should recognize that future information may be stored on devices we cannot even envision today and should focus on the value of the information itself, regardless of what equipment stores the information. It is the information that must be protected, not necessarily the hardware. In contrast to H.R. 2413, S. 1993 provides for unified Governmentwide controls including national security systems. Lastly, OIG recommended that Congress determine if the imposition of Governmentwide controls also means that the entire Government must adopt the same technology and whether national security systems will be handled in the same manner as other systems.

After reviewing the draft of the Agency’s first Accountability Report that included its audited financial statements and program and financial information for FY 1999, OIG had several comments. OIG recommended that the Report discuss problems identified in OIG’s previously issued Top Ten Management Challenges, such as those related to guaranty purchase procedures, lender oversight, and performance by Small Business Lending Companies. Additionally, OIG recommended that the discussion of the development of internal control tools such as a Management Assessment Process be revised to report the results from using the tool. In the OIG’s

OIG Activities

view, a discussion of the results achieved from the use of the tool would be a more useful discussion in an accountability report than development of the tools used. Lastly, OIG recommended that the amount of the income realized from the sale of loan assets was not accurate as stated in the Report because it reflected the excess of a discounted present value, not the amount that would have been reflected if held by SBA to maturity. The CFO agreed with most of OIG's recommendations and revised the Report.

Office of Inspector General

Congressional briefing.

In December, OIG hosted a briefing for staff of our congressional oversight committees to review OIG's Strategic Plan for FY 2001-2006 and the FY 2001 Annual Performance Plan. The discussion also highlighted significant FY 1999 accomplishments and planned FY 2000 activities, including Agency GPRA reviews and lender oversight.

OIG Fraud Awareness Briefings

The strong commitment of SBA employees to reducing waste, fraud, and abuse in Agency programs and improving the Agency's management and control of its programs led to nearly 50 percent of all investigative referrals.

OIG conducted several briefings for SBA's employees, lenders, and other resource partners as part of its mission to educate its customers on identifying waste, fraud, and abuse. During this reporting period, SBA employee contributions to the OIG mission were significant. As the chart below illustrates, nearly 50 percent of the investigations initiated by OIG originated with referrals from within the Agency in the form of referrals either from program heads or other SBA employees. This cooperation indicates the strong commitment of SBA employees to reducing waste, fraud, and abuse in Agency programs and improving the Agency's management and control of its programs. However, we have recognized the shift in SBA's role from primarily reviewing and processing loans to increasingly providing oversight of lending practices; accordingly, we have changed our briefing strategy. Much of our past success resulted from referrals from conscientious SBA employees; our continued successes will depend more on lender referrals. The Investigations Division has now expanded our integrity-awareness briefing program to include participating lenders and other interested parties, as well as SBA employees. During this reporting period we conducted the following briefings.

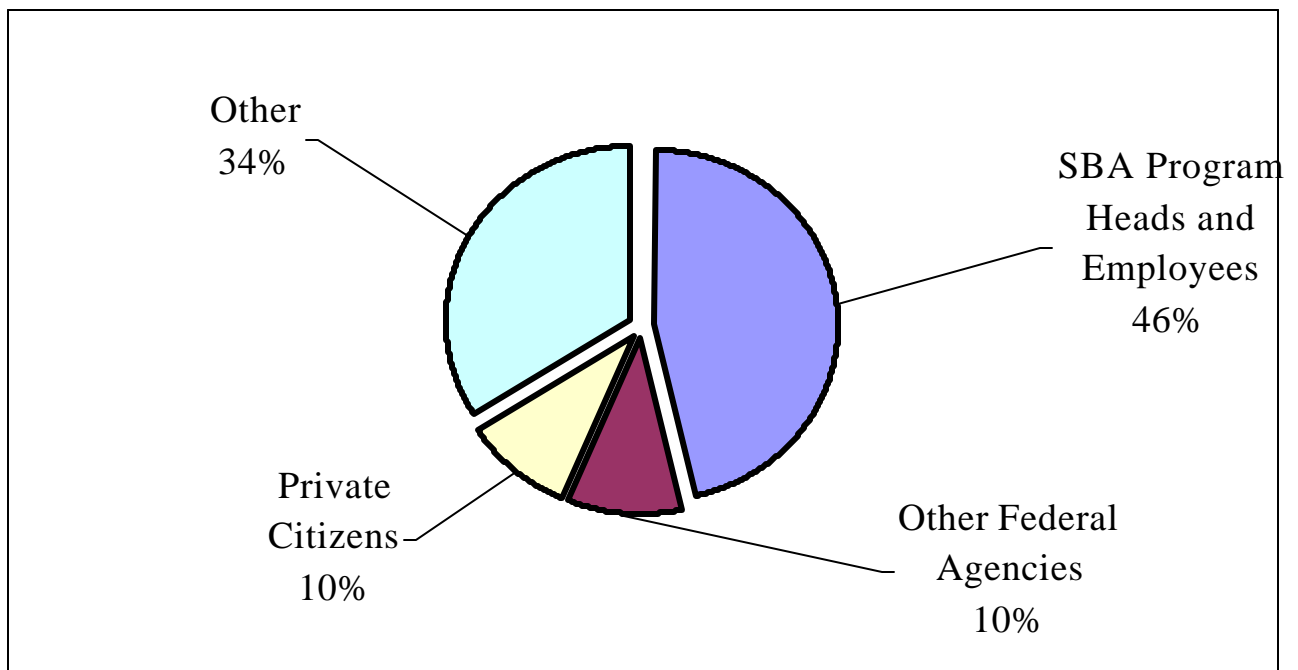
- OIG staff gave a presentation to 20 attendees at a meeting of PLP participants sponsored by SBA's Phoenix District Office.
- OIG staff gave four presentations, to a total of 108 attendees in Georgia and New Jersey, at disaster-fraud awareness meetings conducted jointly

OIG Activities

with special agents from the Federal Emergency Management Agency for State and local law enforcement officers.

- OIG staff presented integrity awareness briefings to approximately 180 Agency employees in three cities.

Sources of Referrals in OIG Investigations October 1, 1999, to March 31, 2000



Office of Security Operations

Pursuant to provisions of the Small Business Act and the Small Business Investment Act of 1958, SBA requires applicants for assistance to meet certain character standards before participating in Agency programs. OIG's Office of Security Operations (OSO) provides a vital service to help SBA ensure that Agency program participants meet the standards by processing name checks and, where appropriate, fingerprint checks on applicants. To make character eligibility determinations, OSO makes use of its on-line connection with the Federal Bureau of Investigation's Machine Readable

OIG Activities

Data system. When program applicants appear to be ineligible for assistance based on character, OSO makes referrals to program officials for adjudication. During this reporting period, OSO made referrals that resulted in officials of SBA's business loan program declining 43 applications and disaster loan program declining 10 applications, totaling \$17,189,061 and \$243,389, respectively, for character reasons. Those declinations made available that amount of credit for applicants in whom SBA can have confidence of repayment. In addition, officials of SBA's Section 8(a) program declined seven applications for certification. Almost \$160 million in loans have been declined during the last 10 years due to character ineligibility.

OSO also performs the background checks to meet the Federal regulations that require Agency employees to have security clearances appropriate for their positions. During this reporting period, OSO initiated 28 background investigations, and issued 15 security clearances. OSO also reviewed and adjudicated 53 background investigative reports in accordance with Executive Order 10450 and OMB Circular A-130, and coordinated with SBA's Office of Disaster Assistance to ensure the timely adjudication of the 82 derogatory background investigative reports forwarded for review and appropriate action.

Government Performance and Results Act

OIG's Strategic Plan for FY 2001-2006 and the FY 2001 Annual Performance Plan were finalized, and the planning team developed definitions and calculation methods for the performance measures. We briefed congressional staff on the Strategic Plan and continued to support GPRA implementation within the IG community and through interagency efforts coordinated by the National Academy of Public Administration.

OIG Activities

Direct Audit Time by Program Area October 1, 1999, to March 31, 2000

Program Area	Direct Time %	Number of Audits	
		Issued	In Progress
Business Loans	44.0%	9	12
Disaster Loans	10.0%	0	1
Surety Bond Guarantees	9.9%	0	3
Government Contracting*	8.3%	0	1
Minority Enterprise Development	13.3%	0	5
Entrepreneurial Development	1.9%	1	0
Agency Management and Financial	12.6%	5	3
Total	100.0%	15	25

Direct Investigation Time by Program Area October 1, 1999, to March 31, 2000

Program Area	Direct Time %	Number of Investigations**	
		Closed***	In Progress
Business Loans	57.4%	18	213
Disaster Loans	19.6%	12	148
SBIC	1.9%	1	10
Surety Bond Guarantees	2.1%	0	3
Government Contracting*	6.5%	2	5
Minority Enterprise Development	7.5%	1	30
Entrepreneurial Development	****	0	1
Agency Management and Financial	5.0%	4	13
Total	100.0%	38	423

* Includes Small Disadvantaged Business

**** Less than 1/2 percent

** Includes civil cases

*** Includes cases canceled

Statistical Highlights

FY 2000 Productivity Statistics First Six Months

Officewide Dollar Accomplishments	Totals
A. Potential Investigative Recoveries and Fines	\$3,020,813
B. Loans Not Made as Result of Investigations and Name Checks	\$17,432,450
C. Disallowed Costs Agreed to by Management.....	\$272,858
D. Recommendations that Funds Be Put to Better Use Agreed to by Management	<u>\$581,523</u>
Total	<u>\$21,307,644</u>

Auditing Division Activities

A. Audit Reports Issued.....	15
B. Audit Recommendations Issued.....	53
C. Dollar Value of Costs Questioned.....	\$485,051
D. Dollar Value of Recommendations that Funds Be Put to Better Use	\$1,926,622

Audit Followup Activities

A. Audit Recommendations Closed.....	51
B. Disallowed Costs Agreed to by Management.....	\$272,858
C. Dollar Value of Recommendations That Funds Be Put to Better Use Agreed to by Management.....	\$581,523
D. Unresolved Audit Recommendations	49

Inspection and Evaluation Division Activities

A. Reports Issued.....	0
------------------------	---

Legislation/Regulations/SOP/Other Review

A. Legislation Reviewed	19
B. Regulations Review	15
C. Standard Operating Procedures Reviewed.....	5
D. Other Issuances Reviewed**	139

**This includes policy notices, procedural notices, Administrator's action memoranda, and other communications, which frequently involve the implementation of new programs and policies.

Statistical Highlights

Investigations Division Activities

A. Total Cases.....	461
B. Closed Cases.....	38
C. Pending Cases.....	14
D. Open Cases.....	409
E. Subjects Under Investigation.....	1,332
F. Cases Referred to FBI or Other Agencies for Investigation.....	15

Summary of Indictments and Convictions

A. Indictments from OIG Cases.....	29
B. Convictions from OIG Cases.....	20

Summary of Recoveries and Management Avoidances

A. Potential Recoveries and Fines as a Result of OIG Investigations.....	\$3,020,813
B. Loans Not Approved as a Result of OIG Investigations.....	\$0
C. Loans Not Approved as a Result of the Name Check Program.....	<u>\$17,432,450</u>
Total:	<u>\$20, 453,263</u>

SBA Personnel Actions Taken as a Result of Investigations

A. Dismissals.....	0
B. Resignations/Retirements.....	0
C. Suspensions.....	1
D. Reprimands	0

Program Actions Taken as a Result of Investigations

A. Suspensions	0
B. Debarments.....	0
C. Removals from Program.....	0
D. Other Program Actions	0

Summary of OIG Fraud Line Operation

A. Total Fraud Line Calls/Letters.....	1,258
B. Total Calls/Letters Referred to Investigations Division for Evaluation.....	21
C. Total Calls/Letters Referred to Program Offices or Other Federal Investigative Agencies	53
D. Total Other Calls/Letters.....	1,184

Inspector General Act Statutory Reporting Requirements

The specific reporting requirements prescribed in the Inspector General Act of 1978, as amended by the Inspector General Act Amendments of 1988, are listed below.

Source		Pages
Section 4(a)(2)	Review of Legislation and Regulations	21-22, 26
Section 5(a)(1)	Significant Problems, Abuses, and Deficiencies	1-24
Section 5(a)(2)	Recommendations with Respect to Significant Problems, Abuses, And Deficiencies	1-24
Section 5(a)(3)	Prior Significant Recommendations Not Yet Implemented	34
Section 5(a)(4)	Matters Referred to Prosecutive Authorities	36-39
Section 5(a)(5) And 6(b)(2)	Summary of Instances Where Information Was Refused	None
Section 5(a)(6)	Listing of Audit Reports	30
Section 5(a)(7)	Summary of Significant Audits	2-24
Section 5(a)(8)	Audit Reports Containing Questioned Costs	31
Section 5(a)(9)	Audit Reports Recommending that Funds Be Put to Better Use	32
Section 5(a)(10)	Summary of Reports Where No Management Decision Was Made	34
Section 5(a)(11)	Significant Revised Management Decisions	None
Section 5(a)(12)	Significant Management Decisions with Which OIG Disagreed	None

TABLE OF APPENDICES

Appendix	Page
Appendix I – Audit Reports Issued.....	30
Appendix II	
Part A – Inspector General-Issued Audit Reports With Questioned Costs	31
Part B – Inspector General-Issued Audit Reports With Recommendations that Funds Be Put to Better Use	32
Part C – Inspector General-Issued Audit Reports With Non-Monetary Recommendations	33
Part D – Inspector General-Issued Audit Reports With Overdue Management Decision.....	34
Part E – Significant Audit Reports Without Final Action.....	34
Appendix III Six Month Arrested/Indicted/Convicted Summary.....	35
Appendix IV Six Month Sentencing Summary.....	38

APPENDIX I
Audit Reports Issued
October 1, 1999, to March 31, 2000

TITLE	NUMBER	ISSUE DATE	QUESTIONED COSTS	FUNDS FOR BETTER USE
Business Loans				
Section 7(a) Loan Processing Summary	0-03	1/11/00		\$0
Whistle Stop Car Wash & Xpress Lube	0-01	12/01/99		\$0
Lindsay Food Mart	0-04	1/20/00		\$0
Dixieland Events/Tamingo Farms	0-05	2/16/00	\$485,051	\$247,500
Jay-Bees, Inc	0-08	3/6/00		\$0
GLT Management Company	0-09	3/22/00		\$834,081
Roshni Foods	0-10	3/23/00		\$204,866
NADI Manufacturing, Inc.	0-11	3/28/00		\$266,311
Vincent R. Forshan Medical Corp.	0-12	3/28/00		\$621,364
Program sub-total	9 Reports		\$ 485,051	\$1,926,622
Agency Management & Financial Activities				
FY 1998 SBA Financial Statements – Management Letter	0-02	12/16/99		
FY 1999 SBA Financial Statements	0-06	2/29/00		
FY 1999 SBA Financial Statements – Management Letter	0-13	3/29/00		
Section 7(a) Service Fee Collections	0-14	3/30/00		
Systems Development Methodology	0-15	3/30/00		
Program sub-total	5 Reports			
Entrepreneurial Development				
Idaho Falls Regional SBDC	0-07	3/2/00		
Program sub-total	1 Report			
TOTALS (all programs)	Reports: 15		\$485,051	\$1,926,622

APPENDIX II - Part A
Audit Reports with Questioned Costs
October 1, 1999, to March 31, 2000

		REPORTS	RECs*	COSTS**	
				QUESTIONED	UNSUPPORTED
A.	For which no management decision had been made by September 30, 1999	6	10	\$1,792,265	\$781,461
B.	Which were issued during the period	1	1	\$485,051	
	Subtotals (A + B)	7	11	\$2,277,316	
C.	For which a management decision was made during the reporting period	5	8	\$677,074	
	(i) Disallowed costs		6	\$272,858	
	(ii) Costs not disallowed		3	\$404,216	
D.	For which no management decision had been made by March 31, 2000	2	3	\$1,600,242	\$781,461

* Recommendations.

** Questioned costs are those which are found to be improper, whereas unsupported costs may be proper but lack documentation.

APPENDIX II - Part B
Audit Reports with Recommendations that Funds Be Put to Better Use
October 1, 1999, to March 31, 2000

		REPORTS	RECS*	RECOMMENDED FUNDS FOR BETTER USE
A.	For which no management decision had been made by September 30, 1999	11	20	\$10,615,023**
B.	Which were issued during the period	4	4	\$1,926,622
	Subtotals (A + B)	15	24	\$12,541,645
C.	For which a management decision was made during the reporting period	11	20	\$10,615,023
	(i) Recommendations agreed to by SBA management	2	3	\$581,523
	(ii) Recommendations not agreed to by SBA management	9	17	\$10,135,045
D.	For which no management decision had been made by March 31, 2000	4	4	\$1,926,622***

* Recommendations.

** There is one more recommendation in opening balance than in the 9/99 SAR closing balance because Rec 1E of the report 87F021018 Kansas City Section 7(a) was reopened after the last SAR was published.

*** In Report 9-25, OIG recommended a note receivable be established for \$419,971; in the management decision, SBA established a note receivable for \$521,516.

APPENDIX II - Part C
Audits Reports with Non-Monetary Recommendations
October 1, 1999, to March 31, 2000

		REPORTS	RECOMMENDATIONS
A.	For which no management decision had been made by September 30, 1999	12*	17*
B.	Which were issued during the period	15	48
	Subtotals (A + B)	27	65
C.	For which a management decision was made (for at least one recommendation in the report) during the reporting period	14	23
D.	For which no management decision (for at least one recommendation in the report) had been made by March 31, 2000	10**	42

* Beginning balance corrected to reflect prior period adjustment.

** The recommendations resolved did not address all the recommendations within the reports where they appeared.

APPENDIX II – Part D
Issued Audit Reports with Overdue Management Decisions
March 31, 2000

TITLE	NUMBER	ISSUED	STATUS
Business Loan Guarantee Purchases	7-5-H-011-026	9/20/99	Under review by the Office of General Counsel

APPENDIX II - Part E
Significant Audit Reports Described in Prior Semiannual Reports
Without Final Action as of March 31, 2000

Report Number	Title	Date Issued	Date of Management Decision	Final Action Target
5-3-004-006	SBA Loan Servicing and Debt Collection Activities	3/31/95	4/30/95	9/30/98
7-7-H-001-011	Grant Closeout Procedures	3/26/97	10/20/97	10/20/98
7-6-H-006-015	FY 1996 Financial Statements	4/29/97	9/30/97	4/30/99
7-7-S-918-018	Users Technology Associates, Inc.	6/06/97	3/26/98	6/5/98
7-5-H-011-026	Business Loan Guarantee Purchases	9/30/97	Some recommendations remain open.	3/30/00
8-8-H-006-025	GSA Kansas City Sole Source 8a IDIQ Contracts	9/29/98	7/23/98	12/31/98
8-7-H-002-017	NOAA Computer Contracts	6/18/98	3/1/99	12/31/99
9-08	Giving of Self Partnership	3/24/99	9/15/99	12/1/99
9-11	Non-Tax Delinquent Debt	7/28/99	8/13/99	12/30/99
9-14	Bank of Castile	7/29/99	9/30/99	12/1/99
9-15	Disaster Home Loan Servicing Center	8/3/99	9/16/99	12/31/99
9-19	SBA's Information System Controls	9/2/99	9/30/99	1/30/00
9-20	Bankers Insurance Co. SBA Guaranteed Bonds with Georgia Coastal Construction Group	9/10/99	10/26/99	10/22/99
9-23	Survey of Electronic Records Management	9/15/99	11/30/99	11/30/00

APPENDIX III
Six Month Arrested/Indicted/Convicted Summary

State	Program	Alleged Violation(s) Prosecuted	Arrested/ Indicted/ Convicted/	Investigated Jointly With. . .
CA	BL*	Loan broker packaged altered tax returns in applications for \$1,250,000 in loans	Charged in information	FBI
CA	BL*	Gas station owner submitted altered tax returns in application for \$700,000 loan	Charged and pled guilty	FBI
CA	BL*	Gas station owner submitted altered tax returns in application for \$320,000 loan	Charged and pled guilty	FBI
CA	BL*	Gas station owner submitted altered tax returns in application for \$450,000 loan	Charged in information	FBI
CA	BL	In application for \$161,500 loan, liquor store owner listed real estate properties he had transferred to brother	Charged and pled guilty	None
CA	DL	In applying for \$67,700 in SBA disaster loans, businessman failed to disclose he had filed for bankruptcy under different name and SSN; also failed to inform SBA he was on criminal probation	Arrested and found guilty	ATF, SSA/OIG
CA	IA*	Using computer SBA had assigned him, SBA employee repeatedly accessed Internet pornography sites, including images of children involved in various sexual acts	Pled guilty	FBI
CA	DL*	Man obtained \$137,300 disaster home loan following Northridge earthquake using name and SSN of his brother	Charged by complaint, arrested	State law enforcement agency
CA	BL*	Accountant prepared altered tax returns submitted in applications for \$2,020,000 in loans	Indicted	FBI
CA	BL*	Mini-mart owner submitted altered tax returns in application for \$550,000 loan and abetted accountant	Indicted	FBI
CA	BL*	Real-estate executive obtained \$550,000 SBA-guaranteed loan by using false SSN, fraudulent checks, and false financial statements in, and by omitting criminal record from, SBA application	Indicted	HUD/OIG, FBI, IRS
IL	BL*	Meatpacking executive submitted altered tax returns to obtain \$490,000 loan, failed to make promised \$150,000 capital injection, sold majority of farmland pledged as collateral	Charged and pled guilty	FBI
MD	BL*	On documents to obtain \$260,000 loan, realty firm owner listed name/date of birth/SSN of his son in place of his own; also failed to disclose he owed approximately \$3 million to IRS and others	Indicted	None
.MO	BL*	To obtain \$70,000 loan, accountant generated documents, including his cousin's SBA loan application and fictitious tax returns, that contained false SSN	Indicted	HUD/OIG, SSA/OIG, IRS, FBI

State	Program	Alleged Violation(s) Prosecuted	Arrested/ Indicted/ Convicted/	Investigated Jointly With...
MO	BL*	To obtain \$387,000 loan, child care executive failed to disclose that she owed delinquent taxes and had prior arrest; also falsely documented her required \$111,000 cash injection; also submitted false documents as to use of \$12,690 of loan funds	Pled guilty	TIGTA
MT	BL	To obtain \$54,000 loan, restaurateur represented on his SBA application that he had no criminal history; in fact, he had been arrested more than 20 times	Pled guilty	FBI
NY	BL	Bridal shop owner used name and SSN of another person to obtain \$100,000 SBA-guaranteed loan	Arrested (by SSA/OIG)	SSA/OIG
NY	CC*	Project manager of construction company forged bond to defraud Government in connection with \$379,079 Section 8(a) contract	Arrested	FBI
OH	BL*	Real estate salesman forged endorsement on \$427,074 check he had represented was going to repay SBA-guaranteed loan; deposited funds to his business account instead	Indicted	County prosecutor's office
PA	CC*	Construction executive conspired to improperly obtain 8(a) contracts; also denied in his SBA 8(a) application that he had criminal history; in fact, he had seven prior arrests and three convictions	Indicted, surrendered	USDA/OIG, DOL/OIG, Navy, Army, DCIS
PA	CC*	Construction executive conspired to improperly obtain 8(a) contracts; also represented his assets at \$40,000 to SBA on same day that he represented his assets at over \$1.6 million to bonding company	Indicted, surrendered	USDA/OIG, DOL/OIG, Navy, Army, DCIS
PA	CC*	Construction corporation conspired to improperly obtain 8(a) contracts	Indicted	USDA/OIG, DOL/OIG, Navy, Army, DCIS
TX	SB*	To obtain \$510,000 SBA-guaranteed surety bond, pipe-installation contractor represented on his application that he had no criminal history; in fact, he had been charged/arrested/convicted of at least nine criminal offenses	Indicted	None
TX	BL*	To obtain \$156,000 loan, auto-repair employee submitted altered tax returns and falsified IRS verifications and falsified invoices	Indicted	TIGTA
TX	BL*	Supplier falsified invoices in connection with \$156,000 loan	Indicted	TIGTA
VI	DL	Woman applied for \$34,000 disaster home loan jointly in names of her and her mother, who had died 9 months before	Charged in information	SSA/OIG
VI	BL*	To obtain \$432,000 loan, construction executive submitted documents listing \$420,000 as value of machinery to be purchased with loan funds, when actual cost of machinery was only \$120,000	Pled guilty	FBI

APPENDIX IV
Six Month Sentencing Summary

State	Program	Alleged Violation(s) Prosecuted	Confinement Time and Dollar Results (Criminal Restitution/Fines/Etc.)	Investigated Jointly With. . .
CA	BL*	Car wash owner submitted altered tax returns in application for \$1 million loan	2 months incarceration, \$259,121	FBI
CA	BL*	Car wash owner submitted altered tax returns in application for \$1 million loan	2 months incarceration, \$164,256	FBI
CA	BL*	Furniture store owner submitted altered tax returns in application for \$250,000 loan and diverted loan proceeds to purchase personal residence	24 months incarceration, \$145,000	FBI
CO	DL*	Telemarketing executive submitted false documents as "proof" of using \$1.2 million of proceeds of \$1.5 million physical-damage loan to purchase new equipment	30 months incarceration, \$1,500,000	None
CO	IA*	SBA voucher examiner embezzled more than \$21,000 in SBA travel and purchasing funds via electronic invoices	6 months at home, \$21,284	None
FL	BL	Credit-repair executive misrepresented on SBA Settlement Sheets that she intended to use disbursements from \$80,000 loan to purchase fixed assets; in fact, she falsely negotiated joint-payee loan checks when she purchased equipment from third parties, and then returned equipment for refunds	Charged and pled guilty, 4 months incarceration (+ 4 months at home), \$66,726	None
FL	DL	Jewelry store owner submitted altered estimates as "receipts" documenting use of \$20,400 of her \$70,400 physical-damage loan	Pled guilty, \$20,400	FBI, IRS
IA	BL	Restaurateur made numerous false statements to SBA regarding his use of proceeds of \$50,000 loan, which were intended to pay for equipment, remodeling expenses, and purchase price of his restaurant	4 months at home, \$48,287	None
ID	BL	To obtain disbursements on \$90,000 SBA-guaranteed loan, direct mail advertiser created false invoices to document purchase of equipment for \$28,872	Charged and pled guilty, 6 months at home, \$19,391	FBI

State	Program	Alleged Violation(s) Prosecuted	Confinement Time and Dollar Results (Criminal Restitution/Fines/Etc.)	Investigated Jointly With. . .
IL	DL*	Construction executive concealed that he was controlling officer of applicant for \$151,000 loan, to avoid disclosure that he had been imprisoned for credit card fraud and was still on supervised release	46 months incarceration, \$128,593	None
NY	IC*	Village official conspired to misappropriate SBA funds through specialized SBIC, to which SBA had provided \$1.2 million of leverage funding, by making and concealing of improper loans	78 months incarceration, \$100,000	ED/OIG, HUD/OIG, IRS
NY	IC*	Village official conspired to misappropriate SBA funds through specialized SBIC, to which SBA had provided \$1.2 million of leverage funding, by making and concealing of improper loans	70 months incarceration	ED/OIG, HUD/OIG, IRS
NY	IC*	Village official conspired to misappropriate SBA funds through specialized SBIC, to which SBA had provided \$1.2 million of leverage funding, by making and concealing of improper loans	57 months incarceration	ED/OIG, HUD/OIG, IRS
NY	IC*	Village official conspired to misappropriate SBA funds through specialized SBIC, to which SBA had provided \$1.2 million of leverage funding, by making and concealing of improper loans	30 months incarceration	ED/OIG, HUD/OIG, IRS
NY	IC	As SBIC director, approved improper disbursement of \$750,000 in loans from SBIC to its president	Civil suit settled without admitting allegations \$41,900 civil	FBI
NY	IC	As SBIC director, approved improper disbursement of \$750,000 in loans from SBIC to its president	Civil suit settled without admitting allegations \$13,500 civil	FBI
NY	BL*	Dentist had leased, not purchased, equipment he pledged as collateral on \$150,000 loan, instead using loan proceeds to buy personal items; failed to make payments, causing leasing company to repossess equipment lender thought was security for loan	Charged and pled guilty, 4 months at home, \$147,222	FBI
OK	BL	To obtain \$50,000 loan, computer store owner indicated he had never been arrested or convicted; in fact, prior to applying for this loan he had been arrested multiple times for felony offenses and convicted on multiple occasions	Pled guilty, 6 months incarceration, \$47,691	None
VA	BL	To obtain \$35,000 loan, taxi owner stated on her SBA application that she had no criminal history; in fact, prior to date of her application she had been arrested in five separate times.	Pled guilty, 6 months at home, \$21,713	SSA/OIG

State	Program	Alleged Violation(s) Prosecuted	Confinement Time and Dollar Results (Criminal Restitution/Fines/Etc.)	Investigated Jointly With. . .
WA	BL*	Chiropractic clinic owner made false statements to obtain \$80,000 loan and later converted loan proceeds to his personal use; also falsely claimed that he was a U.S. citizen	Pled guilty, 30 months incarceration, \$159,223	FBI, INS

* This matter is discussed in the narrative section of this report.

Program codes: BL=business loans, CC=Section 8(a) business development, DL=disaster loans, IA=Agency management and financial activities, IC=small business investment companies, SB=surety bond guaranties

Joint-investigation Federal agency acronyms : ATF=Bureau of Alcohol, Tobacco and Firearms; DCIS=Defense Criminal Investigative Service; DOL/OIG=Labor Department OIG; ED/OIG=Education Department OIG; FBI=Federal Bureau of Investigation; HUD/OIG=Housing & Urban Development Department OIG; INS=Immigration & Naturalization Service; IRS=Internal Revenue Service; SSA/OIG=Social Security Administration OIG; TIGTA=Treasury Department Tax Administration OIG; USDA/OIG=Agriculture Department OIG

MAKE A DIFFERENCE

To promote integrity, economy, and efficiency, we encourage you to report instances of fraud, waste, or mismanagement to the SBA OIG FRAUD LINE.*

CALL

1-800-767-0385 (Toll Free)

202-205-7151 (Washington, DC Area)

Write or Visit

U.S. Small Business Administration
Office of Inspector General
Investigations Division
409 Third Street, SW (5th Floor)
Washington, DC 20416

*Upon request, your name will be held in confidence.