SEMIANNUAL REPORT OF THE INSPECTOR GENERAL

FOR THE PERIOD

October 1, 1996, To March 31, 1997

July 15, 1997

PREFACE

Pursuant to Public Law 95-452, the U.S. Small Business Administration's (SBA) Office of Inspector General (OIG) is required to prepare a Semiannual Report of its activities for the Congress of the United States. This Semiannual Report, transmitted to the Congress by the SBA Administrator, covers the full range of SBA/OIG activities from October 1, 1996 to March 31, 1997.

As has been the case in past reports to the Congress, I have highlighted the truly extraordinary growth of the SBA portfolio over the last few years and the dearth of resources available to the SBA/OIG to provide more than a modicum of oversight. The current situation has not changed; that is, the Agency's portfolio continues to grow, while the OIG's capability to provide meaningful oversight of program activity remains virtually unchanged. Apparently, Senator Christopher Bond, Chairman of the Senate Committee on Small Business is also concerned for in a recent letter (March 1997) to his colleague, Senator Judd Gregg, Chairman of the cognizant Senate Appropriations Subcommittee, he expressed his support for an increase in SBA/OIG resources to address the increased risk expected to become a secondary consequence of the Agency's plans for transferring the administration of its loan portfolio to the private sector.

I am pleased to report that over the reporting period, the SBA/OIG closed 58 investigative cases and obtained 22 indictments and 34 convictions. In addition, $37.8 million were realized from management avoidances and court-ordered recoveries and fines during the reporting period. For our other operating activities, productivity totals stand at 11 audit and 3 inspection reports issued and $6.3 million in dollar accomplishments. Again, these OIG achievements enabled the Agency to operate more effectively and make more funds available to qualified small businesses who meet the eligibility criteria for SBA assistance.

Beyond productivity statistics, the success of the Agency's tax verification program is noteworthy in terms of the OIG's mandated mission to prevent and detect fraud and abuse in SBA's programs and supporting operations. While the Agency formally adopted its income tax verification program in October 1994, the OIG started recording data on false tax return cases as early as FY 1992. To date, 91 individuals, from 11 states, have been indicted for submitting false tax information (or returns); 84 of those have pled or been found guilty; and 78 have been sentenced, producing $20 million in court-ordered fines and restitutions. More importantly, $32 million of requested loan amounts were never disbursed as a result of SBA's tax verification policy and the vigilance of its employees. These funds, of course, were subsequently made available to honest small business men and women who needed their Government's financial assistance.

As for the SBA/OIG's efforts to promote economy, efficiency, and effectiveness in SBA's programs and supporting operations, this reporting period's total of 14 audit and inspection reports speaks to our commitment. For example, an inspection report on the "best practices" of Section 7(a) lenders focuses on the credit management procedures identified in case studies of nine successful lenders as the most efficient means of controlling risk. The report was distributed to the Agency's Preferred and Certified Lenders, and many of these lenders have requested additional copies for use within their organizations.

Turning to other initiatives, the SBA/OIG is an active supporter of the inspector general community's activities. Working closely with the Inspections Roundtable, which supports the Inspection and Evaluation Committee of the President's Council on Integrity and Efficiency (PCIE), the SBA/OIG recently pulled together a compendium of successful initiatives performed by the community's inspection and evaluation units across the Federal Government. These abstracts illustrate the varied nature of the community's inspections and evaluations and their impact--ranging from correcting employee ethics problems to saving millions of taxpayers' dollars. Also, in the spirit of the Government Performance and Results Act (GPRA), the SBA/OIG completed its Strategic Plan for Fiscal Years 1997-2002, the highlights of which are summarized in this report's Executive Summary. While not required by GPRA, the SBA/OIG's strategic plan will be included along with the Agency's strategic plan to be submitted to the Congress in September 1997.

Finally, I am again pleased to report that the cooperation received from SBA's policy officials, senior executives, program managers, and employees during the conduct of SBA/OIG audits, inspections, and investigations has been excellent. The OIG's working hypothesis continues to prove itself, i.e., the more closely OIG employees work with program managers, the more effective SBA will be in meeting the critical needs of the Nation's small business community. Allowing for resource constraints, I trust the results reflected in this Semiannual Report to the Congress offer strong evidence that the OIG is meeting its responsibilities to the best of its ability.

James F. Hoobler
Inspector General

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Executive Summary

This report on the activities of the Office of Inspector General (OIG) of the Small Business Administration (SBA) is submitted pursuant to Section 5(b) of P.L. 95-452, the Inspector General Act of 1978, as amended. It summarizes OIG activities for the 6-month period from October 1, 1996, to March 31, 1997.

Summary of Accomplishments

OIG audits, inspections, and investigations over the last 6 months achieved $44,150,901 in potential dollar results, 22 indictments, and 34 convictions. The dollar results consist of $21,251,476 in potential recoveries, including judicially-awarded fines and restitution; $16,545,466 in management avoidances; $1,035,911 in disallowed costs agreed to by SBA's management; and $5,318,048 in management commitments to use funds more efficiently.

The OIG alone could not have achieved the accomplishments set forth in this report to the Congress. The results for this reporting period reflect the cooperation and support of other Federal audit, inspection, and investigative organizations such as the Federal Bureau of Investigation (FBI); U.S. Secret Service; U.S. Marshals Service; Internal Revenue Service (IRS); Office of the Comptroller of the Currency; Resolution Trust Corporation; Environmental Protection Agency's (EPA) Office of Criminal Enforcement; other Federal OIGs; Department of Justice (DOJ) prosecutors; and, most importantly, the actions of SBA program managers and employees. Indeed, much of our success is due to referrals made by conscientious SBA employees.

OIG Mission for FY 1997

The OIG's mission for 1997 is delineated in its recently completed Strategic Plan for Fiscal Years 1997-2002. The first two goals of the strategic plan and their associated objectives provide a roadmap for the OIG's program-related mission. The OIG's first goal is to **improve the economy, efficiency, and effectiveness of SBA programs** through the Agency's adoption of recommendations resulting from the OIG's oversight activities. Achievement of this goal will be accomplished by meeting the following objectives:

1. Find opportunities for the reduction of operating costs (salaries and expenses)

associated with and supporting activities of SBA's programs.

2. Identify means for reducing the subsidy cost of SBA programs.

3. Ensure that SBA programs are meeting mandated public policy goals, high performance standards, and the needs of targeted participants.

4. Improve the accuracy of SBA accounting and management information.

5. Assure Agency implementation of accepted OIG recommendations and, to the extent that OIG resources allow, provide assistance to program managers in implementing recommendations.

6. Reduce the opportunity for loan packager fraud through cooperation with Agency officials in the registration of loan packagers and the pursuit of packager investigations.

7. Review proposed legislation, regulations, standard operating procedures, and other SBA issuances to improve Agency programs and to eliminate the potential for mismanagement.

8. Identify program vulnerabilities or systems weaknesses found during investigations and alert appropriate SBA program managers.

The OIG’s second goal is to **reduce fraud and abuse in Agency programs and foster integrity** in SBA’s personnel and the Agency’s resource partners. This goal will be accomplished by meeting the following objectives:

1. Assist the SBA in its efforts to deter fraud and abuse by auditing a sample of defaulted loans and Section 8(a) program participants suspected of abusing the contracting assistance program.

2. Assist the SBA in deterring waste, fraud, and abuse by responding to complaints concerning such activities with OIG staff assistance and consultation.

3. Recommend actions to reduce any program vulnerabilities uncovered as a result of OIG oversight activities.

4. Conduct investigations into allegations of fraud in SBA programs according to the perceived level of risk to the Agency and the potential for program impact or increased deterrence.

5. Pursue asset forfeiture proceedings in all applicable cases.

6. Participate in development of SBA's fraud and corruption awareness training programs and emphasize cooperation of Section 7(a) lenders in combating fraud through fraud awareness briefings and outreach contacts with lenders.

7. Refer an average of 75 cases annually to the Department of Justice for Affirmative Civil Enforcement (ACE) and increase the value of civil fines imposed.

8. Preclude persons of poor character from participating in SBA programs or employment through the use of name check requests, fingerprint requests, pre-

employment screening, and required background investigations.

The OIG's last two goals involve communicating OIG findings, recommendations, and results to all SBA stakeholders; and ensuring the economical, efficient, and effective operation of the OIG. The extent to which the OIG will be able to achieve its mission depends, in part, on the sufficiency of resources available to fund its operations.

Highlights of the Past Six Months

Efforts to Improve SBA Program Management

Best Practices of Section 7(a) Lenders. The OIG issued an inspection report focused on the credit management procedures identified by nine successful lenders in case studies as the most effective means for controlling risk. Although not all the procedures may be applicable to every Section 7(a) lender, the OIG believes that SBA's encouragement of such "best practices" could improve the effectiveness of its lending partners while keeping loan losses to a minimum. Among other things, the inspection team found that the successful lenders in the sample rely more on evaluating an individual borrower's situation than on automated screening methods such as credit scoring; generally avoid using external loan packagers; require the borrower to pledge both personal and business assets as collateral, despite the availability of the SBA guarantee; centralize final lending decisions to ensure consistency and control; assign risk ratings to new loans and periodically reassess them through the life of the loans; proactively watch for warning signs of future loan repayment problems; and identify past due loans early and initiate vigorous collection efforts. Although the report contained no formal recommendations, the OIG suggested that the Agency incorporate the best practices identified into its guidance for new lenders, its monitoring criteria for existing lenders, and its selection criteria for the Preferred Lenders Program. The report was distributed to all Preferred Lenders, Certified Lenders, and SBA field offices. *(See page 7)*

Annual Audit of SBA's Financial Statements Yields SBA's First Unqualified Opinion. For the first time in 6 years of audits conducted in response to the Chief Financial Officers Act, SBA's financial statements for FY 1996 received an unqualified opinion. The independent auditors found that SBA had made progress on the two problems that caused the previous opinions to be qualified. *(See page 47.)*

Audit of Early Defaulting Loans Finds Indications of Fraud and Abuse. An audit of 17 guaranteed loans that defaulted within 24 months of origination showed that 9 of the loans had indications of fraud and abuse that may have contributed to the early defaults. SBA recorded a loss of $6.2 million on the 17 loans after paying on the guarantees and liquidating the loans' assets. Only one of the nine loans was referred to a law enforcement agency for investigation; the remaining eight loans were not because neither SBA nor the lenders detected any indications of fraud and abuse. The OIG's Auditing Division did, however, refer these eight loans to the Investigations Division.

(See page 8.)

Activities to Enhance Fraud Detection and Deterrence

<u>Results of False Tax Return Cases Increase</u>. Over the last 6 years, the OIG has received 333 allegations that false tax returns were submitted in support of SBA business or disaster loan applications. These fraud referrals now involve loan applications submitted to 48 SBA district offices, totaling $120 million and involving 1,146 individual subjects. To date, 91 individuals have been **indicted on criminal charges:** 84 have been adjudicated guilty, 3 indictments have been dismissed, and 4 others have not gone to trial.

<u>Affirmative Civil Enforcement Program</u>. The OIG continues to expand the scope of its efforts to make optimal use of the Department of Justice's Affirmative Civil Enforcement (ACE) program. This U.S. Attorney program targets cases which might not be prosecuted criminally because of the minimal dollar amounts involved, absence of financial loss to the Government, or because the facts of the case might not support a criminal prosecution. Heretofore, our success with the ACE program was focused in only 13 states; however, over the course of this reporting period, the OIG realized its first ACE results in Connecticut, Louisiana, and Puerto Rico.

During the approximately 45 months the OIG has been involved with the ACE program, we have had a total of **76 successful cases,** resulting in **$2,742,010 in civil penalties** and **$3,735,900 in recoveries** by SBA. Individual ACE outcomes are reported in the program area chapters, as appropriate.

<u>Millions Recovered from Disaster Fraud Scheme</u>. A joint OIG and U.S. Secret Service investigation targeted two southern California brothers who had acted as disaster loan packagers. At the end of the reporting period, more than $11 million had been realized through court-ordered restitutions and fines, loans declined, or loans canceled. The investigation had also resulted in guilty pleas from 27 of the 28 persons charged with crimes in the case. In addition to the brother who has pled guilty to the largest fraud scheme ever perpetrated against SBA's disaster assistance program, 26 others also pled guilty to false statements made in their applications for economic injury loans in the wake of the 1992 civil unrest in Los Angeles. Many of the applicants applied in the names of businesses that did not exist; much of the fraud was facilitated by the submission of copies of fictitious income tax returns or the use of altered copies of actual tax returns. The case was opened as a result of a tip from a concerned citizen and a referral from the Disaster Assistance Area 4 Office. *(See page 27.)*

Business Loan Program

SBA's small business loan programs serve one of the most important missions of the Agency: to ensure that Federal funds and resources are used to help finance qualified small enterprises. Under the **Section 7(a) Guaranteed Loan Program**, SBA guarantees loans to small businesses that are unable to obtain private financing. These loans must be of such merit, or be so secured, as to reasonably ensure repayment to the lending institution. No loan may be made unless the financial assistance is not otherwise available on reasonable terms from elsewhere in the credit market. Under the guarantee plan, SBA agrees to purchase the guaranteed portion of the loan upon default by the small business. SBA's guarantee share of loans by private lenders averages about 77 percent.

More than 8,000 lenders have made at least one Section 7(a) loan in the past 5 years. Currently, approximately 38 percent of these loans are being made by participants in the Agency's **Certified Lender Program (CLP)** or its **Preferred Lender Program (PLP).**

Lenders who are heavily involved in the SBA guarantee program and meet the Agency's criteria can participate through the **CLP**. Over 900 participating lenders, approved for the **CLP** program, are permitted to assume greater authorities and responsibilities in processing, closing, servicing, and liquidating loans. As a result, SBA can process loan guarantee applications in 3 days, rather than the 2 weeks that it may take for a thorough analysis by Agency staff. About 9 percent of all business loan guarantees are made through the **CLP** process.

As permitted by Section 7(a)(2) of the Small Business Act, SBA delegates even wider authority to preferred lenders, i.e., lenders who can commit the Agency to guarantee eligible business loans and decide the level of SBA participation. This program, with over 350 participants, reduces processing time on strong credit applications and uses the resources of SBA's best lenders to the maximum. About 29 percent of all business loan guarantees are made through the **PLP** process.

The **504 Loan Program** provides long-term, fixed-rate financing through certified development companies (CDCs) to small businesses to acquire real estate, machinery, and equipment for expansion of business or modernizing facilities. Typically, 504 loan proceeds are provided as follows: 50 percent by an unguaranteed first mortgage bank loan, 40 percent by an SBA-guaranteed debenture, and 10 percent by the small business customer. The maximum SBA debenture is $1 million.

With the creation of the Agency's Low Documentation (**LowDoc**) application process, lenders are now able to use their own internal loan application documents, plus a single, two-sided SBA form to apply for an SBA guarantee on a loan of $100,000 or less. The demand for this program is unprecedented; **over one third of all SBA loan guarantee applications are now submitted through the LowDoc application process.**

Summary of OIG Activity

The following summarizes OIG activities relating to SBA's business loan programs over the reporting period:

- Two audit reports were issued and eleven audits were underway.
- One inspection report was issued and two others were underway.
- Business loan investigations resulted in 10 new indictments and 21 convictions.
- Business loan investigations produced $10,109,006 in court-ordered restitution, $2,374,927 in other recoveries by SBA, $4,313,934 in reductions to the Agency's financial risk, and $319,698 in civil penalties and fines.
- The OIG's name check activity resulted in the declination of 50 business loans, totaling $10,825,787.
- Twenty-nine business loan investigations were closed, leaving an inventory of 145 active cases involving 725 subjects. Due to other workload demands, another 13 business loan cases were referred to another law enforcement agency for investigation, giving the OIG a total of 50 business loan referrals to monitor.
- Four regulations and five Standard Operating Procedures (SOP) were reviewed.

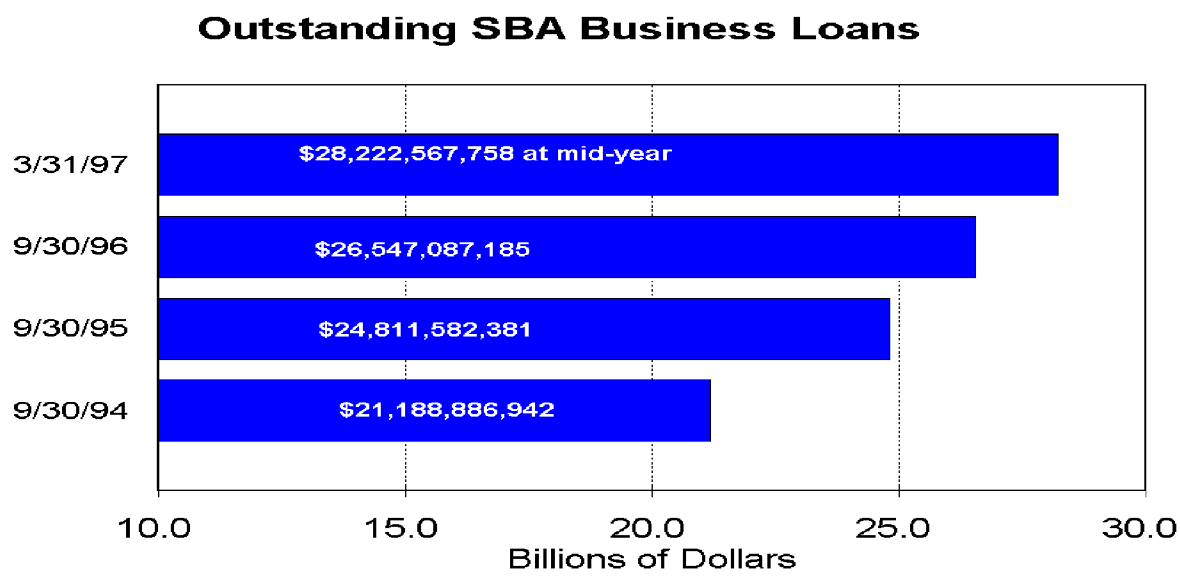


Figure 1

Efforts to Improve SBA Program Management

Study of "Best Practices" of Section 7(a) Lenders Issued

The OIG issued an inspection report on the "best practices" of Section 7(a) lenders. The report focuses on the **credit management procedures identified in case studies of nine successful lenders as the most effective means for controlling risk**. Although not all the procedures may apply to every Section 7(a) lender, the OIG believes that by encouraging such practices, SBA will be able to improve the effectiveness of its lending partners, while keeping loan losses to a minimum.

Among other things, the OIG found that the successful lenders in the sample:

- rely more on evaluating an individual borrower's situation than on automated screening methods such as credit scoring;
- generally avoid using third-party loan packagers, who prepare prospective borrowers' Section 7(a) applications for a fee, because of concerns over the quality of the loans and/or supporting documentation;
- require the borrower to pledge both personal and business assets as collateral, despite the availability of the SBA guarantee;
- centralize final lending decisions to ensure consistency and control over

originating loan officers' actions;

- assign risk ratings to new loans and periodically reassess those ratings through the life of the loans;

- proactively watch for warning signs of future loan repayment problems, such as the borrower's failure to renew hazard insurance; and

- identify past due loans early and initiate vigorous collection efforts.

Although the report contains no formal recommendations, the OIG suggests that the Agency incorporate these "best practices" into its guidance for new lenders and its criteria for monitoring existing lenders.

Audit of Early Defaulting Loans Finds Indications of Fraud and Abuse

An audit of 17 guaranteed loans that defaulted within 24 months of origination showed that 9 of the **loans had indications of fraud and abuse that may have contributed to the loans' early default**. SBA recorded a loss of $6.2 million on the 17 loans after paying on the guarantees and liquidating the loan assets. Only one of the nine loans was referred by SBA to a law enforcement agency for investigation; the remaining eight loans were not referred because neither SBA nor the lenders involved detected any indications of fraud and abuse. The remaining eight loans were referred by the Auditing Division for investigation.

During a 3 year period ending September 30, 1993, SBA transferred 4,335 loans to liquidation, including 1,100 loans that were less than 24 months old. Applying the theory that loans which default within 2 years of origination may be the result of poor origination or servicing, the OIG judgmentally selected 17 loans from the latter group for review.

A review of the borrowers' accounting books and records for the 17 loans disclosed that the primary indicators of irregularities were incomplete or false financial data and misuse of working capital. Neither SBA nor the lenders routinely reviewed the borrowers' books and records after defaults were declared, a practice that could detect irregularities such as fraud and abuse. After the completion of the audit field work, the Associate Administrator for Financial Assistance (AA/FA) issued a policy notice effective July 15, 1996, requiring lenders to make a site visit to the borrower when a loan is transferred to liquidation; this visit would have to include a review of the borrower's accounting books and records.

The audit report recommended that the AA/FA incorporate the site visit policy in the new SOPs, increase referrals to OIG for irregularities, and determine the feasibility of using joint payee checks or partial disbursements as an internal control over the use of working capital loans. Although the AA/FA agreed with these recommendations as presented in a summary report, final agreement with the audit recommendations is not due until August 1997.

Audit Uncovers Improper Loan Made to Missouri Company

A Missouri firm was **approved for a $1.1**

million international trade loan by SBA's St. Louis District Office, even though there was little evidence that the firm was involved in international trade. The loan was one of three loans made to the Missouri firm by a Preferred Lending Company (the lender). All three loans went into liquidation 7 months after their approval.

The three loans were reviewed because they defaulted early and the St. Louis District Director requested the audit due to concerns about a possible conflict of interest by a representative of the lender. Although the auditors found no basis for a conflict of interest, they found that origination of one of the loans was indeed defective because neither the lender nor the District Office established that the Missouri firm met program requirements. To qualify for an international trade loan, an applicant must demonstrate that (1) the loan will enable the borrower to significantly expand existing markets or develop new export markets, or (2) that the borrower was adversely affected by import competition.

The audit also showed that $29,000 in interest expenses charged by the lender was inappropriate because it exceeded the amount authorized by SBA. The lender collected the unauthorized interest expenses from the sale of collateral. Because the $29,000 interest expense was not authorized, it should have been considered a recovery on collateral and shared with SBA at the agreed upon ratio.

The audit report recommended that the St. Louis District Office take steps to ensure that eligibility for international trade loans is established before loan approval and that the lender be required to return $22,000 (75%) of the amount improperly retained as interest expenses. While the St. Louis District Director had no objections to the draft audit findings and recommendations, the OIG has not yet received his formal management decisions.

Business Loan Program SOPs Reviewed

As part of SBA's initiative to update and streamline its SOPs, the OIG reviewed five business loan program SOPs and commented on proposed revisions to three of them. In reviewing SOP 50 10 4, Loan Origination, the office commented on collateral requirements, tax verification procedures, prudent and quality lending practices, use of loan proceeds, assignment of primary standard industrial codes (SIC), eligibility determinations, loan modifications, lender servicing procedures, and audits of Small Business Lending Companies (SBLC) and Certified Development Companies (CDC). The review of SOP 50 50 4, Loan Servicing, led to comments on procedures for referrals of suspected irregularities to the OIG, site reviews of delinquent borrowers, reviews of lenders, loan modifications, and releases of SBA from liability on a guarantee. Finally, in reviewing the loan liquidation procedures (SOP 50 51 2), the OIG commented on "charge-offs" of secured loans and the required provision of data concerning charge-offs to a Government-wide database.

Activities to Enhance Fraud Detection and Deterrence

Latest Results From Affirmative Civil Enforcement (ACE) Program

Over this reporting period, the OIG's participation in DOJ's ACE program produced 11 successful business loan cases, resulting in $2,003,203 in recoveries and $236,348 in civil penalties. The nine smallest cases, which produced the civil penalties, involved fraudulent representations in applications for loans (primarily bogus tax returns), most of which were stopped before funds were disbursed. (One produced a $90,000 civil penalty against an unsuccessful applicant for a $614,000 loan.) The two other cases, described in detail below, involved settlements of claims against participating lenders in Connecticut and New York.

OIG Briefs Members of Lender Community

During this reporting period, OIG investigations staff continued its practice of making presentations to groups of participating lenders. More than 50 bankers at a Lenders Quality Circle Forum in Washington, D.C. were briefed on Procedures for Receiving Positive Responses to the Statement of Personal History (SBA Form 912). In addition, senior investigators from the Los Angeles and Washington field offices gave presentations to more than 220 participants in Phoenix, Arizona; Glendale, California; and Greenbelt, Maryland, highlighting the benefits to be gained from cooperating with OIG personnel in combating waste, fraud, and abuse in the Agency's guaranteed loan programs.

Connecticut Businessmen Sentenced for Bank Fraud and Accessory-After-the-Fact

Two officers of a Chester, Connecticut, manufacturer of wire products were convicted and sentenced for a fraud scheme against SBA. One was convicted on one count of **bank fraud** for submitting false information while applying for a $300,000 SBA-guaranteed loan. He was sentenced to 30 months imprisonment and $450,000 restitution. The second negotiated a guilty plea to one count of being an **accessory-after-the-fact** to a false statement used in obtaining the loan; he was sentenced to 1 year probation. In applying for the loan, the existence of previous loans was not disclosed and the offer of certain items of unavailable machinery and equipment as collateral was made. He also falsely certified that the other principal officer had no criminal record. After the SBA-guaranteed loan proceeds had been disbursed, the principal with the criminal record perpetuated the misrepresentation. The joint OIG/FBI investigation was based on a referral from SBA's Hartford District Office.

Ohio Medical Equipment Manufacturer Sentenced for Bank Fraud

The president of a now-bankrupt manufacturer of medical equipment in Chardon, Ohio, negotiated a guilty plea to one count of **bank fraud**. He was sentenced to 5 months imprisonment, 5 months home confinement, 5 years supervised release, and

$75,000 restitution, of which 82 percent goes to SBA. An OIG investigation determined that at the time the company president was negotiating to obtain a $700,000 SBA-guaranteed loan, and during the subsequent loan disbursement period, he concealed from SBA and the participating lender bank his intent to sell a substantial portion of the business assets. He also diverted a majority of the proceeds from those sales to pay off other debts and caused $100,000 to be fraudulently wired from another bank to the participating lender. During a subsequent interview by an OIG special agent, the company president made material false statements by stating that officials of the participating lender had known about and approved the sale of assets. This investigation was initiated based on a referral from SBA's Cleveland District Office.

Two Pennsylvania Jewelry Retailers Sentenced for Making False Statements

The president and vice president of a watch and jewelry retailer in Plymouth Meeting, Pennsylvania, were each sentenced to 2 years probation and a $4,050 fine. The businessmen had pled guilty to **making false statements** to SBA in an unsuccessful attempt to obtain a $50,000 LowDoc loan. They had submitted altered tax returns to a participating lender bank. On learning that the tax returns submitted with the application differed significantly from those on file with the IRS, SBA canceled the loan before any funds were disbursed. The certified public accountant (CPA) for the company had previously been sentenced for preparing altered tax returns and he has surrendered his CPA license. The discrepancies, which were detected by SBA's tax return verification program, were referred to the OIG by SBA's Philadelphia District Office.

Minnesota Businessman Sentenced for Bank Fraud

The president of a Bloomington, Minnesota, technology company was sentenced to 1 month incarceration, 90 days home detention, and 3 years supervised release. He had previously pled guilty to one count of **bank fraud**. A joint SBA/OIG investigation with the FBI revealed that the businessman submitted a bogus independent auditor's report to a participating bank in an unsuccessful effort to obtain a $175,000 SBA-guaranteed loan. The investigation was based on a referral from the bank forwarded by SBA's Minneapolis District Director.

Former Georgia Tax Accountant Sentenced for Submitting False Documents

A former Decatur, Georgia, tax accountant was sentenced to pay SBA $81,688 restitution. Now a resident of Montego Bay, Jamaica, he also was sentenced to 5 years probation and is prohibited from returning to the United States for 3 years. He had previously pled guilty to one count of **submitting false documents to SBA** in connection with a $154,000 SBA-guaranteed loan to his sole proprietorship. The investigation established that he submitted altered copies of tax returns for the years 1986-88, substantially overstating his income for the purpose of procuring the loan. He also submitted a "deed to secure debt" as collateral, on which his wife's signature had been forged. The OIG initiated the investigation based on a referral from SBA's Atlanta District Office.

Indiana Businessman Sentenced for Making False Statement

A Muncie, Indiana, businessman was sentenced to 3 months home detention, 2 years probation, and $115,000 restitution to SBA. He had pled guilty to one count of **making a false statement** to obtain a $400,000 SBA-guaranteed loan. The SBA/OIG's joint investigation with the FBI disclosed that the man falsely certified that the loan proceeds were to be used as operating capital for his machine and foundry company when he actually used a substantial portion of the loan proceeds for his personal benefit. This investigation was initiated based on a referral from SBA's Indianapolis District Office.

South Dakota Rancher's False Statements Lead to Prison Sentence

An Eagle Butte, South Dakota, rancher was sentenced to 24 months imprisonment, 3 years supervised release, $115,000 restitution, and a $5,000 fine. He had previously pled guilty to one count of **making a false statement** to a Federal agency. The SBA/OIG's joint investigation with the Department of the Interior (DOI) OIG determined that, to obtain a $150,000 SBA-guaranteed loan, the applicant concealed from SBA and the participating lender that he had failed to repay a previous $30,000 loan guaranteed by DOI's Bureau of Indian Affairs (BIA). He also submitted a document falsely claiming that he had received a $50,000 BIA grant. The investigation also found that the rancher **tampered with a witness** by attempting to persuade the participating bank's loan officer to remove the fraudulent BIA document from the loan file. The DOI/OIG asked the SBA/OIG to join the investigation.

Texas Couple Sentenced to Prison for Making False Statements

An Alvin, Texas, wife and husband were sentenced to 5 months and 1 month imprisonment, respectively. They were also sentenced to 3 years supervised release, the first 5 months of which will be under home restriction, and a $50 special assessment. Both had pled guilty to one count of **making false statements on loan applications to Federally-insured financial institutions** in an unsuccessful attempt to obtain more than $500,000 in SBA-guaranteed loans. The couple submitted bogus tax returns for their convenience store in Houston, Texas, in an effort to obtain approval of a $338,000 loan to finance their purchase of the store. They also submitted false tax returns for another convenience store in LaMarque, Texas, to obtain approval of a $200,000 loan to be used for the purchase of the store. SBA foiled the couple's scheme by declining the loan applications after the profits reflected on the false returns could not be verified. The charges were the result of an OIG investigation based on a referral from the Office of District Counsel of SBA's Houston District Office.

California Gas Station Owner Sentenced for Forgery and Possession of Stolen Mail

The owner of a gas station in San Diego, California, was sentenced to 2 years imprisonment and a $10,000 fine. He had previously been convicted of **forging U.S. Treasury checks** and **possession of stolen mail**. The U.S. Secret Service asked the SBA/OIG to join its investigation, which had identified $340,000 in stolen U.S. Treasury checks deposited into the man's business bank account. The OIG's portion of the investigation confirmed that he had also submitted altered tax returns to a participating lender bank to obtain an $80,000 SBA-guaranteed loan for business improvements. As part of his application, the owner provided "copies" of 3 years of corporate income tax returns which greatly overstated the business' taxable income. In the returns actually filed with the IRS, the business had reported losses for the same 3-year period.

Investigation Finds that New York City Bank Improperly Administered SBA-Guaranteed Loans

An Argentine bank, which was once one of SBA's largest participating lenders in New York City, paid $1,260,033 to the U.S. Treasury to settle civil claims for **improperly administering loans** guaranteed by SBA. The OIG investigation found that bank officers (1) demanded and obtained from borrowers compensating balances to offset the non-guaranteed portion of loans; (2) failed to disburse loan proceeds in accordance with the bank's agreements with SBA; (3) recovered repayments on a loan without sharing such proceeds proportionately with SBA; and (4) solicited illegal "commissions" in connection with certain SBA-guaranteed loans. In addition to the $1,260,033 payment, which comprised both reimbursement of amounts the SBA had paid to the bank earlier on six loan guaranties and resulting penalties, the bank, which did not admit to any wrongdoing, has released SBA from liability on its guaranties of 22 other loans totaling $4,423,668. In an earlier result of the OIG investigation conducted jointly with the FBI and the bank's cooperation, a former bank vice president was sentenced to 18 months imprisonment for soliciting the illegal commissions.

California Loan Broker and One Client Sentenced to Prison

A former La Canada, California, loan broker and eight other persons connected to SBA-guaranteed loans he brokered were sentenced; three more individuals associated with his SBA loan fraud scheme had charges brought against them.

> ❶ The loan broker was sentenced to 18 months imprisonment, 3 years supervised release, and $2,928,211 restitution, with $2,499,358 specifically designated for payment to SBA. He had previously pled guilty to five counts of **making false statements in a loan application to a Federally-insured financial institution** in connection with his scheme to broker more than $15 million of fraudulent SBA-guaranteed business loans and SBA disaster loans. In addition, he pled guilty to a **criminal forfeiture** count allowing the Government to recapture the illegal proceeds of his crimes, although at sentencing this count was dismissed in the interest of

justice and in return for the defendant's cooperation. The investigation, based on information provided by a participating lender, disclosed that the subject brokered over two dozen fraudulent loans between 1987 and 1992, primarily for Korean-American clients. His scheme involved submitting false financial information to induce both the banks and SBA to grant and guarantee the loans. That false information included numerous bogus tax returns, financial statements, invoices, and cashier's checks evidencing cash infusions into the businesses. When the banks and SBA approved the loan applications, he would launder part of the proceeds through his "dummy" equipment business.

❷ The owner of an automobile transmission establishment in Los Angeles, California, was sentenced to 3 years probation, 300 hours community service, a $50,000 fine, and restitution to SBA of $366,155. He previously pled guilty to one count of **making a false statement on a loan application to a Federally-insured financial institution** in connection with his $420,000 SBA-guaranteed business loan. The applicant submitted altered tax returns for the years 1988-90, each of which significantly overstated his income. He also submitted invoices using the names of nonexistent businesses.

❸ The former owner of a Pomona, California, restaurant pled guilty to one count of **making a false statement on a loan application to a Federally-insured financial institution**; in return, the other counts on which he had been indicted were dismissed. He was sentenced to 3 years probation and 200 hours community service. In applying for his $550,000 SBA-guaranteed loan, the businessman submitted tax returns to the participating lender which significantly overstated his business income; he also submitted a false financial statement to induce the lender to grant a payment deferment and not foreclose on the loan.

❹ The owner of a general merchandise discount store in Los Angeles, California, was sentenced to 3 months in a halfway house, 3 months in home detention, 3 years probation, 1,500 hours community service, and $1,144,070 restitution. He had pled guilty to one count of **making a false statement on a loan application to a Federally-insured financial institution** in connection with his $1,000,000 SBA-guaranteed loan. In addition to false documents associated with his capital injection, the man submitted altered Federal income tax returns for 1987-89, which significantly overstated his income, to induce approval of the loan.

❺A former personal banking officer at a bank in Paramount, California, was sentenced to 3 years probation, a

$5,000 fine, and 200 hours of community service. The judge also prohibited her from ever again working for a financial institution. The bank officer had previously pled guilty to **making a false statement** to SBA. In an attempt to help her sister, who had applied for a $2.1 million Section 504 loan, she prepared a false deposit verification form for submission to SBA and a participating lender bank. On the form, the bank officer represented that her bank had two accounts, with a combined balance of $790,000, held solely in the loan applicant's name. In fact, the accounts were never the sole property of her sister. The accounts listed on the form had been opened by another person, and the bank officer had added her sister's name at a later date. The false statement was detected during the investigation and SBA canceled the loan, producing a $750,000 cost avoidance (SBA's guaranteed share); the bank officer was terminated from her position.

❻ The bank officer's sister was charged in a criminal information with one count of **making a false statement** to SBA. She had been approved for a $1.5 million Section 504 loan to fund the acquisition of a motel in Tehachapi, California. SBA, however, canceled the loan as a result of this investigation. The investigation revealed that the applicant made false statements concerning the source of her capital for the project.

❼ The former owner of a Riverside, California, cafe pled guilty to one count of **making a false statement on a loan application to a Federally-insured bank**. In return, the Government agreed to dismissal of four other counts on which he had been indicted. He was sentenced to 4 months in a halfway house, 2 years probation, and 50 hours community service. In pleading guilty, the man admitted submitting altered income tax returns for the years 1987-89 with his application for a $225,000 SBA-guaranteed loan to purchase the cafe. He also represented on his business plan that his personal capital came from the sale of another business; in fact, he had borrowed the funds from a friend. The man also represented that he intended to purchase machinery and equipment totaling $125,000 from a company which was controlled by the loan broker. The loan broker returned the funds to the applicant, who then repaid the undisclosed personal loan.

❽ The owner of a sporting goods store in Los Angeles, California, was sentenced to 1 year home detention, 3 years supervised release, $50,000 restitution, and 600 hours of community service. The businesswoman previously pled guilty to **making a false statement to a Federally-insured financial institution** in support of her application for a $1,000,000 SBA-guaranteed business loan. She admitted submitting altered tax returns, each of which significantly overstated her income.

❾The owner of a grocery and liquor store in Los Angeles, California, was sentenced to 2 years probation, 200 hours community service, $231,000 restitution, and a $5,000 fine. The businessman previously pled guilty to **making a false statement** to SBA in applying for his $231,000 disaster business loan. The investigation initially discovered that an altered tax return had been submitted to obtain an earlier $161,119 SBA-guaranteed loan that enabled him to purchase the market; it also established that he had submitted altered tax returns to obtain a disaster loan for the repair of damage stemming from the 1992 civil unrest. Each of the returns significantly overstated his income.

❿ The owner of a clothing manufacturer in La Canada, California, was sentenced to 1 year imprisonment, 5 years supervised release, and restitution of $875,827 to SBA for **making false statements in a loan application to a Federally-insured bank**. He had obtained a $1 million SBA-guaranteed loan, supported by an application that contained altered copies of income tax returns for 1987-89, each of which significantly overstated the net profit from his business.

11 A Los Angeles, California, businessman and radio talk show host was indicted on one count of **making a false statement in a loan application to a Federally-insured financial institution**. The investigation disclosed that the man sold land and a building to the sporting goods store owner mentioned above and assisted her with the purchase by signing an escrow modification statement which falsely claimed that she had paid him $160,000 outside of escrow. The $160,000 "payment" was submitted as evidence to both the bank and SBA that she had made the necessary capital injection into the project (purchasing the land and building in which her company was located) to qualify for an SBA-guaranteed loan.

12 A tax preparer in Los Angeles, California, pled guilty to aiding and abetting the **making of false statements in a loan application to a Federally-insured bank**. He prepared false income tax returns submitted in support of a loan application submitted by the Pomona, California, restaurant mentioned earlier. By overstating the business’ income, the tax preparer created the illusion that the applicant had adequate repayment ability and was creditworthy. The OIG/U.S. Secret Service investigation revealed several more individuals for whom the tax preparer had prepared false income tax returns.

The SBA/OIG initiated this investigation after a participating lender and SBA's Los Angeles District Office referred the matter. The U.S. Secret Service subsequently joined the investigation at the OIG's invitation.

California Loan Packager Sentenced to Prison, More Clients Indicted or Pled Guilty

A fourth former client of a Garden Grove, California, loan packager has been indicted, two others who were indicted earlier have entered guilty pleas, and these two and the packager were sentenced on charges of **making false statements on loan applications to Federally-insured financial institutions**.

❶ The former packager was sentenced to 2 years imprisonment, 3 years supervised release, and $15,000 restitution. He had pled guilty to five counts more than 1 year earlier, but the plea agreement remained sealed while the investigation of his former clients was completed. The packager admitted putting together SBA loan applications containing altered copies of the applicants' income tax returns which were submitted to two southern California participating lender banks.

❷ The former owner of a Garden Grove, California, furniture company was indicted on one count. She obtained a $250,000 SBA-guaranteed loan for her business, but the OIG investigation found that she had diverted the loan proceeds to the purchase of a personal residence and subsequently defaulted on the loan. The indictment charged the businesswoman with providing a false invoice to conceal the true source of her down payment on the home.

❸The former owner of a Vietnamese restaurant and billiard club in San Gabriel, California, pled guilty to one count; in return, the other counts on which he had been indicted were dismissed. He was sentenced to 6 months home confinement, 3 years supervised release, and $16,600 restitution to SBA. The applicant submitted altered income tax returns with his application for a $150,000 SBA-guaranteed loan, which subsequently defaulted.

❹ The former owner of a beauty salon in Long Beach, California, pled guilty to one count; the other count on which he had been indicted was dismissed. He was sentenced to 6 months home confinement, 3 years supervised release, and $5,000 restitution, of which 80 percent goes to SBA. The applicant submitted false documents to obtain disbursement of his $150,000 SBA-guaranteed loan; the loan also defaulted.

The joint OIG/FBI investigation, initiated in 1990 based on information provided by SBA’s Santa Ana District Office, involved 32 loan applications prepared by this packager. To date, 20 of those loans have defaulted, resulting in more than $3.2 million in losses to SBA and the banks.

Illinois Manufacturing Company Pleads Guilty to Making False Statement

An Arthur, Illinois, manufacturer of grain wagons and other farm equipment pled guilty to one count of **making a false statement** to obtain a $1 million SBA-guaranteed loan. In a loan application document, the company stated that it had not discharged any hazardous waste onto its property (a question regarding compliance with environmental laws is included in the application), when it knew that hazardous waste had indeed been unlawfully buried on its property. The corporation also pled guilty to one count of **unlawful disposal of hazardous solvents and paint wastes**. This plea agreement was a result of the OIG's joint investigation with the Environmental Protection Agency's Office of Criminal Enforcement.

Guilty Pleas to Money Laundering and Racketeering in New York Defense Contractor Case

A Syracuse, New York, warfare-simulation software development company and its chief executive officer (CEO) recently pled guilty. The CEO pled to one count of **money laundering**, and the corporation--through its attorney--pled to being a **criminal enterprise under the Racketeer Influenced and Corrupt Organization statute**, both in connection with a $750,000 SBA-guaranteed loan. In return for the guilty pleas, the Government agreed to dismissal of the other charges against them listed in a 54-count indictment alleging that they defrauded the U.S. Navy, the participating bank, investors, and creditors of $8 million. The investigation found that the company and its CEO had failed to disclose a significant debt when applying for the loan and used the loan's proceeds to pay off the debt. The OIG conducted this investigation jointly with the Defense Criminal Investigative Service, which brought the case to the OIG's attention.

Former New York Bank Directors Convicted on Conspiracy and Bank Fraud Charges

The former president (and board chairman) of a now-defunct SBA participating lender headquartered in Watertown, New York, and a former counsel to the bank were convicted on charges of **conspiracy**, **bank fraud**, and the acceptance and payment, of **money as an inducement and reward for bank transactions**. The OIG investigation revealed that the bank's president had agreed to refer the bank's legal work to the attorney's law firm in return for one-sixth of the legal fees collected. The bank officer received more than $332,000 from the scheme. In furtherance of the conspiracy, he caused the bank to make loans totaling $1,879,500 to the attorney and his associates, allowed other individuals to borrow money from the bank for transfer to the attorney, and permitted the attorney to represent both parties in connection with the closing of most of these loans. As a consequence of these arrangements, the loans, several of which were guaranteed by SBA, were not properly secured and not repaid. Having lost $13 million on bad loans, the participating lender bank, which had been a major community lender to small business, was declared insolvent and seized by the Office of the Comptroller of the Currency (OCC) in 1993. The SBA/OIG investigation was conducted jointly with the OCC, the Resolution Trust Corporation, and the FBI; it was based on a referral from SBA's Syracuse District Office.

Washington Manufacturing Company President Pleads Guilty to Bank Fraud and Money Laundering

The former president of a Port Angeles, Washington, crane manufacturer pled guilty to one count of **bank fraud** and one count of **money laundering**. He was sentenced on to 37 months imprisonment; 5 years probation; and restitution of $43,298 to SBA and its participating lender bank, and $390,500 to the bank's investors. The SBA/OIG's joint investigation with the FBI and the IRS found that the man made false statements about his criminal history, his Social Security number, and his cash injections into his company to obtain a $100,000 SBA-guaranteed business loan. Once the loan was disbursed, the businessman also misused approximately $12,000 of the loan proceeds for personal expenses, including payment of his rent and credit card bills. The loan defaulted after he fled the Port Angeles area with his firm's investors' funds. OIG and FBI agents subsequently arrested him. The OIG's investigation was initiated after SBA's Seattle District Office referred an inquiry from the Washington State Attorney General's Office.

Georgia Caterer Found Guilty of Conspiracy and Bank Fraud

A co-owner of a now-defunct Atlanta, Georgia, catering company was found guilty of **conspiracy, bank fraud,** and **submission of false loan documents to SBA**. The man was sentenced to 10 years imprisonment and $745,115 restitution. The SBA/OIG investigation, based on a referral from SBA's Atlanta District Office, disclosed that the owner and his former wife and business partner defrauded SBA and Federally-insured lenders of more than $1 million, including a $650,000 SBA-guaranteed loan from a non-bank participating lender. The couple had fled the country prior to their 1991 indictment, but they were deported to the United States--she from Russia in 1995 and he from Cyprus in April 1996. As a condition of his extradition under Cypriot law, the U.S. Government dismissed 15 other felony counts on which he had been indicted. As previously reported, his wife negotiated a guilty plea to two counts and agreed to cooperate with the Government's prosecution of her husband.

California Jewelry Store Owner Convicted of Making False Statements

The owner of a retail jewelry store in San Luis Obispo, California, was convicted of **making false statements to a Federally-insured financial institution**. A lengthy investigation, based on information provided by SBA's Fresno District Office and conducted jointly with the FBI, revealed that the man submitted fraudulent 1986 and 1987 individual tax returns in support of an application for a $450,000 SBA-guaranteed loan approved in 1988. He subsequently provided false tax returns, both individual and corporate, for 1988-90 and was successful in obtaining another SBA-guaranteed loan for $100,000. Both loans, however, went into default and were liquidated. Following liquidation efforts, a total of $336,895 was "charged off" by the lender.

Montana Clothing Retailer Pleads Guilty to Making False Statements

A partner in a clothing retailer in Whitefish, Montana, was charged with and pled guilty to one count of **making false statements** to SBA. This businessman submitted financial statements and other documents purporting to give a true picture of the partnership's financial situation in an effort to persuade SBA and its participating lender bank to accept a $27,500 offer in compromise of its liability for two SBA loans which defaulted in 1993; however, 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. This fraudulent offer was intended to persuade SBA to settle for an unreasonably small amount. In 1993, he (under a corporate name) also received $205,000 in SBA-guaranteed loans from a participating lender in Idaho based on substantially different financial statements. The OIG initiated its investigation based on referrals from SBA's Helena and Boise District Offices.

California Automobile Repair Business Owner Pleads Guilty to Making False Statements

The owner of an automobile repair business in North Hollywood, California, was charged with and pled guilty to one count of **making false statements in a loan application to a Federally-insured bank**. The investigation revealed that the man submitted false individual and corporate income tax returns for 1987-89, all of which significantly overstated his income to qualify for two SBA-guaranteed loans totaling $656,000. The investigation expanded into his acquisition of two additional fraudulently-obtained loans valued at $2,408,600. After the collateral supporting the $3,064,600 in loans was sold, the lenders suffered losses of $1,062,068. Information regarding this borrower was established by SBA/OIG and U.S. Secret Service agents looking into disaster loan applications prepared by two southern California brothers acting as loan brokers. The repair business owner and his brother were the only businessmen who had obtained Section 7(a) loans.

Ohio Limousine Repair Company Owner Charged with Conversion of Government Property

The owner of a limousine repair company in South Euclid, Ohio, was charged in a criminal information with one felony count of **conversion of Government property** in connection with a $50,000 SBA-guaranteed LowDoc business loan. The SBA/OIG investigation found that the owner sold assets of the business which he had pledged as collateral for the SBA loan guarantee. Moreover, he had converted $8,170 of the proceeds to his own use. The OIG initiated the investigation in response to a referral from SBA's Cleveland District Office.

Missouri Osteopath Arrested Based on Indictment for Making False Statements

The president of an Excelsior Springs, Missouri, convenience store was arrested as he reentered the United States. Based on an investigation by the OIG, the osteopath had been indicted on one count of **making false statements** to obtain a $300,000 SBA-guaranteed loan, but the indictment was suppressed while he was out of the country. The loan to his convenience store, the guaranteed share of which SBA purchased in 1993 for $242,508, was made by a "non-bank" participating lender located in the geographical area served by SBA's St. Louis District Office. The man's alleged false statements included failure to report his debt to SBA from a defaulted 1977 loan to a group of his health clinics through SBA's Kansas City District Office. He also submitted tax returns which allegedly overstated his adjusted gross income. This matter was referred to the SBA/OIG by a servicing loan officer in SBA's Kansas City District Office.

$1.4 Million Paid on Behalf of Connecticut Bank for Fraudulent Representations and Improper Servicing of SBA-Guaranteed Loans

The Federal Deposit Insurance Corporation, as receiver for the successor to an Orange, Connecticut, bank, issued a $1,486,340 Notice of Allowance of Claim and paid the first $1,398,081 of that claim, in connection with a settlement of the bank's liability for its handling of nine SBA-guaranteed loans that ultimately went into default. SBA had alleged, based on findings of an OIG audit and an investigation, that the bank had violated the **False Claims Act** and **breached its contract** with SBA by knowingly allowing false statements to be submitted to the Agency, failing to properly collateralize the loans, and generally failing to follow prudent banking practices in servicing the loans. The bank's president had acted as both loan officer and approving official on both these guaranteed loans and five others that also defaulted. Without admitting liability, he had paid the Government a $65,000 settlement in 1989. The Department of Justice had requested both the SBA/OIG audit and the investigation. Half of the dollar recoveries associated with this claim are reported under the OIG's Investigative Recoveries and Fines category of the FY 1997 Productivity Statistics table, the other half under Disallowed Costs Agreed to by Management.

New York Computer Company Owner Sentenced for Bank Fraud and Making False Statements

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

Last Client of California Loan Packager Sentenced to Prison for False Tax Returns in Loan Application

The former owner of a Paramount, California, marble flooring company was sentenced to 30 months imprisonment, 10 years supervised release, and $292,581 restitution. He had been found guilty on seven counts of **making false statements on a loan application to a Federally-insured financial institution** in connection with his $300,000 SBA-guaranteed business loan. The businessman was identified in a joint SBA/OIG and FBI investigation examining the inclusion of false tax returns and false invoices in applications submitted to SBA's participating lenders by a Westminster, California, loan packager (who also was sentenced to 2 years imprisonment). The investigation was opened based on a referral from SBA's Los Angeles District Office.

California Father Sentenced to Prison for Bank Fraud and Loan Fraud

A Woodland Hills, California, man was sentenced to 41 months imprisonment, 3 years supervised release, and $524,891 restitution payable 80 percent to SBA and 20 percent to the participating lender bank. He had been convicted on charges of **bank fraud** and **making a false statement to a Federally-insured lender**. His daughter had also been indicted on two felony charges, which were subsequently dismissed based on her claim that, at only 18 years of age, she had not understood the significance of the documents she signed. The OIG investigation revealed that the daughter's application for a $665,000 SBA-guaranteed loan to purchase real property for the operation of a nursery contained false financial documents, including false tax returns. Her father, acting under an alias, had purchased the property for $450,000 and then immediately sold it to her for $900,000, thereby doubling its purchase price. The participating bank financed the purchase based on this inflated price. The father also falsely represented to the bank that he was giving his daughter a gift of $160,000 toward the purchase of the property. The nursery never opened for business, and the loan went into default after only two loan payments had been made. The SBA/OIG initiated this investigation based on a referral from SBA's Los Angeles District Office.

Disaster Loan Program

Pursuant to Section 7(b) of the Small Business Act, as amended, SBA's disaster loans represent the primary form of Federal assistance for non-farm, private sector disaster losses. For this reason, the **Disaster Loan Program** is the only form of SBA assistance **not limited to small businesses**. Disaster loans from SBA help homeowners, renters, businesses of all sizes, and non-profit organizations fund rebuilding. SBA's disaster loans are also a critical source of economic stimulation in disaster-ravaged communities, helping to energize employment and stabilize tax bases.

By providing disaster assistance in the form of loans which are repaid to the U.S. Treasury, the SBA disaster loan program helps reduce Federal disaster costs compared to other forms of assistance like grants. When victims need to borrow to repair uninsured damages, the low interest rates and the long terms available from SBA make recovery more affordable. Because SBA tailors the repayment of each disaster loan to each borrower's capability, unnecessary interest subsidies paid by the taxpayers are avoided.

The need for SBA disaster loans is unpredictable. During FY 1996, SBA approved 37,822 loans for $987.9 million, of which almost 30,000 loans totalling $867 million were actually disbursed. Since the inception of the program, SBA has approved more than 1,336,800 disaster loans for more than $23.9 billion. As of the end of FY 1996, the SBA disaster loan portfolio included more than 274,000 loans valued at over $6.9 billion. The total available for FY 1997 disaster loans, including carryover and contingency funds, is approximately $1.628 billion.

SBA is authorized by law to make two types of disaster loans: (1) physical disaster loans, which are a primary source of funding for permanent rebuilding and replacement of uninsured disaster damages to real and personal property homeowners, renters, businesses of all sizes, and non-profit organizations; and (2) economic injury disaster loans (available by law only to small businesses), which provide necessary working capital until normal operations can resume after a physical disaster. SBA delivers disaster loans through four specialized Disaster Area Offices located in Niagara Falls, New York; Atlanta, Georgia; Fort Worth, Texas; and Sacramento, California.

Summary of OIG Activity

The following summarizes OIG activities relating to SBA's disaster loan programs during the reporting period:

- Three audit reports were issued during the reporting period, and three others were underway.

- Disaster loan investigations resulted in 9 new indictments and 10 convictions, and produced $7,292,782 in court-ordered restitution, $39,000 in other recoveries by SBA, and $13,900 in fines and civil penalties.

- Office of Security Operations name checks resulted in the declination of 14 disaster loans totaling $1,405,745.

- Six disaster loan investigations were closed, leaving an inventory of 92 active cases involving 414 subjects. Due to workload demands, another two disaster loan cases were referred to other law enforcement agencies for investigation, resulting in a total of seven disaster loan referrals for the OIG to monitor.

- Five Standard Operating Procedures (SOP) were reviewed during the reporting period.

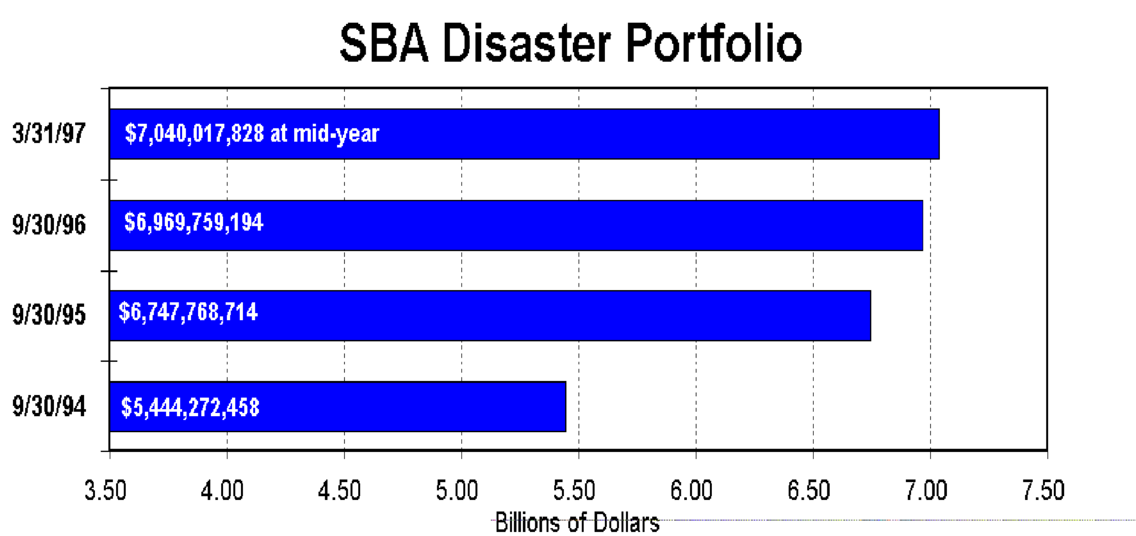


Figure 2

Efforts to Improve SBA Program Management

Audit Finds Electronically Disbursed Disaster Funds Are Supported by Appropriate Internal Controls

The OIG issued an audit survey report that found that internal controls for a **new system to disburse disaster loans electronically** were generally appropriate. The survey also found that some required procedures, however, had not been adopted. An audit survey of the conversion found that improvements were needed relating to certain physical security measures, separation of duties, documentation of certain Electronic Fund Transfer (EFT) procedures, data protection (encryption), password renewal, dual controls for setting up new users, written procedures for rejected transmissions to the Department of the Treasury, and the keeping of troubleshooting logs. The audit survey also found a need for a contingency plan for emergencies, computer security training, and a computer security recertification of the Office of Disaster Assistance's Automated Loan Control System. The Associate Administrator for Disaster Assistance, who requested the review, agreed to consider these issues in the overall development of a system security plan.

Disaster Loan Origination and Servicing Problems Found at SBA's Los Angeles District Office

An OIG audit of disaster loan servicing at SBA's Los Angeles District Office (LADO) found that there were **problems in the origination or servicing of 17 of a judgmental sampling of 24 disaster loans** assigned to the LADO. Origination shortcomings included approving loans to borrowers that had access to credit elsewhere, overestimating borrower repayment ability, misjudging the impact of undisclosed liens on SBA collateral, not verifying information supplied by borrowers, and not detecting or rejecting potentially fraudulent documents. Servicing shortfalls included failure to contact borrowers, lack of follow up on servicing actions, uneven enforcement loan terms, and failure to respond to early warning signals.

The auditors recommended the establishment of a quality assurance process; the Associate Administrator for Disaster Assistance concurred and agreed to take action. The auditors also recommended increasing the servicing and liquidation staff or developing other alternatives to address the problems identified; the Associate Administrator for Financial Assistance generally concurred with this recommendation.

Activities to Enhance Fraud Detection and Deterrence

Mississippi Businessmen Sentenced for Conspiracy and Making False Statements

The proprietor of a timber company in Hattiesburg, Mississippi, and his attorney were sentenced. Each was ordered to pay $3,600 restitution and a $150 special assessment. In addition, the owner was sentenced to 18 months imprisonment and 2 years supervised release, and the attorney received a sentence of 4 months home confinement and 2 years probation. The attorney had pled guilty to **making material false statements** to influence SBA, and the owner had been convicted on one count of **conspiracy** and two counts of **making material false statements** to influence the Agency. At the sentencing hearing, the judge set aside the conviction of the owner's wife, who had been found guilty on one count of **making material false statements** to influence SBA. All the charges relate to a $222,400 economic injury disaster loan the owner received in 1993. The OIG initiated the investigation based on a referral from SBA's Gulfport Branch Office.

North Dakota Resident Sentenced for Theft of Public Money

A resident of Mandan, North Dakota, was sentenced to 1 month home detention, 1 year probation, and 25 hours community service. She previously pled guilty to one count of **theft of public money**. The OIG investigation determined that the applicant failed to show a $103,189 judgment on her application for a $35,000 disaster home loan. A court-authorized search of her home by an SBA/OIG agent and Deputy U.S. Marshals documented that she had not used the loan proceeds to repair her home, as she had claimed, resulting in the charge of theft of public money. The investigation was initiated based on a referral from SBA's Fargo District Office.

California Food Market Owner Sentenced for Filing a False Claim

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

California Homeowner Pleads Guilty to Lying About Debts

A Northridge, California, homeowner pled guilty to one count of **making a false statement** to SBA. He was approved for a $123,100 disaster home loan following the 1994 earthquake. After receiving $38,900 in disaster loan proceeds, the man submitted a series of letters, one supported by a signed financial statement, requesting that SBA reduce his monthly payments because his financial condition had worsened due to a new $20,000 installment debt incurred for the purchase of a 1994 Acura automobile. The SBA/OIG's investigation revealed, however, that the applicant had paid cash for the vehicle. The man learned of the OIG investigation in September 1996 and immediately repaid the $39,000 balance of his SBA loan. The investigation was initiated at the request of the U.S. Attorney for the Central District of California.

Two Alabama Businessmen Plead Guilty to Mail Fraud

The owner of a real estate company in

Enterprise, Alabama, pled guilty to one count of **mail fraud** in an effort to obtain a $186,800 SBA business physical disaster loan. In return, the Department of Justice agreed to dismissal of the other 11 counts on which he had been indicted and the 1 count on which his codefendant, a Dothan, Alabama, man had been indicted. The SBA/OIG's investigation determined that, following a 1990 flood, the real estate company owner applied for the loan and fraudulently listed damaged properties that he did not own. While misusing the loan proceeds, he mailed claims and receipts showing that these properties had been repaired or replaced. His accomplice’s alleged part in the scheme involved falsifying repair receipts and thereby precipitating SBA’s ordering of a $12,800 joint payee Treasury check; the accomplice endorsed the check but the co-payee never received any of the proceeds. The investigation was based on a referral from SBA's Birmingham District Office.

California Real Estate Development Company Owners Sentenced for Filing a False Claim

The former co-owners of a real estate development company in Monterey Park, California, each pled guilty to one count of **filing a false claim** with SBA. One was sentenced to 366 days imprisonment and a $50 special assessment; the other was sentenced to 4 months home detention, 3 years probation, and a $50 special assessment. Together, they were ordered to pay $109,300 restitution.

The investigation leading to the above results was based on information provided by the SBA/OIG's Auditing Division. One partner applied for a $300,000 economic injury disaster loan following the 1992 Los Angeles civil unrest. The investigation disclosed that the application package, prepared with the assistance of the owner, included copies of falsified individual income tax returns for the second man and an altered copy of the 1991 corporate income tax return. Relying on these false documents, SBA approved and disbursed a $109,300 loan that ultimately went into default without a single payment having been made.

California Loan Packager Sentenced to Prison for Submitting False Documents to Government

One of two Beverly Hills, California, brothers, both primary subjects of the OIG’s investigation of unscrupulous loan packagers, was sentenced to 6½ years imprisonment and restitution of $7,069,332 in connection with the eight felony counts to which he had previously pled guilty. The man admitted that he had participated in the **submission of false documents to a Federal Government agency**. As a part of his criminal activity, he also assisted others in the submission of false tax returns supporting six SBA disaster business loan applications, totaling more than $3.9 million. The disaster loan applications included claims of both physical and economic injury and spanned three Los Angeles-area disasters: the 1992 civil unrest, the 1993 fires, and the 1994 earthquake. In addition, the man admitted **making false statements to Federally-insured financial institutions**, i.e., submitting false tax returns. This sentencing was one result of a joint

SBA/OIG and U.S. Secret Service investigation prompted by a tip from a concerned citizen and a referral from SBA's Disaster Assistance Area 4 Office. Of the 27 individuals who have been charged as a result of this investigation, all have pled guilty. One of the two brothers remains a fugitive at large. Other results in this period are:

❶ The owner of a Los Angeles, California, clothing manufacturer was sentenced to 2,000 hours community service, 5 years probation, a $2,000 fine, and full restitution to SBA. He pled guilty to **knowingly converting SBA disaster loan proceeds to his own use.** He had submitted a fraudulent application for a $180,000 economic injury disaster loan following the 1992 Los Angeles civil unrest. Because he applied for a loan for which he knew he was ineligible, his use of the loan proceeds constituted conversion.

❷ The owner of a clothing manufacturer in Los Angeles, California, was charged with and pled guilty to one count of **filing a false claim** with SBA. She was sentenced to 4 months home detention, 3 years probation, and 100 hours community service. She submitted falsified income tax returns for 1990-91 with her application for a $300,000 economic injury disaster loan following the 1992 Los Angeles civil unrest. Based on the bogus financial information reflected in her tax returns, which significantly overstated her business income, SBA disbursed $61,500; she has failed to make a single payment on this loan.

❸ The owner of another company was sentenced to 5 years probation, 2,000 hours community service, $116,300 restitution to SBA, and a $2,500 fine. He had pled guilty to **filing a false claim** with SBA. With his application for a $500,000 loan, the businessman submitted altered copies of tax returns which significantly overstated his business' income. He also submitted a schedule of liabilities that included numerous creditors with whom he had never actually done business.

❹The owner of a liquor store in Los Angeles, California, pled guilty to one count of **making false statements in a loan application to a Federally-insured bank** and one count of **making a false statement to SBA**. In March 1991, the man submitted fraudulent 1987-90 income tax returns to a participating lender bank to obtain a $631,500 SBA-guaranteed business loan. Following the 1992 Los Angeles civil unrest, he submitted false tax returns for 1989-91 to SBA in an effort to obtain disaster assistance. He ultimately obtained both a $71,800 physical damage business loan and a $59,200 economic injury loan. In addition, the investigation led to his acquisition of other additional fraudulently-obtained bank loans totaling $1,193,750. The store owner's actions resulted in losses to SBA and other lenders of $1,097,388 after he filed for bankruptcy and the existing collateral was sold.

❺ A tax preparer in Glendale, California, was charged with and pled guilty to aiding and abetting the **making of material false statements**. He prepared altered income tax returns which were submitted to SBA in support of a $450,000 economic injury disaster loan application. The man significantly overstated a loan applicant's income on both corporate and personal tax returns. The SBA/OIG's joint investigation with the U.S. Secret Service revealed that the tax preparer altered income tax returns for other SBA disaster loan applicants as well, two of whom previously pled guilty to related criminal charges. This is the first tax preparer charged in the continuing investigation of disaster loan applications packaged by the two southern California brothers.

Georgia Disaster Loan Applicant Sentenced for Making False Statements

A St. Marys, Georgia, businessman was sentenced to 5 years probation, 200 hours community service, and a $5,000 fine. He had pled guilty to **making material false statements** to induce SBA to disburse a $125,000 disaster business loan to cover physical damage to a mobile home park. The investigation found that he falsely represented that he had been the sole owner of a mobile home park and six mobile homes when they were damaged or destroyed during a severe storm; he also falsely stated that he would use proceeds of the disaster loan to repair or replace the six mobile homes. The SBA/OIG initiated the investigation based on information from an anonymous caller.

Virgin Islands Resident Pleads Guilty to Making False Statements

A resident of St. Croix, U.S. Virgin Islands, pled guilty to one count of **making false statements to SBA**. The SBA/OIG's joint investigation with the Federal Emergency Management Agency's (FEMA) OIG developed evidence that the man’s application for a $10,000 disaster home loan contained false claims for lost property, a false bill of sale for an automobile, and falsified property rental agreements. The applicant received the loan and a $1,290 grant from FEMA to cover purported damage from Hurricane Marilyn. The investigation was based on a referral from the temporary SBA Disaster Assistance Office in St. Croix.

California Television Repair Shop Owner Indicted for Making False Statements

The former owner of a television repair shop in Los Angeles, California, was indicted on two counts of **making false statements** to SBA. The SBA/OIG initiated the investigation based on a referral from the Liquidation Division of SBA's Los Angeles District Office and continued it jointly with the Social Security Administration’s OIG and the U.S. Secret Service. The investigation revealed that the man had filed for bankruptcy under several Social Security numbers and concealed the bankruptcy filings from SBA to obtain two disaster loans for his business following the 1992 civil unrest. He also submitted altered copies of income tax returns with his applications for the $26,400 physical damage loan and the $13,300 economic injury loan.

North Carolina Disaster Home Loan Borrower Indicted for Making False Statements

A Waynesville, North Carolina, disaster home loan borrower was indicted on two counts of **making material false statements** that influenced SBA to disburse a $38,400 disaster home loan. The homeowner allegedly submitted to SBA's Disaster Assistance Area 2 Office falsified documentation of her use of the loan proceeds, including a mobile home certificate of title, a purchase order, a certification of hazard insurance, a deed of separation, and a title insurance policy. Subsequently, the woman also submitted allegedly false documents, including a purchase contract and two bank statements, to the investigating OIG special agent in support of her disaster-related claims. This SBA/OIG investigation was initiated based on a referral from SBA's Disaster Assistance Area 2 Office.

California Restaurateur Indicted for SBA and Social Security Fraud

The former owner of a Compton, California, restaurant was indicted on one count of **making a material false statement** to SBA and one count of **fraudulent use of a Social Security number** (SSN). The restaurateur had applied for disaster loans totaling $240,579 for his business following the 1992 Los Angeles civil unrest. The SBA/OIG's investigation disclosed that his application package included a falsified individual income tax return and a Form 413, Personal Financial Statement, that overstated his income. On both those documents, as well as on his Form 912, Statement of Personal History, the man is alleged to have used a bogus. Relying on this false information, SBA disbursed a $115,800 physical damage loan and another $18,200 of his economic injury loan. The investigation was based on information provided by SBA's Disaster Assistance Area 4 Office.

California Meat Market Owner Pleads Guilty to Filing False Claim

A former owner of a meat market in Huntington Park, California, pled guilty to one count of **filing a false claim** with SBA. In return, the Federal Government agreed to dismissal of the five remaining felony charges on which he had been indicted. The SBA/OIG initiated the investigation of the owner following receipt of a letter from his insurance company. The investigation documented that the man had received a $174,100 disaster business loan following the 1992 civil unrest in Los Angeles, claiming extensive damage to his store from looting. After only making two payments, the loan went into default. Interviews with numerous witnesses confirmed that little or no looting took place at the market. When interviewed, the owner confessed that he had overstated his losses and admitted overstating his income on the bogus tax returns submitted with the loan application. The IRS had no record of the owner having filed any tax returns for the years in question, 1988 through 1991. He was sentenced to 3 months home detention with electronic monitoring and 3 years probation.

Small Business Investment Companies

The primary purpose of the Small Business Investment Company Program is to provide a source of long-term debt and equity capital to new or expanding small businesses. **Small Business Investment Companies (SBICs)** are independently-owned and managed, profit-making investment companies which are licensed by SBA to finance small businesses by making long-term loans and investing in their equity securities. SBICs often also provide management assistance to the companies they finance.

The role of SBA is (a) to determine which SBICs to license, (b) to oversee and regulate those licensees, and (c) to arrange for government-guaranteed financing from private sources to add to their capital. Such financing, termed "leverage", is provided through either debentures or participating securities issued by the SBIC. The participating security was created by the Small Business Equity Enhancement Act of 1992 to serve the needs of SBICs investing principally in equity securities which do not generate income to cover the interest on their debenture leverage. They represent a limited partnership interest in the SBIC whereby SBA advances the cost of the leverage, termed prioritized payments and equivalent to interest, until profits have been generated from the SBIC's equity investments. In consideration, SBA participates in approximately 10 percent of the SBIC's profits. SBA arranges quarterly public offerings of trust certificates backed by pools of SBIC debentures or participating securities which it guarantees as to payment of principal and interest.

As of the end of FY 1996, there were 282 licensed, active SBICs, with private capital of $4.5 billion and leverage of $1.4 billion for total capital of $5.9 billion. Included are 88 Specialized SBICs (SSBICs) which were licensed under Section 301(d) of the Small Business Investment Act to invest only in small businesses owned and managed by socially or economically disadvantaged persons. (Section 301(d) was repealed in 1996, but existing SSBICs were "grandfathered" and continue to operate as before.) In addition, there were 160 SBICs in liquidation owing SBA $302 million. The SBIC program level in FY 1996 was $374 million. The FY 1997 program level will be $667 million, signaling a material expansion of the program.

The SBI Act generally requires that all SBICs licensed by SBA be examined every 2 years to ensure licensee compliance with law and Agency regulations. The Small Business Credit and Business Enhancement Opportunity Act of 1992 transferred the responsibility for examining SBICs from the OIG to the Agency effective October 1, 1992. While SBA's Investment Division is now responsible for these examinations, the OIG continues to have authority to audit the SBIC program pursuant to its responsibility to oversee all Agency programs and activities.

Summary of OIG Activity

The following summarizes OIG activities relating to the SBIC program during the reporting period:

- SBIC investigations resulted in one indictment, one conviction, and a $1 million recovery.
- One SBIC investigation was closed, leaving an inventory of 13 active cases, involving 29 subjects.
- Two SBIC regulations were reviewed, as were four Standard Operating Procedures (SOP).

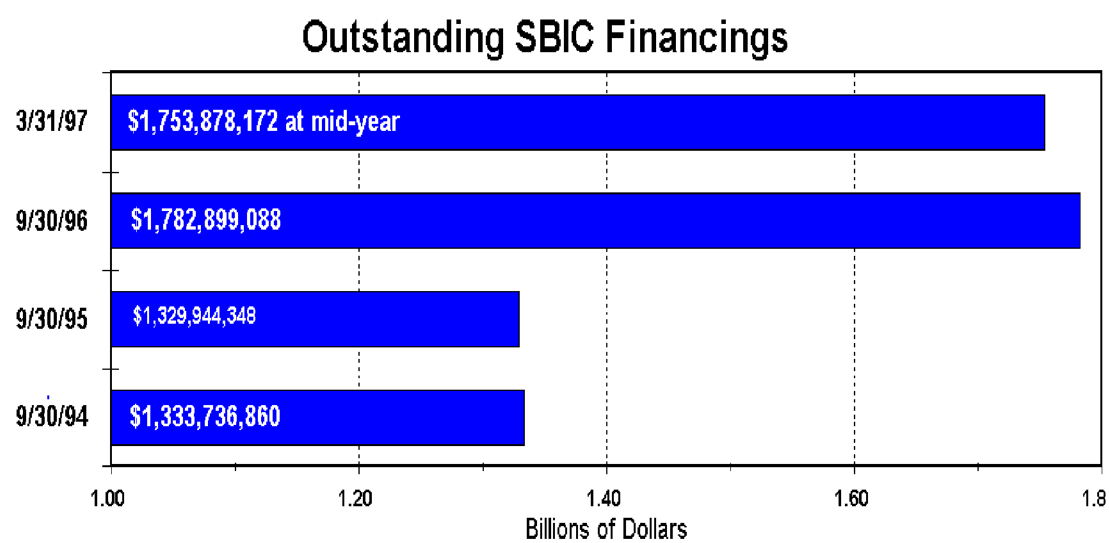


Figure 3

Efforts to Improve SBA Program Management

SBIC Program SOPs Reviewed

As part of SBA's initiative to update and streamline its SOPs, the OIG reviewed and commented on proposed revisions to several SBIC program SOPs. In reviewing SOP 10 06 2, Oversight and Regulation of SBICs, the OIG commented on plans for orderly liquidation, examination report findings, resolution of adverse findings, capital impairment, and repeated regulatory violations. The office's review of SOP 10 08, SBIC Examinations, and SOP 10 09, Examination of SBICs, led to comments on the review of independent public accountants' reports and verification of use of proceeds by portfolio concerns.

Activities to Enhance Fraud Detection and Deterrence

California Restaurateur Indicted for Bank Fraud

The former owner of a restaurant in La Mesa, California, was indicted on three counts of **bank fraud**. One count involved a $465,000 loan from a now-defunct specialized small business investment company (SSBIC) in Southfield, Michigan. The owner applied for the loan in the name of the restaurant, purportedly to make improvements to the facility. He is alleged to have falsified documents submitted to the SSBIC in an effort to conceal that the true (and ineligible) use of the loan proceeds was to make a down payment on an option contract to purchase stock in a chain of convenience stores. The joint SBA/OIG, FBI, and U.S. Secret Service investigation developed from information uncovered in a previous OIG investigation of this particular SSBIC.

Owner of Defunct California SSBIC Pleads Guilty to Misapplying Funds

A Korean national who had been president and majority shareholder of a now-defunct SSBIC in Los Angeles, California, pled guilty to four felony counts of **misapplication of funds** of an SBIC. In return, the Government agreed to dismissal of the 11 remaining charges on which he had been indicted in May 1989. At that time, the businessman was believed to be out of the country, and a fugitive warrant for his arrest was issued. The warrant remained outstanding until November 1996 when he re-entered the United States and was arrested. The indictment was a result of a lengthy investigation which the SBA/OIG conducted jointly with the FBI. The case was initiated after allegations of wrongdoing were received from the SSBIC's investment advisor, an individual who had been placed in that position by SBA to monitor the company's operations. The investigation disclosed that the owner made false statements concerning the amount of money he had invested in the SSBIC and that he misapplied more than $400,000 by pledging company assets for his personal enrichment. To conceal his illegal activities, he also falsely reported in the SSBIC's records that loans totaling at least $337,500 had been repaid. In 1987, the SSBIC was placed in receivership by SBA, which thereafter obtained a civil judgment in excess of $5 million against the SSBIC and its owner. SBA ultimately suffered a loss of more than $3.7 million, however, because of his actions.

Receivership of Corruptly-Run SSBIC Pays SBA Another $1 Million

The receivership of a Southfield, Michigan, SSBIC, which was ordered as a result of information developed during the SBA/OIG's joint investigation with the U.S. Secret Service, paid SBA another $1 million generated from its "closing down" of the former licensee's business. This brings the **total recovered by SBA under the terms of the 3-year old receivership to $4 million**. The SSBIC's former owner was previously sentenced to 1 day's imprisonment and forfeiture of $50,000 to the Government for receiving an unlawful benefit during the time period he operated the SSBIC. The investigation found that from 1987 through 1992 he solicited and received money or payment of a personal debt from prospective borrowers of the SSBIC in exchange for approving and disbursing loans to their companies.

Surety Bond Guarantees

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.** Under this program, SBA guarantees a portion of the losses sustained by a surety company as a result of the issuance of a bid, payment, and/or performance bond to a small business concern.

Businesses in the construction and service industries can meet the SBA's size eligibility standards if their average annual receipts (including those of their affiliates) for the last 3 fiscal years do not exceed $5 million. Any contract bond is eligible for SBA guarantee if the bond is covered by the Contract Bonds section of the Current Manual of Rules, Procedures and Classifications of the Surety Association of America, required by the invitation to bid or by the contract, and executed by a surety company that is determined by SBA to be eligible to participate in the program and certified acceptable by the Department of the Treasury.

The **Preferred Surety Bond (PSB)** program allows selected sureties to issue, monitor, and service surety bonds without SBA's prior approval. SBA accomplishes two primary objectives through this program: (1) expanding the number of sureties participating in the surety bond guarantee program, and (2) increasing bonding availability to business concerns that would otherwise not be able to obtain bonding in the standard marketplace. Title II of Public Law 100-590 also requires an annual audit of each surety participating in this program.

SBA can guarantee bonds for contracts with a face value of up to $1.25 million. In FY 1996, SBA contingent liability for new final bond guarantees, including those issued under the PSB program, was $724 million. The appropriated guarantee authority level for FY 1996 surety bond guarantees was $1.767 billion; in FY 1997, it is $1.767 billion.

Summary of OIG Activity

The following summarizes OIG activities relating to SBA's surety bond guarantee program during the reporting period:

- Two audit reports were issued during the reporting period.
- One surety bond investigation, with two subjects, remained active at the end of the reporting period.

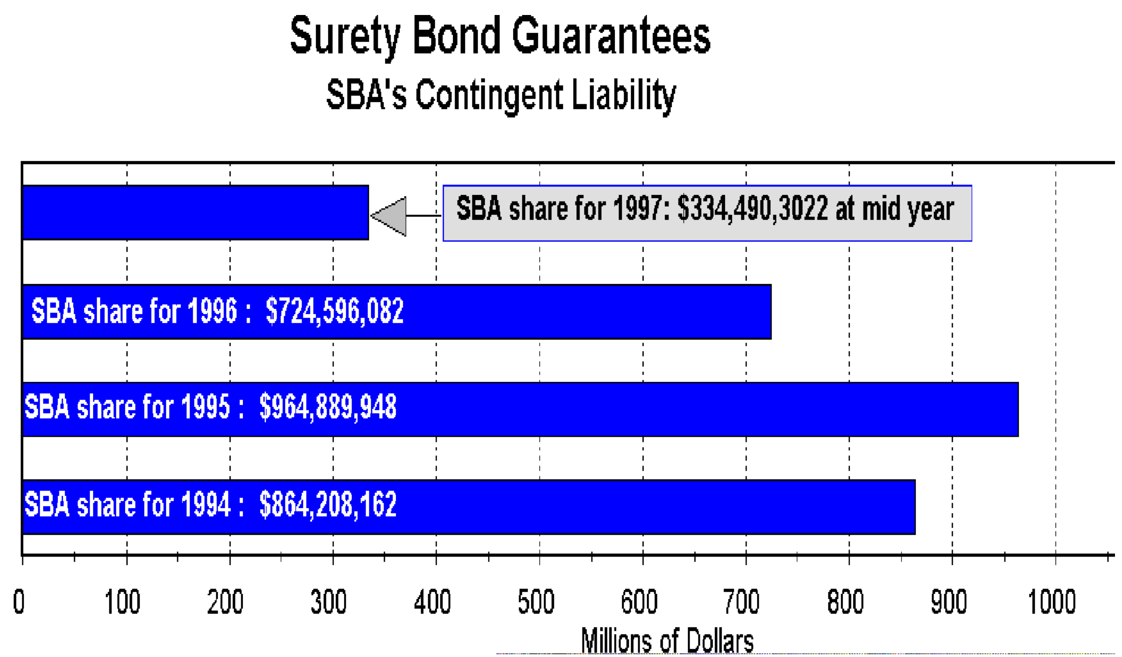


Figure 4

Audit Reveals Incomplete Forms Used to Support Surety Guarantees

A recently released audit of a surety company in Baltimore, Maryland, revealed that complete **information on surety applications was not being provided to SBA on Form 994**. The surety company claimed that the form was not being filled out completely because of improper instructions issued by SBA in March 1996. Without the completed form, SBA lacks important information on start dates, subcontractors, previous SBA bonds, SBA debts, type of business, affiliates, and gross receipts. As a result of the audit, which was requested by the Office of Surety Guarantees, the Associate Administrator for Surety Guarantees issued clarifying instructions on January 27, 1997, that Form 994 is to be completed in its entirety on initial surety bond guarantees for a contractor.

Audit of a Maryland Surety Uncovers Bonds Improperly Underwritten

An audit of a preferred surety company (a company that can underwrite SBA-guaranteed bonds without prior approval of SBA) in Maryland found that SBA **guarantees were issued inappropriately in 10 of 50 bonds** examined in the audit. As a result, SBA provided $5.3 million in guarantees that should not have been made. The bonds were inappropriate because of contract splitting and the fact that some projects had already started. Splitting a contract into two or more contracts to avoid the $1,250,000 limit on SBA-bonded projects is a violation of the regulations. Bonding a project after it has started is also a violation of regulations, unless the Surety obtains SBA written permission. Nine of the 10 bonds cited in the audit involved contract splitting; 6 were issued after the project started and without Agency approval. The OIG recommended that SBA deny liability on all the bonds involving contract splitting or untimely approvals and remind the company that it must adhere to SBA regulations. The Associate Administrator for Surety Guarantees agreed with the recommendations.

Government Contracting Programs

SBA provides assistance to small businesses in obtaining a fair share of Federal Government contracting opportunities. SBA also works with each department or agency to establish procurement goals for contracting with small, small-disadvantaged, and women-owned businesses. The Agency's Government contracting programs include **Prime Contracts, Subcontracting Assistance, Certificate of Competency, Natural Resources Sales Assistance,** and the **Procurement Automated Source System.**

The goals of the **Prime Contract Program** are to increase small business opportunities in the Federal acquisition process and to expand full and open competition to effect savings to the Federal Government. Supporting initiatives are carried out by traditional and breakout procurement center representatives assigned to major Federal acquisition activities.

The **Subcontracting Assistance Program** promotes the optimal use of small businesses by the Government's large prime contractors. This is carried out by commercial market representatives who monitor the procurement activities of the large prime contractors.

The **Certificate of Competency (COC) Program** provides an appeal process to assure that small business concerns, especially those new to the Federal procurement market, are given a fair opportunity to compete for and win Government contracts. If a small business is the successful offeror on a contract but is found non-responsible, it can appeal to SBA. After reviewing a firm's capabilities, SBA can issue a COC that requires the contracting officer to award the contract to that business.

Natural Resources Sales Assistance helps small businesses obtain a fair share of Federal property offered for sale or disposal, with a focus on sales of Federal timber, royalty oil, coal leases, and other mineral leases.

The **Procurement Automated Source System (PASS)** is SBA's computerized inventory of U.S. small businesses that are interested in Federal procurement opportunities, either directly with the Government or with prime contractors. Both Federal agencies and large prime contractors use PASS as a resource in identifying small businesses for procurement opportunities.

Summary of OIG Activity

The following summarizes OIG activities relating to SBA's Government contracting programs during the reporting period:

- One Government contracting investigation was closed; 6 others were active, involving 14 subjects.

- One Government contracting investigation continued to be monitored. Due to SBA/OIG workload constraints, it had previously been referred to another law enforcement agency for investigation.

- Two regulations were reviewed in this program area, as were six Standard Operating Procedures (SOP).

Efforts to Improve SBA Program Management

Women-Owned Business Regulations Reviewed

The SBA/OIG reviewed a proposed amendment to 13 C.F.R. Part 125 (SBA's Government contracting regulations) that would incorporate the definition of "women-owned business," as established in the Federal Acquisition Streamlining Act of 1994; provide for a self-certification process for firms claiming status as women-owned businesses; and establish administrative procedures for resolving challenges to such self-certifications. The OIG commented on ownership requirements for limited liability companies, the self-certification process, the penalties for adverse status determinations, and groups or individuals who may protest awards of sole source contracts.

Government Contracting SOPs Reviewed

As part of SBA's initiative to update and streamline its SOPs, the OIG reviewed proposed revisions to six Government contracting SOPs and commented on several. In reviewing SOP 60 03 5, Subcontracting Assistance Program, the OIG commented on prime contractor and subcontractor of the year award procedures. Our review of SOP 60 04 4, Certificate of Competency Program, led to a comment on procedures for integrity referrals. Finally, in reviewing the Size Determinations procedures (SOP 90 01 3), the OIG commented on provisions concerning criminal, civil, and administrative penalties for misrepresenting small business size status.

Minority Enterprise Development

Section 7(j)(10) of the Small Business Act established the **Minority Small Business and Capital Ownership Development Program** for the purpose of promoting greater access to the free enterprise system for socially and economically disadvantaged individuals. Under the Act, SBA provides business development assistance to small business concerns that are at least 51 percent unconditionally owned, controlled, and managed by one or more socially and economically disadvantaged individuals and that meet other eligibility requirements. Firms may participate in the program for a maximum of 9 years and must take steps to enhance their competitiveness during this period to be prepared to compete in the commercial sector upon graduation from the program.

One of the business development tools available to participant firms is access to Federal contracting opportunities authorized by **Section 8(a)** of the Small Business Act. Under the Section 8(a) program, SBA contracts with other Government agencies to provide goods and services, and subcontracts the performance of these contracts to program participants. As of September 30, 1996, there were more than 6,115 approved program participants. In FY 1996, Section 8(a) program participants received 5,678 contracts and 27,262 modifications with an aggregate value of $6.0 billion. Generally, Section 8(a) contracts with estimated values, including all options, of more than $5 million (manufacturing) or $3 million (all other industries) must be competed among eligible Section 8(a) program participants. The vast majority of the contracts awarded under the program, however, have estimated values below these thresholds and are awarded on a sole-source basis.

Under the **Section 7(j) Management and Technical Assistance Program**, which is housed in the Office of Minority Enterprise Development, SBA provides specialized training, professional consultant assistance, and executive development to certified Section 8(a) firms, socially and economically disadvantaged individuals whose firms are not participants in the Section 8(a) program, low-income individuals, and small businesses located in areas of low income or high unemployment.

There are over $9 billion in Section 8(a) subcontracts currently outstanding and subject to OIG audit, inspection, and investigation oversight activities. These contracts are reflected in other Government agencies' portfolios; therefore, their values are not included in our almost $35 billion audit, inspection, and investigation universe.

Summary of OIG Activity

The following summarizes SBA/OIG activities relating to the Agency's minority enterprise development (MED) programs during the reporting period:

- The Investigations Division's name checks resulted in the declination of six applications for the Section 8(a) program.
- Seven MED investigations were closed, leaving an inventory of 6 active cases involving 18 subjects. Three MED cases continued to be monitored which, due to workload demands, had previously been referred to other law enforcement agencies for investigation.
- Two audits were underway during the reporting period.
- The OIG reviewed two regulations in the MED program area.

Efforts to Improve SBA Program Management

Program Vulnerability Memorandum Issued on Need for Nationwide Section 8(a) Applicant Database

In October 1996, SBA's Inspector General (IG) issued a program vulnerability memorandum (PVM) to the Associate Deputy Administrator for Government Contracting and MED (ADA/GC&MED). The PVM was prompted by a referral to the OIG's Investigations Division that revealed an Agency vulnerability to potentially fraudulent Section 8(a) applications. The PVM was based on the understanding that applicants for the Section 8(a) program are not checked against a list of prior applicants; consequently, a rejected Section 8(a) applicant could move to another state and simply reapply for admission to the program, possibly with a fraudulent application or with the hope that the reason for disqualification would be overlooked.

An OIG review of SOP 80 05 02 found no requirement to check an applicant company's name or its principals against a nationwide list of previous applicants and participants. As a result, unscrupulous company principals could fraudulently tailor their application to satisfy program admission requirements, change their company's mailing address, and reapply for admission to the Section 8(a) program.

The OIG suggested the creation of a database containing, at a minimum, the names of both current and prior Section 8(a) participants, as well as those whose applications were either withdrawn or rejected. Identifiers, such as address, Social Security number, date and place of birth, employer identification number, and type of business, should accompany each name. The OIG also suggested that, to put such a database to effective use, SOP 80 05 02 should be revised to include a requirement that the database be queried by any SBA district office or Central Office Duty Station processing a Section 8(a) application. While duplicate "hits" would in most cases be resolved in favor of the applicant, deceptive or fraudulent applications could be detected and unjustified certifications avoided.

Finally, the OIG expressed the view that MED's Central Tracking System, currently being converted from mainframe to Personal Computer use, represents a good start on a workable solution. The OIG urged MED to continue refining the system's capabilities and to make its use part of the routine processing of Section 8(a) applications. As of the close of this reporting period, the OIG had received no reply from the ADA/GC&MED.

Minority Enterprise Development Program Regulations

The OIG reviewed a draft of proposed amendments to 13 C.F.R. Part 124, governing the minority enterprise development program, and provided numerous comments to the Agency for its consideration in developing proposed regulations. The OIG's comments focused on such issues as evidence of social disadvantage, determinations of economic disadvantage, net worth limits, the requirement that a firm have been in business for two years, brokers' participation in the program, the non-manufacturer rule, graduation from the program, termination proceedings, transfers and withdrawals of business assets, sole source contracts, competitive mix requirements, joint ventures, Section 8(a) sole source contracts, and subcontracting limitations.

Activities to Enhance Fraud Detection and Deterrence

Colorado Construction Company Terminated from Program

SBA's termination of a Denver, Colorado, company from the Section 8(a) program became final during this period. SBA had proposed the termination more than 1 year earlier based on the findings in an OIG investigation report. Shortly after the company was awarded a $22.5 million Small Disadvantaged Business (SDB) set-aside contract, a complaint was received that the owner **was not disadvantaged, as he had claimed**. At the time of this protest, the OIG and the FBI were investigating the man on a separate contracting-related allegation. The investigation determined that the company owner also submitted documents to SBA representing that he was born in Bombay, India and was therefore, presumed to be disadvantaged. Documents obtained during the investigation disclosed that he was actually born in Iran, a country of origin to which the presumption of disadvantage has not been accorded. Based on the investigation report, SBA determined that the construction company was ineligible for SDB set-aside contracts.

Economic Development
(Business Education and Training)

SBA provides assistance to small business owners, managers, and prospective owners through its many counseling and training programs. SBA established the **Small Business Development Center** (**SBDC**) program to make management assistance and counseling widely available. SBDCs offer one-stop assistance to small businesses by providing a wide variety of information and guidance in easily accessible locations. The program is a partnership between the private sector; the educational community; and Federal, State, and local governments. There are SBDCs in all 50 states, the District of Columbia, Puerto Rico, the Virgin Islands, and Guam, with approximately 1,000 subcenters or service locations located at colleges, universities, vocational schools, chambers of commerce, economic development corporations, or downtown storefronts. In FY 1996, SBDCs provided counseling and training to over 570,000 clients.

The **Service Corps of Retired Executives** (**SCORE**) is another of the valuable business development resource partners of SBA. Composed of approximately 12,400 volunteers working in over 700 sites, SCORE provides counseling and training to current or prospective business persons. Counseling sessions are free to the public and training is provided at a low cost. Over 250,000 clients were assisted in FY 1996.

The vast majority of SBA business development and education activities in the areas of training, counseling, and providing management information materials occur through outreach efforts with external organizations. **Cosponsorship** arrangements, authorized under the Small Business Act, play a key part in this process. The Act gives SBA the authority to cosponsor training and counseling activities for small business concerns with non-profit entities and/or with other Federal Government agencies. In addition, the Act authorizes the Agency to cosponsor training, but not counseling, with for-profit concerns.

Business Information Centers (BICs) provide business owners with access to computers, software, databases, and other resources to assist them in starting and expanding their businesses. All BICs have at least one on-site counselor and can address the varied business start-up and growth issues encountered by small business owners. There are currently 40 BICs in operation.

Summary of OIG Activity

The following summarizes SBA/OIG activities relating to the Agency's economic development programs during the reporting period:

- One economic development case produced civil settlements totaling $91,479, and two other cases were opened; three cases (four subjects) remained active at the end of the reporting period.
- One audit was issued during the reporting period and another was underway.

Efforts to Improve SBA Program Management

Audit of Maryland Small Business Development Center Identifies Erroneous Claims

An audit of a Maryland small business development center identified $529,000 of **claimed costs that were unallowable** under program guidelines. These included the salary of a non-SBDC employee, paid leave for employees not entitled to the benefit, unrelated travel, improper procurement, and excessive indirect cost. The SBDC's sponsor, the Maryland Department of Business and Economic Development, acknowledged $152,000 in erroneous claims during the audit. After netting the remainder of questioned costs against cash match requirements, the audit report said the SBDC should reimburse SBA $125,000.

Problems in counseling services for small businesses were also noted in the audit report. SBDC counselors at one subcenter spent an unreasonable amount of time on administrative functions and failed to document the delivery of counseling services. While the sponsor disputed some of the findings, SBA's Baltimore District Director concurred in all the audit's findings and recommendations.

Puerto Rico University Pays $122,454 in Administrative Settlement

A university in Puerto Rico paid the Government $122,454 to settle (without admitting guilt) OIG findings that the university had deposited program income of its small business development center (SBDC) it administered into a revolving account but had not, as required, reported it to SBA. An initial audit had found **numerous violations of program requirements and unallowable charges to grant funds**; the ensuing investigation uncovered evidence of even more extensive **misuse of SBA funds** and of the university's efforts to **conceal program income and unauthorized expenditures**. The settlement agreement specifically excluded the former SBDC Director, who has already made a $30,252 settlement payment but whose liability for alleged misuse of SBDC funds has not yet been resolved. In response to the investigative report, SBA previously terminated its cooperative agreement with the university, whose SBA funding in FY

1997 was slated to be $1,035,441; during this reporting period, SBA awarded $1.5 million to another Puerto Rico university to administer the SBDC in 1997.

Agency Management and Financial Activities

Agency **Management and Financial Activities** include SBA's administration of the loan programs, as well as the full range of internal administration and financial management operations. OIG audit, investigative, and inspection activities assist SBA managers by reviewing these operations and by conducting audits of Agency financial statements as required by the Chief Financial Officers Act, audits of cash management activities, and integrity assurance activities.

SBA's management and financial activities are supported by the Agency's total availability of $1.061 billion for FY 1997, including appropriations enacted in P.L. 104-208. Of the $1.061 billion available, which includes carry-overs and estimated recoveries, $379.4 million are for Salaries and Expenses, $22 million for Disaster loan servicing, and $103.8 million for Disaster loan making. $226.6 million are available for Business Loans, $314.8 million for Disaster loans, and $3.73 million for the Surety Bond Guarantee program.

Summary of OIG Activity

The following summarizes SBA/OIG activities relating to the Agency's administration and financial management activities during the reporting period:

- Three audit reports were issued and two other audits were underway.
- One study was completed and issued during the reporting period.
- Integrity assurance cases resulted in two indictments, two convictions, and a $10,684 recovery.
- Fourteen integrity assurance investigations were closed, leaving an inventory of 16 active cases involving 20 subjects.
- Two integrity assurance investigations continued to be monitored. Due to workload constraints, they had previously been referred to other law enforcement agencies for investigation.
- The OIG reviewed 2 pieces of proposed legislation, 2 regulations, and 23 Standard Operating Procedures (SOP).

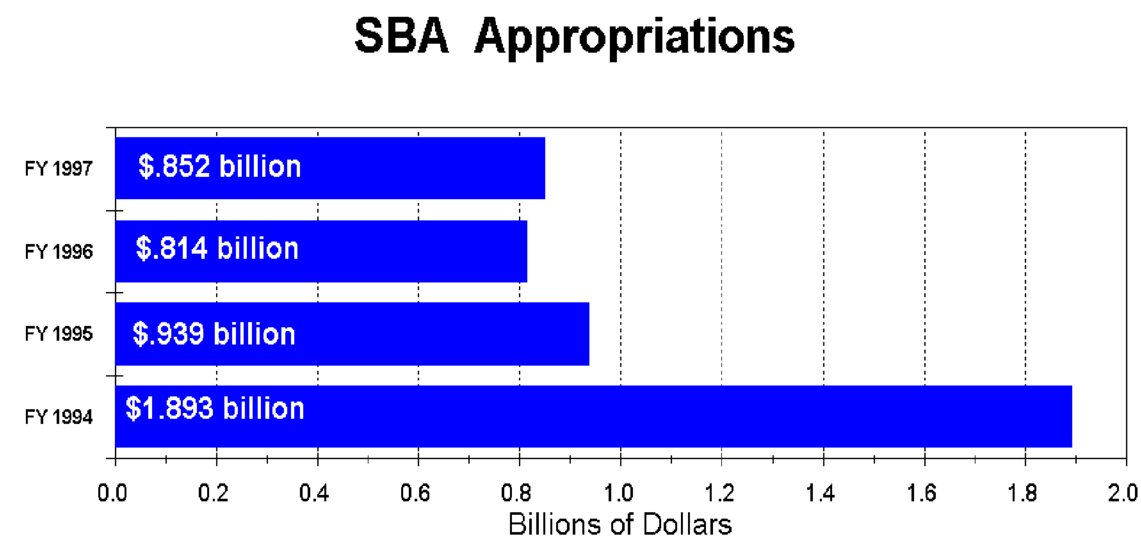


Figure 5

Efforts to Improve SBA Program Management

SBA's Annual Chief Financial Officers Act Audit Results in Unqualified Opinion

For the first time in 6 years of audits under the mandated requirements of the Chief Financial Officers Act, **the SBA financial statements for FY 1996 received an unqualified opinion**. The unqualified opinion means that the independent auditors, Cotton & Company (Cotton), found SBA's principal financial statements to be presented fairly in all material respects in accordance with Office of Management and Budget guidelines and SBA accounting policies. The results of the audit were transmitted to the Chief Financial Officer by the SBA/OIG, which had contracted with Cotton to perform the independent audit.

Cotton found that SBA had made progress on the two problems that caused the 1995 opinion to be qualified: (1) reconciliation of fund balances with Treasury and (2) inventory of foreclosed properties. These two problems, however, were still identified as "reportable conditions" in the internal control structure, and the cash reconciliation was still classified as a material control weakness.

Four other internal control weaknesses were reported: (1) inconsistent valuation of foreclosed property, (2) lack of annual estimates of credit reform subsidy rates for disaster loans, (3) inadequate computer user password security procedures, and (4) unclear year-end cut-off procedures. In the section on compliance with laws and regulations, the auditors found SBA complied in all material respects with provisions of applicable laws and regulations tested.

OIG Completes Study of Centralization of Agency Functions

In response to a request from SBA's Administrator, the OIG issued a study identifying SBA **functions which might potentially be centralized**. Entitled "A Framework for Considering the Centralization of SBA Functions," it suggests a rationale for centralizing SBA programs where appropriate, outlines an approach for deciding whether to consolidate the common functions of various SBA programs in central locations, and discusses the advantages and disadvantages of centralized operations compared with decentralized operations.

Audit-Related Memorandum Seeks Recovery of Unexpended Grant Funds

During the conduct of a pre-award audit of a West Virginia grantee's work proposal, the OIG **discovered that as much as $435,775 from a previous $2 million grant had not been expended or obligated by the grant expiration date**. Because there was no provision for carryover of funds, further obligation of funds could not occur without an extension of the grant period. The memorandum recommended that SBA's Assistant Administrator for Administration (AA/A) require the grantee to remit the outstanding advance. However, after requesting and receiving additional information from the grantee, the AA/A resolved this issue by extending the grant to cover the period when all remaining grant funds were expended.

Audit-Related Memorandum Recommends Revision of SOPs Pertaining to Grant Close-outs

A pre-award audit of an SBA grantee revealed that a West Virginia foundation had not submitted final financial reports within 90 days of the grant expiration dates on two prior grants. The OIG discovered that as much as $435,755 had not been expended or obligated by the expiration date in connection with one of these prior grants (see previous article). The auditors found that procedures were not in place requiring the Office of Procurement and Grants Management (OPGM) to follow up with the grantee if the final financial report was not received in a timely manner. The OIG recommended that SOP 00 11 2 be modified to require followup with grantees to ensure that financial reports are submitted within the prescribed period and unobligated advances, if any, are returned promptly. In addition, the OIG recommended a review of all grants awarded within the last 3 years. The Assistant Administrator for Administration agreed with the recommendations.

Agency Management and Financial Activities SOPs

As part of SBA's initiative to update and streamline its SOPs, the OIG reviewed proposed revisions to 23 SOPs governing SBA management and financial activities.

The OIG provided comments on directives concerning issues such as delegations of authority, directives management, imprest funds, travel, disbursement functions, audit follow up, congressional and legislative activities, employee relations, labor relations, attendance and leave, position classification, and property management.

Activities to Enhance Fraud Detection and Deterrence

OIG Conducts Employee Awareness Briefings

In addition to investigating complaints of waste, fraud, and abuse involving SBA programs, OIG Investigations Division staff presented 10 **Standards of Conduct briefings** to a total of more than 500 **Agency employees**. The involvement and cooperation of all SBA employees in combating waste, fraud, and abuse is critical to an effective OIG investigations program and to the Agency's overall productivity and efficiency.

During the reporting period, employee contributions to our mission were significant. As Figure 6 on page 51 shows, more than 67 percent of all investigative referrals originated from within the Agency, in the form of referrals either from program heads or from 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.

Investigation Prompts SBA to Establish Sole Source Review Process

As a result of an OIG investigation into possible **improprieties regarding the award of a sole-source contract**, SBA established a board to review all proposed sole-source contracts for more than $25,000. The investigation had disclosed several irregularities in the procedures and timing of how SBA awarded a $150,000 consulting contract. In January 1997, following the OIG's issuance of the report of investigation, the SBA manager who selected the sole-source contractor retired from Federal service. The OIG opened the investigation in response to a request from SBA management.

SBA Employee Pleads Guilty to Credit Card Fraud

On January 16, 1997, a former Minority Enterprise Development technician in SBA’s New York District Office pled guilty to a criminal information charging her with **using unauthorized access devices** (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 (SSN) 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, from an undetermined date in 1994 until January 1996, the SBA employee used her position to obtain the SSNs of at least three current or former co-workers. She used their names and SSNs to open numerous fraudulent charge accounts and to purchase merchandise valued at over $3,000.

Based upon a criminal complaint by the investigating SBA/OIG agent, the technician was arrested in the Agency's New York District Office on July 18, 1996. She resigned her position with the SBA in August.

OIG Concern Leads Office of Financial Assistance to Clarify Policy on Purging of Loan Files at Servicing Centers

As a result of concerns expressed by the OIG's Investigations Division, SBA's Office of Financial Assistance has clarified its policy concerning the **purging of certain documents from loan files**. In an effort to deal with a shortage of file storage space, SBA staff had been removing and disposing of duplicates of materials in larger files, routine financial statements not related to any loan servicing action, and "boilerplate" portions of voluminous reports such as appraisals and EPA studies. The OIG was concerned that any misunderstanding on the part of SBA staff as to Agency policy in this area could result in the disposal of records critical to criminal or civil prosecution of false claims. This matter was brought to the attention of the OIG by an employee of the Fresno Servicing Center.

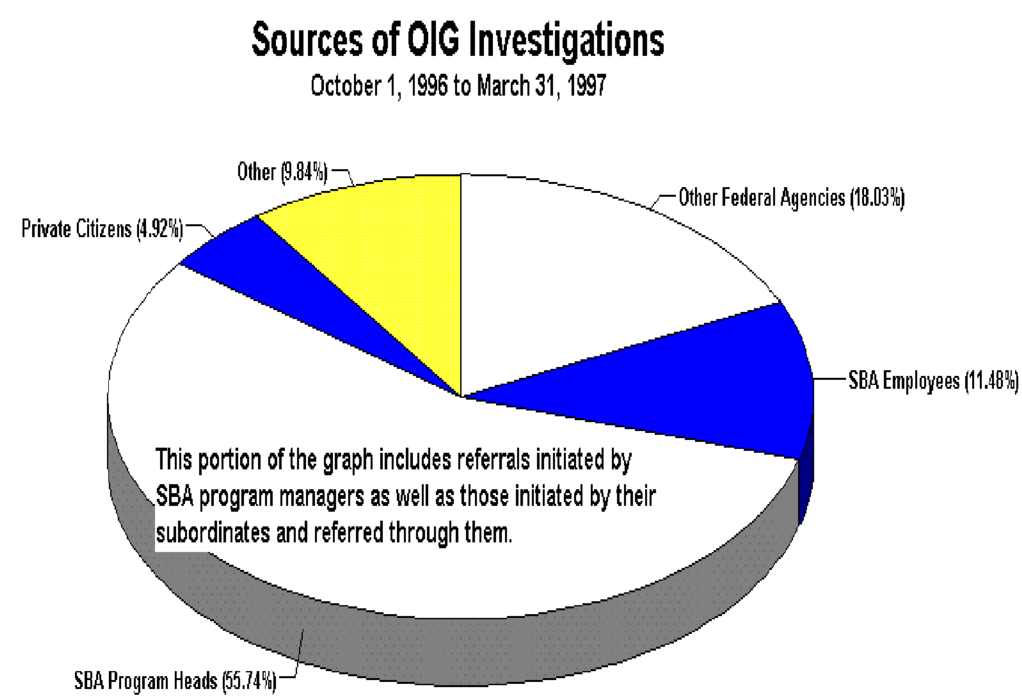
In response to the OIG's concerns, SBA program managers have reaffirmed Agency policy (regarding the removal of duplicate and boilerplate material from loan files) to assure that all essential loan documentation is properly maintained in the case files.

OIG Takes Custody of Safe Containing Subpoenaed Documents

On October 23, 1996, officials of SBA's Office of General Counsel (OGC) and the OIG became aware of allegations that a former Department of Commerce (DOC) employee, subsequently employed by SBA, **was storing DOC records (including classified documents) in his SBA office safe**. The OIG immediately took custody of both the safe and its contents and notified U.S. District Judge Royce C. Lamberth of its action. The records in question are allegedly the subject of ongoing litigation between a public interest group and the DOC. On the same day, SBA's Inspector General (IG) received a letter from the then-Chair of the House Small Business Committee requesting access to the entire contents of the safe. Judge Lamberth directed the IG to retain custody of the safe and its contents but noted that nothing precluded the IG from providing controlled access pursuant to appropriate Congressional requests. The judge also endorsed the IG's plan to inventory the contents of the safe in the presence of certain observers (DOC and SBA officials, selected Congressional staff members, a representative from the U.S. Attorney's office, the employee in question, and his counsel); the inventory took place on October 28, 1996. Since taking custody of the safe, the OIG has taken strict security measures to ensure the integrity of the safe and its contents pending further instructions from the court. Based on initial OIG findings, the employee's security clearance was downgraded on October 29, 1996, and he resigned from SBA on November 15, 1996.

SBA Clerk Pleads Guilty to Defrauding Businesses by Abusing Client's Social Security Number

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



Fi gu re 6

Organization, Resources, and Management Initiatives

The two missions of the Office of Inspector General are to help improve management in the Agency and to detect and deter fraud in SBA's programs. These dual missions are accomplished through the provision of audit, investigation, and inspection and evaluation oversight to the Agency's portfolio and programs. This chapter provides an overview of the OIG's organizational structure and personnel and budget resources and summarizes key internal management initiatives to use those resources as effectively as possible.

Organization

The SBA/OIG is organized into four divisions as follows:

- Auditing Division
- Investigations Division
- Inspection and Evaluation Division
- Management and Legal Counsel Division

The Auditing and Investigations Divisions each administer their field activities through field offices and resident offices around the country. The Auditing Division has offices located in Atlanta, Dallas, Los Angeles, and Washington. In addition to these cities, the Investigations Division has offices in Chicago, Denver, Houston, Kansas City, New York, Philadelphia, San Francisco, Seattle, and Syracuse. The Investigations Division's Office of Security Operations is located in Washington, D.C.

Both the Inspection and Evaluation Division and the Management and Legal Counsel Division operate out of Washington, D.C. A current OIG organization chart can be found at Figure 7.

Resources

In FY 1997, the OIG is operating at a funding level of $9.0 million and at an authorized personnel ceiling of 102 full-time equivalent (FTE) positions. While this level of funding represents a modest increase from the number of dollars appropriated in FY 1996, it provides only a minimal level of oversight to SBA programs and program dollars at risk. Congressionally-mandated law enforcement availability pay, annual cost of living increases, and various locality pay adjustments are still not fully reflected in authorized spending levels. Consequently, in 1996, the OIG was forced to request a transfer of funds from the Agency to ensure that ongoing operations could be funded. SBA's Administrator transferred $200,000 in May 1996 to the OIG's appropriation, enabling the OIG to avoid uncompensated furloughs of its staff and to carry out other priority activities.

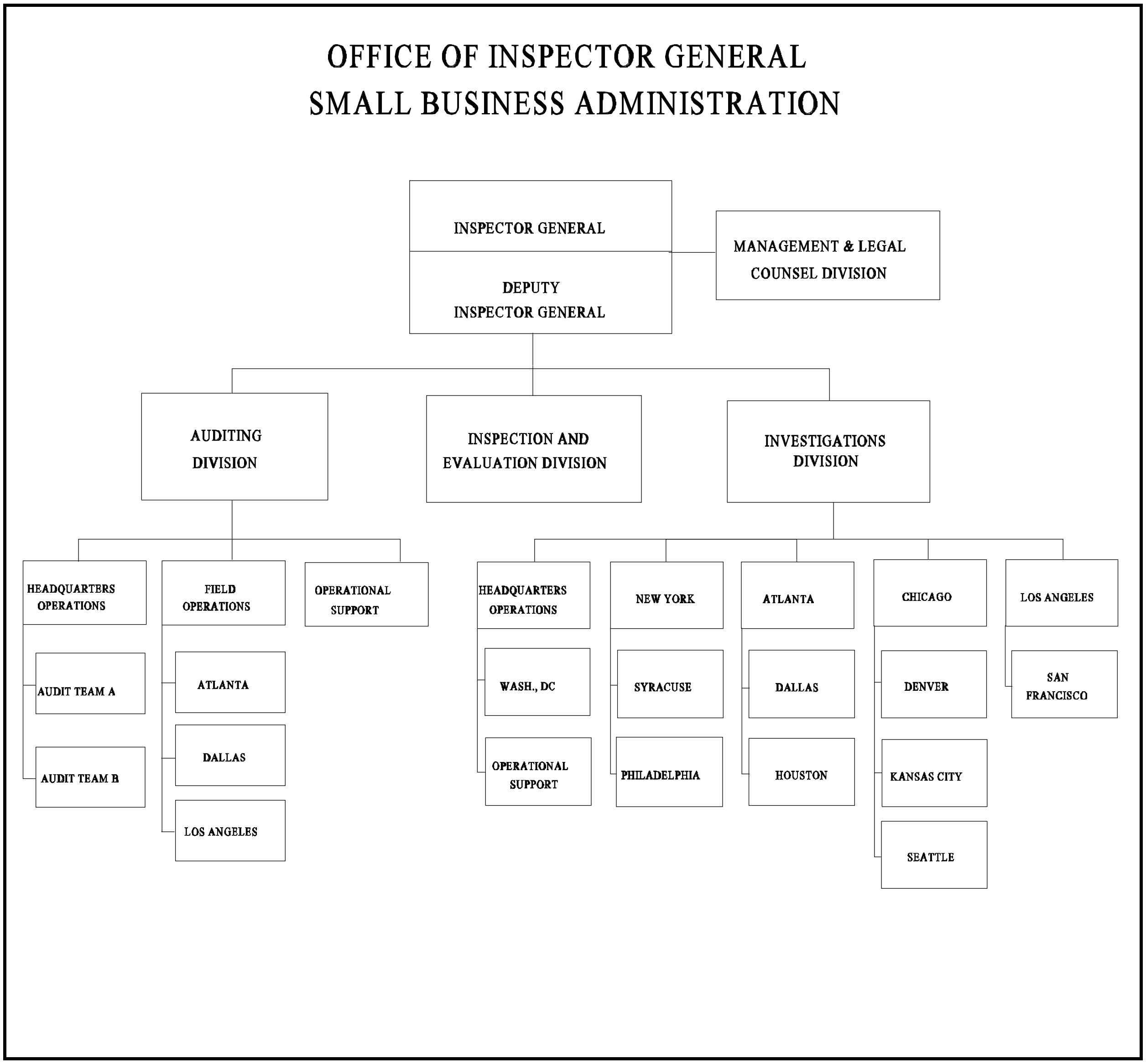


Figure 7

Notwithstanding the transfer of funds, the OIG ended FY 1996 with an average FTE of just over 98, or 4 positions under its authorized ceiling.

In FY 1994, the OIG also received $3 million in supplemental “no year” disaster funds to be used for activities related to the Agency's vastly expanding disaster assistance program; these funds will remain available until expended (see discussion below). Also, the Congress authorized a transfer of $500,000 in Agency funds in the FY 1997 budget specifically for OIG disaster-related oversight. As of the end of the current reporting period, four auditors, four investigators, one attorney, and two secretaries were on board on temporary appointments using disaster funding. Although the OIG’s disaster staffing plan calls for as many as 16 disaster-funded employees to be on board at this time, considerable difficulty has been experienced in recruiting, training, and retaining employees in these temporary-appointment positions.

The nature of the funding for disaster oversight forces the OIG to pursue recruitment of disaster-funded auditors and investigators on a “non-permanent” basis. Temporary employees are understandably eager to obtain more permanent positions elsewhere, and when they are successful, the OIG is deprived of both the expertise they have developed as well as their productivity.

The continuing reduction in OIG FTE resources remains troubling. As depicted in Figures 1 and 2, the expanding nature of the Agency's portfolio and its concomitant demand for OIG oversight would suggest that resources be increased (not reduced) to ensure adequate oversight. In recognition of this need, the President requested $9.985 million for the OIG for FY 1997. With the resources made available in the FY 1997 appropriation ($9 million), the OIG will again find it difficult to carry out its mandate to provide oversight of the Agency's programs and activities and to safeguard the Government's investment in its extensive credit programs. For FY 1998, the President has requested a slight increase in the OIG’s budget ($10.6 million and 10 additional FTE) in recognition of these rapidly growing programs.

The OIG continues to be concerned with the strong demand for investigations of fraud in Agency programs. As evidenced by the table on page 56, both business loan and disaster loan fraud continue to be our major areas of concentration, in terms of both active cases carried and time expended on those cases. During this reporting period the lion’s share of investigative time (81.6 percent) was expended on business and disaster loan fraud cases. With demand for SBA business and disaster loans remaining high, we expect that our investigative efforts will continue to be dominated by those two programs and our resources stretched severely.

The table on page 56 also illustrates the Auditing Division's emphasis on the business loan and disaster assistance programs. This priority is reflected in the increase in Auditing Division time spent looking at the disaster assistance program, which has grown incrementally from 3 percent to 12 percent of the available audit hours over the last 6 reporting periods. The IG is, of course, also greatly concerned by the meager coverage the OIG is able to provide to other Agency programs, supporting activities, and its program participants. There has been no audit oversight of the Agency computer systems, and the OIG has been virtually unable to respond to specific Agency requests for audit coverage. Key programs such as Section 8(a) have received but minimal audit oversight during the past year. Other programs such as Small Business Investment Companies have had no OIG oversight whatsoever.

Management Initiatives

Inspector General Issues Study of Inspection and Evaluation Units

The Inspection and Evaluation Committee of the President's Council on Integrity and Efficiency, which is chaired by SBA's Inspector General, issued a report on **OIG Inspection and Evaluation Units: Examples of Impact**. The report provides examples of the work performed by inspection and evaluation units across the inspector general community. The abstracts show the varied nature of OIG inspections and evaluations and the impact they have had. The document will be made available on the Internet ***(http://www.sbaonline.sba.gov/ignet).***

OIG Legislative Proposals

The OIG developed four legislative proposals that, if enacted, would improve OIG operations, provide necessary staff and budget resources, and facilitate OIG oversight of SBA programs.

- Asset forfeiture - the proposal would authorize the SBA/OIG to participate in the equitable sharing of cash and proceeds from the sale of forfeited property, when such assets are obtained as a result of SBA/OIG direct participation in law enforcement activities.

- Audits of preferred sureties - the proposal would remove the annual audit requirement for preferred sureties and replace it with a requirement for an annual review.

- False statements to SBICs - the proposal would provide civil and criminal penalties under the Financial Institutions Reform, Recovery, and Enforcement Act for false statements made to SBA or to an SBIC.

- Funds for disaster oversight - the proposal would authorize the Administrator to transfer funds to the OIG for disaster loan program oversight activities.

Inspector General Hosts Canadian Government Visitors

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

Direct Investigation Time by Program Area
October 1, 1996, to March 31, 1997

Program Area	Direct Time %	Number of Investigations	
		Closed	In Progress
Business Loans	55%	29	145
Disaster Loans	26%	6	92
SBIC	3%	1	13
Surety Bond Guarantees	*	0	1
Government Contracting	1%	1	6
Minority Enterprise Development	1%	7	6
Economic Development	1%	0	3
Agency Management and Financial	12%	14	16
Total	100%	58	282

Direct Auditing Time by Program Area
October 1, 1996, to March 31, 1997

Program Area	Direct Time %	Number of Audits	
		Issued	In Progress
Business Loans	69%	2	11
Disaster Loans	12%	3	3
SBIC	0%	0	0
Surety Bond Guarantees	2%	2	0
Government Contracting	0%	0	0
Minority Enterprise Development	4%	0	2
Economic Development	9%	1	1
Agency Management and Financial	4%	3	2
Total	100%	11	19

* less than ½ percent

Profile of Operating Results

October 1, 1996 to March 31, 1997

Audit Activities	**Totals**
A. Reports Issued	11
B. Desk Reviews of CPA Audit Reports Issued	0
C. Audit Recommendations Issued	35
D. Dollar Value of Costs Questioned	$734,867
E. Dollar Value of Recommendations that Funds Be Put to Better Use	$5,318,048

Audit Followup Activities

F. Audit Recommendations Closed	18
G. Disallowed Costs Agreed to by Management	$1,035,911
H. Dollar Value of Recommendations That Funds Be Put to Better Use Agreed to by Management	$5,318,048
I. Unresolved Audit Recommendations	40
J. Dollar Value of Unresolved Audit Recommendations	$1,686,906

Inspection Activities

A. Reports Issued	3

Legislation/Regulation/SOP/Other Reviews

A. Legislation Reviewed	2
B. Regulations Reviewed	12
C. Standard Operating Procedures Reviewed	43
D. Other Issuances Reviewed*	56

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

Status of Investigations as of March 31, 1997	**Totals**
A. Total Cases	340
B. Closed Cases	58
C. Pending Cases	28
D. Open Cases	254
E. Subjects Under Investigation	1,226

Summary of Indictments and Convictions

A. Indictments from OIG Cases	22
B. Convictions from OIG Cases	34

Summary of Recoveries and Reductions of Risk

A. Potential Recoveries and Fines as a Result of OIG Investigations	$21,251,476
B. Reductions of Financial Risk as a Result of OIG Investigations	$4,313,934
C. Reductions of Financial Risk as a Result of the Name Check Program	$12,231,532
Total:	$37,796,942

SBA Personnel Actions Taken as a Result of Investigations

A. Dismissals	0
B. Resignations/Retirements	2
C. Suspensions	0
D. Reprimands	2

Program Actions Taken as a Result of Investigations

A. Suspensions	0
B. Debarments	0
C. Removals from Program	1
D. Other Program Actions	2

Summary of OIG Fraud Line Operation

A. Total Fraud Line Calls/Letters	1,226
B. Total Calls/Letters Referred to Offices Outside the OIG	1,202
C. Total Calls/Letters Referred to Investigations Division for Evaluation	24

Investigations Activities - Referral Program

A. Cases Referred to FBI	13
B. Referred to Other Agencies (Excluding FBI)	2
C. Indictments from Referrals	0
D. Convictions from Referrals	1
E. Potential Recoveries and Fines as a Result of Referral Program	$0
F. Reductions of Financial Risk as a Result of Referral Program	$0

Office of Inspector General
Staffing as of March 31, 1997

A. Immediate Office		3
B. Auditing Division		34
Professional	30	
Support	4	
C. Investigations Division		46
Professional	37	
Support	9	
D. Inspection and Evaluation Division		9
Professional	8	
Support	1	
E. Management and Legal Counsel Division		9
Professional	7	
Support	2	
OIG Total		101

Additional Temporary Disaster Staffing
Funded from Supplemental Appropriations

A. Auditing Division	5.5
B. Investigations Division	4
C. Management and Legal Counsel Division	1
OIG Disaster Total	10.5

FY 1997 Productivity Statistics

First Six Months

Office-Wide Dollar Accomplishments	**Totals**
A. Potential Investigative Recoveries and Fines	$21,251,476
B. Management Avoidances as Result of Investigations	$16,545,466
C. Disallowed Costs Agreed to by Management	$1,035,911
D. Recommendations that Funds Be Put to Better Use Agreed to by Management	$5,318,048
Total	$44,150,901

Auditing Division Activities

A. Reports Issued	11
B. Disallowed Costs Agreed to by Management	$1,035,911
C. Recommendation that Funds Be Put to Better Use Agreed to by Management	$5,318,048

Inspection and Evaluation Division Activities

A. Reports Issued	3

Investigations Division Activities

A. Cases Closed		58
B. Indictments		22
C. Convictions		34
D. Potential Investigative Recoveries and Fines		$21,251,476
E. Management Avoidances		$16,545,466
- Investigation Cases	$4,313,934	
- Name Check Program	$12,231,532	

Statutory Reporting Requirements

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

Source		Location in this Report
Section 4(a)(2)	Review of Legislation and Regulations	Pages 5 to 52
Section 5(a)(1)	Significant Problems, Abuses, and Deficiencies	Pages 5 to 52
Section 5(a)(2)	Recommendations With Respect to Significant Problems, Abuses, and Deficiencies	Pages 5 to 52
Section 5(a)(3)	Prior Significant Recommendations Not Yet Implemented	Page 70
Section 5(a)(4)	Matters Referred to Prosecutive Authorities	Pages 5 to 52
Section 5(a)(5) and 6(b)(2)	Summary of Instances Where Information Was Refused	None
Section 5(a)(6)	Listing of Audit Reports	Page 64
Section 5(a)(7)	Summary of Significant Audits	Pages 5 to 52
Section 5(a)(8)	Audit Reports Containing Questioned Costs	Page 66
Section 5(a)(9)	Audit Reports Recommending that Funds Be Put to Better Use	Page 67
Section 5(a)(10)	Summary of Reports Where No Management Decision Was Made	Page 69
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 I

Audit Reports Issued
October 1, 1996 to March 31, 1997

TITLE	NUMBER	ISSUE DATE	QUESTIONED COSTS	FUNDS FOR BETTER USE
Business Loans				
Defaulted Loans Made by Allied Lending Corporation	76F006002	1/29/96	$22,264	
Early Default of Guaranteed Loans	74E001009	2/18/97		
Program Subtotal	Reports: 2			
Disaster Loans				
Disaster Loan Fraud Complaints	75F004001	11/8/96		
Disaster Loans Assigned to Los Angeles District Office	75F005004	12/23/96		
Survey of Electronic Fund Transfer Disbursements	76H005003	12/20/96		
Program Subtotal	Reports: 3			
Surety Bond Guarantees				
Use of SBA Surety Form 994	76H007005	12/20/96		
Surety Bond Underwriting Process	76H007008	2/14/97		$5,318,048
Program Subtotal	Reports: 2			
SBDC				
Maryland Small Business Development Center	76H001006	2/6/97	$277,848	
Program Subtotal	Reports: 1			
Agency Management and Financial				
SBA's 1996 Financial Statements	76H006010	2/28/97		
Grant Closeout Procedures	77H001011	3/31/97		

TITLE	NUMBER	ISSUE DATE	QUESTIONED COSTS	FUNDS FOR BETTER USE
West Virginia High Technology Consortium Foundation	77H001007	2/10/97	$434,755	
Program Subtotal	Reports: 3			

TOTALS (all programs)	**Reports: 11**		**$734,867**	**$5,318,048**

APPENDIX II - Part A

Audit Reports with Questioned Costs
October 1, 1996 to March 31, 1997

		REPORTS	RECs*	DOLLAR VALUES	
				QUESTIONED	UNSUPPORTED
A.	For which no management decision had been made by September 30, 1996	2	2	$769,698	
B.	Which were issued during the period	3	3	$734,867	
	Subtotals (A + B)	5	5	$1,504,565	
C.	For which a management decision was made during the reporting period	1	1	$142,659	
	(I) Disallowed costs	1	1	$144,454**	
	(a) Due SBA				
	(b) Due program participant				
	(ii) Costs not disallowed				
D.	For which no management decision had been made by March 31, 1997	4	4	$1,361,906	

* Recommendations
** Management disallowed $1,795 more than recommended

Note: The total number of dollars reported in the category of Disallowed Costs Agreed to by Management in the FY 1997 Productivity table and the Profile of Results table is $1,035,911. This amount includes the $144,454 shown above as well as other settlements and non-routine recoveries described in this report which have been classified into this category.

APPENDIX II - Part B

Audit Reports with Recommendations that Funds Be Put to Better Use October 1, 1996 to March 31, 1997

		REPORTS	RECs*	RECOMMENDED FUNDS FOR BETTER USE
A.	For which no management decision had been made by September 30, 1996	1	1	$325,000
B.	Which were issued during the period	2	2	$5,318,048
	Subtotals (A + B)	3	3	$5,643,048
C.	For which a management decision was made during the reporting period	1	1	$5,318,048
	(I) Recommendations agreed to by SBA management	1	1	$5,318,048
	(a) SBA level	1	1	$5,318,048
	(b) Program participant level			
	(ii) Recommendations not agreed to by SBA management			
D.	For which no management decision had been made by March 31, 1997	2	2	$325,000

* Recommendations.

APPENDIX II - Part C

Audit Reports with Non-Monetary Recommendations
October 1, 1996 to March 31, 1997

		REPORTS	RECOMMENDATIONS
A.	For which no management decision had been made by September 30, 1996	7	20
B.	Which were issued during the period	9	31
	Subtotals (A + B)	16	51
C.	For which a management decision was made (for at least one recommendation in the report) during the reporting period	9	16
D.	For which no management decision (for at least one recommendation in the report) had been made by March 31, 1997	10	35

APPENDIX II - Part D

Overdue Management Decisions
March 31, 1997

AUDITEE	REPORT NUMBER	ISSUED	STATUS
Business Loan Center	6-5-H-002-019	9/20/96	Office of Financial Assistance (OFA) is reviewing recommendations.
Low Documentation Loan Program	6-5-E-002-022	9/30/96	OFA's response was not acceptable; awaiting final response.
Virginia SBDC	6-6-H-003-023	9/30/96	No response received from SBA's district office.

APPENDIX II - Part E

Significant Audit Reports Described in Prior Semiannual Reports Without Final Action as of March 31, 1997

REPORT NUMBER	TITLE	DATE ISSUED	DATE OF MANAGEMENT DECISION	FINAL ACTION TARGET
3-2-S-401-014	Colson Service Corp.	12/03/92	09/24/96	06/30/96
3-3-E-002-025	Controls over Advisory and Assistance Services	03/01/93	03/10/93	03/31/93
3-2-C-002-033	Administration of 8(a) Program	03/31/93	09/30/94	09/30/95
4-3-H-011-016	SBA's Award of 8(a) Contracts to ASCI	05/16/94	12/30/94	06/30/95
5-3-H-004-006	SBA Loan Servicing and Debt Collection Activities	03/31/95	09/30/96	9/30/98
5-4-H-008-008	Population and Marketing Analysis Center	03/31/95	09/30/96	None
5-3-W-010-018	Section 7(a) Credit Elsewhere	09/18/95	03/29/96	06/30/96
5-5-H-004-016	Administration of $825,000 Line of Credit	08/18/95	03/29/96	06/30/96
5-3-E-010-021	8(a) Competitive Mix	09/29/95	03/29/96	09/30/96
5-4-H-003-014	National Education Center for Women in Business	08/04/95	02/15/96	09/11/95
6-4-W-008-003	California SBDC	01/11/96	09/30/96	12/31/96
6-5-S-918-006	Daniel Dennis & Co.	01/24/96	09/30/96	10/14/96
6-6-H-002-011	GeoDemographics, Ltd.	03/29/96	09/30/96	04/01/98
6-5-H-002-019	Business Loan Center	9/20/96	None	None
6-5-E-002-022	Low Documentation Loan Program	9/30/96	*	*
6-4-W-005-013	Woodway Bank and Trust Co.	4/26/96	9/13/96	11/4/96
6-5-E-001-021	Basic Ordering Agreements	9/25/96	2/10/97	9/25/97
6-5-H-006-017	Section 8(a) Regular Dealers	8/21/96	9/30/96	8/20/97
6-6-H-003-023	Virginia SBDC	9/30/96	None	None
6-5-S-918-018	Boone, Young & Associates	9/20/96	3/20/97	5/30/97

REPORT NUMBER	TITLE	DATE ISSUED	DATE OF MANAGEMENT DECISION	FINAL ACTION TARGET
6-5-H-007-014	FY 1995 Financial Statements	5/1/96	10/28/96	9/30/97
6-5-H-007-016	FY 1995 Financial Statements - Management Letter	5/31/96	8/22/96	8/31/96
6-5-S-918-020	Rushman Associates, Inc. Closeout Audit	9/23/96	12/20/96	3/23/97

* A management decision has not been made on all recommendations in the audit report.