Office of Inspector General
Small Business Administration

December 2000 Update

Business Loans

Audit Issued on Section 7(a) Business Loan Program Compliance with the Government Performance Results Act of 1993 (Results Act). On December 4, 2000, an audit report was issued on the Section 7(a) Business Loan Program's compliance with the Results Act. In response to requests from Congress, OIG initiated a series of audits to evaluate the performance indicators SBA developed for its major programs.

The audit found that the program did not have indicators to determine the extent to which it was accomplishing its mission under the Small Business Act. Most indicators measured outputs rather than outcomes. The program did not have performance indicators to address each of the FY 2000 Annual Plan's performance goals. Also, some of the program's performance data were not reliable due primarily to a lack of effective validation and verification strategies and methods. Lastly, loan quantity indicators were not a valid measure of loan output. The program was reporting loans approved rather than actual loans made.

SBA management agreed with the recommendations and provided specific short-term and long-term efforts that would be taken.

Advisory Memorandum Reports Views of District Officials on Review Process. A recently issued advisory memorandum, *District Office Perspectives on SBA's Preferred Lenders Program (PLP) Review Process*, reported the views of district officials on the PLP review process. These perspectives were derived from a survey conducted during August and September 2000, and will be considered in an OIG audit of the PLP program that is currently under way.

Over half of the survey respondents were either "slightly dissatisfied" or "very dissatisfied" with the current PLP review process, while nearly 40 percent reported being "fairly satisfied" or "very satisfied." As revealed in various comments, much of the dissatisfaction stems from the lack of participation by district offices and the high cost of the reviews, particularly for small volume lenders and locally owned banks. Survey results further indicated that district officials believed PLP oversight could be strengthened by shifting the review process' emphasis from a compliance checklist to a more thorough examination of a lender's credit underwriting practices and procedures for loan servicing and liquidation.

New York Photo Studio Owner Found Guilty of Lying About Criminal History. An owner of a now-defunct photo studio in Bronx, New

York, was found guilty on December 8, 2000, of the one count of **making material false statements** to obtain an SBA-guaranteed loan. During the trial, the jury examined evidence and heard testimony that the defendant falsely stated in an application for a $260,000 SBA-guaranteed loan from a New Jersey bank that he was a U.S. citizen and that he did not have any prior criminal convictions. In fact, the defendant had been convicted of alien smuggling and was a Federal fugitive wanted by the U.S. Marshals Service on a parole warrant issued in 1989. Further, Immigration and Naturalization Service records showed that he was not a U.S. citizen, but rather a legal resident alien facing deportation proceedings. SBA eventually charged off the $249,166 outstanding loan balance. In July 2000, the defendant was arrested while residing in Florida under a false name. This investigation was initiated based on information provided by the U.S. Marshals Service and was worked jointly with the Social Security Administration's OIG.

Three Texas Businessmen Indicted for Alleged Scheme to Get Inflated Loans. Three businessmen from Dallas, Texas, were indicted on December 12, 2000, on one count each of **conspiracy** and seven counts each of **making material false statements**. Each businessman was charged with inducing a non-bank participating lender and SBA to fund a $293,000 SBA-guaranteed loan for the purchase of a restaurant from one of them. The three businessmen allegedly devised a scheme whereby the purported buyer (one of the businessmen) would apply for the loan in place of the actual buyer (another of the businessmen), and they would inflate the selling price of the business by $110,000. They also submitted falsified copies of three tax returns, three fraudulent Internal Revenue Service (IRS) tax return verifications, and numerous other fraudulent documents in support of the loan. OIG conducted this investigation jointly with the Department of Treasury's OIG for Tax Administration.

Former Principal of California Loan Brokerage Sentenced to Incarceration. A former principal of an Inglewood, California, loan brokerage was sentenced on December 11, 2000, to 5 months incarceration, 5 months home detention, 5 years probation, $60,000 restitution, and a $200 special assessment. The defendant previously pled guilty to one count of **aiding and abetting the making of false statements to a federally-insured lender** by causing the submission to an SBA participating lender of individual income tax returns which he knew had been altered to overstate the applicants' adjusted gross income. The loans applied for totaled $1,850,000. OIG conducted its investigation jointly with the Federal Bureau of Investigation (FBI) and IRS based on allegations from an anonymous complaint. The investigation focused on loans submitted to the participating lender by the loan brokerage. The loan brokerage's portfolio at the participating lender totaled approximately 170 loans, originally valued at more than $60 million. Partially as a result of the default rate of these allegedly fraudulent loans, the Office of the Comptroller of the Currency closed the participating lender in 1994.

Former Nebraska Bank President Pleads Guilty to Concealing Payment from Loan Applicants. The former president of a Keystone, Nebraska, bank pled guilty on November 20, 2000, to a one-count information that charged him with **submitting a false statement to SBA**. OIG's investigation found that the defendant requested and received $1,750 in cash payments from two local small businessmen applying for SBA-guaranteed loans from the bank. Although he told the businessmen he needed these sums for expenses, the defendant falsely reported on an SBA settlement sheet that the bank collected no additional fees. The defendant actually pocketed the money he received.

Government Contracting and Business Development

<u>New York Construction Company Project Manager Sentenced to Prison for Bond Scheme</u>. The project manager of a Long Island City, New York, construction company was sentenced on December 7, 2000, to 1 year and 1 day of incarceration, 3 years of supervised release, and restitution of $45,375. He previously pled guilty to one count of **conspiracy**. On April 25, 1997, the construction company entered into a $379,079 Section 8(a) contract with the Federal Bureau of Prisons (BOP). As a condition of the contract, the construction company was required to obtain payment and performance bonds to cover any cost resulting from its failure to perform adequately and/or pay its subcontractor. His original indictment charged that the project manager submitted to a BOP contracting officer payment and performance bonds purportedly issued to the company by a bonding/insurance company. OIG's joint investigation with FBI found that the bonding/insurance company never issued the bonds and that the signatures on them were forged. According to the indictment, the project manager knowingly submitted forged bonds and conspired with others to defraud the Government through the counterfeit bonds and the alteration of other records. The president of the construction company previously pled guilty to **conspiracy** in connection with his role in the construction company's submission of fraudulent payment and performance bonds. OIG initiated the case based on a referral from BOP.

Surety Bond

<u>Audit Report Issued on Surety Company</u>. On December 27, 2000, an audit report was issued on a California surety company. The audit found that the surety company did not always comply with SBA regulations for underwriting and servicing SBA bonds. More specifically the company did not (1) maintain complete underwriting documentation for two bonds, (2) notify SBA of default for three bonds in a timely manner, and (3) implement written underwriting and servicing policies and procedures for SBA-guaranteed bonds. SBA management agreed with OIG's recommendation that SBA notify the surety to implement written policies and procedures to correct these problems.

Agency Management & Financial Activities

<u>Top Ten Management Challenges Submitted to Congress</u>. In response to a congressional request, on December 1, 2000, OIG submitted a list and assessment of the ten most serious management challenges facing SBA in FY 2001. The current list identifies three new challenges and updates and/or consolidates those submitted last year. The first four focus on Agencywide issues that are critical to SBA's goal of modernizing the Agency—managing for results, modernizing SBA's information systems for loan monitoring and financial management, improving information systems security, and managing human capital. Loan program challenges include those on guaranty purchases and lender oversight. Section 8(a) Business Development challenges include the fact that benefits are not equitably distributed among Section 8(a) firms, some participants continue to receive benefits after they are no longer qualified for the program, and many benefits pass through to large businesses. The final challenge focuses on preventing loan fraud. OIG received substantial feedback from Agency managers and staff on these challenges. While OIG and SBA do not fully agree on some issues, the Agency's input helped OIG ensure that all

points of view were given careful consideration and that the narrative discussions were factually accurate.

Advisory Memorandum on FY 1999 Cost Allocation Study Issued. On December 7, 2000, OIG issued an Advisory Memorandum on the FY 1999 Cost Allocation Study, used by SBA to determine all costs attributable to each SBA program. The auditors found that that the cost identified through the study overstated Small Disadvantaged Business (SDB) certification expenses by $3.9 million. It reported SDB expenses as $14.6 million rather than $10.7 million. Additionally, since the Cost Allocation Study was based on obligations that included unliquidated balances on closed obligations, the model did not show actual SDB expenditures. The Economy Act requires SBA to determine the actual cost of the SDB Certification program. Lastly, SBA did not clearly document the model, as required by the Office of Management and Budget Circular A-127.

The auditors recommended that SBA's Chief Financial Officer implement internal controls to verify the accuracy of future surveys and models, enforce procedures for immediate de-obligation of unliquidated obligations on completed projects/contracts, and document the logic and methodology behind the cost allocation model. While Office of the Chief Financial Officer (OCFO) officials stated that procedures for the FY 2000 cost study included internal control improvements that should address OIG's concerns, they did not address verifying the model to detect and correct potential errors. The OCFO agreed to implement the other two recommendations.

Office of Inspector General

OIG has established an e-mail address (oig@sba.gov) that we encourage the public to use to communicate with our office. We welcome your comments on our publications, suggestions for possible audits, or referrals of possible incidents of waste, fraud, or abuse.

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Comments or questions concerning this Update or request for copies of OIG audits, inspections, and/or other documents should be directed to:

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