

U.S. Small Business Administration  
Office of Inspector General

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Semiannual Report to Congress  
Spring 2004



October 1, 2003 – March 31, 2004

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# Inspector General Act Statutory Reporting Requirements

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

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Section 4(a)(2 )	Review of Legislation and Regulations	17
Section 5(a)(1)	Significant Problems, Abuses, and Deficiencies	3-16
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Section 5(a)(3)	Prior Significant Recommendations Not Yet Implemented	30-31
Section 5(a)(4)	Matters Referred to Prosecutive Authorities	26-29
Section 5(a)(5) And 6(b)(2)	Summary of Instances Where Information Was Refused	None
Section 5(a)(6)	Listing of OIG Reports	19
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Section 5(a)(8)	Audit Reports with Questioned Costs	20
Section 5(a)(9)	Audit Reports with Recommendations that Funds Be Put to Better Use	20
Section 5(a)(10)	Summary of Reports From Prior Semiannual Reports Where No Management Decision Was Made	22-23
Section 5(a)(11)	Significant Revised Management Decisions	None
Section 5(a)(12)	Significant Management Decisions with Which the OIG Disagreed	None

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## A Message From The Inspector General

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I am pleased to present the Small Business Administration (SBA), Office of Inspector General (OIG), Semiannual Report covering activities from October 1, 2003 through March 31, 2004.

During this reporting period, we issued 19 reports with significant recommendations for improving Agency operations, reducing fraud and unnecessary losses, and recovering funds. OIG investigations led to 17 indictments and 13 convictions of subjects who defrauded the Federal government. In addition, the Office collectively reviewed 72 legislative, regulatory, policy, procedural, and other proposals concerning the SBA and government-wide programs. With a staff of 100, the OIG continues to produce substantial savings and important program improvements.

Equally important, the OIG continues to monitor and adjust to, SBA's transformation into a new type of organization. The Agency seeks to leverage its limited resources by relying more on private and nonprofit sector partners, computer technology, and the consolidation of functions, including the new loan liquidation center in Herndon, Virginia. Nonetheless, while streamlining can reduce operational costs, the side effects can be increased risks for waste, fraud, and abuse, as well as diminished accountability, as fewer experienced employees are available to oversee programs.

Moreover, various types of fraud continue to plague the Agency. For example, the OIG, in conjunction with other Federal and state agencies, has demonstrated a pattern of borrowers falsely claiming to be U.S. citizens, with millions of dollars of loans at risk. Thus far during Fiscal Year 2004, a number of individuals have been convicted or indicted for this type of crime and more are expected. In response to the OIG's efforts, SBA has begun to mitigate the vulnerabilities that enable such false claimants to receive funding.

Another major challenge is SBA's lack of an integrated financial accounting system and reporting process, which led to a disclaimer of an opinion on both the FY 2003 and restated FY 2002 Financial Statements. While the results of the audit were disappointing, SBA's Administrator and Chief Financial Officer have expressed their commitment to improve SBA's financial management process and related financial statements.

I would like to thank Administrator Barreto for his support of the OIG and our work. We will continue to make every effort to protect the interests of taxpayers and small businesses as we work closely with the Agency and the Congress.

Harold Damelin  
Inspector General

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# Overview of the SBA and the OIG

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## The Small Business Administration

The Small Business Administration (SBA) was established in 1953 to assist small businesses from startup through the many stages of growth. The SBA's two major goals are to help small businesses succeed and to recover from disasters. The SBA offers many services to entrepreneurs through its Offices of Capital Access, Entrepreneurial Development, Government Contracting and Business Development, and Disaster Assistance. Services include assistance with developing business plans using counseling services and resource partners; obtaining financing through the Agency's various business and disaster lending programs; marketing products and services; accessing Federal procurement opportunities; and addressing management issues. The SBA's programs are delivered by a network of field offices in every state, the District of Columbia, the U.S. Virgin Islands, Guam, American Samoa, and Puerto Rico. The SBA has an FY 2004 appropriation of \$756 million, and as of March 31, 2004, had 3,310 employees (number of employees includes the Office of Disaster Assistance and Office of Inspector General (OIG) personnel).

## The Office of Inspector General

The SBA OIG was established by the Inspector General (IG) Act of 1978. Through its five divisions, the OIG performs the following functions nationwide, as mandated by Congress.

- **The Auditing Division** performs program performance reviews, internal control assessments, and financial, information technology, and mandated audits to promote the economical, efficient, and effective operation of SBA programs.
- **The Investigations Division** manages a program to prevent and detect illegal and/or improper activities involving SBA programs, operations, and personnel. The criminal investigative staff carries out a full range of traditional law enforcement functions. The security operations staff ensures that all Agency employees have the appropriate background investigations and security clearances for their duties. The name check program provides SBA officials with character-eligibility information on loan applicants and other potential program participants.
- **The Inspection and Evaluation Division** conducts assessments of the effectiveness of SBA programs and activities, analyses of critical program issues, best practices studies, and research on matters concerning performance.
- **The Counsel Division** provides legal and ethical advice to all OIG components, represents the OIG in litigation arising out of or affecting OIG operations, assists with the prosecution of civil enforcement matters, and processes subpoenas and Freedom of Information and Privacy Act requests.
- **The Management and Policy Division** is responsible for developing and executing the OIG budget; developing and supporting information systems and hardware; developing the OIG Human Resource (HR) policy and providing a full-service HR program to the OIG; providing support services to headquarters OIG employees; managing a nationwide facilities management function; providing communications services; authoring and publishing semi-annual, strategic, performance, and operating plans and reports; and reviewing and commenting on proposed Agency policy.

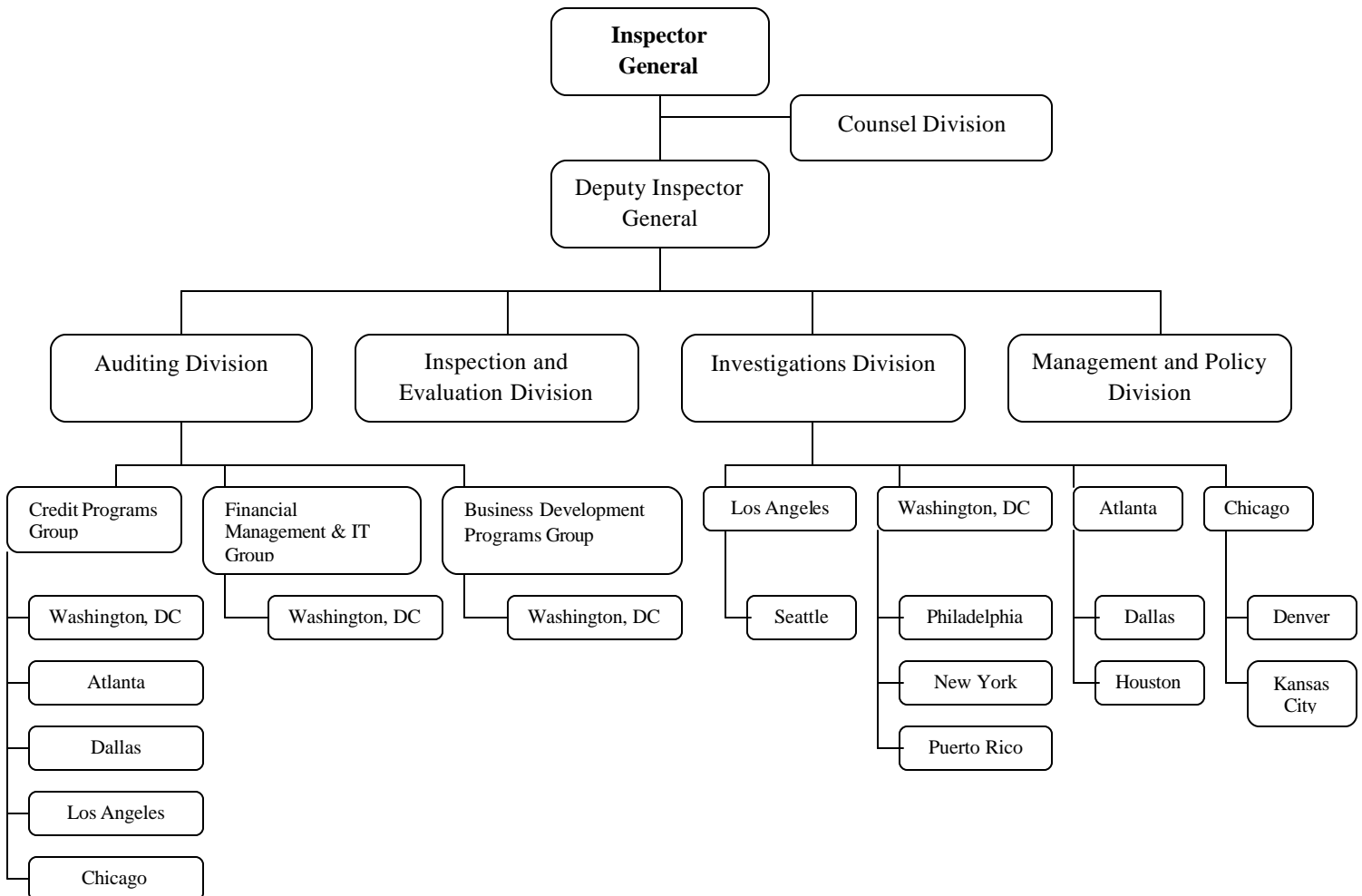
# Overview of the SBA and the OIG

The OIG is headquartered in Washington, DC, and has field audit and investigation offices in Atlanta, Chicago, Dallas, Denver, Houston, Kansas City, Los Angeles, Philadelphia, New York, San Juan, and Seattle.

As of March 31, 2004, the OIG's on-board strength was 100. The OIG FY 2004 appropriation is \$13.358 million, with a \$495,000 transfer for disaster assistance oversight activities (net of rescissions).

The OIG's responsibility is to improve SBA programs by identifying key issues facing the Agency, ensuring that corrective actions are taken, and promoting a high level of integrity. The OIG continues to focus on serving the needs of our customers and stakeholders and on safeguarding SBA resources from waste, fraud, and abuse. The five strategic goals we seek to achieve are to: (1) prevent fraud and unnecessary losses in SBA programs; (2) improve the security over and the accuracy of SBA accounting and management information; (3) assist SBA in improving its small business development programs and Government contracting; (4) assist SBA management in identifying and resolving persistent and emerging management issues; and (5) strengthen our ability to identify and have maximum impact on the most significant SBA issues.

## Office of Inspector General



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## Significant OIG Activities

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### Goal 1: Prevent Fraud and Unnecessary Losses in SBA Programs

The SBA has a wide range of programs designed to help small businesses gain access to capital, participate in the Federal procurement market, and better plan and manage their operations. Seventy-five percent of the SBA's resources are devoted to providing financial assistance to qualified small businesses. The Section 7(a) Guaranteed Loan Program is the SBA's largest lending program and the primary vehicle for providing small businesses access to credit they cannot obtain elsewhere. This program is vulnerable to fraud and unnecessary losses because it relies on numerous parties (including borrowers, loan agents, lenders, and the SBA) to complete loan transactions. The processes for loan approval are risky, and no party has complete knowledge of the activities of all of the other parties.

The Disaster Loan Program is another key SBA lending program. It is the primary form of direct Federal assistance for non-farm private sector disaster losses. This highly visible program is vulnerable to fraud and unnecessary losses due to the need to expedite processing of disaster loans.

All SBA programs have some vulnerability either because of insufficient internal controls or dishonest program participants who seek to take advantage of the program. As the SBA seeks to reengineer its business loan programs, vulnerabilities may increase.

### Fraud Detection and Prevention

During this semiannual reporting period, the efforts of the Investigations Division resulted in approximately \$6.1 million in potential fines and recoveries, \$13.5 million in loans/contracts not being approved, 17 indictments, and 13 convictions. During this reporting period, the Investigations Division opened 50 new cases and closed 62 cases. Investigations were initiated as a result of complaints and allegations received from both the Agency and the public. The basic underlying theme in almost all of the allegations comes down to one concept – a person or a company made misrepresentations to obtain money from the SBA or to qualify for participation in an SBA program. Generally the misrepresentation occurs before the approval, but some occur after the fact.

Misrepresentations take several forms. They may be related to the applicant's financial situation, the individual's criminal history, the actual use of funding provided through an SBA program, or the person's true identity or status of citizenship. The misrepresentations may involve elaborate plots with forged documents and corrupt employees of the lending institution or of the Government, or failure to admit to previous bankruptcy or to include the SBA loan on a new bankruptcy. The examples below demonstrate the types of misrepresentations that lead to a vulnerability for the Agency. Because the SBA relies so heavily upon the truthfulness of the applicants, this will remain an extremely vulnerable area that the OIG will continue to focus on.

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## Significant OIG Activities

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### False Claims of U.S. Citizenship Continue

As discussed in the previous Semiannual Report, Operation Fleeced America, based in Texas, has led to legal actions against individuals who falsely claim to be U.S. citizens on the SBA Statement of Personal History (Form 912) and on applications for Texas alcoholic beverage licenses. The ongoing operation has shown a pattern of false citizenship claims on SBA loans, with some loans more than \$1 million in size. This operation is part of a continuing joint effort among state and Federal agencies to disrupt organized criminal enterprises that coordinate similar financial violations across the U.S. and to identify the final destinations of monetary proceeds.

In the first four examples shown below, the SBA OIG conducted the investigations jointly with the Department of the Treasury's OIG for Tax Administration, Department of Homeland Security (DHS), Social Security Administration (SSA), the Department of Agriculture, and the Texas Alcoholic Beverage Commission. In the third and fourth examples, the Texas Department of Public Safety also participated.

- The owner of a convenience store and service station in Grand Prairie, Texas, was sentenced to 6 months incarceration and fined \$2,500 for making a false statement to SBA. He had induced a financial institution and SBA into funding a \$675,000 guaranteed loan by falsely representing himself as a U.S. citizen. This investigation was initiated based on a referral from the former Immigration and Naturalization Service (INS).
- A convenience store owner in Fort Worth, Texas, was sentenced to 2 months incarceration and fined \$5,000 for making a false statement to SBA. He had induced a bank and SBA to fund a \$435,000 guaranteed loan by falsely representing himself as a U.S. citizen. This investigation was initiated based on a referral from INS.
- A convenience store and service station owner in North Richland Hills, Texas, was indicted for a false claim of U.S. citizenship and making a false statement to SBA. He had induced a bank and SBA into funding a \$1,200,000 guaranteed loan by falsely representing himself as a U.S. citizen.
- A convenience store and service station owner in Arlington, Texas, was indicted for a false claim of U.S. citizenship. His wife was indicted for inducing a financial institution and SBA to fund a \$605,000 guaranteed loan by falsely representing herself as a U.S. citizen.

In other parts of the Nation:

- Two Chicago business owners, a husband and wife, were indicted for conspiracy to submit false statements to a financial institution. In addition, the husband was charged with bribery of a public official, submitting false statements and reports to a financial institution, possession and use of a counterfeit U.S. Certificate of Naturalization, and aiding and abetting, in connection with his Section 504 loan application. The business owner was previously arrested and charged for bribery of a public official and for submitting a false statement to a financial institution, in connection with his Section 504 loan application. Although he claimed to be a U.S. citizen in his



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## Significant OIG Activities

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application, an OIG investigation revealed that he was not a citizen and was residing in the U.S. illegally. When the SBA requested that the Certified Development Company (CDC) obtain evidence of naturalization, he admitted that he was not a U.S. citizen and requested a meeting with an SBA official. At that meeting, he again admitted he was not a U.S. citizen, presented a counterfeit certificate of naturalization, and offered a \$5,000 cash bribe to the SBA official who was cooperating with the OIG. The owner was arrested outside of the SBA Illinois District Office. This investigation also found that the wife had conspired with her husband to prepare and submit several application forms containing false statements; to meet with a CDC representative, a bank officer and a SBA official, and to conceal the acts to further their conspiracy. This investigation was based on an anonymous complaint. SBA OIG is conducting this ongoing investigation jointly with the DHS.

- The SBA received its previously paid guaranty of nearly \$317,000 on a loan made to a Missouri business. The \$405,000 SBA-guaranteed loan had defaulted almost immediately. The OIG investigation determined that the corporate president and part owner of the business was an illegal alien when this loan was made, having overstayed his 6-month visitor visa since January 1995. The corporate president indicated on a form that he was not a citizen of the U.S., but he provided no further immigration status information. Internal lender documents showed that the lender was aware of this, but apparently never verified his immigration status. Nonetheless, the lender still certified that the principals of the business were U.S. citizens or resident aliens and that capable and consistent management had been assured. After the OIG contacted the lender, the lender informed SBA that it was canceling and refunding the guaranty. Since SBA has suffered no loss, the U.S. Attorney declined criminal prosecution. The corporate president remains at large. The OIG will provide its findings to the Bureau of Customs and Immigration Enforcement.

### Small Business Investment Company (SBIC)-Related Fraud

- A former New York, NY, pension plan manager was sentenced to 12 months and 1 day incarceration, to be followed by 3 years of supervised release, and was ordered to pay \$250,000 in restitution for his embezzlement of employee benefit plan funds. The investigation revealed that he was responsible for recommending investments of pension funds made through various venture capital firms, including an SBA-licensed SBIC in receivership. This investigation was initiated based on a request by the U.S. Attorney's Office. The SBA OIG conducted this investigation jointly with the Department of Labor OIG.

### Fraud in Obtaining Business Loans

- A former Norfolk, Virginia, businessman and management corporation director was sentenced to 6 months in prison, 3 years of subsequent supervised release, and restitution of nearly \$674,000 to SBA and \$1,253,000 to a financial institution for conspiracy to commit wire fraud. He conspired to inflate the purchase price of the management corporation's properties by \$1,148,000 to fraudulently obtain loan proceeds from two financial institutions. The scheme included having the corporation pay \$550,000 from loan proceeds to another company he owned for repairs that were not to be done. The businessman also conspired to pay \$200,000 each to the management corporation's stockholders and to disburse \$198,000 of the loan proceeds to purchase another motel. He submitted to the two institutions false financial information about management

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## Significant OIG Activities

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corporation shareholders and deceitfully stated that he was giving a combined gift of \$825,000 to the two shareholders of the management corporation to be used as capital injection, knowing that it was not a gift and that it had to be paid back to him from the loan proceeds. Consequently, he caused one of the financial institutions to wire nearly \$2,300,000 and the other to wire nearly \$1,000,000 in loan funds to the management corporation.

In addition, a second business operator and an attorney were indicted in connection with the case. The operator had been charged with conspiracy to commit wire fraud and conspiracy to make false statements, and the attorney had been charged with conspiracy to make false statements as well as making material false statements. This is an on-going joint investigation with the Federal Bureau of Investigation (FBI).

- A Forked River, New Jersey, property owner was indicted for conspiracy and making a material false statement relating to a guaranteed loan obtained by an automotive repair business. The investigation revealed that the business owner (not the property owner) obtained a \$560,000 loan requiring a minimum capital injection of nearly \$150,000. The business owner did not do so and conspired with the property owner to fraudulently misrepresent the injection. They entered into an \$80,000 mortgage agreement, which was concealed from the lender, in lieu of the capital injection. The business owner defaulted on the entire loan balance, causing SBA to pay the guarantee. The OIG conducted this investigation based on a referral from the lender.
- The SBA Delaware District Counsel denied the application of a business in Bear, Delaware, that had applied for a \$350,000 guaranteed loan, due to issues of character ineligibility. Based on an SBA Delaware District Office referral, the SBA OIG investigation determined that the applicant did not fully disclose his criminal history record. Further, the applicant, who was a permanent resident but not a U.S. citizen, had advised that he had two Social Security numbers because he had entered the U.S. twice and mistakenly completed the paperwork for a Social Security number both times. The Social Security Administration could not verify his explanation. Moreover, an SBA Office of Financial Assistance character evaluation determined that the applicant could not be found “of good character.”
- The owner of a Laramie, Wyoming, sporting goods store was sentenced to 1 year and 1 day of incarceration, 3 years supervised release, and restitution of more than \$147,000 after having pled guilty to making a false statement to SBA. The investigation found that he submitted two false personal financial statements to the bank to obtain two separate SBA loans totaling \$250,000. He failed to disclose four debts totaling approximately \$312,000 and faxed several loan documents to further his scheme. The investigation was conducted jointly with the FBI and was based on a referral from the SBA Wyoming District Office and the FBI.
- A San Antonio, Texas, man was sentenced to 19 months in a Federal correctional facility—followed by 5 years of supervised release—and was ordered to pay more than \$152,000 in restitution. He previously pled guilty to bank fraud, after having been indicted for bank fraud, conversion of collateral pledged to SBA, and money laundering. He had submitted inflated income statements to misrepresent his net worth in connection with a \$213,000 guaranteed loan to start a Las Vegas, Nevada, ice cream business. He further misrepresented the source of his required equity injection by concealing personal loans obtained prior to funding. After his loan

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## Significant OIG Activities

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defaulted, he concealed pledged proceeds and converted collateral equipment to impede full liquidation. Based on a request from the FBI, the SBA OIG conducted this investigation jointly with the Bureau of Alcohol, Tobacco and Firearms, the FBI, and the Internal Revenue Service (IRS).

- A Dallas, Texas, real estate proprietor pled guilty to bank fraud involving his packaging/brokering of 10 guaranteed loans. The investigation revealed that he recruited individuals and assisted them with submitting fraudulent documents to obtain loan approval. He artificially inflated the borrowers' checking accounts, submitted fraudulent gift letters representing funds for required down payments, used loan proceeds to purchase cashiers checks in the names of the borrowers, and employed these checks to fraudulently represent the borrowers' capital injections. In response to a referral from the participating lender, the OIG conducted this investigation jointly with the FBI.
- A former president of a Bloomington, Illinois, business was sentenced to 16 months incarceration and 4 years supervised release, and ordered to pay nearly \$218,000 in restitution and a special assessment. The business owner previously pled guilty to bank fraud and making false statements to a bank. The indictment related to a \$375,000 guaranteed loan. The investigation revealed that the owner submitted fraudulent invoices to the financial institution in order to receive loan disbursements. After the loan closed, he took the \$125,000 capital injection out of his business and paid off a personal loan that he previously secured to come up with the capital injection. This violated the loan agreement, which stated that the capital injection was to be used as working capital and to purchase inventory. This investigation was based on a referral from the SBA Springfield Branch Office.
- The president of an Edgemoor, South Carolina, business provided inaccurate and fraudulent information to a CDC. The CDC withdrew its approval of a \$688,000 SBA Section 504 guaranteed loan, resulting in a \$516,000 cost avoidance (SBA's guaranteed debenture portion of the loan). The borrower allegedly inflated inventory and claimed assets that did not exist. He also allegedly had a criminal record that was not disclosed during the application process. A National Crime Information Center criminal history check determined that the president had three arrests on his record, although he marked "NO" to all application questions regarding arrests and convictions. The CDC withdrew its loan approval based on his false criminal history statements. This investigation resulted from an SBA Hotline call.

### **Fraud after Business Loan Approval**

- A Lancaster, Pennsylvania, business owner was found guilty of mail fraud and making false statements to SBA. The owner obtained a \$315,000 SBA-guaranteed loan in 1990, which defaulted in 1991. He made offers of compromise from 1992 through 1995, stating that the only payment he could make was \$60,000, his purported home equity. The scheme's purpose was to induce SBA to accept the \$60,000 and forgive the remaining estimated loan balance of \$437,000. The owner was found guilty of concealing from SBA \$551,000 obtained through an unrelated stock sale. To accomplish this, he opened bank accounts in his children's names and prepared

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## Significant OIG Activities

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false stock certificates showing that his children and other entities owned the \$551,000 in stock. However, the jury found that he had complete control of the stock and monies from its sale, purchased a warehouse for \$475,000 in 1994, and concealed this from SBA. He was also found guilty of submitting false financial information and stock certificates to SBA through the United States Postal Service and Federal Express. This case originated from an SBA Philadelphia District Office referral.

- A Berthoud, Colorado, man was sentenced to 6 months incarceration and 3 years supervised release after having pled guilty to bankruptcy fraud and conspiracy. The investigation determined that his wife (the business owner) obtained a \$100,000 SBA-guaranteed LowDoc loan from a financial institution and, shortly thereafter, defaulted and filed for bankruptcy. The couple had conspired to hide assets of over \$25,000 from the bankruptcy court. The man's indictment was based on information obtained during the investigation of his wife, who had pled guilty to making a false statement to a financial institution and to bankruptcy fraud. This investigation was based on a referral from the Colorado District Office and was conducted jointly with the FBI.

### Disaster Loan Fraud

- As part of our proactive review of disaster loans made in response to the September 11<sup>th</sup> tragedy, which was discussed in the previous semiannual report, two New York businessmen were convicted for false statements, conspiracy, mail fraud, and wire fraud. After the September 11, 2001, terrorist attacks, they applied for and received a \$228,200 SBA disaster loan. Both stated, in writing and verbally, that their company had been located at 2 World Trade Center, that they were subleasing office space from their parent company (which had been legitimately located at 2 World Trade Center), and that they lost approximately \$94,000 worth of equipment, supplies, furniture, and fixtures, as well as the parent company's financial backing and their customer base. The investigation revealed that their business was not located at 2 World Trade Center on September 11, 2001. Officials of their parent company stated that there had been no financial backing, that the two men had been fired, and that they did not own any office equipment. In addition to SBA disaster assistance, the men applied for and received aid from the New York State Empire State Development Corporation (funded by the Department of Housing and Urban Development), the New York City Economic Development Corporation, the Federal Emergency Management Agency (FEMA), the American Red Cross, and Safe Horizon, Inc. The total fraudulent gain was approximately \$350,000. The SBA OIG initiated the case based on a Niagara Falls Disaster Office referral.
- Three individuals of St. Thomas, U.S. Virgin Islands, were indicted for conspiracy and mail fraud involving FEMA and SBA disaster assistance. Two individuals were joint property owners and falsely claimed on a FEMA application that this was their primary residence and that it had been damaged during 1996's Hurricane Bertha, even though the property had actually been damaged in 1995 by Hurricane Marilyn and purchased "as is" just before Hurricane Bertha. The result was a new roof costing FEMA \$90,000. The third individual, an insurance loss adjuster, prepared the owners' Hurricane Bertha loss report. Based on the report, the owners received \$95,000 in insurance proceeds. They were also approved for an \$80,000 SBA disaster home loan as a result of 1998 hurricane damages, although they received only \$45,000 because they failed to submit certain financial information. Finally, because of the adjuster's multiple hurricane loss reports,

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## Significant OIG Activities

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the two owners received \$90,000 in insurance proceeds. The adjuster's loss reports for two of the hurricanes were almost identical. Based upon a referral from the U.S. Attorney's Office, the SBA OIG conducted this investigation jointly with the DHS OIG.

- A resort owner in Talofofo, Guam, pled guilty to making a material false statement. He was indicted after submitting a disaster loan application claiming damages to the resort resulting from typhoon Pongsana. Although he had been arrested, indicted, and convicted in 1998 for bribery of a public official, he stated on his application that he had no prior criminal history. In fact, he had attempted to bribe an SBA employee for \$5,000 to approve a disaster loan after typhoon Paka in 1997. The SBA OIG conducted this investigation jointly with the FBI.

### Section 8(a) Program Fraud

- The president of a defunct Huntingdon Valley, Pennsylvania, construction company was found guilty of making a material false statement to SBA, mail fraud, wire fraud, making a false statement to a Federally-insured financial institution, and money laundering. He improperly transferred \$495,000 from his construction business account to his personal offshore account in the Bahamas to hide the money from creditors, while closing the business and abandoning its contracts and subcontractors. He also falsely represented that he had relocated to Pennsylvania along with his SBA Section 8(a) certified business and that he controlled the firm's day-to-day operations. In fact, he did not relocate and had another individual, who previously pled guilty to conspiracy and mail fraud, operate the business. The two individuals submitted false financial statements to a bonding company to obtain bonding for the construction company's bids and contracts. Because of defaults on contracts, the bonding company lost almost \$6 million. The president also falsely certified to the Department of Veterans Affairs (VA) that he was paying and intended to pay his subcontractors on a timely basis from the proceeds of a VA Medical Center contract. The president was also found guilty for submitting false financial statements to a bank to support a \$300,000 construction company line of credit. Based upon a request from the Naval Criminal Investigative Service (NCIS), the SBA OIG conducted this investigation jointly with NCIS, VA OIG, and the Defense Criminal Investigative Service.

## Identifying Potential Losses

### Five OIG Audits Identify Loan Origination Problems on Early Defaulted SBA-Guaranteed Loans

Five audits of early defaulted guaranteed loans resulted in over \$2.7 million in questioned costs due to loan origination problems. The loans were judgmentally selected for review as part of the OIG's ongoing program to audit Section 7(a) loans charged off or transferred to liquidation with 24 months of approval, i.e., early defaults. The SBA is released from liability on a guaranty, in whole or in part, if the lender fails to comply materially with any provisions of the regulations or loan authorization, or does not make or handle the loan in a prudent manner.

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## Significant OIG Activities

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For example, one audit found that the loan did not meet SBA's requirements for size, change in ownership, and repayment ability. After the loan defaulted, the lender agreed to a reduced guaranty payment. Because the problems identified by the district office and the OIG provide a basis to deny full liability on the guaranty, the OIG recommended that the district director seek to recover the \$376,000 made to honor the reduced guaranty.

Another audit found that the lender made a material error in assessing the borrower's repayment ability, resulting in a loan to a borrower having no repayment ability. The borrower defaulted after only one payment, resulting in an erroneous payment of over \$777,000 when SBA purchased the guaranty. Originally, the borrower had projected gasoline sales of \$3.4 million during the first year of operation, although a third party market analysis found that maximum annual sales could be only about \$275,000. In response to the OIG recommendation, SBA has sought recovery of the payment from the lender.

### **SBA Purchase Cards: Audit Identifies Internal Control Weaknesses—but No Apparent Fraud**

An audit of SBA purchase cards identified five purchases over \$2,500 that were split into multiple charges to keep each charge under the \$2,500 micro-purchase threshold, thus circumventing Federal Acquisition Regulation requirements to set aside acquisitions over \$2,500 for competition among small businesses. Moreover, a number of requisition forms were unsigned by the approving official, more than half of the cardholder statements examined did not have the approving official's certification, and four cardholder accounts remained open after the cardholders left SBA. Nonetheless, the audit found no fraudulent transactions. The SBA agreed with OIG recommendations, including that the Agency remind cardholders and approving officials of appropriate procedures for procurements costing over \$2,500 and of possible penalties.

### **Character Eligibility**

The SBA requires applicants for assistance to meet certain character standards before participating in Agency programs. The OIG's Office of Security Operations (OSO) is responsible for ensuring that program participants meet these standards by processing name checks and, where appropriate, fingerprint checks on applicants. OSO also assists the Agency in making character eligibility determinations through its on-line connection with the FBI's Machine Readable Data system by referring applicants who appear to be ineligible to program officials for adjudication. During this reporting period, OSO made referrals that resulted in SBA business loan program managers declining 37 applications, and disaster loan program officials declining 14 applications, totaling \$10,103,225 and \$421,267 respectively. These actions made credit available to other applicants without character eligibility issues.

In addition, based on the OIG character eligibility information, officials of the SBA's Section 8(a) and surety bond programs declined, respectively, 10 applications for certification and three applications for guaranty. More than \$238 million in loans have been declined during the last 10 years due to character eligibility.



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## Significant OIG Activities

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The OSO also coordinates background investigations for Agency employees required to have security clearances. During this reporting period, OSO initiated 64 background investigations and issued 19 security clearances. The OSO also reviewed and adjudicated 44 background investigative reports in accordance with Executive Order 10450 and Office of Management and Budget (OMB) Circular A-130 and coordinated with the SBA's Office of Disaster Assistance to adjudicate 35 derogatory background investigative reports forwarded for review and appropriate action.

### **OIG Fraud Awareness Briefings**

During this reporting period, the OIG conducted 3 briefings for more than 31 SBA employees, lenders, and other resource partners as part of its mission to heighten awareness of waste, fraud, and abuse.

### **Goal 2: Improve the Security Over and the Accuracy of SBA Accounting and Management Information**

The SBA depends on a complex information technology (IT) environment, which includes 38 mission critical systems running on a mix of legacy mainframe, client-server, and minicomputers. The SBA has difficulty producing reliable and timely financial and management information to support its operations, primarily because of reliance on outdated IT systems that are not integrated. The SBA is developing a new Disaster Credit Management system to modernize and improve its disaster loan-making activities. The SBA is also implementing a Loan Monitoring System to monitor its business loan portfolio. These efforts are critical to the SBA's successful future operations. However, these efforts do not impact SBA's Loan Accounting System, which is sorely outdated and in need of replacement.

The Chief Financial Officers Act of 1990 requires each Federal agency to have annual audited financial statements. One of the OMB's key initiatives is to have agencies improve their financial management activities, including providing financial statements and financial performance information in a timelier manner. Because of the lack of integrated financial and accounting systems, SBA has major challenges and uncertainties surrounding its ability to produce Fiscal Year (FY) 2004 financial statements by the accelerated date of November 15, 2004. For the past few years, and again for the FY 2003 financial statements, the auditors have been critical of the Agency's reporting process and its ability to provide accurate, complete, and reliable financial data.

In FY 2003, SBA undertook a major effort in developing new credit subsidy models for its disaster assistance loan program and the secondary market guaranty program and made significant changes to two other credit subsidy models. This should result in more accurate financial statement estimates for SBA's credit programs.

### **Audit of SBA's Financial Statements Disclaims Opinions and Discloses Material Weaknesses**

The OIG issued Cotton and Company's Audit Report for SBA's FY 2003 Financial Statements, which disclaimed an opinion on both the FY 2003 financial statements and the restated FY 2002 financial statements. The scope of the examination was limited because SBA was late in completing development and testing of certain credit program subsidy models, its credit program subsidy re-estimates, and its

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## Significant OIG Activities

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financial statements. One example of a major change in subsidy re-estimates is in the SBIC participating securities program, where SBA reported an estimated loss of more than \$1.8 billion in its credit subsidy re-estimates. Consequently, the auditors were unable to apply all necessary auditing procedures or dispose of reservations identified during their work. This prevented them from expressing an opinion on the financial statements.

Reportable conditions included two material weaknesses: (1) credit reform controls and (2) financial management and reporting controls. The remaining reportable condition related to the need for improvement in SBA's information system controls, particularly in addressing previously identified weaknesses and allocating sufficient resources to support the Office of the Chief Information Officer's (OCIO) security programs.

Moreover, the Agency was not in substantial compliance with the Federal Financial Management Improvement Act because of noncompliance with Federal financial systems requirements, Federal accounting standards, and the United States Standard General Ledger at the transaction level. Auditors also noted instances of noncompliance with the Prompt Pay Act and limitations on their examination's scope, which prevented the completion of testing of SBA's compliance with the Antideficiency Act.

The Chief Financial Officer (CFO) generally agreed with the audit's findings and recommendations. Acknowledging that SBA did not meet key milestone dates for some credit programs' budgeting and accounting work and for preparing financial statements, he accepted responsibility for not providing sufficient time for the auditors to complete their work. The most important recommendations called for the CFO to (1) improve controls over SBA's credit modeling processes, including documentation, data analysis, and reconciliation procedures; (2) improve controls and procedures surrounding SBA's financial reporting process; (3) develop and enhance procedures for funds control management, Antideficiency Act compliance, and Prompt Pay Act compliance; and (4) direct a coordinated effort to investigate and explain unusual subsidy balances.

### **Other Financial Weaknesses**

The OIG issued a management letter communicating to SBA management "non-reportable conditions" that came to Cotton & Company's attention during their audit of FY 2003 financial statements. The conditions, which were reported last year, included problems with foreclosed property records and valuation, the general ledger, administrative costs, and intra-governmental reconciliations.

The management letter also noted new weaknesses, such as in the areas of Disaster Area Office travel authorizations, loan servicing center shipping costs, valuation of interest receivable, surety bond guarantee liability estimate documentation, completeness of performance data reporting, recording of Master Reserve Fund cash held outside of Treasury, and inappropriate augmentation of appropriations involving methods of payment of contractors. The CFO generally agreed with the auditors' findings and recommendations.



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## Significant OIG Activities

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### **SBA Information Technology Enterprise Architecture Not Adequately Enforced for Disaster Program System**

Enterprise architecture establishes an Agency-wide roadmap for unifying what otherwise would be dissimilar and inefficient information systems. An OIG audit found that SBA did not adequately enforce its information technology enterprise architecture during the initial development phase of the Disaster Credit Management System project. The OIG recommended that the Chief Information Officer (CIO) perform reviews for large-scale development projects to ensure such enforcement occurs and formulate a related strategy for more proactive oversight of such projects. The CIO agreed with both recommendations.

### **Goal 3: Assist SBA in Improving its Small Business Development Programs and Government Contracting**

The SBA provides assistance to existing and prospective small businesses through a variety of counseling and training services offered by Agency partner organizations. Among these are Small Business Development Centers (SBDCs), the Service Corps of Retired Executives (SCORE), and Women's Business Centers (WBCs). The SBA also manages the Section 8(a) Business Development Program, which was established to provide business development assistance to small businesses owned by socially and economically disadvantaged individuals and to help them access the \$200 billion Federal procurement market. Through its broader Government contracting program, the SBA works with Federal agencies to establish and implement procurement goals for contracting with small, small-disadvantaged, women-owned, service-disabled veteran-owned, and historically underutilized business zone (HUBZone) small businesses. These programs demand effective and efficient management, outreach, and service delivery. Determining whether business development and Government contracting programs meet these demands depends on reliable internal and external data for effective monitoring and oversight.

### **Inappropriate Cosponsorship Activities in Two District Offices**

The Small Business Act gives SBA statutory authority to sponsor a wide variety of training and counseling programs to assist small businesses. Section 8(b)(1)(a) of the Act authorizes SBA to plan and conduct activities jointly with public or private entities. These activities are referred to as cosponsorships, and the Act requires that they be evidenced by a written agreement between the parties.

- An OIG audit on nine cosponsored events in the Los Angeles District Office concluded that the events were not planned and conducted in accordance with Federal laws and SBA policies and procedures. Cosponsorships are to be planned so they do not generate a profit. If profits occur, they should be applied to similar events. The cosponsors inappropriately accumulated \$248,000 in profits, used \$121,000 for activities unrelated to the events, and received \$7,500 from prohibited sources. In addition, district office employees solicited gift funds totaling \$122,500 from donors whose participation in cosponsored activity could result in a conflict of interest. Significant recommendations called for the Associate Administrator for Field Operations to (1) follow Federal law and SBA policies and procedures in conducting cosponsored events and in soliciting and accepting gifts for the Agency and (2) deposit all funds resulting from employee solicitations according to Agency Standard Operating Procedures (SOPs), with excess gift

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## Significant OIG Activities

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funds to be deposited in the Business Assistance Trust (BAT) Fund or dispersed per the donor's instructions. Management agreed with the recommendations.

- Another audit—this time in the Puerto Rico and Virgin Islands District Office—determined that the district's cosponsored activities and its Business Resource Center (BRC) did not comply with SBA policies and procedures and Federal law. Problems occurred in the preparation and approval of cosponsorship agreements, gift fund solicitation and disposition, the charging of fees, the use of cosponsor contributions, the planned use of Economy Act funds, procurement activities, BRC counseling services, recordkeeping, reporting, and asset accountability. The problems occurred because district office personnel did not follow existing guidance, regional and headquarters personnel did not provide sufficient oversight, and formal operating procedures did not thoroughly address cosponsorship operations and funds management. Although SBA officials agreed with some OIG recommendations, most recommendations will be handled during the audit resolution process. Significant recommendations called for the Associate Administrator for Field Operations and the Associate Administrator for Strategic Alliances to (1) remind district offices of the requirement to deposit all gift funds into the BAT Fund; (2) establish controls to prevent the solicitation and acceptance of funds from prohibited sources; and (3) ensure that sources requiring a conflict of interest case-by-case determination are submitted to the appropriate SBA official. Management has not formally responded to the recommendations.

### **SBA Circumvented Small Business Set-Aside Procurement Rules**

The Asset Sale Program was initiated to sell SBA's owned loan portfolio. For each sale, the Agency procured a contractor to review loan portfolios and provide accurate information to potential investors. An OIG audit found that procurement practices used to obtain such contractors' services, which were "set-aside" for small businesses, did not benefit small businesses, as provided for in regulations. This is significant because SBA develops the regulations to promote and protect small businesses, and SBA circumvented these regulations.

SBA's use of the General Services Administration's (GSA) Federal Supply Schedule did not ensure that the Agency received the best value in terms of cost and quality of services. SBA also did not ensure that its small business regulations on subcontracting were complied with, including the rule requiring contractors to perform at least 50 percent of the personnel costs of the procurement. Of \$147 million in revenue received by contractors, over \$81 million (55.5%) went to subcontractors, imaging specialists, third party report vendors, database contractors, and independent contractors, including potentially "other than small" businesses.

The OIG made 30 recommendations and questioned nearly \$1.7 million in contractors' overcharges. The report's recommendations included developing corrective procedures for reviewing procurement proposals, requiring contractors classified as small businesses to certify their size, and ensuring written acquisition plans are prepared for all future asset sales. SBA officials agreed with some recommendations and disagreed with others.

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# Significant OIG Activities

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## Section 8(a) Program's Primary Database is Ineffective

An OIG inspection found that the Section 8(a) Business Development (BD) Program's primary database, SACS/MEDCOR, has serious problems, including (1) missing, out-of-date, or inaccurate data; (2) lack of information needed for reporting to Congress; (3) poor reporting capability; and (4) an inability to be used to manage the 8(a) BD Program. In short, SACS/MEDCOR is an ineffective and inefficient program management tool. To effectively manage the 8(a) Program and assess its effectiveness, SBA needs quality data and a system that will (1) make data easily available; (2) track and evaluate firms' progress, thereby supporting management reporting and analysis; and (3) help disseminate SBA products to stakeholders.

The report recommended that the Office of Government Contracting and Business Development (GC&BD) analyze its business processes to determine specific programmatic data needs and that GC&BD, in conjunction with OCIO, develop a management information system that will support the program, provide useful information, and enable the Agency to measure program results. GC&BD concurred with the OIG's findings and recommendations and is taking steps to implement the recommendations.

## Goal 4: Assist SBA Management in Identifying and Resolving Persistent and Emerging Management Issues

### Top Management Challenges

During this reporting period, the OIG issued its FY 2004 report on the most serious Management Challenges facing the SBA, as required by the Reports Consolidation Act of 2000. The report provides the OIG's assessment of Agency programs or activities that pose significant risks, including those that are particularly vulnerable to fraud, waste, error, or mismanagement. For each management challenge, we provided recommended remedial actions along with our assessment of Agency progress on each item.

The SBA's most serious Management Challenges in FY 2004 are as follows:

- SBA needs to improve its managing for results processes and performance data.
- SBA faces significant challenges in financial management and reporting which affects its ability to provide reliable, timely and accurate financial information.
- Information systems security needs improvement.
- Maximizing program performance requires that SBA fully develop, communicate and implement a human capital management/transformation strategy.
- SBA needs better controls over the business loan purchase process.
- SBA needs to continue improving lender/participant oversight.
- The Section 8(a) Business Development program needs to be modified so that more participating companies receive access to business development and standards for determining economic disadvantage are clear and objective, so that more eligible companies receive 8(a) contracts.
- SBA needs to clarify its rules intended to deter Section 8(a) Business Development participants from passing through procurement activity to non-Section 8(a) Business Development firms.
- Preventing loan agent fraud requires additional measures.

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## Significant OIG Activities

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- SBA needs to update its system of directives to provide proper guidance and control over its operations.

For more information on the OIG's assessment of the SBA's FY 2004 Management Challenges, please review the report at <http://www.sba.gov/ig/challenges.html>.

### **OIG Inspection Identifies Need for FAST Program Core Performance Measures**

The purpose of SBA's Federal and State Technology Partnership (FAST) program is to strengthen the technological competitiveness of small business concerns in the States by ensuring their participation in Federal research and development. A statutorily mandated inspection report assessed the extent to which program recipients have developed and utilized effective performance indicators to measure the results of their activities. It also discussed overall program management and effectiveness. The OIG recommended that SBA refine its guidance to program participants on developing performance measures and take the lead to establish a core set of measures. Moreover, the OIG recommended that SBA vigorously enforce its reporting requirements and take action against grantees who do not comply. The Agency agreed with all recommendations.

## Other Significant Management Issues

### **Increase in Overdue Management Decisions**

Management decisions on OIG recommendations may take several forms. Program officials may agree to a recommendation as presented by the OIG, they may seek to negotiate a compromise agreement with the OIG, or they may disagree. The IG Act requires that Federal agencies make management decisions on all findings and recommendations within a maximum of 6 months of report issuance. During this reporting period, there has been a significant increase in the number of overdue management decisions—i.e., decisions which are not made within 6 months of report publication. As of March 31, 2004, management decisions on 21 OIG reports were overdue (See Appendix V). This is the highest number of overdue management decisions for any single reporting period since March 1999. Moreover, in the 8 years prior to FY 2003, the average number of overdue management decisions was only five per reporting period. We are concerned that, while we continue to work with the Agency on these issues, they remain unresolved.

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## Statistical Highlights

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### FY 2004 6-Month Productivity Statistics October 1, 2003, through March 31, 2004

Office-wide Dollar Accomplishments	Totals
A. Potential Investigative Recoveries and Fines .....	\$6,135,984.00
B. Loans Not Made as Result of Investigations and Name Checks .....	\$13,536,384.00
C. Disallowed Costs Agreed to by Management .....	\$1,011,699.90
D. Recommendations that Funds Be Put to Better Use Agreed to by Management .....	\$535,470.18
<b>Total</b> .....	<b><u>\$21,219,538.08</u></b>

#### Efficiency and Effectiveness Activities

A. Reports Issued .....	19
B. Recommendations Issued .....	121
C. Dollar Value of Costs Questioned .....	\$4,609,872.73
D. Dollar Value of Recommendations that Funds Be Put to Better Use .....	\$7,000.00
E. Collections as a Result of Questioned Costs .....	\$1,398,691.87

#### Follow-up Activities

A. Recommendations Closed .....	50
B. Disallowed Costs Agreed to by Management .....	\$1,011,699.90
C. Dollar Value of Recommendations that Funds Be Put to Better Use Agreed to by Management .....	\$535,470.18
D. Unresolved Recommendations .....	193

#### Legislation/Regulations/Standard Operating Procedures (SOPs)/Other Reviews

A. Legislation Reviewed .....	42
B. Regulations Reviewed .....	11
C. Standard Operating Procedures Reviewed .....	10
D. Other Issuances Reviewed* .....	9

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

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# Statistical Highlights

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## Summary of Indictments and Convictions

A. Indictments from OIG Cases .....	17
B. Convictions from OIG Cases .....	13

## Summary of Recoveries and Management Avoidances

A. Potential Recoveries and Fines as a Result of OIG Investigations .....	\$ 6,135,984.00
B. Loans/Contracts Not Approved as a Result of OIG Investigations .....	\$ 3,011,892.00
C. Loans/Contracts Not Approved as a Result of the Name Check Program .....	<u>\$10,524,492.00</u>
<b>Total</b> .....	<u>\$19,672,368.00</u>

## SBA Personnel Actions Taken as a Result of Investigations

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

## Program Actions Taken as a Result of Investigations

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

## Summary of OIG Hotline Operation

A. Total Fraud Line Calls/Letters.....	196*
B. Total Calls/Letters Referred to Investigations Division .....	19
C. Total Calls/Letters Referred to SBA or Other Federal Agencies.....	63
D. Total Calls/Letters Needing No Action .....	114

\*Total no longer includes hang-ups.

**APPENDIX I**  
**OIG Reports Issued**  
**October 1, 2003, through March 31, 2004**

Title	Report Number	Issue Date	Questioned Costs	Funds for Better Use
<i>Capital Access</i>				
Audit of an Early Defaulted Loan	4-01	11/10/03	\$692,250.00	
Audit of an Early Defaulted Loan	4-02	11/24/03	\$376,106.00	
Audit of an SBA Guaranteed Loan	4-04	12/23/03	\$105,000.00	
Audit of a SBA Guaranteed Loan	4-06	1/8/04	\$777,516.00	
Audit of an Early Defaulted Loan	4-13	3/2/04	\$767,049.00	
<b>Program Subtotal</b>	5 Reports		\$2,717,921.00	\$0
<i>Agency Management</i>				
Advisory Memorandum Report on SBA's Federal Intragovernmental Activity and Balances Data	4-08	1/23/04		
Review of SBA Purchase Cards	4-09	1/26/04		
Audit of SBA's FY 2003 Financial Statements	4-10	1/30/04		
Advisory Memorandum Report – Agreed-upon Procedures Report on SBA's Federal Agencies' Centralized Trial-Balance System (FACTS) Data	4-11	2/3/04		
Enforcement of SBA's Information Technology Enterprise Architecture During the Development of the Disaster Credit Management System	4-14	3/2/04		
Audit of SBA's Administration of the Procurement Activities of Asset Sale Due Diligence Contracts and Task Orders	4-16	3/17/04	\$1,690,838.00	
Audit of SBA's FY 2003 Financial Statements – Management Letter	4-17	3/23/04		
Management Challenges Report		1/04		
<b>Program Subtotal</b>	8 Reports		\$1,690,838.00	\$0
<i>Government Contracting and Business Development</i>				
Cosponsorship Activities – Los Angeles District Office	4-03	12/17/03		
Audit of Puerto Rico & US Virgin Island District Office Cosponsored and SBA-Sponsored Activities	4-07	1/20/04	\$201,113.73	\$7,000.00
Independent Accountants' Report on the Performance Audit of Farmington Casualty Company	4-12	2/20/04		
SBA's Federal and State Technology Partnership (FAST) Program (Inspection)	4-05	12/30/03		
SACS/MEDCOR: Ineffective and Inefficient (Inspection)	4-15	3/9/04		
<b>Program Subtotal</b>	4 Reports		\$201,113.73	\$7,000.00
<b>TOTALS (all programs)</b>	<b>19 Reports</b>		<b>\$4,609,872.73</b>	<b>\$7,000.00</b>

**APPENDIX II**  
**OIG Reports with Questioned Costs**  
**October 1, 2003, through March 31, 2004**

		<b>Reports</b>	<b>Recs*</b>	<b>Questioned Costs***</b>	<b>Unsupported Costs***</b>
A.	For which no management decision had been made by September 30, 2003	6	15	\$3,623,654.27**	\$2,209,718.90**
B.	Which were issued during the period	7	7	\$4,609,872.73	\$376,106.00
	<b>Subtotals (A + B)</b>	13	22	\$8,233,527.00	\$2,585,824.90
C.	For which a management decision was made during the reporting period	5	5	\$1,894,215.90	\$28,593.90
	(i) Disallowed costs	3	3	\$1,011,699.90	\$28,593.90
	(ii) Costs not disallowed	2	2	\$882,516.00	\$0
D.	For which no management decision had been made by March 31, 2004	8	17	\$6,339,311.10	\$2,557,231.00

\* Recommendations; reports may have more than one recommendation.

\*\* The beginning balance is different from the ending of the last SAR because several management decisions for report 3-14 were not reported even though they had been signed before 9/30/03.

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

**APPENDIX III**  
**OIG Reports with Recommendations that Funds Be Put to Better Use**  
**October 1, 2003, through March 31, 2004**

		<b>Reports</b>	<b>Recs*</b>	<b>Recommended Funds For Better Use</b>
A.	For which no management decision had been made by September 30, 2003	5	5	\$1,361,720.18
B.	Which were issued during the period	1	1	\$7,000.00
	<b>Subtotals (A + B)</b>	6	6	\$1,368,720.18
C.	For which a management decision was made during the reporting period	2	2	\$535,470.18
	(i) Recommendations agreed to by SBA management	2	2	\$535,470.18
	(ii) Recommendations not agreed to by SBA management	0	0	\$0
D.	For which no management decision had been made by March 31, 2004	4	4	\$833,250.00

\* Recommendations; reports may have more than one recommendation.



**APPENDIX IV**  
**OIG Reports with Non-Monetary Recommendations**  
**October 1, 2003, through March 31, 2004**

		<b>Reports</b>	<b>Recommendations</b>
A.	For which no management decision had been made by September 30, 2003	*28	*101
B.	Which were issued during the period	9	113
	<b>Subtotals (A + B)</b>	37	214
C.	For which a management decision was made (for at least one recommendation in the report) during the reporting period	15	42
D.	For which no management decision (for at least one recommendation in the report) had been made by March 31, 2004	27	172

\* The beginning balance is different from the ending of the last SAR because total number of reports and recommendations did not include a Program Vulnerability Memorandum (PVM). It is also different because one recommendation was listed more than once.

**APPENDIX V**  
**OIG Reports From Prior Semiannual Periods**  
**with Overdue Management Decisions**  
**as of March 31, 2004**

<b>Title</b>	<b>Number</b>	<b>Issued</b>	<b>Status</b>
PLP Oversight Process	1-19	9/27/01	One outstanding recommendation is to be submitted to the resolution process.
Borrowers with Prior Defaulted Loans	2-19	5/28/02	Mgmt states they have satisfied all open recommendations. Evidence of their actions should have been submitted to the OIG by 10/31/03.
Georgia District Office Sponsorship Activities	2-25	8/26/02	Management proposals were to have been provided to the OIG for evaluation by 10/24/03.
Internal Control Over Colson Services Corporation's Contract as Central Servicing Agent for SBA's Certified Development Company Loan Program	2-29	9/16/02	Awaiting management decision on outstanding recommendations; expected by 7/31/04.
SBA-Guaranteed Loan to Earth Treasures, Inc.	2-30	9/24/02	Appealing District Office decision to the Office of Financial Assistance. General Counsel is still reviewing the recommendation.
Impact of Loan Splitting on Borrowers and SBA	2-31	9/30/02	Awaiting management decision on outstanding recommendations.
Eligibility of 15 HUBZone Companies and a Review of the HUBZone Empowerment Contracting Program's Internal Controls	3-05	1/22/03	Awaiting management decision on outstanding recommendation; expected by 7/31/04.
SBA's Oversight of the Fiscal Transfer Agent for the 7(a) Loan Program	3-08	1/30/03	Awaiting management decision on outstanding recommendations; expected by 5/31/04.
Program Vulnerability Memorandum (PVM) – Pro-Net Registrant Data Integrity Warnings and Certification	3-09	2/7/03	Awaiting management decisions on outstanding recommendations.
TEP Consulting Inc.	3-14	3/14/03	Awaiting management decision on outstanding recommendations; expected by 4/30/04.
Guaranty Purchase Process	3-15	3/17/03	Awaiting management decision on outstanding recommendations.
Asset Sales Program	3-19	3/31/03	Awaiting management decision on outstanding recommendations.
SBA's Information System Controls for FY 2002	3-20	3/31/03	Awaiting management decisions on outstanding recommendations; expected by 5/31/04.
Equity Injection in the SBA 7(a) Loan Guaranty Program	3-21	3/31/03	Three recommendations are in management resolution.
The Microloan Program: Moving Toward Performance Management (Inspection)	3-26	5/13/03	Awaiting management decisions on two outstanding recommendations.
SBA's Acquisition, Development and Implementation of the Joint Accounting and Administrative Management System	3-32	6/20/03	Awaiting management decision on outstanding recommendations; expected by 7/31/04.

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**APPENDIX V**  
**OIG Reports From Prior Semiannual Periods**  
**with Overdue Management Decisions**  
**as of March 31, 2004**

<b>Title</b>	<b>Number</b>	<b>Issued</b>	<b>Status</b>
SBIC Oversight	3-33	7/1/03	Awaiting management decision on outstanding recommendations.
Audit of the National Women's Advisory Council	3-35	7/28/03	Awaiting management decision on outstanding recommendations; expected by 7/31/04.
Audit of an Early Defaulted Loan	3-41	9/29/03	Awaiting management decision on outstanding recommendation.
Travel Card and Purchase Card Controls	3-42	9/29/03	Awaiting management decision on outstanding recommendations; expected by 7/31/04.
Insufficient Proof of Citizenship Status for SBA Loans (Inspection)	3-43	9/30/03	Awaiting management decision on one outstanding recommendation.

**APPENDIX VI**  
**OIG Reports Without Final Action as of March 31, 2004**

<b>Report Number</b>	<b>Title</b>	<b>Date Issued</b>	<b>Date of Management Decision</b>	<b>Final Action Target</b>
43H006021	8(a) Continuing Eligibility Reviews	9/30/94	10/30/94	10/30/02
87H002017	NOAA Computer Workstation Contracts	6/19/98	3/1/99	3/31/03
9-23	Survey of Electronic Records Management	9/15/99	11/30/99	4/15/03
0-14	7(a) Service Fee Collections	3/30/00	8/22/00	9/30/03
0-19	SDB Certification Program Obligations and Expenditures	6/30/00	3/30/01	9/30/02
0-25	GPRA for the SBIC Program	9/7/00	12/27/00	3/31/04
0-28	Rhode Island District Advisory Council	9/29/00	***	**
0-29	MBELDEF	9/29/00	***	1/31/03
0-30	SBA's Administration of MBELEDF Cosponsorship	9/30/00	3/26/01	**
0-31	Boscart Construction, Inc.	9/30/00	***	**
1-01	GPRA for the 7(a) Business Loan Program	12/4/00	***	**
1-09	PDD 63	3/26/01	9/27/01	9/15/03
1-11	GPRA for the MSB&COD Program	3/27/01	9/28/01	7/31/03
1-12	SBA's Information Systems Controls – FY 2000	3/27/01	***	**
1-16	SBA's Follow-up on SBLC Examinations	8/17/01	9/25/01	12/31/03
1-19	PLP Oversight Process	9/27/01	8/27/02	12/31/03
1-20	Agreed-Upon Procedures Report on Sensitive Payments	9/28/01	12/18/01	11/30/03
A1-06	Evaluation of SBA's Computer Security Program	9/28/01	***	**
2-12	Improvements in the SBLC Oversight Process	3/20/02	8/27/02	**
2-17	SBA's FY 2001 Financial Statements – Management Letter	4/12/02	***	**
2-18	SBA's Information Systems Controls FY 2001	5/6/02	***	**
2-19	Borrowers with Prior Defaulted Loans	5/28/02	3/19/03	1/15/04
2-22	Travel of SBA's Former Region VI Regional Administrator	8/7/02	9/26/02	**
2-27	SBA's Experience with Defaulted Franchise Loans	9/16/02	12/19/02	6/30/03
2-29	Internal Control over Colson CSA for SBA's CDC Program	9/16/02	12/12/02	12/15/03
2-33	7(j) Management & Technical Assistance Program	9/30/02	12/10/02	**
2-34	SBA's Controls over the Access, Disclosure and Use of Social Security Numbers by Third Parties	9/30/02	7/23/03	9/15/03
3-02	Performance Measurement in the Federal and State Technology (FAST) Program	1/3/003	9/30/03	12/1/03
3-03	SBA's Implementation of its CIPP	1/10/03	2/4/03	7/15/03

**APPENDIX VI**  
**OIG Reports Without Final Action as of March 31, 2004**

<b>Report Number</b>	<b>Title</b>	<b>Date Issued</b>	<b>Date of Management Decision</b>	<b>Final Action Target</b>
3-05	Eligibility of 15 HUBZone Companies and a Review of the HUBZone Empowerment Program's Internal Controls	1/22/03	7/10/03	7/21/03
3-06	SBA's FY 2002 Financial Statements	1/30/03	3/28/03	11/15/03
3-08	SBA's Oversight of the FTA for the 7(a) Loan Program	1/30/03	***	**
3-09	Program Vulnerability Memorandum – Pro-Net Registrant Data Integrity Warnings and Certification	2/7/03	***	**
3-10	504 Loan Program Oversight	2/6/03	10/1/03	12/31/03
3-13	Economic Injury Disaster Loans	3/14/03	***	**
3-14	TEP Consulting, Inc.	3/14/03	4/10/03	6/30/03
3-15	Audit of Guaranty Purchase Process	3/17/03	11/6/03	12/31/03
3-18	Grants to the Texas Center for Women's Business Enterprise	3/20/03	6/04/03	10/15/03
3-20	SBA's Information System controls for FY 2002	3/31/03	***	**
3-22	OVBD's Monitoring of Cooperative Agreement	4/2/03	5/8/03	10/15/03
3-23	Service Corps of Retired Executives Program	4/11/03	9/30/03	6/30/04
3-24	Audit of SBA's FY 2002 Financial Statements Management Letter	4/14/03	***	**
3-26	The Microloan Program: Moving Toward Performance Management (Inspection)	5/13/03	***	**
3-29	SBA's Acquisition, Development and Implementation of the Joint Accounting and Administrative Management System	6/30/03	***	**
3-32	SBA's Acquisition, Development and Implementation of the Joint Accounting and Administrative Management System	6/30/03	9/11/03	9/30/04
3-33	SBIC Oversight	7/1/03	10/6/03	**
3-34	SBA's Compliance with JFMIP Property Management System Requirements	7/23/03	9/11/03	**
3-35	National Women's Business Council	7/28/03	***	**
3-36	Audit of an Early Defaulted Loan	8/19/03	10/1/03	9/30/04
3-39	Monitoring of SBA's Implementation of the Disaster Credit Management System	9/24/03	12/11/03	**
4-03	Cosponsorship Activities – Los Angeles District Office	12/17/03	1/15/04	3/20/04

\*\* Target dates vary with different recommendations. \*\*\* Management decision dates vary with different recommendations.

**APPENDIX VII**  
**6-Month Legal Actions Summary**  
**October 1, 2003, through March 31, 2004**

<b>State</b>	<b>Program</b>	<b>Alleged Violation(s) Prosecuted</b>	<b>Legal Action</b>	<b>Investigated Jointly With</b>
CO	BL	Business owner obtained a \$100,000 LowDoc loan, defaulted shortly after, and filed for bankruptcy. She and her husband conspired to hide assets from the bankruptcy court.*	Business owner and her husband pled guilty. He was sentenced to 6 months incarceration, 3 years probation and a \$200 assessment fee	FBI
DE	BL	Applicant did not fully disclose his criminal history in connection with a \$350,000 SBA guaranteed loan application.*	Application denied due to character ineligibility	None
GU	DL	Resort owner failed to disclose his criminal history on his disaster loan application, when he had previously been convicted of bribery of a public official.*	Resort owner pled guilty	FBI
IL	BL	Businessman claimed he was a U.S. citizen, presented a counterfeit certificate of naturalization and offered a \$5,000 bribe to the SBA official to close the \$594,000 guaranteed SBA loan. Wife conspired to falsify documents.*	Both were indicted for conspiracy	INS
IL	BL	Business owner submitted fraudulent invoices to lender and paid off a personal loan with a business capital injection in connection with a \$375,000 guaranteed loan.*	Business owner received 16 months incarceration, 4 years supervised release, and to pay \$218,000	
MO	BL	The corporate president indicated on a form that he was not a U.S. citizen, which the lender was aware of, but never verified his immigration status and certified the business principals' citizenship status as that of U.S. citizen or resident alien.*	Lender canceled and refunded the guaranty of nearly \$317,000 to SBA	SSA-OIG
MO	BL	President and secretary falsified the required \$75,000 equity injection in connection with a \$311,000 SBA guaranteed loan. Additionally, the owners conspired to submit false application forms.	Company president indicted, and company secretary pled guilty to an Information	None
NJ	BL	Businessman conspired with borrower to misrepresent the capital injection, by concealing an \$80,000 mortgage agreement until months after the loan was disbursed.*	Businessman indicted	None
NJ	BL	Businessman submitted a false invoice representing the purchase of equipment and failed to pay equipment leases with loan funds in connection with a \$350,000 SBA guaranteed loan.	Businessman indicted	USPI

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<b>State</b>	<b>Program</b>	<b>Alleged Violation(s) Prosecuted</b>	<b>Legal Action</b>	<b>Investigated Jointly With</b>
NY	DL	Two businessmen received a \$228,200 disaster loan after they falsely claimed they were located in 2 World Trade Center and lost M&E, and F&F, and financial backing from their parent company as a result of the 9/11 disaster. *	Businessmen found guilty by jury	None
NY	IC	Pension plan manager misused company credit cards, double and triple billed for expenses and used the monies for personal expenses. *	Pension plan manager received 12 months incarceration, 3 years probation, and an order to pay \$250,000 in restitution	DOL-OIG
OR	BL	Former loan broker submitted loan applications containing false client information and forged signatures, opened bank accounts in clients names to which loan funds were deposited, and used the funds for personal benefit.	Former loan broker indicted	FBI
PA	GC	Company president falsely represented in his 8(a) annual update that his business relocated to PA. Additionally, he created false financial statements to obtain bonding for the company's bids and contracts, and to support a line of credit. *	Company president found guilty by jury	NCIS, VA-OIG, DCIS
PA	BL	Business owner attempted to conceal \$551,000 from a stock sale in order to induce SBA to accept a \$60,000 offer in compromise in connection with a \$315,000 SBA guaranteed loan which he defaulted on. *	Owner found guilty by jury	None
PR	BL	Business owner submitted a false real estate purchase agreement and paid an individual to pose as the president of his company in connection with a \$946,000 Section 504 loan.	Business owner paid a total of \$601,612 as part of a pre-trial diversion agreement	FBI, USPI
SC	BL	Company president inflated inventory and claimed assets that did not exist and did not disclose his criminal history on SBA Form 912, in connection with a \$688,000 SBA guaranteed loan. *	CDC withdrew its approval for company president's loan resulting in a cost avoidance of \$516,000	None
TX	BL	Defendant submitted inflated income statements and misrepresented the source of his equity injection, in connection with a \$213,000 SBA guaranteed loan. Additionally, he concealed and converted pledged proceeds and collateral to impede liquidation. *	Defendant received 19 months confinement, 5 years probation, and an order to pay \$152,529 restitution	BATF, FBI, IRS
TX	BL	Convenience store/service station owner falsely represented that he was a U.S. citizen on his SBA Form 912 in connection with a \$675,000 SBA guaranteed loan. *	Owner received 6 months incarceration, and a \$2,500 fine	TIGTA, DHS, SSA-OIG, USDA-OIG, TEXAS-ABC

**APPENDIX VII**  
**6-Month Legal Actions Summary**  
**October 1, 2003, through March 31, 2004**

<b>State</b>	<b>Program</b>	<b>Alleged Violation(s) Prosecuted</b>	<b>Legal Action</b>	<b>Investigated Jointly With</b>
TX	BL	Convenience store/service station owner falsely represented that he was a U. S. citizen on his SBA Form 912 in connection with a \$435,000 SBA guaranteed loan. *	Owner received 2 months incarceration, and a \$5,000 fine	TIGTA, DHS, SSA-OIG, USDA-OIG, TEXAS-ABC
TX	BL	Convenience store/service station owner falsely represented that he was a U. S. citizen on his SBA Form 912 in connection with a \$1,200,000 SBA guaranteed loan. *	Business owner indicted	TIGTA, DHS, SSA-OIG, USDA-OIG, TEXAS-ABC & DPS
TX	BL	Two business owners conspired to submit fraudulent personal financial statements, a false purchase contract and fraudulent copies of cashiers' checks as proof of equity injection in connection with an attempt to purchase another business for \$2.7 million.	Business owners pled guilty	FBI
TX	BL	Convenience store/service station owner and wife falsely represented that they were U. S. citizens on their SBA Form 912 in connection with a \$605,000 SBA guaranteed loan. *	Business owner and wife indicted	TIGTA, DHS, SSA-OIG, USDA-OIG, TEXAS-ABC & DPS
TX	BL	Packager assisted borrowers with submitting false and fraudulent documents in order to obtain loan approval, by inflating checking accounts, submitting false gift letters, and using loan proceeds to purchase cashiers checks, which were used to represent capital injections. *	Business owner pled guilty to an Information	FBI
VA	BL	A former management corporation director conspired to inflate the purchase price of the management corporation properties, submit false financial statements, and falsify capital injection to obtain loans. A second business operator and an attorney conspired in the scheme.	Former management corporation director received 6 months confinement, 3 years probation, \$674,000 restitution to SBA, \$1,252,779 restitution to financial institution. The second business operator and the attorney were indicted.	FBI



**APPENDIX VII**  
**6-Month Legal Actions Summary**  
**October 1, 2003, through March 31, 2004**

<b>State</b>	<b>Program</b>	<b>Alleged Violation(s) Prosecuted</b>	<b>Legal Action</b>	<b>Investigated Jointly With</b>
VI	DL	Two joint property owners and an insurance adjuster conspired and falsely claimed damages to the owners' property, which they claimed were their primary residence, as a result of Hurricanes Bertha and Georges. *	Property owners and adjuster indicted	DHS OIG
VT	BL	Company president/owner submitted false invoices to the bank and collected receivables that were supposed to be turned over to the bank in connection with a \$200,000 SBA guaranteed loan.	Company president/owner indicted	FBI
WY	BL	Sporting goods store owner submitted false personal financial statements, where he failed to disclose four debts totaling \$312,000, to the bank in connection with two SBA guaranteed loans totaling \$250,000. *	Sporting goods store owner received 1 year and 1 day incarceration, 3 years probation, and an order to pay \$147,535 in restitution	FBI

\* This case is further discussed in the narrative section of this report.

Program codes: BL=Business Loans; DL=Disaster Loans; GC=Government Contracting and Business Development/Section 8(a) Business Development; IC = Investment Company

Joint-investigation Federal agency acronyms: BATF=Bureau of Alcohol, Tobacco, and Firearms; DCIS=Defense Criminal Investigative Service; DHS=Department of Homeland Security; DOL/OIG=Department of Labor OIG; FBI=Federal Bureau of Investigation; IRS=Internal Revenue Service; IRS-CID=IRS Criminal Investigation Division; NCIS=Naval Criminal Investigative Service; SSA/OIG=Social Security Administration OIG; TEXAS-ABC=Texas Alcoholic Beverage Commission; TEXAS-DPS=Texas Department of Public Safety; TIGTA=Treasury Inspector General for Tax Administration; USDA/OIG=United States Department of Agriculture OIG

**APPENDIX VIII**  
**Significant Recommendations**  
**From Prior Semiannual Reporting Periods**  
**Without Final Action as of March 31, 2004\***

<b>Report Number</b>	<b>Date Issued</b>	<b>Recommendation</b>	<b>Management Decision Date</b>	<b>Final Action Target</b>
43H006021	9/30/94	Establish procedures for determining whether Section 8(a) participants should no longer be considered economically disadvantaged based on their ownership interest in their 8(a) firm, the equity and market value of their primary residence, and the net worth of their spouses.	12/21/01	10/30/02
98-03-01	3/31/98	Establish a loan agent monitoring system.	7/21/98	9/30/99
87H002017	6/18/98	Provide definitive guidance and definitions to evaluate the manufacturing criteria shown in regulations.	11/19/01	3/31/03
0-25	9/7/00	Assert to the accuracy and completeness of performance data, or if data is not currently accurate and complete, explain how the Investment Division plans to overcome any quality problems in the future.	1/3/01	3/31/04
1-01	12/4/00	Develop Section 7(a) program indicators to gauge mission effectiveness, key outcomes and quality of services and the delivery process.	5/10/01	6/30/03
1-11	3/27/01	Ensure that performance plans include indicators for determining how effectively and efficiently the Section 8(a) program is operating.	9/28/01	7/31/03
1-19	9/27/01	Revise the scoring for the annual review process to ensure the volume and weighting of point values of other questions does not offset low scores for eligibility and credit quality.	3/27/02	12/31/03
2-12	3/20/02	Develop a formal policy regarding effective supervisory and enforcement actions.	8/27/02	12/31/03
2-18	5/6/02	Develop an Agency-wide security plan to establish and implement the policies, procedures and practices for the following: (1) full integration of the information security approach and implementation process; (2) coordination among program offices to support their security needs; (3) guidance to the program office to implement information system security controls; and (4) methods to monitor the effectiveness of each part of information technology security.	6/28/02	11/17/03
2-33	9/30/02	Ensure that cooperative agreements and grants are solicited to allow for proper planning and timely processing.	12/10/02	1/30/04
3-06	1/30/03	Develop a process for estimating SBA's ownership in earnings from the Master Reserve Fund (MRF) that provides accurate data for the financial statements.	3/28/03	11/15/03
3-08	1/30/03	Initiate a new procurement action for fiscal and transfer agent (FTA) activities and terminate the existing contract with the FTA when a new contract can be enacted.	12/10/03	3/31/06

\*These are a subset of the universe of recommendations without final actions.

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**APPENDIX VIII**  
**Significant Recommendations**  
**From Prior Semiannual Reporting Periods**  
**Without Final Action as of March 31, 2004\***

<b>Report Number</b>	<b>Date Issued</b>	<b>Recommendation</b>	<b>Management Decision Date</b>	<b>Final Action Target</b>
3-08	1/30/03	Review FTA activities and identify contract costs for fees and services. Report these contract costs in proposed Master Reserve Fund (MRF) financial statements so future FTA contracts will have historical cost data for comparison purposes.	10/15/03	11/17/03
3-10	2/6/03	Design a review guide to incorporate performance aspects to address financial risk, address the specific requirements of the Section 504 loan program, and incorporate a performance-driven scoring system.	10/01/03	12/31/03
3-15	3/17/03	Establish a time frame for completing the training of all individuals involved with guaranty purchase processing.	11/6/03	12/31/03
3-26	5/13/03	Develop a comprehensive Microloan Program SOP and a systematic approach to disseminate guidance.	8/28/03	12/31/03
3-26	5/13/03	Ensure that Microloan Program goals are set and that outcome-oriented data is required of program participants.	Appeal pending	Depends on appeal.
3-33	7/1/03	Revise SOP on Small Business Investment Companies (SBICs) to ensure it includes requirements to perform quarterly risk assessments for capially impaired SBICs, include an analysis of potential for repayment of outstanding leverage, and determine what criteria should be used to recommend an SBIC be transferred to liquidation.	10/6/03	12/28/03

\*These are a subset of the universe of recommendations without final actions.