# SEMIANNUAL REPORT TO CONGRESS
# OFFICE OF INSPECTOR GENERAL
# U.S. SMALL BUSINESS ADMINISTRATION

**PERIOD: APRIL 1, 1999 TO SEPTEMBER 30, 1999**

# Foreword

Pursuant to Public Law 95-452, the U.S. Small Business Administration's (SBA) Office of Inspector General (OIG) is required to prepare a Semiannual Report of its activities for the Congress of the United States. This report covers the full range of SBA/OIG activities from April 1, 1999, to September 30, 1999.

Fiscal Year 1999 has proven to be another period of solid accomplishment by this Office. Looking at the usual productivity measures for OIG activities, we see that the Office issued reports on 26 audits, 2 inspections, and 4 advisory initiatives. OIG investigations resulted in 44 indictments and 50 convictions for criminal violations. The Office brought its collective experience to bear in reviewing 288 legislative, regulatory, policy, and procedural proposals concerning SBA and Government-wide programs. Overall, OIG dollar accomplishments from all activities totaled over $44 million. All of this was accomplished with an appropriation of $11.3 million and an average staff level of 109.

While the numbers are impressive, they do not tell the whole story. One of the more significant activities we completed this year has been to revise our strategic plan. SBA's increased emphasis on outsourcing and information systems modernization has provided us with increased challenges in our oversight efforts. Our new plan, which has been sent to Congress, the Office of Management and Budget, and SBA program officials as part of our consultative efforts, outlines our strategic focus on five key areas: financial management systems, information systems and computer security, lender oversight, other selected high risk issues, and new Agency initiatives. In FY 2000 and beyond, we will focus our efforts and resources in these areas.

Over the past year, the Office has addressed many of the critical issues facing SBA. In the area of information technology (IT), we devoted resources towards oversight of the Agency's IT security, electronic records, and Y2K efforts. We issued an inspection report identifying the potential security, legal, and management issues that public and private sector managers face in converting existing business processes to an electronic environment. Our investigative staff has responded to new situations involving misuse of the Internet and has worked proactively with Agency managers to address these issues. As to lender oversight, we issued the last in a series of audits on lender procedures for Section 7(a) business loans, and an inspection on SBA's oversight of the certified development company program. Both of these efforts contain significant findings and recommendations for improvements. With respect to financial management within SBA, we provided oversight for the audit of SBA's FY 1998 financial statements. The Agency obtained an unqualified opinion on its financial statements for the third year in a row, and is taking significant actions to address timeliness, systems controls, and the estimating process.

Finally, because we do not work in a vacuum, I would like to express my appreciation for the ongoing support and interest of the Administrator, Deputy Administrator, and SBA's senior staff.

Without their willingness to assist us and take action on our recommendations, we would not be effective. I look forward to continuing this professional and productive relationship.

Phyllis K. Fong
Inspector General

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# Executive Summary

This report on the activities of the Office of Inspector General (OIG) of the Small Business Administration (SBA) is submitted pursuant to Section 5(b) of Public Law (P.L.) 95-452, the Inspector General Act of 1978, as amended. It summarizes OIG activities for the 6-month period from April 1, 1999 to September 30, 1999.

## Summary of Accomplishments

OIG audits, inspections, and investigations over the last 6 months achieved $19,537,668 in potential dollar results, 19 indictments, and 26 convictions. The dollar results consist of $4,898,128 in potential recoveries, including judicially awarded fines and restitution, $12,123,521 in loans not approved as a result of investigations and name checks, $1,434,464 in disallowed costs agreed to by SBA's management, and $1,081,555 in management commitments to use funds more efficiently.

OIG alone could not have achieved the accomplishments set forth in this report to the Congress. The results for this reporting period reflect the cooperation and support of other audit, inspection, and investigative organizations such as: the Federal Bureau of Investigation; U.S. Marshals Service; U.S. Secret Service; Postal Inspection Service; Internal Revenue Service; Immigration and Naturalization Service; Bureau of Alcohol, Tobacco and Firearms; other Federal OIGs; Department of Justice (DOJ) prosecutors; State and local law enforcement agencies; and most importantly, the actions of SBA program managers and employees. Indeed, many of our results are due to referrals made by conscientious SBA employees.

## Highlights of the Past Six Months

## Efforts to Improve SBA Program Management

### Audits of Section 7(a) Lending Find Lender Non-Compliance with Required Procedures

A nationwide audit of Section 7(a) business loans concluded during this period with the issuance of the report on Kansas City the last of eight districts in the sample. A summary report on the systemic issues identified is nearing completion and will be issued in the first quarter of fiscal year (FY) 2000.

The purpose of the audit was to determine if Section 7 (a) loans were originated, disbursed, and used in accordance with 22 key procedures. The eight districts were randomly selected, and 30 loans in each district were randomly picked for examination.

Results in Kansas City were similar to results in the preceding 7 reports, with 17 of 30 loans having at least 1 noncompliance with the 22 procedures. Typical lender errors are lack of IRS tax verification, failure to verify use of proceeds, failure to verify equity injections, and failure to issue joint payee checks. Recommendations were made to the district office to correct the problems found.

### Inspection Finds SBA Needs to Improve Oversight of CDC Program

An inspection of the Certified Development Company (CDC) Program found that **SBA's monitoring of the CDCs needs tightening to be effective**. The report contains recommendations for strengthening internal controls and improving the effectiveness and timeliness of program delivery.

To correct oversight problems, SBA needs to require more specific data in the annual reports submitted by the CDCs and make more effective use of that information for monitoring CDC activities. The Agency should also clarify its policy on CDCs contracting out services to for-profit companies and exercise closer oversight to prevent program violations. SBA needs to track fees charged to borrowers more closely, ensure that district offices approve Accredited Lenders Program (ALP) loan applications within the required three-day time period, revoke the ALP status of CDCs that submit loan packages that do not meet ALP standards, and ensure that all district offices perform site visits of CDCs at least once every three years.

### Audit of Disaster Home Loan Servicing Centers Finds Need for More Timely and Frequent Collection Effort

An OIG audit of Disaster Home Loan Servicing Centers found more timely and frequent collection efforts were needed. The audit also found that delinquent disaster home loans were routinely charged off without using available liquidation tools, such as litigation and garnishment.

The Associate Administrator for Financial Assistance agreed with the recommendation to increase referrals to the Department of Justice.

### Audits of Two Surety Bond Companies Find Failure to Comply with SBA Requirements and Inappropriate Claims

Audit reports on two sureties identified noncompliance with SBA procedures for guarantees and claims in the areas of: (1) executing a bond after work on the contract had started, (2) submitting bond applications in excess of the number allowed, (3) submitting legal expenses that were not allocable to the bond, (4) not remitting salvage on time, and (5) not remitting claim recoveries and fees due SBA. The Associate Administrator for Surety Guarantees agreed with our recommendations to recover funds due the SBA.

### Inspection Identifies Management Issues in a "Paperless" Environment

An inspection report identified potential security, legal, and organizational challenges that managers need to be aware of before converting existing paper procedures to an electronic process. To address security and privacy concerns, we recommend that SBA (1) identify the types of data that require a high level of security, (2) develop precautionary contracts with trusted third parties providing Public Key Infrastructure services, (3) limit the amount of information in the digital certificates used to verify an electronic document's authenticity, and (4) periodically post on computers prominent notices to remind employees of their security responsibilities and the lack of privacy in using the Agency's computer system.

Until uniform standards are developed for electronic transactions, the OIG recommends that the Agency ensure that its contractual agreements with resource partners and small businesses include each party's (1) electronic identity, (2) responsibility for providing accurate information, and (3) recourse if the other fails to meet the terms of the agreement. Finally, we recommend that a central coordination group be formed to identify the work processes that are appropriate for electronic conversion.

### SBA's Financial Statements Received Third Straight Unqualified Opinion

SBA's FY 1998 financial statements for the third straight year received an unqualified opinion. The unqualified opinion means that the auditors found SBA's principal financial statements to be presented fairly in all material respects in accordance with Office of Management and Budget (OMB) guidelines and SBA accounting policies.

The audit, however, found three material weaknesses in SBA's internal control structure: (1) lack of planning for financial reporting which resulted in untimely and erroneous draft financial statements; (2) incorrect calculations used in the credit reform subsidy modeling and reestimating process for the Section 7(a), 504, and disaster programs, resulting in substantial errors (these calculations were corrected upon discovery by the auditors); and (3) inadequate SBA computer security and applications development standards.

### Audit Finds Agency Has Not Fully Implemented Requirements of Debt Collection Improvement Act

As part of a project of the President's Council on Integrity and Efficiency, OIG conducted an audit to determine whether SBA had implemented the Debt Collection Improvement Act of 1996 (DCIA) and whether SBA accurately reported delinquent debt to the Department of the Treasury (Treasury). The audit found SBA **had not fully implemented the DCIA and had not established a timeframe to implement wage garnishment.** Also, **purchased loans serviced by lenders were not referred to the Treasury Offset Program (TOP).** The delinquent debt reported to Treasury was accurate.

The report recommended that the Associate Administrator for Financial Assistance (AA/FA) revise the loan accounting system to automatically refer to Treasury eligible loans over 180 days delinquent, refer to TOP purchased loans serviced by lenders, and establish a timeframe for implementing garnishment of non-Federal wages. The AA/FA agreed with the recommendations and advised that the revisions to the loan accounting system to refer loans to Treasury were in process and a date to implement wage garnishment has been established.

## Top Ten Management Issues Facing SBA Identified by OIG

In response to separate requests from the Senate Committee on Governmental Affairs, the House Majority Leader, and the House Committee on Government Reform and Oversight, in December 1998, OIG identified what it considered to be the top 10 management issues facing SBA. OIG continued to work with SBA officials to implement the recommended actions that would resolve these issues. The issues that were identified in December 1998 were the following:

- SBA needed to hold lenders more accountable for errors in loan processing and servicing.
- Borrowers needed to be held accountable for misuse of funds.
- SBA was not maximizing recoveries in servicing and liquidation.
- Fraud deterrence and detection required continued emphasis.
- Contract dollars were too concentrated among relatively few 8(a) companies whose owners remain in the program after amassing substantial wealth.
- SBA did not adequately enforce its rule precluding excessive subcontracting.
- SBA should more closely monitor Section 8(a) companies.
- SBA needed to develop and implement a program-based, cost accounting system.
- SBA needed to improve its information system controls.
- The Paperwork Reduction Act and the Privacy Act need to be rationalized with the Government Performance and Results Act (GPRA) to permit effective measurement of performance outcomes.

OIG will review and update the list of top management issues in December 1999, to reflect the current challenges facing SBA.

## GPRA Activities

OIG has developed a new FY 2001-2006 Strategic Plan that will allow us to respond more effectively to changes in SBA, particularly the Agency's increasing emphasis on outsourcing and information systems modernization. Our strategic focus will be on five areas: Financial management systems, information systems and computer security, lender oversight, other selected high risk issues, and new Agency initiatives. The plan is designed also to emphasize our commitment to the goals of recent Government reform legislation and maximize OIG management efficiency, effectiveness, and accountability. We have also begun GPRA audits of the Small Business Investment Company and Disaster Loan Programs, and most OIG inspections will include a review of program performance measures.

## Activities to Enhance Fraud Detection and Deterrence

### Results of False Tax Return Cases Increased

Over the last 9 years, OIG has received 437 allegations that false tax returns were submitted in support of SBA business or disaster loan applications. These fraud referrals now involve loan applications totaling $127 million that have been submitted to 52 SBA district offices. To date, 138 individuals have been indicted on criminal charges, 132 have been adjudicated guilty, 3 indictments were dismissed, and 3 others have not yet gone to trial.

### Affirmative Civil Enforcement Program

The OIG continued to produce results from its participation in DOJ's Affirmative Civil Enforcement (ACE) program. This program, which is implemented by U.S. attorney offices around the country, targets cases which might not be prosecuted criminally because of the minimal dollar amounts involved, absence of financial loss to the Government, or because other facts of the case might not support a criminal prosecution.

During the 6½ years that OIG has been involved with the ACE program, we have had a total of 112 successful cases, resulting in $3,031,820 in civil penalties and $5,009,126 in recoveries by SBA. These successes came from actions in 21 States (including, during this reporting period, OIG's first ACE success in Nevada) and the Commonwealth of Puerto Rico. During this reporting period, OIG had two successful ACE outcomes. Each was a $5,000 civil penalty in connection with SBA's business loan program.

### Results of California Loan Broker Investigation Continued to Multiply

The number of individuals charged with crimes in the wake of the investigation of an Inglewood, California, loan brokerage firm has grown to 18. All 18 have entered guilty pleas, and with 13 defendants sentenced, court-ordered restitution and fines thus far total nearly $2.25 million in this case revolving around loan packages submitted to a now-defunct participating lender bank. The brokerage firm's portfolio at the bank totaled approximately 160 loans, originally valued at some $60 million. During the last 6 months, the following results occurred.

- Four more borrowers were charged with and pled guilty to **making false statements to a federally insured lender**; the one who was sentenced was ordered to serve 10 months' confinement and to pay a $4,050 fine.

- Five other borrowers who previously entered guilty pleas to SBA-related charges were sentenced. Their sentences totaled 43 months' confinement and more than $1.2 million in restitution.

- A Harbor City, California, tax preparer who previously entered an SBA-related guilty plea was sentenced to serve 15 months in prison and to pay $15,000 in restitution. He assisted principals of the loan brokerage by preparing fraudulent documents for the firm's clients.

All these actions related to the borrowers' SBA-guaranteed loans and resulted from an extensive investigation by OIG, conducted jointly with the Federal Bureau of Investigations and Internal Revenue Service, based on allegations from an anonymous complainant. Partially as a result of the default rate of these allegedly fraudulent loans, the Office of the Comptroller of the Currency closed the bank in 1994.

### Former SBA Employees Sentenced for Making False Statements

A former employee in SBA's Disaster Assistance Area 4 Office pled guilty to two counts of **making a material false statement** and was sentenced to serve 4 months in prison, 4 months in a halfway house, and 3 years on supervised release. He was ordered to pay $57,400 in restitution to SBA, $10,000 in restitution to the Federal Emergency Management Agency (FEMA), and $10,150 in fines.

A second former employee, who was also a licensed contractor, was sentenced after pleading guilty to one count of **making a material false statement**. He was ordered to serve 4 months in home confinement and 3 years on probation, pay $2,100 in fines, and perform 300 hours of community service. In addition, each man was prohibited from seeking Federal employment.

## Business Loan Program

SBA's small business loan programs serve one of the most important missions of the Agency: to ensure that Federal funds and resources are used to help finance qualified small enterprises. Under the **Section 7(a) Guaranteed Loan Program**, SBA guarantees loans to small businesses that are unable to obtain private financing. These loans must be of such merit, or be so secured, as to reasonably ensure repayment to the lending institution. No loan may be made unless the

market. Under the guarantee program, SBA agrees to purchase the guaranteed portion of the loan upon default by the small business. SBA's guarantee share of loans by private lenders

More than 8,000 lenders have made at least one Section 7(a) loan in the past 5 years. Currently, approximately 40 percent of these loans are being made by participants in the Agency's or its **Preferred Lender Program (PLP).**

can participate through **CLP** **CLP** program, are

and liquidating loans. As a result, SBA can process loan guarantee applications in 3 days, rather than the 2 weeks that it may take for a thorough analysis by Agency staff. About 6 percent of all **CLP** process.

to preferred lenders, i.e., lenders who can commit the Agency to guarantee eligible business loans and decide the level of SBA participation. This program, with more than

of SBA's best lenders to the maximum. About 33 percent of all business loan guarantees are made through the process.

The provides long-term, fixed-rate financing through Certified Development Companies (CDCs) to small businesses to acquire real estate, machinery, and

proceeds are provided as follows: 50 percent by an unguaranteed first mortgage bank loan,

The maximum SBA debenture is $750,000, except for projects that fulfill a public policy goal, in which case the maximum is $1,000,000.

With the creation of the Agency's Low Documentation (**LowDoc**) application process, lenders are now able to use their own internal loan application documents, plus a single page, two-sided SBA form to apply for an SBA guarantee on a loan of $150,000 or less. The demand for this

The **SBA*Express* Loan Program** allows lenders to use their own loan analyses, procedures, and documentation to originate loans of $150,000 or less with a 50 percent SBA guarantee. Lenders can thus use their own application forms, internal credit memoranda, notes, and documentation pertaining to loan collateral, servicing, and liquidation. This pilot program minimizes the use of Government mandated forms and procedures while reducing the cost of originating smaller, less complex SBA loans.

| **Summary of OIG Activity / *Business Loan Program*** | |
|---|---|
| Audit Reports and Advisory Memoranda Issued | 6 |
| Audits Underway | 14 |
| Indictments Resulting from Investigations | 13 |
| Convictions Resulting from Investigations | 13 |
| Investigations Closed / Canceled / Remaining Inventory | 22 / 1 / 193 |
| Investigations: Restitutions / Fines / Other Recoveries | $2,858,800 / $279,458 / $0 |
| Investigations: Declination of Loans Due to Name Checks | $10,724,550 |
| Investigations: Cases Referred to Other Agencies | 3 |
| Inspections Completed | 1 |
| Inspections Underway | 1 |
| Reviews of Proposed Regulations | 4 |
| Reviews of Standard Operating Procedures | 2 |
| Reviews of Other Issuances | 24 |

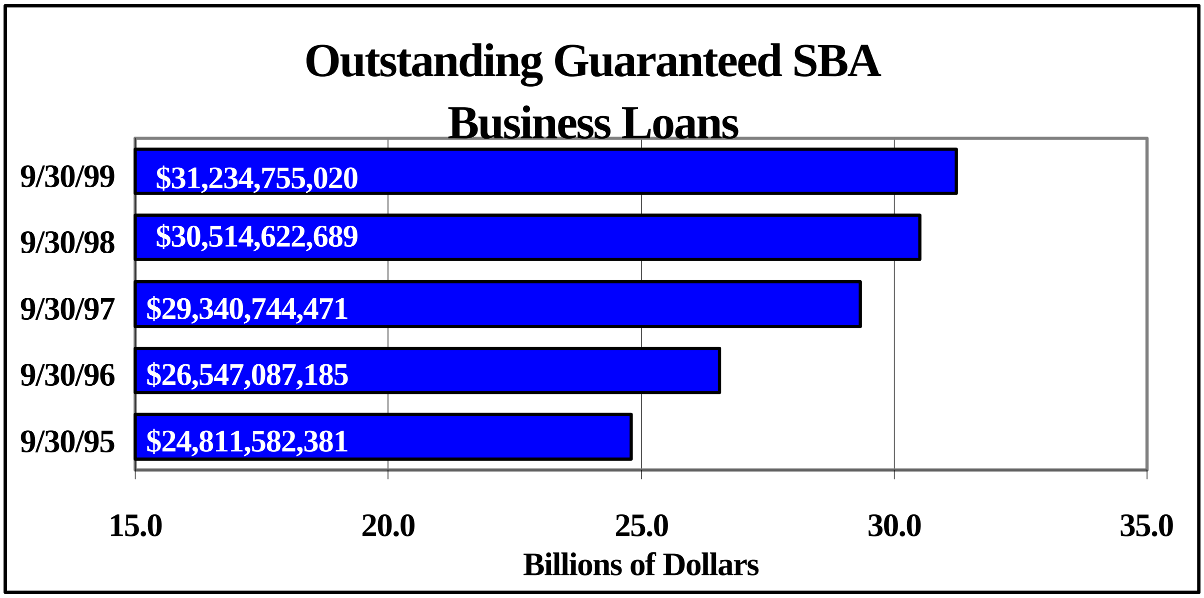


**Figure 1**

## Efforts to Improve SBA Program Management

### Audit Finds Agency Has Not Fully Implemented Requirements of Debt Collection Improvement Act

As part of a project of the President's Council on Integrity and Efficiency, OIG conducted an audit to determine whether SBA had implemented the Debt Collection Improvement Act of 1996 (DCIA) and whether SBA accurately reported delinquent debt to the Department of the Treasury (Treasury). The audit found SBA **had not fully implemented the DCIA and had not established a timeframe to implement wage garnishment**. Of the 88 loans reviewed, 22 loans (25 percent) should have been referred to Treasury for collection. The 22 loans had a value of $1.5 million. Also, **purchased loans serviced by lenders were not referred to the Treasury Offset Program (TOP)**. The delinquent debt reported to Treasury, however, was accurate. The report recommended that the Associate Administrator for Financial Assistance (AA/FA) revise the loan accounting system to automatically refer to Treasury eligible loans over 180 days delinquent, refer to TOP purchased loans serviced by lenders, and establish a timeframe for implementing garnishment of non-Federal wages. The AA/FA agreed with the recommendations and advised that the revisions to the loan accounting system to refer loans to Treasury were in process and a date to implement wage garnishment has been established.

### Oversight Evaluation of SBLC Exams

SBA entered into an agreement to have the Farm Credit Administration (FCA) conduct safety and soundness examinations of the 14 Small Business Lending Companies (SBLCs). SBLCs are non-bank lending companies that are authorized to participate in SBA's 7(a) loan guarantee program, but have no financial institution oversight other than that performed by SBA. The OIG performed a review of the adequacy of FCA's examination process after FCA completed four exams.

OIG review found that, in general, the examinations were adequate. SBA however, **had not established routine procedures to (1) report problem loans to OIG (2) completely analyze the allowance for loan losses, and (3) rate the safety and soundness of SBLCs,** using a rating process similar to the process used by other financial institution examiners. A rating system would help identify the types of corrective and follow-up actions needed on examination findings.

The OIG recommended development of these procedures. The Deputy to the Associate Deputy Administrator for Capital Access agreed to take appropriate action.

### 7(a) Loans Audited in SBA's Kansas City District Office

As part of a nationwide review to determine whether Section 7(a) loans were processed, disbursed, and used in accordance with SBA requirements, OIG conducted an audit of 30 Section 7(a) loans assigned to SBA's Kansas City District Office. The **audit found that lenders and SBA loan officers did not follow at least 1 of 22 selected SBA procedures for 17 of the 30 loans reviewed**. The report recommended that SBA deny the guarantee of $100,500 for one loan in liquidation based upon unauthorized use of proceeds, the lender's failure to issue joint payee checks, and the lender's failure to verify financial data with the IRS. In addition, the report recommended that the district office: Verify financial information with the IRS for four loans, reduce the guarantee of another loan by $17,830 that was used to pay off other debt owed the lender, require that the remaining equity injections for two loans be made, and reduce the guarantee percentage of one loan to reflect the lender's failure to verify the use of $23,847 of loan proceeds. The district director agreed with the recommendations and stated that guarantees would be denied or reduced for these loans. Appropriate action will be taken to ensure the lenders verify equity injections and financial information with the IRS.

### Inspection Finds SBA Needs to Improve Oversight of CDC Program

OIG issued an inspection report on the CDC Program that examines the oversight and operations of the Section 504 Loan Program. The report contains recommendations for strengthening internal controls and improving the effectiveness and timeliness of program delivery. More specifically, it focuses on CDC reporting requirements, CDC contractual agreements with service providers, Section 504 fees charged to borrowers, compliance with program rules, and performance measurement.

Overall, OIG believes that SBA's oversight of the CDCs needs tightening to be effective. **OIG found that some SBA district offices were not diligent in**

**reviewing CDC annual reports, preparing summary assessments, and forwarding the reports and assessments to Headquarters**. To correct this problem and improve oversight, **OIG recommends that SBA (1) ensure that the district offices obtain, review, and forward all CDC annual reports and assessments to Headquarters in a timely manner, and (2) provide the field offices with appropriate guidance on reviewing the reports.**

CDCs are allowed to contract for certain services, such as marketing, packaging, processing and servicing, with SBA's prior approval. **Some district offices did not have a prior approval process in place, nor did they review CDC contracts on an annual basis, as required**. We found that at least three non-profit CDCs contracted out virtually all CDC functions to for-profit companies whose owners were directly involved in the management of the CDC. Further, most or all CDC compensation was passed to these for-profit companies. Not only does this arrangement allow CDCs to circumvent the rules barring for-profit CDCs, it also violates regulations that forbid self-dealing. To correct such problems, **OIG recommends that SBA (1) provide district offices with standard procedures for reviewing CDC contracts, (2) hold those offices accountable for conducting annual reviews, (3) require CDCs to provide copies of all contractual agreements in their annual reports, (4) clarify its policy on contracting out the majority of services to for-profit companies, and (5) exercise closer oversight to prevent program violations.**

OIG attempted to use the information provided in CDC annual reports to determine if CDCs were charging borrowers the appropriate processing fees. Although **we identified five CDCs that were charging excessive fees, most of the annual reports did not contain sufficient detail to allow the Agency to verify specific Section 504 revenues. We also found that some CDCs' financial statements did not comply with Generally Accepted Accounting Principles (GAAP), as required**. CDCs are not compelled to undergo an audit by a Certified Public Accountant (CPA); their expense may make such audits inappropriate for smaller CDCs. As a result of these findings, **OIG recommends that SBA (1) require CDCs to list separately each Section 504-related revenue and expense in their financial statements, (2) review all Section 504 revenues to identify CDCs that may be charging borrowers excessive fees, (3) issue guidance to all district offices and CDCs clarifying what fees can be charged to borrowers, and (4) develop a means for certifying compliance with GAAP requirements by CDCs that do not have their financial statements audited by a CPA.**

OIG also conducted a survey of CDC directors that **identified significant variation in closing fees charged by CDCs and substantial dissatisfaction with the time district offices took to approve loans submitted under the Accredited Lender Program (ALP)**. The survey also revealed that 21 percent of the CDCs had not received a site visit from their district offices in 4 or more years. As a result of these findings, **OIG recommends that SBA (1) monitor closing fees in excess of $2,500 to ensure that they are reasonable**

**for the work performed, (2) ensure that district offices approve ALP applications within the required 3-day time period, (3) take necessary steps to revoke the ALP status of CDCs that submit loan packages that take longer to review because they do not meet ALP standards, and (4) ensure that all district offices perform site visits of CDCs at least once every 3 years.**

### Audit Finds Ineligible Loan

An audit of a Section 7(a) loan in upstate New York found that a PLP lender approved an $82,000 SBA guaranteed loan, of which $49,993 was **ineligible for the guarantee because the borrower had credit available elsewhere**. In obtaining SBA's approval, the lender misinformed SBA about the status of the applicant's existing loan. While the lender disagreed with the finding, the Associate Administrator for Financial Assistance agreed to notify the lender that a record of the finding would be placed in its PLP file for review during consideration of any future request for PLP renewal or expansion. Furthermore, if the loan defaults, the lender will be called upon to explain why the refinancing was eligible and why SBA should not deny liability.

### Audits of Early Defaulted Loans

A program of auditing early defaulted loans is yielding dollar recoveries for SBA. In this period, **a lender was collecting payments on a note receivable held as collateral on a defaulted loan, but was not forwarding SBA its guarantee share (62.5 percent) as required by the lender agreement**. As a result of the audit, the lender started making payments to SBA. SBA should now continue to receive $4,881 a month through the year 2006, a potential recovery of $419,971, or 75 percent of the amount SBA paid out to honor the guarantee on the loan.

An "early default" is a loan which goes into liquidation within 3 years of origination. This sometimes indicates there was error or fraud on the part of the lender or borrower. The Auditing Division is auditing a sample of early defaulted loans each year.

### Proposed Rule to Modify Certified Development Companies' Operations Reviewed

OIG reviewed a proposed rule, which would modify the operations of CDCs. While supporting the proposed modifications, OIG recommended that the regulations address the steps a CDC should take to obtain the advice of someone with commercial lending experience in those situations where the member of the board of directors with such experience must disqualify himself or herself from evaluating a loan because of an actual or apparent conflict of interest. OIG further noted that while the proposed rule attempts to restrict "self-dealing" by members of the board of directors or loan committees, it lacked a specific definition of "self-dealing."

## Activities to Enhance Fraud Detection and Deterrence

### Latest Results from Affirmative Civil Enforcement Program

During this reporting period, OIG's participation in the Department of Justice's Affirmative Civil Enforcement (ACE) program produced two successful business loan cases, each resulting in a $5,000 civil penalty. One case involved a loan application, including "copies" of income tax returns that were determined to be false, which was stopped before the participating lender bank disbursed any funds. The other case involved a business executive **who failed to disclose, in applying for an SBA-guaranteed loan, that 15 years earlier another corporation of his had received, and subsequently defaulted on, an SBA loan**. During an earlier reporting period, while OIG was investigating the matter, the executive fully satisfied a 7 year-old judgment for the defaulted loan's balance.

### OIG Briefs Members of Resource-Partner Community

The investigations staff continued its practice of **making presentations to groups of SBA's resource partners**. A Special Agent from OIG's Los Angeles field office gave a presentation to 115 attendees at a meeting sponsored by SBA's Santa Ana District Office. The presentation highlighted the benefits to be gained from cooperation between participants (in the Section 7(a) lending program, in this case) and OIG in combating waste, fraud, and abuse in SBA's programs.

### Texas Clothing Manufacturer Indicted for Making Material False Statements

The owner of a clothing manufacturer in Dallas, Texas, was indicted on one count each of **making material false statements, misuse of a Social Security number (SSN),** and **misappropriation of SBA collateral** in connection with a $675,000 SBA-guaranteed loan from a participating nonbank lender. Using an alias, she sought the loan to open a second business in Prattville, Alabama. In the loan application, she allegedly represented the second company as employing 75 people with a 1995 profit of more than $2 million. Actually, she was its sole employee and worked out of a 700 square foot apartment. She also allegedly gave a false SSN and a false name on the loan application as part of an effort to conceal the fact that her previous business had defaulted on an SBA loan. She also allegedly submitted fictitious tax returns and supporting IRS documentation, falsified financial statements, false lessors' agreements, and false invoices to secure the loan. To substantiate some documents, she allegedly established several telephone numbers in the names of fictitious companies and had voice-mail taking messages for the bogus companies. This loan was disbursed in August 1996. The business owner then failed to purchase the equipment pledged as collateral and allegedly used most of the loan proceeds for personal purchases including two homes, cars, furniture, and other unauthorized items. She went into immediate default on this loan, with a loss to the nonbank lender and SBA of $689,983. This investigation was based on a referral from the lender through SBA's Alabama District Office.

### Missouri Child Care Center Operator Indicted for Making False Statements to SBA

The president of an educational center in Kansas City, Missouri, was indicted on seven counts of **making false statements to SBA** in connection with a $387,000 guaranteed PLP loan she received from a nonbank lender. The businesswoman received this loan in January 1998 to purchase a building and expand her child care operation. According to the indictment, she failed to disclose on her application and related documents that she owed delinquent taxes and had a prior arrest for passing a bad check. She also allegedly made numerous false statements to document her required $111,000 cash injection and falsely reported that she purchased 50 new computers funded partially by proceeds of the loan. She made no regular payments on the loan, and the lender has foreclosed on the real property and is in the process of evicting the occupants. SBA/OIG initiated this investigation based on information received from the Treasury Department's Inspector General for Tax Administration and conducted it jointly with that office.

### Missouri Businessman Indicted for Mail Fraud and Making False Statements

A Missouri businessman was indicted on two counts of **mail fraud**; two counts of **using a false Social Security number**; one count of **making material false statements;** and one count of **impersonating a U.S. Government officer** in connection with alleged schemes to defraud SBA, a small business lending company, and an insurance company. One count each of **mail fraud** and **making material false statements** relate to a $295,000 SBA-guaranteed loan he applied for in March 1999. His corporation was supposed to use SBA loan proceeds to purchase an existing day care center in St. Louis. The investigation found that the businessman submitted false statements regarding his educational background, work experience, criminal history, and financial status, for the purpose of obtaining the SBA-guaranteed loan. The joint SBA/OIG, Department of Health and Human Services (HHS) OIG, Social Security Administration OIG, and Postal Inspection Service investigation was initiated based on a referral from HHS/OIG. Following the man's indictment, a warrant for his arrest was issued, and he subsequently surrendered to Federal authorities.

### Virginia Insurance Agent Sentenced for Mail Fraud

A Vienna, Virginia, field agent for a life insurance company was charged with and pled guilty to one count of **mail fraud**. He was sentenced to serve 18 months in prison and 3 years on supervised release. He was also ordered to pay the insurance company $261,758 in restitution. A joint investigation by SBA/OIG, the Postal Inspection Service, and FBI showed that, from 1992 through 1998, the agent fraudulently misappropriated approximately $261,758 from the insurance company and its policyholders. OIG initiated its investigation following a May 1998 referral from SBA's Washington District Office. The insurance company had forwarded a copy of a letter authorizing them to release a collateral lien SBA held on an insurance policy that belonged to one of the agent's clients, a former SBA loan applicant. The letter was purportedly from SBA's Washington District Director, who actually had retired more than 1 year before the date on the letter. The investigation proved that the bogus letter was prepared and sent by the agent as part of his scheme to defraud the insurance company and the policyholder.

### Iowa Restaurateur Pleads Guilty to Making Material False Statements

The former president of a restaurant and dairy freeze in Lineville, Iowa, was charged with and pled guilty to one count of **making material false statements** to SBA regarding his use of funds from a $50,000 direct SBA loan he received in 1994. The restaurant owner qualified for this loan as a Vietnam-era veteran. OIG's investigation found that he made numerous false statements to SBA regarding his use of the loan proceeds, which were intended to pay for equipment, remodeling expenses, and the remainder of the purchase price of his restaurant. After making only a few payments, he defaulted on this loan, closed the restaurant, and left Iowa. SBA recovered only $2,280 in the resulting liquidation. This investigation was initiated based on a referral from SBA's Des Moines District Office.

### Virginia Taxicab Company Owner Indicted for Making False Statement to SBA

The president and owner of a taxicab company in Culpeper, Virginia, was indicted on one count of **making a false statement to SBA** to obtain a $35,000 LowDoc loan for her business. She had represented on SBA Form 4-L, Application for Business Loan, that she had no previous criminal history. The investigation by OIG established, however, that prior to the date of her loan application she had been arrested in five separate incidents.

## Results of Previously Reported Investigations

### President of Washington, D.C., Waste Paper Recycling Company Sentenced for Making False Statements and Perjury

The president of a now-defunct wastepaper recycling company in Washington, D.C., was sentenced to serve 37 months in prison and 5 years of supervised release. She was also ordered to pay restitution of $427,865 to SBA and $114,916 to the participating lender bank. She was previously convicted on one count each of **making false statements in a loan application to a federally insured bank**, **making false statements to SBA**, and **perjury**. *(Updated from the September 1998 Semiannual Report.)*

### Former Law Enforcement Official Sentenced to Prison for Franchise-Loan Fraud

A former chief deputy sheriff in Minnesota was sentenced in U.S. District Court in Colorado. He was ordered to serve 21 months of incarceration and 5 years of supervised release and to pay $126,207 in restitution. He had pled guilty to one count of **wire fraud** and one count of **bank fraud**. *(Updated from the March 1999 Semiannual Report.)*

### Investigation of California Loan Brokerage Firm Yields Further Results

The number of individuals charged with crimes, in the wake of the 6-year investigation of an Inglewood, California, loan brokerage firm, has grown to 18. All 18 have entered guilty pleas, and with the number of defendants sentenced having risen to 13, total court-ordered restitution and fines thus far total nearly $2.25 million. This case revolves around loan packages submitted to a participating lender bank that, partially as a result of the default rate of the allegedly fraudulent loans, the Office of the Comptroller of the Currency closed in 1994.

1 A former owner of a gas station in San Bernardino, California, was sentenced to serve 5 months of home detention and

3 years of supervised release. She also was ordered to pay $10,000 restitution to SBA. She previously pled guilty to three counts of **making false statements to a federally insured lender** by submitting altered individual income tax returns for 1988 through 1990 as part of her application for a $300,000 SBA-guaranteed loan.

**2** A former owner of a car wash in Hemet, California, and his brother, a former owner of a car wash in Palmdale, California, were each charged with and pled guilty to one count of **making false statements to a federally insured lender**. The brothers had submitted altered 1987 through 1989 individual income tax returns in support of their separate applications for $1 million SBA-guaranteed loans (one for each car wash).

**3** A former owner of a fish market in Castaic, California, was charged with one count of **making false statements to a federally insured lender**. He allegedly submitted altered individual income tax returns for 1988 through 1990 as part of his application for a $1 million SBA-guaranteed loan.

**4** A former owner of an automotive repair business in Glendale, California, was charged with and pled guilty to one count of **making false statements to a federally insured lender**. He was sentenced to serve 5 months imprisonment, 5 months on home detention, and 3 years of supervised release. He was also ordered to pay $4,050 in fines. He had submitted altered Federal income tax returns for 1987 through 1989 as part of his application for a $1 million SBA-guaranteed loan.

**5** Married owners of a gas station in West Covina, California, who previously pled guilty to four counts of **making false statements to a federally insured financial institution**, were sentenced. The husband was sentenced to serve 15 months in prison, 5 months of home detention, and 5 years of supervised release; his wife was sentenced to serve 1 month in prison, 5 months of home detention, and 5 years of supervised release. In addition, they were ordered jointly to pay $25,000 in restitution to SBA.

**6** The former owner of a gas station in Fontana, California, was sentenced to serve 2 months in prison, 4 months of home detention, and 5 years on supervised release. He was also ordered to pay $1,044,514 in restitution (75 percent to SBA). He previously pled guilty to three counts of **making false statements to a federally insured lender**.

**7** A Harbor City, California, tax preparer was sentenced to serve 15 months in prison and 5 years on supervised release. He was also ordered to pay $15,000 in restitution. He previously pled guilty to three counts of aiding and abetting the **making of false statements to a federally insured lender**.

**8** The former co-owner of a West Covina, California, gas station was sentenced to serve 1 month in prison, 5 months on home detention, and 5 years on supervised release. He was also ordered to pay $132,000 in restitution. He previously pled guilty to one count of **making false statements to a federally insured lender** for submitting altered income tax returns for 1987 through 1989 with his application for a $1 million SBA-guaranteed loan. *(March 1999 and September 1998 Semiannual Reports.)*

### President of Washington Construction Company Pleads Guilty to Making False Statements on Loan Application

The former president of a construction/ management company in Des Moines, Washington, pled guilty to one count of **making false statements on a loan application**. He was sentenced to serve 1 year and 1 day in prison and 5 years on supervised release. He was also ordered to pay $480,150 in restitution and an additional $37,506 obligation to the Internal Revenue Service. *(Updated from March 1999 Semiannual Report.)*

### Pennsylvania Beauty Supply Company Owner Pleads Guilty to Making False Statements on Loan Application

The owner of a beauty supply company in Philadelphia, Pennsylvania, pled guilty to two counts of **making material false statements** in an unsuccessful 1994 attempt to obtain a $60,000 SBA-guaranteed bank loan. The man was sentenced to serve 3 years on probation and perform 250 hours of community service and ordered to pay $2,800 in fines. *(Updated from March 1999 Semiannual Report.)*

### Carolina Computer Consultant Sentenced for Aiding and Abetting Making of Material False Statement

The president of a computer consulting firm in Charlotte, North Carolina, was sentenced to serve 4 months of community confinement, 4 months of home detention, and 5 years of supervised release. He was also ordered to pay $102,201 restitution to SBA and a $50 special assessment. He previously pled guilty to one count of **aiding and abetting the making of a material false statement in a loan application to a federally insured bank**. *(Updated from the September 1998 Semiannual Report.)*

### Owner of a Mississippi Trucking Accessories Business Sentenced for Bank Fraud

The owner of a trucking accessories business in Long Beach, Mississippi, was sentenced to serve 1 month in prison, 5 months in home confinement, and 5 years on supervised release. He was also ordered to pay restitution of $109,505 to SBA and $79,084 to other lenders. He previously pled guilty to one count of **bank fraud** in connection with a $100,000 SBA LowDoc loan. *(Updated from the March 1999 Semiannual Report.)*

### California Loan Broker Pleads Guilty to Making False Statements

The principal of a brokerage firm in San Jose, California, pled guilty to two counts of **making false statements to a federally insured lender** to obtain SBA-guaranteed loans. In return, the other 16 felony counts on which he had been indicted were dismissed. The joint investigation conducted by OIG and FBI was initiated based on information provided by SBA's San Francisco District Office. In his plea agreement, he acknowledged that in the course of securing financing for two clients to purchase convenience stores, he assisted them by preparing and submitting fraudulent applications for SBA-guaranteed loans to a bank. The personal financial statements provided failed to disclose loans that the loan broker was making to his clients to facilitate their store purchases. *(Updated from the March 1998 Semiannual Report.)*

### President of Washington Credit Exchange Pleads Guilty to Making False Statements on Loan Application

The president of a credit exchange in Kennewick, Washington, pled guilty to one count of **making false statements to SBA**. In return, a **bank fraud** count on which she had also been indicted was dismissed. She was sentenced to serve 3 years on probation with the first 4 months to be served as home detention with electronic monitoring. She was also ordered to pay restitution of $54,604 (65 percent to SBA and 35 percent to the participating bank). *(Updated from March 1999 Semiannual Report.)*

### Massachusetts Businessman Sentenced for Making False Statements on Loan Application

The president of a company located in Quincy, Massachusetts, was sentenced to serve 5 months of incarceration, 5 months of home detention, and 3 years of supervised release. He was also ordered to pay restitution totaling $216,838 to SBA and two other victims. He previously pled guilty to five counts of **making false statements on loan applications to a federally insured financial institution**. *(Updated from September 1998 Semiannual Report.)*

### President of Washington College Foundation Charged with Mail Fraud

A superseding indictment was returned against a Seattle, Washington, man. The superseding indictment charged him with an additional count of **mail fraud** pertaining to a grant he obtained for a college foundation, a nonprofit organization of which he was the president. The investigation found that he used the U.S. mail to submit false statements to the Boeing Employees Good Neighbor Fund for a $187,000 grant. In addition, he used the U.S. mail to submit additional false documents to support his expenditures of the grant proceeds. Previously, while operating an injury rehabilitation clinic, he was charged in a seven-count indictment. The original charges included two counts of **bank fraud**, one count of making **false statements to SBA**, one count of **false claim of citizenship**, and three counts of making **false statements on loan applications**. The original indictment pertained to his February 1994, application for an $80,000 SBA-guaranteed business loan from a participating lender to purchase chiropractic equipment for his clinic. The investigation found that he made false statements on his loan application documents to obtain the loan, and later converted loan proceeds to his personal use. In addition, the investigation found that he falsely claimed that he was a U.S. citizen on SBA's Statement of Personal History form, and on three loan applications in order to obtain guaranteed student loans from a federally insured financial institution. The joint SBA/OIG and FBI investigation is still ongoing. *(Updated from the March 1999 Semiannual Report.*

### Missouri Music Company President Sentenced for Making False Statements to SBA

The former president of a retail musical instruments company in Springfield, Missouri, was sentenced to serve 1 year on probation. He previously pled guilty to one count of **making false statements to SBA**. *(Updated from the March 1999 Semiannual Report.)*

## Disaster Loan Program

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

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

The need for SBA disaster loans is unpredictable. During FY 1999, SBA approved 36,176 loans. Since the inception of the program, SBA has approved more than 1,452,300 disaster loans valued at some $26 billion. As of the end of FY 1999, the SBA disaster loan portfolio included more than 270,000 loans worth more than $6.8 billion.

SBA is authorized by law to make two types of disaster assistance loans: (1) physical disaster loans, which are a primary source of funding for permanent rebuilding and replacement of uninsured disaster damages to real and personal property homeowners, renters, businesses of all sizes, and nonprofit organizations; and (2) economic injury disaster loans which provide necessary working capital to small businesses until normal operations can be resumed after a physical disaster. SBA delivers its disaster loans through four specialized Disaster Assistance Area Offices located in Niagara Falls, New York (Area 1); Atlanta, Georgia (Area 2); Fort Worth, Texas (Area 3); and Sacramento, California (Area 4).

| **Summary of OIG Activity / *Disaster Loan Program*** | |
|---|---|
| Audit Reports Issued | 1 |
| Audits Underway | 1 |
| Indictments Resulting from Investigations | 2 |
| Convictions Resulting from Investigations | 7 |
| Investigations Closed / Canceled / Remaining Inventory | 18 / 2 / 146 |
| Investigations: Restitutions / Fines / Other Recoveries | $1,338,259 / $16,600 / $0 |
| Investigations: Declination of Loans Due to Name Checks | $1,398,971 |
| Investigations: Cases Referred to Other Agencies | 4 |
| Reviews of Regulations | 4 |
| Reviews of Other Issuances | 4 |

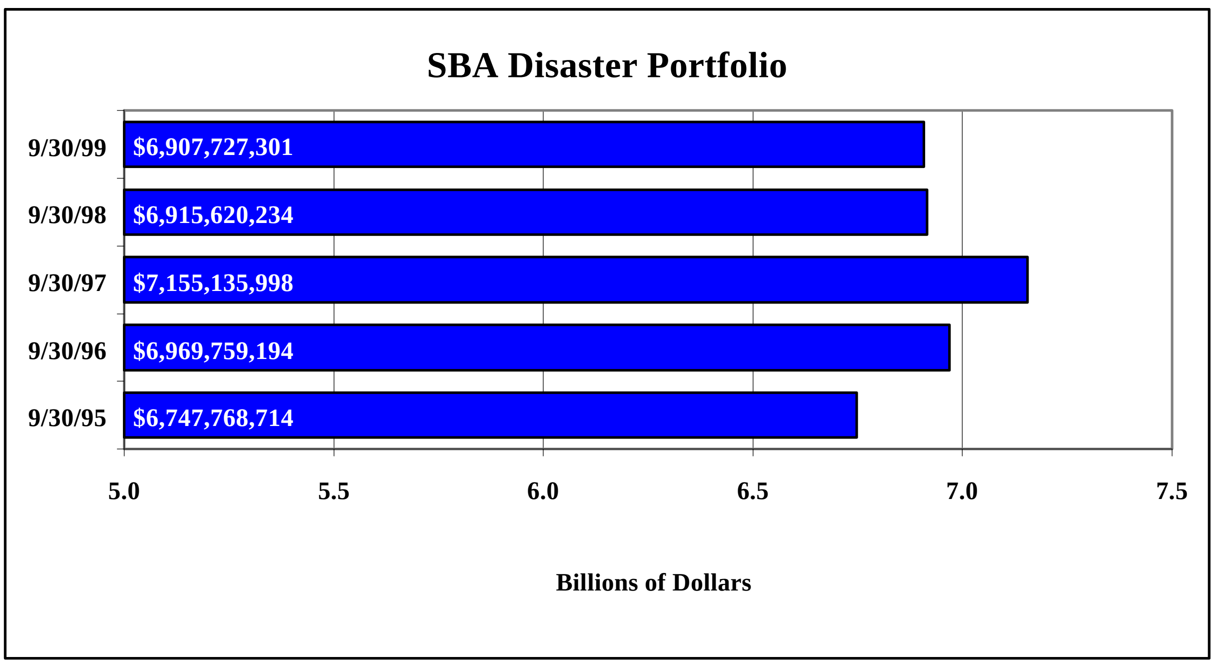


**Figure 2**

# Efforts to Improve SBA Program Management

### Audit of Disaster Home Loan Servicing Centers Finds Need for More Timely and Frequent Collection Effort

An OIG audit of Disaster Home Loan Servicing Centers found that **more timely and frequent collection efforts were needed for past due disaster home loans**. For example, the audit found that collection contacts were concentrated on loans more than 180 days past due, whereas the Department of the Treasury guidance calls for collection actions at the earliest stages of delinquency. The audit also found the goal of weekly contact was achieved in only 40 percent of the delinquent loans in 1997. Additional staff was assigned to the collection function, and by February 1999 there was weekly contact with 99.9 percent of the delinquent loans.

The audit also found that delinquent disaster home loans were routinely charged off without using available liquidation tools such as litigation and garnishment. The Associate Administrator for Disaster Assistance agreed with the recommendations to increase referrals to the Department of Justice.

The audit findings and recommendations were based on a statistical sample of 432 loans that were past due, delinquent, or in liquidation status as of September 30, 1997. As of that date, SBA's disaster loan portfolio totaled 185,417 loans valued at $3 billion, including 12,843 loans valued at $179 million that were past due, delinquent, or in liquidation.

# Activities to Enhance Fraud Detection and Deterrence

### Florida Jeweler Indicted for Making False Statements and Mail Fraud

The owner of a jewelry store in Miami, Florida, was indicted on three counts of **making false statements to SBA** and two counts of **mail fraud** to induce SBA to approve and disburse a $70,400 SBA physical-damage disaster loan for her business. Following Hurricane Andrew, the owner applied for a loan purportedly to replace damaged machinery, equipment, and inventory, and to repair/replace damaged leasehold improvements. She received SBA's permission to open a new store in a different part of Miami from where the storm-damaged store was located. She submitted numerous receipts as documentation of her expenditures of the loan proceeds. After the loan defaulted, an on-site inspection by an SBA liquidation loan officer indicated that the new store might never have been opened. Subsequent inquiries determined that the "receipts" she submitted to SBA were false and most were altered estimates. SBA charged off this loan in 1997 with a loss of $69,368. This indictment was returned as a result of a joint investigation with FBI and IRS. Special agents from FBI and OIG arrested the woman at her home in Miami and, while there, observed and seized numerous apparently counterfeit credit cards and the computer used to produce them. This evidence was referred to the U.S. Secret Service. The referral from SBA's South Florida District Office was originally referred to FBI; in 1998, the Assistant U.S. Attorney overseeing the investigation asked OIG to join the case.

### California Owner of Italian Marble Business Indicted for Mail Fraud

The former owner of an Italian marble business in North Hills, California, was indicted on three counts of **mail fraud**. It was almost 3 months later that the Immigration and Naturalization Service (INS) arrested him in New York City as he entered the country following a flight from Italy; INS subsequently turned him over to the custody of SBA/OIG special agents. He had obtained a $417,000 physical-damage disaster loan for his business from SBA following the 1994 Northridge earthquake. OIG initiated this investigation based on a call to its Fraud Line and additional information provided by SBA's Disaster Assistance Area 4 Office. The investigation revealed that the owner submitted a false corporate tax return and an altered personal tax return to secure the disaster loan from SBA. According to his accountant, he transferred most of the funds from the SBA disaster loan to his bank account in Italy. The loan has been placed into liquidation status.

## Results of Previously Reported Investigations

### California Resident Sentenced for Making Material False Statements

A resident of Los Angeles, California, was sentenced to serve 5 years probation. She previously pled guilty to three counts of **making material false statements** to Federal agencies and one count of **making false statements to a Federally insured financial institution**. *(Updated from the September 1998 Semiannual Report.)*

### Missouri Marina Operator Sentenced for Making Material False Statements

A marina operator in West Alton, Missouri, was sentenced to perform 60 hours of community service and to serve 3 years of probation. He previously pled guilty to one count of **making material false statements** to SBA to fraudulently obtain disaster assistance for his company. *(Updated from the March 1998 Semiannual Report.)*

### Former SBA Employees Sentenced for Making False Statements on Loan Application

A former employee in SBA's Disaster Assistance Area 4 Office pled guilty to two counts of **making a material false statement** and was sentenced on the same day. He was ordered to serve 4 months in prison, 4 months in a halfway house, and 3 years on supervised release. He was ordered to pay $57,400 in restitution to SBA, $10,000 in restitution to the Federal Emergency Management Agency (FEMA), and $10,150 in fines. In addition, he was prohibited from seeking future Federal employment. A second former employee, who was also a licensed contractor, was sentenced after pleading guilty to one count of **making a material false statement**. He was ordered to serve 4 months in home confinement and 3 years on probation, pay $2,100 in fines, and perform 300 hours of community service. In addition, he is prohibited from seeking Federal employment. *(Updated from the March 1999 Semiannual Report.)*

### Illinois Contractor Convicted of Making Material False Statements

The president and owner of a construction company in Silvis, Illinois, was convicted on all four counts of **making material false statements** on which he was indicted in 1998. He made the false statements to SBA in connection with a $151,000 physical-damage disaster loan made to a resort in Orion, Illinois, after the Great Midwest flood of 1993. *(Updated from the September 1998 Semiannual Report.)*

### Alabama Realtor Sentenced for Mail Fraud

The owner of a real estate company in Enterprise, Alabama, was sentenced to serve 4 months in prison, 4 months in home confinement, and 3 years on supervised release. He was also ordered to pay $206,316 (principal and interest) in restitution to SBA. The owner previously pled guilty to one count of **mail fraud**. *(Updated from the March 1997 Semiannual Report.)*

### Indiana Resident Sentenced for Making False Statement

A resident of Indianapolis, Indiana, pled guilty to one count of **making a material false statement** to SBA, and was sentenced to serve 7 months in prison, 7 months of home detention, and 3 years of supervised release. She was also ordered to pay SBA $23,815 in restitution. *(Updated from the March 1999 Semiannual Report.)*

### Pennsylvania Attorney Pleads Guilty to Failing to File Federal Income Tax

An attorney in Harrisburg, Pennsylvania, pled guilty to one count of **failing to file a Federal income tax return**. He was previously indicted on one count of **making false statements** to SBA by overstating his income, and by omitting a theft conviction, on his application for three SBA disaster loans. As part of his plea agreement, the indictment was dismissed and a criminal information charging him with the tax charge was substituted. (*Updated from the March 1998 Semiannual Report.*)

### Colorado Telemarketer Convicted of Making False Statements on Loan Application

The owner of a telemarketing company in Denver, Colorado, was convicted on two counts of **making false statements to SBA**. (*Updated from the March 1999 Semiannual Report.)*

### California Shopping Center Owner Sentenced for Grand Theft and Insurance Fraud

The owner of a shopping center in Los Angeles, California, was sentenced to serve 2 years in prison and ordered to pay a $200 fine, $281,800 in restitution to SBA, and $521,371 in restitution to an insurance company. The owner previously pled guilty to one count of **grand theft** and one count of **insurance fraud**. *(Updated from the March 1999 Semiannual Report.)*

### California Businessman Sentenced for Making False Statements on Loan Application

A Canoga Park, California, man was sentenced to serve 5 months in prison, 5 months in a halfway house, and 5 years on supervised release. He was ordered to pay $247,557 in restitution (88 percent to SBA). He had pled guilty to one count of **making a false statement to a federally insured financial institution**. *(Updated from the March 1999 Semiannual Report.)*

### North Dakota College President Sentenced for Failure to Refund Unearned Federal Student Aid Funds

The former president of a corporation that operated a business college in Grand Forks, North Dakota, was sentenced to serve 18 months in prison and 3 years on supervised release. She was also ordered to pay $914,000 in restitution to the U.S. Department of Education. She previously pled guilty to one count of **failure to refund unearned Federal student aid funds**. *(Updated from the March 1999 Semiannual Report.)*

### Virgin Islands Grocery Store Owner Sentenced for Making False Statements to SBA

The owner of a grocery and feed shop on St. Croix, U.S. Virgin Islands, was sentenced to serve 2 years on probation and ordered to pay $4,050 in fines. He previously pled guilty to **making false statements to SBA** in connection with two disaster loan applications, totaling $215,900, which he had submitted for his business and for his home. *(Updated from the March 1999 Semiannual Report.)*

# Small Business Investment Companies

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

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

As of September 30, 1999, there were 354 licensed and active SBICs, with a total capitalization of $10.6 billion (private capital of $8.3 billion and committed leverage of $2.3 billion). Included are 66 Specialized SBICs (SSBICs) which were licensed under Section 301(d) of the Small Business Investment (SBI) Act to invest only in small businesses owned and managed by socially or economically disadvantaged persons. (Section 301(d) was repealed in 1996, but existing SSBICs were "grandfathered" and continue to operate as before.) While the SBIC program level utilized in FY 1998 was $1.37 billion, authorization ceilings allow for $1.5 billion in the FY 1999 program level, signaling a continuing expansion of the program. As of March 31, 1999, $682 million of the FY 1999 program level was committed.

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

| Summary of OIG Activity / *Small Business Investment Companies* | |
|---|---|
| Audits Underway | 1 |
| Indictments Resulting from Investigations | 0 |
| Convictions Resulting from Investigations | 2 |
| Investigations Closed / Remaining Inventory | 1 / 9 |
| Investigations: Restitutions / Fines / Other Recoveries | $0 / $0 / $400,000 |
| Reviews of Regulations | 1 |
| Reviews of Other Issuances | 2 |

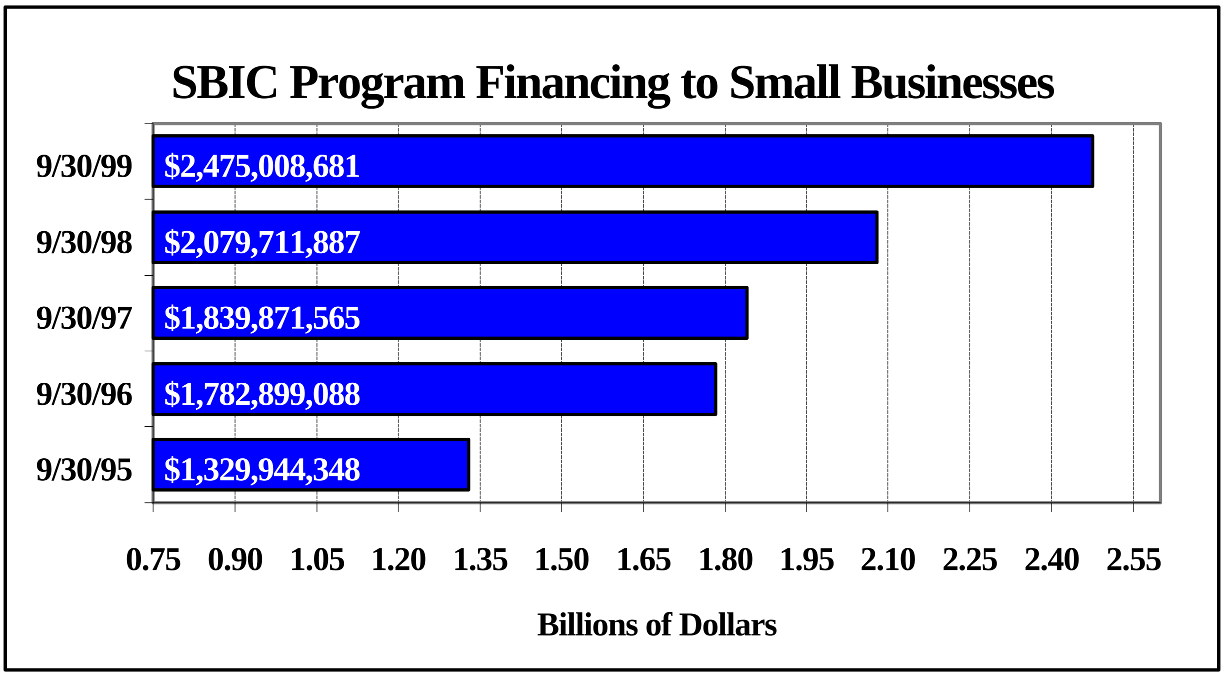


**Figure 3**

## Results of Previously Reported Investigations

### New York Small Business Investment Company Official Pleads Guilty

The president of an SBIC in New York, New York, pled guilty to one count each of **bank fraud** and **making material false statements**. In return, the Government agreed to dismiss the charge of **misapplication of SBIC funds** on which he was previously indicted. His actions caused the SBIC to fail and forced SBA to begin liquidating the SBIC in 1997. SBA expects to lose $1.4 million as a result of this failure. *(Updated from the March 1999 Semiannual Report.)*

### Florida Consultant Pleads Guilty to Bank Fraud

A West Palm Beach, Florida, man who was a consultant to the officers of a now-failed SBIC in New York, New York, pled guilty to the one count of **bank fraud** on which he was previously indicted. *(Updated from the September 1998 Semiannual Report.)*

# Surety Bond Guarantees

Small and emerging contractors who cannot get surety bonds through regular commercial channels can apply for SBA bonding assistance under the **Surety Bond Guarantee Program.** Under this program, SBA guarantees a portion of the losses sustained by a surety company as a result of the issuance of a bid, payment, and/or performance bond to a small business concern.

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

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

SBA can guarantee bonds for contracts with a face value of up to $1.25 million. In FY 1998, SBA contingent liability for new final bond guarantees, including those issued under the PSB program, was $328 million. The appropriated guarantee authority level for FY 1999 surety bond guarantees was $1.672 billion.

| Summary of OIG Activity / *Surety Bond Guarantees* | |
|---|---|
| Audit Reports Issued | 4 |
| Audits Underway | 1 |
| Investigations Closed / Remaining Inventory | 0 / 2 |
| Investigations: Declinations Due to Name Checks | 1 |
| Investigations: Cases Referred to Other Agencies | 1 |
| Reviews of Other Issuances | 1 |

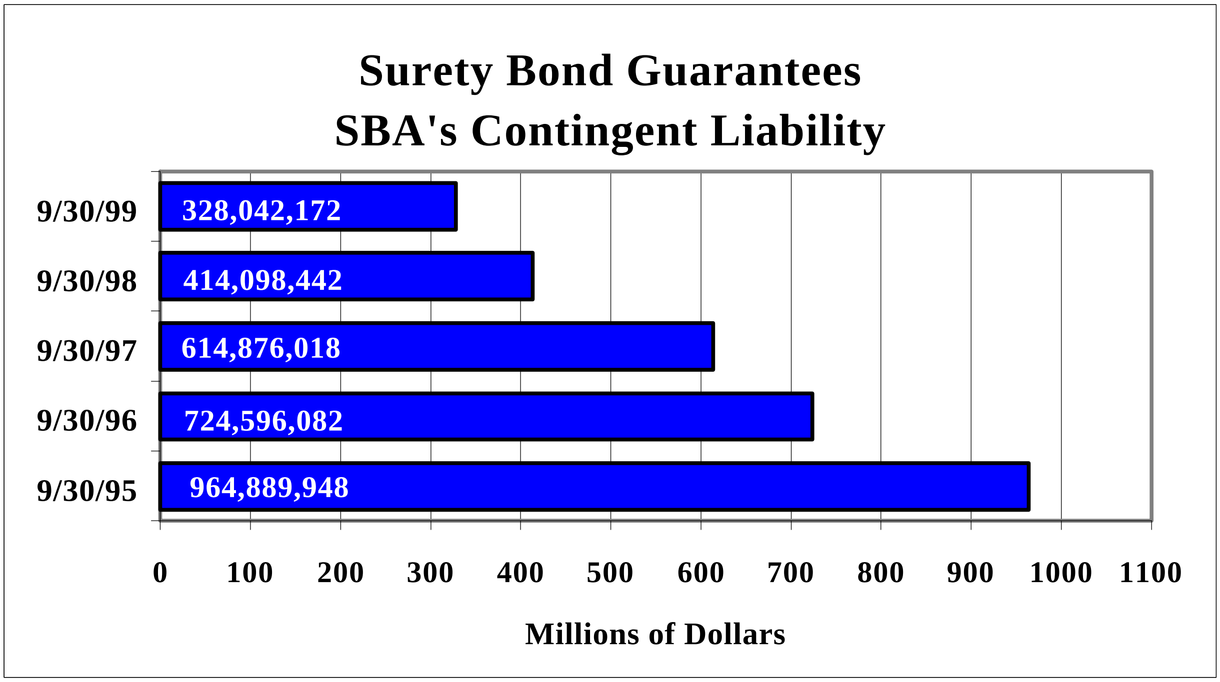


**Figure 4**

## Efforts to Improve SBA Program Management

### Surety Company Audit Finds Noncompliance

An audit of a surety company in New York, New York, found certain instances of noncompliance with SBA's policies and procedures for bond guarantees and claims. OIG reviewed 10 bonds with claim payments totaling about $2.3 million. **The noncompliances included execution of a bond after work on the contract had started, submission of bond applications in excess of the number allowed by SBA, submission of legal expenses that were not allocable to the bond, and untimely remittance of salvage**. The audit report recommended corrective actions to recover $142,284. The Associate Administrator for Surety Guarantees agreed with the recommendations and the surety company agreed to remit $142,284 to SBA.

### Audit of California Surety Finds Noncompliance with SBA Procedures

An audit of a surety company located in San Diego, California, found that the **surety did not comply with SBA procedures for remitting claim recoveries and fees due SBA**. Specifically, the insurance company failed to remit $1,124 in additional fees when the original contract was increased. In addition, SBA requires sureties to remit recoveries within 90 days; however, the company averaged 256 days in remitting the recoveries to SBA. OIG recommended that the fees owed SBA be paid by the company and that it timely remit recoveries to SBA. The Associate Administrator for the Office of Surety Guarantees agreed with the recommendations. Upon receipt of the draft audit, the company paid additional fees owed SBA, and has agreed to implement controls to ensure timely remittance of recoveries to SBA.

# Government Contracting Programs

SBA provides assistance to small businesses to obtain a fair share of Federal Government contracting opportunities. SBA also works with each department or agency to establish procurement goals for contracting with small, small-disadvantaged, and women-owned small businesses. The Agency's Government contracting programs include **Prime Contracts, Subcontracting Assistance, Certificate of Competency (COC), Natural Resources Sales Assistance, Procurement Marketing Access Network (PRO-Net), HUBZone Empowerment Contracting Program,** and the **Small Disadvantaged Business (SDB).**

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

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

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

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

**PRO-Net** is SBA's Internet-based inventory of U.S. small businesses that are interested in Federal procurement opportunities, either directly with the Government or with prime contractors. Federal agencies, large prime contractors, state and local governments use PRO-Net as a resource in identifying small businesses for procurement opportunities. Small businesses use this interactive mechanism to market their products and services.

**The HUBZone Empowerment Contracting Program** encourages economic development in historically underutilized business zones – "HUBZones" – through the establishment of Federal contract awards preferences for small businesses located in such areas. After determining eligibility, SBA lists qualified businesses in its PRO-*NET* database.

**The Small Disadvantaged Business (SDB) Certification Program** ensures that small businesses owned and controlled by individuals claiming to be socially and economically disadvantaged meet the eligibility criteria. Once certified, the businesses are eligible to receive price evaluation credits when bidding on Federal contracts.

| **Summary of OIG Activity / *Government Contracting*** | |
|---|---|
| Audits Underway | 3 |
| Investigations Closed /Remaining Inventory | 2 / 5 |
| Reviews of Proposed Regulations | 8 |
| Reviews of Other Issuances | 4 |

## Efforts to Improve SBA Program Management

### Government Contracting Audits in Process

OIG has three audits in process: (1) Small Disadvantaged Business (SDB) expenses; (2) Private Certifiers for SDB; and (3) Economic Disadvantage for SDB. The objectives of the audit on SDB expenses are to determine the guidelines for the usage of SDB funds and whether the funds were used for SDB purposes. The objectives of the audit on private certifiers for SDB are to determine whether the criteria used for allowing a company to become a private certifier ensure that the process will not be compromised and whether the criteria has been followed. The objective of the audit on SDB economic disadvantage is to determine whether the net worth limits established by SBA are reasonable.

## Section 8(a) Business Development

**Section 7(j)(10)** of the Small Business Act established the **Minority Small Business and Capital Ownership Development Program**, recently renamed the **Section 8(a) Business Development Program**, for the purpose of promoting greater access to the free enterprise system for socially and economically disadvantaged individuals. Under the Act, SBA provides business development assistance to small business concerns that are at least 51 percent unconditionally owned, controlled, and managed by one or more socially and economically disadvantaged individuals and also meets other program eligibility requirements. Such companies may participate in the program for a maximum of 9 years and must enhance their competitiveness during this period so as to prepare for commercial sector competition upon graduation from the program.

One of the business development tools available to participant firms is access to Federal contracting opportunities authorized by **Section 8(a)** of the Small Business Act. Under the Section 8(a) program, SBA contracts with other Government agencies to provide goods and services and subcontracts the performance of these contracts to program participants. As of September 30, 1999, based on preliminary data pending the final Federal Procurement Data System report, there were 5,452, approved program participants. In FY 1999, active Section 8(a) program participants received 4,937 contracts and 17,903 modifications with an aggregate value of $4.552 billion. Generally, Section 8(a) contracts with estimated values, including all options, of more than $5 million (manufacturing) or $3 million (all other industries) must be competed among eligible Section 8(a) program participants. The vast majority of the contracts awarded under the program, however, have estimated values below these two thresholds and are awarded on a sole-source basis.

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

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

| Summary of OIG Activity / *8(a) Business Development* | |
|---|---|
| Audits Underway | 2 |
| Indictments Resulting from Investigations | 1 |
| Convictions Resulting from Investigations | 1 |
| Investigations Closed / Canceled / Remaining Inventory | 0 / 4 / 27 |
| Investigations: Declinations Due to Name Checks | 4 |
| Investigations: Cases Referred to Other Agencies | 1 |
| Reviews of Other Issuances | 3 |

## Activities to Enhance Fraud Detection and Deterrence

### OIG Briefs Members of Resource-Partner Community

The investigations staff continued its practice of **making presentations to groups of SBA's resource partners**. A Special Agent from OIG's Washington, D.C., field office participated in an Ethics in Government Contracting training seminar sponsored by SBA's Richmond District Office. He served as a panelist presenting information on criminal and civil investigations of eligibility issues in the Section 8(a) program. Attendees included approximately 20 representatives of local Section 8(a) contractors.

### New York Contractor Pleads Guilty

The president of a Long Island City, New York, construction company was arrested by special agents of OIG and FBI pursuant to an arrest warrant charging him with one count of **making material false statements** to SBA. The complaint charged that in his application to obtain certification into the Section 8(a) Program in 1995, he falsely stated on an SBA Form 912, Statement of Personal History, that he had never been arrested or charged with a crime. The investigation disclosed that Maryland authorities had arrested him on theft charges in 1986. Four months after his arrest, he was charged in a three-count criminal information with **conspiracy**, **making material false statements** to SBA, and **bank fraud**. The charges, related to the Section 8(a) application, included submitting documents containing inflated income information to induce a federally insured financial institution to extend a $50,000 line of credit to his company. In 1997, the company was awarded a $378,000 Section 8(a) contract to do work at the Federal Correctional Institution in Otisville, New York. The information charges that he and others conspired to defraud the United States by submitting fraudulent payment and performance bonds and falsified payroll reports in connection with the contract. He pled guilty to all three charges.

## Entrepreneurial Development (Business Education and Training)

SBA provides assistance to small business owners, managers, and prospective owners through a variety of counseling and training programs housed under its Office of Entrepreneurial Development.

SBA established the **Small Business Development Center** (**SBDC**) program to make management assistance and counseling widely available. SBDCs offer "one-stop" assistance to small businesses by providing a wide variety of information and guidance in easily accessible locations. The program is a partnership between the private sector, the educational community and Federal, State, and local governments. There are SBDCs in all 50 states, the District of Columbia, Puerto Rico, the Virgin Islands, and Guam, with approximately 1,000 subcenters or service locations located at chambers of commerce, economic development corporations, institutions of higher learning, or in downtown storefronts. In FY 1999, SBDCs provided counseling and training to more than 595,000 clients.

The **Service Corps of Retired Executives** (**SCORE**) is another of the valuable business development resource partners of SBA. Composed of approximately 12,400 volunteers working in over 700 sites, SCORE provides counseling and training to current or prospective business persons. In addition, this year SCORE began providing assistance by e-mail from their website (www.score.org). On-site sessions are free to the public, and formal training is provided at a low cost. In FY 1999, SCORE conducted more than 383,000 client sessions.

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

**Business Information Centers (BICs)** provide business owners with access to computers, software, databases, and other resources to assist them in starting and expanding their businesses. All BICs have at least one on-site counselor. Centers can address the varied business start-up and growth issues encountered by small business owners and provide access to computer applications and the internet. There are currently 61 BICs in operation.

The **Women's Business Center (WBC)** program provides training and counseling specifically tailored to the needs of the vastly underserved market of women entrepreneurs. This program includes a network of 80 funded and graduated women's business centers in nearly every state, Puerto Rico, the Virgin Islands and the District of Columbia. One of the currently funded sites is the Online Women's Business Center on the internet (www.onlinewbc.org), which receives more then 1 million hits per month from over 100 countries.

SBA' s 18 **One-Stop Capital Shops (OSCS)** provide centralized access to the full range of a community's small business resources, including entrepreneurial development, access to capital, and procurement of Government contracts. The program cuts across and combines a variety of SBA's technical assistance resources. Clients can access small business information resources (through the BICs), receive counseling (from SCORE volunteers) and training (from a local SBDC chapter), learn to develop a business plan or mend damaged credit (from non-Governmental resource partners), as well as apply for financing (traditionally with microloan intermediaries). An OSCS is a partnership between the Federal Government, led by SBA, and a local community designed to offer small business assistance from a single, easy to access, retail location. In FY 1999, more than 53,000 clients were served. The web site is also available in Spanish and Russian.

In 1997, SBA began an aggressive **Welfare to Work (W2W)** initiative that cuts across SBA's technical assistance programs to increase small business access to hiring new employees. Through local contacts in each of the 70 district and 15 branch offices SBA provides businesses with information on tax credits and other incentives for hiring, as well as assist in creating new entrepreneurs from the welfare rolls. Using a combination of the SBA toll free number (1-800 U ASK SBA), the SBA web page (www.sba.gov/welfare), electronic and paper versions of pledge cards and a welfare to work toolkit, and through the assistance of SBDC's, SCORE, and WBC programs. SBA has provided assistance to more than 130,000 businesses and entrepreneurial training to more than 50,000 former welfare recipients. The initiative serves as a vehicle to help businesses find effective resources and solutions to their labor shortage needs.

| **Summary of OIG Activity / *Entrepreneurial Development*** | |
|---|---|
| Audit Reports Issued | 2 |
| Audits Underway | 1 |
| Investigations Closed / Canceled / Remaining Inventory | 0 / 1 / 1 |
| Inspections Underway | 1 |

# Efforts to Improve SBA Program Management

## Audits of Women's Business Development Center Finds Unallowable Costs

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

A second audit of the same grantee found an additional $16,799 of claimed costs that were unallowable, $2,650 of unexpended funds, and the required amount of training sessions had not been conducted. The audit report recommended that the center reimburse SBA $15,000 for unallowable and unexpended Federal funds. The Assistant Administrator for Administration concurred with the recommendation.

# Agency Management and Financial Activities

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

SBA's management and financial activities are supported by the Agency's $819.9 million in operating funds, partially provided by FY 1999 appropriations enacted in P.L. 105-119. Of the $819.9 million available, which includes carry-overs and estimated recoveries, $288.3 million funds Salaries and Expenses, $30.9 million is for disaster loan servicing, and $85.3 million is for disaster loan making. In addition, $224.2 million is available for business loans, $147.3 million for disaster loans, and $3.8 million for the Surety Bond Guarantee program.

| **Summary of OIG Activity / *Agency Management and Financial*** | |
|---|---|
| Audit Reports and Advisory Memoranda Issued | 6 |
| Audits Underway | 6 |
| Indictments Resulting from Investigations | 3 |
| Convictions Resulting from Investigations | 3 |
| Investigations Closed / Canceled / Remaining Inventory | 11 / 1 / 11 |
| Investigations: Restitutions / Fines / Other Recoveries | $5,011 / $0 / $0 |
| Inspections Completed | 1 |
| Reviews of Proposed Legislation | 5 |
| Reviews of Proposed Regulations | 3 |
| Reviews of Standard Operating Procedures | 3 |
| Reviews of Other Issuances | 45 |

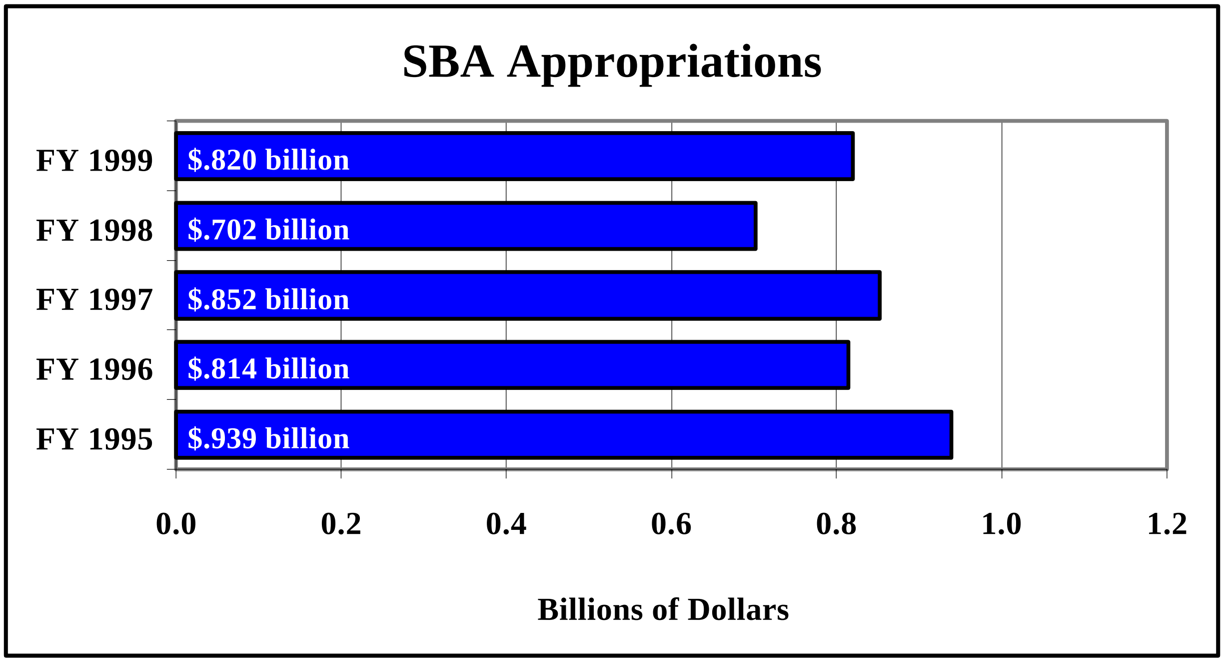


**Figure 5**

## Efforts to Improve SBA Program Management

### SBA's Financial Statements Receive Unqualified Opinion

The SBA's FY 1998 financial statements received an unqualified opinion from its independent auditors. The unqualified opinion means that the auditors found SBA's principal financial statements to be presented fairly in all material respects in accordance with OMB guidelines and SBA accounting policies. The results of the audit were transmitted to the Chief Financial Officer by OIG, which contracted for the independent audit. This was the third year that the Agency received an unqualified opinion.

**The Auditors did, however, find three problems that were considered "reportable conditions" in the internal control structure: (1) lack of planning for financial reporting which resulted in untimely and erroneous draft financial statements; (2) incorrect calculations were used in the credit reform subsidy modeling and reestimating process for the Section 7(a), 504, and disaster programs, resulting in substantial errors (these calculations were corrected upon discovery by the auditors); and (3) inadequate SBA computer security and applications development standards.** The independent auditors considered the three reportable conditions to be material control weaknesses. The auditors issued a separate report for the material weaknesses related to SBA information systems (see below).

### Internal Control Weaknesses in SBA's Information Systems

As a part of the audit of the financial statements, the independent public accountants reviewed SBA's general information systems controls to determine if they complied with established policies and procedures. The auditors concluded that SBA's general controls were not fully in compliance with established policies and procedures. For example, (1) SBA had not funded and implemented an entity-wide security program, (2) unnecessary and excessive access privileges reduced accountability and created segregation of duties weaknesses, (3) application development and change control procedures were not consistently applied in systems outside the Office of Chief Information Officer's control, (4) programmers' abilities to access operating systems could not be monitored, and (5) security administrators and program managers needed training.

The report included two recommendations for establishing an ongoing Agency-wide information systems security program. The Agency response to the draft report stated that responsible SBA management officials will be establishing a committee to work on this issue.

### Audit Finds SBA Could Improve Its Administration of Special Appropriation Grants

OIG issued a report identifying areas where SBA's Office of Procurement and Grants Management (OPGM) could have used different procedures in the administration of a special appropriations grant that involved a relatively unique set of circumstances. The grant funded a portion of the construction of a building. Although funds other than grant funds were necessary to complete the project, there was no requirement in the grant language to withhold funds until outside funding became available, i.e. a match requirement. OPGM interpreted the grant language to require payment of legitimate construction costs up to the total grant amount as they were incurred. The audit found that in this situation OPGM could have authorized payments on a percentage basis for the portion of the building that was actually to be used for grant purposes even though there is no such requirement in the grant language. Using this method, the grantee could be viewed as charging 41 percent of the cost of the building to the grant but only allotting 13 percent of the space to grant purposes. In addition, by making partial payments on reimbursement requests, OPGM could have withheld more grant funds until the building was completed. OIG recommended that the Director of OPGM work with the Office of General Counsel to confirm that the OIG approach is appropriate and, if so, develop and implement procedures for grants of this nature.

### Inspection Identifies Management Issues in a "Paperless" Environment

To maintain efficient operations in a period of reduced staffing, many SBA programs will need to make the transition to a more "paperless" environment. An OIG inspection report identified the security, legal, and organizational problems that program managers are likely to face in converting their existing paper procedures to an electronic process.

The report also recommends steps to be taken by SBA to ensure a successful transition Agency-wide. To address security and privacy concerns while conserving its limited resources, SBA should (1) identify the types of data requiring the highest level of security, (2) develop precautionary contracts with trusted third parties providing Public Key Infrastructure services, (3) limit the amount of information in the digital certificates used to verify an electronic document's authenticity, and (4) create a computer screen notice reminding SBA employees and contractors of their security responsibilities.

Until uniform standards are developed for electronic transactions, OIG recommends that the Agency make certain that its contractual agreements with resource partners and small businesses clearly specify each party's (1) electronic identity, (2) responsibility for providing accurate information, and (3) recourse if the other fails to meet the terms of the agreement. Finally, OIG recommends that SBA form a central coordination group to identify the work processes that are appropriate for electronic conversion. Senior SBA officials agreed with OIG recommendations.

#### Proposed Legislation Reviewed; Government Waste Corrections Act of 1999

OIG reviewed and commented on H.R. 1827, Government Waste Corrections Act of 1999. OIG recommended that the terminology "recovery audits" be changed to avoid confusion with the statutory audit function of Inspectors General (IGs) pursuant to the Inspector General Act (IG Act). The legislative history for the IG Act clearly indicates it was the intent of Congress to centralize auditing functions in an independent office. Establishing an audit function in a department or agency would erode the independence and audit authority of its IG and minimize his or her oversight responsibilities in the area of auditing overpayments by program activities. The OIG suggested substituting terminology such as "recovery examinations," "recovery reviews," or "payment matching reviews" to distinguish between the differing roles and functions. The requirement to consult and coordinate with the IG should, however, be retained. OIG advocated that language be added requiring department or agency officials or contractors performing recovery reviews to immediately report to the IG any indication of fraud or other criminal activity discovered during the course of the reviews. Additionally, the bill should expressly state that the act of repayment of overcharges does not preclude the department or agency or any other governmental entity from pursuing other administrative, civil, or criminal actions or proceedings that may be available.

### Activities to Enhance Fraud Detection and Deterrence

#### OIG Conducted Employee Awareness Briefings

In addition to investigating complaints of waste, fraud, and abuse involving SBA programs, OIG Investigations Division staff presented **integrity awareness briefings** to approximately 60 Agency employees in two cities. The involvement and cooperation of all SBA employees in combating waste, fraud, and abuse is critical to an effective OIG investigations program and to the Agency's overall productivity and efficiency.

During the reporting period, employee contributions to our mission were significant. As Figure 6 shows, more than 69 percent of the investigations initiated by OIG originated with referrals from within the Agency. This cooperation indicates the strong commitment of SBA employees to reducing waste, fraud, and abuse in Agency programs and improving the Agency's management and control of its programs.

### SBA Employee in Colorado Indicted for Embezzlement and Misusing Social Security Number

A former voucher examiner in SBA's Office of Chief Financial Officer (OCFO), Denver, Colorado, was indicted on 13 felony counts of **embezzlement** and one count of **misusing a Social Security number**. She subsequently pled guilty to one felony count of **embezzlement**; in return, the Government agreed to dismiss the other counts on which she had been indicted. OIG's investigation determined she fraudulently obtained more than $21,000 in SBA funds by means of false electronic travel vouchers and false electronic vendor invoices. Her scheme involved entering false information via her work computer in order to have Government funds electronically deposited into her bank account. After being contacted by OIG, the employee resigned her position at SBA. An internal review by OCFO of their procedures following OIG's investigation revealed that substantially more funds were embezzled than OCFO was initially aware of. This investigation was initiated based on a referral from OCFO's Denver Finance Center.

### SBA Employee Sentenced for Theft of Government Property

A former office automation assistant in the Office of Field Operations (OFO) in SBA's Headquarters was charged with and pled guilty to one misdemeanor count of **theft of Government property**. She was sentenced to serve 3 years on probation and perform 25 hours of community service. She was ordered to pay SBA full restitution of $3,918. The restitution amount was less than SBA's original loss due to deductions for 1) annual leave hours that would have actually accumulated had she properly reported her leave; 2) useful items she wrongfully purchased which were returned to SBA; and 3) her final paycheck, which SBA withheld. In January 1999, when her supervisor discovered that a number of unauthorized purchases had been made on their supply credit card, OFO asked OIG to investigate. The investigation also determined the employee had transmitted fraudulent time and attendance records on herself to the National Finance Center. SBA sustained a loss of more than $6,300 as a result of her conduct. The unauthorized credit card purchases, totaling $2,168, included computer hardware and software, a stereo, a cordless telephone, gasoline, and car rentals. The documentation for some of the purchases contained the forged signature of her supervisor. The investigation showed that, from March 1998 through January 1999, she fraudulently reported 132 hours of overtime and she failed to report 130 hours of annual leave she had taken. These fraudulent time and attendance submissions resulted in her receiving $4,149 of unearned income. Based on the investigative findings, she was terminated from her employment with SBA in March 1999.

### SBA Employee Indicted for Child Pornography on Office Computer

An economic development specialist in SBA's Sacramento District Office was indicted by a Federal grand jury on four counts of **knowingly possessing visual depictions of minors engaged in sexually explicit conduct**. Subsequently, the employee pled "not guilty" during his initial court appearance. OIG initiated the investigation after complaints were received that he was accessing pornographic sites while on duty, using the computer SBA had assigned him. The investigation consisted primarily of copying the hard drive from his computer on several different occasions and monitoring his daily activity on the computer over a period of time. The investigation determined the employee was accessing Internet sites where images of children involved in a variety of sexual acts were displayed and he was storing many of these images on the hard drive of his SBA computer. OIG presented the results of the investigation to an assistant U.S. attorney who requested that FBI join the case. Prior to the indictment, a U.S. Magistrate issued an arrest warrant and agents of OIG and FBI arrested the employee at SBA's Sacramento District Office.

## Results of Previously Reported Investigations

### SBA Employee in Ohio Sentenced for Felony Theft

A former office automation assistant in SBA's Cleveland District Office pled guilty to one count of **felony theft 5**, a violation of the Ohio Revised Code. She was sentenced in Cuyahoga County, Ohio, to serve 6 months in jail and ordered to pay SBA $1,093 in restitution. *(Updated from March 1999 Semiannual Report.)*

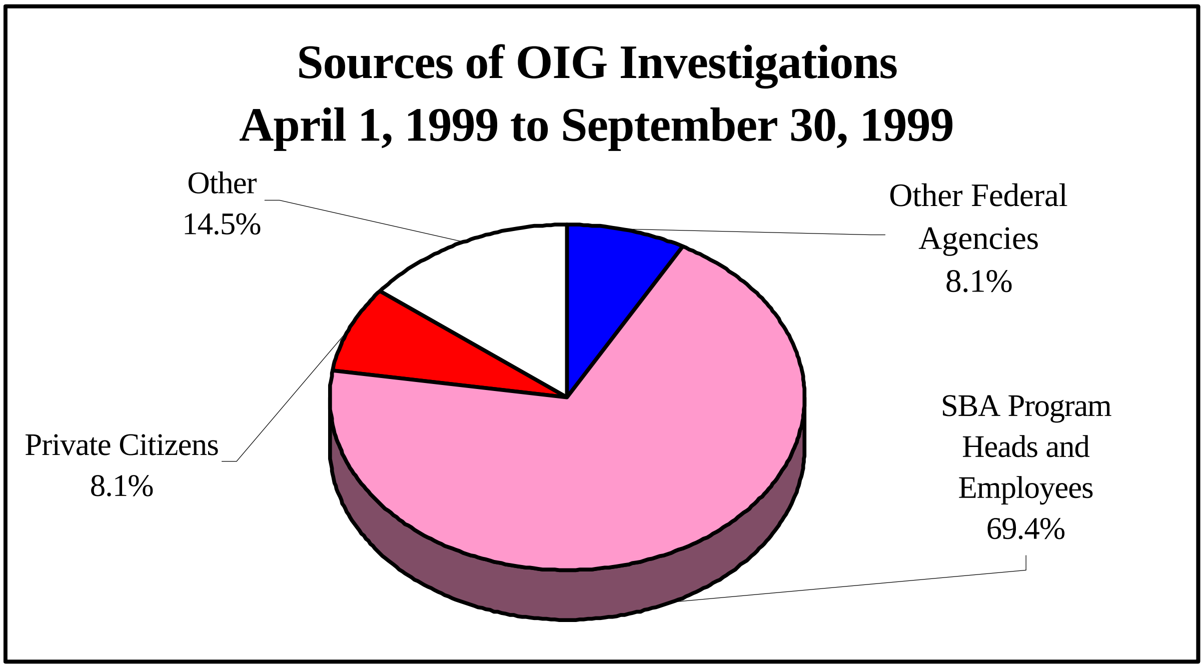
Sources of OIG Investigations
April 1, 1999 to September 30, 1999
Other
14.5%
Other Federal
Agencies
8.1%
Private Citizens
8.1%
SBA Program
Heads and
Employees
69.4%

**Figure 6**

# Organization, Resources, and Management Initiatives

The dual missions of the Office of Inspector General are to help improve management in the Agency and to detect and deter fraud in SBA's programs. Mission goals and objectives are accomplished through the provision of audit, investigation, and inspection and evaluation oversight of the Agency's portfolio, programs, and supporting operations. This chapter provides an overview of the OIG's organizational structure and its personnel and financial resources. It also summarizes key internal management initiatives designed to use available resources as effectively as possible.

## Organization

SBA/OIG is organized into four divisions as follows:

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

The Auditing and Investigations Divisions each administer their field activities through field offices and resident offices around the country. The Auditing Division has offices located in Atlanta, Dallas, Los Angeles, and Washington. The Investigations Division has offices in those cities as well as in Chicago, Denver, Houston, Kansas City, New York, Philadelphia, San Francisco, Seattle, and Syracuse. The Investigations Division's Office of Security Operations is located in Washington, D.C. Both the Inspection and Evaluation Division and the Management and Legal Counsel Division operate out of Washington, D.C. A current OIG organization chart can be found on the following page.

## Resources

In FY 1999, OIG operated with a funding level of $10.8 million for operating costs and an additional $500,000 for disaster oversight, for a total of $11.3 million. Although OIG had an authorized personnel ceiling of 122 full time equivalent (FTE) positions, an increase of 8 FTE over the FY 1998 ceiling, the funding level only permitted an average FTE level of 109. This level of funding and FTE only provided for a minimal level of oversight to SBA programs and program dollars at risk. Congressionally mandated law enforcement availability pay, annual

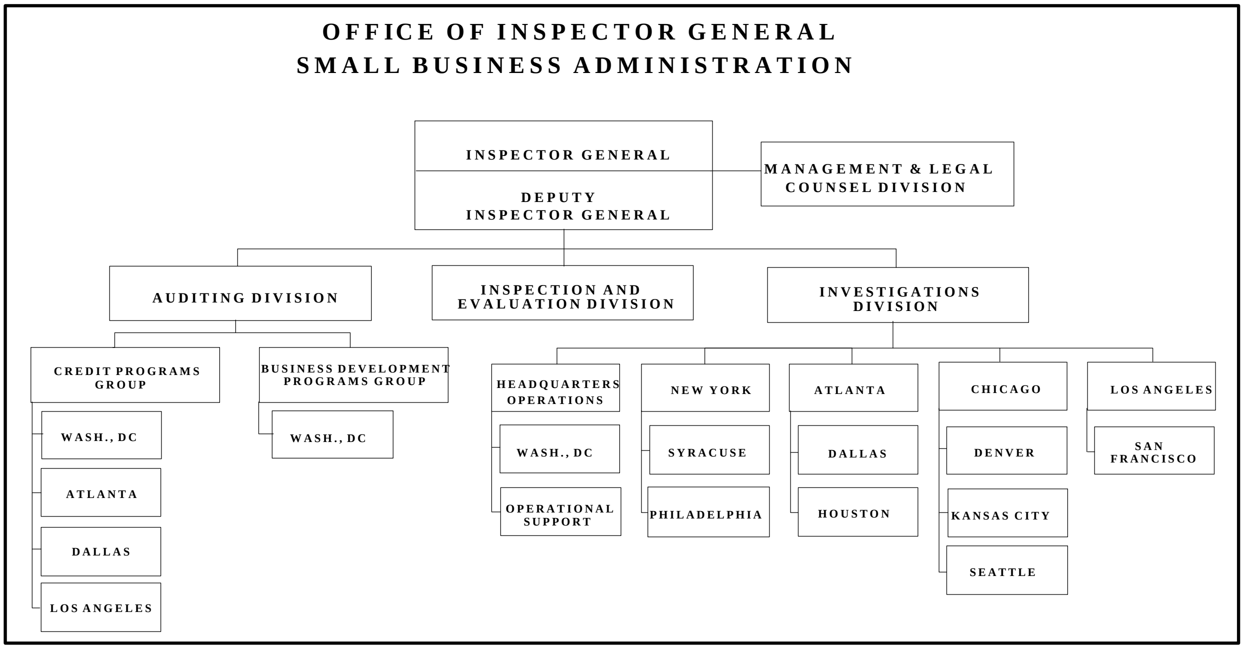


**Figure 7**

cost of living increases, and various locality pay adjustments are still not fully funded by OIG's authorized spending levels. In FY 1999, 12 temporary appointments supported by disaster funding were converted to permanent status to retain expertise and experience in disaster assistance oversight.

In FY 1994, OIG received $3 million in supplemental "no year" disaster funds to be used for activities related to the Agency's expanding disaster assistance program. These funds will remain available until expended. At this time, OIG projects that these "no year" funds will be expended by the end of FY 2000.

Additionally, in each of the FY 1997, 1998, and 1999 appropriations, Congress directed the Agency to transfer $500,000 from its disaster assistance account to OIG for disaster program oversight.

The relatively static level of resources over the past 5 years remains a concern. As depicted in both Figures 1 and 2 (pages 9 and 23, respectively), the dynamics of the Agency's portfolio and the President's New Markets Initiative, designed to reach more distressed rural and urban areas of the country, would suggest that OIG's resources must be increased to ensure an adequate level of program oversight. While the increase in resources from FY 1998 to FY 1999 ($10.5 million to $11.3 million) has been helpful, it did not allow OIG to "catch up" to its expenses after years of chronic underfunding, and still does not allow OIG to fully address SBA's increasing portfolio and programs. OIG continues to experience difficulty in carrying out its mandate to provide meaningful oversight of the Agency's programs and supporting activities and to safeguard the Government's investment in SBA's extensive credit programs. As is apparent from the accompanying narrative, some SBA programs received only modest oversight while others virtually went without oversight.

As the table on page 53 illustrates, the business and disaster loan programs consume most of OIG's direct investigation and auditing time (80 and 55 percent, respectively). Because these two programs represent the greatest risk of financial loss to the taxpayer, OIG has made a conscious decision to devote a substantial amount of its limited resources to these programs. As the table also illustrates, however, this emphasis on these critical areas results in only minimal or no audit and investigative coverage of other program areas.

For FY 2000, the President has requested Congress to appropriate $11 million for OIG. Although OIG expects to be funded by SBA for six FTE for oversight of the Small and Disadvantaged Business Program, the OIG budget will be unable to completely absorb the combined cost-of-living and locality pay raises of an estimated 4.8 percent in FY 2000.

## Management Initiatives

### Government Performance and Results Act Activities

OIG has developed a new FY 2001 through 2006 Strategic Plan under the Government Performance and Results Act (GPRA). Drafts have been provided to SBA's Administrator and Management Board, key congressional committees, and to the Office of Management and Budget for consultations. We developed the plan to accomplish the following objectives.

- To respond more effectively to changes in SBA. The Agency's emphasis on outsourcing and information systems modernization poses increasing challenges to our oversight efforts and led us to develop a strategic focus on five are as: financial management systems, information systems and computer security, lender oversight, other selected high risk issues, and new Agency initiatives.

- To maximize OIG management efficiency, effectiveness, and accountability.

- To emphasize our commitment to the goals of recent Government reform legislation, including the GPRA, the Chief Financial Officer's Act, and the Clinger-Cohen Act.

We are also directing OIG resources to oversight of SBA's implementation of GPRA requirements. Most of our inspections will include a review of program performance measures; for example, a recent report on SBA oversight of the CDC program found that the CDC job creation data currently being used in Agency plans has serious flaws and has not been verified. GPRA audits begun during the last quarter of FY 1999 will focus on the Small Business Investment Company and Disaster Loan Programs. The audits will review the goals and performance measures of these and other SBA programs in the FY 2000 Annual Plan to determine if they —

- reflect the statutory mission,
- include efficiency and effectiveness measures,
- have measurable performance indicators, and
- have reliable supporting data.

An OIG representative continued to participate on the President's Council on Integrity and Efficiency/Chief Financial Officers' Council Dialogue Series Committee. The committee is an ad hoc interagency group that develops periodic seminars on GPRA issues of common interest to IGs and Chief Financial Officers. In May she organized a Dialogue on "Moving to the Next GPRA Level: Using the Plans for Decision-Making" with panelists from OMB, congressional staff, and several Federal departments/agencies. Our representative was also active in the OIG GPRA Coordinators' Interest Group

### OIG Annual Training Conference

The annual training conference for OIG professional and support staff was held in June in San Antonio, Texas. Among the topics presented to the entire staff were Government Performance Results Act (GPRA) strategic and annual planning, Government ethics, and conflict resolution. The remainder of the conference focused on providing technical training on audit, investigation, inspection, and administrative topics.

**Direct Investigation Time by Program Area**
**April 1, 1999 to September 30, 1999**

| **Program Area** | **Direct Time %** | **Number of Investigations*** | |
|---|---|---|---|
| | | Closed** | In Progress |
| Business Loans | 55% | 23 | 193 |
| Disaster Loans | 25% | 20 | 146 |
| SBIC | 3% | 1 | 9 |
| Surety Bond Guarantees | 1% | 0 | 2 |
| Government Contracting*** | 2% | 2 | 5 |
| Minority Enterprise Development | 8% | 4 | 27 |
| Entrepreneurial Development | **** | 1 | 1 |
| Agency Management and Financial | 5% | 12 | 11 |
| **Total** | 99%***** | 63 | 394 |

**Direct Auditing Time by Program Area**
**April 1, 1999 to September 30, 1999**

| **Program Area** | **Direct Time %** | **Number of Audits** | |
|---|---|---|---|
| | | Issued | In Progress |
| Business Loans | 53 % | 6 | 14 |
| Disaster Loans | 2 % | 1 | 1 |
| SBIC | 0 | 0 | 2 |
| Surety Bond Guarantees | 10 % | 4 | 1 |
| Government Contracting*** | 3% | 0 | 3 |
| Minority Enterprise Development | 9 % | 0 | 2 |
| Entrepreneurial Development | 7 % | 2 | 1 |
| Agency Management and Financial | 16 % | 6 | 6 |
| **Total** | 100% | 19 | 30 |

* Includes civil cases
** Includes cases canceled
*** Includes Small Disadvantaged Business
**** Less than ½ percent
***** Total less than 100% due to rounding

# Profile of Operating Results

**April 1, 1999 to September 30, 1999**

| **Audit Activities** | | **Totals** |
|---|---|---|
| A. | Reports Issued | 16 |
| B. | Audit Recommendations Issued | 48 |
| C. | Dollar Value of Costs Questioned | $364,534 |
| D. | Dollar Value of Recommendations that Funds Be Put to Better Use | $482,628 |

**Audit Follow-Up Activities**

| | | |
|---|---|---|
| A. | Audit Recommendations Closed | 75 |
| B. | Disallowed Costs Agreed to by Management | $1,434,464 |
| C. | Dollar Value of Recommendations That Funds Be Put to Better Use Agreed to by Management | $1,081,555 |
| D. | Unresolved Audit Recommendations | 46 |
| E. | Dollar Value of Unresolved Audit Recommendations | $12,233,288 |

**Inspection Activities**

| | | |
|---|---|---|
| A. | Reports Issued | 2 |

**Legislation/Regulation/SOP/Other Reviews**

| | | |
|---|---|---|
| A. | Legislation Reviewed | 5 |
| B. | Regulations Reviewed | 20 |
| C. | Standard Operating Procedures Reviewed | 5 |
| D. | Other Issuances Reviewed* | 83 |

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

**Status of Investigations as of September 30, 1999**

| | | |
|---|---|---|
| A. | Total Cases | 457 |
| B. | Closed Cases | 63 |
| C. | Pending Cases | 16 |
| D. | Open Cases | 378 |
| E. | Subjects Under Investigation | 1,303 |
| F. | Cases Referred to FBI or Other Agencies for Investigation | 8 |

**Summary of Indictments and Convictions**

| | | |
|---|---|---|
| A. | Indictments from OIG Cases | 19 |
| B. | Convictions from OIG Cases | 26 |

**Summary of Recoveries and Management Avoidances**

| | | |
|---|---|---|
| A. | Potential Recoveries and Fines as a Result of OIG Investigations | $4,898,128 |
| B. | Loans Not Approved as a Result of OIG Investigations | $0 |
| C. | Loans Not Approved as a Result of the Name Check Program | $12,123,521 |
| | Total: | $17,021,649 |

**SBA Personnel Actions Taken as a Result of Investigations**

| | | |
|---|---|---|
| A. | Dismissals | 0 |
| B. | Resignations/Retirements | 2 |
| C. | Suspensions | 0 |
| D. | Reprimands | 1 |

**Program Actions Taken as a Result of Investigations**

| | | |
|---|---|---|
| A. | Suspensions | 0 |
| B. | Debarments* | 2 |
| C. | Removals from Program | 0 |
| D. | Other Program Actions | 0 |

**Summary of OIG Fraud Line Operation**

| | | |
|---|---|---|
| A. | Total Fraud Line Calls/Letters | 1,315 |
| B. | Total Calls/Letters Referred to Investigations Division for Evaluation | 32 |
| C. | Total Calls/Letters Referred to Program Offices or Other Federal Investigative Agencies | 86 |
| D. | Total Other Calls/Letters | 1,197 |

*Former officers of participating lender were debarred from jobs in the banking industry.

**Office of Inspector General**
**Actual Personnel on Board as of September 30, 1999**

| | |
|---|---|
| A. Immediate Office | 4 |
| B. Auditing Division | 42 |
| Professional | 37 |
| Support | 5 |
| C. Investigations Division | 53 |
| Professional | 44 |
| Support | 9 |
| D. Inspection and Evaluation Division | 7 |
| Professional | 7 |
| Support | 0 |
| E. Management and Legal Counsel Division | 9 |
| Professional | 7 |
| Support | 2 |
| OIG Total | 115 |

# FY 1999 Productivity Statistics
**Last Six Months**

| **Officewide Dollar Accomplishments** | **Totals** |
|---|---|
| A. Potential Investigative Recoveries and Fines | $4,898,128 |
| B. Loans Not Approved as Result of Investigations and Name Checks | $12,123,521 |
| C. Disallowed Costs Agreed to by Management | $1,434,464 |
| D. Recommendations that Funds Be Put to Better Use Agreed to by Management | $1,081,555 |
| Total | $19,537,668 |

**Auditing Division Activities**

| | |
|---|---|
| A. Audit Reports Issued | 16 |
| B. Disallowed Costs Agreed to by Management | $1,434,464 |
| C. Recommendation that Funds Be Put to Better Use Agreed to by Management | $1,081,555 |
| D. Advisory Reports | 3 |

**Inspection and Evaluation Division Activities**

| | |
|---|---|
| A. Reports Issued | 2 |

**Investigations Division Activities**

| | |
|---|---|
| A. Cases Closed | 63 |
| B. Indictments | 19 |
| C. Convictions | 26 |
| D. Potential Investigative Recoveries and Fines | $4,898,128 |
| E. Loans Not Approved as a Result of: | $12,123,521 |
| - Investigation Cases | $0 |
| - Name Check Program | $12,123,521 |
| F. Advisory Reports | 1 |

# FY 1999 Productivity Statistics
**Full Year**

| **Office-Wide Dollar Accomplishments** | **Totals** |
|---|---|
| A. Potential Investigative Recoveries and Fines | $10,419,102 |
| B. Loans Not Approved as Result of Investigations and Name Checks | $28,382,286 |
| C. Disallowed Costs Agreed to by Management | $2,322,780 |
| D. Recommendations that Funds Be Put to Better Use Agreed to by Management | $2,929,983 |
| Total | $44,054,151 |

**Auditing Division Activities**

| | |
|---|---|
| A. Audit Reports Issued | 26 |
| B. Disallowed Costs Agreed to by Management | $2,322,780 |
| C. Recommendation that Funds Be Put to Better Use Agreed to by Management | $2,929,983 |
| D. Advisory Reports | 3 |

**Inspection and Evaluation Division Activities**

| | |
|---|---|
| A. Reports Issued | 2 |

**Investigations Division Activities**

| | |
|---|---|
| A. Cases Closed | 130 |
| B. Indictments | 44 |
| C. Convictions | 53 |
| D. Potential Investigative Recoveries and Fines | $10,419,102 |
| E. Loans Not Approved as a Result of: | $28,382,286 |
| - Investigation Cases | $0 |
| - Name Check Program | $28,382,286 |
| F. Advisory Reports | 1 |

# Statutory Reporting Requirements

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

| Source | | Pages |
|---|---|---|
| Section 4(a)(2 ) | Review of Legislation and Regulations | 6 - 45 |
| Section 5(a)(1) | Significant Problems, Abuses, and Deficiencies | 6 - 45 |
| Section 5(a)(2) | Recommendations with Respect to Significant Problems, Abuses, and Deficiencies | 6 - 45 |
| Section 5(a)(3) | Prior Significant Recommendations Not Yet Implemented | 65 |
| Section 5(a)(4) | Matters Referred to Prosecutive Authorities | 6 - 45 |
| Section 5(a)(5) and 6(b)(2) | Summary of Instances Where Information Was Refused | None |
| Section 5(a)(6) | Listing of Audit Reports | 59 |
| Section 5(a)(7) | Summary of Significant Audits | 6 - 45 |
| Section 5(a)(8) | Audit Reports Containing Questioned Costs | 61 |
| Section 5(a)(9) | Audit Reports Recommending that Funds Be Put to Better Use | 62 |
| Section 5(a)(10) | Summary of Reports Where No Management Decision Was Made | 64 |
| Section 5(a)(11) | Significant Revised Management Decisions | None |
| Section 5(a)(12) | Significant Management Decisions with Which OIG Disagreed | None |

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# APPENDIX I
## Audit Reports Issued
## April 1, 1999 to September 30, 1999

| TITLE | NUMBER | ISSUE DATE | QUESTIONED COSTS | FUNDS FOR BETTER USE |
|---|---|---|---|---|
| **Business Loans** | | | | |
| Bank of Castile | 9-14 | 7/29/99 | | $0 |
| Kansas City District 7(a) Loans | 9-16 | 8/4/99 | $118,330 | $0 |
| Main Street Athletic Club | 9-25 | 9/24/99 | | $419,971 |
| Non-Tax Delinquent Debt | 9-11 | 7/28/99 | $0 | $0 |
| SBLC Examination Process | Unnumbered | 4/29/99 | $0 | $0 |
| Ken's Air | 9-21 | 9/10/99 | $0 | $0 |
| Program sub-total | 6 Reports | | $118,330 | $419,971 |
| **Disaster Loans** | | | | |
| Disaster Home Loan Servicing | 9-15 | 8/3/99 | | |
| Program sub-total | 1 Reports | | $0 | |
| **Surety Bond Guarantees** | | | | |
| Bankers Insurance Group | 9-20 | 9/10/99 | $0 | $0 |
| Great American Ins. Co. | 9-26 | 9/28/99 | $1,326 | $0 |
| Gulf Insurance Group | 9-13 | 7/28/99 | $142,284 | |
| Insurance Company of the West | 9-17 | 8/19/99 | $1,124 | $0 |
| Program sub-total | 4 Reports | | $144,734 | $0 |
| **Entrepreneurial Development** | | | | |
| Texas Women's BDC | 9-12 | 7/28/99 | $12,350 | $2,650 |
| Texas Women's BDC | 9-22 | 9/15/99 | $65,273 | $60,007 |
| Program sub-total | 2 Reports | | $77,623 | $62,657 |
| **Agency Management & Financial Activities** | | | | |
| Electronic Records Mgt | 9-23 | 9/15/99 | | |
| FY 1998 Financial Statements | 9-24 | 9/20/99 | | |
| Information System Controls | 9-19 | 9/2/99 | | |
| Special Appropriation Grants | 9-18 | 8/24/99 | | |
| Budget Execution | 9-1 | 4/29/99 | | |
| Y2K Verification | 9-2 | 7/29/99 | | |
| Program sub-total | 6 Reports | | $0 | $0 |
| TOTALS (all programs) | Reports: 19 | | $340,687 | $482,628 |

# APPENDIX II - Part A

## Audit Reports with Questioned Costs

## April 1, 1999 to September 30, 1999

| | | REPORTS | RECs* | COSTS*** | |
|---|---|---|---|---|---|
| | | | | QUESTIONED | UNSUPPORTED |
| A. | For which no management decision had been made by March 31,1999 | 11 | 27 | $3,952,872 | $781,461 |
| B. | Which were issued during the period | 6 | 11 | $364,534 | $2,650 |
| | Subtotals (A + B) | 17 | 37 | $4,317,406 | $784,111 |
| C. | For which a management decision was made during the reporting period | 13 | 28 | $2,525,141 | $784,111 |
| | (i) Disallowed costs | 10 | 25 | $1,434,464 | $2,650 |
| | (ii) Costs not disallowed | 5 | 8 | $1,090,677 | $0 |
| D. | For which no management decision had been made by September 30, 1999 | 5 | 9 | $1,792,265 | $781,461 |

* Recommendations.

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

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

# APPENDIX II - Part B

## Audit Reports with Recommendations that Funds Be Put to Better Use
## April 1, 1999, to September 30, 1999

| | | REPORTS | RECs* | RECOMMENDED FUNDS FOR BETTER USE |
|---|---|---|---|---|
| A. | For which no management decision had been made by March 31, 1999 | 11 | 20 | $ 17,197,375 |
| B. | Which were issued during the period | 3 | 4 | 482,628 |
| | Subtotals (A + B) | 14 | 24 | $ 17,680,003 |
| C. | For which a management decision was made during the reporting period | 4 | 5 | 7,238,980 |
| | (i) Recommendations agreed to by SBA management | 3 | 3 | $ 1,081,555 |
| | (ii) Recommendations not agreed to by SBA management | 2 | 2 | $ 6,157,425 |
| D. | For which no management decision had been made by September 30, 1999 | 11 | 19 | $10,441,023 |

* Recommendations.

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

*** Management agreed to $159,178 more than recommended.

# APPENDIX II - Part C

## Audits Reports with Non-Monetary Recommendations
## April 1, 1999 to September 30, 1999

| | | REPORTS | RECOMMENDATIONS |
|---|---|---|---|
| A. | For which no management decision had been made by March 31, 1999 | 14 | 26 |
| B. | Which were issued during the period | 13 | 33 |
| | Subtotals (A + B) | 27 | 59 |
| C. | For which a management decision was made (for at least one recommendation in the report) during the reporting period | 17 | 42 |
| D. | For which no management decision (for at least one recommendation in the report) had been made by September 30, 1999 | 12 | 17 |

* Beginning balance corrected to reflect prior period adjustment.
** The recommendations resolved did not address all the recommendations within the reports where they appeared.

# APPENDIX II - Part D
## Audit Reports with Overdue Management Decisions
## September 30, 1999

| TITLE | NUMBER | ISSUED | STATUS |
|---|---|---|---|
| | | | |
| Low Documentation Loan Program | 65E002022 | 9/30/96 | Reopened and will be escalated. |
| LowDoc Loan Program – Atlanta | 77F006017 | 7/7/97 | Reopened and will be escalated |
| LowDoc Loan Program - Santa Ana | 77F009020 | 7/8/97 | Reopened and will be escalated. |
| LowDoc Loan Program - Dallas | 77F008022 | 7/31/97 | Reopened and will be escalated. |
| Business Loan Guarantee Purchases | 75H011026 | 9/30/97 | Impasse will be escalated. |
| SBIC Surety | 9-10 | 3/31/99 | Under OGC review. |
| 7(a) Loan Processing - Atlanta | 87F019014 | 5/13/98 | Reopened and will be escalated. |
| 7(a) Loan Processing - New Jersey | 88F003019 | 7/8/98 | Reopened and will be escalated. |
| 7(a) Loan Processing - Buffalo | 87F021018 | 7/8/98 | Reopened and will be escalated. |
| Emergent Business Capital, Inc. | 87F013020 | 7/13/98 | DD reversed prior agreement- will be escalated. |
| 7(a) Loan Processing - Madison | 87F020022 | 7/22/98 | Reopened and will be escalated. |
| 7(a) Loan Processing – Colorado | 9-05 | 2/24/99 | Reopened and will be esvalated. |

# APPENDIX II – Part E

## Significant Audit Reports Described in Prior Semiannual Reports Without Final Action as of September 30, 1999

| REPORT NUMBER | TITLE | DATE ISSUED | DATE OF MANAGE-MENT DECISION | FINAL ACTION TARGET` |
|---|---|---|---|---|
| 3-2-C-002-033 | Administration of the 8(a) Program Work Performance Requirements | 3/31/93 | 9/30/94 | 9/30/95* |
| 4-3-H-006-021 | 8a Continuing Eligibility Reviews | 12/13/94 | 3/31/95 | 1/31/95 |
| 5-3-H-004-006 | SBA Loan Servicing and Debt Collection Activities | 3/31/95 | 4/30/95 | 12/31/95 |
| 5-3-H-010-021 | 8(a) Competitive Mix | 9/29/95 | 3/29/96 | 3/29/97 |
| 6-5-E-001-021 | Basic Ordering Agreements | 9/15/96 | 2/10/97 | 9/25/97 |
| 6-5-E-002-022 | Low Documentation Loan Program | 9/30/96 | * | * |
| 7-7-H-001-011 | Grant Closeout Procedures | 3/26/97 | 10/20/97 | 10/20/97 |
| 7-6-H-006-015 | FY 1996 Financial Statements | 4/29/97 | 9/30/97 | 4/30/99 |
| 7-7-S-918-018 | User Technology Associates Inc. | 6/06/97 | 3/26/98 | 6/05/98 |
| 7-7-F-006-017 | LowDoc Program – Atlanta DO | 7/7/97 | * | * |
| 7-7-F-009-020 | LowDoc Loan Program – Santa Ana DO | 7/8/97 | * | * |
| 7-7-F-007-021 | LowDoc Loan Program – Washington DO | 7/18/97 | 10/06/97 | 7/22/97 |
| 7-7-F-008-022 | LowDoc Loan Program – Dallas DO | 7/31/97 | * | * |
| 7-5-H-011-026 | Business Loan Guarantee Purchases | 9/30/97 | * | 3/30/00 |
| 8-7-F-005-002 | LowDoc Loan Program Summary Report | 11/24/97 | * | 3/31/99* |
| 8-7-F-019-014 | 7a Loans – Atlanta | 5/13/98 | * | * |

| | | | | |
|---|---|---|---|---|
| 8-7-F-021-018 | 7a Loans – Buffalo | 7/8/98 | * | * |
| 8-8-F-003-019 | 7(a) Loans – New Jersey | 7/31/98 | * | * |
| 8-7-F-013-020 | Emergent Business Capital | 7/13/98 | * | * |
| 8-8-H-006-025 | GSA Kansas City Sole Source 8(a) IDIQ Contracts | 9/29/98 | 9/30/99 | 10/15/99 |
| 8-8-H-004-027 | SBG Fee Refunds | 9/30/98 | 2/25/99 | 3/31/99 |
| 8-7-H-002-017 | NOAA Computer Contracts | 6/18/98 | 3/1/99 | 12/31/99 |
| 9-03 | CAN Surety Companies | 1/29/99 | 4/23/99 | 7/28/99 |
| 9-05 | Colorado 7(a) Loans | 2/24/99 | * | * |
| 9-08 | Giving of Self Partnership | 3/24/99 | 6/24/99 | 12/31/99 |
| 9-09 | Northridge Defaulted Loans | 3/31/99 | 4/30/99 | 9/30/00 |
| 9-10 | SBIC Surety | 3/31/99 | 6/14/99 | 9/30/99 |

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